INDIAN INSTITUTE OF MANAGEMENT & COMMERCE
DEGREE & P.G COLLEGE, An Autonomous College
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FINANCIAL MANAGEMENT

QUESTION BANK

UNIT I: INTRODUCTION TO FINANCIAL MANAGEMENT

Section A: Short-Answer Questions

1. Define Financial Management.
2. Explain the nature of Financial Management.
3. State the objectives of Financial Management.
4. What is wealth maximization?
5. Distinguish between profit maximization and wealth maximization.
6. Explain the scope of Financial Management.
7. What are the major functions of a Finance Manager?
8. Define investment decision.
9. What is meant by financing decision?
10. Explain the importance of Financial Management in business.
11. What is working capital management?
12. Explain the relationship between risk and return.

Section B: Essay Questions

1. Define Financial Management and explain its nature, scope, and importance.
2. Discuss the objectives of Financial Management, highlighting profit maximization and wealth maximization.
3. Explain the major functions and responsibilities of a Finance Manager.
4. Discuss the role of Financial Management in achieving organizational objectives.
5. Explain the major financial decisions taken by a Finance Manager.
6. Differentiate between profit maximization and wealth maximization.
7. Explain the relationship between Financial Management and other functional areas of management.
8. Discuss the importance of risk and return in financial decision-making.

UNIT II: COST OF CAPITAL

Section A: Short-Answer Questions

1. Define Cost of Capital.
2. Explain the significance of Cost of Capital.
3. What is the cost of debt?
4. Define cost of preference share capital.

5. What is the cost of equity share capital?
6. Explain the concept of retained earnings as a source of finance.
7. What is the Weighted Average Cost of Capital (WACC)?
8. Define marginal cost of capital.
9. Distinguish between explicit cost and implicit cost of capital.
10. What is the tax adjustment in the calculation of the cost of debt?
11. Explain the Dividend Growth Model.
12. What is the Capital Asset Pricing Model (CAPM)?

Section B: Essay Questions

1. Define Cost of Capital and explain its importance in financial decision-making.
2. Explain the methods of calculating the cost of debt.
3. Discuss the methods of calculating the cost of preference share capital.
4. Explain the methods of calculating the cost of equity share capital.
5. What is Weighted Average Cost of Capital? Explain its calculation and significance.
6. Explain the factors affecting the Cost of Capital.
7. Discuss the methods of calculating the cost of retained earnings.

Section C: Problems

1. A company issues 10% debentures of ₹1,00,000 at par. The tax rate is 30%. Calculate the after-tax cost of debt.
2. A company issues 12% preference shares of ₹100 each at an issue price of ₹95. Calculate the cost of preference share capital.
3. A company issues equity shares of ₹100 each at a market price of ₹125. The expected dividend is ₹10 per share, and the growth rate is 5%. Calculate the cost of equity using the Dividend Growth Model.
4. A company has the following capital structure:
    - Equity share capital: ₹5,00,000; cost 15%
    - Preference share capital: ₹2,00,000; cost 10%
    - Debentures: ₹3,00,000; after-tax cost 7%

    Calculate the Weighted Average Cost of Capital using book-value weights.

5. A company has an expected dividend of ₹8 per share. The market price of the share is ₹80, and the expected growth rate in dividends is 6%. Calculate the cost of equity using the Dividend Growth Model.

UNIT III: CAPITAL BUDGETING

Section A: Short-Answer Questions

1. Define Capital Budgeting.
2. Explain the importance of Capital Budgeting.
3. What is a capital investment decision?
4. Define Payback Period.
5. What is the Accounting Rate of Return (ARR)?
6. Define Net Present Value (NPV).
7. What is the Internal Rate of Return (IRR)?

8. Explain the Profitability Index.
9. Distinguish between independent and mutually exclusive projects.
10. What is the time value of money?
11. Explain the concept of discounted cash flows.
12. State the limitations of the Payback Period method.

Section B: Essay Questions

1. Define Capital Budgeting and explain its nature, importance, and objectives.
2. Explain the various stages involved in the Capital Budgeting process.
3. Discuss the Payback Period and Accounting Rate of Return methods, highlighting their merits and limitations.
4. Explain the Net Present Value method with its advantages and limitations.
5. Discuss the Internal Rate of Return method and explain its merits and limitations.
6. Explain the Profitability Index method of evaluating investment proposals.
7. Distinguish between NPV and IRR methods of Capital Budgeting.
8. Explain the factors affecting Capital Budgeting decisions.
9. Discuss the importance of risk analysis in Capital Budgeting.
10. Explain the role of Capital Budgeting in long-term financial planning.

Section C: Problems

1. A project requires an initial investment of ₹1,00,000 and generates annual cash inflows of ₹25,000 for five years. Calculate the Payback Period.
2. A project costs ₹2,00,000 and generates annual cash inflows of ₹60,000 for five years. Calculate the Payback Period, assuming uniform cash inflows.
3. A machine costs ₹1,00,000 and has a useful life of five years with no scrap value. The average annual profit after depreciation and tax is ₹20,000. Calculate the Accounting Rate of Return using average investment.
4. A project requires an initial investment of ₹1,00,000 and generates the following cash inflows:
    - Year 1: ₹40,000
    - Year 2: ₹35,000
    - Year 3: ₹30,000
    - Year 4: ₹25,000

    Calculate the Net Present Value at a discount rate of 10%, using the following discount factors:

    - Year 1: 0.909
    - Year 2: 0.826
    - Year 3: 0.751
    - Year 4: 0.683
5. A project requires an investment of ₹1,50,000. The present value of cash inflows is ₹1,80,000. Calculate the Profitability Index and state whether the project should be accepted.
6. A project requires an initial investment of ₹1,00,000 and generates annual cash inflows of ₹40,000 for three years. Calculate NPV at 10% using the following discount factors:
    - Year 1: 0.909

- Year 2: 0.826
- Year 3: 0.751

UNIT IV: FINANCING DECISIONS AND LEVERAGES

Section A: Short-Answer Questions

1. Define Financing Decision.
2. What is Capital Structure?
3. Define financial leverage.
4. What is operating leverage?
5. Define combined leverage.
6. What is trading on equity?
7. Define Earnings Per Share (EPS).
8. Explain the concept of EBIT.
9. What is the Degree of Operating Leverage (DOL)?
10. What is the Degree of Financial Leverage (DFL)?
11. Distinguish between operating leverage and financial leverage.
12. State the factors affecting Capital Structure.
13. What is an optimum capital structure?
14. Explain the significance of leverage in financial decision-making.

Section B: Essay Questions

1. Define Financing Decision and explain the factors influencing financing decisions.
2. Explain the concept of Capital Structure and discuss the factors determining an appropriate capital structure.
3. What is financial leverage? Explain its significance, advantages, and limitations.
4. Define operating leverage and explain its calculation and importance.
5. Explain combined leverage and discuss its significance in financial planning.
6. Distinguish between operating leverage, financial leverage, and combined leverage.
7. Explain the relationship between leverage, risk, and return.
8. Discuss the concept of trading on equity and its impact on Earnings Per Share.
9. Explain the EBIT-EPS analysis and its role in financing decisions.
10. Discuss the importance of an optimum capital structure.

Section C: Problems

1. A company has sales of ₹5,00,000, variable costs of ₹3,00,000, and fixed operating costs of ₹1,00,000. Calculate:
   a. Contribution
   b. EBIT
   c. Degree of Operating Leverage
2. A company has EBIT of ₹2,00,000 and interest expenses of ₹50,000. Calculate the Degree of Financial Leverage.
3. A company has sales of ₹10,00,000, variable costs of ₹6,00,000, and fixed operating costs of ₹2,00,000. Interest expenses are ₹50,000. Calculate:
   a. Contribution
   b. EBIT
   c. Degree of Operating Leverage

d. Degree of Financial Leverage
e. Degree of Combined Leverage

4. A company earns EBIT of ₹5,00,000 and pays interest of ₹1,00,000. The corporate tax rate is 30%, and the company has 40,000 equity shares. Calculate Earnings Per Share (EPS).
5. A company has the following details:
    - Sales: ₹8,00,000
    - Variable costs: ₹4,80,000
    - Fixed operating costs: ₹1,60,000
    - Interest expenses: ₹40,000

   Calculate the Degree of Operating Leverage, Degree of Financial Leverage, and Degree of Combined Leverage.

6. A company has EBIT of ₹4,00,000. It is considering two financing plans:
    - Plan A: ₹10,00,000 equity capital divided into 1,00,000 shares.
    - Plan B: ₹5,00,000 equity capital divided into 50,000 shares and ₹5,00,000 debt carrying 10% interest.

   Calculate EPS under both plans, assuming a tax rate of 30%, and recommend the more suitable plan based on EPS.

UNIT V: DIVIDEND DECISIONS

Section A: Short-Answer Questions

1. Define Dividend Decision.
2. What is a dividend?
3. Explain dividend policy.
4. What is a cash dividend?
5. Define stock dividend or bonus shares.
6. What is an interim dividend?
7. What is a final dividend?
8. Explain the concept of dividend payout ratio.
9. What is the retention ratio?
10. State the factors affecting dividend policy.
11. What is dividend stability?
12. Explain the concept of residual dividend policy.

Section B: Essay Questions

1. Define Dividend Decision and explain its importance in Financial Management.
2. Discuss the various factors affecting dividend policy.
3. Explain the different types of dividends.
4. Discuss the Walter Model of dividend policy and its assumptions.
5. Explain the Gordon Model of dividend policy and its assumptions.
6. Discuss the Modigliani and Miller (MM) approach to dividend policy.
7. Distinguish between the Walter Model and Gordon Model.
8. Explain the concept of dividend stability and discuss its advantages.
9. Discuss the relationship between dividend policy and the market value of shares.

10. Explain the importance of dividend policy in balancing shareholders' expectations and the company's growth requirements.

Problems: Page no. 10.15 Question no: 1,2,3,4,5,6,7