CBCS SCHEME

USN | | | | | | | | | | |

16/17MBAFM304

Third Semester MBA Degree Examination, Dec.2019/Jan.2020

Advanced Financial Management

Time: 3 hrs. Max. Marks:80

Note: 1. *Answer any FOUR full questions from Q.No.1 to Q.No.7.*
2. *Question No. 8 is compulsory.*

1 a. What are the dangers of excess working capital? **(02 Marks)**
b. Explain the three alternative approaches for working capital. **(06 Marks)**
c. Discuss the various sources of financing working capital. **(08 Marks)**

2 a. What are the motives for holding cash? **(02 Marks)**
b. Explain the strategies for managing surplus funds. **(06 Marks)**
c. A firm uses a continuous billing system that results in an average daily receipt of Rs.40,00,000. It is contemplating the institution of concentration banking, instead of the current system of centralized billing and collection. It is estimated that such a system would reduce the collection period of account receivable by 2 days. Concentration banking would cost Rs.75000 annually and 8% can be earned by the firm on its investment. It is also found that lock-box system could reduce its overall collection time by 4 days and could cost annually Rs.1,20,000.
(i) How much cash would be released with the concentration banking?
(ii) How much money can be saved due to reduction in the collection period by 2 days? Should the firm institute the concentration banking system?
(iii) How much cash would be freed by lock-box system?
(iv) Between concentration banking and lock-box system, which is better? **(08 Marks)**

3 a. What are credit standards? **(02 Marks)**
b. Explain the 5C's of credit. **(06 Marks)**
c. ABC Ltd., is considering relaxing its credit policy and evaluating two proposed plans. Currently, the firm has credit sales amounting to Rs.50,00,000 and accounts receivables of Rs.12,50,000. The current level of loss due to bad debts is Rs.1,50,000. The firm is required to give a return of 20% on investment in the new (additional) accounts receivable. The company's variables cost are 70% of the selling price.

Particulars	Present Plan	Proposed Plan I	Proposed Plan II
Annual credit Sales (Rs.)	50,00,000	60,00,000	67,50,000
A/C receivables (Rs.)	12,50,000	20,00,000	28,12,500
Bad debt losses (Rs.)	1,50,000	3,00,000	4,50,000

What will be the most rewarding credit plan in cash for ABC Ltd., under these circumstances? **(08 Marks)**

4 a. What is meant by the ABC inventory control system? **(02 Marks)**
b. Define EOQ (Economic Order Quantity). What are the assumptions and limitations of EOQ model? **(06 Marks)**

Important Note : 1. On completing your answers, compulsorily draw diagonal cross lines on the remaining blank pages.
2. Any revealing of identification, appeal to evaluator and /or equations written eg, 42+8 = 50, will be treated as malpractice.

c. The purchase department of an organization has received an offer of quantity discounts on its order of material as under:

Price per tonne (in Rs.)	Tonnes
1400	Less than 500
1380	500 and less than 1000
1360	1000 and less than 2000
1340	2000 and less than 3000
1320	3000 and above

The annual requirement of the material is 5000 tonnes. The delivery cost per order is Rs.1200 and the annual stock holding cost is estimated at 20% of the average inventory. The purchase department wants you to consider the following purchase options and advise which among them will be the most EOQ, presenting the information in a tabular form:
The purchase quantity options to be considered are: 400 tonnes, 500 tonnes, 1000 tonnes, 2000 tonnes and 3000 tonnes. **(08 Marks)**

5 a. What do you mean by optimum capital structure? **(02 Marks)**
b. What are the assumptions of capital structure theories? **(06 Marks)**
c. Assume there are two firms, L and U, which are identical in all respects except that firm L has 10% and Rs.5,00,000 debentures. The EBIT of both the firms are equal, that is, Rs.1,00,000. The equity capitalization rate (Re) of firm L is higher (20%) than that of firm U (12.5%). An investor owns 10% of the equity shares of the over values firm. Determine his investment cost of earnings the same income so that he is at a breakeven point? Will he gain by investing in the under values firm? **(08 Marks)**

6 a. What do you mean by homemade leverage? **(02 Marks)**
b. What are the merits and demerits of issue of bonus shares? **(06 Marks)**
c. Suppose a firm has a capital structure exclusively comprising of ordinary shares amounting to Rs.10,00,000. The firm now wishes to raise additional Rs.10,00,000 for expansion. The firm has four alternative financial plans.
(i) It can raise the entire amount in the form of equity capital.
(ii) It can raise 50% as equity capital and 50% as 5% debentures.
(iii) It can raise the entire amount as 6% debentures.
(iv) It can raise 50% as equity capital and 50% at 5% preference capital.
Further assume that the existing EBIT are Rs.1,20,000, the tax rate is 35%. Outstanding ordinary shares 10000 and the market price per share is Rs.100 under all the four alternatives. Which financing plan should the firm select? **(08 Marks)**

7 a. What do you mean by stable dividend? **(02 Marks)**
b. The earnings per share of a company is Rs.8 and the rate of capitalization applicable is 10%. The company has before it, an option of adopting (i) 50, (ii) 75 and (iii) 100 percent dividend payout ratio. Compute the market price of the companies quoted shares as per Walter's model if it can earn a return of (i) 15 and (ii) 10 percent on its retained earnings. **(06 Marks)**
c. A company belongs to a risk class for which the approximate capitalization rate is 10%. It currently has outstanding 25000 shares selling at Rs.100 each. The firm is contemplating the declaration of a dividend of Rs.5 per share at the end of the current financial year. It expects to have a net income of Rs.2,50,000 and has a proposal for making new investments of Rs.5,00,000. Show that under the MM assumptions, the payment of dividend does not affect the value of the firm. **(08 Marks)**

8 ***CASE STUDY:***

Venkat Industries (New company) requested to prepare a cash budget for the period of 6 months from July-Dec 2018. They have provided the following information:

(Rs. in lakhs)

Particulars	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan
Sales	15.00	15.00	25.00	35.00	45.00	25.00	25.00	15.00	15.00
Materials	8.00	15.00	22.00	29.00	15.00	15.00	8.00	8.00	-
Rent	-	-	0.50	0.50	0.50	0.50	0.50	0.50	-
Salaries	-	-	1.50	2.00	2.50	1.50	1.50	1.00	-
Miscellaneous Expenses	-	-	0.20	0.30	0.40	0.20	0.20	0.10	-
Taxes	-	-	-	-	-	5.00	-	5.00	-
Building construction	-	-	-	-	-	15.00	-	-	-

Credit terms are: customers are allowed 40 days, if they pay within 20 days cash discount will be given. 20 percent sales are paid on the same months of sales. 70% of the sales paid during the second and 10% of the sales are paid in third month. Materials are bought in the month before the company expects to sell the finished goods. Suppliers are allowed one month credit.

Rs.4 lakhs to be paid in the month of September 15 and December 15 as tax. The company wants to maintain a minimum cash balance of Rs.6,00,000 in all the months. It is assumed that the firm will have a beginning balance of Rs.5 lakhs on July 1. Determine the company's requirements of cash for the period from July to December. **(16 Marks)**

* * * * *