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MOCK TEST PAPER

FINANCIAL MANAGEMENT AND ECONOMICS FOR FINANCE

Maximum Marks: 100 **Time Allowed: 3 Hours**

Topic cover in exam

Financial Management

Types of Financing, Cost of Capital, Financing Decisions - Capital Structure, Financing Decisions – Leverages, Dividend Decisions

Economics for Finance

Public Finance - Unit I: Fiscal Functions: An Overview, Unit II: Market Failure, Unit III: Government Interventions to Correct Market Failure, Unit IV: Fiscal Policy

International Trade - Unit II: The Instruments of Trade Policy, Unit III: Trade Negotiations

SECTION – A: FINANCIAL MANAGEMENT (60 Marks)

Answer all questions

Question 1.

In May, 2020 shares of RT Ltd. was sold for ₹ 1,460 per share. A long term earnings growth rate of 7.5% is anticipated. RT Ltd. is expected to pay dividend of ₹ 20 per share.

i. Calculate rate of return an investor can expect to earn assuming that dividends are expected to grow along with earnings at 7.5% per year in perpetuity?

ii. It is expected that RT Ltd. will earn about 10% on retained earnings and shall retain 60% of earnings. In this case, state whether, there would be any change in growth rate and cost of Equity?

10 Marks

Question 2.

a. ABC Company's equity share is quoted in the market at ₹ 25 per share currently. The company pays a dividend of ₹ 2 per share and the investor's market expects a growth rate of 6% per year.

You are required to:

i. Calculate the company's cost of equity capital.

ii. If the company issues 10% debentures of face value of ₹100 each and realises ₹ 96 per debenture while the debentures are redeemable after 12 years at a premium of 12%, calculate cost of debenture Using YTM?

5 Marks

b. Aaina Ltd. is considering a new project which requires a capital investment of ₹ 9 crores. Interest on term loan is 12% and Corporate Tax rate is 30%. Calculate the point of indifference for the project considering the Debt Equity ratio insisted by the financing agencies being 2 : 1.

5 Marks

Question 3.

Zordon Ltd. has net operating income of ₹ 5,00,000 and total capitalization of ₹ 50,00,000 during the current year. The company is contemplating to introduce debt financing in capital structure and has various options for the same. The following information is available at different levels of debt value:

Debt value (₹)	Interest rate (%)	Equity capitalization rate (%)
0	-	10.00
5,00,000	6.0	10.50
10,00,000	6.0	11.00
15,00,000	6.2	11.30
20,00,000	7.0	12.40
25,00,000	7.5	13.50
30,00,000	8.0	16.00

Assuming no tax and that the firm always maintains books at book values, you are required to calculate:

i. Amount of debt to be employed by firm as per traditional approach.

ii. Equity capitalization rate, if MM approach is followed. **10 Marks**

Question 4.

The following particulars relating to Navya Ltd. for the year ended 31st March 2021 is given:

Output	1,00,000 units at normal capacity
Selling price per unit	₹ 40
Variable cost per unit	₹ 20
Fixed cost	₹ 10,00,000

The capital structure of the company as on 31st March, 2021 is as follows:

Particulars	₹
Equity share capital (1,00,000 shares of ₹ 10 each)	10,00,000
Reserves and surplus	5,00,000
7% debentures	10,00,000
Current liabilities	5,00,000
Total	30,00,000

Navya Ltd. has decided to undertake an expansion project to use the market potential, that will involve ₹ 10 lakhs. The company expects an increase in output by 50%. Fixed cost will be increased by ₹ 5,00,000 and variable cost per unit will be decreased by 10%. The additional output can be sold at the existing selling price without any adverse impact on the market.

The following alternative schemes for financing the proposed expansion programme are planned:

i. Entirely by equity shares of ₹ 10 each at par.

ii. ₹ 5 lakh by issue of equity shares of ₹ 10 each and the balance by issue of 6% debentures of ₹ 100 each at par.

iii. Entirely by 6% debentures of ₹ 100 each at par.

Find out which of the above-mentioned alternatives would you recommend for Navya Ltd. with reference to the risk and return involved, assuming a corporate tax of 40%.

10 Marks

Question 5.

a. From the following information extracted from the books of accounts of Imax Ltd., calculate percentage change in earnings per share, if sales increase by 10% and Fixed Operating cost is ₹ 1,57,500:

Particulars	Amount in ₹
EBIT (Earnings before Interest and Tax)	31,50,000
Earnings before Tax (EBT)	14,00,000

5 Marks

b. The annual report of XYZ Ltd. provides the following information for the Financial Year 2020-21:

Particulars	Amount (₹)
Net Profit	50 lakhs
Outstanding 15% preference shares	100 lakhs
No. of equity shares	5 lakhs
Return on Investment	20%
Cost of capital i.e. (K_e)	16%

Calculate price per share using Gordon's Model when dividend pay-out is-

i. 25%;

ii. 50%;

iii. 100%.

5 Marks

Question 6.

Kalyanam Ltd. has an operating profit of ₹ 34,50,000 and has employed Debt which gives total Interest Charge of ₹ 7,50,000. The firm has an existing Cost of Equity and Cost of Debt as 16% and 8% respectively. The firm has a new proposal before it, which requires funds of ₹ 75 Lakhs and is expected to bring an additional profit of ₹ 14,25,000. To finance the proposal, the firm is expecting to issue an additional debt at 8% and will not be issuing any new equity shares in the market. Assume no tax culture.

You are required to Calculate the Weighted Average Cost of Capital (WACC) of Kalyanam Ltd.:

i. Before the new Proposal

ii. After the new Proposal

10 Marks

SECTION – B: ECONOMICS FOR FINANCE (40 Marks)

Answer all questions

Question 7.

a. Average per capita income of country Y rose from 42,300 to 50,000 and the corresponding figures for per capita consumption rose from 35,400 to 42,500. Find the spending multiplier for this economy.

3 Marks

b. Explain in brief the signification of global public goods?

3 Marks

c. What is the importance of demand side driven fiscal policy?

2 Marks

d. What do you understand by the term 'Most-favored-nation' (MFN)?

2 Marks

Question 8.

a. Explain how a tariff levied on an imported product affects both the country exporting a product and the country importing that product.

3 Marks

b. How does Free Rider Problems causes market failure?

3 Marks

c. What are the conceptual three functions framework of the responsibilities of Government in Public Finance?

2 Marks

d. How fiscal Policy can be used as a tool for Reduction in inequalities of Income and Wealth?

2 Marks

Question 9.

a. Many apprehensions have been raised in respect of the WTO and its ability to maintain and extend a system of liberal world trade. Comment.

5 Marks

b. Why GATT lost its relevance by 1980?

3 Marks

c. How does government subsidies help in balancing the role as allocative function?

2 Marks

Question 10.

a. What do you understand by the term "Tragedy of Common's "in Public Finance.

2 Marks

b. Assume that the MPC is equal to 0.6.

i. What is the value of government spending multiplier?

ii. What impact would a 50 billion increase in government spending have on equilibrium GDP?

iii. What about a 50 billion decrease in government spending?

3 Marks

c. For an Economy with the following specifications

Consumption,	C	$= 50 + 0.75\ Y_d$
Investment,	I	= 100
Government Expenditure,	G	= 200
Transfer Payments,	R	= 110
Income Tax		= 0.2Y

Calculate the equilibrium of income and the value of expenditure multiplier.

5 Marks