Name: **Enrolment No:**	UPES UNIVERSITY WITH A PURPOSE

UNIVERSITY OF PETROLEUM & ENERGY STUDIES

End Semester Examination (Online) – July, 2020

Program: B.Com (BMI)+ Taxation **Semester : II**

Subject/Course: Financial Management **Max. Marks: 100**

Course Code: FINC 2019 **Duration : 3 Hours**

IMPORTANT INSTRUCTIONS

1. *The student must write his/her name and enrolment no. in the space designated above.*
2. *The questions have to be answered in this MS Word document.*
3. *After attempting the questions in this document, the student has to upload this MS Word document on Blackboard.*

		Marks	COs
Q.1	"The Profit Maximization is not an operationally feasible criterion" Do you agree? Illustrate your views?	20	1
Q.2	How company assess their Working Capital Requirement?	20	2
Q.3	How Capital Structure is constructed considering the impact on value of the firm and Cost of Capital by following NOI Model?	20	3
Q.4	How effective rate and revised effective rate is assessed? How these rates will affect assessment of FV of Annuity and PV of Annuity?	20	4
Q.5	**Read the case and answer the following questions** The capital asset pricing model (CAPM) is a mathematical model that offers an explanation about the relationship between investment risk and return. By dividing the covariance of an asset's return by the variance of the market, an asset value can be determined. To ascertain the risk level of a particular asset, the market is evaluated as a whole. Unlike the DCF model, the time value of money is not considered. This model assumes the investors understands the risk involved and trades without cost. Two types of risk is associated with the CAPM model: unsystematic and systematic. Unsystematic risks are company-specific risk. For example, the value of an asset can increase or decrease by changes in upper management or bad publicity. To prevent total loss, the model suggests diversification. Systematic risk is due to general economic uncertainty. The marketplace compensates investors for taking systematic risk but not for taking specific risk. This is because specific risk can be diversified away. Systematic risk can be measured using beta. For example, suppose a stock has a beta of 0.8.	20	5

The market has an expected annual return of 0.12 and the risk-free rate is .02 Then the stock has an expected one-year return of 0.10.

$Ke = .02 + .8[.12 - .02] = 0.10$

According to CAPM, the value of an asset fluctuates because of unpredictable economic shifts. The basis for CAPM is that asset risk is measured by the variance of its return over future periods. (McCullough, 2005) Assets with β < I will display average movements in return less extreme than the overall market, while those with a > I will show return fluctuations greater than the overall market. All other measures of risk is not important. CAPM works best for long-term investments. Ki = the required return on asset i

Rf = risk-free rate of return on a U.S. Treasury bill

βi = beta coefficient or index of non-diversifiable risk for asset i

km = the return on the market portfolio of assets

The Discounted Cash Flow Method, (DCF) summarizes a company cash flow to reflect the time value of money. It can be used to evaluate or compare investments or purchases. Unlike CAPM, DCF uses the present value concept. It puts forth the idea that money invested today should be worth more than money received in the future. Thus, the value of money received in the future is discounted to reflect its lesser value. DCF can be applied to various situations. Business can use the method to prepare budgets and make projections. It can also be used to analyze receipt and disbursements for a particular project or activity. A disadvantage of using DCF is that the model is based on assumptions. (Block, 2008). Predicting future cash flows can be challenging. If the information used to make an investment decision proves to be incorrect, the value of an asset will decline. The success of this model depends on the investor's ability to make good future projections. The advantage of the CDF models is that it allows an investor to track an organization's cash flow. DCF also provides information that allows investors to compute the value of organization.

Long-term financing provide capital deficit businesses funds for the period over 1 year. To achieve balance in their capital structure, corporations may offer preferred or common stock, leasing or bonds.

For most large US companies, bonds are offered as means of raising revenue. A bond typically includes the par or face value, coupon rate and maturity date. A detailed summary of the terms can also be found on the bond indenture. This legal document is administered by an independent financial trustee. In case of default, the trustee can liquated pledged assets or secured debt to bondholders. Debenture or unsecured bonds are offered by some corporations. Rather than offering specific items as collateral, debenture bonds allows a general claim to be placed against assets. Various repayment methods are available to corporations when bonds mature. In addition to the lump-sum single payment, serial payment and conversions are available options. Serial payments are paid on an installment basis according to their serial number. Conversions are used to retired outstanding debt by converting bonds to common stock. Bond debt offers tax-deductible interest payments. The drawback of bond financing is the debt must be repaid regardless of the economic condition of the company .

Long-term leasing has become a popular way for business to finance debt. As such FASB requires certain leases to be included in financial statements. A capital lease or financing lease must be reflected on an organization's balance sheet. In comparison to an operating lease, which is usually short-term, a capital lease is a long term obligation. It also transfers ownership of the property to the lessee at the end of the lease. A capital lease also affects the income statement. The property is amortized over the life of the lease and the expense is deducted on an annual basis. Long-term leasing is a lucrative business. The advantage of this type of financing is the lack of a required down payment;

lease obligations are not as restrictive as a bond agreement. Tax benefits such as depreciation on equipment and lease payment on land is tax deductible.

Issuing stock is another tool organizations can use to finance business activities. Offering common stock allows organizations to generate income while relinquishes ownership. Long-term financing is more often associated with the need for fixed assets such as property, manufacturing plants, and equipment where the assets will be used in the business for several years. It is also a practical alternative in many situations where short-term financing requirements recur on a regular basis some control over the organization. Common stock gives shareholders ownership rights and the right to elect board members. Additionally, common stockholders have a residual claim to income. That is all income that is not allotted to preferred shareholders belongs to common shareholders. While a preferred stockholder does not have ownership in a corporation, they have first claims to dividends. Unlike interest due on bonds, it is not mandatory for corporations to pay dividends to preferred stock holders.

Q 1: What are the risks discussed in CAPM Model? **10 Marks**

Q 2: How Ke is assessed using CAPM Model **5 Marks**

Q 3: What are the various means of raising revenue in US Companies ? **5 Marks**

ANSWERS