MBA 2nd Semester

Solution

Financial Management and Corporate Finance (KMB-204)

Duration: 1hour 30 minutes **Max. Marks: 30**

<u>Note: Attempt all the Questions</u>

Section-A		(5*1=5)			
Q. No.		**Question**	**Marks**	**CO**	**BL**
1.	**a.**	Why money should have time value? **Ans.** The main reason behind the time value of money is inflation. Time value of money takes the present value and future value of the money into account. The present value of money helps an investor to decide the amount he should invest today to receive a particular amount of money in the future.	**1**	**1**	**1**
	b.	What is offer for sale? **Ans.** Institutional investors like venture funds, private equity funds etc., invest in unlisted company when it is very small or at an early stage. When the company becomes large, these investors sell their shares to the public, through issue of offer document and the company's shares are listed in stock exchange. This is called as offer for sale.	**1**	**1**	**1**
	c.	Why systematic risk is always at macro in nature? **Ans.** Systematic risk is always at macro in nature because it can be generated by the whole economy and it can't be control by an organisation.	**1**	**1**	**2**
	d.	Differentiate between debenture and bank loan? **Ans.** The following difference are: ▪ **<u>Lending Partner:</u>** In debenture, the public lends its money to the company in return for a certificate promising afixed rate of interest. In loans, the lending institutions are banks and other financial institutions. ▪ **<u>Collateral:</u>** Debentures do not require any physical asset or collateral from the firm, whereas banks and other institutions require collateral for the loans unless it is a small amount of unsecured loan. ▪ **<u>Transferability:</u>** Debentures can be transferred from one person to another. However, bank loans are non-transferable.	**1**	**1**	**1**
	e.	Discuss the functions of primary market? **Ans.** The functions of primary market are: **1.** **<u>Origination:</u>** It simply means origin of the new issue. It is the work which begins before an issue is actually floated in the market. The following things is being determined before origin of issue i.e. **a.** Time of floating the new issue. **b.** Type of issue **c.** Price **2.** **<u>Underwriting:</u>** It is a kind of guarantee undertaken by an institution or firm of brokers ensuring the marketability of an issue. It is a method in which the guarantor promises to the issuing company that he/she would purchase certain specific shares if the public not invested in it. The following organisations who give guarantee are: **a.** LIC **b.** GIC	**1**	**1**	**1**

		c. Development Banks (IDBI, ICICI, etc.) **d.** Brokers, etc. **3. <u>Distribution:</u>** It involves the function of sale of shares and debentures to the investors. It is performed by brokers and agents. Brokers can maintain regular list of clients and directly contact for purchase and sale of securities.			

Section-B		**(4*5=20)**			
Q. No.		**Question**	**Marks**	**CO**	**BL**
2.	**a.**	"The Indian financial system was fairly well-developed even on the eve of planning." Justify the statement? **Ans.** It is a system that allows the exchange of funds between lenders, investors, and borrowers. It operates at national, global, and firm-specific levels. Money and credit are used as media of exchange in this system. It serve as a medium of known value for which goods and services can be exchanged as an alternative to barter system. A modern financial system may include banks (operated by the government or private sector), financial markets, financial instruments and financial services. It allows funds to be allocated, invested, or moved between economic sectors. It link between savers and investors. It allocates risk. Price-related information available. Reduce cost of transaction and borrowing. Financial expansion and development.	**5**	**1**	**2**
	b.	What is primary market? Discuss the methods to raise equity capital in the primary market? **Ans.** Market where new securities i.e. shares and bonds first time issued. Both the new companies and the existing ones can issue securities in this market to raise capital. In this market transactions are made between an issuer and the investors. This market is directly regulated by SEBI. The process of selling new issues to investors is called underwriting. In the case of a new stock issue, this sale is called as an Initial Public Offer (IPO). The methods are: **1. <u>Public issue:</u>** When a company raises funds by issuing its shares, debentures and bonds to the public, it is called as a public issue. **2. <u>Initial Public Offer (IPO):</u>** When a company makes a public issue for the first time and gets its shares listed on stock exchange, the public issue is called as initial public offer (IPO). **3. <u>Follow-on public offer (FPO)</u>**: When a listed company makes additional public issue on running projects to raise capital, it is called follow-on offer (FPO). **4. <u>Offer for sale:</u>** Institutional investors like venture funds, private equity funds etc., invest in unlisted company when it is very small or at an early stage. When the company becomes large, these investors sell their shares to the public, through issue of offer document and the company's shares are listed in stock exchange. This is called as offer for sale. **5. <u>Private Placement:</u>** It is the sale of securities to a relatively small number of select investors for raising capital. Investors involved in private placements are usually large banks, mutual funds, insurance companies and pension funds. Private placement is the opposite of a public issue, in which securities are made available for sale on the open	**5**	**1**	**2**

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<tr><td></td><td></td><td>market.
6. <u>Rights Issue:</u> When a company raises funds from its existing shareholders by issuing them new shares / debentures, it is called as rights issue. The offer document for a rights issue is called as the Letter of Offer. The issue is open for 90 days.
7. <u>Bonus Issue:</u> The Company issues new shares to its existing shareholders. Shareholders need not pay any money to the company for receiving the new shares.</td><td></td><td></td><td></td></tr>
<tr><td></td><td>c.</td><td>What do you understand by shares? Discuss atleast four types of shares?
Ans. Shares are units of ownership interest in a corporation or financial asset that provide for an equal distribution in any profits, if any are declared, in the form of dividends. A share is a single unit of ownership in a company or financial asset. It is essentially an exchangeable piece of value of a company which can fluctuate up or down, depending on several different market factors. Companies divide capital into shares as a means of raising capital.
The four types of shares are:
▪ <u>Equity Shares:</u> It is basically issued against the ownership of the business. It represents the ownership capital. It is also called as ordinary shares. The holders of these shares are the real owners of the company. They have a voting right in the meetings of holders of the company. They have control over the working of the company. The rate of dividend on these shares depends upon the profits of the company. Equity shareholders take risk both regarding dividend and return of capital. Equity share capital cannot be redeemed during the life time of the company.
▪ <u>Preference Shares:</u> Preference shares, more commonly referred to as preferred stock, are shares of a company’s stock with dividends that are paid out to shareholders before common stock dividends are issued. Most preference shares have a fixed dividend, while common stocks generally do not. If the company is in a position of loss the fixed dividend can be carry forward to the next year and company can pay return of both the years. If the company enters bankruptcy, the shareholders with preferred stock are entitled to be paid from company assets first. Preferred stock shareholders also typically do not hold any voting rights of the company.
▪ <u>Right Share:</u> These are the shares issued to the existing shareholders of a company. Such kind of shares is issued to protect the ownership rights of the investors.
▪ <u>Bonus Share:</u> These are the type of shares given by the company to its shareholders as a dividend.</td><td>5</td><td>2</td><td>2</td></tr>
<tr><td></td><td>d.</td><td>Explain the various sources of finance which need to be arranged and managed efficiently?
Ans. The following sources are:
1. <u>Business Growth:</u> It can be categorised into two parts:
a. <u>Internal Sources of Finance and Growth:</u> It is as follows:
☐ ‘Organic growth’ – growth generated through the development and expansion of the business itself. Can be achieved through:
▪ Generating increasing sales – increasing revenue to impact on overall profit levels.
▪ Use of retained profit – used to re-invest in the business.</td><td>5</td><td>1</td><td>2</td></tr>
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		▪ **Sale of assets** – can be a double edged sword – reduces capacity? **b. <u>External Sources of Finance and Growth:</u>** It is as follows: ☐ **Long Term** ■ Shares ☐ Ordinary Shares ☐ Preference Shares ☐ New issue Shares ☐ Rights Issue ☐ Bonus Issue ■ Loans ☐ Debentures ☐ Bank loans ☐ Merchant or Investment Banks ☐ **Short Term** ■ Bank loans ■ Overdraft facilities ■ Trade credit ☐ **<u>'Inorganic Growth':</u>** ▪ **Acquisitions-** ownership of more than 50%. ▪ **Merger-** ownership distributed among both the firms. ▪ **Takeover-** one firm controls other at 100% level. **2. <u>Business Angels:</u>** It is as follows: ▪ Individuals looking for investment opportunities. ▪ Generally small sums. ▪ Could be an individual or a small group. ▪ Generally have some say in the running of the company. **3. <u>Venture Capital:</u>** It is as follows: ▪ Pooling of capital in the form of limited companies – Venture Capital Companies. ▪ Looking for investment opportunities in fast growing businesses or businesses with highly rated prospects. ▪ May also buyout firms in administration who are going concerns. ▪ May also provide advice, contacts and experience. ▪ In India, venture capitalists have invested ₹ 500 Lakh crore since 2019.			

Section-C		**(2*5=10)**			
Q. No.		**Question**	**Marks**	**CO**	**BL**
3.	**a.**	"Finance plays a key role in the part of economic and business activities of the country." Justify the statement with the help of suitable examples. **Ans.** The functioning of an economy depends on the financial system of a country. The financial system includes banks as a central entity along with other financial services providers. The financial system of a country is deeply entrenched in society and provides employment to a large population. According to Baily and Elliott, there are three major functions of the financial system: Credit Provision – Credit supports economic activity. Governments can invest in infrastructure projects by reducing the cycles of tax revenues and correcting spends, businesses can invest more than the cash they have and	**5**	**1**	**2**

individuals can purchase homes and other utilities without having to save the entire amount in advance. Banks and other financial service providers give this credit facility to all stakeholders.

Liquidity provision – Banks and other financial providers protect businesses and individuals against sudden cash needs. Banks provide the facility of demand deposits which the business or individual can withdraw at any time. Similarly, they provide credit and overdraft facility to businesses. Moreover, banks and financial institutions offer to buy or sell securities as per need and often in large volumes to fulfil sudden cash requirements of the stakeholders.

Risk management services – Finance provides risk management from the risks of financial markets and commodity prices by pooling risks. Derivative transactions enable banks to provide risk management. These services are extremely valuable even though they receive a lot of flak due to excesses during the financial crisis.

The above three major functions are important for the running and development activities of any economy. Apart from these functions, an economy's growth is boosted by the savings-investment relationship. When there are sufficient savings, only then can there be a sizeable investment and production activity. This savings facility is provided by financial institutions through attractive interest schemes. The money saved by the public is used by the financial institutions for lending to businesses at substantial interest rates. These funds allow businesses to increase their production and distribution activities.

Another important work of finance is to boost the growth of capital markets. Businesses need two types of capital – fixed and working. Fixed capital refers to the money needed to invest in infrastructures such as building, plant and machinery. Working capital refers to the money needed to run the business on a day-to-day basis. This may refer to the ongoing purchase of raw materials, cost of finishing goods and transport of finished goods to stores or customers.

The financial system helps in raising capital in the following ways:

Fixed capital – Businesses issue shares and debentures to raise fixed capital. Financial service providers, both public and private, invest in these shares and debentures to make profits with minimal risk.

Working capital – Businesses issue bills, promissory notes etc. to raise short term loans. These credit instruments are valid in the money markets that exist for this purpose.

In order to support the export and import businessmen, there are foreign exchange markets whereby businesses can receive and transmit funds to other countries and in other currencies. These foreign exchange markets also enable banks and other financial institutions to borrow or lend sums in other currencies. Moreover, financial institutions can invest and reap profits from their short term idle money by investing in foreign exchange markets. Governments also meet their foreign exchange requirements through these markets. Hence, foreign exchange markets impact the growth and goodwill of an economy in the international markets.

Governments use the financial system to raise funds for both short term and long term fund requirements. Governments issue bonds and bills at attractive interest rates and also provide tax concessions. Budget gaps are taken care of by government securities. Thus, capital markets, foreign exchange markets and government securities markets are essential for helping businesses,

		industries and governments to carry out development and growth activities of the economy. The growth of different sectors of an economy is balanced through the financial system. There are primary, secondary and tertiary sector industries and all need sufficient funds for growth. The financial system of the country funds these sectors and provides sufficient funds for each sector – industrial, agricultural and services. Thus, finance plays a key role in the development of any economy and no economy can run successfully without a sound financial system.			
	b.	Define unsystematic risk? Discuss the types of unsystematic risk? **Ans.** Unsystematic risk is the risk that is inherent in a specific company or industry. By investing in a range of companies and industries, unsystematic risk can be drastically reduced through diversification. Synonyms include diversifiable risk, non-systematic risk, residual risk and specific risk. The types of unsystematic risk are: ▪ **<u>Business or liquidity risk:</u>** Business risk is also known as liquidity risk. It is so, since it originates from the sale and purchase of securities affected by business cycles, technological changes, etc. ▪ **<u>Financial or credit risk:</u>** Financial risk is also known as credit risk. It arises due to change in the capital structure of the organization. The capital structure mainly comprises of three ways by which funds are sourced for the projects. These are as follows: **i.** Owned funds. For e.g. share capital. **ii.** Borrowed funds. For e.g. loan funds. **iii.** Retained earnings. For e.g. reserve and surplus. ▪ **<u>Operational risk:</u>** Operational risks are the business process risks failing due to human errors. This risk will change from industry to industry. It occurs due to breakdowns in the internal procedures, people, policies and systems.	**5**	**1**	**2**

Section-C		**(2*5=10)**			
Q. No.		**Question**	**Marks**	**CO**	**BL**
4.	**a.**	Suppose you are a CFO of a company and you want to take decision as which type of instruments have to issue in the prosperity and recession market? Justify with suitable reasons? **Ans.** In prosperity market the instruments which companies have to issue are ordinary shares and preference shares because in the market the opportunities for both company and investors are at optimum level. Business is capable to pay and investors are capable to invest in risky instruments. In recession market the instruments which companies have to issue are debentures, bonds and mutual funds because in the market the opportunities for both company and investors are at low level. There is a shortage of money and opportunities in the market and the investors are not capable to invest in risky instruments. Investors want some fixed return and if the companies need the fund from the investors then company have to issue the instrument which have a fixed return paying capacity.	**5**	**2**	**5**
	b.	Differentiate between finance and accounting? **Ans. The following differences are:** ▪ Accounting concentrates on record keeping and submitting of financial	**5**	**1**	**2**

		statements whereas Finance focuses on making decisions and carrying out analysis based on information presented by accounting. ▪ Accounting tends to be more concerned with the past whereas Finance tends to be more interested in present and the future. ▪ Accounting tends to have an income focus and Finance tends to have a cash flow focus.			

Section-C		**(2*5=10)**			
Q. No.		**Question**	**Marks**	**CO**	**BL**
5.	**a.**	Explain in detail the different types of financial decisions as required for the smooth functioning of an organization? **Ans.** The types are: 1. **<u>Investment Decisions:</u>** ▪ Should we built this component or buy it? ▪ What specific assets should be acquired? ▪ Should we introduce a new product? ▪ Which projects should be undertaken? 2. **<u>Financing Decisions:</u>** ▪ What is the best structure of financing (debt versus equity)? ▪ How much of our debt should be short-term as opposite to long-term? ▪ What is the best dividend policy? ▪ How will the funds be physically acquired? 3. **<u>Asset-Management Decisions:</u>** ▪ How do we manage existing assets efficiently? ▪ Greater emphasis on current asset management than fixed asset management	**5**	**1**	**5**
	b.	What do you understand by secondary market? Explain the different functions performed by secondary market? **Ans.** A secondary market is a market where stockbrokers and traders can buy and/or sell stocks (also called shares), bonds and other securities. It is a market place where listed securities buy and sell for investment or speculation. It is an organised and regulated market for various securities issued by corporate sector and other institutions. It is a privately organised market which is used to facilitate trading of securities. It is as ready market where buyers and sellers are always available to buy and sell the securities. The securities of corporations, trusts, Government, municipal corporations, etc. are allowed to deal at stock exchange. It is a market wholly governed and regulated by SEBI. The functions are: 1. **<u>Ensure Liquidity of Capital:</u>** It provides a place where securities are converted into cash. It is a market where buyers and sellers are always available and those who need hard cash can sell their securities. 2. **<u>Contributes to Economic Growth:</u>** In secondary market securities of various companies are bought and sold. This process of investment and re-investment helps to invest in most productive investment proposal and this leads to capital formation and economic growth. 3. **<u>Spreading of Ownership culture:</u>** Secondary market encourages people to invest in ownership securities by regulating new issues, better trading practices and by educating public about investment.	**5**	**1**	**2**

		4. <u>Providing Scope for Speculation:</u> To ensure liquidity and demand of supply of securities the stock exchange permits healthy speculation of securities. **5. <u>Better Allocation of Capital:</u>** The shares of profit making companies are quoted at higher prices and are actively traded so such companies can easily raise fresh capital from stock market. The general public hesitates to invest in securities of loss making companies. So stock exchange facilitates allocation of investor's fund to profitable channels. **6. <u>Promotes the Habits of Investment:</u>** The stock market offers attractive opportunities of investment in various securities. These attractive opportunities encourage people to save more and invest in securities of corporate sector rather than investing in unproductive assets such as gold, silver, etc. **7. <u>Safety of Transactions:</u>** In stock market only the listed securities are traded and stock exchange authorities include the companies names in the trade list only after verifying the soundness of company. The companies which are listed they also have to operate within the strict rules and regulations. This ensures safety of dealing through stock exchange.			