

OPEN STUDENT FOUNDATION
Std-12 Business Administration
Day - 8

Chapters : 8

Date : 24/02/24

Section A

- Choose correct answer from the given options. [Each carries 1 Mark] [9]
1. With what is financial management related? (March -2018, March-23)
(A) Finance market (B) Finance function (C) Stock market (D) Capital market
 2. On which concept is the approach to the wealth maximisation based? (March -2018)
(A) Cash flow (B) Social Responsibility
(C) Present Values of Assets (D) Negativity
 3. Excess of current assets over current liabilities means....
(A) Gross working capital (B) Equilibrium working capital.
(C) Negative working capital. (D) Positive working capital.
 4. On which capital is dividend paid?(March - 2019, March-2020)
(A) Paid-up capital (B) Authorized capital (C) Called up capital (D) Working capital
 5. A capital structure having the right proportion of equity capital and debt is (Murch-2019)
(A) Optimum capital structure (B) Simple capital structure
(C) Working capital structure (D) Proportional capital structure
 6. How many types of capital structure are there? (July-2018, July-2019, Aug-2020, March-2022)
(A) Five (B) Four (C) Three (D) Two
 7. With whom does a foreign investment organization have to register itself? (July-2019, Aug-2020, March-2022)
(A) Company Registrar (B) Court (C) Stock Market (D) SEBI
 8. Decisions of investment means.....
(A) Capital cost (B) Capital budgeting
(C) Capital structure (D) Re-investment of profit
 9. By which other name is the objective of wealth maximisation known? (May-2021, March-2023)
(A) Social Welfare (B) Capital investment (C) Net present value (D) Trading on equity

Section B

- Write the answer of the following questions. [Each carries 2 Marks] [8]
10. "Capital structure is a mixture of owner's capital and debt." - Explain.
 11. "Working capital means circulating capital in business." - Explain.
 12. What is production cycle ? (July-2019, Aug-2020, March-2022, July- 2022)
 13. What is meant by optimum capital structure ?

Section C

- Write the answer of the following questions. [Each carries 3 Marks] [9]
14. Explain the objectives of financial management. (March-2020, March-2023)
 15. State the factors affecting working capital. (March-2022, March-2023)
 16. Write Notes : (1) Decisions related to investment (2) Decisions related to dividend.

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Section A

- **Choose correct answer from the given options. [Each carries 1 Mark]** **[9]**
1. **With what is financial management related? (March -2018, March-23)**
(A) Finance market (B) Finance function (C) Stock market (D) Capital market
- ➡ Ans : (B)
2. **On which concept is the approach to the wealth maximisation based? (March -2018)**
(A) Cash flow (B) Social Responsibility
(C) Present Values of Assets (D) Negativity
- ➡ Ans : (A)
3. **Excess of current assets over current liabilities means....**
(A) Gross working capital (B) Equilibrium working capital.
(C) Negative working capital. (D) Positive working capital.
- ➡ Ans : (D)
4. **On which capital is dividend paid?(March - 2019, March-2020)**
(A) Paid-up capital (B) Authorized capital (C) Called up capital (D) Working capital
- ➡ Ans : (A)
5. **A capital structure having the right proportion of equity capital and debt is (Murch-2019)**
(A) Optimum capital structure (B) Simple capital structure
(C) Working capital structure (D) Proportional capital structure
- ➡ Ans : (A)
6. **How many types of capital structure are there? (July-2018, July-2019, Aug-2020, March-2022)**
(A) Five (B) Four (C) Three (D) Two
- ➡ Ans : (B)
7. **With whom does a foreign investment organization have to register itself? (July-2019, Aug-2020, March-2022)**
(A) Company Registrar (B) Court (C) Stock Market (D) SEBI
- ➡ Ans : (D)
8. **Decisions of investment means.....**
(A) Capital cost (B) Capital budgeting
(C) Capital structure (D) Re-investment of profit
- ➡ Ans : (B)
9. **By which other name is the objective of wealth maximisation known? (May-2021, March-2023)**
(A) Social Welfare (B) Capital investment (C) Net present value (D) Trading on equity
- ➡ Ans : (C)

Section B

- **Write the answer of the following questions. [Each carries 2 Marks]** **[8]**
10. **“ Capital structure is a mixture of owner’s capital and debt.” - Explain.**
- ➡ A company can raise the necessary capital funds from different securities.

- ➡ A company raises capital by issuing various securities like equity shares, preference shares, debentures etc.
- ➡ The financial manager decides how much of these securities to be issued.
- ➡ Thus, capital structure refers to the combination of various sources of capital such as equity shares, preference shares, debentures, reserves and loan funds.
- ➡ Hence it can be said that "Capital structure is a mixture of owner's capital and debt."

11. "Working capital means circulating capital in business." - Explain.

- ➡ Working capital is short term capital. It includes debtors, debentures, short-term securities among current assets.
- ➡ Working capital is constantly required to pay day-to-day expenses. Such capital is continuously converted from current assets to cash and from cash to current assets. Hence it can be said that working capital means circulating capital in business.

12. What is production cycle ? (July-2019, Aug-2020, March-2022, July- 2022)

- ➡ Production cycle means the period of conversion from raw materials to finished goods.
- ➡ As the period is longer, working capital is required more, as the period is shorter, working capital is required less.
- ➡ More working capital is required for industries like iron-steel, textile industries, etc as the time is longer while less capital is required for industries like sugar, dairy industries, etc. As the time is shorter.

13. What is meant by optimum capital structure ?

- ➡ Capital structure is a mixture of owner's capital and debt. Financial manager has to take decision regarding the portion to be maintained between equity and debt in capital structure. A balance between equity capital and debt is necessary. Capital structure having a proper proportion of equity capital and debt is called optimum capital structure. Optimum Capital Structure is less risky and ensures maximum return.

Section C

● Write the answer of the following questions. [Each carries 3 Marks]

[9]

14. Explain the objectives of financial management. (March-2020, March-2023)

- ➡ The objective of financial management is to 'maximise the economic welfare of the owner'
- ➡ The aims of Financial management should be 'economic maximization of the owner' who are the shareholders of the company through the use of financial instruments.

➡ There are two approaches for this:

(A) Objective of Profit maximization

(B) Objective Wealth maximization

(A) Objective of Profit Maximisation:

⇒ Profit maximization means maximizing the company's revenue. Investors in a company buy shares of the company with the expectation of getting maximum dividends. According to this approach, a company should make the most of its available resources to earn profit and accept only profitable business.

⇒ A company can increase earnings per share through profit maximization objective.

(B) Wealth maximization objective

⇒ The objective of wealth maximization is also known as 'Net Present Value'. Net present value creates shareholders' wealth. The wealth maximization approach is based on the cash flow concept. In this approach cash flow is considered as a measure and accounting profit is ignored. According to this

approach, a company should only accept financial decisions that increase the net present value of assets.

- ⇒ The difference between the present value of the asset and the required investment is the net present value of the asset.
- ⇒ Net present value of the asset = Present value of the asset - Investment required for the asset.
- ⇒ Financial decisions should be taken in such a way that the assets of the company are maximized. If assets are maximized by the company, it will be reflected in the share price of the company in the stock market. Share prices will increase in the stock market. As a result shareholders' wealth will be maximized and their property will increase.
- ⇒ The objective of wealth maximization has become appropriate and universally accepted for making financial decisions. Wealth maximization approach is superior to profit maximization approach. Prof. Solomon has favoured the objective of wealth maximisation.

15. State the factors affecting working capital. (March-2022, March-2023)

⇒ The Factors affecting working capital are as follows :

(1) Type and form of business :

- ⇒ Requirement of working capital mainly depends on the type and form of business.
- ⇒ E.g. Large business units have to keep large stock of goods and sell on credit, thus requiring more working capital.
- ⇒ Amount of working capital varies according to the nature of the industry.
- ⇒ E.g. Gas company, electricity company require less working capital. While labour intensive industry requires more working capital.

(2) Size of Business :

- ⇒ As the size of the business is small, the requirement of working capital is less and as the size of the business is large, the requirement of working capital is more.

(3) Production cycle:

- ⇒ The period between the purchase of raw materials and the production of finished goods from them, is called the production cycle, as the duration of the production cycle is longer, as the working capital is invested in raw materials and semi-finished goods, its requirement is more. E.g. Cotton and jute industry requires more working capital due to longer production cycle. Whereas in bakery and dairy industry less working capital is required due to shorter production cycle time.

(4) Production Policy and Type of Demand :

- ⇒ The requirement of working capital is more, if the policy of production is to continue for twelve months when the demand for the product is seasonal. I.e. winter season clothes.

(5) Storage of raw materials :

- ⇒ Raw materials have to be stockpiled when sources of raw materials are limited or irregular in supply or seasonal. Hence more working capital is required.

(6) Credit Policy :

- ⇒ Less working capital is required when the policy is to sell finished goods for cash and more working capital is required when the policy is to sell finished goods on credit. The same applies to the purchase of raw materials.

(7) Conversion of Current Assets into Cash :

- ⇒ Less working capital is needed when debtors are collected quickly, finished goods are sold in cash and bills receivable are paid on maturity. More working capital is required in the opposite situation.

(8) Stock turnover rates :

⇒ When the turnover rate of finished goods stock is high, the working capital requirement is less and when the turnover rate of finished goods stock is low, the working capital requirement is more.

(9) Efficiency of Operation :

⇒ If the management is efficient, the equipment can be utilized to the maximum extent. Administrators can speed up recovery from debtors if they are efficient. Thus, less working capital is required due to efficient managerial performance.

(10) Allocation of Profits :

⇒ As the company distributes a large portion of its profits as dividends, more cash requires in the business, as a result, more working capital is needed.

16. Write Notes : (1) Decisions related to investment (2) Decisions related to dividend.

⇒ Financial management is also known as finance function as it is related with the finance function. In financial management, decisions have to be made on the following three important questions:

(i) Decisions related to investment

(ii) Decisions related to dividend

(iii) Decisions related to financing

(i) **Decisions relating to investment**

⇒ Fixed capital is invested for long term in fixed assets of business. The financial manager has to take decisions regarding the selection of the fixed assets in which capital funds are to be invested in the future and the investment in them. Investment decision is called capital budgeting. There is an element of risk in investment decisions. Hence investment decisions should be evaluated in terms of expected return and risk. Different methods of capital budgeting are used in making investment decisions in fixed assets when the financial manager has more than one option to invest money like Pay-back Method, Rate of Return Method, Excess Cash Flow Method (Discounted Cash-Flow Method) etc.

⇒ **Factors affecting investment decision:**

(1) Need of total capital.

(2) Estimated rate of return and profitability receivable in future from investment.

(3) Estimated cash flow receivable from investment.

(4) Element of risk involved in investment.

(5) Requirement of working capital after investment.

(6) Useful economic life of investment and its estimated life.

(7) Significance of investment.

(8) Capital rationing.

(9) Certainty or uncertainty of earning in future.

(ii) **Decisions Related to Dividend :**

⇒ A dividend is the portion of a company's profits that is distributed among shareholders on their paid-up capital. Shareholders get return on their investment is called dividend.

⇒ Financial managers have to make important decisions about how much of the business's earnings should be distributed to shareholders in the form of dividends and how much of the profits should be kept in the business.

⇒ If a large portion of profits are distributed in the form of dividends, then reinvestment of profits decreases. On the other hand, if most of the profits are reinvested, then less amount is available for

dividends.

⇒ **Factors Affecting Dividend Decision:**

- (1) The distributable profit of the company during the current financial year
- (2) Projection of future earnings
- (3) Rate of dividend paid by the company during previous years
- (4) Need for reinvestment of profits in the business
- (5) Current financial condition and financial needs of the company
- (6) Amount of reserves held by the company
- (7) Planning of future profitable investment
- (8) Attitude of Company Managers
- (9) Taxation policy
- (10) Statutory Restrictions
- (11) Expectations of the Company's Shareholders
- (12) Capital market conditions
- (13) Company's growth rate
- (14) Liquidity position of the company.