TOPPER'S CLASSES

CA-INTER

FINANCIAL MANAGEMENT

Group II – Paper 6

OBJECTIVE QUESTIONS

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SCOPE AND OBJECTIVES OF FINANCIAL MANAGEMENT 1

MULTIPLE CHOICE QUESTIONS (MCQs)

Q1. Focus of financial management is mainly concerned with the decision related to:
- **(a)** Financing
- **(b)** Investing
- **(c)** Dividend
- **(d)** All of the above.

Q2. The main objective of financial management is to:
- **(a)** Secure profitability
- **(b)** Maximise shareholder wealth
- **(c)** Enhancing the cost of debt
- **(d)** None of these.

Q3. The shareholder value maximisation model holds that the primary goal of the firm is to maximise its:
- **(a)** Accounting profit
- **(b)** Liquidity
- **(c)** Market value
- **(d)** Working capital.

Q4. Wealth maximisation approach is based on the concept of:
- **(a)** Cost benefit analysis
- **(b)** Cash flow approach
- **(c)** Time value of money
- **(d)** All of the above.

Q5. Management of all matters related to an organisation's finances is called:
- **(a)** Cash inflows and outflows
- **(b)** Allocation of resources
- **(c)** Financial management
- **(d)** Finance.

Q6. Which of the following is the disadvantage of having Shareholders Wealth Maximisation goals?
- **(a)** Emphasizes the short-term gains.
- **(b)** Ignores the timing of returns.
- **(c)** Requires immediate resources.
- **(d)** Offers no clear relationship between financial decisions and share price.

Q7. The most important goal of Financial Management is:
- **(a)** Profit maximisation
- **(b)** Matching income and expenditure
- **(c)** Using business Assets effectively
- **(d)** Wealth Maximisation.

Q8. To achieve Wealth Maximisation, the Finance Manager has to take careful decision in respect of:

(a) Financing **(b)** Investing **(c)** Dividend **(d)** All of the above.

Q9. Early in the history of Finance, an important issue was:

(a) Liquidity **(b)** Technology **(c)** Capital structure **(d)** Financing options.

Q10. Investment Decision in Financial Management does not include:

(a) Dividend Payout Decision
(b) Capital Budgeting Decision
(c) Working Capital Management
(d) Re-allocation of Capital.

Q11. The main function of a Financial Manager includes the following except:

(a) Asset Management
(b) Capital Structure Planning
(c) Fund Management
(d) Internal Control and Audit.

Q12. Financial Management is mainly concerned with the:

(a) Acquiring and developing assets to forfeit its overall benefit.
(b) Acquiring, financing and managing assets to accomplish the overall goal of a business enterprise.
(c) Efficient management of the business.
(d) Sole objective of profit maximisation.

Q13. Which of the following need not be followed by the Finance Manager for measuring and Maximising Shareholder's Wealth?

(a) Accounting profit analysis
(b) Cash flow approach
(c) Cost benefit analysis
(d) Application of time value of money.

Q14. Which of the following are microeconomic variables that help define and explain the discipline of Finance?

(a) Risk and return
(b) Capital structure
(c) Inflation
(d) All of the above.

Q15. A Company would like to have liquid resources for transaction purposes, as a precautionary measure and for .... :

(a) Finance Opportunities
(b) Resource Utilization
(c) Speculative Opportunities
(d) Accumulation of Future Reserves.

Q16. Which of the following Statement is correct, related to Fixed Charges like Interest on Loans and Debentures etc:

(a) Higher the Fixed Charges, greater the Risk
(b) Higher the Fixed Charges, lower the Risk
(c) Higher the Fixed Charges, no change in the Risk
(d) Higher the Fixed Charges, Risk may either be lower or higher.

Q17. Find the correct Statement regarding the Profit Maximisation:

(a) Profit Maximisation considers the Firm's Risk level

(b) Profit Maximisation will not lead to increasing short-term profits at the expenses of lowering expected future profits

(c) Profit Maximisation does consider the impact on individual shareholder's EPS

(d) Profit Maximisation is concerned more with maximising Net Income than the Stock Price.

Q18. The competing objectives of Financial Management have been:

(a) Profit Maximisation and Wealth Maximisation

(b) Profit Maximisation and Economic Value Maximisation

(c) Economic Value Maximisation and Wealth Maximisation

(d) EPS Maximisation and Economic Value Maximisation.

Q19. Profit Maximization may lead to better and efficient utilization of the resources only when there is

(a) Monopoly **(b)** Perfect Competition **(c)** Oligopoly **(d)** None of these.

Q20. Which of the following is True regarding Financial Decisions of a Firm?

(a) Investment Decisions are dependent on the Financing Decisions

(b) Financing Decisions are dependent on Dividend Decisions

(c) Dividend Decisions are dependent on Investment Decisions

(d) All three decisions are inter-related.

Q21. The competing objectives of Financial Management have been:

(a) Profit Maximisation and Wealth Maximisation

(b) Profit Maximisation and Economic Value Maximisation

(c) Economic Value Maximisation and Wealth Maximisation

(d) EPS Maximisation and Economic Value Maximisation.

Q22. The Finance Manager of the Company can take care of duties such as:

(a) Forecasting of Sales

(b) Raising Funds

(c) Managing funds

(d) Both (b) and (c).

Q23. Financial Management is broadly concerned with .... :

(a) Raising of Funds

(b) Creating Value to the Assets of the Business Enterprise

(c) Efficient Allocation of Funds

(d) All of the above.

Q24. A permanent .... may lead an Organization to the chaotic state .... :

(a) Financial Distress; Identified Risk

(b) Financial Insolvency; Financial Certainty

(c) Identified Risk; Financial Insolvency

(d) Financial Distress; Financial Insolvency.

Q25. Long-term Objective of Financial Management is to be .... :

(a) Maximize Earnings Per Share

(b) Maximize the Value of the Firm's Common Stock

(c) Maximize Return on Investment

(d) Maximize Market Share.

Q26. The Market Price of a Share (MPS) of Common Stock of a Company is determined by:
- **(a)** The President of the Company
- **(b)** The Stock Exchange on which the Stock is listed
- **(c)** The Board of Directors of the Company
- **(d)** Individual Buying and Selling the Stock.

Q27. Shareholders Wealth in a Firm is reflected by:
- **(a)** The number of people employed in the Firm
- **(b)** The Book Value of the Firm's Assets less the Book Value of its Liabilities
- **(c)** The amount of Salary paid to its Employees
- **(d)** The Market Price Per Share of the Firm.

Q28. Profit Maximisation is the main objective of Business because:
- **(a)** Profit acts as a measure of efficiency
- **(b)** It serves as a protection against Risk
- **(c)** Both (a) and (b)
- **(d)** None of these.

Q29. Stock Holder's Wealth equals to .... :
- **(a)** No. of Shares Owned x Current Stock Price Per Share
- **(b)** No. of Shares Owned x Current Earnings Per Share
- **(c)** No. of Shares Owned x Current Dividend Per Share
- **(d)** None of these.

Q30. Financial Planning is .... function of a Finance Manager:
- **(a)** Executive
- **(b)** Incidental
- **(c)** Auxiliary
- **(d)** None of these.

Q31. The Job of Finance Manager is confined to:
- **(a)** Raising of Funds
- **(b)** Management of Cash
- **(c)** Raising of Funds and their Effective Utilization
- **(d)** None of these.

Q32. Financial Management is a part of .... :
- **(a)** Financial Accounting
- **(b)** Business Management
- **(c)** Accounting
- **(d)** Tax Laws.

Q33. Which of the following is not the responsibility Financial Management?
- **(a)** Allocation of Funds to Current and Capital Assets
- **(b)** Obtaining the best mix of financing alternatives
- **(c)** Preparation of the firm's accounting statements
- **(d)** Development of an appropriate dividend policy.

Q34. Which is the limitation of Traditional Approach of Financial Management:

(a) Ignores allocation of resources
(b) One sided approach
(c) More emphasis on long-term problems
(d) All of the above.

Q35. The Financial Management is responsible for the:

(a) Controlling of the organisation
(b) Organizing trading programs
(c) Recording the transaction
(d) Finance function of the firm.

Q36. The Profit Maximisation Objective ignores the Concept of ''Time Value of Money''. Is this Statement True?

(a) No
(b) Yes
(c) Cannot determine
(d) None of these.

Q37. Which of the following is not the advantage of Wealth Maximisation in case of the Company?

(a) It emphasizes on long-term prospect
(b) It recognises the risk factor as well as time value of money concept
(c) It easily determines the relationship between financial decisions and profits of the company
(d) All of the above.

Q38. Financial Management helps in the following:

(a) It keeps the risks under control
(b) It reduces the cost of funds
(c) It helps to achieve effective deployment of funds
(d) All of the above.

Q39. Decisions related to Investment in long-term assets are appropriately known as:

(a) Financial Management
(b) Business Finance Decisions
(c) Capital Budgeting Decisions
(d) All of the above.

Q40. Now-a-days, A Company can obtain funds for its requirement from the following sources of finance:

(a) Loans from Banks and Financial Institutions
(b) Can issue of Equity Share or Preference Share Capital
(c) Can issue of debentures
(d) All of the above.

Q41. The Objective of Wealth Maximisation is to be considered superior to the Objective of Profit Maximisation?

(a) No
(b) Yes
(c) Cannot say
(d) None of these.

Q42. .... indirect form of Working Capital Financing and Bank assume only the risk the credit being provided by the supplier himself:

- **(a)** Bank Overdraft
- **(b)** Mortgage Loan
- **(c)** Letter of Credit
- **(d)** Cash Credit.

Q43. Profit Maximisation as an Objective of Financial Management is criticised due to the following reasons:

- **(a)** It ignores the risk factor as well as time value of money concept.
- **(b)** It is vague and narrow concept.
- **(c)** It emphasizes on the short-term profitability and fails to consider social responsibility of the business.
- **(d)** All of the above.

Q44. Red Apple Company earns huge profits during the financial year 2023-24, it distributes quite high dividend out of its profits to the shareholders and some undistributed profits is that portion which remains with the company for future re-investment is known as:

- **(a)** Earnings Available to all shareholders
- **(b)** Earnings Available to Equity shareholders only
- **(c)** Earnings Available to Debt-holders
- **(d)** Retained Earnings only.

Q45. Which of the following Statement is not connected with the decisions of Financial Management?

- **(a)** From where to arrange the required funds
- **(b)** Where to investment the arranged funds
- **(c)** Quality of human resource required
- **(d)** How much to retain for future re-investment out of the total income earned.

Q46. The Term .... means the action of an organisation or government selling or liquidating an Asset or Subsidiary:

(a) Lock-Out (b) Wind-Up (c) Disinvestment (d) Sale Out.

Q47. .... is a blending of two or more existing undertaking into one undertaking:

- **(a)** Joint Venture
- **(b)** Partnership
- **(c)** Amalgamation
- **(d)** Joint Stock Company.

Q48. .... is the Primary Institutional Source of Working Capital Finance in india:

- **(a)** Creditors
- **(b)** Debtors
- **(c)** Loan from friends and Relatives
- **(d)** Bank Credit.

Q49. The Persons interested in the Analysis of Financial Statements can be grouped as .... :

- **(a)** Owners or Investors
- **(b)** Creditors
- **(c)** Financial Executives
- **(d)** All of the above.

Q50. .... is an Entity formed two or more Companies to undertake Financial Activity together:

- **(a)** Partnership
- **(b)** Acquisition
- **(c)** Merger
- **(d)** Joint Venture.

Q51. The Term .... means the management of an organisation maximises the present value not only for shareholders but for all including employees, customers, suppliers and community at large.

- **(a)** Economic Value Added
- **(b)** Market Value Added
- **(c)** Profit Maximisation
- **(d)** Wealth Maximisation.

Q52. .... is an Entity formed two or more Companies to undertake Financial Activity together:

- **(a)** Partnership
- **(b)** Acquisition
- **(c)** Merger
- **(d)** Joint Venture.

Q53. Every Debt Instrument has .... :

- **(a)** A Face Value
- **(b)** A Maturity Value
- **(c)** A Face Value as well as a Maturity Value
- **(d)** Liquidity Value.

Q54. The type of Collateral Security used for Short-term Loan is:

- **(a)** Real Estate
- **(b)** Plant and Machinery
- **(c)** Stock of Goods
- **(d)** Equity Share Capital.

ANSWERS

1	2	3	4	5	6	7	8	9	10
d	b	c	d	c	d	d	d	a	a
11	12	13	14	15	16	17	18	19	20
d	b	a	d	c	a	d	a	b	d
21	22	23	24	25	26	27	28	29	30
a	d	d	d	b	a	d	c	a	a
31	32	33	34	35	36	37	38	39	40
c	b	c	d	d	b	c	d	c	d
41	42	43	44	45	46	47	48	49	50
d	b	d	d	c	c	c	d	d	d
51	52	53	54						
d	d	c	c						

TYPES OF FINANCING 2

MULTIPLE CHOICE QUESTIONS (MCQs)

Q1. Equity shares:
- **(a)** Have an unlimited life, and voting rights and receive dividends
- **(b)** Have a limited life, with no voting rights but receive dividends
- **(c)** Have a limited life, and voting rights and receive dividends
- **(d)** Have an unlimited life, and voting rights but receive no dividends

Q2. External sources of Finance do not include:
- **(a)** Debentures
- **(b)** Retained Earnings
- **(c)** Overdrafts
- **(d)** Leasing

Q3. Internal sources of Finance do not include:
- **(a)** Better management of working capital
- **(b)** Ordinary Shares
- **(c)** Retained Earnings
- **(d)** Reserves and Surplus.

Q4. In Preference Shares:
- **(a)** Dividends are not available
- **(b)** Limited Voting Rights are available
- **(c)** Are not part of a company's share capital
- **(d)** Interest can be received

Q5. A Debenture:
- **(a)** Is a long-term loan
- **(b)** Does not require security
- **(c)** Is a short-term loan
- **(d)** Receives dividend payments

Q6. Debt Capital refers to:
- **(a)** Money raised through the sale of shares
- **(b)** Funds raised by borrowing that must be repaid
- **(c)** Factoring Accounts receivable
- **(d)** Inventory Loans

Q7. The most popular source of short-term funding is:
- **(a)** Factoring
- **(b)** Trade Credit
- **(c)** Family and friends
- **(d)** Commercial Banks

Q8. Marketable securities are primarily:

- **(a)** Short-term Debt instruments
- **(b)** Short-term Equity securities
- **(c)** Long-term Debt instruments
- **(d)** Long-term Equity securities

Q9. Which of the following marketable securities is the obligation of a Commercial Bank?

- **(a)** Commercial Paper
- **(b)** Negotiable Certificate of Deposit
- **(c)** Repurchase Agreement
- **(d)** T-bills

Q10. Reserves and Surplus are which form of financing?

- **(a)** Security Financing
- **(b)** Internal Financing
- **(c)** Loans Financing
- **(d)** International Financing

Q11. With reference to 'IFC Masala Bonds', which of the statements given below is/are correct?

- **(a)** The International Finance Corporation, which offered these bonds, is an arm of the World Bank.
- **(b)** They are rupee-denominated bonds and are a source of debt financing for the public and private sector.

1. (a) Only **2.** (b) Only
3. Both (a) and (b) **4.** Neither (a) nor (b)

Q12. External Commercial Borrowings can be accessed through ....

- **(a)** Only automatic route
- **(b)** Only approval route
- **(c)** Both automatic and approval route
- **(d)** Neither auto nor approval route.

Q13. Which is the most expensive source of Funds?

- **(a)** New Equity Shares
- **(b)** New Preference Shares
- **(c)** New Debts
- **(d)** Retained Earnings.

Q14. Which of the following is true?

- **(a)** Retained Earnings are cost free
- **(b)** External Equity is cheaper than Internal Equity
- **(c)** Retained Earnings are cheaper than External Equity
- **(d)** Retained Earnings are costlier than External Equity.

Q15. Debt Financing is a cheaper source of Finance because of:

- **(a)** Rate of Interest
- **(b)** Time Value of Money
- **(c)** Tax-deductibility of Interest
- **(d)** Dividends not payable to lenders.

Q16. Advantage of Debt Financing is:

- **(a)** Interest is Tax-deductible
- **(b)** It reduces WACC
- **(c)** Does not dilute owners control
- **(d)** All of the above.

Q17. Cost of Equity Share Capital is more than Cost of Debt because:

- **(a)** Face value of debentures is more than face value of shares
- **(b)** Equity shares have higher Cost than debt
- **(c)** Equity shares are easily saleable
- **(d)** All of the three above.

Q18. If a Company sells its receivables to another party to raise funds for short period of time, it is known as:

- **(a)** Securitization
- **(b)** Factoring
- **(c)** Pledging
- **(d)** None of the above.

Q19. Which of the following is a government-backed source of funds designed to Support Small businesses (SSB)?

- **(a)** Angel Investing
- **(b)** Microloans
- **(c)** Venture Financing
- **(d)** Bridge Loan.

Q20. When a Company raises funds through a private placement to a select group of investors, it is called:

- **(a)** Initial Public Offering
- **(b)** Follow On Offering
- **(c)** Private Equity
- **(d)** Seed Funding

Q21. In India, Commercial Papers are issued as per the guidelines issued by:

- **(a)** Security and Exchange Board of India (SEBI)
- **(b)** Reserve Bank of India (RBI)
- **(c)** Forward Market Commission (FMC)
- **(d)** None of the above.

Q22. Commercial Papers are generally issued at a Price:

- **(a)** Equal to face value
- **(b)** More than face value
- **(c)** Less than face value
- **(d)** Equal to redemption value

Q23. Which of the following is not applicable to Commercial Paper:

- **(a)** Face value
- **(b)** Issue price
- **(c)** Coupon rate
- **(d)** None of the above.

Q24. Which of the following is not a source of long-term finance?

(a) Equity Capital (b) Preference Capital (c) Debenture (d) Commercial Paper

Q25. A cumulative Preference Share is one:

(a) In which all the unpaid dividends are carried forward and payable in future period of time
(b) Which can be converted into Equity Shares
(c) Which can be redeemed
(d) Which entitle the preference shareholders to participate in surplus profits and assets

Q26. Which source of funds does not require repayment since it represents the owner's investment in the business?

(a) Long-term debt
(b) Equity financing
(c) Trade credit
(d) Factoring.

Q27. Which of the following is a Long-term Liability that represents the fixed obligation to repay borrowed funds?

(a) Trade credit
(b) Accrued Expenses
(c) Prepaid Expenses
(d) Debts.

Q28. A Company can raise funds by issuing shares in the stock market. This process is known as:

(a) Initial Public Offering
(b) Direct Public Offering
(c) Return on Investment
(d) None of the above.

Q29. Which of the following is a feature of Factoring?

(a) Tool of short term borrowing
(b) Purchase of export bill only
(c) Used in export business only
(d) Done without recourse to the client.

Q30. Floating Capital means:

(a) Liquid Capital
(b) Permanent Working Capital
(c) Redundant Working Capital
(d) Gross Working Capital

Q31. Under the Lease Agreement, the Lessee gets the right to:

(a) Participate in the management of the organisation
(b) Share profits earned by the lessor
(c) Sell the Assets
(d) Use the Asset for a specified period.

Q32. Which one is the source of short-term funds:

(a) Trade credit
(b) Short-term Bank Finance
(c) Public Deposits
(d) All of these.

Q33. In India Commercial Paper is regulated by .... :

(a) RBI

(b) SEBI

(c) SBI

(d) Indian Companies Act, 2013.

Q34. SPO refers to .... the second and subsequent time a company raises money from the public directly:

(a) Second Public Offering

(b) Subsequent Public Offering

(c) Subsequent Public Offer

(d) Seasonal Public Offering.

Q35. The Debt Capital can be raised from issue of .... :

(a) Bonds

(b) Equity Share Capital

(c) Right Share

(d) Preference Share Capital

Q36. IPO refers to ....; the first time a Company comes to the public to raise money for the business:

(a) Immediate Public Offer

(b) Immediate Public Offering

(c) Initial Public Offering

(d) Initial Public Offer.

Q37. Reserve and Surplus are which form of financing?

(e) Security Financing

(f) Internal Financing

(g) Loans Financing

(h) International Financing.

Q38. Which of the following is not regulated by SEBI?

(a) Foreign Institutional Investors

(b) Foreign Direct Investment

(c) Mutual Funds

(d) Depositories.

Q39. In India Commercial Paper is regulated by .... :

(a) RBI

(b) SEBI

(c) SBI

(d) Indian Companies Act, 2013.

Q40. How many depositories are there in India?

(a) 2 (b) 3 (c) 0 (d) 13

Q41. .... is a Collaborative Funding Model that lets you to collect small contribution from many individuals (The Crowd).

(a) Financial Group Funding

(b) Crowd-funding

(c) Financing

(d) All of the above.

Q42. Commercial Paper is a type of:

(a) Fixed Coupon Bond
(b) Unsecured short-term debt
(c) Equity share capital
(d) Government Bond.

Q43. The Term ''Redeemable'' is used with respect to the following source of Finance:

(a) Commercial Paper
(b) Public Deposit
(c) Equity Share Capital
(d) Preference Share Capital.

Q44. Money required for Operating the Business is an example of:

(a) Fixed Capital Requirement
(b) Ploughing Back of Profits
(c) Working Capital Requirement
(d) Lease Financing.

Q45. Which of the following is required for developing a new project/new product in its initial stage?

(a) Start-up capital
(b) Seed Capital
(c) Second round financing
(d) None of these.

Q46. Which one of the following is a medium term source of finance?

(a) Public Deposits
(b) Leasing Financing
(c) Euro Debt Issue
(d) All of the above.

Q47. Which of the following is not applicable to Commercial Paper?

(a) Face Value
(b) Issue Price
(c) Coupon Rate
(d) None of the above.

Q48. .... is an unsecured promissory note issued by a firm to raise funds for a short period, generally, varying from a few days to a few months.

(a) Commercial Paper
(b) Bank Credit
(c) Bills Receivables
(d) All of the above.

Q49. Cost of additional Equity Share Capital is the same as that of existing Equity Share Capital:

(a) True
(b) False
(c) Can't Say

Q50. Equity Share Capital does not carry any cost as a Company is under no legal obligation to pay dividends.

(a) True
(b) False
(c) Can't Say

Q51. Retained Earnings have no market value, so these are not included in WACC based on Market Value weights:

(a) True

(b) False

(c) Can't Say.

ANSWERS

1	2	3	4	5	6	7	8	9	10
a	b	b	b	a	b	b	a	b	b
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b	c	d	d	a	b	d	a	a	a
31	32	33	34	35	36	37	38	39	40
d	d	a	b	a	c	b	b	a	a
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b	d	c	b	d	d	b	a	b	b
51									
b									

RATIO ANALYSIS 3

MULTIPLE CHOICE QUESTIONS (MCQs)

Q1. Ratio of Net Sales to Net Working Capital is a:
- **(a)** Profitability Ratio
- **(b)** Liquidity Ratio
- **(c)** Current Ratio
- **(d)** Working Capital Turnover Ratio

Q2. Long-term Solvency is indicated by:
- **(a)** Debt/Equity Ratio
- **(b)** Current Ratio
- **(c)** Operating Ratio
- **(d)** Net Profit Ratio

Q3. Ratio of Net Profit before interest and tax to Sales is:
- **(a)** Gross Profit Ratio
- **(b)** Net Profit Ratio
- **(c)** Operating Profit Ratio
- **(d)** Interest Coverage Ratio

Q4. Observing changes in the financial variables across the years is:
- **(a)** Vertical analysis
- **(b)** Horizontal analysis
- **(c)** Peer-firm analysis
- **(d)** Industry analysis

Q5. The Receivable-Turnover Ratio helps management to:
- **(a)** Managing resources
- **(b)** Managing inventory
- **(c)** Managing customer relationship
- **(d)** Managing working capital

Q6. Which of the following is a Liquidity Ratio?
- **(a)** Equity Ratio
- **(b)** Proprietary Ratio
- **(c)** Net Working Capital
- **(d)** Capital Gearing Ratio

Q7. Which of the following is not a part of Quick Assets?
- **(a)** Disposable Investments
- **(b)** Receivables
- **(c)** Cash and Cash Equivalents
- **(d)** Prepaid Expenses

Q8. Capital Gearing Ratio is the fraction of:

(a) Preference Share Capital and Debentures to Equity Share Capital and Reserves & Surplus.
(b) Equity Share Capital and Reserves & Surplus to Preference Share Capital and Debentures.
(c) Equity Share Capital to Total Assets.
(d) Total Assets to Equity Share Capital.

Q9. From the following information, Calculate P/E Ratio:

Equity Share capital of ₹10 each	₹8,00,000
9% Preference Share Capital of ₹10 each	₹3,00,000
Profit (after 35% tax)	₹2,67,000
Depreciation	₹67,000
Market price of Equity Share	₹48

(a) 15 times
(b) 16 times
(c) 17 times
(d) 18 times

Q10. Equity Multiplier allows the investor to see:

(a) What portion of interest on debt can be covered from earnings available to equity shareholders?
(b) How many times preference share interest be paid from earnings available to equity shareholders?
(c) What portion of return on equity is the result of debt?
(d) How many times equity is multiplied to get the value of debt?

Q11. A Company has average accounts receivable of ₹10,00,000 and annual credit sales of ₹60,00,000. Its average collection period would be:

(a) 60.83 days
(b) 6.00 days
(c) 1.67 days
(d) 0.67 days

Q12. A Company has net profit margin of 5% of total assets of ₹90,00,000 and return on assets of 9%. Its total assets turnover ratio would be:

(a) 1.6 (b) 1.7 (c) 1.8 (d) 1.9

Q13. What does Q Ratio measures?

(a) Relationship between market value and book value per equity share.
(b) Proportion of profit available per equity share.
(c) Overall earnings on average total assets.
(d) Market value of equity as well as debt in comparison to all assets at their replacement cost.

Q14. Calculate operating expenses from the information given below:

Sales	₹75,00,000
Rate of income tax	50%
Net profit to sales	5%
Costs of goods sold	₹32,90,000
Interest on debentures	60,000

(a) ₹41,00,000
(b) ₹8,10,000
(c) ₹34,00,000
(d) ₹33,90,000

Q15. Which of the following is not a profitability ratio?
- **(a)** P/E Ratio
- **(b)** Return on capital employed (ROCE)
- **(c)** Q Ratio
- **(d)** Preference Dividend Coverage Ratio

Q16. Net Profit Ratio Signifies:
- **(a)** Operational Profitability
- **(b)** Liquidity Position
- **(c)** Big-term Solvency
- **(d)** Profit for Lenders.

Q17. DuPont Analysis deals with:
- **(a)** Analysis of Current Assets
- **(b)** Analysis of Profit
- **(c)** Capital Budgeting
- **(d)** Analysis of Fixed Assets.

Q18. TU Ltd. has Net Working Capital of ₹119 lakhs, Total Liabilities ₹225 lakhs and Non-current Liabilities are ₹140 Lakhs.
The Current Ratio will be:
(a) 2.4 : 1 (b) 1.85 : 1 (c) 2.46 : 1 (d) 1.15 : 1.

Q19. In Ratio Analysis, the Term Capital Employed refers to:
- **(a)** Equity Share Capital
- **(b)** Net Worth
- **(c)** Shareholder's Funds
- **(d)** Current Assets.

Q20. Inventory Turnover measures the relationship of inventory with:
- **(a)** Average Sales
- **(b)** Cost of Goods Sold
- **(c)** Total Purchases
- **(d)** Total Assets.

Q21. Return on Investment (ROI) may be improved by:
- **(a)** Increasing Turnover
- **(b)** Reducing Expenses
- **(c)** Increasing Capital Utilization
- **(d)** All of the above.

Q22. There is deterioration in the management of working capital of XYZ Ltd. What does it refer to?
- **(a)** That the Capital Employed has reduced
- **(b)** That the Profitability has gone up
- **(c)** That debtors collection period has increased
- **(d)** That Sale has decreased.

Q23. Which of the following does not help to increase Current Ratio?
- **(a)** Issue of Debentures to buy Stock
- **(b)** Issue of Debentures to pay Creditors
- **(c)** Sale of Investment to pay Creditors
- **(d)** Avail Bank Overdraft to buy Machine.

Q24. Ratio Analysis can be used to study liquidity, turnover, profitability etc. of a firm. What does Debt-Equity Ratio help to study?

- **(a)** Solvency
- **(b)** Liquidity
- **(c)** Profitability
- **(d)** Turnover.

Q25. XYZ Ltd. has a Debt-Equity Ratio of 1.5 as compared to 1.3 Industry Average. It means that the firm has:

- **(a)** Higher Financial Risk
- **(b)** Higher Liquidity
- **(c)** Higher Profitability
- **(d)** Higher Capital Employed.

Q26. Debt to Total Assets Ratio can be improved by:

- **(a)** Borrowing More
- **(b)** Issue of Debentures
- **(c)** Issue of Equity Shares
- **(d)** Redemption of Debt.

Q27. Ratio of Net Income to Number of Equity Shares known as:

- **(a)** Price Earnings Ratio
- **(b)** Net Profit Ratio
- **(c)** Earnings per Share
- **(d)** Dividend per Share.

Q28. Suppliers and Creditors of a firm are interested in:

- **(a)** Profitability Position
- **(b)** Liquidity Position
- **(c)** Market Share Position
- **(d)** Debt Position.

Q29. Which of the following is a measure of Debt Service capacity of a firm?

- **(a)** Current Ratio
- **(b)** Acid Test Ratio
- **(c)** Interest Coverage Ratio
- **(d)** Debtors Turnover.

Q30. Which of the following statements is correct?

- **(a)** A Higher Receivable Turnover is not desirable
- **(b)** Interest Coverage Ratio depends upon Tax Rate
- **(c)** Increase in Net Profit Ratio means increase in Sales
- **(d)** Lower Debt-Equity Ratio means lower Financial Risk.

Q31. XYZ Ltd. has earned 8% Return of Total Asset of ₹50,00,000 and has a Net Profit Ratio of 5%. Find out the Sales of the firm.

- **(a)** ₹4,00,000
- **(b)** ₹2,50,000
- **(c)** ₹80,00,000
- **(d)** ₹83,33,333.

Q32. A firm has Capital of ₹10,00,000; Sales of ₹5,00,000; Gross Profit of ₹2,00,000 and Expenses of ₹1,00,000. What is the Net Profit Ratio?

- **(a)** 20%
- **(b)** 50%
- **(c)** 10%
- **(d)** 40%.

Q33. Which of the following helps analysing Return to Equity Shareholders?

- **(a)** Return on Assets
- **(b)** Earnings Per Share
- **(c)** Net Profit Ratio
- **(d)** Return on Investment.

Q34. Return on Assets and Return on Investment Ratios belong to:

- **(a)** Liquidity Ratios
- **(b)** Profitability Ratios
- **(c)** Solvency Ratios
- **(d)** Turnover Ratios.

Q35. Debt to Total Assets of a firm is 2. The Debt to Equity would be:

- **(a)** 0.80
- **(b)** 0.25
- **(c)** 1.00
- **(d)** 0.75.

Q36. The nature of Ratio Analysis is:

- **(a)** Quantitative Analysis
- **(b)** Qualitative Analysis
- **(c)** Both (a) and (b)
- **(d)** None of these.

Q37. Which of the following is a method used in analysing Financial Statements:

- **(a)** Variance Analysis
- **(b)** Trend Analysis
- **(c)** Break-Even Analysis
- **(d)** Budget Analysis.

Q38. Return on Investment is also known as:

- **(a)** Du-Pont Chart
- **(b)** Activity Ratio
- **(c)** P/V Ratio
- **(d)** Market Test Ratio.

Q39. Gross Profit Ratio for a firm was 20% in the year 2023 and 2024 but the Net Profit Ratio was 15% in the year 2023 and 12% in the year 2024.

The Reason for such behaviour could be:

- **(a)** Increase in manufacturing expenses
- **(b)** Increase in indirect expenses
- **(c)** Increase in cost of goods sold
- **(d)** Decrease in sales.

Q40. Return on Investment depends on two ratios:
- **(a)** Net Profit Ratio and Capital Turnover Ratio
- **(b)** Gross Profit Ratio and Net Profit Ratio
- **(c)** Capital Employed Ratio and Asset Turnover Ratio
- **(d)** Earnings Per Share and Net Profit Ratio.

Q41. Which of the following pairs is not correctly matched:
- **(a)** Dividend Per Equity Share/Earnings Per Share = Payout Ratio
- **(b)** [Operating Profit/Capital Employed] x 100 = Return On Capital Employed
- **(c)** [(Cost of goods sold + Operating Expenses)/Net Sales] x 100 = Operating Profit Ratio
- **(d)** None of the above.

Q42. Which one of the following is a Non-Current Item:
- **(a)** Securities Premium
- **(b)** Outstanding wages
- **(c)** Trade Payables
- **(d)** Bank Balance.

Q43. Return on Investment (ROI) is calculated to measure:
- **(a)** Long-term Solvency of Business
- **(b)** Earning Power of Net Assets of Business
- **(c)** Short-term Liquidity position of Business
- **(d)** Good sold and inventory level of Business.

Q44. If P/E Ratio is 0.05 and Earnings Per Share is ₹8, the Market Price of Share will be:
- **(a)** ₹120
- **(b)** ₹100
- **(c)** ₹160
- **(d)** ₹0.40.

Q45. Debtors Velocity = 3 months; Sales value = ₹25,00,000; Bills Receivable and Bills Payable were ₹60,000 and ₹36,667 respectively. Sundry Debtors??
- **(a)** ₹6,25,000
- **(b)** ₹5,25,000
- **(c)** ₹5,65,000
- **(d)** ₹6,65,000.

Q46. The Net Income of a Company after deducting preference dividend is ₹4,00,000 and the number of the Equity Shares is 50,000. Find out Price-Earnings Ratio if Market Price of the share is ₹32?
- **(a)** 4 times
- **(b)** 2 times
- **(c)** 3 times
- **(d)** 8 times.

Q47. P Ltd. furnishes the following is classified as Liquidity Ratio?

Cost of Goods Sold	:	₹6 Lakhs
Net Profit	:	₹3 Lakhs
Sales Return	:	₹1 Lakh

If the net profit margin of P Ltd. was 25%, then the gross profit margin was:

(a) 55% (b) 60% (c) 40% (d) 50%.

Q48. For the financial year ended on 31st March, 2024, the following figures extracted from the Balance Sheet of MTS Ltd. are as follows:

Opening Stock : ₹29,000
Closing Stock : ₹31,000
Cost of goods sold : ₹2,40,000

The Stock Turnover Ratio will be:

(a) 12 times
(b) 10 times
(c) 8 times
(d) 9 times.

Q49. Proprietor's Net Capital Employed is known as:

(a) Net Worth
(b) Equity Shares
(c) Long-term Loans
(d) Fixed Assets (PPE).

Q50. Short-term Solvency is indicated by:

(a) Debtors Turnover Ratio
(b) Liquid Ratio
(c) Price-Earnings Ratio
(d) Stock Turnover Ratio.

Q51. The Ratio that explains how efficiently Companies use their Assets to generate Sales is:

(a) Revenue Asset Ratio
(b) Receivable Turnover Ratio
(c) Income Ratio
(d) Fixed Asset Turnover Ratio.

Q52. Long-term Solvency is indicated by:

(a) Debt-Equity Ratio
(b) Proprietary Ratio
(c) Fixed Assets (PPE) Ratio
(d) All of the above.

Q53. Debt Service Coverage Ratio is obtained by dividing Net Profit before interest and taxes by:

(a) Taxes
(b) Income
(c) Equity
(d) Interest Charges.

Q54. Which of the following is not included in the Activity Ratios?

(a) Sales to Capital Employed
(b) Debtors Turnover Ratio
(c) Proprietary Ratio
(d) Working Capital Turnover Ratio.

Q55. .... examines the policy of the Company regarding of Dividend and Retain Earnings.

(a) Earnings Per Share (EPS)
(b) Price Earnings Ratio
(c) Dividend Payout Ratio
(d) Return on Investment.

Q56. Interest Coverage Ratio = 6 times indicates:

(a) Sales are 6 times of interest
(b) Profit after tax is 6 times of interest
(c) EBIT is 6 times of interest
(d) Interest is 6 times after tax.

Q57. Debtors Turnover Ratio reflects:

(a) Collection Period
(b) Number of times debtors against credit sales
(c) Aging of the debtors
(d) Number of times debtors against total sales.

Q58. TT Ltd. has closing stock ₹64.8 lakhs and prepaid expenses ₹3.2 lakhs. Total Liquid Assets were ₹1,83.0 lakhs. If the Liquid Ratio is 1.5 : 1, then Working Capital will be:

(a) ₹83.667 lakhs
(b) ₹129.00 lakhs
(c) ₹125.80 lakhs
(d) ₹115.00 lakhs .

Q59. From the following information, Calculate Net Profit Ratio:

Gross Profit is 1/4th of Cost and Sales is ₹2,00,000. Indirect expenses is ₹12,000.

(a) 20% (b) 14% (c) 25% (d) 19%.

Q60. A Liquid Ratio lower than 1 : 1 shows:

(a) Under trading
(b) Under Investment
(c) Over trading
(d) Over Investment.

Q61. If a Concern has a very high Stock Turnover Ratio, which of the following statement is False?

(a) Stock Velocity Ratio is Low
(b) Stock has many fast moving items
(c) There is under trading
(d) Funds blocked in working capital are less.

Q62. If a Concern has a very high Stock Turnover Ratio, which of the following statement is False?

(a) Stock Velocity Ratio is Low
(b) Stock has many fast moving items
(c) There is under trading
(d) Funds blocked in working capital are less.

Q63. Proprietary Funds is .... :

(a) Equity Share Capital + Preference Share Capital + Reserves
(b) Equity Share Capital + Preference Share Capital
(c) Equity Share Capital + Preference Share Capital + Reserves – Fictitious Assets
(d) Equity Share Capital + Preference Share Capital + Reserves + Fictitious Assets.

Q64. Dividend Pay-out Ratio is:

(a) PAT ÷ Capital
(b) DPS ÷ EPS
(c) Preference Dividend ÷ PAT
(d) Preference Dividend ÷ Equity Dividend.

Q65. If the Selling Price of a Product is ₹85,800 and the Profit Margin on Cost is 10%, the amount of profit will be:

(a) ₹7,800
(b) ₹8,580
(c) ₹7,200
(d) ₹9,533.

Q66. Credit Sales of a Company for the year is ₹12,00,000 and debtors at the end of year ₹2,40,000. Assuming 360 days in a year, Average Collection Period will be:

(a) 180 days
(b) 72 days
(c) 80 days
(d) 70 days.

Q67. Current Ratio is 2.5 : 1 and Liquid Ratio is 1 : 1. Stock is ₹60,000. Calculate Current Liability:

(a) ₹40,000
(b) ₹60,000
(c) ₹1,00,000
(d) ₹50,000.

Q68. Net Income of a Company after payment of preference dividend was ₹63,00,000. The number of Equity Shares was 1,40,000. The P/E Ratio of the company was 8.50 times. Earnings per share and Market per share would be:

(a) ₹45 and ₹382.50 respectively
(b) ₹45 and ₹308.20 respectively
(c) ₹33.16 and ₹281.86 respectively
(d) ₹45 and ₹5.29 respectively.

Q69. In a Company, Working Capital is ₹1,00,000 and Current Ratio 3 : 1. The Value of Current Assets is:

(a) ₹1,00,000
(b) ₹50,000
(c) ₹1,50,000
(d) ₹15,000.

Q70. Determine a firm's total Assets Turnover, if its Net Profits margin is 8%, total Assets are ₹8,00,000 and the Return on Investment is 14%:

(a) 2.05
(b) 4.00
(c) 1.75
(d) 2.

Q71.

Cost of goods sold	₹4,00,000
Administration and office expenses	₹35,000
Selling and Distribution expense	₹45,000
Net Credit Sales	₹4,75,000
Cash Sales	₹4,75,000

Operating Profit Ratio will be:

(a) 35%
(b) 30%
(c) 20%
(d) 25%.

Q72. Current Liabilities of a Firm are ₹1,50,000. Its Current Ratio is 3 : 1 and Liquid Ratio is 1 : 1. The Value of Stock will be:

- **(a)** ₹3,00,000
- **(b)** ₹1,50,000
- **(c)** ₹4,25,000
- **(d)** ₹2,50,000.

Q73. If the number of Equity Shares 3,000; Net Profit ₹22,000; Dividend per equity share ₹0.30; Provision for taxation ₹12,000 and Preference dividend paid ₹4,000, the Pay-out Ratio is:

- **(a)** 16%
- **(b)** 5%
- **(c)** 10%
- **(d)** 15%.

Q74. Which of the following is not included in the Activity Ratios?

- **(a)** Working Capital Turnover Ratio
- **(b)** Sales to Capital Employed Ratio
- **(c)** Debtors Turnover Ratio
- **(d)** Proprietary Ratio.

Q75. The Balances of some of the Assets and Liabilities as on 31st March, 2024 are:
Cash ₹10,000; Plant ₹2,00,000; Bills receivable ₹5,000; Goodwill ₹90,000; Debtors ₹25,000; Stock ₹20,000; Creditors ₹20,000; Bills Payables ₹10,000 and Cost of Sales ₹1,80,000. In this case, the Working Capital Turnover Ratio is:

- **(a)** 10 times
- **(b)** 5 times
- **(c)** 3 times
- **(d)** 6 times.

Q76. From the following information, Calculate Average Collection Period (ACP):
Closing Debtors ₹2,00,000, Cash Sales 25% of Credit Sales; Excess of closing debtors over opening debtors ₹80,000; Total Sales ₹12,00,000

- **(a)** 10 Months
- **(b)** 5 Months
- **(c)** 2 Months
- **(d)** 6 Months.

Q77. Equity Share Capital ₹25,00,000; Face value of share ₹100; Profit for Equity Shareholders ₹5,15,000; Dividend Pay-out Ratio 40%; P/E Ratio 30. The Dividend Per Share is .... :

- **(a)** ₹26.60
- **(b)** ₹5.56
- **(c)** ₹8.24
- **(d)** ₹30.24.

Q78. If Current Ratio is 2.5, Acid Test Ratio is 1.5 and Current Liabilities are ₹50,000, the Value of Inventory is:

- **(a)** ₹1,00,000
- **(b)** ₹50,000
- **(c)** ₹1,50,000
- **(d)** ₹1,25,000.

Q79. The Net Profit Margin of R Ltd. is 8% and its Total Assets are ₹6,00,000 and the Return on Investment is 18%. Total Assets Turnover will be:

- **(a)** 2.15
- **(b)** 4.15
- **(c)** 2.25
- **(d)** None of the above.

Q80. The relevant information are given below for a particular Company:

Cash	₹1,50,000
Trade receivables	₹4,00,000
Short-term Investment	₹3,30,000
Stock	₹25,00,000
Prepaid expenses	₹50,000
Current liabilities	₹10,00,000

The Quick Ratio will be:

- **(a)** 3.43 : 1
- **(b)** 0.93 : 1
- **(c)** 0.88 : 1
- **(d)** 3.1 : 1

Q81. From the following information, Find the Value of Closing Stock:

Stock Velocity	6 months
Gross Profit Ratio	25%
Gross Profit for the year ended	₹1,00,000

Closing Stock for the period ₹20,000 more than it was in the beginning of the year:

- **(a)** ₹1,40,000
- **(b)** ₹1,50,000
- **(c)** ₹1,60,000
- **(d)** ₹70,000.

Q82. A Current Ratio is less than one, what does it mean to you?

- **(a)** Share Capital is greater than Current Assets
- **(b)** Current Assets are less than Current Liabilities
- **(c)** Current Liabilities are less than Current Assets
- **(d)** Fixed Assets are greater than Current Assets.

Q83. Annual Credit Sales ₹4,00,000; Average Collection Period 45 days (Assume 360 days in a year). What is Average Debtors?

- **(a)** ₹60,000
- **(b)** ₹74,000
- **(c)** ₹50,000
- **(d)** ₹4,00,000.

Q84. Gross Margin is added to Cost of Goods sold for calculating:

- **(a)** Revenues
- **(b)** Selling Price
- **(c)** Unit Price
- **(d)** Bundle Price.

Q85. Return on Investment (ROI) can be decomposed into the following ratios:

(a) Overall Turnover Ratio and Current Ratio
(b) Net Profit Ratio and Fixed Assets Turnover
(c) Working Capital Turnover Ratio and Net Profit Ratio
(d) Net Profit Ratio and Overall Turnover Ratio.

Q86. Ratio Analysis is the process of determining and interpreting numerical relationships based on:

(a) Financial Values
(b) Financial Statements
(c) Financial numerical information
(d) All of the above.

Q87. Ratio Analysis is based on .... measure:

(a) Relative
(b) Absolute
(c) Both of the above
(d) None of the above.

Q88. Liquid Liability = [Current Liability **–** Bank Overdraft **–** ....]:

(a) Cash Credit
(b) Trade Credit
(c) Both of the above
(d) None of the above.

Q89. All of the following are Debt Utilization Ratios except:

(a) Debt to total assets
(b) Times interest earned
(c) Fixed charge coverage
(d) Debt to sale.

Q90. If the Average balance of Debtors has increased, which of the following might not show a change in general?

(a) Total Sales
(b) Average Payables
(c) Current Ratio
(d) Bad debt loss

Q91. Liquid Ratios measure:

(a) The speed at which the firm is turning over its assets
(b) The ability of the firm to earn an adequate return on sales, total assets and invested capital
(c) The firm's ability to pay off short term obligations as they are due
(d) The debt position of the firm in light of its assets and earning power

ANSWERS

1	2	3	4	5	6	7	8	9	10
d	a	c	b	d	c	d	a	b	c
11	12	13	14	15	16	17	18	19	20
a	c	d	c	d	a	b	a	d	b
21	22	23	24	25	26	27	28	29	30
d	c	d	a	b	d	c	b	c	d
31	32	33	34	35	36	37	38	39	40
c	a	b	b	b	a	b	c	b	a
41	42	43	44	45	46	47	48	49	50
c	a	b	d	c	a	d	c	a	b
51	52	53	54	55	56	57	58	59	60
b	d	d	c	c	c	b	b	b	b
61	62	63	64	65	66	67	68	69	70
c	c	c	b	a	b	a	a	c	c
71	72	73	74	75	76	77	78	79	80
c	a	d	d	d	c	c	b	c	c
81	82	83	84	85	86	87	88	89	90
c	b	c	a	d	d	a	a	d	c
91									
c									

COST OF CAPITAL 4

MULTIPLE CHOICE QUESTIONS (MCQs)

Q1. Which of the following is not an assumption of the Capital Asset Pricing Model (CAPM)?
- **(a)** The capital market is efficient.
- **(b)** Investors lend or borrow at a risk-free rate of return.
- **(c)** Investors do not have the same expectations about the risk and return.
- **(d)** Investor's decisions are based on a single-time period.

Q2. Given: Risk free rate of return = 5%; Market return = 10%; Cost of equity = 15%; Value of beta (β) is:
- **(a)** 1.9
- **(b)** 1.8
- **(c)** 2.0
- **(d)** 2.2

Q3. .... may be defined as the cost of raising an additional rupee of capital:
- **(a)** Marginal cost of capital
- **(b)** Weighted average cost of capital
- **(c)** Simple average cost of capital
- **(d)** Liquid cost of capital

Q4. Which of the following Cost of Capital requires to adjust taxes?
- **(a)** Cost of Equity Shares
- **(b)** Cost of Preference Shares
- **(c)** Cost of Debentures
- **(d)** Cost of Retained Earnings

Q5. Marginal Cost of Capital is the cost of:
- **(a)** Additional Revenue
- **(b)** Additional Funds
- **(c)** Additional Interests
- **(d)** None of the above

Q6. In order to calculate Weighted Average Cost of Capital, weights may be based on:
- **(a)** Market values
- **(b)** Target values
- **(c)** Book values
- **(d)** Anyone of the above.

Q7. Firm's Cost of Capital is the average cost of:
- **(a)** All sources of finance
- **(b)** All Borrowings
- **(c)** All Share capital
- **(d)** All Bonds and Debentures

Q8. A Company has a financial structure where equity is 70% of its total debt plus equity. Its cost of equity is 10% and gross loan interest is 5%. Corporation tax is paid at 30%. What is the company's weighted average cost of capital (WACC)?

(a) 7.55%
(b) 7.80%
(c) 8.70%
(d) 8.05%

Q9. The cost of equity capital is all the following except:

(a) The minimum rate that a firm should earn on the equity-financed part of an investment.
(b) A return on the equity-financed portion of an investment that, at worst, leaves the market price of the stock unchanged.
(c) By far, the most difficult component cost to estimate.
(d) Generally, lower than the before-tax cost of debt.

Q10. What is the overall cost of capital when the firm has ₹20 crores in long-term debt, ₹4 crores in preferred stock, and ₹16 crores in equity shares? The before-tax cost for debt, preferred stock, and equity capital are 8%, 9%, and 15% respectively. Assume a 50% tax rate.

(a) 7.60%
(b) 6.90%
(c) 7.30%
(d) 8.90%.

Q11. The Cost of each component of a firm's Capital Structure multiplied by its weight in the capital structure is called:

(a) Marginal Cost of Capital
(b) The Cost of Debt
(c) Weighted Average Cost of Capital
(d) Opportunity Cost.

Q12. Which of the following statements is/are correct?

(a) Weighted Average Cost of Capital using Book Value weights will be generally understated if the market value of shares is higher than book value
(b) The relationship of Book Value and Market Value of securities has nothing to do with calculation of Weighted Average Cost of Capital
(c) Both (a) and (b) are correct
(d) Both (a) and (b) are incorrect.

Q13. Which of the following sources of funds has an implicit cost of capital?

(a) Equity Share Capital
(b) Preference Share Capital
(c) Debentures
(d) Retained Earnings.

Q14. Which of the following has the highest cost of capital?

(a) Loans
(b) Equity Share
(c) Bonds
(d) Preference Shares.

Q15. Which of the following statement is true?

(a) Retained earnings are cost free

(b) External Equity is cheaper than Internal Equity

(c) Retained Earnings are cheaper than External Equity

(d) Retained Earnings are costlier than External Equity.

Q16. Debt Financing is a cheaper source of finance because of:

(a) Time Value of Money

(b) Rate of Interest

(c) Tax-deductibility of Interest

(d) Dividend not Payable to Lenders.

Q17. Tax-rate is relevant and important for calculation of specific cost of capital of:

(a) Equity Share Capital

(b) Preference Share Capital

(c) Debentures

(d) (a) and (b) both.

Q18. A Company issued 6%, 2,000 irredeemable debentures of ₹100 each at 10% Premium. The company falls in 50% tax bracket. Find out the Cost of Debenture after tax:

(a) 2.73%

(b) 6.00%

(c) 3.00%

(d) 3.73%.

Q19. Which of the following is correct regarding Cost of Retained Earnings?

(a) Since the Company is not required to pay dividend on Retained Earnings, there is no cost associated to it

(b) Opportunity Cost of foregone dividends must be considered as cost of retained earnings

(c) Both (a) and (b) are correct

(d) None of the above.

Q20. Which of the following is not a generally accepted approach for calculation of cost of equity?

(a) CAPM

(b) Dividend Discount Model

(c) Rate of Preference Dividend Plus Risk Model

(d) Price-Earnings Ratio.

Q21. A Company has expected earnings at ₹40 per share which is growing at 9% annually. Company follows fixed Pay-out ratio of 60%. The Market Price of its Share is ₹500. What is the Current Cost of Equity?

(a) 12.80%

(b) 12%

(c) 12.10%

(d) 13.80%.

Q22. A Company has currently 2,000 Equity Shares of ₹100 each and its earnings are ₹20,000. Its current Market Price is ₹110 and the growth rate of EPS is expected to be 5%. The Cost of Equity is .... :

(a) 10.94%

(b) 9.55%

(c) 9.95%

(d) 11.60%.

Q23. Cost of Equity Share Capital is more than Cost of Debt because:
- **(a)** Face value of debentures is more than face value of shares
- **(b)** Equity Shares have higher risk than debt
- **(c)** Equity Shares are easily saleable
- **(d)** All of the above.

Q24. Minimum Rate of Return that a firm must earn in order to satisfy its investors, is also known as:
- **(a)** Average Return on Investment
- **(b)** Weighted Average Cost of Capital
- **(c)** Net Profit Ratio
- **(d)** Average Cost of Borrowing.

Q25. Cost of Redeemable preference share capital is:
- **(a)** Rate of Dividend
- **(b)** After Tax Rate of Dividend
- **(c)** Discount Rate that equates PV of inflows and outflows relating to capital
- **(d)** None of the above.

Q26. In case the firm is all Equity financed, the WACC would be equal to:
- **(a)** Cost of Debt
- **(b)** Cost of Equity
- **(c)** Neither (a) nor (b)
- **(d)** Both (a) and (b).

Q27. Which of the following Cost of Capital require tax adjustment?
- **(a)** Cost of Equity Share Capital
- **(b)** Cost of Preference Share Capital
- **(c)** Cost of Debentures
- **(d)** Cost of Retained Earnings.

Q28. Cost of Capital for Equity Share Capital does not imply that:
- **(a)** Market price is equal to book value of share
- **(b)** Shareholders are ready to subscribe to right issue
- **(c)** Market price is more than issue price
- **(d)** All of the above.

Q29. Cost of Issuing New Shares to the Public is known as:
- **(a)** Cost of Equity
- **(b)** Cost of Capital
- **(c)** Flotation Cost
- **(d)** Marginal Cost of Capital.

Q30. In order to find out Cost of Equity Capital under CAPM, Which of the following is not required:
- **(a)** Beta Factor
- **(b)** Market Rate of Return
- **(c)** Market Price of Equity Share
- **(d)** Risk-free Rate of Interest.

Q31. The Weighted Average Cost of Capital computations:
- **(a)** Assign more weight to Equity
- **(b)** Assign more weight to debentures
- **(c)** Excludes Retained Earnings
- **(d)** Assigns Weights based on Market Value or Book Value.

Q32. The Cost of retained Earnings is equal to:
- **(a)** Dividend Pay-out Ratio
- **(b)** Rate of Return Expected on the Equity Share
- **(c)** Risk-Free Rate of Return
- **(d)** Dividend Yield Ratio.

Q33. A Company has issued 10,000 Equity Shares of ₹100 each. Its Current Market Price is ₹98 per share and the current dividends is ₹4.5 per share. The dividends are expected to grow at the rate of 10%. Compute the Cost of Equity Capital:
- **(a)** 15.05%
- **(b)** 9.80%
- **(c)** 10%
- **(d)** 4.50%.

Q34. While calculating Weighted Average Cost of Capital which is not considered:
- **(a)** Retained Earnings
- **(b)** Bank Borrowing for Working Capital
- **(c)** Cost of issue shares
- **(d)** Weights are based on Market Value or on Book Value.

Q35. The Internal sources of long-term finance are:
- **(a)** Equity Share Capital, Preference Share Capital, Retained Earnings
- **(b)** Equity Share Capital, Preference Share Capital, Debentures
- **(c)** Debentures, Term Loans, Retained Earnings
- **(d)** Preference Share Capital, Term Loans, Debentures.

Q36. The Cost of Retained Earnings are often taken as equal to the:
- **(a)** Cost of Equity
- **(b)** Cost of Debentures
- **(c)** Weighted Average Cost of Capital
- **(d)** Any of the above.

Q37. Long-term Finance is required to finance:
- **(a)** Fixed Assets, Variable Part of working capital and expansion of business
- **(b)** Fixed Assets, Permanent part of working capital and expansion of business
- **(c)** Fixed Assets and Working Capital
- **(d)** Only Fixed Assets

Q38. Number of existing Equity Shares are 8 Crore; Market value of existing shares ₹55; Net Earnings ₹80 crore; Cost of Equity on basis of Earnings-Price Ratio Approach is:
- **(a)** 5.15%
- **(b)** 5.55%
- **(c)** 18.18%
- **(d)** 18.02%.

Q39. A Company issues 10,000 10% Preference Shares of ₹100 each redeemable after 10 years at a premium of 5%. The cost of issue is ₹2 per share. The Cost of Preference Capital is:
- **(a)** 10.14%
- **(b)** 10.34%
- **(c)** 10.74%
- **(d)** 10.54%.

Q40. A Corporation common Stock has a beta, of 1.5. The Risk-free rate of return is 8% and the Market Return is 12%. Determine the Cost of Equity Shares using the CAPM:

(a) 14%
(b) 11%
(c) 12%
(d) 13%.

Q41. A Company is currently financed with ₹5,00,000 of 10% Debenture and ₹15,00,000 of Equity Share. The Equity Share has a beta of 1.5 and the Risk free rate is 6% and the Market risk premium is 4%. The tax rate is 20%. What is the WACC of the Company?

(a) 12%
(b) 11%
(c) 10%
(d) 13%.

Q42. A Company has issued 50,000 Equity Shares of ₹100 each. Its current Market Price is ₹90 per share and the current dividend is ₹8 per share. The dividends are expected to grow at the rate of 10%. Compute the Cost of Equity Capital:

(a) 15.07%
(b) 19.55%
(c) 19.78%
(d) 9.78%.

Q43. A Company issues ₹50,000, 8% Debenture at a discount of 5%. Tax rate is 50%. The Cost of Debt is:

(a) 5.10%
(b) 5.42%
(c) 4.21%
(d) 4.42%.

Q44. A Company keeps a perpetual fixed amount of debenture with coupon rate of 16% in its books. Debenture sells at par (Face Value ₹100) in the market and Company pays 40% tax. What is the cost of debenture, if sold at 10% premium in the market?

(a) 8.82%
(b) 8.72%
(c) 8.27%
(d) 9.19%.

Q45. A Company has a target Capital Structure of 60 percent Common Stock, 10 percent Preferred Stock, and 30 percent Debt. Its Cost of Equity is 15%, the Cost of Preferred Stock is 7 percent, and the Cost of Debt is 10 percent. The relevant tax rate is 40%. What is its WACC?

(a) 11.30%
(b) 11.70%
(c) 11.50%
(d) 13.10%.

Q46. A Company is issuing 1,00,000, 12% Irredeemable Preference Shares of the Face Value of ₹100 each. If the floatation cost is ₹2 per share, what is the Cost of these preference shares?

(a) 12.14%
(b) 12.00%
(c) 12.24%
(d) 12.34%.

Q47. The liability side of a Company's Balance Sheet shows Equity Capital ₹25 lakhs and Retained Earnings ₹50 Lakhs. Face value of its share is ₹100 each and Market Value is ₹300 each. If the investors expect a rate of return of 18%, and if the cost of floatation of issuing fresh Equity is 5%, what is the Cost of Retained Earnings? :

- **(a)** 17.50%
- **(b)** 18.00%
- **(c)** 9.00%
- **(d)** 8.75%.

Q48. Equity Share Capital ₹10,00,000, 10% Preference Share capital ₹5,00,000, 8% Debenture ₹15,00,000. Cost of Equity is estimated to be 15%. Calculate the Weighted Average Cost of Capital, assuming tax rate is 50%:

- **(a)** 8.67%
- **(b)** 6.67%
- **(c)** 9.67%
- **(d)** 7.67%.

Q49. Compute the Average Cost of Capital by using Market Value as Weights from the following information: Net Operating Income ₹2,00,000. Total Investment ₹10,00,000, if the firm uses 5% Debenture of ₹4,00,000 and Equity Capitalization rate is 11%.

- **(a)** 20%
- **(b)** 9.82%
- **(c)** 9.9%
- **(d)** 11%.

Q50. A Company issued Equity Shares of ₹10 Lakhs comprising of 1,00,000 shares of ₹10 each. The Current Market Price per share is ₹50 and current dividend paid is ₹5 per share. The dividend is expected to grow at the 5% per annum. On the basis of dividend growth model, the Cost of Equity is:

- **(a)** 15.00%
- **(b)** 15.20%
- **(c)** 15.50%
- **(d)** 16.00%.

Q51. Cost of Capital for Government Securities is also known as:

- **(a)** Risk-Free Rate of Interest
- **(b)** Maximum Rate of Return
- **(c)** Rate of Interest On Fixed Deposits
- **(d)** None of the above.

Q52. Marginal Cost of Capital is the Cost of:

- **(a)** Additional Sales
- **(b)** Additional Funds
- **(c)** Additional interests
- **(d)** None of the above.

Q53. While computing Average Cost of Capital on a Market Value basis which of the following is not to be considered?

- **(a)** Cost of long term loan
- **(b)** Weight of each fund in capital structure
- **(c)** Post tax cost of debt
- **(d)** Reserve and Surplus.

Q54. All of the following are true regarding Beta except:

(e) It is widely used with portfolios of common stock

(f) It measures the volatility of returns relative to the expected value

(g) It is an important component of the Capital Asset Pricing Model (CAPM)

(h) The higher the beta, the greater the risk level.

Q55. The Risk-free rate of return on government securities is subtracted from the expected rate of return from the market is considered as:

(a) Diversifiable Risk Premium

(b) Systematic Risk Premium

(c) Equity Risk Premium

(d) Market Risk Premium.

Q56. A Company issues 25,000, 14% Debentures of ₹1,000 each. The debentures are redeemable after the expiry period of 5 years. Tax rate applicable to the company is 35% (including Surcharge and Education Cess). Calculate the Cost of Debt after tax, if Debentures are issued at 5% Discount with 2% floatation cost.

(a) 10.95%

(b) 10.90%

(c) 10.88%

(d) 11.12%.

Q57. A Company issued 40,000, 12% Redeemable Preference Shares of ₹100 each at a premium of 5 each, redeemable after 10 years at a premium of ₹10 each. The flotation cost of each share is ₹2. Calculate the cost of preference share capital ignoring dividend tax:

(a) 11.95%

(b) 11.92%

(c) 11.80%

(d) 11.12%.

Q58. Determine the Market Price Per Share of A Ltd. by using Gordon's Model. Given, Ke = 12%, E = ₹20, r = 12%, b = 60%.

(a) ₹166.67

(b) ₹210.52

(c) ₹189.19

(d) ₹181.82.

Q59. ''Bird in hand'', this argument is given by:

(a) MM Model

(b) Walter Model

(c) Gordon Model

(d) None of these.

Q60. The Capital Structure of ABC Limited consist Debentures, Preference Shares, Equity Shares and Retained Earnings. The weight of each security is 28.57%, 9.53%, 14.28% and 47.62% respectively. The specific cost of capital is 14.60%, 10.50%, 20.00% and 18% respectively. Determine the Weighted Average Cost of Capital (WACC):

(a) 18.20%

(b) 15.68%

(c) 16.60%

(d) 17.24%.

Q61. Y Ltd. retains ₹7,50,000 out of its Current Earnings. The expected rate of return to the shareholders, if they had invested their funds elsewhere is 10%, brokerage is 3%, and the shareholders come in 30% tax bracket. Calculate Cost of Retained Earnings.

(a) 6.79%
(b) 5.54%
(c) 5.79%
(d) 7.79%.

Q62. The Post-Tax Cost of Debentures not redeemable during the lifetime of the company is:

(a) [Interest ÷ Net Proceeds] x (1 + t)
(b) [Interest x (1 + t) ÷ Net Proceeds]
(c) [Interest x (1 - t) ÷ Net Proceeds]
(d) [Interest ÷ Net Proceeds] x (1 - t).

ANSWERS

1	2	3	4	5	6	7	8	9	10
c	c	a	c	b	d	a	d	d	d
11	12	13	14	15	16	17	18	19	20
c	a	d	b	c	c	c	a	b	c
21	22	23	24	25	26	27	28	29	30
d	b	b	b	c	b	c	d	c	c
31	32	33	34	35	36	37	38	39	40
d	b	a	b	a	a	b	c	d	a
41	42	43	44	45	46	47	48	49	50
b	c	c	b	c	c	b	a	b	
51	52	53	54	55	56	57	58	59	60
a	b	d	b	d	c	b	a	c	c
61	62								
a	c								

CAPITAL STRUCTURE 5

MULTIPLE CHOICE QUESTIONS (MCQs)

Q1. The assumptions of MM Hypothesis of capital structure do not include the following:

- **(a)** Capital markets are imperfect
- **(b)** Investors have homogeneous expectations
- **(c)** All firms can be classified into homogeneous risk classes
- **(d)** The dividend-payout ratio is cent percent, and there is no corporate tax.

Q2. Which of the following is irrelevant for optimal capital structure?

- **(a)** Flexibility
- **(b)** Solvency
- **(c)** Liquidity
- **(d)** Control.

Q3. Financial Structure refers to:

- **(a)** All financial resources
- **(b)** Short-term funds
- **(c)** Long-term funds
- **(d)** None of the above.

Q4. An EBIT-EPS indifference analysis chart is used for:

- **(a)** Evaluating the effects of business risk on EPS
- **(b)** Examining EPS results for alternative financial plans at varying EBIT levels
- **(c)** Determining the impact of a change in sales on EBIT
- **(d)** Showing the changes in EPS quality over time.

Q5. The term "Capital Structure" means:

- **(a)** Long-term debt, preferred stock, and equity shares
- **(b)** Current assets and current liabilities
- **(c)** Net working capital
- **(d)** Shareholder's equity.

Q6. The Cost of monitoring management is considered to be a (an):

- **(a)** Bankruptcy cost
- **(b)** Transaction cost
- **(c)** Agency cost
- **(d)** Institutional cost.

Q7. Which of the following steps may be adopted to avoid the negative consequences of over-capitalization?

- **(a)** The shares of the company should be split-up. This will reduce dividend per share, though EPS shall remain unchanged.
- **(b)** Issue of Bonus shares.
- **(c)** Revising upward the par value of shares in exchange of the existing shares held by them.
- **(d)** Reduction in claims of debenture holders and creditors.

Q8. Market values are often used in computing the weighted average cost of capital because:

(a) This is the simplest way to do the calculation.

(b) This is consistent with the goal of maximizing shareholder value.

(c) This is required by SEBI.

(d) This is a very common mistake.

Q9. .... of an organisation refers to the composition of its long-term funds and its capital structure.

(a) Capitalisation

(b) Over-Capitalisation

(c) Under-Capitalisation

(d) Market-Capitalisation.

Q10. A firm's optimal capital structure:

(a) Is the debt-equity ratio that results in the minimum possible weighted average cost of capital

(b) 40% debt and 60% equity

(c) When the debt-equity ratio is 0.50

(d) When cost of equity is minimum.

Q11. Decisions related to the mix of Debt and Equity in the Balance Sheet best relates to which of the following?

(a) Capital Budget

(b) Capital Structure

(c) Capital Expenditure

(d) Operating Leverage.

Q12. Consider the below mentioned statements:

(a) A company is considered to be over-capitalised when its actual capitalization is lower than the proper capitalization as warranted by the earning capacity.

(b) Both over-capitalization and under-capitalization are detrimental to the interests of the society.

State True or False:

1. (a) True, (b) True

2. (a) False, (b) True

3. (a) False, (b) False

4. (a) True, (b) False

Q13. The traditional approach towards the valuation of a firm assumes:

(a) That the overall capitalization rate changes in financial leverage.

(b) That there is an optimum capital structure.

(c) That the total risk is not changed with the changes in the capital structure.

(d) That the markets are perfect.

Q14. A critical assumption of the Net Operating Income (NOI) approach to valuation is:

(a) That debt and equity levels remain unchanged.

(b) That dividends increase at a constant rate.

(c) That K_o remains constant regardless of changes in leverage.

(d) That interest expenses and taxes are included in the calculation.

Q15. Capital structure of a firm influences the:

(a) Risk

(b) Return

(c) Both Risk and Return

(d) Return but not Risk.

Q16. Which of the following is not a valid assumption of MM Approach to capital structure?

(a) Lack of free flow of information
(b) Securities are infinitely divisible
(c) Transactions costs are zero
(d) There is no taxation.

Q17. Earnings per share (EPS) is equal to:

(a) Profit after tax/No. of Shares in authorized capital
(b) Profit after tax/No. of Shares in issued capital
(c) Profit after tax/Net Worth
(d) Profit before tax/Net Worth.

Q18. Which approach in Capital Structure argues that the Overall Capitalization rate and the Cost of Debt remain constant for all degrees of leverage, as the same is offset by an increase in the Equity Capitalization rate?

(a) NI Approach
(b) NOI Approach
(c) Walter's Approach
(d) Gordon's Approach.

Q19. When EBIT is higher than Financial Break-even point, there would be:

(a) Positive Financial Leverage
(b) No Financial Leverage
(c) Higher Financial Leverage
(d) Negative Financial Leverage.

Q20. A critical assumption of the Net Operating Income (NOI) approach to valuation is:

(a) That debt and equity levels remain unchanged
(b) That dividends increase at a constant rate
(c) That Ko remains constant regardless of changes in leverage
(d) The interest expense and taxes are included in the calculation

Q21. An EBIT-EPS analysis indifference analysis chart is used for .... :

(a) Evaluating the effects of business risk on EPS
(b) Examining EPS results for alternative financing plans at varying EBIT levels
(c) Determining the impact of a change in sales on EBIT
(d) Showing the changes in EPS quality over time.

Q22. The Financial Break-even point is:

(a) Level of EBT at which EPS is zero
(b) Level of EAT at which EPS is zero
(c) Level of EBIT at which EPS is zero
(d) Level of EBIT at which EPS is zero and above.

Q23. A Company is considering three different financing alternatives: Debt, Preferred Stock and Common Equity. The firm has created an EBIT-EPS chart that shows several indifference points. What does each indifferent point show the firm?

(a) The level of EBIT that generates identical EPS under different alternative financing plans
(b) The level of sales that generates identical EBIT and EPS figures
(c) It shows the level of EBIT and EPS at which DFL is identical under different alternative financing plans
(d) None of the above.

Q24. A Company informed that Profit After Tax (PAT) ₹7,50,000, Interest expenses were ₹2,75,000, Tax rate was 40%. What will be the Net Operating Income of A Company?

(a) ₹13,25,000 (b) ₹14,25,000 (c) ₹13,75,000 (d) ₹15,25,000.

Q25. The Capital Structure of a Company is as under:

Equity + Reserves & Surplus	₹200 Lakhs
10% Preference Shares	₹50 Lakhs
12% Term Loan	₹150 Lakhs

What should be the approx. Earnings Before Interest and Tax (EBIT) so that Earnings Per Share is zero? Assume Tax Rate 35%.

(a) ₹23.00 Lakhs
(b) ₹24.75 Lakhs
(c) ₹25.69 Lakhs
(d) ₹29.30 Lakhs.

Q26. ABC Limited's books of accounts show Profit from operation (EBDIT) at ₹500 Lakhs, it paid 12% on a debt of ₹1,000 Lakhs, Depreciation is ₹100 Lakhs and Tax 35%. Profit after tax will be:

(a) ₹180 Lakhs
(b) ₹184 Lakhs
(c) ₹182 Lakhs
(d) ₹178 Lakhs.

Q27. Calculate the value of the firm according to the Net Income Approach. The Company expects a Net Operating Income of ₹80,000. It has ₹2,00,000, 8% Debentures. The Equity capitalization rate of the company is 10%. Ignore the Income Tax.

(a) ₹8,40,000
(b) ₹8,60,000
(c) ₹8,80,000
(d) ₹8,90,000.

Q28. A Firm has EBIT of ₹50,000. Market value of debt is ₹80,000 and Overall Capitalization rate is 20%. Market value of Equity under NOI Approach is:

(a) ₹1,70,000
(b) ₹2,50,000
(c) ₹30,000
(d) ₹1,30,000.

Q29. A Company has EBIT of ₹2,00,000. Expected return on its investment at the rate of 12%. What is the total value of the firm according to Miller-Modigliani Theory?

(a) ₹17,85,714
(b) ₹16,66,667
(c) ₹22,40,000
(d) ₹20,00,000.

Q30. A Company expects a Net Operating Income of ₹1,00,000. It has ₹5,00,000, 6% Debentures. The Overall Capitalisation is 10%. Calculate Cost of Equity according to the Net Operating Income Approach:

(a) 20.00%
(b) 21.82%
(c) 14.00%
(d) 18.00%.

Q31. The XYZ Co. Ltd. borrowed capital is NIL and entire Capital block of ₹300 Lakhs is funded by owners. Earnings before interest and Tax (EBIT) for the year @ 28.50%, applicable tax rate @ 45%. Calculate Earnings After Tax (EAT):

- **(a)** ₹42.75Lakhs
- **(b)** ₹42.50 Lakhs
- **(c)** ₹47.03 Lakhs
- **(d)** ₹42.60 Lakhs.

Q32. BBT Ltd has EBIT for the year ₹15 Lakhs interest @ 12.50% Loan capital of ₹40 Lakhs and 13.75% Loan Capital of ₹30 Lakhs and Soft Loan Interest @ 5.50% against loan capital of ₹75 Lakhs. The Company's EBT as % to EBIT is:

- **(a)** 11.37%
- **(b)** 11.67%
- **(c)** 11.33%
- **(d)** 11.55%.

Q33. If a firm has no preference share capital, Financial Break-even Level is defined as equal to:

- **(a)** EBIT
- **(b)** Interest liability
- **(c)** Equity Dividend
- **(d)** Tax Liability.

Q34. Indifference Level of EBIT is one at which:

- **(a)** EPS is zero
- **(b)** EPS is minimum
- **(c)** EPS is highest
- **(d)** None of the above.

Q35. At Indifference Level of EBIT, different Capital has:

- **(a)** Same EBIT
- **(b)** Same EPS
- **(c)** Same PAT
- **(d)** Same PBT.

Q36. Which of the following is true of Net Income Approach?

- **(a)** VF = VE + VD
- **(b)** VE = VF + VD
- **(c)** VD = VF + VE
- **(d)** VF = VE – VE

Q37. Net Operating Income Approach, which one of the following is constant?

- **(a)** Cost of Equity
- **(b)** Cost of Debt
- **(c)** WACC and Cost of Debt
- **(d)** Cost of Equity and Cost of Debt.

Q38. In case of Net Income Approach, when the Debt proportion is increased, then the Cost of Debt:

- **(a)** Increases
- **(b)** Decreases
- **(c)** Constant
- **(d)** None of the above.

Q39. In case of Net Income Approach, the Cost of Equity is:
- **(a)** Constant
- **(b)** Increasing
- **(c)** Decreasing
- **(d)** None of the above.

Q40. ''Judicious Use of Leverage'' is suggested by:
- **(a)** Net Income Approach
- **(b)** Net Operating Income Approach
- **(c)** Traditional Approach
- **(d)** All of the above.

Q41. Which of the following is true for Net Operating Income Approach?
- **(a)** VE = VF + VD
- **(b)** VE = VF – VD
- **(c)** VD = VF + VE
- **(d)** VD = VF – VE

Q42. In the Traditional Approach, which one of the following remains constant?
- **(a)** Cost of Debt
- **(b)** Cost of Equity
- **(c)** Weighted Average Cost of Capital
- **(d)** None of the above.

Q43. In Modigliani and Miller Model, irrelevance of Capital Structure is based on:
- **(a)** Cost of Equity and Cost of Debt
- **(b)** Decreasing WACC
- **(c)** Arbitrage Process
- **(d)** All of the above.

Q44. 'That there is no Corporate Tax' is assumed by which the following Approach:
- **(a)** Net Income Approach
- **(b)** Net Operating Income Approach
- **(c)** Traditional Approach
- **(d)** All of the above.

Q45. According to .... the degree of leverage is Irrelevant in determining the Value of a Firm:
- **(a)** MM Model
- **(b)** Walter's Model
- **(c)** Baumol's Model
- **(d)** None of the above.

Q46. Which of the following is incorrect for NOI?
- **(a)** Cost of Equity is constant
- **(b)** Cost of Debt is constant
- **(c)** WACC is constant
- **(d)** Cost of Debt and Overall Cost of Capital.

Q47. 'That Personal Leverage can replace Corporate Leverage' is assumed by:
- **(a)** Traditional Approach
- **(b)** MM Model
- **(c)** Net Income Approach
- **(d)** Net Operating Income Approach.

Q48. Which of the following is incorrect for value of the firm?

(a) In the initial preposition, MM Model argues that value is independent of the financing mix

(b) Total value of levered and unlevered firms is otherwise arbitrage will take place

(c) Total value incorporates borrowings by firm but excludes personal borrowing

(d) Total value does not change because underlying does not change with financing mix.

Q49. Modigliani and Miller Model of Dividend irrelevance Theory uses Arbitrage between:

(a) Dividend and Capital Issue

(b) Dividend and Bonus

(c) Profit and Investment

(d) All of the above.

Q50. In Optimal Capital Structure the Company's Cost of Capital will be:

(a) Minimum

(b) Average

(c) Maximum

(d) Medium.

Q51. Net Income Approach was suggested by:

(a) Modigliani and Miller

(b) David Durand

(c) Walter

(d) None of the above.

Q52. Buying a particular Security from Low Priced Market and Selling at High Priced Market is called:

(a) Speculation

(b) Efficient Investment

(c) Arbitrage

(d) Gambling.

Q53. Financial Structure is .... concept while the Capital Structure is .... concept:

(a) Inappropriate; Appropriate

(b) Appropriate; Inappropriate

(c) Broader; Narrow

(d) Narrow; Broader.

Q54. Which of the following Capital Structure consists of zero debt components in the structure mix?

(a) Pyramid Shaped Capital Structure

(b) Inverted Pyramid Shaped Capital Structure

(c) Horizontal Capital Structure

(d) Vertical Capital Structure.

Q55. Financial Break-Even Level of EBIT is:

(a) Intercept at Y-axis

(b) Intercept at X-axis

(c) Slope of EBIT-EPS

(d) None of the above.

Q56. The Traditional Approach of Capital Structure was propounded by .... :

(a) David Durand

(b) Modigliani and Miller

(c) Solomon Ezra

(d) None of the above.

Q57. The use of long-term fixed bearing Debt and Preference share capital along with Equity shares is called:

- **(a)** Operating Leverage
- **(b)** Financial Leverage
- **(c)** Trading on Equity
- **(d)** Both (b) and (c).

Q58. Which of the following Factors are considered when a Capital Structure decision is taken?

- **(a)** Dilution of Control
- **(b)** Cost of Capital
- **(c)** Floatation Cost
- **(d)** All of the above

ANSWERS

1	2	3	4	5	6	7	8	9	10
a	b	a	b	a	c	d	b	a	a
11	12	13	14	15	16	17	18	19	20
b	2	b	c	c	a	b	b	a	c
21	22	23	24	25	26	27	28	29	30
b	c	a	d	c	c	a	a	b	c
31	32	33	34	35	36	37	38	39	40
c	b	b	d	b	a	c	c	a	c
41	42	43	44	45	46	47	48	49	50
b	d	c	d	a	a	b	d	a	a
51	52	53	54	55	56	57	58		
b	c	c	c	b	c	d	d		

LEVERAGE ANALYSIS 6

MULTIPLE CHOICE QUESTIONS (MCQs)

Q1. Given: Operating fixed costs ₹20,000

Sales ₹1,00,000

P/V ratio 40%

The Operating leverage is:

- **(a)** 2.00
- **(b)** 2.50
- **(c)** 2.67
- **(d)** 2.47.

Q2. If EBIT is ₹15,00,000, interest is ₹2,50,000, corporate tax is 40%, degree of financial leverage is:

- **(a)** 1.11
- **(b)** 1.20
- **(c)** 1.31
- **(d)** 1.41.

Q3. If DOL is 1.24 and DFL is 1.99, DCL would be:

- **(a)** 2.14
- **(b)** 2.18
- **(c)** 2.31
- **(d)** 2.47.

Q4. From the following information, calculate Combined Leverage:

Sales	₹20,00,000
Variable Cost	40%
Fixed Cost	₹10,00,000
Borrowings	₹10,00,000 @ 8% p.a.

- **(a)** 10 times
- **(b)** 6 times
- **(c)** 1.6667 times
- **(d)** 0.10 times

Q5. Operating Leverage is calculated as:

- **(a)** Contribution ÷ EBIT
- **(b)** EBIT ÷ PBT
- **(c)** EBIT ÷ Interest
- **(d)** EBIT ÷ Tax

Q6. Financial Leverage is calculated as:

- **(a)** EBIT ÷ Contribution
- **(b)** EBIT ÷ PBT
- **(c)** EBIT ÷ Sales
- **(d)** EBIT ÷ Variable Cost

Q7. Which of the following is correct?

(a) CL = OL + FL
(b) CL = OL – FL
(c) CL = OL x FL
(d) OL = OL ÷ FL

Q8. Degree of Combined Leverage is the fraction of:

(a) Percentage change in EBIT on Percentage change in Sales.
(b) Percentage change in EPS on Percentage change in Sales.
(c) Percentage change in Sales on Percentage change in EPS.
(d) Percentage change in EPS on Percentage change in EBIT.

Q9. Which of the following indicates Business Risk?

(a) Operating Leverage
(b) Financial Leverage
(c) Combined Leverage
(d) Total Leverage.

Q10. Operating Leverage is a function of which of the following factors?

(a) Amount of variable cost.
(b) Variable contribution margin.
(c) Volume of purchases.
(d) Amount of semi-variable cost.

Q11. Financial Leverage may be defined as:

(a) Use of funds with a product cost in order to increase earnings per share.
(b) Use of funds with a contribution cost in order to increase earnings before interest and taxes.
(c) Use of funds with a fixed cost in order to increase earnings per share.
(d) Use of funds with a fixed cost in order to increase earnings before interest and taxes.

Q12. A Firm provides the following information: Sold 2,00,000 units @ ₹30 per unit; Variable cost is ₹15 per unit, Fixed cost ₹10,00,000 and debt of ₹10,00,000 at 10% rate of interest.

Calculate the Degree of Financial Leverage (DFL):

(a) 0.67 times
(b) 1.50 times
(c) 1.053 times
(d) None of the above.

Q13. If Margin of safety is 0.25 and there is 8% increase in output, then EBIT will be:

(a) Decrease by 2%
(b) Increase by 32%
(c) Increase by 2%
(d) Decrease by 32%.

Q14. If degree of financial leverage is 3 and there is 15% increase in EPS, then EBIT will be:

(a) Decrease by 15%
(b) Increase by 45%
(c) Decrease by 45%
(d) Increase by 5%.

Q15. When EBIT is much higher than Financial Break-even point, then degree of financial leverage will be slightly:

(a) Less than 1
(b) Equals to 1
(c) More than 1
(d) Equals to 0.

Q16. Firm with high Operating Leverage will have:

(a) Higher break-even point
(b) Lower business risk
(c) Higher margin of safety
(d) All of the above.

Q17. When Sales are at break-even point, the degree of operating leverage will be:

(a) Zero
(b) Infinite
(c) One
(d) None of the above.

Q18. If degree of Combined Leverage is 3 and Margin of Safety is 0.50, then degree of Financial Leverage is:

(a) 6.00 times
(b) 3.00 times
(c) 0.50 times
(d) 1.50 times.

Q19. If a firm has a DOL of 2.8, it means:

(a) If Sales increase by 2.8%, the EBIT will increase by 1%
(b) If EBIT increase by 2.896, the EPS will increase by 1%
(c) If Sales rise by 1%, the EBIT will rise by 2.8%
(d) None of the above.

Q20. Higher DOL is related to the use of higher:

(a) Debt
(b) Equity
(c) Fixed Cost
(d) Variable Cost.

Q21. Higher FL is related to the use of:

(a) Higher Equity
(b) Higher Debt
(c) Lower Debt
(d) Lower Equity.

Q22. Trading on Equity is:

(a) Always beneficial
(b) May be beneficial
(c) Never beneficial
(d) Sometimes beneficial.

Q23. Benefit of 'Trading on Equity' is available only if:
- **(a)** Rate of Interest < Rate of Return
- **(b)** Rate of Interest > Rate of Return
- **(c)** Both (a) and (b)
- **(d)** None of (d) and (b).

Q24. Indifference Level of EBIT is one at which:
- **(a)** EPS is zero
- **(b)** EPS is minimum
- **(c)** EPS is highest
- **(d)** None of these.

Q25. Which Combination is generally good for firms:
- **(a)** High OL, High FL
- **(b)** Low OL, Low FL
- **(c)** High OL, Low FL
- **(d)** Moderate OL, Moderate FL.

Q26. Capital Structure of ABC Ltd. consists of Equity Share Capital ₹1,00,000 (10,000 shares of @ ₹10 each) and 8% debentures of ₹50,000 and Earnings Before Interest and Tax is ₹20,000. The Degree of Financial Leverage is:
- **(a)** 2.5 times
- **(b)** 1.25 times
- **(c)** 2 times
- **(d)** 1 time.

Q27. Financial Leverage is zero if:
- **(a)** EBIT = Interest
- **(b)** EBIT = Zero
- **(c)** EBIT = Fixed Cost
- **(d)** EBIT = Pref. Dividend.

Q28. Operating Leverage arises because of:
- **(a)** Fixed Cost of Production
- **(b)** Fixed Interest Cost
- **(c)** Variable Cost
- **(d)** Step Cost.

Q29. Financial Leverage arises because of:
- **(a)** Fixed Cost of Production
- **(b)** Fixed Interest Cost
- **(c)** Variable Cost
- **(d)** Step Cost.

Q30. High degree of Financial Leverage means:
- **(a)** High debt proportion
- **(b)** Lower debt proportion
- **(c)** Equal debt and equity
- **(d)** No debt.

Q31. Financial Break-even level of EBIT is one at which:

(a) EPS is one

(b) EPS is zero

(c) EPS is infinite

(d) EPS is negative.

Q32. X Company has Sales of ₹12,00,000, Variable Cost is 50% and Fixed cost ₹2,50,000. Degree of Operating Leverage of the Company is:

(a) 1.67 times

(b) 1.33 times

(c) 1.71 times

(d) 2.00 times.

Q33. If a Company acquired a Imported Car for its top management for a certain period on a fixed payment, which of the following will be true regarding Leverage?

(a) DOL will increase

(b) DFL will increase

(c) DOL will decrease

(d) DCL will remain unchanged

Q34. A Firm has a DOL of 6 at a certain production level. If sales of the Firm rise by 1%, it implies that:

(a) EBIT will also rise by 1%

(b) EBIT will rise by 1/6%

(c) EBIT will rise by 6%

(d) Change in EBIT is undecided.

Q35. The .... is the percentage change in earnings per share that results from a percentage change in Operating Income:

(a) Degree of Combined Leverage

(b) Degree of Financial Leverage

(c) Break-Even Point

(d) Degree of Operating Leverage.

Q36. ANT Co. Ltd., reported Sales for the year ₹50 Lakhs and Variable Cost Ratio is 57% and Fixed Cost of Administration and Selling and Distribution as ₹9.50, ₹4.80 and ₹3.90 Lakhs respectively. The resulting Operating Leverage is:

(a) 6.52 times (b) 6.69 times (c) 6.72 times (d) 6.89 times.

Q37. AXN Co. Ltd. has two Products X and Y. Y's selling price @ 120% of X and Sales Volume of X as 150% of Y's Sale of 3,00,000 units @ ₹90 per unit. The Variable Cost per unit X and Y is ₹70 and ₹88 respectively and Fixed Cost ₹8.50 Lakhs per annum. Calculate Operating Leverage:

(a) 1.25 (b) 1.58 (c) 1.92 (d) 1.43.

Q38. From the following information, Calculate Combined Leverage. Sales ₹20,00,000; Variable Cost 40%; Fixed Cost ₹10,00,000; Borrowings ₹10,00,000 @ 8% p.a.

(a) 7 (b) 10 (c) 0.9 (d) 9

Q39. Capital Structure of A Ltd. comprises of the following:

Equity Share Capital	₹25 Lakhs
10% Debentures	₹10 Lakhs

If EBIT is ₹6 Lakhs, Degree of Financial Leverage is:

(a) 2 (b) 1.5 (c) 1.2 (d) 1.3

Q40. The Financial Leverage can be arrived by using the formula:

(a) Operating Profit/Profit After Tax

(b) Profit After Tax/EBIT

(c) EBIT/EPS

(d) EBIT/PBT.

Q41. There is no Operating Leverage if there is no .... :

(a) Sales

(b) Contribution

(c) Fixed Costs

(d) EPS.

Q42. The presence of Fixed Costs in the total cost structure of firms results into:

(a) Combined Leverage

(b) Financial Leverage

(c) Operating Leverage

(d) All of the above.

Q43. Degree of Combined Leverage is equal to its Degree of Operating Leverage .... its Degree of Financial Leverage:

(a) Minus

(b) Plus

(c) Divided by

(d) Multiplied by.

Q44. High Operating Leverage combined with high Financial Leverage will constitute:

(a) Positive Situation

(b) Favourable Situation

(c) Less Risky Situation

(d) Risky Situation.

Q45. Suppose Operating Leverage is 3 times. It means a 20% change in sales will cause:

(a) 60% change in variable cost

(b) 60% change in EPS

(c) 60% change in EBIT

(d) 60% Change in EBT

Q46. If the Return on Investment (ROI) exceeds the rate of interest on debt, it is a .... Financial Leverage:

(a) Unfavourable (b) Negative (c) Favourable (d) Can't say.

Q47. Lower Financial Leverage is related to the use of additional:

(a) Fixed Costs

(b) Variable costs

(c) Debt Financing

(d) Common Equity Financing.

Q48. Earnings available to Equity Shareholders per share (EPS) will fluctuate violently if:

(a) Financial Leverage is very high

(b) Operating Leverage is very high

(c) Working Capital Leverage is very high

(d) Operating Leverage is very low.

Q49. Use of Preference Share Capital in Capital Structure:

(a) Increases DOL

(b) Increases DFL

(c) Decreases DOL

(d) Decreases DFL.

Q50. If a Firm has no debt, which one is the correct statement?

(a) DOL is one

(b) DFL is one

(c) DOL is zero

(d) DFL is zero.

ANSWERS

1	2	3	4	5	6	7	8	9	10
a	b	d	a	a	b	c	b	a	b
11	12	13	14	15	16	17	18	19	20
c	c	b	d	c	a	b	d	c	c
21	22	23	24	25	26	27	28	29	30
b	b	a	d	c	b	b	a	b	a
31	32	33	34	35	36	37	38	39	40
b		a	c	a	a	d			d
41	42	43	44	45	46	47	48	49	50
c	c	d	d	c	c	d	a	b	b

INVESTMENT DECISIONS 7

MULTIPLE CHOICE QUESTIONS (MCQs)

Q1. A Capital Budgeting technique which does not require the computation of cost of capital for decision making purposes is:

(a) Net Present Value Method
(b) Internal Rate of Return Method
(c) Modified Internal Rate of Return Method
(d) Payback Period Method.

Q2. If two alternative proposals are such that the acceptance of one shall exclude the possibility of the acceptance of another then such decision making will lead to.

(a) Mutually exclusive decisions
(b) Accept-reject decisions
(c) Contingent decisions
(d) None of the above.

Q3. In case a company considers a discounting factor higher than the cost of capital for arriving at present values, the present values of cash inflows will be:

(a) Less than those computed on the basis of cost of capital
(b) More than those computed on the basis of cost of capital
(c) Equal to those computed on the basis of cost of capital
(d) None of the above.

Q4. Capital rationing refers to a situation where:

(a) Funds are restricted and the management has to choose from amongst available alternative investments.
(b) Funds are unlimited and the management has to decide how to allocate them to suitable projects.
(c) Very few feasible investment proposals are available with the management.
(d) None of the above.

Q5. While evaluating capital investment proposals, time value of money is used in which of the following techniques:

(a) Payback Period Method
(b) Accounting Rate of Return
(c) Net Present value
(d) None of the above.

Q6. If the cut off rate of a project is greater than IRR, we may:

(a) Accept the proposal
(b) Reject the proposal
(c) Be neutral about it
(d) Wait for the IRR to increase and match the cut off rate.

Q7. The re-investment assumption in the case of the IRR technique assumes that:
- **(a)** Cash inflows can be re-invested at the projects IRR.
- **(b)** Cash inflows can be re-invested at the weighted cost of capital.
- **(c)** Cash inflows can be re-invested at the marginal cost of capital.
- **(d)** None of the above.

Q8. Multiple IRRs are obtained when:
- **(a)** Cash inflows in the early stages of the project exceed cash flows during the later stages.
- **(b)** Cash flows reverse their signs during the project.
- **(c)** Cash flows are uneven
- **(d)** None of the above.

Q9. Depreciation is included as a cost in which of the following techniques:
- **(a)** Accounting Rate of Return
- **(b)** Net Present value
- **(c)** Internal Rate of Return
- **(d)** None of the above.

Q10. Assume cash outflows equals ₹1,20,000 followed by cash inflows of ₹25,000 per year for 8 years and a cost of capital of 11%. What is the Net Present Value?
- **(a)** (₹38,214)
- **(b)** ₹9,653
- **(c)** ₹8,653
- **(d)** ₹38,214.

Q11. What is the Internal Rate of Return for a project having cash flows of ₹40,000 per year for 10 years and a cost of ₹2,26,009?
- **(a)** 8%
- **(b)** 9%
- **(c)** 10%
- **(d)** 12%.

Q12. While evaluating investments, the release of working capital at the end of the project's life should be considered as:
- **(a)** Cash inflow
- **(b)** Cash outflow
- **(c)** Having no effect upon the capital budgeting decision
- **(d)** None of the above.

Q13. Capital Budgeting is done for:
- **(a)** Evaluating short term investment decisions.
- **(b)** Evaluating medium term investment decisions.
- **(c)** Evaluating long term investment decisions.
- **(d)** None of the above.

Q14. Capital Budgeting is a part of:
- **(a)** Investment Decision
- **(b)** Working Capital Management
- **(c)** Marketing Management
- **(d)** Capital Structure.

Q15. Capital Budgeting Decisions are:

- **(a)** Reversible
- **(b)** Irreversible
- **(c)** Unimportant
- **(d)** All of the above.

Q16. Which of the following is not incorporated in Capital Budgeting?

- **(a)** Tax-Effect
- **(b)** Time Value of Money
- **(c)** Required Rate of Return
- **(d)** Rate of Cash Discount.

Q17. Which of the following is not a Capital Budgeting Decision?

- **(a)** Expansion Programme
- **(b)** Merger
- **(c)** Replacement of an Asset
- **(d)** Inventory Level.

Q18. A sound of Capital Budgeting technique is based on:

- **(a)** Cash Flows
- **(b)** Accounting Profit
- **(c)** Interest Rate on Borrowings
- **(d)** Last Dividend Paid.

Q19. Which of the following is not a relevant cost in Capital Budgeting?

- **(a)** Sunk Cost
- **(b)** Opportunity Cost
- **(c)** Allocated Overheads
- **(d)** Both (a) and (c) above.

Q20. Which of the following does not affect Cash Flows Proposal?

- **(a)** Salvage Value
- **(b)** Depreciation Amount
- **(c)** Tax Rate Change
- **(d)** Method of Project Financing.

Q21. Which of the following is not true with reference of Capital Budgeting?

- **(a)** Capital Budgeting is related to asset replacement decisions
- **(b)** Cost of Capital is equal to minimum required return
- **(c)** Existing investment in a project is not treated as Sunk Cost
- **(d)** Timing of Cash Flows is relevant.

Q22. Which of the following is not followed in Capital Budgeting?

- **(a)** Cash Flows Principle
- **(b)** Interest Exclusion Principle
- **(c)** Accrual Principle
- **(d)** Post-Tax Principle.

Q23. A Proposal is not a Capital Budgeting Proposal if it:

- **(a)** Is related to Fixed Assets
- **(b)** Brings long-term benefits
- **(c)** Brings short-term benefits only
- **(d)** Has a very large investment.

Q24. .... ignores the Time Value of Money:

- **(a)** IRR
- **(b)** ARR
- **(c)** NPV
- **(d)** PI.

Q25. If the NPV is positive or at least equal to zero, the project can be .... :

- **(a)** Break-even situation
- **(b)** Accepted or rejected
- **(c)** Rejected
- **(d)** Accepted.

Q26. The following information is given for a project:

Annual cash inflows ₹8,00,000
Useful life 4 years
Payback period of 2.855 years
The Cost of the Project would be-

- **(a)** ₹22,80,000
- **(b)** ₹22,84,000
- **(c)** ₹22,86,000
- **(d)** ₹22,87,800.

Q27. Annual Cost Saving ₹4,00,000; Useful life 4 Years; Cost of the Project ₹11,42,000. The Payback period would be:

- **(a)** 2 years and 8 months
- **(b)** 2 years and 11 months
- **(c)** 3 years and 2 months
- **(d)** 3 years and 10 months.

Q28. A Project has a 10% discounted payback of 2 years with annual after-tax cash inflows commencing from year end 2 to 4 of ₹400 lakhs. How much would have been the initial cash outlay which was fully made at the beginning of year 1?:

(a) ₹400 lakhs (b) ₹422 lakhs (c) ₹452 lakhs (d) ₹497.20 lakhs.

Q29. Accounting Rate of Return (ARR) is based on the .... :

- **(a)** Average Cash Profit
- **(b)** Average Past Profit
- **(c)** Average Expected Profit
- **(d)** None of the above.

Q30. Which of the following is not used in Capital Budgeting?

- **(a)** Time Value of Money
- **(b)** Net Assets Method
- **(c)** Sensitivity Analysis
- **(d)** Cash Flows.

Q31. Two Mutually Exclusive Projects with different economic lives can be compared on the basis of:

- **(a)** Internal Rate of Return
- **(b)** Profitability Index
- **(c)** Net Present Value
- **(d)** Equivalent Annuity Value.

Q32. In Risk-Adjusted Discount Rate Method, which one is adjusted?

(a) Cash Flows
(b) Life of the Proposal
(c) Rate of Discount
(d) Salvage Value.

Q33. In Risk-Adjusted Discount Rate Method, the Normal Rate of Discount is:

(a) Decreased
(b) Increased
(c) Unchanged
(d) None of the above.

Q34. In Certainty-Equivalent Approach, Adjusted Cash Flows are discounted at:

(a) Internal Rate of Return
(b) Accounting Rate of Return
(c) Target Rate
(d) Risk-Free Rate.

Q35. If there is no inflation during a period, then the Money Cash Flow would be equal to:

(a) Real Cash Flow
(b) Present Value
(c) Real Cash Flow – Present Value
(d) Real Cash Flow + Present Value.

Q36. The Real Cash Flows must be discounted to get the present value at a rate equal to:

(a) Inflation Rate
(b) Money Discount Rate
(c) Real Discount Rate
(d) Risk-Free Rate of Interest.

Q37. IRR would favour project proposals which have:

(a) Heavy cash inflows in the early stages of the project
(b) Evenly distributed cash inflows throughout the project
(c) Heavy cash inflows at the later stages of the project
(d) None of the above.

Q38. Management is considering a ₹1,00,000 investment in a project with a 5 year life and no residual value. If the total income from the project is expected to be ₹60,000 and recognition is given to the effect of straight line depreciation on the investment, the average rate of return is:

(a) 12% (b) 24% (c) 60% (d) 75%.

Q39. Initial Investment ₹20,00,000. Expected annual cash flows ₹6,00,000 for 10 years. Cost of capital @ 15%. Profitability Index (PI) is .... : (Cumulative Discounting Factor @ 15% for 10 years is 5.019)

(a) 1.51 Years
(b) 1.71 Years
(c) 2.51 Years
(d) 2.91 Years.

Q40. Capital Budgeting Decisions are based on

(a) Incremental Profit
(b) Incremental Cash Flows
(c) Incremental Assets
(d) Incremental Capital.

Q41. Depreciation is incorporated in cash flows because it:
- **(a)** Is unavoidable cost
- **(b)** Is a cash flow
- **(c)** Reduces Tax Liability
- **(d)** Involves an outflow

Q42. Which of the following is not true for Capital Budgeting?
- **(a)** Sunk costs are ignored
- **(b)** Opportunity costs are excluded
- **(c)** Incremental cash flows are considered
- **(d)** Relevant cash flows are considered.

Q43. Which of the following is not applied in Capital Budgeting?
- **(a)** Cash flows be calculated in incremental terms
- **(b)** All costs and benefits are measured on cash basis
- **(c)** All accrued costs and revenues be incorporated
- **(d)** All benefits are measured on after tax basis.

Q44. In Capital Budgeting, Sunk Cost is excluded because it is:
- **(a)** Of small amount
- **(b)** Not incremental
- **(c)** Not reversible
- **(d)** All of the above.

Q45. A Profitability Index of 0.90 for a project means:
- **(a)** The present value of benefits is 90% greater than the project's costs.
- **(b)** The project's NPV is positive
- **(c)** The project returns 90 cents in present value for each current rupee invested
- **(d)** The payback period is less than two years.

Q46. Which of the following statements is correct?
- **(a)** If the NPV of a Project is greater than 0, its PI will be negative
- **(b)** If the IRR of a project is 0%, its NPV, using a discount rate, K, greater than 0, will be 0.
- **(c)** If the PI of a project is less than 1, its NPV should be negative
- **(d)** If the IRR of a project is greater than the discount rate, k, its PI will be less than 1 and its NPV will be greater than 0.

Q47. Profitability Index Method gives due consideration to the .... :
- **(a)** Time value of money
- **(b)** Finance cost of investments
- **(c)** Traditional value of money
- **(d)** Cost and time value of money.

Q48. The initial investment of a project is ₹5,00,000, the expected annual cash inflow is ₹90,000 for ten years. Determine the Pay Back Period:
- **(a)** 5 years and 9 months (Approx.)
- **(b)** 5 years and 4 months (Approx.)
- **(c)** 4 years and 7 months (Approx.)
- **(d)** 5 years and 7 months (Approx.)

Q49. A Long-term Project having a Profitability Index (PI) of .... is accepted:
- **(a)** PI = 1 (b) PI < 1 (c) PI > 1 (d) None of the above.

ANSWERS

1	2	3	4	5	6	7	8	9	10
d	a	a	a	c	b	a	b	a	c
11	12	13	14	15	16	17	18	19	20
d	a	c	a	b	d	d	a	d	d
21	22	23	24	25	26	27	28	29	30
c	c	c	b	d	b	b	c	c	b
31	32	33	34	35	36	37	38	39	40
d	c	b	d	a	c	a	b	a	b
41	42	43	44	45	46	47	48	49	
c	b	c	b	c	c	a	d	c	

DIVIDEND DECISIONS 8

MULTIPLE CHOICE QUESTIONS (MCQs)

Q1. Which one of the following is the assumption of Gordon's Model:

(a) $K_e > g$
(b) Retention Ratio (b), once decide upon, is constant
(c) Firm is an all equity firm
(d) All of the above.

Q2. What should be the Optimum Dividend Pay-Out Ratio, when r = 15% and K_e = 12%:

(a) 100%
(b) 50%
(c) Zero
(d) None of the above.

Q3. Which of the following is the irrelevance theory?

(a) Walter Model
(b) Gordon Model
(c) MM Hypothesis
(d) Linter's Model.

Q4. If the Company's Dividend Payout Ratio is 60% and ROI is 16%, what should be the growth rate?

(a) 5%
(b) 7%
(c) 6.4%
(d) 9.6%.

Q5. If the shareholders prefer regular income, how does this affect the dividend-decision:

(a) It will lead to payment of dividend
(b) It is the indicator to retain more earnings
(c) It has no impact on dividend decision
(d) Can't say.

Q6. Mature Companies having few investment opportunities will show high payout ratios, this statement is:

(a) False
(b) True
(c) Partial True
(d) None of these.

Q7. Which of the following is the limitation of Linter's Model?

(a) This model does not offer a market price for the shares.
(b) The adjustment factor is an arbitrary number and not based on any scientific criterion or methods.
(c) Both (a) & (b)
(d) None of above.

Q8. What are the different options other than cash used for distributing profits to shareholders?

(a) Bonus Shares
(b) Stock Split
(c) Both (a) & (b)
(d) None of the above.

Q9. Which of the following statement is correct with respect to Gordon's Model?

(a) When IRR is greater than cost of capital, the price per share increases and dividend pay-out decreases.
(b) When IRR is greater than cost of capital, the price per share decreases and dividend pay-out increases.
(c) When IRR is equal to cost of capital, the price per share increases and dividend pay-out decreases.
(d) When IRR is lower than cost of capital, the price per share increases and dividend pay-out decreases.

Q10. Compute EPS according to Graham & Dodd Approach from the given information:

Market price	₹56
Dividend Pay-out Ratio	60%
Multiplier	2

(a) ₹30
(b) ₹56
(c) ₹28
(d) ₹84.

Q11. Which among the following is not an assumption of Walter's Model?

(a) Rate of Return and Cost of capital are constant.
(b) Information is freely available to all.
(c) There is discrimination in taxes
(d) The firm has perpetual life.

Q12. Walter Model can be applied only to those companies which:

(a) Earn high profits
(b) Make investment by resorting to high level of debts
(c) Make investments without borrowing or raising external equity
(d) Do not make any investment.

Q13. According to the Walter's Model, a firm should have 100% dividend pay-out ratio when:

(a) r = Ke
(b) r < Ke
(c) r > Ke
(d) g > Ke.

Q14. A Company has 5,000 shares of ₹100 each. The capitalisation rate is 12%. Income before tax is ₹2,00,000. Tax rate is 30%. Dividend pay-out ratio is 50%. Find Market Price Per Share (MPS) at the end of the current year based on MM Approach if dividend is paid.

(a) ₹101
(b) ₹100
(c) ₹99
(d) ₹98.

Q15. An Investor is holding 100 shares of PQR Ltd. The current rate of dividend paid by the company is ₹10 per share. The long-term growth rate is expected to be 10% and the expected rate of return is 20%. Current market price of the share is:

(a) ₹110 (b) ₹112 (c) ₹120 (d) ₹111.

Q16. Determine the Market Price of a Share of A Ltd. by using Gordon's Model. Given Ke = 12%, E = ₹20, r = 12%, b = 60%.

(a) ₹166.67 (b) ₹210.52 (c) ₹189.19 (d) ₹181.82.

Q17. When Return on Investment is equal to the Market Capitalization Rate, the Optimum Pay-out Ratio would be:

(a) Zero
(b) 100%
(c) 50%
(d) All the Pay-out Ratios would be Optimum.

Q18. Determine the Market Price of a Share of XYZ Ltd. as per Gordon's Model, given Equity Capitalisation rate = 11%, Expected Earning = ₹20, Rate of return on investment = 10% and retention ratio =30%.

(a) ₹165
(b) ₹175
(c) ₹185
(d) ₹195.

Q19. When the firm does not pay-out fixed dividend regularly, the dividend policy is known as:

(a) Irregular
(b) Regular
(c) No immediate
(d) Liberal.

Q20. In Stock Dividend:

(a) Authorised Capital always increases
(b) Paid up Capital always increases
(c) Face value per share decreases
(d) Market price for share decreases.

Q21. Which of the following is not considered in Lintner's Model?

(a) Dividend Payout Ratio
(b) Current EPS
(c) Speed of Adjustment
(d) Preceding year's EPS.

Q22. Which of the following statements is not true in the context of MM Dividend Theory?

(a) The firm operates in perfect capital markets
(b) All investors are rational
(c) There is no fixed investment policy of the firm
(d) The dividend policy of the firm is irrelevant.

Q23. What are the different options other than cash used for distributing profits to shareholders?

(a) Bonus shares
(b) Stock split
(c) Stock dividend
(d) All of the above.

Q24. If a Firm declared 25% dividend on share of Face Value of ₹10, its growth rate is 5%, and if the rate of Capitalisation is 12%, its expected price would be .... :

- **(a)** ₹31.25
- **(b)** ₹33.50
- **(c)** ₹36.00
- **(d)** ₹37.50.

Q25. Modigliani and Miller argue that the dividend decision .... :

- **(a)** Is irrelevant as the value of the firm is based on the earning power of its assets
- **(b)** Is relevant as the value of the firm is not based just on the earning power of its assets
- **(c)** Is irrelevant as dividends represent cash leaving the firm to shareholders, who own the firm anyway
- **(d)** Is relevant as cash outflow always influences other firm decisions.

Q26. If a Company is using Constant Pay-out Ratio policy of Dividend, the Amount of Dividend would:

- **(a)** Decrease with an increase in income
- **(b)** Increase with an increase in income
- **(c)** Remain same
- **(d)** Can't be determined.

Q27. Which one of the following is not an assumption of Walter's Model?

- **(a)** The Firm finance all investment through Debt or Retained Earnings
- **(b)** The Firm's internal rate of return is constant
- **(c)** The Firm's Cost of Equity Capital is constant
- **(d)** The Firm has a very long or infinite life.

Q28. Modigliani and Miller, recognizing that dividends do somehow affect stock prices, suggest that positive effects of dividend increases are attributable:

- **(a)** Directly to the dividend policy
- **(b)** Directly to the Optimal Capital Structure
- **(c)** Not to the information content but to the consistency in the payment of dividends
- **(d)** Not to the dividend itself but to the informational content of the dividends with respect to future earnings.

Q29. PQR Company earns ₹10 per share, is capitalised at a rate of 10% and has a rate of return on investment of 20%. If dividend payout ratio is 50%, what should be the price per share, according to Walter's Model?

- **(a)** ₹200
- **(b)** ₹150
- **(c)** ₹125
- **(d)** ₹225.

Q30. According to Gordon's Dividend Capitalisation Model, if the share price of a firm is ₹43, its dividend payout ratio is 60%, Cost of Equity is 9%, ROI is 12% and the number of shares are 12,000, what will be the net profit of the firm?

- **(a)** ₹15,480
- **(b)** ₹23,220
- **(c)** ₹36,120
- **(d)** ₹54,180.

ANSWERS

1	2	3	4	5	6	7	8	9	10
d	c	c	c	a	b	c	a	a	a
11	12	13	14	15	16	17	18	19	20
c	c	b	d	a	a	d	b	a	d
21	22	23	24	25	26	27	28	29	30
d	c	d	d	a	b	a	d	b	

MANAGMENT OF WORKING CAPITAL 9

MULTIPLE CHOICE QUESTIONS (MCQs)

Q1. The credit terms may be expressed as "3/15 net 60". This means that a 3% discount will be given if the customer pays within 15 days, if he does not avail the offer, he must make payment within 60 days.

- **(a)** I agree with the statement.
- **(b)** I do not agree with the statement.
- **(c)** I cannot say.

Q2. The term 'net 50' implies that the customer will make payment:

- **(a)** Exactly on 50th day
- **(b)** Before 50th day
- **(c)** Not later than 50th day
- **(d)** None of the above.

Q3. Trade credit is a source of:

- **(a)** Long-term finance
- **(b)** Medium term finance
- **(c)** Spontaneous source of finance
- **(d)** None of the above.

Q4. The term float is used in:

- **(a)** Inventory Management
- **(b)** Receivable Management
- **(c)** Cash Management
- **(d)** Marketable Securities

Q5. William J Baumol's model of Cash Management determines Optimum Cash Level where the Carrying Cost and Transaction Cost are:

- **(a)** Maximum
- **(b)** Minimum
- **(c)** Medium
- **(d)** None of the above.

Q6. In Miller-ORR Model of Cash Management:

- **(a)** The lower, upper limit, and return point of Cash Balance are set out.
- **(b)** Only upper limit and return point are decided.
- **(c)** Only lower limit and return point are decided.
- **(d)** None of the above are decided.

Q7. Working Capital is defined as:

- **(a)** Excess of current assets over current liabilities.
- **(b)** Excess of current liabilities over current assets.
- **(c)** Excess of fixed assets over long-term liabilities.
- **(d)** None of the above.

Q8. Working Capital is also known as "Circulating Capital, Fluctuating Capital and Revolving Capital". The aforesaid statement is;

(a) Correct
(b) Incorrect
(c) Cannot say.

Q9. The basic objectives of Working Capital Management are:

(a) Optimum utilization of resources for profitability
(b) To meet day-to-day current obligations
(c) Ensuring marginal return on current assets is always more than cost of capital.
(d) Select any one of the above statements.

Q10. The term Gross Working Capital is known as:

(a) The investment in current liabilities
(b) The investment in current assets
(c) The investment in long-term liability
(d) None of the above.

Q11. The term Net Working Capital refers to the difference between the current assets minus current liabilities:

(a) The statement is correct
(b) The statement is incorrect
(c) I cannot say.

Q12. .... has suggested three methods of working out of the maximum amount that unit may expect from the Bank (MPBF):

(a) Chore Committee
(b) Tandon Committee
(c) Jilani Committee
(d) None of the above

Q13. The concept of operating cycle refers to the average time which elapses between the acquisition of raw materials and the final cash realization. This statement is:

(a) Correct
(b) Incorrect
(c) Partially True
(d) I cannot say.

Q14. The term "Core Current Assets" was coined by:

(a) Chore Committee
(b) Tandon Committee
(c) Jilani Committee
(d) None of the above

Q15. As a matter of self-imposed financial discipline can there be a situation of zero working capital now-a-days in some of the professionally managed organizations:

(a) Yes
(b) No
(c) Impossible
(d) Cannot say.

Q16. Over trading arises when a business expands beyond the level of funds available. The statement is:

- **(a)** Incorrect
- **(b)** Correct
- **(c)** Partially correct
- **(d)** I cannot say.

Q17. A Conservative Working Capital strategy calls for high levels of current assets in relation to sales.

- **(a)** I agree
- **(b)** Do not agree
- **(c)** I cannot say.

Q18. The term Working Capital leverage refers to the impact of level of Working Capital on Company's profitability. This measures the responsiveness of ROCE for changes in current assets.

- **(a)** I agree
- **(b)** Do not agree
- **(c)** The statement is partially true.

Q19. The term spontaneous source of finance refers to the finance which naturally arises in the course of business operations. The statement is:

- **(a)** Incorrect
- **(b)** Correct
- **(c)** Partially correct
- **(d)** I cannot say.

Q20. Under hedging approach to financing of working capital requirements of a firm, each asset in the balance sheet assets side would be offset with a financing instrument of the same approximate maturity. This statement is:

- **(a)** Incorrect
- **(b)** Correct
- **(c)** Partially correct
- **(d)** I cannot say.

Q21. Trade credit is a:

- **(a)** Negotiated source of finance
- **(b)** Hybrid source of finance
- **(c)** Spontaneous source of finance
- **(d)** None of the above.

Q22. Factoring is a method of financing whereby a firm sells its trade debts at a discount to a financial institution. The statement is:

- **(a)** Incorrect
- **(b)** Correct
- **(c)** Partially correct
- **(d)** I cannot say.

Q23. A factoring arrangement can be both with recourse as well as without recourse:

- **(a)** True
- **(b)** False
- **(c)** Partially correct
- **(d)** Cannot say.

Q24. The Bank financing of working capital will generally be in the following form. Cash credit, overdraft, bills discounting, bills acceptance, line of credit; Letter of credit and bank guarantee.

(a) I agree
(b) I do not agree
(c) I cannot say.

Q25. When the items of inventory are classified according to value of usage, the technique is known as:

(a) XYZ Analysis
(b) ABC Analysis
(c) DEF Analysis
(d) None of the above.

Q26. When a firm advises its customers to mail their payments to special Post Office Collection Centres, the system is known as:

(a) Concentration Banking
(b) Lock Box System
(c) Playing the float
(d) None of the above.

Q27. If the Current Ratio is 2.4:1 and Working Capital is ₹25,20,000, find the amount of Current Assets and Current Liabilities:

(a) ₹43,20,000 and ₹18,00,000
(b) ₹44,00,000 and ₹18,50,000
(c) ₹45,50,000 and ₹19,00,000
(d) ₹46,60,000 and ₹19,30,000.

Q28. Working Capital is also known as .... Capital:

(a) Current Asset
(b) Operating
(c) Projecting
(d) Operation Capital.

Q29. .... Working Capital refers to the firm's investment in Current Assets:

(a) Zero
(b) Net
(c) Gross
(d) Distinctive.

Q30. A .... Net Working Capital occurs when Current Liabilities are in excess of Current Assets:

(a) Positive
(b) Negative
(c) Excessive
(d) Zero.

Q31. On the basis of ...., Working Capital is classified as Gross Working Capital and Net Working Capital:

(a) Concept
(b) Time
(c) Future
(d) Work.

Q32. Operating Cycle is also called as:
- **(a)** Business Cycle
- **(b)** Working Capital Cycle
- **(c)** Working Cycle
- **(d)** Current Asset Cycle.

Q33. X Ltd. distributes its products to more than 500 retailers. The Company's collection period is 30 days and keeps its inventory for 20 days. The Operating Cycle:
- **(a)** 40 days
- **(b)** 43 days
- **(c)** 45 days
- **(d)** 50 days.

Q34. Average collection period is 2 months, Cash Sales and Average Receivables are ₹5,00,000 and ₹6,50,000 respectively. The Sales amount would be:
- **(a)** ₹40,00,000
- **(b)** ₹42,00,000
- **(c)** ₹44,00,000
- **(d)** ₹48,50,000.

Q35. Which of the following is not a valid assumption of Economic Order Quantity Model?
- **(a)** Demand Forecast is available
- **(b)** Inventory can be replenished immediately
- **(c)** Cost per order is variable
- **(d)** Carrying cost is in a fixed percentage.

Q36. Determination of "Safety Stock" requires a trade-off between:
- **(a)** Carrying costs and stock-out cost
- **(b)** Ordering cost and carrying cost
- **(c)** Ordering cost and stock-out cost
- **(d)** Lead time and order point.

Q37. ABC Analysis is useful for:
- **(a)** Analyzing inventory based on their usage and movement
- **(b)** Reduction of total investment in material
- **(c)** Determining the Optimal Level of Safety Stock
- **(d)** Analyzing Inventory based on their availability.

Q38. Cash Management Model has been propounded by:
- **(a)** Lintner
- **(b)** Walter
- **(c)** Baumol
- **(d)** Gordon.

Q39. Economic Order Quantity (EOQ) determines:
- **(a)** The order size that minimize the total inventory cost
- **(b)** The order size where ordering cost is the lowest
- **(c)** The order size where the carrying cost is minimum
- **(d)** The order size which will earn discounts on purchase.

Q40. An arrangement where a bank allows a borrower to overdraw up to a certain limit for working capital financing is known as:

(a) Bridge Loan
(b) Cash Credit
(c) Term Loan
(d) Leverage Buy Out.

Q41. Funds represented by cheques which have been issued, but which have not been debited from bank is technically referred to as:

(a) Indenture
(b) Forward Cover
(c) Float
(d) Proxy.

Q42. Efficiency of a Credit Control System does not get influenced by:

(a) Timely Billing
(b) Accurate Billing
(c) Compliance with the specified credit policy
(d) Cash discount availed by the customers.

Q43. .... varies inversely with profitability:

(a) Liquidity
(b) Risk
(c) Gross Profit
(d) None of the above.

Q44. Credit Term '4/20 net 90' means:

(a) 0.40% discount will be granted if the customer pays within 90 days
(b) 20% discount will be granted if the customer pays within 4 days, and if he does not avail the offer he must make payment within 90 days
(c) Net 90% discount will be granted if the customer pays 4 times the amount due within 20 days
(d) 4% discount will be granted if the customer pays within 20 days, otherwise he must make payment within 90 days.

Q45. Debtors Turnover Ratio reflects:

(a) Collection Period
(b) Debtors in relation to credit sales
(c) Debtors in relation to total sales
(d) Aging of the debtors.

Q46. Net Operating Cycle (NOC) can be defined as sum of:

(a) Raw Material, WIP and Finished Goods Conversion Period
(b) Raw Material, WIP, Finished Goods and Receivables Conversion Period
(c) Inventory Plus Receivables Conversion period minus Deferral period
(d) None of the above.

Q47. Which of the following statements is not true?

(a) Management of working capital is as essential task of the finance manager
(b) Fluctuating working capital needed to meet the seasonal requirements of the business
(c) A conservative current asset financing policy relies more on short term bank financing and less on long term sources
(d) An aggressive current asset financing policy relies heavily on short term bank finance.

Q48. Permanent Working Capital:

(a) Varies with seasonal needs
(b) Includes fixed assets
(c) Is the number of current assets required to meet a firm's long-term minimum needs
(d) Includes accounts payables.

Q49. Consider the following factors – Gross Operating Cycle 80 days; Net Operating Cycle 55 days; Raw Material Holding Period 40 days; Conversion Period 2 days; Finished goods holding period 20 days; Average Collection Period will be:

(a) 87 days
(b) 18 days
(c) 37 days
(d) 62 days.

Q50. What do you understand by the term "Factoring" with respect to management of accounts receivable?

(a) Use of accounts receivables as prime collateral for a secured loan
(b) Pledging of accounts receivables to a lender
(c) Outright sale of accounts receivables to a financial agency
(d) En-cashing accounts receivable before closure of accounts.

Q51. A higher Current Assets/Fixed Assets Ratio indicates:

(a) Hedging Approach
(b) Conservative Approach
(c) Matching/Hedging Approach
(d) Aggressive Approach.

Q52. Maximum Permissible Bank Finance (MPBF) as per the first norms of Tandon Committee was ₹57,41,813, while Current Liabilities are reported at ₹32,50,000. Current Assets?

(a) ₹1,09,05,750
(b) ₹81,79,313
(c) ₹1,09,07,550
(d) ₹1,05,09,750.

Q53. A Conservative policy implies:

(a) Greater Liquidity and lower risk
(b) Greater risk and lower liquidity
(c) Negligible risk
(d) No risk at all with low liquidity.

Q54. Calculate Maximum Permissible Bank Finance (MPBF) as per First Method suggested by the Tandon Committee, from the information given below:

Creditors ₹150 Lakhs; Other Current liabilities ₹50 Lakhs; Debentures ₹400 Lakhs; Finished Goods ₹500 Lakhs; Receivables ₹150; Other Current Assets ₹150:

(a) ₹150 Lakhs
(b) ₹200 Lakhs
(c) ₹350 Lakhs
(d) ₹450 Lakhs.

Q55. According to .... approach, cash inflow from assets should match with the cash outflow required to acquire them.

(a) Aggressive Approach
(b) Hedging Approach
(c) Conservative Approach
(d) Optimization.

Q56. Concentration Banking helps in:

(a) Reducing Idle Bank Balance
(b) Increasing Collection
(c) Increasing Creditors
(d) Reducing Bank Transactions.

Q57. Difference between the Bank Balance as per Cash Book and Pass Book may be due to:

(a) Factoring
(b) Overdraft
(c) Float
(d) All of the above.

ANSWERS

1	2	3	4	5	6	7	8	9	10
a	c	c	c	b	a	a	a	b	b
11	12	13	14	15	16	17	18	19	20
a	b	a	b	a	b	a	a	b	b
21	22	23	24	25	26	27	28	29	30
c	b	a	a	b	b	a	b	c	b
31	32	33	34	35	36	37	38	39	40
a	b	d	c	c	a	a	c	a	b
41	42	43	44	45	46	47	48	49	50
c	d	a	d	b	b	c	a	b	c
51	52	53	54	55	56	57			
c	a	d	d	b	b	c			