VPM's
DR VN BRIMS, Thane
Programme: PGDM (2015-17)
Second Trimester Examination January 2016

Subject	Financial Management		
Roll No.		Marks	60 Marks
Total No. of Questions	7	Duration	3 Hours
Total No. of printed pages		Date	03.02.2016

Note: Q1 is compulsory and solve any FOUR from the remaining SIX questions.

Q1) 20 Marks (Compulsory)

After running as a family business for over 100 years, when in late 1990s the management of the Dabur was handed over to a team of professional managers, the new management faced a gigantic task of improving performance in several critical areas. In particular, working capital and cost management required urgent attention as the company's performance in these areas had been far from satisfactory. The then prevailing current ratio of 3.2 and quick ratio of 2.4 were considered too high and indicative of heavy unnecessary investments in working capital that would have a negative effect on company's profitability.

Efforts to improve the working capital efficiency were met with stiff resistance from various quarters, but finally yielded results. The case study discusses the measures taken to improve the working capital and cost management performance, and how with concerted efforts the management turned around a highly inefficient working capital management into one of the most efficizent in the FMCG sector of Indian Industry. In fact, the company seemed to have taken the matter to the other extreme of negative working capital, with the current ratio declining to 0.8 and the quick ratio to just 0.4 in 2004-05.

In 2005-06 as the company was ready to launch itself into the next phase of fast growth, several critical issues related to the liquidity and solvency of the company confront the management which are also discussed in the case study.

"How could a company have a 'negative' working capital and call itself successful?" Bo asked his friend Sharad. They had just joined Dabur India as Management Trainees and at the moment were having their lunch in the company's staff canteen. Bo (nick named for Bose) had spent the morning studying the company's balance sheets for the years 2003-04 and 2004-05 and was surprised to see that the company's current liabilities exceeded its current assets. He remembered reading in his textbooks that such a situation indicated that the company could face difficulties in meeting its short-term liabilities.

"I don't know about that", Sharad replied, "but I think it is a highly profitable company."
"Sure, no problem with the company's profitability. In fact the net profit in 2004-05 jumped by as much as46% to Rs 148 Crore from Rs 101 Crore last year."
"Wow, that's a lot of increase in one year," Sharad said, "In fact I am told the company has an impressive market share in its product line and is the fourth largest FMCG company in India. But if the company is making high profits and has a good market share, then where is the problem?"
Bo was ready with his reply, "The way I understand, that could be a common trap for the profitable but fast growing companies. Liquidity and profitability are two separate issues and it is naïve to assume that a profitable company would necessarily be liquid too. See, what happens is that in order to provide finance for expansion and diversification projects, a company could cut down on inventories, reduce the credit period to customers while at the same time seek extended credit facilities from its suppliers of raw materials, other goods and services. Also, it tries to manage with nil or as little cash in hand as possible. As a result, the current assets represented by inventories, debtors and cash would be reduced and current liabilities represented by creditors would increase, culminating in a situation when the company might not have enough current assets to pay for its current liabilities if all creditors wanted them to be settled at once, what to talk about leaving some surplus to continue with its normal business operations." Bo said emphatically.

Dabur India's corporate office was housed in a beautifully landscaped, imposing six storied glass building set on several acres of prime land at Kaushambi adjacent to New Delhi. "Well, if the company can make its working capital more efficient, I don't see any body should have a problem with that. But don't forget we have an orientation meeting with the finance department in a little while from now."

Sharad looked at his watch, "My friend, the times are changing. Reduction in inventory and debtors could Bo was too engrossed with his own thoughts to be affected by such interruption, and continued, "The traditional wisdom of having a positive net working capital means that at least some part of the working capital finance should come from the company's long term sources so that at any time, even if the company has to settle all its current liabilities at once, it would still be left with some minimum current assets with which it could continue to do its normal business. In technical terms, they say a company needs some permanent working capital and a fluctuating working capital. From what I have read, ideally the permanent working capital and may be some part of the fluctuating working capital also should be financed out of the company's long-term sources in order to ensure good liquidity and avoid the threat to its solvency."as well be a management strategy. The Japanese have shown the world how to manage with zero inventories. As far as debtors are concerned, when a firm can sell on cash or near cash terms, why should it sell on credit just to make the balance sheet fit in to your traditional wisdom? Modern enterprises have to be efficient, lean and mean, if we could put it that way, to remain competitive."

Bo did not like this argument and said, "You don't get the point, do you? Once a company defaults on payment of any of its current liabilities, the word spreads like wild fire and affects the company's image and credit rating. With lower credit rating, not many lenders would come forward if it wanted to borrow more, and even if they do, it would cost the company dearer. All this might just start a roller coaster the company might not have bargained for."

Sharad did not like Bo's habit of lecturing, and firmly said, "Bo, come out of the textbooks. I think there's more to liquidity than just the ratio of current assets and current liabilities." Then getting up he said, "Any ways, let's not be late for the orientation meeting. We can continue with our discussion later on."

The stage was already set for the orientation meeting by the time Bo and Sharad walked in. The meeting had a touch of professional perfection and was more detailed and thorough than they had anticipated. Mr. D.K. Chhabra, Additional GM - Financial Planning, made an impressive PowerPoint presentation and dealt with many aspects including the company's history, handing over of the management to professional team, current challenges and future strategy.

Q1) What do you think are the advantages and disadvantages of a 'negative' net working capital policy? If you are the CFO of a company, which policy would you like to follow and why?

Q2) What is the importance of cost control and reduction in the emerging business environment? Using Dabur India's experience as an illustration, discuss the techniques or methods that a company could use to reduce costs.

Q2) ***Any one from (a) or (b)*** ***10 Marks***

A) What is the future value of an annuity which pays Rs.25000 per year at the end of the each next 15 years, given the investment is to earn 11% rate of return ?

B) Explain the structure of financial markets in India

Q3) ***Any one (a) or (b)*** ***10 Marks***

A) The operating income of Hypothetical Ltd.amounts to Rs 186000. It pays 35% on iits income . Its capital structure consists of following

14% Debentures 5,00,000, 15% prefenec shares 1,00,000

Equity shares (Rs 100 each) 4,00,000 Determine the firms EPS. Determine the degree of financial leverage at the current level of EBIT

B) Explain difference between money market and capital market

Q4) ***Any one from (a) or (b))*** ***10 Marks***

Q4) Following information is available from the books of XYZ Ltd

	Rs In Lakhs
Sales	500
Cost of Raw Materials	200
Labour cost for manufacturing	100
Interest on borrowings	60

The capitalization rate for debt is 10% and capitalization rate for the entire firm is 12.5%.Assuming that the firm does not retain any earnings and there is no tax ,What is the total market value of firm ?What is the equity capitalization rate

B) Explain working capital cycle. What is its importance in business. Can companies manage the business with negative working capital.

Q5) ***Any one from (a) or (b))*** ————— ***10 Marks***

A) 'A firm has sales of Rs. 10,00,000/- Variable cost is 70% Total cost is Rs 900000/- and debt of rs 5,00,000 at 10%rate of interest .If the tax rate is 40% calculate

Operating leverage,Financial leverage &Combined Leverage

B) What is financial system? Explain the structure of financial system in India.

Q6) ***Any two from (a) or (b)*** ***10 Marks***
A) Write short notes on 1) stock markets and its types 2. IPOS .

B) What is the present value of Rs.10,00,000 which you would get at the end of 10 years, given the average inflation in the interim is say 8% per annum, in the following cases ?

Q7) ***Any two from (a) or (b)*** ***10 Marks***

A) Explain the importance of capital structure decisions in an orgaisation

B) A firm has total sales of Rs 15 lacs with 40% variable cost and the total cost of Rs 900000/- It also has debt of Rs 8,00,000,at 10% rate of interest .If the tax rate is 45% Calculatea)operating leverage financial leverage &combined leverage