FOR 2 MARKS

1Q. Meaning of Operating Leverage.

ANS: Operating leverage measures a company's fixed costs as a percentage of its total costs. It is used to evaluate the breakeven point of a business, as well as the likely profit levels on individual sales.

2Q. Define Capital Structure.

ANS: The capital structure is the particular combination of debt and equity used by a company to finance its overall operations and growth. Debt comes in the form of bond issues or loans, while equity may come in the form of common stock, preferred stock, or retained earnings.

3Q. Meaning Financial Leverage.

ANS: Financial leverage is the use of borrowed money (debt) to finance the purchase of assets with the expectation that the income or capital gain from the new asset will exceed the cost of borrowing

4Q. Nature Of Financial Management.

Ans: There is some Nature of financial management are discussed below:

Determines Financial Needs: Financial management estimates the adequate amount of funds required by the business for its functioning. It determines both short-term as well as long-term financial requirements of business and accordingly prepares a financial plan.
Designs Capital Structure: Financial managers take all decisions regarding the capital structure. They are responsible for deciding the optimum proportion of equity and debt in the capital of the business. A proper balance between debt and equity should be attained which minimizes the overall cost of capital.

5Q. Objective of financial management.

Ans: The objectives of financial management are given below:

1. Profit maximization

The main aim of any kind of economic activity is earning profit. A business concern is also functioning mainly for the purpose of earning profit.

The finance manager tries to earn maximum profits for the company in the short-term and the long-term. He cannot guarantee profits in the long term because of business uncertainties. However, a company can earn maximum profits even in the long-term, if:

- The Finance manager takes proper financial decisions
- He uses the finance of the company properly

2. Wealth maximization

Wealth maximization is also the main objective of financial management. Wealth maximization means to earn maximum wealth for the shareholders.

6Q. Meaning of Capital Budgeting.

Ans: Capital budgeting is the process of making investment decisions in long term assets. It is the process of deciding whether or not to invest in a particular project as all the investment possibilities may not be rewarding.

7Q. Define Break-Even Point.

Ans: When a company reaches a break-even point, its total sales equal to its total expenses. This means that they bring in the same amount of money they need to cover all of their expenses and run their business. When they break-even, their business does not profit. But, it also does not have a loss.

8Q. What is the cost of Capital ?

Ans: Cost of capital is the minimum rate of return that a business must earn before generating value. Before a business can turn a profit, it must at least generate sufficient income to cover the cost of the capital it uses to fund its operations. This consists of both the cost of debt and the cost of equity used for financing a business.

9Q. What is the meaning of the accounting rate of return ?

Ans: Accounting Rate of Return (ARR) is the percentage rate of return that is expected from an investment or asset compared to the initial cost of investment. Typically, ARR is used to make capital budgeting decisions. For example, if your business needs to decide whether to continue with a particular investment, whether it's a project or an acquisition, an ARR calculation can help to determine whether going ahead is the right move.

The Accounting Rate of Return formula is as follows:

- ARR = average annual profit / average investment

10Q. What do you mean by financial planning ?

Ans: Financial planning is an important part of financial management. It is the process of determining the objectives; policies, procedures, programmes and budgets to deal with the financial activities of an enterprise. Financial planning reflects the needs of the business and is integrated with the overall business planning. Proper financial planning is necessary to enable the business enterprise to have the right amount of capital to continue its operations efficiently.

11Q. How is the average collection period computed ?

Ans : The average collection period is calculated by dividing the average Debtors balance by Average Credit Sale of the particular periods

Average collection periods are most important for companies on receivables for their cash flows.

12Q. What is Stock Dividend ?

Ans : A stock dividend, a method used by companies to distribute wealth to shareholders, is a dividend payment made in the form of shares rather than cash. Stock dividends are primarily issued when the company is low on liquid cash on hand.

13Q. State the objective of Wealth maximization .

Or What is the wealth or value maximisation goal of a Corporate entity?

Ans : It is a prescriptive idea . The objective is not descriptive of what the firms actually do. The objective of wealth maximisation is not necessarily socially desirable .

Follow BLG Page no 18 , Q.no - 5

14Q. State the meaning of “Risk” in financial management.

Ans: Risk is defined in financial terms as the chance that an outcome or investment's actual gains will differ from an expected outcome or return. Risk includes the possibility of losing some or all of an original investment.

15Q. State the use of credit policy in the context of working capital.

Ans: Follow GBD page no- 187 Q.no - 2(c)

16Q. State The meaning of accounting rate of return.

Ans: Accounting Rate of Return (ARR), also popularly known as the average rate of return measures the expected profitability from any capital investment. ARR indicates the profitability from investments using simple estimates which helps in evaluating capital projects.

17Q. State the meaning of EPS.

Ans: Earnings Per Share, or EPS, is calculated by dividing profit available for distribution to common equity shareholders by the number of common equity shares outstanding. In other words, EPS shows how much profit per share has been generated by a company in a particular financial year. EPS is also a reflection of the financial performance of a company.

FOR 5 MARKS

1Q. Discuss five leading determinants of working capital of a firm.

Ans: There are some of the leading determinants of working capitals are discuss below :

1. Nature of business:

It is an important factor for determining the amount of working capital needed by various companies. The trading or manufacturing concerns will require more amount of working capital along-with their fixed investment of stock, raw materials and finished products.

2. Volume of business:

Generally, the size of the company has a direct relation with the working capital needs. Big concerns have to keep higher working capital for investment in current assets and for paying current liabilities.

3. Use of Manual Labour or Mechanisation:

In labour intensive industries, larger working capital will be required than in the highly mechanized ones.

4. large stocks of raw materials for finished goods:

The manufacturing concerns generally have to carry stocks of raw materials and other stores and also finished goods. The larger the stocks (whether of raw materials or finished goods) more will be the needs of working capital.

5. Seasonal Variations:

There are some industries which either produce goods or make sales only seasonally. For example, the sugar industry produces practically all the sugar between December and April and the woollen textile industry makes its sales generally during winter.

In both these cases the needs of working capital will be very large, during few months {i.e., season). The working capital requirements will gradually decrease as and when the sales are made.

2Q. Mention the different types of financial decisions and examine their mutual relationship.

Ans: There are four main financial decisions-

1. Investment decision ,

2. Financing decision ,

3. Dividend decision and

4. Working Capital Management Decision

In order to accomplish the goal of the firm , to maximize shareholder's (owner's) wealth.

1. Investment decision:

The process of planning and managing a firm's long-term investments is called capital budgeting. In capital budgeting, the financial manager tries to identify profitable investment opportunities, i.e., assets for which value of the cash flow generated by asset exceeds the cost of that asset. Evaluating the size, timing, and risk of future cash flows (both cash inflows & outflows) is the essence of capital budgeting.

2. Financing decision

A firm's capital structure or financing decision is concerned with obtain-ing funds to meet firm's long term investment requirements. It refers to the specific mixture of long-term debt and equity, which the firm uses to finance its assets. The finance manager has to decide exactly how much funds to raise, from which sources to raise and when to raise.

3. Dividend decision

Dividend decision involves two issues-whether to distribute dividends and how much of profits to distribute as dividends. A finance manager has to decide what percentage of after tax profit is to be retained in the business to meet future investment requirements and what proportion has to be distributed as dividend among shareholders. Proportion of profits distributed as dividend is called dividend pay-out ratio and the proportion of profits retained in the business is retention ratio.

4. Working Capital Management Decision

Working capital management is concerned with management of a firm's short-term or current assets, such as inventory, cash, receivables and short-term or current liabilities, such as creditors, bills payable. Assets and Liabilities which mature within the operating cycle of business or within one year are termed as current assets and current liabilities respectively.

FOR 10 MARKS

1Q. What are the Factors Determining the Capital Structure?

Ans: Factors Determining Capital Structure

1. **Trading on Equity-** The word "equity" denotes the ownership of the company. Trading on equity means taking advantage of equity share capital. It refers to additional profits that equity shareholders earn.

2. **Degree of control-** In a company, it is the directors who are called representatives of equity shareholders. These members have got maximum voting rights in concern as compared to the preference shareholders and debenture holders.

3. **Flexibility of financial plan-** In an enterprise, the capital structure should be such that there is both contractions as well as relaxation in plans. Debentures and loans can be refunded back as the time requires. While equity capital cannot be refunded at any point which

provides rigidity to plans. Therefore, in order to make the capital structure possible, the company should go for issue of debentures and other loans.

4. **Choice of investors-** The company's policy generally is to have different categories of investors for securities. Therefore, a capital structure should give enough choice to all kind of investors to invest. Bold and adventurous investors generally go for equity shares and loans and debentures are generally raised keeping into mind conscious investors.
5. **Capital market condition-** In the lifetime of the company, the market price of the shares has got an important influence. During the depression period, the company's capital structure generally consists of debentures and loans. While in period of boons and inflation, the company's capital should consist of share capital, generally equity shares.
6. **Period of financing-** When a company wants to raise finance for a short period, it goes for loans from banks and other institutions; while for a long period it goes for issue of shares and debentures.
7. **Cost of financing-** In a capital structure, the company has to look to the factor of cost when securities are raised. It is seen that debentures at the time of profit earning of a company prove to be a cheaper source of finance as compared to equity shares where equity shareholders demand an extra share in profits.
8. **Stability of sales-** An established business which has a growing market and high sales turnover, the company is in position to meet fixed commitments. Interest on debentures has to be paid regardless of profit. Therefore, when sales are high, thereby the profits are high and company is in better position to meet such fixed commitments like interest on debentures and dividends on preference shares. If company is having unstable sales, then the company is not in position to meet fixed obligations. So, equity capital proves to be safe in such cases.
9. **Sizes of a company-** Small size business firms capital structure generally consists of loans from banks and retained profits. While on the other hand, big companies having goodwill, stability and an established profit can easily go for issuance of shares and debentures as well as loans and borrowings from financial institutions. The bigger the size, the wider is total capitalization.

2Q. What is Over Capitalisation? Discuss the Consequences of Over Capitalisation And Suggest remedies for overcapitalization.

Ans: Overcapitalization occurs when a company has issued more in debt and equity than its assets are worth. If this is the case, the market value of the company is less than the total capitalized value of the company.

An overcapitalized company might be paying more in interest and dividend payments than it can sustain in the long term.

Some Of the Consequences of over Capitalisation:

A. Effects on company:

(i) Destroys the goodwill and credit worthiness:

Over- capitalisation marked by low earning capacity destroys the reputation and goodwill of the company with deterrent effect on its prospects of business.

(ii) Difficulty in raising additional funds:

It causes decline in share values which brings down the credit- standing and financial reputation of the company. Thus, it finds difficulty in mobilising additional funds.

B. Effects on consumers:

Over-capitalisation is unfair to the consumers also. Over-capitalised companies desirous of increasing their earnings would unjustifiably raise the price of their products and ignore or lower the quality of the goods.

C. Effects on Society:

(i) An over-capitalised company increases prices and reduces the quality of goods. Thus, the public is a loser both as regards price and quality.

(ii) An over--capitalised company may try to increase its profits by reducing wages of workers. This may spoil industrial relations.

Some of the remedies of Over capitalisation Are discuss below:

1. To have Efficient Management:

Management should try to become more efficient and try to curb excess expenditure. Earning capacity should be improved and care must be taken to spend every single rupee in the most profitable and economic manner.

2. Redemption of Preference Shares:

Preference shares carrying a high rate of dividend should be redeemed out of retained earnings in order to raise the share of equity shareholders.

3. Reduction of Funded Debts:

Debentures, public deposits and loans taken at higher rates of interest should be prepaid out of accumulated profits or out of fresh borrowings at lower rates of interest, if there are no accumulated profits.

4. Reorganisation of Equity Share Capital:

The face value or the number of equity shares may be reduced in order to rectify over-capitalisation. Sometimes, shareholders may oppose this proposal but actually their proportionate interest in the equity is not reduced. The amount available due to reorganisation of share capital is utilised for writing off the fictitious assets and other overvalued assets.

3Q. What is Under Capitalisation ? Discuss the Consequences of under Capitalisation And Suggest remedies for under Capitalisation.

Ans: Under-capitalisation is just the reverse of over-capitalisation. Properly speaking, an enterprise is said to be under-capitalised when its actual capitalisation is lower than the proper capitalisation. In case of under-capitalisation, the rate of dividend and the market value of shares are fairly higher than the market value of shares of similar enterprises.

Some of the Consequences of under Capitalisation Are discuss below:

1. Higher dividends on shares, not related to corporate growth.

2. Rise in share prices.

3. Growing intensity of competition due to the emergence of new rivals.

4. Liberal provision for depreciation.

5. Worker demand for higher wages and compensation (either directly or through their organisations).

6. Consumer demand for lower prices.

Some of the Remedies of Under Capitalisation Are discuss below:

1. Splitting up of shares:

The easiest remedy is for the directors to split up the shares in order to reduce earnings per share. This corrective measure does not affect the total capitalisation of a company because only the par value of share is reduced.

2. Increase in par value of shares:

The second remedy of under-capitalisation is to increase the par value of equity shares by revising upwards the value of assets. This will lead to a fall in earnings per share. Additionally, the company may offer the existing shareholders a share split-up and an in-crease in par value.

3. Issue of bonus shares:

Perhaps the most effective remedy for under capitalisation is the conversion of reserves into shares. This will serve two purposes — reducing both dividend per share and the overall rate of earnings. This is why this method is most widely used.

4. Issue of shares and debentures:

Finally, where under-capitalisation is due to shortage of capital, a company may issue more shares and debentures to the public as per the guidelines of SEBI.

4Q. Mention the scope and function of financial management .

Ans : Scope - M5 - Q2

There are some of functions are discuss below :