K. J. SOMAIYA INSTITUTE OF MANAGEMENT STUDIES AND RESEARCH

Program: PGDM (Core) III Trimester (Batch 2018-2020)

Subject: Financial Management
(End Term examination)

Maximum Marks: 50

Date: 01/04/2019

Notes:
1. All questions carry equal marks. There are 5 questions
2. Answer all questions
3. Make suitable assumptions if required and state them
4. It is an OPEN BOOKS examination and students are allowed to use ONLY OWN books, notebooks and calculators.

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1. In evaluating the performance of a company, which three ratios you feel would be enough to get an understanding of the financial situation of the firm. Explain

2. We claim that the goal of the firm is to maximise shareholders wealth. Are the following actions necessarily consistent with that goal?
a. The firm donates Rs. 3 lacs to the local art museum.
b. The firm reduces its dividend payment, choosing to reinvest more of earnings in the business.
c. The firm buys a corporate jet for its executives.

3. Captivate Remodeling is a small, owner-managed construction company. The owner, Venkat, typically works on a single residential remodeling project at a time. The business is very simple because Venakt does not carry any inventory. The project is completed in four months, on average; thus, Venkat can take on three projects each year. The total cost that he bills to his clients averages Rs. 400,000, so he books revenues of Rs. 1,200,000 per year. After accepting a project, Venkat collects the payments from his client in two installments. He collects the first installment of Rs. 200,000 at the end of the second month, and the balance of Rs. 200,000 at the end of the project (i.e., at the end of four months). Venkat's expenses are largely payments to his subcontractors (e.g., plumbers, electricians, and so on). Venkat pays all his subcontractors every week once they start on the job (for simplicity, assume that he pays his subcontractors four times a month). His margin on a project is 10%, so his payment for expenses every week is, on average, Rs. 22,500. Venkat is constantly being asked to take on more projects due to his excellent reputation. He also has an excellent network of subcontractors and could easily take on more projects. He is thinking about taking on six projects each year and, instead of working on a single project at a time, working on two overlapping projects simultaneously.
a. How much capital will Venkat need to double his business?
b. If Venkat has only half the capital needed and cannot obtain any additional loans, what

possible avenues exist for him to achieve this growth?

4. Aparna Singal runs a specialist food store in Mumbai. The store specializes in hard-to-find food and condiments. The store keeps an inventory that, valued at cost, is approximately Rs. 1.2 million. The store generates average sales of Rs. 2 million per year, with an operating margin of 8% (after tax). News about her excellent foods has spread, and Aparna is considering opening an online retail option for the limited selection of the most popular products. Many of these products are sourced from around the world and involve long lead times. Aparna would need to order a number of these items in advance to make sure she has adequate supplies. She estimates that the online channel can generate an additional Rs. 400,000 in sales per year. She would have to spend about Rs. 150,000 upfront to build a robust online store website. (She estimates that the cost of capital for a small business like hers is about 15%.) Aparna also expects the operating margins from the business to be the same as her existing business. Assuming that additional sales from the online channel will be sustained for the foreseeable future (in perpetuity), is this project worth undertaking?

5. Your brother-in-law offers you the opportunity to invest Rs. 15,000 in a project that he promises will return Rs. 17,000 at the end of the year. Because you have only Rs. 3,000 in cash, you will have to borrow Rs. 12,000 from a bank. The bank charges interest at 12%. After reflection, you decide not the accept the offer because you figure the net return would only be Rs.15,560 (Rs.17,000 less Rs.1,440 interest paid to the bank). When your brother-in-law asks why, you tell him that because the bank charges you 12%, it is ridiculous for him to expect you to invest in a risky project that returns less than 4%. Please comment.

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