Financial Management

Previous Years' CBSE Board Questions

9.1 Financial Management: Concept, Role and Objective

VSA (1 mark)

1. State the objective of 'Financial Management.
(2020 C, AI 2014)

2. What is meant by 'financial management?
(Delhi 2017)

3. Is Management concerned only with doing the right task, completing activities and achieving goals without taking into consideration the cost benefit? Give reason in support of your answer. **(AI 2016)**

SA I (3 marks)

4. Give the meaning of Financial Management. State its main objective.
(NCERT, Delhi 2019)

5. Somnath Ltd. is engaged in the business of export of garments. In the past, the performance of the company had been upto the expectations. In line with the latest technology, the company decided to upgrade its machinery. For this, the Finance Manager, Dalmia estimated the amount of funds required and the timings. This will help the company in linking the investment and the financing decisions on a continuous basis. Dalmia therefore, began with the preparation of a sales forecast for the next four years. He also collected the relevant data about the profit estimates in the coming years. By doing this, he wanted to be sure about the availability of funds from the internal sources of the business. For the remaining funds, he is trying to find out alternative sources from outside. Identify the financial concept discussed in the above para. Also state the objectives to be achieved by the use of financial concept, so identified.
(Delhi 2017)

9.2 Financial Decisions: Investment,

Financing and Dividend - Meaning and Factors Affecting

MCQ

6. 'Temptations' is a food joint in Imperial Mall in Bengaluru. It is becoming popular among students and working people due to healthy, on-the-go dishes on its menu like 'Paneer Wrap', 'Chickpeas Salad', 'Grilled Sandwiches, etc. It has now decided to open two new branches in other parts of Bengaluru. Which financial decision has been discussed in the above case?

(a) Long-term investment decision

(b) Short-term investment decision

(c) Dividend decision

(d) Financing decision

(2020 C)

VSA (1 mark)

7. Koby Ltd. is an 87-year-old reputed consumer goods company. It is known for offering good quality electronic products at reasonable prices. It has branches all over India. It has a large shareholder base. The shareholders desire that some dividend is paid every year on their investments. Company's management understands that it is important to keep the shareholders happy and satisfied. As a matter of policy, they declare a certain amount of dividend every year out of profits rather than reinvesting the whole as retained earnings. Identify the factor affecting dividend decision being highlighted in the above situation.
(Foreign 2019)

8. The size of assets, the profitability and competitiveness are affected by one of the financial decisions. Name and state the decision.
(Delhi 2016)

9. Besides the investment decision the finance function is concerned with two other broad decision. Name these decisions.
(Delhi 2015 C)

10. Besides financing decision the finance, function is concerned with two other broad decisions. Name these decisions.
(Delhi 2015 C)

11. Besides the dividend decision, the finance function is concerned with two other broad decisions. Name these decisions.
(AI 2015 C)

12. What is meant by 'Financial Risk'?
(AI 2014)

SA I (3 marks)

13. State any three factors affecting the dividend decision. **(2023, Term-II, 2021-22)**

14. Give the meaning of 'Investment' and 'Financing' decisions of financial management. **(AI 2014)**

15. Give the meaning of 'Investment decision' and 'Dividend decision.
(AI 2014 C)

16. Explain the factors that affect capital budgeting decision.
(Delhi 2014 C)

SA II (4 marks)

17. What is meant by 'Investment Decision'? State how 'Long term Investment Decision' and 'Short term Investment Decision' affect the business.
(2023)

18. Explain any two factors that affect the dividend decision of a company.
(2021 C, 2020 C)

19. Explain any two factors that affect the Financing decision of a company.
(2021 C)

LA (5 marks)

20. NB Ltd. is India's largest manufacturer of cement. Its operations are spread throughout the country with 17 modern cement factories. It has a workforce of 9,000 persons. Since its inception, the company has been a trendsetter for the cement industry. The company is planning to grow in long-run and wants to double its capacity in next 3 years. For this, Finance Manager has to decide about the quantum of finance to be raised from various long-term sources. For this, he needs to identify various available sources of funds and the proportion of funds from each source.

(i) Identify the financial decision to be taken by the Financial Manager.

(ii) State any four factors which would affect the decision identified in (i) above.
(Term-II, 2021-22)

21. Anant Ltd. is a company dealing in ready-made garments from last many years. Recently, the profit of the company has started increasing. The finance manager decided to retain the profit instead of distributing it among shareholders.

(i) Identify and state the financial decision taken by finance manager in the above case.

(ii) state any three factors affecting the decision identified in (i) above.
(Term-11, 2021-22)

22. Ravi has joined as a finance manager in MTA Ltd. He had to arrange funds of rupees one crore for the company. The Chief Executive Officer of the company wants to arrange the funds by a public issue whereas the finance manager wants to have a mix of debt and equity as this will determine the overall cost of capital and the financial risk of the enterprise.

(i) Identify and give the meaning of the financial decision suggested by the finance manager in the above case.

(ii) State any three factors affecting the decision identified in (i) above.
(Term-11, 2021-22)

23. 'A.M. Motors Ltd. is a leading company in car manufacturing. Due to the changing environment and initiatives taken by the Government of India, the company wants to enter into manufacturing of e-cars also. For this project the company requires 2,000 crores. But before purchasing the machines and other assets, the finance manager has to assess the degree of risk involved in the project as this type of decision affects the earning capacity of the business over the long run. Besides this, there are various other factors which may affect this decision of the finance manager.

(i) Identify and state the financial decision discussed in the above para.

(ii) State any two factors that may affect the decision of the finance manager identified in (i) above.

(Term-II, 2021-22 C)

24. Sun Industries Ltd. is a leading company in India which manufactures steel. Its plants are located in Jamshedpur and Bokaro. Currently it produces about three million tonnes of saleable steel. As the demand for steel is growing, it is planning to expand the capacity of the existing steel plants. It is estimated that it will require < 1,800 crore of fixed capital and < 200 crore of working capital. To raise the funds, the company is considering whether it should issue equity shares or 7% debentures of <2,000 crore. Presently the capital structure is comprising of equity only. The Finance Manager of the company suggested that since the stock markets are undergoing a bearish phase, it should issue debentures.

(a) Is it justified to raise funds by issuing debentures? Give reason in support of your answer.

(b) Explain the impact of issue of debentures on the risk faced by the company.

(c) Explain the impact of 'cost of debt' and 'cost of equity' on the capital structure of the company.

(2020 C)

ET (6 marks)

25. 'Sarah Ltd. is a company manufacturing cotton yarn. It has been consistently earning good profits for many years. This year too, it has been able to generate enough profits. There is availability of enough cash in the company and good prospects for growth in future. It is a well-managed organisation and believes in quality, equal employment opportunities and good remuneration practices. It has many shareholders who prefer to receive a regular income from their investments.

It has taken a loan of ₹40 lakhs from IDBI and is bound by certain restrictions on the payment of dividend according to the terms of loan agreement. The above discussion about the company leads to various factors which decide how much of the profits should be retained and how much has to be distributed by the company. Quoting the lines from the above discussion, identify and explain any four such factors.
(Delhi 2015)

26. 'Abhishek Ltd.' is manufacturing cotton clothes. It has been consistently earning good profits for many years. This year too, it has been able to generate enough profits. There is availability of enough cash in the company and good prospects for growth in future. It is a well-managed organisation and believes in quality, equal employment opportunities and good remuneration practices. It has many shareholders who prefer to receive a regular income from their investments.

It has taken a loan of 50 lakhs from ICICI Bank and is bound by certain restrictions on the payment of dividend according to the terms of the loan agreement.

The above discussion about the company leads to various factors which decide how much of the profits should be retained and how much has to be distributed by the company.

Quoting the lines from the above discussion, identify and explain any four such factors. **(Al 2015)**

27. Explain the following as factors affecting dividend decision:

(i) Stability of earnings. (ii) Growth opportunities;

(iii) Cash flow position and (iv) Taxation policy.
(Delhi 2014)

9.3 Financial Planning-Concept and Importance

MCQ

28. Which of the following statements does not highlight the importance of financial planning?

(a) Detailed plans of action prepared under financial planning increase waste, duplication of efforts and gaps in planning.

(b) It helps in forecasting what may happen in future under different business situations.

(c) It provides a link between investment and financing decisions on a continuous basis.

(d) It helps in avoiding business shocks and surprises and helps the company in preparing for the future.
(2023)

VSA (1 mark)

29. 'XY Ltd' is registered with an authorised capital of 10 crore. The paid-up capital of the company is 6 crores. The company was facing shortage of funds. The management of the company decided to raise funds by issue of 1,00,000 equity shares of 100 each. The issue was fully subscribed. After this it was realised that the funds raised were in excess of the actual requirement.

Identify and define the concept which was not considered by the company before deciding the amount of funds to be raised.
(Foreign 2019)

30. Name and state the aspect of financial management that enables to foresee the fund requirements both in terms of the quantum and the timings.
(Al 2016)

SA II (4 marks)

31. Harish is working as a finance manager in 'Kozee Softwares Ltd. He has been awarded 'Best employee of the year award because of his foresightedness. He always aims at smooth operations of all the financial activities by focusing on fund requirements and their availability in the light of financial decisions. He takes into consideration the growth, performance, investments and requirement of funds for a given period so that financial resources are not left idle and don't unnecessarily add to the cost. By doing all this, Harish strives to achieve the two main objectives of an important concept of financial management. Identify the concept and explain its two objectives.

(2023)

9.4 Capital Structure - Concept & Factors

Determining Capital Structure

MCQ

32. Which of the following is not a factor affecting capital structure of a company?

(a) Cost of Debt

(b) Growth Opportunities

(c) Cash Flow Position

(d) Interest Coverage Ratio

(2023)

33. ____________ refers to the increase in profit earned by the equity shareholders due to the presence of fixed financial charges like interest.

(a) Capital structure

(b) Earning per share

(c) Trading on equity

(d) Return on investment

(2023)

VSA (1 mark)

34. How does 'Cost of Debt' affect the capital structure of an enterprise?
(Delhi 2019)

35. Rizul Bhattacharya after leaving his job wanted to start a Private Limited Company with his son. His son was keen that the company should start manufacturing of mobile phones with some unique features. Rizul Bhattacharya felt that the mobile phones are prone to quick obsolescence and a heavy fixed capital investment would be required regularly in this business. Therefore, he convinced his son to start a furniture business.

Identify the factor affecting fixed capital requirement which made Rizul Bhattacharya to choose furniture business over mobile phones.
(AI 2016)

36. A textile company is diversifying and starting a steel manufacturing plant. State with reason the effect of diversification on the fixed capital requirements of the company. **(Delhi 2015 C)**

37. How does 'Cost of Equity' affect the capital structure of an enterprise?
(AI 2015)

SA I (3 marks)

38. What is meant by 'Capital Structure? Explain any two factors that affect the capital structure of a company.
(Delhi 2019)

39. The Return on Investment (ROI) of a company ranges between 10-12% for the past three years. To finance its future fixed capital needs, it has the following options for borrowing debt:

Option 'A': Rate of interest 9%

Option 'B': Rate of interest 13%

Which source of debt, 'Option A' or 'Option B', is better? Give reason in support of your answer. Also state the concept being used in taking the decision.
(AI 2018)

SA II (4 marks)

40. 'X Ltd. issued 14% Debentures of ₹ 4,00,000 and 10,000 Equity shares of 60 each. This investment resulted in a net profit of 2,00,000 before interest and tax. The tax rate was 50%.

(a) Calculate the 'Return on Investment' and 'Earning per Share' of 'X Ltd.

(b) State with reason whether the above example is that of favourable or unfavourable financial leverage.
(2023)

LA (5 marks)

41. 'Determining the relative proportion of various types of funds depends upon various factors. Explain any five such factors.
(Delhi 2014)

ET (6 marks)

42. 'Viyo Ltd., is a company, manufacturing textiles. It has a share capital of 60 lakh. The earning per share in the previous year was 0.50. For diversification, the company requires additional capital of 40 lakh. The company raised funds by issuing 10% debentures for the same. During the current year, the company earned profit of 28 lakh on capital employed. It paid tax @ 40%.

(a) State whether the shareholder gained or lost, in respect of earning per share on diversification. Show your calculations clearly.

(b) Also, state any three factors that favour the issues of debentures by the company as part of its capital structure.
(Delhi 2016)

43. Explain the following as factors affecting the choice of capital structure:

(i) Cash flow position (ii) Cost of equity

(iii) Floatation costs (iv) Stock market conditions
(AI 2014)

9.5 Fixed and Working Capital - Concept and Factors Affecting their Requirements

MCQ

44. During the Covid-19 pandemic, the restaurant industry faced many challenges. The slowdown led to huge decrease in demand. From April 2022, the effect of Covid started reducing. The economy started picking up and a boom was noticed in the restaurant industry. As a result, larger amount of working capital was required with increased production and sales.

The factor affecting the working capital requirement discussed above is:

(a) Seasonal factor (b) Production cycle

(c) Operating efficiency (d) Business cycle.

(2023)

45. Match the factors affecting fixed capital requirements in the Column-I with their explanations given in Column-II.

Column I		Column II	
A.	Nature of business	(i)	A trading organisation needs lower investments in fixed assets as compared to a manufacturing organisation.
B.	Technology upgradation	(ii)	A textile manufacturing company is installing a cement manufacturing plant and thus its investments in fixed assets is increasing.
C.	Diversification	(iii)	A capital-intensive organisation requires higher investments in fixed assets as compared to labour-intensive organisation.
D.	Choice of technique	(iv)	Mobile phones became obsolete faster and are replaced much sooner than furniture or many other assets. Hence these type of businesses require more fixed capital.

	A	B	C	D
(a)	(i)	(iv)	(ii)	(iii)
(b)	(ii)	(iii)	(iv)	(i)
(c)	(iii)	(ii)	(i)	(iv)
(d)	(iv)	(i)	(iii)	(ii)

(2023)

VSA (1 mark)

46. Organisations which choose to diversify their operations require ___________ fixed capital. (more/less)
(2020 C)

47. In the paint industry, various raw materials are mixed in different proportions with petroleum for manufacturing different kinds of paints. One specific raw material is not readily and regularly available to the paint manufacturing companies. Bonler Paints Company is also facing this problem and because of this there is a time lag between placing the order and the actual receipt of the material. But once it receives the raw materials, it takes less time in converting it into finished goods.

Identify the factor affecting the working capital requirements of this industry.
(AI 2018)

48. Radhika and Vani who are young fashion designers who left their job with famous fashion designer chain to set-up a company 'Fashionate Pvt. Ltd'. They decided to run a boutique during the day and coaching classes for entrance examination of National Institute of Fashion Designing in the evening. For the coaching centre, they hired the first floor of nearby building. Their major expense was money spent on photocopying of notes for their students. They thought of buying a photocopier knowing fully that their scale of operations was not sufficient to make full use of the photocopier.

In the basement of the building of 'Fashionate Pvt. Ltd: Praveen and Ramesh were carrying on a printing and stationery business in the name of 'Neo Prints Pvt. Ltd. Radhika approached Praveen with the proposal to buy a photocopier jointly which could use by both of them without making separate investment, Praveen agreed to this.

Identify the factor affecting fixed capital requirements of 'Fashionate Pvt. Ltd.
(Delhi 2016)

49. 'Indian Logistics' has its own warehousing arrangements at key locations across the country. Its warehousing services helps business firms to reduce their overheads, increase efficiency and cut down distribution time.

State with reason, whether the working capital requirements of Indian Logistics will be high or low.

(Delhi 2015)

OR

'Bharat Express' specialises in Courier Services, its wide range of express package and parcel services help business firms to make sure that the goods are made available to the customers at the right place and at the right time.

State with reason, whether the working capital requirements of 'Bharat Express' will be higher or low.
(AI 2015)

SA I (3 marks)

50. Explain any three factors that affect the working capital requirements of a company.

(NCERT, Delhi 2019)

51. Indian equity markets are going through a phase of boom. There is a huge growth potential for innovative technologies. This has resulted in lots of new ventures lying for a market share and old enterprises trying to keep up with the pace with which changes are taking place in the economy. This technological innovation has helped even smaller businesses to compete on a global scale.

Identify and explain the three factors highlighted above which affect the working capital requirements of such enterprises.
(Delhi 2019)

SA II (4 marks)

52. Explain the following factors affecting the working capital requirements of an enterprise:

(i) Nature of business

(ii) Availability of raw material

(2023)

53. Rajesh wants to start a small factory for producing Hand Sanitizers. For establishing the plant and acquiring other fixed assets he needs ₹ 80 lakh. Explain any two factors which affect the requirement of fixed capital of this company.
(2021 C)

54. 'R.K. Fertilizers Ltd. has planned to set up a plant for manufacturing urea fertiliser which has very high market potential as there is excess demand as compared to supply. The company is planning to operate at a higher scale which will require a bigger plant, more space, etc. The company has also planned to replace its plant and machinery as the same are prone to obsolescence with the change in technology. To meet the growing demand of fertilisers that may result in increase in profits, the company is also planning to diversify its operations. It wants to enter in the area of cement manufacturing. Thus, it is a capital-intensive project involving an investment of ₹ 3,000 crore.

Identify and state any five factors affecting the fixed capital requirements of 'R.K. Fertilisers Ltd. discussed in the above para.
(Term-11,2021-22 C)

55. From last many years, in the month of November, due to sudden rise in the pollution levels in Delhi and other parts of northern India, there has been an increase in the demand for air purifiers. Inderprastha Technologies Ltd., a manufacturer of air purifiers wants to encash this opportunity and wants to raise its investment in stock. It is expected that this decision would increase the rate of profitability of the business. Due to this many competitors have recently entered in this industry. In order to increase the sales, the company has started selling air purifiers on liberal credit terms. It is not affecting the profits of the company since the production cycle of the product is short. Identify and state any two factors that 'Inderprastha Technologies Ltd.' will keep in mind before deciding its working capital requirements. Also state three other factors which should be kept in mind while deciding the working capital requirements of a company.
(2020 C)

ET (6 marks)

56. Explain the following as factors affecting the requirements of working capital:

(i) Nature of business

(ii) Scale of operations

(iii) Seasonal factors

(iv) Production cycle
(AI 2014)

57. Explain how the following factors affecting the working capital requirements of a business:

(i) Inflation,

(ii) Business cycle,

(iii) Level of competition and

(iv) Nature of business.
(AI 2014)

CBSE Sample Questions

9.2 Financial Decisions: Investment,

Financing and Dividend - Factors Affecting

SA II (4 marks)

1. State any four factors affecting the financial decision that is concerned with raising of finance using shareholders' funds and borrowed funds.

(2022-23)

LA (5 marks)

2. Vansh Limited is a large and reputed company which manufactures ventilators. After the outbreak of 'COVID-19' in 2020, the company witnessed an increase in revenue by 40%. It has plans to further increase its production capacity and also start production of PPE kits, sanitisers and masks in 2022. The Finance manager of the Company, Mr. Rajiv feels confident about the future of the company and its liquidity position. Discuss the meaning of Dividend Decision and in the light of the above statement explain any two factors which should be considered by 'Vansh Limited' while formulating the dividend policy of the company.

(Term-II, 2021-22)

9.4 Capital Structure - Concept & Factors

Affecting Capital Structure

LA (5 marks)

3. Vedansh Limited has a share capital of ₹ 10,00,000 divided into shares of ₹ 100 each. For expansion purpose, the company requires additional funds of ₹ 5,00,000. The management is considering the following alternatives for raising funds:

Alternative 1: Issue of 5000 Equity shares of ₹ 100 each

Alternative 2: Issue of 10% Debentures of Rs. 5,00,000 The company's present Earnings Before Interest and Tax (EBIT) is ₹ 4,00,000 p.a. Assuming that the rate of Return of Investment remains the same after expansion, which alternative should be used by the company in order to maximise the returns to the equity shareholders. The Tax rate is 50%. Show the working.

(Term-11, 2021-22)

4. Explain any four factors that affect the choice of capital structure of a company. **(2020-21)**

9.5 Fixed and Working Capital - Concept and Factors

Affecting their Requirements

SA I (3 marks)

5. List any three factors affecting the Working Capital requirement of a company. **(Term-II, 2021-22)**

SA II (4 marks)

6. Krish limited is in the business of manufacturing and exporting carpets and other home décor products. It has a share capital of ₹ 70 lacs at the face value of ₹ 100 each. Company is considering a major expansion of its production facilities and wants to raise ₹ 50 lacs. The finance manager of the company Mr. Prabhakar has recommended that the company can raise funds of the same amount by issuing 7% debentures. Given that earning per share of the company after expansion is ₹ 35 and tax rate is 30%, did Mr. Prabhakar give a justified recommendation? Show the working. **(2022-23)**

7. Dheeraj wants to start a business of selling N-95 masks after the outbreak of the global pandemic of COVID-19. Due to the uncertain market conditions, he wants to make a low investment in fixed capital. Suggest how the decisions related to the choice of technique and financing alternatives can help Dheeraj in ensuring a low investment in fixed capital requirements. **(2020-21)**

ANSWERS

Previous Years' CBSE Board Questions

1. The objective of 'Financial Management' is to maximise shareholders' wealth.

2. Financial Management is concerned with procurement of finance at optimal cost as well as the most efficient usage of finance. It seeks to identify the best financing alternatives and the best investment alternatives.

3. No, in addition, getting things done effectively and efficiently, these have to be done economically.

4. Financial management refers to the efficient acquisition, allocation and usage of funds by the company. It is carried out with the primary aim of reducing the cost of the funds that are procured, minimising the risk and effective distribution of funds to different opportunities. The primary objective of financial management is 'Wealth Maximisation' which refers to taking those financial decisions that aim at maximising the shareholders' wealth. That is, to opt for those financial decisions that proves gainful from the point of view of its shareholders. Here, the shareholders are said to gain when the market value of the shares held by them rises, which in turn takes place when the benefits from the financial decisions made by the company exceeds the cost involved. When the financial decisions successfully fulfil the objective of wealth maximisation, other objectives such as proper utilisation of funds, maintenance of liquidity, maximisation of profits and meeting financial obligations are automatically fulfilled.

5. The financial concepts discussed above are Investment decisions and Financing decisions.

(a) Capital budgeting decision was taken as the firm required upgradation of its machinery. This being a crucial long term financial decision the Finance Manager made the sales' forecast for the next four years along with profit estimates were made.

(b) Financing decision **-** The estimates about the quantum of finance to be generated internally over a period of next few years was taken. The remaining finance was being planned from the most suitable external source. The objectives to be achieved by the above exercise of the finance manager is to generate finance at minimal cost to the company. He is trying to ensure that the required amount of finance is available to the company at the exact time of need.

6. (a): Long-term investment decision

7. The factor affecting dividend decision being highlighted in the above situation is "shareholders' preference". While distributing the dividends, a company must also keep in mind the preferences of its shareholders.

8. 'Investment Decision' is the financial decisions that affects the size of asset of the company and its profitability and competitiveness. Investment Decision relates to how the firm's funds are deployed in different assets. So, that the firm is able to earn the highest possible return on investment.

9. Dividend decision and Financing decision.

10. Investment decision and Dividend decision.

11. Investment decision and Financing decision.

12. The risk of default on payment of borrowed funds at a fixed time is known as financial risk.

13.

Three factors affecting dividend decision of company :-

- Amount of earnings :- Dividend is declared on the bases of current and past earnings of the company.
- Stability of earnings :- Company having stable earnings are likely to declare higher dividend.

• Taxation Policy :- If the tax rate is higher, then company would be providing lesser dividend ~~as the and~~ vice - versa.

• Growth prospectus :- Companies those who are having growth prospectus in future are likely to retain their earnings for future and thus providing lesser dividend.

[Topper's Answer, 2022]

14. Investment Decision: It relates to decisions about how the firm's funds are invested in different assets. These may relate to investment is short-term/current assets (working capital decisions) or long term, fixed assets (capital budgeting decisions).

Financing Decision: This decision relates to quantum of finance raised from different sourc $ICR = \frac{EBIT}{Interest}$ y can raise finance from various sources such as by issue of shares, ... or by taking loan and advances. Deciding how much fund to raise from which source of finance is dealt in financing decision. Sources of finance can be divided into two categories:

(a) Owner's fund (b) Borrowed fund.

15. Investment decision: Relates to decision about how the firm's funds are invested in different assets. These may related to investment in short term/current assets (working capital decision) or long term/fixed assets (capital budgeting decisions).

Dividend decision: Relates to the decision as to how much profit after paying taxes should be distributed to the shareholders as dividend or how much should be retained in the business to finance long term needs of the firm.

16. Factors Affecting Capital Budgeting Decision:

(a) Cash flows of the project: When a firm invest huge funds in investment project, it expects to generate reasonable and regular cash flows from the project. Cash flow must not only cover fixed cash payment obligation but there should be adequate buffer fund also.

(b) Rate of return : The most important criterion for capital budgeting decision is the expected rate of return from a project.

(c) Interest Coverage Ratio (ICR): It is the number of times earnings before interest and taxes of a company covers the interest obligation.

(d) Debt Service Coverage ratio (DSCR). In this case, the cash profit generated is compared with total cash required for the service of debt and preference share capital. High DSCR is desirable.

(e) Because interest is deductible expense cost of debt is affected by tax rate. A high tax rate makes debt relatively cheaper.

17. The decision relates to careful selection of assets in which funds will be invested by the firms. A firm has many options to invest their funds but firm has to select the most appropriate investment which will bring maximum benefit for the firm and selecting most appropriate proposal is investment decision. Example - purchase of new plant and premises.

(i) Long term Investment decision (Capital Budgeting decision) involves committing the finance on a long-term basis. These decisions special for any business because they impact business earning capacity in the long-run.

(ii) Short-term Investment Decision (Working Capital decision) affects the day-to-day working of business. They affect liquidity as well as profitability of business.

18. Factors affecting dividend decision of a company are:

(a) Amount of Earnings: Dividends are paid out of current and past earning. Therefore, earnings is a major determinant of the decision about dividend.

(b) Stability Earnings: Other things remaining the same, a company having stable earning is in a better position to declare higher dividends. As against this, a company having unstable earnings is likely to pay smaller dividend.

(c) Stability of Dividends: Companies generally follow a policy of stabilising dividend per share. The increase in dividends is generally made when there is confidence that their earning potential has gone up and not just the earnings of the current year.

(d) Growth Opportunities: Companies having good growth opportunities retain more money out of their earnings so as to finance the required investment. The dividend in growth companies is, therefore, smaller, than that in the non-growth companies

19. Factors affecting financing decision are:

(a) Fixed Operating Costs: If a business has high fixed operating costs (e.g., building rent, Insurance premium, Salaries, etc.), It must reduce fixed financing costs. Hence, lower debt financing is better. Similarly, if fixed operating cost is less, more of debt financing may be preferred.

(b) State of Capital Market: Health of the capital market may also affect the choice of source of fund. During the period when stock market is rising, more people invest in equity. However, depressed capital market may make issue of equity shares difficult for any company.

20.

i) Financing Decision ~~is~~ has to be taken by finance Manager. ~~It is~~

ii) Four factors affecting financing desicion are:-

- Cost :- Amount of cost that would be incured during procurement of finance is a major factor affecting the decision. For ex :- debentures are less costly than equity. less Costly option should be selected.
- Risk Involved :- Amount of risk assosiated with the source also has to be seen before choosing the source of funds. For ex- debentures are more riskier than equity. Less risky option should be selected.
- Flotation Cost :- Higher the flotation cost, ~~to~~ less attrative the source will become.
- Fixed operating expenses :- If company is having higher fixed operating expenses, then they should go for equity ie. less riskier option.
- Cash Flow Position :- If the company wants a stronger cash flow then they should go for debentures.

[Topper's Answer, 2022]

21. (i) The Finance Manager of Anant Ltd. has taken a Dividend Decision. It refers to the decisions regarding the distribution of profit or surplus of the company. The profits can either be distributed to the shareholders in the form of dividends or retained by the company itself.

(ii) Factors Affecting the Dividend Decisions are:

(a) Amount of earnings: As a firm pays dividends out of its own earnings (either current or past), it can be said that companies with higher earnings are in a position to pay a higher amount of dividend to its shareholders and vice versa.

(b) Stable earnings: A company with stable and smooth earnings is in a position to distribute higher dividend as compared to those that have an unstable earning.

(c) Stable dividends: In general, companies try to avoid frequent fluctuations in dividend per share and opt for increasing (or decreasing) their value only when there is a consistent rise (or fall) in the earnings of the company.

22. (i) The Financial decision suggested by the Finance Manager is the Financing Decision.

It refers to the decisions regarding the identification of various sources of funds (as debt and equity) and deciding the best combination among them. These decisions are taken on the basis of risk and profitability of various alternatives.

(ii) Factors Affecting Financing Decision are -

(a) Cost of raising funds: Those sources of funds are preferred that involve minimum cost.

(b) Risk involved: Sources of funds that involve moderate risk are preferred over those that involve high risk. For example, debt or debentures involve the risk of default payment which must be carefully analysed before taking the debt.

(c) Floatation cost: These are the costs involved in the process of raising funds. They can be in the form of broker's commission, fees of underwriters, etc. Those sources of funds are preferred that involve minimum floatation cost.

23. (i) Investment decision

The investment decision relates to how the firm's funds are invested in different assets.

(ii)Factors affecting Long-term Investment decision/Capital Budgeting Decision:

(a) The amount of cash flows of the project should be carefully analysed before considering a capital budgeting decision, which may be in the form of a series of cash receipts and payments over the life of an investment.

(b) The expected rate of return from each proposal and the assessment of risk involved are important factors while taking capital budgeting decisions.

(c) Several investment criteria may be used to evaluate investment proposals regarding the amount of investment, interest rate, cash flows and rate of return, etc., before taking the decision to invest in a particular project.

24. (a) Yes, it is justified to raise funds by issuing debentures.

Reason:

(i) During a bearish phase in the capital market, a company may find raising of equity capital more difficult and it may opt for debt.

(ii) It will help to lower the overall cost of capital.

(iii) It will help to reduce the tax liability.

(b) The issue of debentures will increase the financial risk faced by the company as the payment of interest and the return of principle is obligatory for the business. Any default in meeting these commitments may force the business to go into liquidation.

(c) Impact of 'cost of debt' on the capital structure of the company: More debt can be used in the capital structure if debt can be raised at a lower rate.

Impact of 'cost of equity' on the capital structure of the company: When a company increases debt, the financial risk faced by the equity shareholders increases. Consequently, their desired rate of return may increase due to which cost of capital will increase.

25. Factors affecting dividend decision of a company:

(i) Stability of earnings: A company having stable earnings is in a position to declare more dividends and vice-versa. "It has been consistently for many years."

(ii) Cash flow position: The better the cash flow position

of the company, the better will the capacity of the company to pay dividend. "There is availability of enough cash in the company."

(iii) Growth opportunities: If the company has more opportunities for growth, it will require more finance. In such a situation, a major part of the income should be retained and a small part of it should be paid as dividend. "Good prospects for growth in the future"

(iv) Contractual constraints: When a company receives finance in the form of debt, the debt provider can put a ban on the company to give any dividend. "It has taken a load of ₹ 40 lakh agreement".

26. Factors affecting dividend decision of a company:

(i) Stability of earnings: A company having stable earnings is in a position to declare more dividends and vice-versa. "It has been consistently for many years."

(ii) Cash flow position: The better the cash flow position of the company, the better will the capacity of the company to pay dividend." There is availability of enough cash in the company"

(iii) Growth opportunities: If the company has more opportunities for growth, it will require more finance. In such a situation, a major part of the income should be retained and a small part of it, should be paid as dividend. "Good prospects for growth in the future".

(iv) Contractual constraints: When a company receives finance in the form of debt, the debt provider can put a ban on the company to give any dividend. "It has taken a load of ₹ 50 lakhs agreement".

27. (i) Stability of earnings: A company having stable earnings is in a position to declare higher dividends. A company with unstable income will prefer to give smaller dividend.

(ii) Growth opportunities: Companies having good growth opportunities retain more money from their earnings so as to finance the required investment.

(iii) Cash flow position: Comfortable cash flow position is the pre-condition to declare dividend by a company.

(iv) Taxation policy: The choice between dividend payment and retention of earning is also affected by the difference is tax treatment of dividend and capital gains. If dividends are tax free, it would be better to pay more dividends.

28. (a): Detailed plans of action prepared under financial planning increase waste, duplication of efforts and gaps in planning.

29. The concept which was not considered by the company before deciding the amount of funds to be raised is 'Financial Planning'.

30. Financial Planning enables to foresee the fund requirements both in terms of quantum and the timing. The process of estimating the fund requirement of a business and specifying the source of funds is known as Financial Planning.

31. Financial Planing

Twin objectives of financial planing are:

(i) To ensure availability of funds whenever required: This includes a proper estimation of the funds required for different purposes such as for the purchase of long-term assets or to meet day-today expenses of business etc.

Apart from this, there is a need to estimate the time at which these funds are to be made available. Financial planning also tries to specify possible sources of these funds.

(ii) To see that the firm does not raise resources unnecessarily: Excess funding is almost as bad as inadequate funding. Even if there is some surplus money, good financial planning would put it to the best possible use so that the financial resources are not left idle and don't unnecessarily add to the cost.

32. (b): Growth opportunities

33. (c): Trading on equity

34. Cost of debt: The cost of debt affects the capital structure in the sense that if the firm can borrow at a lower cost, then it can increase its debt. That is, more debt can be used, if cost of debt is lower and vice-versa.

35. Technology Upgradation: In mobile phones, business assets becomes obsolete very soon, so their replacement is to be done faster. Hence, fixed capital requirement will be high to purchase such assets. Considering this, Rizul choose furniture business over mobile phones.

36. Diversification will lead to increase in the fixed capital requirement of the company as more money will be required for investment in fixed assets.

37. Cost of equity: The rate of return expected by the shareholders is directly related to the risk associated with their investment. As the financial risk faced by the company increases, the shareholders' expectation of rate of return increases and vice versa. Now, as the company increases the component of debt, the financial risk faced by it also increases.

38. Capital structure is simply referred to as the combination of debt and equity used by a company for financing its fund requirements.

Algebraically Capital Structure is equal to

Two factors which affect the capital structure of a company are:

(i) Equity cost: The rate of return expected by the shareholders is directly related to the risk associated with their investment made by them. As the financial risk faced by the company increases, the shareholders' expectation of rate of return increases and vice versa.

Now, as the company increases the component of debt, the financial risk faced by it also increases. Therefore, the shareholders' expectation of rate of return increases. This relationship suggests that a company cannot increase the component of debt in its capital structure beyond a certain level.

(ii) Floatation cost: It refers to the cost of raising funds such as broker's commission and underwriting commission. Higher the floatation cost involved in raising funds from a particular source, the lower is its proportion in the capital structure. For example, if public issue of shares involves higher floatation cost

$\frac{\text{Debt}}{\text{Equity}}$ or $\frac{\text{Debt}}{\text{Debt+Equity}}$ company would go for more of debt and less of equity in the

39. 'Option A' source of debt is better than 'Option B. Aim of financial management is to increase earning of its shareholders. Debt will result in increase in earning only when Return on Investment (ROI) is more than rate of interest on debt. If rate of Interest on debt is more than the return on investment then more debt means more loss for company. Concept of Trading on Equity is used in taking the decision.

40. (a): EBIT = ₹ 2,00,000

(–) Interest (14% of ₹ 4,00,000)	=	₹ 56,000
EBT	=	₹ 1,44,000
(–) Tax (50% of ₹ 1,44,000)	=	₹ 72,000
EAT	=	₹ 72,000

$$\boxed{\text{EPS} = \frac{72,000}{10,000} = 7.2}$$

$$\text{ROI} = \frac{2,22,222}{6,00,000} \times 100 = 33.33\%$$

(b) The given example is unfavourable financial leverage.

41. Following are the factors determining the relative proportion of types of funds:

(a) Cash flow position: Size of projected cash flows must be considered before issuing debt. If the company does not have regular and predictable cash flows, it should avoid debt and issue more equity, while if it has regular and predictable cash flows, it can go in for more debt.

(b) Cost of debt: Lower cost of debt increases the capacity of the company to employ larger debt. However, in case of higher cost of debt, company should prefer more of equity.

(c) Taxrate: Since interest paid on debt is a tax-deductible expense, a higher tax rate makes debt relatively cheaper.

(d) Cost of equity: It indicates the expected rate of return for the equity shareholder which is commensurate with the risk they are assuming. It increases with the increase in debt. Thus, debt should be used only to a limited level.

(e) Return on investment: If return on investment is more than rate of interest then company must prefer debt in its capital structure whereas if return on investment is less than rate of interest to be paid on debt, then company should avoid debt.

42. (a) Assumption: Face value of share is ₹10 each. Computation of profit for equity in the previous year :

$$\text{EPS} = \frac{\text{Profit for Equity}}{\text{No. of Equity Shares}} \Rightarrow 0.50 = \frac{x}{6,00,000}$$

$\Rightarrow$ x = ₹3,00,000

$\Rightarrow$ Profit for equity in previous year = ₹3,00,000

Computation of Profit for equity in current year.

	₹
EBIT	8,00,000
– Interest on 10% debentures	
(10% ×40,00,000)	(–) 4,00,000
EBT	4,00,000
– Tax @40%	(–) 1,60,000
Profit for Equity	2,40,000

$$\text{EPS} = \frac{2,40,000}{6,00,000} = 0.40$$

Loss to the shareholder = ₹60,000

Reduction in EPS = 0.10/share

(b) Factors that favours the issue of debentures by the company are:

(i) Cost: Debt is cheaper source of finance because interest on debt is tax deductible expense. More debt can be used in capital structure, if cost of debt is low.

(ii) Control considerations: Debt normally does not cause a dilution of control while issue of equity shares may reduce management control over the business.

(iii) Cash flow position of the company: A strong cash flow position of the company makes debt financing better than funding through equity because it can generate enough cash flows to pay interest on debt.

43. (i) Cash flow position: Size of projected cash flows must be considered before issuing debt. If the company does not have regular and predictable cash flows, it should avoid debt and issue more equity, while if it has regular and predictable cash flows, it can go in for more debt.

(ii) Cost of equity: It indicates the expected rate of return for the equity shareholder which is commensurate with the risk they are assuming. It increases with the increase in debt. Thus, debt should be used only to a limited level.

(iii) Floatation costs: The fund raising exercise also costs something, example - cost of advertising, printing cost of prospectus, etc. This cost is called floatation cost. Higher the floatation cost, less attractive the source. Public issue of shares and debentures requires considerable expenditure. These consideration may also affect the choice between debt and equity and hence the capital structure.

(iv) Stock market condition : During the period when stock market is rising (i.e., a bullish phase), more people invest in equity. Equity shares are more easily sold even at a higher price. Use of equity is often preferred by companies in such a situation. However, during the period of depressed capital market, (i.e., a bearish phase) a company may find raising of equity capital more difficult and it may opt for debt.

44. (d): Business cycle

45. (a): A-(i), B-(iv), C-(ii), D-(iii)

46. More

47. Availability of Raw Material: Un-interrupted availability of raw-material reduces blockage of funds in working capital requirements of this industry.

48. Level of Collaboration is the factor affecting fixed capital requirements of Fashionate Pvt. Ltd.

According to this factor, certain business organisation shares each other's' facilities, e.g., a bank may use another bank's ATM. Such collaboration reduces the level of investment in fixed assets for each firm so, fixed capital requirement is lower.

49. Low, as it is a service industry, which usually do not have to maintain inventory.

50. The factors which affect the working capital requirements of a company are:

(i) Fluctuations in business cycle: During a boom period, the market flourishes and thereby there is higher sale, higher production, higher stock and debtors. Thus, during this period, the need for working capital by a company increases. As against this, in a period of depression, there is low demand, lesser production and sale, etc. Therefore, the requirement for working capital is also less.

(ii) Inflation: A rise in the rate of inflation implies that the prices of raw materials, labour, etc. increase. This suggests that larger amount of funds would be required to maintain even the existing volume of production and sales. This in turn, increases the requirement of working capital. On the other hand, a low rate of inflation implies less requirement of working capital for a business.

(iii) Extent of availability of raw material: If the raw materials required by the company are such that they are easily available, then this suggests that the firm does not need to maintain a large stock of inventories of raw material. In such situations, the company requires less working capital. On the other hand, if the raw materials are not easily available or their supply is not smooth, then the company must maintain a huge stock of raw material to ensure uninterrupted operations, thereby requiring a large working capital.

51. The factors which affect the working capital requirements of such enterprises highlighted in the question above are:

(i) Fluctuations in business cycle: During a boom period, the market flourishes and thereby there is higher sale, higher production, higher stock and debtors. Thus, during this period the need for working capital by a company increases. As against this, in a period of depression, there is low demand, lesser production and sale, etc. Therefore, the requirement for working capital is also less.

Line: 'Indian equity markets are going through a phase of boom.

(ii) Growth Prospects: Higher growth and expansion of a company is associated with higher production, more sales, more inputs, etc. Thus, companies with higher growth prospects require a higher amount of working capital and vice versa.

Line: There is a huge growth potential for innovative technologies.

(iii) Extent of competition: The higher the extent of competition in the market, the larger is the amount of stock of goods that the firms must maintain to meet the demand and therefore the higher is the requirement of working capital.

Line: This has resulted in lots of new ventures lying for a market share and old enterprises trying to keep up with the pace with which changes are taking place in the economy.

52. (i) Nature of Business: The nature of a business influences the working capital requirement. A trading organisation usually needs a smaller amount of working capital compared to a manufacturing organisation. This is because, there is usually no processing. Therefore, there is no distinction between raw materials and finished goods.

(ii) Availability of Raw Material: If the raw materials and other required materials are available freely and continuously, lower stock levels may suffice. If, however, raw materials do not have a record of uninterrupted availability, higher stock levels may be required thus raising the need for working capital.

53. Factors affecting fixed capital requirements of a company:

(i) Nature of Business: The type of business has a bearing upon the fixed capital requirements. For example, a trading concern needs lower investment in fixed assets compared with a manufacturing organisation; since it does not require to purchase plant and machinery, etc.

(ii) Scale of Operations: A larger organisation operating at a higher scale needs bigger plant, more space etc. and therefore, requires higher investment in fixed assets when compared with the small organisation.

54. Factors affecting the requirement of Fixed Capital:

(i) Nature of Business: The type of business has a bearing upon the fixed capital requirements as a trading concern needs lower investment in fixed assets compared with a manufacturing organisation since it does not require to purchase plant and machinery, etc.

(ii) Scale of Operations: A larger organisation operating at a higher scale needs bigger plant, more space etc. and therefore, requires higher investment in fixed assets when compared with the small organisation.

(iii) Technology Upgradation: In certain industries, assets become obsolete sooner and need to be replaced faster, resulting in higher investment in fixed assets.

(iv) Growth Prospects: Higher growth of an organisation generally requires higher investment in fixed assets to meet the anticipated higher demand quicker.

(v) Diversification: A firm may choose to diversify its operations leading to higher investment in fixed capital.

(vi) Choice of Technique: A capital-intensive organisation requires higher investment in plant and machinery as it relies less on manual labour resulting in higher requirement of fixed capital as compared to a labour intensive organisation.

55. Factors that 'Inderprastha Technologies Ltd. will keep in mind before deciding its working capital requirements:

(i) Seasonal Factor: Peak season requires higher working capital than lean season due to higher level of activity.

(ii) Level of competition: Higher competition requires larger stocks to meet urgent orders, thus, higher working capital is required.

(iii) Credit Allowed: A liberal credit policy results in higher level amount of debtors, increasing the requirements of working capital.

(iv) Production cycle: Shorter the production cycle, lower is the amount of working capital.

Other factors affecting working capital requirements of a company:

(i) Nature of Business: A manufacturing business requires more working capital than a trading business since raw material is converted into finished goods.

(ii) Business Cycle: In case of boom, larger working capital is required as production and sales are more in comparison to depression phase.

(iii) Operating efficiency: Operating efficiency reduces the levels of inventories and debtors, thereby, reducing working capital requirements.

56. (i) Nature of Business: The basic nature of business influences the amount of working capital required. A trading firm needs a lower amount of working capital compared to a manufacturing firm. This is because there is usually no processing, therefore, there is no distinction between raw materials and finished goods in trading firm. Goods can be sold as soon as or even before it is received.

(ii) Scale of Operations: A large-scale organisation requires larger amount of working capital as compared to small-scale organisation because the quantum of inventory, debtors and cash required is generally high.

(iii) Seasonal Factors: Industries, which produce and sell seasonal goods, require large working capital at the time of the season than industries with regular production, and sales.

(iv) Production Cycle: Production cycle is the time span between the receipt of raw material and its conversion into finished goods. Longer the process of production, higher will be the amount of working capital required. On the other hands, firms with shorter production cycle can manage with less working capital.

57. (i) Inflation: With rising prices, larger amount is required to maintain a constant volume of production and sales. It will result in an increase in the working capital requirements. However, it must be noted that an inflation rate of 5%, does not mean that every component of working capital will change by the same percentage.

(ii) Business Cycle: Different phases of business cycle affect the working capital requirement of a firm. More working capital is needed in boom period as compared to dull period.

(iii) Level of Competition: Higher level of competition may compel a firm for higher stock of finished goods and liberal credit to its customer. It will need higher amount of working capital. However, in case of less competition, firms can manage with less working capital.

(iv) Nature of Business: The basic nature of business influences the amount of working capital required. A trading firm needs a lower amount of working capital compared to a manufacturing firm. This is because there is usually no processing, therefore, there is no distinction between raw materials and finished goods in trading firm. Goods can be sold as soon as or even before it is received.

CBSE Sample Questions

1. Following are the factors affecting financial decision of a company:

(a) Size of the projected Cash flows must be considered before borrowing.

(b) Interest Coverage Ratio refers to the number of times earnings before interest and taxes of a company covers the interest obligation.

(c) Debt Service Coverage Ratio takes care of the deficiencies referred to in the interest coverage ratio.

(d) More debt can be used if debt can be raised at a lower rate

(e) A higher Tax Rate makes debt relatively cheaper and increases its attraction vis-a-vis equity.

(f) Process of raising resources also involves some cost which may affect the choice between debt and equity and hence capital structure.

(g) If a firm's business risk is lower, its capacity to use debt is higher and vice versa.

(h) To maintain flexibility the firm must maintain some borrowing power to take care of unforeseen circumstances.

(i) Capital Structure of other companies is a useful guideline in the capital structure planning.

(j) Stock Market Conditions often affect the choice between debt and equity.

(k) Every company operates within a regulatory framework provided by the law.

(l) Control as a factor also influences the choice between debt and equity especially in companies in which the current holding of management is on a lower side.

(m) If the ROI of the company is higher, it can choose to use trading on equity to increase its EPS.

(n) When a company increases debt, the financial risk faced by the equity shareholders increases consequently their desired rate of return may increase.

2. Dividend decision: The decision involved here is how much of the profit earned by the company is to be distributed among the shareholders and how much of it should be kept in the business.

Factors affecting Dividend decision:

(i) Amount of Earnings: Dividends are paid out of current and past earnings. Therefore, earnings are a major determinant of the decision about dividend.

(ii) Growth Opportunities: Companies having good growth opportunities retain more money out of their earnings so as to finance the required investment. The dividend in growth companies is, therefore, smaller than that in the non-growth companies.

3. Rate of Return of Investment is 4,00,000/10,00,000 X 100 = 40%

EBIT after expansion = 40% X 15,00,000 - 6,00,000

Calculation of EPS

	Plan 1	**Plan 2**
EBIT	6,00,000	6,00,000
(-)Interest	–	50,000
EBT	6,00,000	5,50,000
(-)Tax(50%)	3,00,000	2,75,000
EAT	3,00,000	2,75,000
No. Of shares.	15000	10000
EPS	20	27.5

The company should use Plan 2 in order to increase the return to the equity shareholders.

4. Following are the factors affecting capital structure of the company:

(i) Cash Flow Position: Size of projected cash flows must be considered before borrowing. Cash flows must not only cover fixed cash payment obligations but there must be sufficient buffers also.

(ii) Interest Coverage Ratio (ICR): The interest coverage ratio refers to the number of times earnings before interest and taxes of a company covers the interest obligation.

(iii) Debt Service Coverage Ratio (DSCR) : Debt Service Coverage Ratio takes care of the deficiencies referred to in the Interest Coverage Ratio (ICR). The cash profits generated by the operations are compared with the total cash required for the service of the debt and the preference share capital.

(iv) Cost of debt: A firm's ability to borrow at a lower rate increases its capacity to employ higher debt. Thus, more debt can be used if debt can be raised at a lower rate.

5. Factors affecting working capital requirement of the company:

(i) Nature of Business influences working capital requirements in a trading organisation which usually needs a smaller amount of working capital compared to a manufacturing organisation, while service industries which usually do not have to maintain inventory require less working capital.

(ii) Scale of operations influences working capital requirements in large organisations which require a large amount of working capital as compared to the organisations which operate on a lower scale.

(iii) Business cycle affects the requirement of working capital by a firm, as in case of a boom a larger amount of working capital is required as compared to the period of depression.

6. Earnings per share = ₹ 35

EPS = Earning after tax/ Number of equity shares

35 = Earning after tax/70,000

Earning after tax = ₹ 24,50,000

Interest = 50,00,000 × 7/100 = ₹ 3,50,0000

Let the Earning before tax (EBT) = x EBT – Tax = EAT

X - 0.30x = 24,50,000; 0.70x = 24,50,000

x = 24,50,000/0.70; x = 35,00,000

Earning before tax = ₹ 35,00,000

EBIT = Earning before tax + Interest

= 35,00,000 + 3,50,000 = ₹ 38,50,000

ROI = EBIT/Total Investment x 100

= 38,50,000/1,20,00,000 x 100 = 32.08%

As ROI (32.08%) > Rate of interest (7%).

The company can choose to use trading on equity to increase its EPS. The finance manager was justified in making this recommendation.

7. Choice of Technique: As he wishes to stick to a low investment model, we may suggest him to go with the labour-intensive approach to manufacture N- 95 masks.

Since better technology would cost him much and his risk appetite is not conducive for capital intensive techniques of production.

Financial Alternatives: As he wishes to stick to a low investment model, we may suggest him to go with the lease option for fixed assets like building, heavy machinery etc. as this may reduce his investments requirement in the business.