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FINALTERM EXAMINATION
Spring 2010
MGT201- Financial Management (Session - 1)

Question No: 1 (Marks: 1) - Please choose one

Who determines the market price of a share of common stock?

- ► Individuals buying and selling the stock
- ► The board of directors of the firm
- ► The stock exchange on which the stock is listed
- ► The president of the company

Question No: 2 (Marks: 1) - Please choose one

Which of the following would cause the gross profit margin to remain unchanged, but the net profit margin declined over the same period?

- ► Cost Cost of goods sold increased relative to sales
- ► Sales increased relative to expenses
- ► Govt. increased the tax rate
- ► Di DiDividends were decreased

Question No: 3 (Marks: 1) - Please choose one

ABC's and XYZ's debt-to-total assets ratio is 0.4. What is its debt-to-equity ratio?

- ► 0 .2
- ► 0 .77
- ► 0.667
- ► 0.333

Question No: 4 (Marks: 1) - Please choose one

Which of the following make the calculation of NPV difficult?

- ► Estimated cash flows
- ► Discount rate
- ► Anticipated life of the business
- ► All of the given options

Question No: 5 (Marks: 1) - Please choose one

Who is responsible for the decisions relating capital budgeting and capital rationing?

- ► Chief executive officer
- ► Junior management

► Division heads

► All of the given option

Question No: 6 (Marks: 1) - Please choose one

Mortgage bonds are secured by real property whose value is generally _____ than that of the value of the bonds issue?.

► Higher
► Lower

► Equal

► Higher or lower

Question No: 7 (Marks: 1) - Please choose one

The value of direct claim security is derived from which of the following?

► Fundamental analysis
► Underlying real asset
► Supply and demand of securities in the market
► All of the given options

Question No: 8 (Marks: 1) - Please choose one

Which of the following would tend to reduce a firm's P/E ratio?

► The firm significantly decreases financial leverage
► The firm increases return on equity for the long term
► The level of inflation is expected to increase to double-digit levels
► The rate of return on Treasury bills decreases

Question No: 9 (Marks: 1) - Please choose one

How the beta of a stock can be calculated?

► By monitoring price of the stock
► By monitoring rate of return of the stock
► By comparing the changes in the stock market price to the changes in the stock market index
► All of the given options

Question No: 10 (Marks: 1) - Please choose one

Where the stock points will lie, if a stock is a part of totally diversified portfolio?

- ► It will lie below the regression line
- ► It will line above the regression line
- ► It will line exactly on the regression line
- ► It will be tangent to the regression line

Question No: 11 (Marks: 1) - Please choose one

Why debt is a less costly source of fund?

- ► Because additional interest creates a new form of tax shield
- ► Because additional money creates a new form of tax shield
- ► Because banks extend loan at lower interest rates
- ► None of the given options

Question No: 12 (Marks: 1) - Please choose one

When a firm can acquire another firm?

- ► Only by purchasing the assets of the target firm
- ► Only by purchasing the common stock of the target firm
- ► By either purchasing the assets or the common equity of the target firm
- ► None of the given options

Question No: 13 (Marks: 1) - Please choose one

What is the economic order quantity for an automobile dealer selling 2,000 cars per year, at a cost of Rs.750 per order, and a carrying cost of Rs.300 per automobile?

- ► 40 cars
- ► 71 cars
- ► 100 cars
- ► 126 cars

Question No: 14 (Marks: 1) - Please choose one

The stock in your portfolio was selling for Rs. 40 per share yesterday, but has today declared a three for two stock split. Which of the following statements seems to be true?

- ► There will be two-thirds as many shares outstanding, and they will sell for Rs.60.00 each
- ► There will be four times as many shares outstanding, and they will sell for Rs.160.00 each

► There will be 50 percent more shares outstanding and they will sell for Rs.26.67 each

► There will be one-and-one-half times as many shares outstanding, and they will sell for Rs.60.00 each

Question No: 15 (Marks: 1) - Please choose one

Which of the following's existence on the balance sheet generates tax advantages that directly influence the capital structure of the firm?

► Long-term debt

► Retained earnings

► All of the given answers are correct

► A large proportion of fixed assets

Question No: 16 (Marks: 1) - Please choose one

Which of the following is an example of restructuring the firm?

► Dividends are increased from Rs.1 to Rs.2 per share

► A new investment increases the firm's business risk

► New equity is issued and the proceeds repay debt

► A new Board of Directors is elected to the firm

Question No: 17 (Marks: 1) - Please choose one

While calculating the Stock Portfolio Risk using 3x3 Matrix Approach, the terms shown in Boxes on Diagonal are called:

► Covariance

► Variance

► Coefficient

► Correlation

Question No: 18 (Marks: 1) - Please choose one

What is the basis of CAPM which describes how the expected return of a stock or portfolio is correlated to the return of the financial market as a whole?

► Correlation

► Beta

► NPV

► Cash flow

Question No: 19 (Marks: 1) - Please choose one

Ahmad is a 40-year-old employee and he wants to invest his money. He should put how much money in stocks?

► The amount to be invested is a matter of personal preference, based on the Ahmad's goal for his money

► The amount is a matter of personal preference, based on the investment' risk only

► The rule of thumb suggests that 40% of his assets be in cash/bonds and the remaining 60% in stocks

► The rule of thumb suggests that 60% of his assets be in cash/bonds and the remaining 40% in stocks

Question No: 20 (Marks: 1) - Please choose one

If a stock is part of totally diversified portfolio then which of the following is TRUE for that stock?

► Stock's total Risk = Company Risk

► Stock's total Risk = Market Risk

► Stock's total Risk = Market Risk + Company Risk

► All of the given options

Question No: 21 (Marks: 1) - Please choose one

Which of the following is the characteristic of Arbitrage Pricing Model that offers the greatest potential advantage over the Capital Asset Pricing Model?

► It gives the variability of coefficients of sensitivity for a given asset over time

► It provides accurate measurement of the risk-free rate of return over historical time periods

► It uses several factors instead of a single market index to enlighten the risk-return relationship

► It identifies the anticipated changes in production, inflation and term structure as key factors in explaining the risk-return relationship

Question No: 22 (Marks: 1) - Please choose one

Which of the following is true about the security market line (SML) derived from the Arbitrage pricing model?

► The benchmark portfolio for the Security market line may be any well-diversified portfolio

► The Security market line for the Arbitrage pricing model has an intercept equal to the expected return on the market portfolio

► The Security market line for the Arbitrage pricing model shows expected return in relation to portfolio standard deviation

► The Security market line has a downward slope

Question No: 23 (Marks: 1) - Please choose one

What should be used to calculate the proportional amount of equity financing employed by a firm?

► The book value of the firm

► The sum of common stock and preferred stock on the balance sheet

► The current market price per share of common stock times the number of

shares outstanding

- ► The common stock equity account on the firm's balance sheet

Question No: 24 (Marks: 1) - Please choose one

In the WACC equation ($r_D x_D + r_E x_E + r_P x_P$), $\mathbf{x_E}$ represents which of the following?

- ► Weight or Fraction of Total Capital value raised from bonds
- ► Weight or Fraction of Total Capital value raised from preferred stock
- ► Weight or Fraction of Total Capital value raised from common stock
- ► Weight or Fraction of Total Capital value raised from debentures

Question No: 25 (Marks: 1) - Please choose one

The Impairment of Capital Rule refers to what?

- ► Cash Dividends can only be paid from cash
- ► Dividends can not exceed Retained Earnings
- ► Restricting the dividend payout if earnings are too low to pay interest
- ► Investors buy stocks whose dividend policy they like

Question No: 26 (Marks: 1) - Please choose one

Bird-in-the-hand dividend theory was proposed by which of the following?

- ► Miller Modigliani
- ► Myron Gordon and John Lintner
- ► Henry Fayol
- ► William John and Lehman

Question No: 27 (Marks: 1) - Please choose one

The date on which the right to the current dividend no longer accompanies a stock is termed as:

- ► Declaration Date
- ► Holder-of-record Date
- ► Ex-Dividend Date
- ► Payment Date

Question No: 28 (Marks: 1) - Please choose one

Which of the following industry is not the example of high leveraged firm?

- ► Textile industry
- ► Cement plant
- ► Education sector
- ► I.T industry

Question No: 29 (Marks: 1) - Please choose one

Which of the following current asset investment policy leads firm to maintain small amount of current assets?

- ► Fat cat working capital policy
- ► Lean & Mean working capital policy
- ► Moderate working capital policy
- ► All of the given options

Question No: 30 (Marks: 1) - Please choose one

Which of the following industries is considered as capital intensive?

- ► Pharmaceutical industry
- ► Textile industry
- ► Information technology
- ► Automobile industry

Question No: 31 (Marks: 1) - Please choose one

If total assets of the firm are equal to Rs. 2,000 and debt is Rs. 1,000 then the financial leverage of the firm is equal to which of the following?
(FL = Debt / (Debt + Equity))

- ► 40%
- ► 50%
- ► 60%
- ► 65%

Reference:
FL = Debt / Total Assets

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Question No: 32 (Marks: 1) - Please choose one

Which of the following is called the father of corporate finance?

- ► Prasanna Chandra
- ► Modigliani & Miller
- ► Van Horne & Gittman
- ► Robert Alan Hill

Question No: 33 (Marks: 1) - Please choose one

XYZ Company is financing its seasonal requirements of current assets with short-term debt and permanent requirement of current assets with long term debt. The firm is using which of the following approach to finance its working capital?

- ► Aggressive approach
- ► Conservative approach
- ► Moderate approach
- ► Hybrid approach

Question No: 34 (Marks: 1) - Please choose one

NM Corporation is financing its seasonal as well as permanent requirements of current assets with long term debt. The firm is using which of the following approaches to finance its working capital?

- ► Aggressive approach
- ► Conservative approach
- ► Moderate approach
- ► Hybrid approach

Question No: 35 (Marks: 1) - Please choose one

Mr. A, a sole proprietor has purchased the raw material on credit; this transaction has generated which of the following?

- ► Permanent Financing
- ► Spontaneous Financing
- ► Short-term Loan
- ► All of the given options

Question No: 36 (Marks: 1) - Please choose one

Which of the following is **NOT** a source of spontaneous financing?

- ► Trade credits
- ► Short term loans
- ► Accrued taxes
- ► Wages payable

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Question No: 37 (Marks: 1) - Please choose one

Optimal debt/ equity ratio lies between which of the following range?

- ► 20/80 to 70/30
- ► 30/70 to 50/50
- ► 40/60 to 60/40
- ► 20/80 to 60/40

Question No: 38 (Marks: 1) - Please choose one

Company A and Company B merged together in such a way that the combined value and performance of both these companies is greater than the sum of their separate individual parts. This phenomenon is referred as:

- ► Synergy
- ► Acquisition
- ► Leveraged buy-out
- ► Hostile merger

Question No: 39 (Marks: 1) - Please choose one

Which of the following is not one of the types of merger?

- ► Horizontal Merger
- ► Vertical Merger

► Diagonal Merger
► Conglomerate Merger

Question No: 40 (Marks: 1) - Please choose one

A target firm does not want to be acquired. That's why it has taken an excessive short-term debt to appear unhealthy for the acquiring firm. This phenomenon is referred as:

► White Knight
► Poison Pill
► Leveraged Buy-Outs
► White squire

Question No: 41 (Marks: 1) - Please choose one

Under efficient market, the effect of debt on WACC can be represented with the help of which of the following?

► Straight line
► U shaped curve
► Concave
► Time to time fluctuation

Question No: 42 (Marks: 1) - Please choose one

With the increased rate of total risk of the firm, which of the following will be greatly affected?

► Required rate of return
► Expected rate of return
► Multiple rate of return
► Internal rate of return

Question No: 43 (Marks: 1) - Please choose one

Which of the following is called as spontaneous financing?

► Current assets
► Fixed assets
► Current liabilities
► Fixed liabilities

Question No: 44 (Marks: 1) - Please choose one

Which of the following is NOT the interest rate used for discounting calculation?

► Benchmark interest rate
► Effective interest rate
► Periodic interest rate
► Nominal interest rate

Question No: 45 (Marks: 1) - Please choose one

Which of the following is true about payback period?

- ► The regular payback method recognizes all cash flows over a project's life
- ► It recognizes all cash flows over a project's life, and it also adjusts these cash flows to account for the time value of money
- ► It is useful as an indicator of a project's liquidity as it gives an idea that how long it will take to recover the funds invested in a project
- ► The regular payback method was widely used, but virtually no companies even calculate the payback today

Question No: 46 (Marks: 1) - Please choose one

Which of the following describes a set of projects where only one project can be selected?

- ► Mutually exclusive projects
- ► Supplementary projects
- ► Complementary projects
- ► Independent projects

Question No: 47 (Marks: 1) - Please choose one

Risk can be measured with which of the following statistical tool?

- ► Standard deviation
- ► Range
- ► T- test
- ► Mean, median and mode

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Question No: 48 (Marks: 1) - Please choose one

Which is the best measure for an asset held in a diversified portfolio?

- ► Beta
- ► Variance
- ► Standard deviation
- ► Coefficient of variation

Question No: 49 (Marks: 3)

Why do firms need to invest in net working capital?

Solution:-

There is a need to invest in net working capital because net working capital represents the surplus working capital left with the company after payment of current liabilities; hence more net working capital means company has surplus money for its day to day operations

Question No: 50 (Marks: 3)

What kind of dividend policy is the best one for a firm? **(Give answer in bulleted from only)**

Solution:-

Most managers believe the best dividend policy is one that minimizes the weighted average cost of capital.

- This policy should provide stable payments.
- This policy should maintain investor's confidence.
- This policy should give good signals to investors about the ability of the firm to maintain and increase its wealth
- It should be conservative enough to hold the uncertainty of future payments to a minimum. Cyclical firms should pay low dividends regularly, and an "extra dividend" when economic condition are favorable and profits are high

Question No: 51 (Marks: 5)

What are the advantages and disadvantages of raising capital through equity financing?

Solution:

Advantages

The right business angels or venture capitalists can lead and steer the business to profits and growth. They can add precious value to the existing project and with their expertise and experience they can provide valuable suggestions and advice not to mention the contacts. They can aid in decision making and planning of strategies. The investors would be equally concerned and responsible since it is their money at stake and any progress would reflect in their equity value.

Disadvantages

Raising of equity finance is a time consuming task and also very expensive. All in all you need to spend valuable time satisfying their background checks, project understanding and convincing them to risk their capital in your business. Moreover, once they are in they exercise certain control over the management of the business mostly due to their investment rights in the business. Equity finance leads to dilution of ownership and the legal and regulatory rules associated with finance is very cumbersome and delicate. You need to allocate precious time into explaining the progress of your business to the financers so that they can monitor it.

Question No: 52 (Marks: 5)

Firm A has to decide whether to maintain large amount of current assets or

small amount. What can be the possible benefits the firm can enjoy from both of these?

Solution:-
Advantages of Large Current Assets: less risk of shortages & interruptions and less loss of sales due to availability of funds for loan payments and purchases and inventory.
High Liquidity so better CREDIT Rating.

Advantages of Small Current Assets: Less investment in current assets means less amount of money tied to the assets which are generating no return. So lower Opportunity Cost of Capital.

Question No: 53 (Marks: 5)

Economists categorize mergers into four types. Explain these types with the help of examples.

Solution:-

4 Specific Types of Mergers:
- Horizontal Merger: merger of 2 competitors - can lead to Monopoly
- Vertical Merger: merger of a supplier with a buyer
- Co generic Merger: merger of firms in same industry
- Conglomerate Merger: merger of firms in unrelated industries