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**CS-EXECUTIVE**

**(MODULE-2)**

# FINANCIAL MANAGEMENT (MCQ)

**BY:-**


## H. L. GUPTA

**(MBA FINANCE, B.Sc. Math)**

***with* 15 Years of Teaching Experience**

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**JAI MAA SARASWATI**

# EXECUTIVE PROGRAMME
# Module 2
# Paper 8
# FINANCIAL AND STRATEGIC MANAGEMENT

## SYLLABUS

### Objectives

Part I : To provide knowledge of practical aspects of financial management so as to develop skills in taking financial and investment decisions.

Part II : To enable students to acquire multidimensional skills as to equip them to comprehend the process of strategy formulation.

## PART – I: FINANCIAL MANAGEMENT (60 MARKS)

1. Nature, Significance and Scope of Financial Management
2. Capital Budgeting
3. Capital Structure
4. Sources of raising Long term Finance and Cost of Capital
5. Project Finance
6. Dividend Policy
7. Working Capital
8. Security Analysis
9. Portfolio Management
10. Practical Problems and Case Studies

# FINANCIAL MANAGEMENT (MCQ)

***{Strictly as per new syllabus (2017) prescribed by The Institute of Company Secretaries of India (ICSI)}***

## CONTENTS

### PART – I FINANCIAL MANAGEMENT

**This book is updated**
**With all amendments**
**Till 30th January 2020**

***(Afterwards amendments will be included / discussed in live lectures at classroom)***

# 1. Nature Significance and Scope of Financial Management

## MULTIPLE CHOICE QUESTIONS

1. Financial management means the management of finance of a business or an organization in order to achieve the ....................objectives.
   (a) Financial (b) Social
   (c) Financial and Social (d) None of the above

2. .................. is that business activity which concerns with the acquisition and conversion of capital funds in meeting financial needs and overall objectives of a business enterprise.
   (a) Structured Finance (b) Business Finance
   (c) Legal (d) Sourcing

3. ................ is broadly concerned with raising of funds, creating value to the assets of the business enterprise by efficient allocation of funds
   (a) Financial management (b) Treasury Management
   (c) Liquidity Management (d) Fund Management

4. Financial Management is concerned with :
   (a) Investment Decision (b) Financing Decision
   (c) Dividend Decisions (d) All of the above

5. ..................... are concerned with the determination of how much funds to procure from amongst the various avenues available i.e. the financing mix or capital structure:
   (a) Investment Decision (b) Financing Decision
   (c) Dividend Decisions (d) All of the above

6. ................ "is to decide whether the firm should distribute all profits or retain them or distribute a portion and retain the balance:
   (a) Investment Decision (b) Financing Decision
   (c) Dividend Decisions (d) All of the above

7. .................. ensures that firm utilizes its available resources most efficiently under conditions of competitive markets
   (a) Profit maximisation (b) Wealth maximisation
   (c) Goal maximisation (d) None of the above

8. .............means the management of an organization maximizes the present value not only for shareholders but for all including employees, customers, suppliers and community at large
   (a) Profit maximisation (b) Wealth maximisation
   (c) Goal maximisation (d) None of the above

9. Which of the following is not a correct statement?
   (a) Profit maximisation is vague conceptually.
   (b) Profit maximisation ignores timing of returns

(c) Profit maximisation emphasis is generally on short run projects
(d) Profit maximisation considers timing of returns

10. Advantage of profit maximisation is:
(a) Easy to calculate profits
(b) Easy to determine the link between financial decisions and profits.
(c) Both (a) and (b)
(d) None of the above

11. Which of the following is not the advantage of wealth maximisation?
(a) Emphasizes long term
(b) Recognises risk and uncertainty
(c) Recognises the timings of return
(d) Easy to determine the link between financial decisions and profits

12. Wealth maximisation objective is superior to the profit maximization concept.
(a) True (b) False

13. Profit maximisation is the narrow objective of financial management because profit is a test of economic efficiency.
(a) True (b) False

14. Profit maximisation goes beyond the quantitative aspects as it also considers qualitative benefits in a firm.
(a) True (b) False

15. ……………. is the after tax cash flow generated by a business minus the cost of the capital it has deployed to generate that cash flow
(a) Net Present Value (NPV) (b) Economic value added (EVA)
(c) Internal Rate of Return (IRR) (d) Discounted Cash Flow

16. Representing real profit versus paper profit, EVA underlines shareholder value, increasingly the main target of leading company's strategies
(a) True (b) False

17. There is growing evidence that EVA, not earnings, determines the value of a firm.
(a) True (b) False

18. Which of the following statement is not correct?
(a) There are two key components to EVA. The net operating profit after tax (NOPAT) and the capital charge, which is the cost of capital times the amount of capital
(b) EVA underlines shareholder value
(c) There is no difference between EVA .earnings per share, return on assets, and discounted cash flow, as a measure of performance
(d) EVA = (Operating Profit) - (A Capital Charge)

19. Finance Manager has to take following decision:
(a) Investment decision (b) Financing decision
(c) Dividend decision (d) All of the above

20. A finance manager is not required to trade-off .between the risk and return.
    (a) True
    (b) False

21. At risk return trade off, market price of share is:
    (a) Minimised (b) Maximised
    (c) No affect (d) Uncertain

22. Liquidity is not an important aspect of financial management.
    (a) True
    (b) False

23. Which of the following statement is correct?
    (a) Current Ratio is the ratio of current assets to current liabilities
    (b) Current Ratio is the ratio of current assets to short term liabilities
    (c) Current Ratio is the ratio of current assets to long term liabilities
    (d) Current Ratio is the ratio of current assets and fixed assets to current liabilities

24. Liquidity ratio enables a company to assess its :
    (a) Current Assets only (b) Current liabilities only
    (c) Net Working Capital (d) Fixed Assets

25. Net working capital is:
    (a) Current Assets + Current Liabilities
    (b) Current Assets - Current Liabilities
    (c) Current Assets - Total Liabilities
    (d) Current Assets + Fixed Assets-Current Liabilities

26. Average Collection Period (ACP) tells us the average number of days receivables are outstanding i.e., the average time a bill takes to convert into cash.
    (a) True
    (b) False

27. Financial decisions are affected by liquidity analysis of a company in the following areas:
    (a) Management of .cash and marketable securities;
    (b) Credit policy of a firm and procedures for realisation
    (c) Management and control of inventories
    (d) All of the above

28. The gross profit margin ratio indicates the profits relative to sales after deduction of direct production cost
    (a) True
    (b) False

29. Failure of a firm is technical if it is unable to meet its ............ obligations.
    (a) Current (b) Non-current
    (c) Both (a) and (b) (d) None of the above

30. Which of the following is solvency ratio:
(a) Debt to Equity ratio (b) Debt to total Funds Ratios
(c) Interest coverage ratio (d) All of the above

31. Study of financial management:
(a) Is an art (b) Is a science
(c) Mixture of science as well as art (d) None of the above

32. Which of the following is not a direct function of finance manager:
(a) Forecasting of cash flow (b) Raising funds
(c) To facilitate cost control (d) To arrange board meeting

33. ……………………..reflects on the ability of management to earn a return on resources put in by the shareholders evaluating the performance of the company in different spheres.
(a) Profitability ratio (b) Liquidity Ratio
(c) Solvency Ratio (d) Net Working Capital

34. Affairs of the firm should be managed in such a way that the total risk - business as well as financial borne by equity shareholders is minimised and is manageable.
(a) True (b) False

35. With the evolution of finance from being mere a descriptive study to the one that is highly developed discipline, the role of financial managers has also undergone a sea change.
(a) True (b) False



**ANSWER**

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **1** | (a) | **2** | (b) | **3** | (a) | **4** | (d) | **5** | (b) | **6** | (c) |
| **7** | (a) | **8** | (b) | **9** | (d) | **10** | (c) | **11** | (d) | **12** | (a) |
| **13** | (a) | **14** | (b) | **15** | (b) | **16** | (a) | **17** | (a) | **18** | (c) |
| **19** | (d) | **20** | (b) | **21** | (b) | **22** | (b) | **23** | (a) | **24** | (c) |
| **25** | (b) | **26** | (a) | **27** | (d) | **28** | (a) | **29** | (a) | **30** | (d) |
| **31** | (c) | **32** | (d) | **33** | (a) | **34** | (a) | **35** | (a) | | |

# 2. Capital Budgeting

## MULTIPLE CHOICE QUESTIONS

1. Money in hand today is worth more than money that is expected to be received in the future.
   (a) True (b) False

2. ............... refers to the current worth of a future sum of money or stream of cash flows given a specified rate of return
   (a) Present value (b) Future Value
   (c) Annuity (d) Infinite Value

3. .................... refers to the value after a certain period of time at the given rate of interest.
   (a) Present value ; (b) Future Value
   (c) Annuity (d) Infinite Value

4 .......................is a stream of regular periodic payment made or received for a specified period of time.
   (a) Present value (b) Future Value
   (c) Annuity (d) Infinite Value

5. ................. the fund which is created for a specified purpose by way of sequence of periodic payments over a time period at a specified interest rate.
   (a) Mutual Fund (b) Sinking Fund
   (c) Debt Fund (d) Liquid Fund

6. ........................ is the difference between the sum total of present values of all the future cash inflows and outflows
   (a) Net Present Value (b) Internal Rate of Return
   (c) Profitability Index (d) All of the above

7. .............. is concerned with the allocation of the firms source financial resources among the available opportunities
   (a) Capital budgeting (b) Working Capital
   (c) Capital Structure (d) None of the above

8. Which of the following is not an example of capital expenditure?
   (a) Purchase of fixed assets such as land and building, plant and machinery, goodwill, etc.
   (b) The expenditure relating to addition, expansion, improvement and alteration to the fixed assets.
   (c) Expenditure on payment of current liabilities
   (d) The replacement of fixed assets.

9. Need of capital budgeting is due to:
   (a) Wear and tear of old equipment. (b) Expansion
   (c) Productivity improvement (d) All of the above

10. A capital budgeting decision has its effect over a long time span and inevitably affects the company's future cost structure and growth.
   (a) True (b) False

11. Capital budgeting decisions need small amount of capital outlay
   (a) True (b) False

12. Which of the following statement is not correct?
   (a) Capital budgeting decision is surrounded by great number of uncertainties
   (b) Capital budgeting decisions in most of the cases are irreversible.
   (c) Capital budgeting decision making is an easy exercise
   (d) Capital budgeting decisions need substantial amount of capital outlay.

13. Which of the following is one of the types of capital budgeting decisions?
   (a) Accept reject decisions (b) Mutually exclusive decision
   (c) Capital rationing decision (d) All of the above

14. Capital budgeting process includes:
   (a) Identification of investment opportunities
   (b) Decision making'
   (c) Implementation and controlling of projects
   (d) All of the above

15. Which of the following is traditional/non-discounted cash flow technique?
   (a) Net Present Value (NPV) Method
   (b) Internal Rate of Return (IRR) Method
   (c) Profitability Index (PI)
   (d) Pay back method

16. Which of the following is modern/discounted cash flow technique?
   (a) Net Present Value (NPV) Method
   (b) Internal Rate of Return (IRR) Method
   (c) Profitability Index (PI)
   (d) Average Rate of Return (ARR) Method

17. …………… technique estimates the time required by the project to recover, through cash inflows; the firms initial outlay.
   (a) Net Present Value (NPV) Method
   (b) Internal Rate of Return (IRR) Method
   (c) Average Rate of Return (ARR) Method
   (d) Pay back Method

18. ……………… method is designated to consider the relative profitability of different capital investment proposals as the basis for ranking them.
   (a) Net Present Value (NPV) Method
   (b) Internal Rate of Return (IRR) Method

(c) Average Rate of Return (ARR) Method
(d) Pay back Method

19. Payback period method may be successfully applied in which of the following circumstance:
(a) where the firms suffers from liquidity problem and is interested in quick recovery of fund than profitability.
(b) high external financing cost of the project.
(c) for projects involving very uncertain return; and
(d) All of the above

20. Which of the following statement is not correct?
(a) Average return on investment method ignores the time value of money.
(b) The average rate of return on original investment approach can be applied to a situation where part of the investment is to be made after the beginning of the project.
(c) Average Rate of Return is based on accounting principle and not on cash flow analysis
(d) Average Rate of Return method, is easy to understand, simple to follow.

21. ................ is the difference between the sum total of present values of all the future cash inflows and outflows.
(a) Net Present Value (b) Internal Rate of Return
(c) Profitability Index (d) Pay back period

22. Which of the following is the disadvantage of Net Present Value Method?
(a) Income over the entire life of the project is not considered
(b) The method does not take into account time value of money
(c) It is difficult to determine the firm cost of capital or appropriate rate of discount
(d) None of the above

23. ............... refers to the rate which equates the present value of cash inflows and present value of cash outflows
(a) Net Present Value (b) Internal Rate of Return
(c) Profitability Index (d) Pay back period

24. Internal Rate of Return is the rate at which net present value of the investment is
(a) One (b) Zero
(c) Infinite (d) Negative

25. Advantage of Internal Rate of Return (IRR) method include:
(a) This method takes into account the time value of money
(b) This method considers cash benefits, i.e. profitability of the project for the whole of its economic life
(c) This method is considered to be a sophisticated and more reliable technique of evaluating capital investment proposals
(d) All of the above

26 ................. is defined as the rate of present value of the future cash benefits at the required rate of return to the initial cash outflow of the investment.
(a) Net Present Value
(b) Internal Rate of Return
(c) Profitability Index
(d) Pay back period

27. Profitability Index is expressed as :
(a) Profitability Index = Present Value of future cash flows / Initial cash investment
(b) Profitability Index = Total of future cash flows / Initial cash investment
(c) Profitability Index = Present Value of future cash flows of first year /Initial cash investment
(d) Profitability Index = Initial cash investment / Present Value of future cash flows

28. If the profitability index is >1, then:
(a) Accept the project
(b) Reject the project
(c) Profitability index method does not determine the feasibility of the project
(d) None of the above

29. Which of the following statement is not correct?
(a) Under the net present value method rate of interest is assumed as the known factor whereas it is unknown in case of internal rate of return method.
(b) The net present value method took to ascertain the amount which can be invested in a project so that its expected yields will exactly match to repay this amount with interest at the market, rate.
(c) Net Present value attempts to find out the rate of interest which is maximum to repay the invested fund out of the cash inflows.
(d) Net present value method is more reliable than internal rate of return method for ranking two or more projects.

30. Net Present Value Method generally is considered to be superior since:
(a) It is simple to operate as compared to internal rate of return method
(b) It does not suffer from the limitations of multiple rates
(c) The reinvestment assumption of the Net Present Value Method is more realistic than internal rate of return method.
(d) All of the above

31. A firm with ..................... constraint attempts to select the combination of investment projects that will be within the specified limits of investments to be made during a given period of time and at the same time provide greatest profitability.
(a) Capital Budgeting (b) Capital structure
(c) Capital rationing (d) All of the above

32. ................. refers to the outcomes of a given event which are too unsure to be assigned probabilities
(a) Uncertainty (b) Risk
(c) Both (a) and (b) (d) None of the above

33. ……………. refers to a set of unique outcomes for a given event which can be assigned probabilities.
(a) Uncertainty (b) Risk
(c) Both (a) and (b) (d) None of the above

34. Risk and uncertainty are not inherent in capital budgeting decisions
(a) True (b) False

35. Higher value of standard deviation indicates
(a) Higher Risk (b) Lower Risk
(c) No impact on risk (d) None of the above

36. Risk adjusted discount rates method is used in investment and budgeting decisions to cover:
(a) Time value of money! (b) Risk.
(c) Both (a) and (b) (d) None of the above

37 …………… helps in assessing information as to how sensitive are the estimated parameters of the project such as cash flows, discount rate, and the project life to the estimation errors.
(a) Certainty Equivalent Approach
(b) Risk Adjusted Discount Rate Method
(c) Sensitivity Analysis
(d) Decision Tree Analysis

38. Capital Budgeting models are used to evaluate a wide variety of working capital expenditure decisions.
(a) True (b) False

39. The span of time within which the investment made for the project will be recovered by the net returns of the project is known as
(a) Period of return (b) Payback period
(c) Span of return (d) None of the above

40. With limited finance and a number of project proposals at hand, select that package of projects which has:
(a) The maximum net present value
(b) Internal rate of return is greater than cost of capital
(c) Profitability index is greater than unity
(d) Any of the above

41. Which of the following techniques does not take into account the time value of money?
(a) Internal Rate of Return Method (b) Simple payback period Method
(c) Net Present value Method (d) Discounted payback period Method

42. The current worth of a sum of money to be received at a future date is called
(a) Real Value (b) Future Value
(c) Present Value (d) Salvage Value

43. If present value of total cash outflow is $15,000 and present value of total cash inflow is $14,000, what is the net present value of the project?
(a) $1,000 (b) -$1,000
(c) 0 (d) 2000

44. ................. If present value of total cash out flow is $ 2,00,000 and present value of total cash inflow is $2,30,000, what is the net present value of the project?
(a) 30,000 (b) -30,000
(c) 0 (d) 10,000

45. If present value of total cash outflow is equal to present value of total cash inflow, then the net present value of the project will be
(a) Positive (b) Negative
(c) Zero (d) Infinite

46. Generally, a project is considered acceptable if its net present value is:
(a) Negative or Zero (b) Negative or Positive
(c) Positive or Zero (d) Negative

47. A company is considering the following three investment proposals:
(i) Investment required: Rs. 80,000, present value of future cash inflows: Rs. 96,000
(ii) Investment required: Rs. 75,000, present value of future cash inflows: Rs. 120,000
(iii) Investment required: Rs. 100,000, present value of future cash inflows: Rs. 150,000
How would you rank the above investment proposals using profitability index method?
(a) B, A, C (b) C, A, B
(c) A, B, C (d) B, C, A

48. In capital budgeting, a negative net present value results in
(a) zero economic value added (b) percent economic value added
(c) negative economic value added (d) positive economic value added

49. Consider the following data on a proposed investment:
Investment required: Rs.160,000
Annual cash inflows: Rs.40,000
Life of the investment: 6 years
Salvage value: 0 Discount rate: 10%
Based on the above data, what is the payback period of the proposed investment project?
(a) 0.25 years (b) 3 years
(c) 4 years (d) 5 years

50. An increase in the discount rate will:
(a) reduce the present value of future cash flows
(b) increase the present value of future cash flows
(c) have no impact on the present value of future cash flows
(d) None of the above

51. Using profitability index, the preference rule for ranking projects is :
(a) the lower the profitability index, the more desirable the project
(b) the higher the profitability index, the more desirable the project
(c) the lower the sunk cost, the more desirable the project
(d) the higher the sunk cost, the more desirable the project

52. The net present value of four projects is given below.
Project A: Rs. 25,000
Project B: Rs. 10,000
Project C: Rs. 22,000
Project D:Rs. 15,000
The four projects given above require the same amount of investment. How would you rank them using net present value (NPV) method?
(a) B, D, C, A (b) A, B, C, D
(c) A, C, D, B (d) B, C, D, A

53. If the profitability index of a project is 0.75, it means
(a) the NPV of the project is greater than zero
(b) the project's cost is less than the present value of its cash flows
(c) the NPV of the project is greater than
(d) the project returns 75 cents in present value for each dollar invested in it

54. A project whose acceptance prevents the acceptance of another project is known as:
(a) dependent project (b) an independent project
(c) a mutually exclusive project (d) a rational project

55. What are the two drawbacks associated with the payback period?
(a) The time value of money is ignored. It ignores cash flows beyond the payback period.
(b) The time value of money is considered. It ignores cash flows beyond the payback period.
(c) The time value of money is considered. It includes cash flows beyond the payback period.
(d) The time value of money is ignored. It includes cash flows beyond the payback period

56. The XYZ purchases a new equipment. The selected data is given below:
Cost of equipment: $25,000
Useful life of equipment: 5 years
Tax rate: 30%
If equipment is depreciated using straight line method, what is the depreciation tax shield associated with the new equipment?
(a) $5,000 (b) $35,000
(c) $1,500 (d) $ 7,500

57. The ABC purchases a new equipment. The selected data is given below:
Cost of equipment: 1,00,000
Useful life of equipment: 10 years Tax rate: 20%
If equipment is depreciated using straight line method, what is the depreciation tax shield associated with the new equipment?
(a) 10,000 (b) 50,000
(c) 2,000 (d) 1,000

58. If interest expense of a company is $300,000 and tax rate is 40%, the after-tax cost of interest is:
(a) $1,20,000 (b) $3,00,000
(c) $1,80,000 (d) $75,000

59. If interest expense of a company is Rs. 10,00,000 and tax rats is 30%, the after-tax cost Of interest is:
(a) 3,00,000 (b) 7,00,000
(c) 1,00,000 (d) 75,000

60. Calculate the internal rate of return:
Project initial investment is Rs. 18,000
The annual cash flow will be Rs. 5,600 for a period of 5 years.
(a) 14%- (b) 15%
(c) 16% (d) 16.8%

61. Which of the following statements is true about mutually exclusive projects?
(a) They are not in direct competition with each other.
(b) They are in direct competition with each other.
(c) They are not evaluated based on shareholder wealth.
(d) They are never evaluated

62. What is the net present value?
(a) the future value of a project's cash flows plus its initial cost
(b) the present value of a project's cash flows, plus its initial cost
(c) the future value of a project's cash flows minus its initial cost
(d) the present value of a project's cash flows minus its initial cost

63. Why are projects with negative net present values (NPVs) unacceptable to a firm?
(a) Returns lower than the cost of capital result in firm failure.
(b) Returns with negative NPVs cause an equal profit ratio.
(c) Returns with negative NPVs are acceptable to a firm.
(d) Returns lower than the cost of capital result in higher profit ratios

64. The internal Rate of Return is defined as
(a) the discount rate which causes the payback to equal one year.
(b) the discount rate which causes the NPV to equal zero.
(c) the ROE when the NPV equals 0.
(d) the ROE associated with project maximization

65. A project whose acceptance requires the acceptance of another project is known as:
(a) dependent project (b) an independent project
(c) a mutually exclusive project (d) a rational project

66. Each of the following techniques use discounted cash flows to incorporate the time value of money into their analysis except
(a) net present value (NPV)
(b) payback method
(c) internal rate of return (IRR)
(d) modified internal rate of return

67. What is a way to operationalize shareholder wealth maximization?
(a) Identify and select projects that are expected to have negative net future values.
(b) Identify and select projects that are expected to have positive net future values.
(c) Identify and select projects that are expected to have positive net present values.
(d) Identify and select projects that are not expected to have positive net present values

68. The Net Present Value method of evaluating projects is consistent with:
(a) the maximization of earnings per share
(b) the maximization of shareholder wealth
(c) the maximization of net income
(d) None of the above

69. The reinvestment assumption using the Internal Rate of Return method is that:
(a) intermediate cash flows are reinvested at the required rate of return,
(b) intermediate cash flows are reinvested at the internal rate of return.
(c) intermediate cash flows are reinvested at the modified internal rate of return
(d) None of the above

70. In mutually exclusive projects, project which is selected for comparison with others must have
(a) higher net present value (b) lower net present value
(c) zero net present value (d) all of the above

71. Present value of future cash flows is $2000 and an initial cost is $1100 then profitability index will be
(a) 0.55 (b) 1.82
(c) 0.55 (d) 0.0182

72. Profitability index in capital budgeting is used to
(a) negative, projects (b) relative projects
(c) evaluate projects (d) earned projects

73. In calculation of internal rate of return, an assumption states that, received cash flow from project must
   (a) be reinvested (b) not be reinvested
   (c) be earned (d) not be earned

74. Process in which managers of company identify projects to add value is classified as
   (a) capital budgeting (b) cost budgeting
   (c) book value budgeting (d) equity budgeting

75. Number of years forecasted to recover an original investment is classified as
   (a) payback period (b) forecasted period
   (c) original period (d) investment period

76. Situation in which firm limits expenditures on capital is classified as
   (a) optimal rationing (b) capital rationing
   (c) marginal rationing (d) transaction rationing

77. Initial cost is $5000 and probability index is 3.2 then present value of cash flows is
   (a) 8200 (b) 16000
   (c) 0.0064 (d) 1562.5

78. Present value of future cash flows is divided by an initial cost of project to calculate
   (a) negative index (b) exchange index
   (c) project index (d) profitability index

79. If net present value is positive then profitability index will be
   (a) greater than two (b) equal to
   (c) less than one (d) greater than one

80. Sum of discounted cash flows is best defined as
   (a) technical equity (b) defined future value
   (c) project net present value (d) equity net present value

81. An initial cost is $6000 and probability index is 5.6 then present value of cash flows will be
   (a) 25000 (b) 28000
   (c) 33600 (d) 30000

82. A type of project whose cash flows would not depend on each other is classified as
   (a) project net gain (b) independent projects
   (c) dependent projects (d) net value projects

83. Net present value, profitability index, payback and discounted payback are methods to
   (a) evaluate cash flow (b) evaluate projects
   (c) evaluate budgeting (d) evaluate equity

84. Payback period in which an expected cash flows are discounted with help of project cost of capital is classified as
  (a) discounted payback period
  (b) discounted rate of return
  (c) discounted cash flows
  (d) discounted project cost

## ANSWER

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **1** | (a) | **2** | (a) | **3** | (b) | **4** | (c) | **5** | (b) | **6** | (a) |
| **7** | (a) | **8** | (c) | **9** | (d) | **10** | (a) | **11** | (b) | **12** | (c) |
| **13** | (d) | **14** | (d) | **15** | (d) | **16** | (d) | **17** | (d) | **18** | (c) |
| **19** | (d) | **20** | (b) | **21** | (a) | **22** | (c) | **23** | (b) | **24** | (b) |
| **25** | (d) | **26** | (c) | **27** | (a) | **28** | (a) | **29** | (c) | **30** | (d) |
| **31** | (c) | **32** | (a) | **33** | (b) | **34** | (b) | **35** | (a) | **36** | (c) |
| **37** | (c) | **38** | (b) | **39** | (b) | **40** | (a) | **41** | (b) | **42** | (c) |
| **43** | (b) | **44** | (a) | **45** | (c) | **46** | (c) | **47** | (d) | **48** | (c) |
| **49** | (c) | **50** | (a) | **51** | (b) | **52** | (c) | **53** | (d) | **54** | (c) |
| **55** | (a) | **56** | (c) | **57** | (c) | **58** | (c) | **59** | (b) | **60** | (d) |
| **61** | (b) | **62** | (d) | **63** | (a) | **64** | (b) | **65** | (a) | **66** | (b) |
| **67** | (c) | **68** | (b) | **69** | (b) | **70** | (a) | **71** | (b) | **72** | (c) |
| **73** | (a) | **74** | (a) | **75** | (a) | **76** | (b) | **77** | (b) | **78** | (d) |
| **79** | (d) | **80** | (c) | **81** | (c) | **82** | (b) | **83** | (b) | **84** | (a) |

# 3. Capital Structure

## MULTIPLE CHOICE QUESTIONS

1. The optimal capital structure for a company is the one which offers a balance between the ideal debt-to-equity ranges thus minimizing the firm's cost of capital.
   (a) True (b) False

2. …………… is "The mix of a firm's permanent long term financing represented by debt, preferred stock and common stock equity"
   (a) Capital Budgeting (b) Capital Rationing
   (c) Capital Structure (d) Financial Leverage

3. Type of capital structure includes:
   (a) Horizontal capital structure (b) Vertical capital structure
   (c) Pyramid Shaped capital structure (d) all of the above

4. In a the firm has zero debt components in the structure mix
   (a) Horizontal capital-structure
   (b) Vertical capital structure
   (c) Pyramid shaped capital structure
   (d) Inverted Pyramid Shaped capital structure

5. In a vertical capital structure, the base of the structure is formed by a ' small amount of
   (a) Debt (b) Equity share capital
   (c) Preference share capital (d) All of the above

6. A ……………. has a large proportion consisting of equity capital and retained earnings which have been ploughed back into the firm over a considerably large period of time.
   (a) Horizontal capital structure
   (b) Vertical capital structure
   (c) Pyramid shaped capital structure
   (d) Inverted Pyramid Shaped capital structure

7. In ……………..there is a small component of equity capital, reasonable level of retained earnings but an ever increasing component of debt.
   (a) Horizontal capital structure
   (b) Vertical capital structure
   (c) Pyramid shaped capital structure
   (d) Inverted Pyramid Shaped capital structure

8. Which of the following statement is correct?
   (a) The capital structure reflects the overall strategy of the firm
   (b) Capital structure is an indicator of the risk profile of the firm
   (c) Capital structure acts as a tax management tool
   (d) All of the above

9 .................. relates to long term capital deployment for creation of long term assets.
(a) Capital Structure (b) Financial Structure
(c) Financial Leverage (d) Operating Leverage

10. ................. involves creation of both long term and short term assets
(a) Capital Structure (b) Financial Structure
(c) Financial Leverage (d) Operating Leverage

11. Which of the following statement is not correct?
(a) Capital structure of the company should generate maximum returns to the shareholders without adding additional cost to them
(b) The capital structure should be flexible. It should be possible for a company to adapt its capital structure with a minimum cost and delay if warranted by a changed situation
(c) The capital structure should be determined without considering the debt capacity of the company
(d) All of the above

12. While designing capital structure, which point should be kept in view:
(a) Design should be functional
(b) Design should be flexible
(c) Design should be conforming statutory guidelines
(d) All of the above

13. Factors affecting cost of capital includes:
(a) Cash flow position
(b) Interest coverage ratio and debt coverage ratio
(c) Cost of debt *
(d) All of the above

14. Factors affecting cost of capital does not include:
(a) Tax Rate (b) Operating or Business Risk
(c) Cost of equity capital (d) War between 2 nations

15. Which of the following is not the capital structure theories /approach?
(a) Net Income approach
(b) Net Operating Income approach
(c) Modigliani Miller (MM) approach
(d) Sensitivity Analysis approach

16. According to..................... approach, there is a relationship between capital structure and the value of the firm and therefore, the firm can affect its value by increasing or decreasing the debt proportion in the overall financial mix.
(a) Net Income approach
(b) Net Operating Income approach
(c) Modigliani Miller (MM) approach
(d) Traditional Approach

17. The Net income Approach makes the following assumptions:
    (a) The total capital requirement of the firm is given and remains constant.
    (b) Cost of debt (Kd) is less than cost of equity (Ke).
    (c) Both Kd and Ke remain constant and increase in financial leverage
    (d) All of the above

18. According to Net Operating Income Approach (NOI Approach), the market value of the firm depends upon the net operating profit or EBIT and the -
    (a) Cost of debt (b) Cost of equity
    (c) Cost of capital (d) Retained Earnings

19. According to NOI Approach, the financing mix or the capital structure is ……………… and does not affect the value of the firm
    (a) Relevant (b) Irrelevant
    (c) Constant (d) Infinite

20. The NOI Approach makes the following assumption:
    (a) The investors see the firm as a whole and thus capitalize-the total earnings of the firm to find the value of the firm as a whole.
    (b) The overall cost of capital KO, of the firm is constant and depends upon the business risk which also is assumed to be unchanged.
    (c) The cost of debt, Kd, is also taken as constant and there is no taxes.
    (d) All of the above

21. The ………….. to capital structure advocates that there is a right combination of equity and debt in the capital structure, at which the market value of a firm is maximum
    (a) Net Income approach
    (b) Net Operating Income approach
    (c) Modigliani Miller (MM) approach
    (d) Traditional Approach

22. As per Traditional approach, debt should exist, in the capital structure only up to a specific point, beyond which, any increase in leverage would result in the………….. in value of the firm.
    (a) Reduction (b) Increase
    (c) Constant (d) No change

23. Assumptions under traditional approach are:
    (a) The rate of interest on debt remains constant for a certain period and thereafter with an increase in leverage, it increases.
    (b) The expected rate by equity shareholders remains constant or increase gradually. After that, the equity shareholders starts perceiving a financial risk and then from the optimal point and the expected rate increases speedily.
    (c) WACC first decreases and then increases.
    (d) All of the above

24. As per ………….. value of a firm depends solely on its future earnings stream, and hence its value is unaffected by its debt/equity mix
   (a) Net Income approach
   (b) Net Operating Income approach
   (c) Modigliani Miller (MM) approach
   (d) Traditional Approach

25. The use of EBIT - EPS analysis indicates to management the projected for different financial plans
   (a) Revenue (b) Cost
   (c) EPS (d) Dividend

26. EBITDA, an acronym for:
   (a) Earnings before interest, taxes, depreciation and amortization
   (b) Earnings before tax
   (c) Earnings before Interest and tax
   (d) Earnings before Interest, tax and depreciation

27. EBITDA is used to analyze a company's operating profitability before:
   (a) non-operating expenses (such as interest)
   (b) non-cash charges (depreciation and amortization).
   (c) Both (a) and (b)
   (d) None of the above

28. EBITDA is calculated by taking net income and adding _____ expenses back to it.
   (a) Interest (b) Taxes
   (c) Depreciation and amortization (d) All of the above

29. EBITDA cannot be used to compare companies against each other and against industry averages.
   (a) True (b) False

30. Type of leverage includes:
   (a) Operating Leverage (b) Financial Leverage
   (c) Combined Leverage (d) All of the above

31. ……………..may be defined as the company's ability to use fixed operating costs to magnify the effects of changes in sales on its earnings before interest and taxes.
   (a) Operating Leverage (b) Financial Leverage
   (c) Combined Leverage (d) All of the above

32 ……………… represents the relationship between the company's earnings before interest and taxes (EBIT) or operating profit and the earning available to equity shareholders.
   (a) Operating Leverage (b) Financial Leverage
   (c) Combined Leverage (d) All of the above

33. Financial leverage may be …………….. depends upon the use of fixed cost funds.
   (a) Favourable (b) Unfavourable
   (c) Favourable or unfavourable (d) Neither (a) nor (b)

34. …………. depends upon fixed cost and variable cost
(a) Operating Leverage (b) Financial Leverage
(c) Combined Leverage . (d) None of the above

35. …………… depends upon the operating profits
(a) Operating Leverage (b) Financial Leverage
(c) Both(a) and (b) (d) None of the above

36. ………….. Js the level of EBIT which covers all fixed financing costs of the company:
(a) Financial Break Even Point
(b) Operating Break Even-up Point
(c) Combined Break Even Point
(d) All of the above

37. Financial BEP is the level of EBIT at which EPS is
(a) Zero (b) One
(c) Maximum (d) Minimum

38. Indifference Point is the point at which different sets of debt ratios (percentage of debt to total capital employed in the company) gives the same_
(a) EPS (b) EBIT
(c) Revenue (d) Cost

39. ……………. expresses the relationship between the revenue in the account of sales and the taxable income
(a) Operating Leverage (b) Financial Leverage
(c) Combined Leverage (d) None of the above

40 …………….. measures the sensitivity of return in investment of charges in the level of current assets.
(a) Operating Leverage (b) Financial Leverage
(c) Combined Leverage (d) Working Capital Leverage

41. The Proportion of …………….. in the financial-plan of a firm is called leverage
(a) Debt to equity (b) Revenue to Cost
(c) Debt to interest (d) Revenue to EPS

42. As the financial leverage increases, the breakeven point of the company…………..
(a) Increase (b) Decrease
(c) Constant (d) Zero

43. Increase in financial leverage, increases the risk to stockholders.
(a) True (b) False

44. The term "capital structure" refers to:
(a) long-term debt, preferred stock, and common stock equity.
(b) current assets and current liabilities
(c) total assets minus liabilities
(d) shareholders' equity.

45. The traditional approach towards the valuation of a company assumes:
    (a) that the overall capitalization rate holds constant with changes in financial leverage.
    (b) that there is an optimum capital structure.
    (c) that total risk is not altered by changes in the capital structure.
    (d) that markets are perfect

46. Two firms that are virtually identical except for their capital structure are selling in the market at different values. According to M&M:
    (a) one will be at greater risk of bankruptcy
    (b) the firm with greater financial leverage will have the higher value.
    (c) this proves that markets cannot be efficient.
    (d) this will not continue because arbitrage will eventually cause the ' firms to sell at the same value.

47. Retained earnings are
    (a) an indication of a company's liquidity.
    (b) the same as cash in the bank.
    (c) not important when determining dividends .
    (d) the cumulative earnings of the company after dividends

48. Operating leverage analyses the relationship between sales level and 5 EPS.
    (a) True (b) False

49. Financial leverage depends upon the operating leverage.
    (a) True (b) False

50. Dividend on Preference shares is a factor of operating leverage.
    (a) True (b) False

51. Operating leverage may be defined as Contribution - EPS.
    (a) True (b) False

52. Financial leverage depends upon the fixed financial charges.
    (a) True (b) False

53. Combined leverage establishes the relationship between operating 6* leverage and financial leverage.
    (a) True (b) False

54. Financial leverage is always beneficial to the firm.
    (a) True (b) False

55. Total risk of a firm is determined by the combined effect of operating and financial leverages.
    (a) True (b) False

56. Combined leverage helps in analysing the effect of change in sales level on the EPS of the firm
    (a) True (b) False

57. Operating leverage helps in analysis of:
(a) Business Risk (b) Financing Risk
(c) Production Risk (d) Credit Risk

58. Which of the following is studied with the help of financial leverage?
(a) Marketing Risk (b) Interest Rate Risk
(c) Foreign Exchange Risk (d) Financing risk

59. Combined Leverage is obtained from Operating Leverage and Financial Leverage by their:
(a) Addition (b) Subtraction
(c) Multiplication (d) Any of these

60. High degree of financial leverage means:
(a) High debt proportion (b) Lower debt proportion
(c) Equal debt and equity (d) No debt

61. Operating leverage arises because of:
(a) Fixed Cost of Production (b) Fixed Interest Cost
(c) Variable Cost (d) None of the above

62. Financial Leverage arises because of:
(a) Fixed cost of production (b) Variable Cost
(c) Interest Cost (d) None of the above

63. Operating Leverage is calculated as:
(a) Contribution/EBIT (b) EBIT/PBT
(c) EBIT/Interest (d) EBIT/Tax

64. Financial Leverage is calculated as:
(a) EBIT/Contribution (b) EBIT/PBT
(c) EBIT/Sale (d) EBIT/Variable Cost

65. Which combination is generally good for firms
(a) High Operating Leverage, High Financial Leverage
(b) Low Operating Leverage, Low Financial Leverage
(c) High Operating Leverage, Low Financial Leverage
(d) None of these

66. Combined leverage can be used to measure the relationship between:
(a) EBIT and EPS (b) PAT and EPS
(c) Sales and EPS (d) Sales and EBIT

67. Financial Leverage is zero if:
(a) EBIT = Interest (b) EBIT = Zero
(c) EBIT = Fixed Cost (d) EBIT = Pref. Dividend

68. Business risk can be measured by:
(a) Financial leverage (b) Operating leverage
(c) Combined leverage (d) None of the above

69. Financial Leverage measures relationship between
    - (a) EBIT and PBT'
    - (b) EBIT and EPS
    - (c) Sales and PBT
    - (d) Sales and EPS

70. Use of Preference Share Capital in Capital structure
    - (a) Increases Operating Leverage
    - (b) Increases Financial Leverage
    - (c) Decreases Operating Leverage
    - (d) Decreases Financial Leverage

71. Which of the following is correct?
    - (a) Combined Leverage= Operating Leverage + Financial Leverage
    - (b) Combined Leverage= Operating Leverage-Financial Leverage
    - (c) Combined Leverage= Operating Leverage x Financial Leverage
    - (d) Combined Leverage= Operating Leverage-Financial Leverage

72. If the fixed cost of production is zero, which one of the following is correct?
    - (a) Operating Leverage is zero
    - (b) Financial Leverage is zero
    - (c) Combined Leverage is zero
    - (d) None of the above

73. If a firm has no debt, which one is correct?
    - (a) Operating Leverage is one,
    - (b) Financial Leverage is one,
    - (c) Operating Leverage is zero,
    - (d) Financial Leverage is zero

74. If a firm ha£ a Degree of Operating Leverage of 2.8, it means:
    - (a) If sales increase by 2.8%, the EBIT will increase by 1%,
    - (b) If EBIT increase by 2.896, the EPS will increase by 1 %,
    - (c) If sales rise by 1 %, EBIT will rise by 2.8%,
    - (d) None of the above

75. Higher Operating Leverage is related to the use of higher:
    - (a) Debt,
    - (b) Equity
    - (c) Fixed Cost
    - (d) Variable Cost

76. Higher Financial Leverage is related the use of:
    - (a) Higher Equity
    - (b) Higher Debt
    - (c) Lower Debt
    - (d) None of the above

77. Which of the following is not the source of long term finance?
    - (a) Equity shares
    - (b) Preference shares
    - (c) Commercial Paper
    - (d) Reserves and Surplus

78. XYZ Ltd. has the following current and projected information:

| | current | projected |
|---|---|---|
| Current Projected Sales | LKR 700,00 | LKR 800,000 |
| Variable costs (35% of sales) | LKR 245,000 | LKR 280,000 |
| Fixed costs (excluding interest and taxes LKR 120,000 LKR 120,000 Earnings per share | LKR 0.90 | LKR 1.00 |

Given the above information, what is the projected degree of operating leverage for XYZ Ltd.?

(a) 0.78 (b) 0.57
(c) 0.74 (d) 1.36

79. Trout Ltd. produces a single product that has a contribution margin of 60% per unit and sold 500,000 units last year. Trout has a degree of operating leverage of 1.60 and a degree of financial leverage of 1.20 for the current year. If the sales volume were to increase by 10% this coming year, what would be the expected percentage increase in earnings per share (rounded to the nearest percent)?

(a) 16% (b) 12%
(c) 6% (d) 19%

80. SSC Inc. has the following financial information:

| | |
|---|---|
| Current liabilities | $900,000 |
| Long-term debt | $1,300,000 |
| Total liabilities | $2,200,000 |
| Preferred shares | $3,500,000 |
| Common equity | $6,200,000 |

The long-term debt consists of a single bond issue paying 6% interest annually. These bonds currently yield 7.5% in the market. The current cost of the preferred shares is 8%. The current cost of the common shares is 12%. The company's tax rate is 40%. What is SCC Inc.'s weighted average cost of capital (rounded to the nearest tenth of a percent)?

(a) 9.4% (b) 10.2%
(c) 9.8% (d) 9.2%

81. Flower Inc. is issuing preferred shares to raise capital. Each preferred share will be issued with a par value of $200 and a cumulative dividend of $18. The preferred shares will result in after-tax underwriting expenses of $3 per share. What is the cost of issuing the preferred shares?

(a) 9.14% (b) 9.00%
(c) 7.50% (d) 10.50%

## Answer

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **1** | (a) | **2** | (c) | **3** | (d) | **4** | (a) | **5** | (b) | **6** | (c) |
| **7** | (d) | **8** | (d) | **9** | (a) | **10** | (b) | **11** | (c) | **12** | (d) |
| **13** | (d) | **14** | (d) | **15** | (d) | **16** | (a) | **17** | (d) | **18** | (c) |
| **19** | (b) | **20** | (d) | **21** | (d) | **22** | (a) | **23** | (d) | **24** | (c) |
| **25** | (c) | **26** | (a) | **27** | (c) | **28** | (d) | **29** | (b) | **30** | (d) |
| **31** | (a) | **32** | (b) | **33** | (c) | **34** | (a) | **35** | .(b) | **36** | (a) |
| **37** | (a) | **38** | (a) | **39** | (c) | **40** | (d) | **41** | (a) | **42** | (a) |
| **43** | (a) | **44** | (a) | **45** | (b) | **46** | (d) | **47** | (d) | **48** | (b) |
| **49** | (b) | **50** | (b) | **51** | (b) | **52** | (a) | **53** | (b) | **54** | (b) |
| **55** | (a) | **56** | (a) | **57** | (a) | **58** | (d) | **59** | (c) | **60** | (a) |
| **61** | (a) | **62** | (c) | **63** | (a) | **64** | (b) | **65** | (c) | **66** | (c) |
| **67** | (b) | **68** | (b) | **69** | (b) | **70** | (b) | **71** | (c) | **72** | (d) |
| **73** | (b) | **74** | (c) | **75** | (c) | **76** | (b) | **77** | (c) | **78** | (d) |
| **79** | (d) | **80** | (c) | **81** | (a) | | | | | | | | |

# 4. Sources of Raising Long- Term Finance and Cost Of Capital

## Multiple Choice Questions

1. Cost of capital of company plays an important role in deciding the capital structure of a company.
   (a) True (b) False

2. Which of the following statement is not correct?
   (a) Long Term Finance involves financing for fixed capital required for investment in fixed assets
   (b) Long Term Finance is obtained from Capital Market.
   (c) Long term sources of finance have a short term impact on the business
   (d) Long term finance is used for financing big projects, expansion plans, increasing production, funding operations

3. Purpose of long term finance includes:
   (a) To Finance Fixed Assets
   (b) To finance the permanent part of working capital
   (c) To finance growth and expansion of business
   (d) All of the above

4. Factors determining long term finance needs of a company includes:
   (a) Nature of Business (b) Nature of goods produced
   (c) Technology used (d) All of the above

5. Sources of long term finance includes:
   (a) Ownership capital (b) Borrowed Capital
   (c) Both (a) and (b) (d) None of the above

6. Which of the following is not the part of ownership capital?
   (a) Equity Share Capital (b) Preference share capital
   (c) Debentures (d) Retained Earnings

7. Which of the following forms the part of borrowing capital?
   (a) Debentures (b) Term loans
   (c) Both (a) and (b) (d) None of the above

8. ........................represents the investment made by the owners of the business.
   (a) Equity Share Capital (b) Preference Share capital
   (c) Retained Earnings (d) Debentures

9. .................... represents the investment made by the preference shareholders.
   (a) Equity Share Capital (b) Preference Share capital
   (c) Retained Earnings (d) Debentures

10. ................ enjoy preference over payment of dividend.
    (a) Equity Share Capital (b) Preference Share capital
    (c) Retained Earnings (d) None of the above

11. ………….. represents the earnings not distributed to shareholders.
    (a) Equity Share Capital (b) Preference Share capital
    (c) Retained Earnings (d) Debentures

12. Debenture holders have voting rights and there is a dilution of ownership
    (a) True (b) False

13. Debentures can be:
    (a) Convertible debentures (b) Non-convertible debentures
    (c) Both (a) and (b) (d) None of the above

14. Term loans from banks include loan from:
    (a) Industrial development banks (b) Cooperative banks
    (c) Commercial banks (d) All of the above

15. Loan from financial institutions include loan from:
    (a) Industrial Finance Corporation of India (IFCI),
    (b) Industrial Development Bank of India (IDBI)
    (c) Small Industries Development Bank of India (SIDBI)
    (d) All of the above

16. Which of the following statement is not correct?
    (a) Financial Institutions grant loans for a longer period to industrial establishment
    (b) Financial Institutions grant loans to help the establishment of business units that require small amount of funds
    (c) Financial Institutions grant loans to provide support for the speedy development of the economy in general and backward regions in particular
    (d) Financial Institutions grant loans to provide technical and professional management services and help in identification, evaluation and execution of new projects.

17. Cost of capital is the rate of return that a firm ………….. earn on its project investments to maintain its market value and attract funds
    (a) Must (b) Can
    (c) Should (d) None of the above

18 …………………. is the rate of return the firm required from investment in order to increase the value of the firm in the market place.
    (a) Cost of capital (b) Cost of equity share capital
    (c) Cost of Retained earnings (d) Cost of debentures

19. Cost of capital is used to make:
    (a) Capital budgeting decision
    (b) Capital structure decision
    (c) Evaluate the financial performance of company
    (d) All of the above

20. Factors affecting cost of capital can be:
    (a) Controllable factors (b) Uncontrollable factors
    (c) Both (a) and (b) (d) None of the above

21. Which of the following factor is not the controllable factor affecting the cost of capital:
    (a) Capital structure policy (b) Level of interest rates
    (c) Dividend policy (d) All of the above

22. Which of the following factor is the non- controllable factor affecting the cost of capitals
    (a) Tax Rates (b) Level of interest rates
    (c) Both (a) and (b) (d) Dividend Policy

23. Tax rate does not affect the cost of capital of company
    (a) True (b) False

24. Capital structure of the company affects the cost of capital of company.
    (a) True (b) False

25. Tax rates and interest rates prevailing in economy are the non-controllable factor that affects the cost of capital of company
    (a) True (b) False

26 ……………. refers to the cost of long term debentures/bond
    (a) Cost of retained earning (b) Cost of debt
    (c) Cost of company (d) Cost of short term debt

27. Cost of Debt is calculated…………………
    (a) Before Tax (b) After tax
    (c) Both (a) and (b) (d) None of the above

28. If the cost of debt for Cowboy Energy Services is 10% (effective rate) and its tax rate is 40% then Kd is:
    (a) 10% (b) 5%
    (c) 6% (d) 4%

29. If the cost of debt for Rainbow Services is 15% (effective rate) and. its tax rate is 20% then Kd is:
    (a) 15% (b) 12%
    (c) 18% (d) 3%

30. Jain & Co sells a new issue of 6% irredeemable debentures to raise Rs. 100,000 and realizes the full face value of Rs. 100. The company falls in 40% tax bracket. Debts are issued at par. Find Cost of Capital
    (a) 4% (b) 6%
    (c) 2.4% (d) 3.6%

31. Classic Industries sells a new issue of 8% irredeemable debentures to raise Rs. 1,00,000 and realizes the full face value of Rs. 100- The company falls in 20% tax bracket. Debts are issued at par. Find Cost of Capital
(a) 8% (b) 6%
(c) 6.4% (d) 1.6%

32. Jain & Co sells a new issue of 6%, 1000 irredeemable debentures of Rs. 100 each @ 10 % premium. The company falls in 40% tax bracket. Find Cost of Capital
(a) 4% (b) 6%
(c) 2.4% (d) 3.27%

33. Classic Industries sells a new issue of 8%, 1000 irredeemable debentures of Rs. 100 each @ 20 % premium. The company falls in 20% tax bracket. Find Cost of Capital
(a) 8% (b) 6%
(c) 5.33% (d) 1.6%

34. Jain & Co sells a new issue of 6%, 1000 irredeemable debentures of Rs. 100 each @ 10% discount. The company falls in 40% tax bracket. Find Cost of Capital
(a) 4% (b) 6%
(c) 2.4% (d) 3.27%

35. A firm issues debentures worth Rs. 1,00,000 and realizes Rs. 98,000 after allowing 2% commission to brokers. They carry an interest rate of 10% and are due for maturity at the end of 10th year. The company has 40% tax bracket. Calculate cost of debt after tax.
(a) 10% (b) 6%
(c) 6.18% (d) 4%

36. X Limited issues its Bond at par @ Rs. 1,000 per bond. These bonds will mature after 20 years at par and bears coupon rate of 10%. Coupons are annual. The bond will sell for par but flotation costs amount to Rs. 50 per bond. What is the after-tax cost of debt for X Limited?
(a) 10% (b) 6%
(c) 8% (d) 7%

37. Which of the following statement is correct?
(a) Preference shares are entitled to a fixed dividend
(b) Preference shares are not entitled to a fixed dividend
(c) Preference shares are entitled to a fixed dividend, but subject to availability of profit for distribution.
(d) None of the above

38. Preference shares can be:
(a) Irredeemable preference shares
(b) Redeemable preference shares
(c) Both (a) and (b)
(d) None of the above

39 ................ are those shares issuing by which the company has no obligation to pay back the principal amount of the shares during its lifetime
(a) Irredeemable preference shares (b) Redeemable preference shares
(c) Cumulative preference shares (d) Non-cumulative preference shares

40 ………….. are those shares whose dividends will get accumulated if they are not paid
(a) Irredeemable preference shares (b) Redeemable preference shares
(c) Cumulative preference shares (d) Non-cumulative preference shares

41. Calculate the cost of 10% preference capital of Rs. 10,000 preference shares whose face value is Rs. 100. The market price of the share is currently Rs. 115.
(a) 10% (b) 12%
(c) 8,7% (d) 11.5%

42. A limited company issues 8% preference shares which are irredeemable. The face value of share is Rs. 100 but they are issued at Rs. 105. The floatation cost is Rs. 3 per share, calculate case of capital.
(a) 8% (b) 6%
(c) 6.84% (d) 7.84%

43. A company issues Rs. 10,000, 8% preference shares of Rs. 100 each redeemable after 20 years at face value. The floatation costs are Rs. 3 per share find case of capital.
(a) 8% (b) 6%
(c) 8.27% (d) 7.84%

44. ……………….. are the last claimant on the profits of the company.
(a) Equity shareholders (b) Preference shareholders
(c) Debenture holders (d) All of the above

45 ……………… is the minimum rate of return that a company must earn on the equity financed portion of its investments in order to maintain the market price of the equity share at the current level.
(a) Cost of equity capital
(b) Cost of preference share capital
(c) Cost of debentures
(d) Cost of retained earnings

46. Ke = Rf + B(Rm> Rf) is a formula to calculate cost of equity as per: -
(a) CAPM Model
(b) Bond Yield plus Risk Premium Approach
(c) Dividend Growth Model Approach. -
(d) Earning Price Ratio Approach

47. Calculate the cost of equity capital for a company whose Risk-free rate =10%, equity market required return =18% with a beta of 0.5.
(a) 10% (b) 14%
(c) 15% (d) 12%

48. Calculate the cost of equity capital for a company whose Risk-free rate = 8%, equity market required return =15% with a beta of 0.4.
(a) 10% (b) 14%
(c) 10.8% (d) 9.2%

49. Given, the yield on debt is 10% and the risk premium as 5%, calculate the cost of equity.
(a) 10% (b) 5%
(c) 15% (d) 20%

50. Given, the yield on debt is 12% and the risk premium as 2%, calculate the cost of equity.-
(a) 10% (b) 12%
(c) 8% (d) 14%

51. As per ................a judgmental risk premium to the observed yield on the long-term bonds of the firm is added to get the cost of equity.
(a) CAPM Model
(b) Bond Yield Plus Risk Premium Approach
(c) Dividend Growth Model Approach
(d) Earning Price Ratio Approach

52. A company has issued 5,000 equity shares of Rs. 100 each. Its current market price is Rs. 95 per share and the current dividend is Rs. 4.5 per share. The dividends are expected to grow at the rate of 6%. Compute the cost of equity capital
(a) 10% (b) 11 %
(c) 12% (d) o%

53. Capital structure can vary according to changing requirements of the firm
(a) True (b) False

54. Ke = E1 / Po is a formula to calculate cost of equity as per:
(a) CAPM Model
(b) Bond Yield plus Risk Premium Approach
(c) Dividend Growth Model Approach
(d) Earning Price Ratio Approach

55. A company has currently 10,000 equity shares of Rs. 100 each and its' earnings are Rs. 150,000. Its' current market price is Rs. 112 and the growth rate of EPS is expected to be 5%. Calculate the cost of equity
(a) 10% (b) 12%
(c) 14% (d) 16%

56. Kritika Limited is currently financed with Rs. 1,000,000 of 7% bonds, and Rs. 2,000,000 of common stock. The stock has a beta of 1.5, and the risk free rate is 4%, and the market risk premium is 3.5%. The marginal tax rate for a corporation of AKL'§ size is 35%. What is Kritika Limited WACC?
(a) 5.68% (b) 6.68%
(C) 7.68% (d) 8.68%

57. The firm is not required to pay dividends on retained earnings, so it may be argued that the retained earnings have no cost.
(a) True (b) False

58. There is an opportunity cost involved in the firms retaining the earnings and an estimation of this cost may be taken up as a measure of cost of capital of retained earnings.
(a) True (b) False

59. The cost of retained earnings are often taken as equal to the
(a) Cost of debt (b) Cost of preference share
(c) Cost of equity (d) None of the above

60. The weighted average cost of capital (WACC) is the ................ of the costs of different components of the capital structure of a firm.
(a) Weighted average (b) Simple average
(c) Timely average (d) Quarterly average

61. ............................is calculated after assigning different weights to the components according to the proportion of that component in the capital structure
(a) Cost of equity (b) Cost of debt
(c) Weighted Average cost of capital (d) Simple Average cost of capital

62. A company has currently 10,000 equity shares of Rs. 100 each and its' earnings are Rs. 180,000. Its' current market price is Rs. 198 and the growth rate of EPS is expected to be 10%. Calculate the cost of equity
(a) 10% (b) 12%
(c) 14% (d) 16%

63. The weights are said to be book value weights if the proportion of different sources are ascertained on the basis of the...........................
(a) Face value (b) Market value
(c) Both (a) and (b) (d) None of the above

64. The weights to be used for calculation of WACC can be:
(a) Based on the book value (b) Based on the market value of the funds
(c) Both (a) and (b) (d) None of the above

65. ..........................can be defined as the cost of additional capital introduced in the capital structure
(a) Weighted average cost of capital (b) Simple Average cost of capital
(c) Marginal Cost of capital (d) Liquid cost of capital

66. Information costs both increase the marginal cost of capital and reduce the internal rate of return on investment projects.
(a) True (b) False

67. Depreciation expenses involve no direct cash outlay and can be safely ignored in investment project evaluation.
(a) True (b) False

68. The marginal cost of capital will be less elastic for larger firms than for smaller firms.
(a) True (b) False

69. In practice, the component costs of debt and equity are jointly rather than independently determined.
(a) True (b) False

70. Investments necessary to replace worn-out or damaged equipment tend to have low levels of risk.
(a) True (b) False

71. ABC Ltd. has the following capital structure.

| | Rs. |
|---|---|
| Equity (expected dividend 12%) | 10,00,000 |
| 10% preference | 5,00,000 |
| 8%,loan | 15,00,000 |

You are required to calculate the weighted average cost of capital, assuming 50% as the rate of income-tax, before and after tax.
(a) 6.66% (b) 7.66%
(c) 8% (d) 9%

72. A company has on its books the following amounts and specific costs of each type of capital.

| Type of Capital | Book Value | Market Value | Specific Costs (%) |
|---|---|---|---|
| | Rs. | Rs. | |
| Debt | 4,00,000 | 3,80,000 | 5 |
| Preference | 1,00,000 | 1,10,000 | 8 |
| Equity | 6,00,000 | 9,00,000 | 15 |
| Retained Earnings | 2,00,000 | 3,00,000 | 13 |
| | 13,00,000 | 16,90,000 | |

Determine the weighted average cost of capital using: Book value weights
(a) 10% (b) 10.1%
(c) 11.1% (d) 11.9%

73. Weighted cost of capital is not the accepted discounting rate for evaluating investment decisions
(a) True (b) False

74. ABC Ltd. has expected earnings at Rs. 30 per share which is growing at 8% annually. Company follows fixed payout ratio of 50%. The market price of its share is Rs. 300. Find the Current cost of equity

(a) 10% (b) 11%
(c) 12% (d) 13%

75. ABC Ltd. has expected earnings at Rs. 30 per share which is growing at 8% annually. Company follows fixed payout ratio of 50%. The market price of its share is Rs. 300. Find the Cost of new equity if the firm issues fresh shares at current market price but with floatation cost of 5%

(a) 13.68% (b) 11%
(c) 12% (d) 13%

76. Oxford Company has complied the information shown in the following table.

| Source of capital | Book Value | Market value | After tax cost |
|---|---|---|---|
| Equity | 1080000 | 3000000 | 17 |
| Preference stock | 50000 | 60000 | 13 |
| Long term debt | 4500000 | 3840000 | 6 |
| Total | 5630000 | 6900000 | |

Calculate the weighted average cost of capital using book value weights.

(a) 6% (b) 7.17%
(c) 8.17% (d) 10.84%

77. The Mountaineer Airline Company has consulted with its investment bankers and determined that they could issue new debt with a yield of 8%. If Mountaineer' marginal tax rate is 39%, what is the after-tax cost of debt to Mountaineer?

(a) 8% (b) 6%
(c) 4.88% (d) 6.88%

78. Funds required for a business may be classified as long term and short term.

(a) True (b) False

79. For an investment to be worthwhile, the expected return on capital must be greater than the cost of capital

(a) True (b) False

80. Rama Company issued 1,20,000 10% debentures of Rs. 10 each at a premium of 10%. The costs of floatation are 4%. The rate of tax applicable to the company is 55%. Complete the cost of debt capital

(a) 4% (b) 4.34%
(c) 4.24% (d) 4.26%

81. Suraiya Limited issued 4,000 12% preference shares of Rs. 100 each at a discount of 5%. Costs of raising capital are Rs. 8,000. Compute the cost of preference capital.
(a) 12% (b) 12.1%
(c) 12.9% (d) 12.8%

82. In weighted average cost of capital, a company can affect its capital cost through
(a) Policy of capital structure (b) Policy of dividends
(c) Policy of investment (d) All of the above

83. Cost of common stock is 13% and bond risk premium is 5% then bond yield would be
(a) 18% (b) 26%
(c) 8% (d) 18%

84. The cost of equity capital is all of the following except:
(a) the minimum rate that a firm should earn on the equity-financed part of an investment.
(b) a return on the equity-financed portion of an investment that, at worst, leaves the market price of the stock unchanged.
(c) by far the most difficult component cost to estimate.
(d) generally lower than the before-tax cost of debt

85. To compute the required rate of return for equity in a company using the CAPM, it is necessary to know all of the following except:
(a) The Risk free rate
(b) The Beta for the firm
(c) The earnings for the next time period
(d) The market return expected for the time period

86. In calculating the costs of the individual components of a firm's financing, the corporate tax rate is important to which of the following component cost formulas?
(a) Equity share capital (b) Debt
(c) Preference shares (d) None of the above

87. If the CAPM is used to estimate the cost of equity capital, the expected excess market return is equal to the:
(a) Return on the stock minus the risk-free rate.
(b) Difference between the return on the market and the risk-free rate.
(c) Beta times the market risk premium.
(d) Beta times the risk-free rate.

88. Peter's Audio Shop has a cost of debt of 7%, a cost of equity of 11%, and a cost of preferred stock of 8%. The firm has 104,000 shares of common stock outstanding at a market price of $20 a share. There are 40,000 shares of preferred stock outstanding at a market price of $34 a share. The bond issue has a total face value of $500,000 and sells at 102% of face value. The tax rate is 34%. What is the weighted average cost of capital: for Peter's Audio Shop?
(a) 6.14% (b) 6.54%
(C) 8.60% (d) 9.14%

89. Cameron Industries is expected to pay an annual dividend of $1.30 a share next year.

The market price of the stock is $24.80 and the growth rate is 3 percent. What is the firm's cost of equity?

(a) 7.58 percent (b) 7.91 percent
(c) 8.24 percent (d) 8.40 percent

90. The cost of equity capital is all of the following except:
(a) The minimum rate that a firm should earn on the equity-financed part of an investment.
(b) A return on the equity-financed portion of an investment that, at worst, leaves the market price of the stock unchanged.
(c) By far the most difficult component cost to estimate.
(d) Generally lower than the before-tax cost of debt

91. A firm has the following capital structure and after-tax costs for the different sources of funds used:

| Source of Funds | Amount Rs. | Proportion % | After-tax-cost |
|---|---|---|---|
| Debt | 15,00,000 | 25 | 5 |
| Preference Shares | 12,00,000 | 20 | 10 |
| Equity Shares | 18,00,000 | 30 | 12 |
| Retained Earnings | 15,00,000 | 25 | 11 |
| Total | 60,00,000 | 100 | |

You are required to compute the weighted average cost of capital.

(a) 9.6% (b) 8.6%
(c) 10% (d) 11%

92. Continuing above question, the firm has 18,000 equity shares of Rs. 100 each outstanding and the current market price is Rs. 300 per calculate the market, value weighted average cost of capital assuming that the market values and book values of the debt and preference capital are same

(a) 9.6% (b) 8.6%
(c) 10.41% (d) 11.41%

93. You are given the following facts about a firm:
1. Risk free rate of return is 11 %.
2. Beta co-efficient of the firm is 1.25.

Compute the cost of equity capital using Capital Asset Pricing Model (CAPM) assuming a market return of 15 percent next year.

(a) 14% (b) 16%
(c) 18% (d) 20%

94. Weighted average cost of capital represents an averaging of all risks of the company and can be used to evaluate investments

(a) True (b) False

95. Calculate the WACC for the Zodiac Company given the following information about its capital structure.

| Capital Component. | Value | Cost |
|---|---|---|
| Debt | 60,000 | 9% |
| Preferred stock | 50,000 | 11% |
| Common stock | 90,000 | 14% |
| | 2,00,000 | |

(a) 10% (b) 11%
(c) 12% (d) 11.75%

96. The return on the Strand Corporation's stock is relatively volatile as reflected by the company's beta of 1.8. The return on the S&P 500 is currently 12% and is expected to remain at that level.
Treasury bills are yielding 6.5%. Estimate Strand's cost of retained earnings.
(a) 10.4% (b) 12.4%
(c) 14.4% (d) 16.4%

97. Periwinkle Inc. paid a dividend of $1.65 last year and its stock is currently selling for $33.60 a share. The company is expected to grow at 7.5% indefinitely. Estimate the firm's cost of retained earnings.
(a) 10% (b) 12.8%
(c) 13.8% (d) 12%

# Answer

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **1** | (a) | **2** | (c) | **3** | (d) | **4** | (d) | **5** | (c) | **6** | (c) |
| **7** | (c) | **8** | (a) | **9** | (b) | **10** | (b) | **11** | (c) | **12** | (b) |
| **13** | (c) | **14** | (d) | **15** | (d) | **16** | (b) | **17** | (a) | **18** | (a) |
| **19** | (d) | **20** | (c) | **21** | (b) | **22** | (c) | **23** | (b) | **24** | (a) |
| **25** | (a) | **26** | (b) | **27** | (b) | **28** | (c) | **29** | (b) | **30** | (d) |
| **31** | (c) | **32** | (d) | **33** | (c) | **34** | (a) | **35** | (c) | **36** | (d) |
| **37** | (c) | **38** | (c) | **39** | (a) | **40** | (c) | **41** | (c) | **42** | (d) |
| **43** | (c) | **44** | (a) | **45** | (a) | **46** | (a) | **47** | (b) | **48** | (c) |
| **49** | (c) | **50** | (d) | **51** | (b) | **52** | (b) | **53** | (a) | **54** | (d) |
| **55** | (C) | **56** | (c) | **57** | (b) | **58** | (a) | **59** | (c) | **60** | (a) |
| **61** | (c) | **62** | (a) | **63** | (a) | **64** | (c) | **65** | (c) | **66** | (a) |
| **67** | (b) | **68** | (b) | **69** | (a) | **70** | (a) | **71** | (b) | **72** | (c) |
| **73** | (b) | **74** | (d) | **75** | (a) | **76** | (c) | **77** | (c) | **78** | (a) |
| **79** | (a) | **80** | (d) | **81** | (c) | **82** | (d) | **83** | (c) | **84** | (d) |
| **85** | (c) | **86** | (b) | **87** | (b) | **88** | (d) | **89** | (c) | **90** | (d) |
| **91** | (a) | **92** | (c) | **93** | (b) | **94** | (a) | **95** | (d) | **96** | (d) |
| **97** | (b) | | | | | | | | | | |

# 5. Project Finance

## Multiple Choice Questions

1. The.................. is the financing of long-term infrastructure, industrial projects and public services based upon a non-recourse or limited recourse financial structure, in which project debt and equity used to finance the project are paid back from the cash flow generated by the project, without any claims (with some very specific exceptions) on the companies that develop these projects.
   (a) Project Finance (b) Project Restructuring
   (c) Capital restructuring (d) Financial Management

2. .................. is a loan structure that relies primarily on the project's cash flow for repayment, with the project's assets, rights and interests held as secondary security or collateral'
   (a) Capital restructuring (b) Project Financing
   (c) Project Restructuring (d) Financial Management

3. Project finance, comes from a combination of both equity and ........................
   (a) Share Capital (b) Asset
   (c) Debt (d) Current Liabilities

4. .................. defines the project activities and end products that will be performed and describes how the activities will be accomplished.
   (a) Project Planning (b) Capital restructuring
   (c) Project Financing (d) Project Restructuring

5. The project planning activities and goals include defining
   (a) The specific work to be performed and goals that define and bind the project.
   (b) Estimates to be documented for planning, tracking, and controlling the project.
   (c) Commitments that are planned, documented, and agreed to by affected groups
   (d) All of the above

6. A .............. is "a formal, approved document that is used to manage and control a project.
   (a) Documented Plan (b) Strategy
   (c) Project plan (d) Any of the above

7. The project planning process consists of the following basic tasks:,
   (a) Define the technical approach used to solve the problem.
   (b) Define and sequence the tasks to be performed and identify all deliverables associated with the project
   (c) Define the dependency relations between tasks
   (d) All of the above

8. The project report is an extremely important aspect of the project.
   (a) True (b) False

9. .................. is a working plan for implementation of project proposal after investment decision by a company has been taken.
   (a) Documented Plan (b) Project report
   (c) Project plan (d) Any of the above

10. There is no prescribed format for the preparation of a project report - but a project report should contain mainly the following set of information in general:
   (a) Information about industry and its status in the economy, present production and demand
   (b) Broad market trend of the product within and outside the states for 5 years
   (c) Raw material survey, giving specifications and quality of raw materials required and their availability.
   (d) Process - broad description of different processes and their relative economics
   (e) All of the above

11. Timing for project appraisal is most important consideration for all types of appraisers.
   (a) True (b) False

12. Under inflationary conditions, the appraisal of the project generally be done keeping in view the following guidelines:
   (a) Make provisions for delay in project implementation
   (b) Sources of finance should be carefully scrutinized with reference to revision in the rate of interest
   (c) Profitability and cash flow projections as made in the project report require revision and adjustment should be made to take care of the inflationary pressures affecting adversely future projections.
   (d) All of the above

13. Project appraisal under inflationary and deflationary conditions can be done using same approach.
   (a) True (b) False

14. Project appraisal, in general, by the financial institutions seek to consider inter alia the following aspects:
   (a) The project profile, its reliable and formulation and project report
   (b) The promoter's capacity and competence
   (c) Viability Tests
   (d) All of the above

15. Viability Tests includes:
   (a) Technical Aspects (b) Financial Aspects
   (c) Economic Aspect (d) All of the above

16 ............... involves studying the feasibility of selected technical processes and its suitability under Indian conditions, Location of the project, Plant layout, appropriateness of the chosen equipment, machinery and technology, availability of raw material, power and other inputs, appropriateness of technology chosen from social point of view, availability of infrastructure for the project, the techno economic

assumptions and parameters used for analyzing costs and benefits and viability provision for treatment of effluents, training of manpower, legal requirement on documentation, license and registration.

(a) Technical Analysis (b) Financial Analysis
(c) Economic Analysis (d) Societal/Distributive Analysis

17. The primary aim of ............... is to determine whether the project satisfies the investment criteria of generating acceptable level of profitability.
(a) Technical Analysis (b) Financial Analysis
(c) Economic Analysis (d) Societal/Distributive Analysis

18. ..............................is the basis for financial analysis.
(a) Balance-sheet (b) Profit and Loss Statement
(c) Cash Flow Statement (d) Statement of changes in equity

19. In the last year, the inflow is .................. due to the residual value adding to the cash inflow.
(a) Lower (b) Equal
(c) Higher (d) Zero

20. What are the measures of Financial Viability?
(a) NPV (b) BCR
(c) IRR (d) All of the above

21. ................ representing wealth creation by the Project, is calculated by taking the discounted sum of the stream of cash flows during the project life.
(a) NPV (b) BCR
(c) IRR (d) None of the above

22. When two or more mutually exclusive projects are being appraised, the project with the ............... NPV should be selected.
(a) Highest (b) Lowest
(c) Same (d) None of the above

23. .............. is the ratio of discounted value of benefit and discount value of cost.
(a) NPV (b) BCR (Benefit Cost Ratio)
(c) IRR (d) All of the above

24. The project is viable when BCR is one or more than
(a) Zero (b) One
(c) Minus one (d) None of the above

25 .................... represents the returns internally generated by the project.
(a) NPV (b) BCR (Benefit Cost Ratio)
(c) IRR (d) All of the above

26. This is also the rate which makes the net present value equal to 0.:
(a) NPV (b) BCR (Benefit Cost Ratio)
(c) IRR (d) All of the above

27. The calculation of ................. is a process of trial and error
   (a) NPV (b) BCR (Benefit Cost Ratio)
   (c) IRR (d) All of the above

28 .............. helps us in finding out that how sensitive is 4he project to various fluctuations
   (a) Sensitivity Analysis (b) Scenario Analysis
   (c) None of the above (d) Either of the above

29. Under .................... scenario of certain prices, cost and other variables are created and the financial parameters are computed.
   (a) Sensitivity Analysis (b) Scenario Analysis
   (c) None of the above (d) Either of the above

30. Under .................... probabilistic analysis is done by identification of key risk variables, finding out values of each risk variable, assigning probabilities for each value to each of the risk variables, using these values for risk analysis and finding out the probability of negative outcome of the project.
   (a) Sensitivity Analysis (b) Scenario Analysis
   (c) Risk Analysis (d) None of the above

31. The objective of economic appraisal is to examine the project from the entire economy's point of view to determine whether the project will improve, the economic welfare of the country
   (a) Sensitivity Analysis (b) Scenario Analysis
   (c) Risk Analysis (d) Economic Appraisal

32. The ...................... consists of two parts: measurement of the distribution of the income due to the project and identification of the impact on the basic needs objectives of the society.
   (a) Sensitivity Analysis (b) Social Appraisal
   (c) Risk Analysis (d) Economic Appraisal

33. The organizational and managerial aspects evaluate the managerial capacity of the organization or the entrepreneur, responsible for implementing the project.
   (a) Sensitivity Analysis
   (b) Social Appraisal
   (c) Organizational and managerial aspects
   (d) Economic Appraisal

34. Lending policy and appraisal norms by banks are decided by the
   (a) State bank of India (b) Reserve bank of India
   (c) Commercial bank of India (d) None of the above

35. Bank lending must necessarily be based on principles. Principles includes:
   (a) Safety (b) Liquidity
   (c) Profitability and risk diversion. (d) All of the above

36. The loan policy typically lays down lending guidelines in the following areas
   (a) Level of Lending-deposit ratio
   (b) Targeted portfolio mix and Collateral security

(c) Hurdle ratings and Loan pricing
(d) All of the above

37. CRR stands for
(a) Credit Reserve Ration (b) Cash Reserve Ratio
(c) Credit Reserve Rate (d) None of the above

38. SLR stands for
(a) Small Liquid Ration (b) Statutory Liquid Ratio
(c) Statutory Liquid Rate (d) None of the above

39. A bank can lend out only a certain proportion of its deposits, since some part of deposits have to be statutorily maintained as
(a) Credit Reserve Ration (b) Cash Reserve Ratio
(c) Credit Reserve Rate (d) None of the above

40. For new borrowers, a bank usually lays down guidelines regarding minimum rating to be achieved by the borrower to become eligible for the loan. This is also known as the ................ criterion to be achieved by a new borrower.
(a) Credit rating (b) Hurdle rating
(c) Risk rating (d) Lending rating

41. In the case of term loans and working capital assets, banks take as 'primary security' the property or goods against which loans are granted.
In addition to this, banks often ask for additional security or'............... in the form of both physical and financial assets to further bind the borrower.
(a) Loan security (b) Support security
(c) Collateral security (d) None of the above

42. CAR stand for ..........................
(a) Credit adequacy ration (b) Collateral adequacy ration
(c) Capital additional ration (d) Capital adequacy ratio

43. ..................... is the ratio is the capital with the bank as a
(a) Credit adequacy ration (b) Collateral adequacy ration
(c) Capital additional ration (d) Capital adequacy ratio

44. The Basel committee specifies a CAR of at least .................% for banks.:
(a) 7 (b) 8
(c) 9 (d) 10

45. The Reserve Bank of India (RBI) has specified a CAR of at least % for banks.: .
(a) 7 (b) 8
(c) 9 (d) 10

46. What is the exposure norms for Commercial banks in India to a Single Borrower
(a) 10% of Capital fund (Additional 5 percent on infrastructure exposure)
(b) 15% of Capital fund (Additional 5 percent on infrastructure exposure)
(c) 20%of Capital fund (Additional 5 percent on infrastructure exposure)
(d) 25%of Capital fund (Additional 5 percent on infrastructure exposure)

47. What is the exposure norms for Commercial banks in India to a Group Borrower
(a) 10% of Capital fund (Additional 10 percent on infrastructure exposure)
(b) 20% of Capital fund (Additional 10 percent on infrastructure exposure)
(c) 30% of Capital fund (Additional 10 percent on infrastructure exposure)
(d) 40% of Capital fund (Additional 10 percent on infrastructure exposure)

48. What is the maximum exposure norms for Commercial banks in India to capital market
(a) 10% of net worth as on 31st of the Previous year
(b) 20% of net worth as on 31st of the Previous year
(c) 30% of net worth as on 31st of the Previous year
(d) 40% of net worth as on 31st of the Previous year

49. The Reserve Bank of India has brought a new methodology of setting lending rate by commercial banks under the name……………..
(a) Marginal Cost of Funds based Lending Rate
(b) Securities Lending rate
(c) Credit Lending rate
(d) Marginal lending rate

50. The …………………… is an agreement expressed in writing and entered into between the borrower and the lender bank, institution or other creditors.
(a) Loan agreement (b) Credit arrangement
(c) Risk Agreement (d) None of the above

**Answer**

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **1** | (a) | **2** | (b) | **3** | (c) | **4** | (a) | **5** | (d) | **6** | (c) |
| **7** | (d) | **8** | (a) | **9** | (b) | **10** | (e) | **11** | (a) | **12** | (d) |
| **13** | (b) | **14** | (d) | **15** | (d) | **16** | (a) | **17** | (b) | **18** | (c) |
| **19** | (c) | **20** | (d) | **21** | (a) | **22** | (a) | **23** | (b) | **24** | (b) |
| **25** | (c) | **26** | (c) | **27** | (c) | **28** | (a) | **29** | (b) | **30** | (c) |
| **31** | (d) | **32** | (b) | **33** | (c) | **34** | (b) | **35** | (d) | **36** | (d) |
| **37** | (a) | **38** | (b) | **39** | (b) | **40** | (b) | **41** | (c) | **42** | (d) |
| **43** | (d) | **44** | (b) | **45** | (c) | **46** | (b) | **47** | (d) | **48** | (d) |
| **49** | (a) | **50** | (a) | | | | | | | | |

# 6. DIVIDEND POLICY

## MULTIPLE CHOICE QUESTIONS

1. Dividend policy determines what portion of earnings will be paid out to stock holders and what portion will be retained in the business to finance long-term growth
   (a) Dividend Policy (b) Investment Policy
   (c) Procurement Policy (d) Capital Budgeting Policy

2. Dividend constitutes the cash flow that accrues to
   (a) Equity holders (b) Preference Shareholders
   (c) Debentures (d) None of the above

3. Retained earnings is not the source of funds for financing the corporate growth.
   (a) True (b) False

4. Higher dividend means less retained earnings and vice versa.
   (a) True (b) False

5. Type of dividend policy can be:
   (a) Regular dividend policy (b) Irregular dividend policy
   (c) Stable dividend policy (d) All of the above

6. In ……………… the investors get dividend at usual rate
   (a) Regular dividend policy (b) Irregular dividend policy
   (c) Stable dividend policy (d) No dividend policy

7. In …………….payment of certain sum of money is regularly made to the shareholders
   (a) Regular dividend policy (b) Irregular dividend policy
   (c) Stable dividend policy (d) No dividend policy

8. Merits of regular dividend policy are:
   (a) It helps in creating confidence among the shareholders
   (b) It stabilizes the market value of shares.
   (c) It helps in giving regular income to the shareholders.
   (d) All of the above

9. Stable dividend policy can be :
   (a) Constant dividend per share
   (b) Constant payout ratio
   (c) Stable rupee dividend + extra dividend
   (d) All of the above

10. As per ……………. the company does not pay regular dividend to this hare holders
    (a) Irregular dividend policy (b) No dividend policy
    (c) Both (a) and (b) (d) None of the above

11. Dividend policy is determined by:
    (a) Manager (b) Trade Union
    (c) Shareholders (d) Board of Directors

12. Determinants/constraints of dividend policy include:
    (a) Legal and Financial constraints (b) Economic Constraints
    (c) Financial needs of the company (d) All of the above

13. Needs of the Company for additional capital affects the dividend policy.
    (a) True (b) False

14. Dividend can be in the form of:
    (a) Cash dividend (b) Bond dividend/Stock dividend
    (c) Property dividend (d) All of the above

15. If the dividend is paid in the form of cash to the shareholders, it is called ...........
    (a) Cash dividend (b) Bond dividend
    (c) Stock dividend (d) Property dividend

16.. Which of the following approach is not the part of relevant theory of dividend
    (a) Walter's Model (b) Gordon's Model
    (c) M.M. Approach (d) Ail of the above

17. Which approach is based on this formula:

$$P = \frac{D + \frac{r}{k}(E-D)}{1!}$$

Where:
P: market price per share of common stock
D: dividend per share
E: earnings per share
r: return on investment
k: market capitalization rate.
    (a) Walter's Model (b) Gordon's Model
    (c) M.M. Approach (d) All of the above

18. According to Walter's Model, the optimum dividend policy depends on the relationship between the firm's internal rate of return and ...............
    (a) Cost of capital (b) Cost of debt
    (c) Cost of equity (d) Cost of retained earnings

19. According to Walter's Model, If return on investment (r) > market capitalisation rate (k) then firm should ................
    (a) Retain the entire earnings (b) Distribute the earnings
    (c) Both (a) and (b) (d) None of the above

20. If return on investment(r) > market capitalisation rate (k) then firm is referred to as:
    (a) Growth firms (b) Normal firms
    (c) Declining firms (d) None of the above

21. If return on investment (r) < market capitalisation rate (k) then firm is referred to as :
(a) Growth firms (b) Normal firms
(c) Declining firms (d) None of the above

22. If return on investment ,(r) = market capitalisation rate (k) then firm is referred to as:
(a) Growth firms (b) Normal firms
(c) Declining firms (d) None of the above

23. According to Walter, the optimum payout ratio is :
(a) 0% (when r > k) (b) 100% (when r < k)
(c) Both (a) and (b) (d) None of the above

24. Walter's model is based on the following assumptions:
(a) The firm finances all investment through retained earnings; that is debt or new equity is not issued
(b) The firm's internal rate of return (r), and its cost of capital (k) are constant
(c) All earnings are either distributed as dividend or reinvested internally immediately.
(d) All of the above

25. Given that:
r = return on investment is given as 0.12
k = market capitalization rate is as 0.10
E = earnings per share is Rs. 4/-
D = dividend per share is Rs. 21-
Then, the market price per share as per Walter's Model would be:
(a) Rs. 20 (b) Rs. 34
(c) Rs. 44 (d) Rs. 50

26. Which approach is based on this formula:
$$p = \frac{E(1-b)}{ke - br}$$
(a) Walter's Model (b) Gordon's Model
(c) M.M. Approach (d) All of the above

27: Gordon's Model is also known as:
(a) Dividend capitalisation model (b) Dividend Growth model
(c) Both (a) and (b) (d) Walter's Model

28. According to Gordon, when $r > k_e$ the price per share increases as the dividend payout ratio
(a) Decreases (b) Increases
(c) Constant (d) None of the above

29. Determine the market price of a share of LMN Ltd. as per Gordon's Model, given
ke = 11 %
E = Rs 20
r = 12%

b= 90%

| | | | |
|---|---|---|---|
| (a) | Rs. 500 | (b) | Rs. 1,000 |
| (c) | Rs. 210.52 | (d) | Rs. 2,000 |

30. Determine the market price of a share of LMN Ltd. as per Gordon's Model, given
ke = 11 %
E = Rs. 20
r = 12%
b= 60%

| | | | |
|---|---|---|---|
| (a) | Rs. 500 | (b) | Rs. 1,000 |
| (c) | Rs. 210.52 | (d) | Rs. 2,000 |

31. Determine the market price of a share of LMN Ltd. as per Gordon's Model, given
ke = 11%.
E = Rs. 20
r = 10%
b= 90%

| | | | |
|---|---|---|---|
| (a) | Rs. 100 | (b) | Rs. 1,000 |
| (c) | Rs. 210.52 | (d) | Rs. 2,000 |

32. Determine the market price of a share of LMN Ltd. as per Gordon's Model, given
ke = 11%
E = Rs. 20
r = 12%
b = 60%

| | | | |
|---|---|---|---|
| (a) | Rs.100 | (b) | Rs. 1,000 |
| (c) | Rs. 160 | (d) | Rs. 200 |

33. As per ................ the manner in which earnings are divided into dividends and retained earnings does not affect this value.

| | | | |
|---|---|---|---|
| (a) | Waiter's Model | (b) | Gordon's Model |
| (c) | M.M. Approach | (d) | All of the above |

34. Assumptions under M-M hypothesis includes:
(a) Capital markets are perfect- Investors are rational, information is freely available, transaction cost are nil.
(b) There are no taxes- No difference between tax rates on dividends' and capital gains.
(c) The firm has a fixed investment policy which will not change. So if the retained earnings are reinvested, there will not be any change in the risk of the firm.
(d) All of the above

35. X company earns Rs. 5 per share, is capitalised at a rate of 10 per cent and has a rate of return on investment of 18 per cent. According to Walter's model, what should be the price per share at 25 per cent dividend payout ratio?

| | | | |
|---|---|---|---|
| (a) | Rs. 60 | (b) | Rs. 80 |
| (c) | Rs.90 | (d) | Rs. 100 |

36. In the above question, what is the optimum payout ratio according to Walter?
(a) 0% (b) 1%
(c) 100% (d) 50%

37. In the above question, calculate the price based on the optimum payout ratio as per Walter?
(a) Rs. 60 (b) Rs.80
(c) Rs. 90 (d) Rs. 100

38. A company has the following facts:
Cost of capital (ke) = 0.10
Earnings per share (E) = Rs. 10
Rate of return on investments (r) = 8%
Dividend payout ratio: 50%
What is the market price of the shares.
(a) Rs. 90 (b) Rs. 85
(c) Rs. 100 (d) Rs. 120

39. A company has the following facts:
Cost of capital (ke) = 0710
Earnings per share (E) = Rs. 10
Rate of return on investments (r) = 8%
Dividend payout ratio: 25%
What is the market price of the shares.
(a) Rs. 90 (b) Rs. 85
(c) Rs.100 (d) Rs. 120

40. Determination of value of shares, given the following data:
D/P Ratio = 40%
Retention Ratio = 60%
Cost of capital = 17%
R= 12% EPS = Rs.20
(a) Rs. 80 (b) Rs. 81.63
(c) Rs. 62.50 (d) Rs. 100

41. Determination of value of shares, given the following data:
D/P Ratio = 30%
Retention Ratio = 70%
Cost of capital = 18%
R=12% EPS = Rs. 20
(a) Rs. 80 (b) Rs. 81.63
(c) Rs. 62.50 (d) Rs.100

42. From the following information supplied to you, determine the theoretical market value of equity shares of a company as per Walter's model: Earnings of the company: Rs. 5,00,000
Dividends paid : Rs. 3,00,000
Number of shares outstanding = Rs. 1,00,000
Price earnings ratio = 8
Rate of return on investment = 0.15
(a) Rs. 40 (b) Rs. 42
(c) Rs.46 (d) Rs. 43.20

43. In the above question, are you satisfied with the current dividend policy of the firm?
(a) Yes (b) No
(c) Both (a) and (b) (d) None of the above

44. In question no. 42, what should be the optimal dividend payout ratio?
(a) 0% (b) 100%
(c) 1% (d) 50%

Answer Ques no. 45 to 48 based on the following data: A company has 10,000 shares of Rs. 100 each. The capitalisation rate is 12%. Income before tax is Rs. 1,50,000. Tax rate is 30%. Dividend pay-out ratio is 60%. The company has to take up a project costing Rs. 4,00,000.

45. Find Market Price Per Share (MPS) at the end of the current year if dividend is paid as per MM approach
(a) 100 (b) 105.70
(c) 110 (d) 112

46. Find the number of shares to be issued for financing the new project if dividend is paid as per MM approach
(a) 2,000 (b) 3,000
(c) 2,634 (d) 2,165

47. Find Market Price Per Share (MPS) at the end of the current year if dividend is not paid as per MM approach
(a) 100 (b) 105.70
(c) 110 (d) 112

48. Find the number of shares to be issued for financing the new project if dividend is not paid as per MM approach
(a) 2,000 (b) 3,000
(c) 2,634 (d) 2,165

49. X Company Ltd., has 1,00,000 shares outstanding the current market price of the shares Rs. 15 each. The company expects the net profit of Rs. 2,00,000 during the year and it belongs to a rich class for which the appropriate capitalisation rate has been estimated to be 20%. The company is considering dividend of Rs. 2.50 per share for the current year. What will be the price of the share at the end of the year if the dividend is paid
(a) Rs. 10 (b) Rs. 15.50
(c) Rs.16 (d) Rs. 18

50. X Company Ltd., has 1,00,000 shares outstanding the current market price of the shares Rs. 15 each. The company expects the net profit of Rs. 2,00,000 during the year and it belongs to a rich class for which the appropriate capitalisation rate has been estimated to be 20%. The company is considering dividend of Rs. 2.50 per share for the current year. What will be the price of the share at the end of the year if the dividend is not paid ;
(a) Rs. 10 (b) Rs. 15.50
(c) Rs. 16 (d) Rs. 18

51. Dividend payout ratio is :
(a) the dividend yield plus the capital gains yield
(b) dividends per share divided by earnings per share.
(c) dividends per share divided by par value per share.
(d) dividends per share divided by current price per share

52. A payment of either cash or stock out of a corporation's earnings to a firm's owners is called
(a) Normal distribution. (b) Retained distribution.
(c) Operating distribution. (d) Dividend

53. In Walter model formula D stands for
(a) Dividend per share (b) Direct Dividend
(c) Dividend Earning (d) None of these

54. In MM model MM stands for...
(a) M. Khan and Modigiliani (b) Miller and M. Khan
(c) Modigiliani and M. Khan (d) Miller and Modigliani

55. What are the earnings per share (EPS) for a company that earned Rs. 100,000 last year in after-tax profits, has 200,000 common shares outstanding and Rs. 1.2 million in retained earning at the year end?
(a) Rs. 100,000 (b) Rs. 6.00
(c) Rs. 0.50 (d) Rs. 6.50

56. ..................... and............. carry a fixed rate of interest and are to be paid off irrespective of the firm's revenues.
(a) Debentures, Dividends (b) Debentures, Bonds
(c) Dividends, Bonds (d) Dividends, Treasury notes

57. How are earnings per share calculated?
(a) Use the income statement to determine earnings after taxes (net income) and divide by the previous period's earnings after taxes. Then subtract 1 from the previously calculated value.
(b) Use the income statement to determine earnings after taxes (net income) and divide by the number of common shares outstanding.
(c) Use the income statement to determine earnings after taxes (net income) and divide by the number of common and preferred shares outstanding.
(d) Use the income statement to determine earnings after taxes (net income) and divide by the forecasted period's earnings after taxes. Then subtract 1 from the previously calculated value

58. Which of the following is NOT a cash outflow for the firm?
(a) depreciation. (b) dividends.
(c) interest payments. (d) taxes.

59. Dividend payout ratio refers to that portion of total earnings which is distributed among shareholders.
(a) True (b) False

60. Walters model supports the view that dividend is relevant for value of the firm.
    (a) True (b) False

61. Gordon's model suggests that dividend payment does not affect the market price of the share.
    (a) True (b) False

62. MM model deals with irrelevance of dividend decision
    (a) True (b) False

63. MM model asserts that value of the firm is not affected whether the firm pays dividend or not.
    (a) True (b) False

64. Walter's Model suggests that a firm can always increase i.e. of the share by
    (a) Increasing Dividend (b) Decreasing Dividend
    (c) Constant Dividend (d) None of the above

65. MM Model argues that dividend is irrelevant as
    (a) the value of the firm depends upon earning power
    (b) the investors buy shares for capital gain
    (c) dividend is payable after deciding the retained earnings
    (d) dividend is a small amount

## ANSWER

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **1** | (a) | **2** | (a) | **3** | (b) | **4** | (a) | **5** | (d) | **6** | (a) |
| **7** | (c) | **8** | (d) | **9** | (d) | **10** | (c) | **11** | (d) | **12** | (d) |
| **13** | (a) | **14** | (d) | **15** | (a) | **16** | (c) | **17** | (a) | **18** | (a) |
| **19** | (a) | **20** | (a) | **21** | (c) | **22** | (b) | **23** | (c) | **24** | (d) |
| **25** | (c) | **26** | (b) | **27** | (c) | **28** | (a) | **29** | (b) | **30** | (c) |
| **31** | (a) | **32** | (c) | **33** | (c) | **34** | (d) | **35** | (b) | **36** | (a) |
| **37** | (c) | **38** | (a) | **39** | (b) | **40** | (b) | **41** | (c) | **42** | (d) |
| **43** | (b) | **44** | (a) | **45** | (b) | **46** | (d) | **47** | (d) | **48** | (c) |
| **49** | (b) | **50** | (d) | **51** | (b) | **52** | (d) | **53** | (a) | **54** | (d) |
| **55** | (c) | **56** | (b) | **57** | (b) | **58** | (a) | **59** | (a) | **60** | (a) |
| **61** | (b) | **62** | (a) | **63** | (a) | **64** | (d) | **65** | (a) | | |

# 7. WORKIN CAPITAL

## Multiple Choice Questions

1. The capital which is required to finance current assets is called,
   (a) Long Term capital (b) Equity capital
   (c) Working capital (d) Owner's capital

2. An asset is classified as current when:
   (a) It is expected to be realised or intends to be sold or consumed in normal operating cycle of the entity
   (b) The asset is held primarily for the purpose of trading.
   (c) It is expected to be realised within twelve months after the reporting period
   (d) All of the above

3. Which of the following is not an example of current assets?
   (a) Inventory (b) Land
   (c) Receivables (d) Cash and cash equivalents

4. Inventory is an example of:
   (a) Fixed Assets (b) Current Assets
   (c) Both (a) and (b) (d) None of the above

5. Prepaid expenses is an example of:
   (a) Fixed Assets (b) Current Assets
   (c) Both (a) and (b) (d) None of the above

6. A liability is classified as current when:
   (a) It is expected to be settled in normal operating cycle of the entity
   (b) The liability is held primarily for the purpose of trading
   (c) It is expected to be settled within twelve months after the reporting period
   (d) All of the above

7. Outstanding payments (wages & salary etc.) is an example of:
   (a) Current liabilities (b) Long term liabilities
   (c) Non-current liabilities (d) None of the above

8. Management of working capital is not an essential task of the finance manager
   (a) True (b) False

9. A current ratio of ................. for a manufacturing firm implies that the firm has an optimum amount of working capital
   (a) 1:2 (b) 1:1
   (c) 2:1 (d) 3:1

10. A Liquid ratio should be:
   (a) 1:2 (b) 1:1
   (c) 2:1 (d) 3:1

11. Type of working capital can be:
    (a) Initial working capital (b) Regular working capital
    (c) Fluctuating working capital (d) All of the above

12. Gross working capital refers to the firm's investment in
    (a) Current assets (b) Current liabilities
    (c) Fixed Assets (d) Long term liabilities

13. Net working capital refers to:
    (a) Current Assets (b) Current Liabilities
    (c) Current Assets - Current Liabilities (d) Fixed Assets- Current Assets

14. A positive net working capital will arise when:
    (a) Fixed assets exceed Fixed liabilities
    (b) Current assets exceed current liabilities
    (c) Current assets exceed long term liabilities
    (d) Current liabilities exceed current assets,

15. Working capital management is concerned with:-
    (a) Maintaining adequate working capital
    (b) Financing of the working capital
    (c) Both (a) and (b)
    (d) None of the above

16. Factors which need to be considered while planning for working capital requirement includes:
    (a) Nature of business (b) Degree of seasonality
    (c) Production policies (d) All of the above

17. Which of the following is not the factor that need to be considered while planning for working capital requirement?
    (a) Sales Policies (b) Size of business
    (c) Nature of business (d) Owner's Name

18. Working capital needs vary on the basis of sales policy of the same industry
    (a) True (b) False

19. The greater the uncertainty of receipt and expenditure, lower the need for working capital.
    (a) True (b) False

20. Which of the following is the correct statement?
    (a) Investment in working capital does not depend on the nature of industry
    (b) Investment in working capital vary based on the industry i.e. manufacturing vs trading vs service
    (c) Credit policy of the company does not affect the amount of investment of working capital
    (d) All of the above

21. As per ……………. investment in working capital is kept at minimal investment in current assets
(a) Aggressive approach
(b) Conservative approach
(c) Moderate approach
(d) None of the above

22. As per aggressive approach, company follows:
(a) Hold Lower level of inventory
(b) Follow strict credit policy
(c) Keeps Less cash balance
(d) All of the above

23. In ………….. approach, organisation use to invest high capital in current assets.
(a) Aggressive approach
(b) Conservative approach
(c) Moderate approach
(d) None of the above

24. Disadvantage of conservative approach is:
(a) Increase the cost of capital
(b) Higher risk of bad debts
(c) Shortage of liquidity in long run
(d) All of the above

25. Higher current assets/fixed assets ratio indicates a
(a) Aggressive current assets approach
(b) Conservative current assets approach
(c) Moderate current assets approach
(d) None of the above

26. ……………….. is one of the most reliable methods of Computation of Working Capital
(a) Operating cycle
(b) Recurring cycle
(c) Non recurring cycle
(d) None of the above

27. Which of the following is the method to estimate the working capital needs?
(a) Current Assets holding period
(b) Ratio to Sales
(c) Ratio of Fixed Assets
(d) All of the above

28. Current assets usually are converted into cash within
(a) One year
(b) One month
(c) 2 years
(d) 5 years

29. The …………………… is the length of time between the company's outlay on raw materials, wages and other expenditures and the inflow of cash from the sale of the goods
(a) Operating cycle
(b) Recurring cycle
(c) Non recurring cycle
(d) None of the above

30. Operating Cycle = R + W + F + D - C
Where,
R = Raw material storage period
W = Work-in-progress holding period
F = Finished goods storage period
D = Receivables (Debtors) collection period.
C = Credit period allowed by suppliers (Creditors)

(a) True
(b) False

31. Calculate the Operating cycle from the following figures related to company 'X':

| Particulars | Average amount Outstanding Rs. | Average value per day (340 days assumed) Rs. |
|---|---|---|
| Raw Material inventory | 1,80,000 | |
| Work-in-progress inventory | 96,000 | |
| Finished goods inventory | 1,20,000 | |
| Debtors | 1,50,000 | |
| Creditors | 1,00,000 | |
| Purchase of Raw Material | | 2,500 |
| Cost of Sales | | 4,000 |
| Sales | | 5,000 |

(a) 100 days (b) 116'days
(c) 120 days (d) 140 days

32. The following information is available for Swati Ltd.

| | |
|---|---|
| Average stock of raw materials and stores | 2,00,000 |
| Average work-in-progress inventory | 3,00,000 |
| Average finished goods inventory | 1,80,000 |
| Average accounts receivable | 3,00,000, |
| Average accounts payable | 1,80,000 |
| Average raw materials and stores purchased on credit and consumed per day | 10,000 |
| Average, work-in-progress value of raw materials committed per day | 12,500 |
| Average cost of goods sold per day | 18,000 |
| Average sales per day | 20,000 |

Calculate the duration of operating cycle.
(a) 45 days (b) 50 days
(c) 51 days (d) 55 days

33. Working, capital requirement assessment requires :
    (a) Calculation of average value of Raw Material Inventory, Work in Progress inventory and Finished Goods inventory
    (b) Calculation of Trade receivables and trade payables
    (c) Calculation of Cash and Cash Convertibles required for normal running of business
    (d) All of the above

34. Negative working capital is a sign that the company may be:
    (a) Solvent (b) Facing bankruptcy
    (c) Both (a) and (b) (d) None of the above

35. ................ model is used to judge the relationship of two variables for estimating the working capital needs for the given amount of working capital needs
    (a) Simple Regression (b) Average Regression
    (c) Linear Regression (d) Multiple Regression

36. Sources of permanent working capital is as under:
    (a) Owner's Fund
    (b) Bond Financing
    (c) Term loan from banks and short term borrowing
    (d) All of the above

37. Which of the following is not the source of variable/temporary working: capital?
    (a) Commercial Paper (b) Owner's Fund
    (c) Tax liabilities (d) All of the above

38. The level of a firm's Net Working Capital (Current Assets - Current Liabilities) has a bearing on its ..................
    (a) Profitability (b) Risk
    (c) Both (a) and (b) (d) None of the above

39. The relationship between Net Working Capital and risk is such that if net working capital increases, the firm's risk ..............
    (a) Increases (b) Decreases
    (c) Remains Constant (d) None of the above

40. The greater the amount of Net Working Capital, the less risky the firm is, and vice-versa.
    (a) True (b) False

41. Working capital leverage may refer to the way in which a company's profitability is affected in part by its ................
    (a) Working capital management (b) Debt management
    (c) Cash management (d) Equity management

42. The Chore Committee has, inter alia, recommended:
    (a) emphasised need for reducing the dependance of large and medium scale units on bank finance for working capital
    (b) to supplant the cash credit system by loans and bills wherever possible

(c) to follow simplified information system but with penalties when such information is not coming within the specified limit.
(d) all of the above

43. The position at the end of a day is a static position which is not representative of the entire year for assessing the working capital
(a) true (b) False

44 …………… means the management of cash in currency form, bank balances and readily marketable securities
(a) Cash management (b) Working capital management
(c) Capital management (d) Capital budgeting

45. Motive for holding cash includes:
(a) Transactional motive (b) Speculative motive
(c) Contingency motive (d) All of the above

46 ………………for holding cash because cash is the medium through which all the transactions of the firm are carried out.
(a) Transactional motive (b) Speculative motive
(c) Contingency motive (d) All of the above

47. Which one is not the transactional motive for holding cash?
(a) Purchase of Capital Goods like plant and machinery
(b) Payment of rent and wages
(c) Investing cash in short term investments to have better returns
(d) None of the above

48. Level of cash holdings depend on the following:
(a) Nature of business (b) Extend and reach of business
(c) Both (a) and (b) (d) None of the above

49. Cash and bank balances are held by the firms in three major forms:
(a) Cash and cheques in hand
(b) Balances with banks
(c) Investment in liquid securities
(d) All of the above

50. Essential elements of a successful cash management strategy are:-
(a) Realistic cash forecasting (b) Speeding up collections s
(c) Spreading out payments (d) All of the above

51. By realistic cash forecasting we mean that a cash forecast for the entire next year should be prepared at its …………………
(a) Commencement (b) End
(c) Mid of the year (d) None of the above

52. After the cash forecast has been prepared, the firm should ensure that in day to day operations cash (including cheques) should be collected speedily.
(a) True (b) False

53. With speeding up collection, the firm "should spread out payments as far as possible.
(a) True (b) False

54. Working capital management does not include:
(a) Cash Management (b) Debtors Management
(c) Capital Budgeting (d) Debtors Management

55. Which of the following is the component of inventory?
(a) Raw Material (b) Work in Progress
(c) Finished Goods (d) All of the above

56. The cost of holding inventory has the following elements:
(a) Carrying cost (b) Ordering cost
(c) Stock out cost (d) All of the above

57. .................. is the cost of keeping or maintaining the inventory in a usable condition.
(a) Carrying cost (b) Ordering cost
(c) Stock out cost (d) None of the above

58. Carrying cost includes:
(a) storage costs
(b) wage cost of personnel assigned to storing and securing it
(c) Cost of utilities and insurance
(d) All of the above

59. Inventory carrying cost is directly proportional to the level of inventory
(a) True (b) False

60. .................. is the cost associated with placing each individual order for supply of raw materials, stores, packing materials etc.
(a) Carrying cost (b) Ordering cost
(c) Stock out cost (d) None of the above

61. .................. is the cost associated with procuring an inventory item, which has gone out of stock and is needed for immediate supply.
(a) Carrying cost (b) Ordering cost
(c) Stock out cost (d) None of the above

62. If the items are procured in small lots, then the ordering cost per unit of inventory would be less and vice versa.
(a) True (b) False

63. Cost of inventory can be lowered by-
(a) Entering into long term arrangements for supply of raw materials at market driven prices.
(b) Arranging for direct supply of raw material at manufacturing locations.
(c) Availing quantity discounts and spot payment discounts if the carrying cost and financing cost is less than the discounts.
(d) All of the above

64. Inventory level can be managed by adopting the model
(a) Economic Order Quantity (b) Economic Order Quality
(c) Economic Bulk Quantity (d) None of the above

65. The EOQ model is based on the following assumptions except:
(a) The total usage of that particular item for a given period is known with certainty and the usage rate is even throughout the period.
(b) There is time gap between placing an order and receiving supply.
(c) The cost per order of an item is constant and the cost of carrying inventory is also fixed and is given as a percentage of the average value of inventory.
(d) There are only two costs associated with the inventory and these are the cost of ordering and the cost of carrying the inventory.

66. ............... is represented as under:

$$\text{EOQ} = \sqrt{\frac{2\text{AO}}{\text{c}}}$$

Where, A = Total annual requirement for the item
O = Ordering cost per order of that item
C = Carrying cost per unit per annum.
(a) Economic Order Quantity (b) Economic Order Quality
(c) ABC Analysis (d) None of the above

67 ............... is based on the assumption that in view of the scarcity of managerial time and efforts, more attention should be paid to those items which account for a larger chunk of the value of consumption rather than the quantity, of consumption
(a) Economic Order Quantity (b) Economic Order Quality
(c) ABC Analysis (d) None of the above

68. The following details are available in respect of a firm:

| | | |
|---|---|---|
| (i) | Annual requirement of inventory | 40,000 units |
| (ii) | Cost per unit (other than carrying and ordering cost) | Rs. 16 |
| (iii) | Carrying cost are likely to be | 15% per year |
| (iv) | Cost of placing order | Rs. 480 per order. |

Determine the economic ordering quantity.
(a) 2000 units (b) 3000 units
(c) 4000 units (d) 5000 units

69. The experience of the firm being out of stock is summarised below:

| 1. | Stock out (No. of units | No. of times | ( %Probability) |
|---|---|---|---|
| | 500 | 1 | (1) |
| | 400 | 2 | (2) |

| | | |
|---|---|---|
| 250 | 3 | (3) |
| 100 | 4 | (4) |
| 50 | 10 | (10) |
| 0 | 80 | (80) |

Figures in brackets indicate percentage of time the firm has been out of stock.

2. Stock out costs are Rs. 40 per unit.
3. Carrying cost of inventory per unit is Rs. 20 Determine the optimal level of stock out inventory.

(a) 20 units (b) 30 units
(c) 40 units (d) 50 units

70. A publishing house purchases 72,000 rims of a special type paper per annum at cost Rs. 90 per rim. Ordering cost per order, is Rs. 500 and the carrying cost is 5 per cent per year of the inventory cost. Normal lead time is 20 days and safety stock is Nil. Assume 300 working days in a year:
You are required:
Calculate the Economic Order Quantity (E.O.Q).
(a) 4000 Rims (b) 5000 Rims
(c) 6000 Rims (d) 8000 Rims

71. In the above question, calculate the Reorder Inventory Level?
(a) 200 Rims (b) 240 Rims
(c) 300 Rims (d) 400 Rims

72. Based on the above question, if a 1 per cent quantity discount is offered by the supplier for purchases in lots of 18,000 rims or more, should the publishing house accept the proposal?
(a) Accepted (b) Rejected

73. ……………..are near the terminating point of the operating cycle.
(a) Receivables (b) Stock
(c) Cash (d) Creditors

74. Receivables are generally referred to by the name of ……………. In the books of account
(a) Sundry Debtors (b) Sundry Creditors
(c) Asset Management (d) Liability Management

75. Timely realisation of receivables is not an important element of working capital management.
(a) True (b) False

76. Factors determining credit policy includes:
(a) The effect of credit oh the volume of sales
(b) Credit terms
(c) Cash discount
(d) All of the above

77. .............. is a type of financial service which involves an outright sale of the receivables of a firm to a financial institution called the factor which specialises in the management of trade credit
   (a) Leasing (b) Tendor
   (c) Factoring (d) None of the above

78. Under a typical factoring arrangement, a .................... collects the accounts on the due dates, effects payments to the firm on these dates and also assumes the credit risks associated with the collection of the accounts
   (a) Factor (b) Licensor
   (c) Licensee (d) None of the above

79. Factoring may be defined as. a relationship between the financial institution or banker ('factor') and a business concern (the 'supplier') selling goods or providing services to trade customers (the customer) whereby the factor purchases book debts with or without recourse.
   (a) True (b) False

80. Factoring includes:
   (a) Assumption of credit and collection, function
   (b) Credit protection
   (c) Encashing of receivables
   (d) All of the above

81. ................ loan is simply a loan secured by a firm's accounts receivable by way of hypothecation or assignment of such receivables with the power to collect the debts under a power of attorney.
   (a) Accounts receivable (b) Factoring
   (c) Bill discounting (d) Leasing

82. Under a .............. arrangement, the drawer undertakes the responsibility of collecting the bills and remitting the proceeds to the financing agency
   (a) Accounts receivable (b) Factoring
   (c) Bill discounting (d) Leasing

83. Under factoring agreement, the .............. collects client's bills
   (a) Factor (b) Drawer
   (c) Bank (d) Owner

84. Type of factoring can be:
   (a) Recourse Factoring (b) Non-Recourse Factoring
   (c) Agency Factoring (d) Ail of the above.

85 ................ are used to find changes in assets over a period of time showing uses of funds and sources of funds
   (a) Balance Sheet (b) Profit and Loss Statement
   (c) Fund flow statements (d) Fixed Assets

86. Forfeiting Services denotes the purchase of trade bills/promissory notes by a bank/financial institution ..............._to the seller.
(a) With recourse (b) Without recourse
(c) Either (a) or (b) (d) None of the above

87. The salient feature of forfeiting as a form of export relating financing is:
(a) The exporter sells and delivers goods to the importer on deferred payment basis.
(b) The importer draws a series of promissory notes in favour of the exporter for payment including interest charge. Alternatively the exporter draws a series of bill which are accepted by the importer.
(c) The bills/notes are sent to the exporter. The promissory notes/bills are guaranteed by a bank which may not necessarily be the importer's bank.
(d) All of the above

88. A forfeiter discounts the entire value of the note/bill but the factor finances between 75-85% and retains a factor reserve which is paid after maturity
(a) True (b) False

89. Current Assets/Current Liabilities is used to calculate:
(a) Current Ratio (b) Acid Test Ratio
(c) Inventory Turnover Ratio (d) Receivable Turnover

90. Cost of Goods sold / Average' Inventory is used to calculate:
(a) Current Ratio (b) Acid Test Ratio
(c) Inventory Turnover Ratio (d) Receivable Turnover

91. Sales / Average Inventory is used to calculate:
(a) Current Ratio (b) Acid Test Ratio
(c) Inventory Turnover Ratio (d) Receivable Turnover

92. Total long term debts / Shareholders Funds is used to calculate:
(a) Current Ratio (b) Acid Test Ratio
(c) Debt-Equity Ratio (d) Receivable Turnover

93. Calculate inventory conversion period from the financial variables given hereunder:

**(Rs. in lakhs)**

| | **Year 2010-11** | **Year 2011-12** | **Year 2012-13** |
|---|---|---|---|
| Sales | 7,936 | | |
| Cost of Goods sold | 7,036 | | |
| Inventory | | 940 | 936 |
| Bills Receivables | | 942 | 962 |
| Bills Payable | | 608 | 606 |

(a) 61 days (b) 31.5 days
(c) 48.7 days (d) 43.8 days

94. Based on the above question, calculate the Bill Receivable conversion period from the financial variables given above:
(a) 61 days (b) 31.5 days
(c) 48.7 days (d) 43.8 days

95. Based on the above question, calculate the payables conversion period from the financial variables given above:
(a) 61 days (b) 31:5 days
(c) 48.7 days (d) 43.8 days

96. Based on the above question, calculate the cash conversion period from the financial variables given above:
(a) 61 days (b) 31.5 days
(c) 48.7 days (d) 43.8 days

97. Find the average cash conversion period with the help of the following data:

| | |
|---|---|
| Gross operating cycle | 88 days |
| Net operating cycle | 65 days |
| Raw material storage period | 45 days |
| Work-in-progress conversion period | 4 days |
| Finished goods storage period | 25 days |

(a) 10 days (b) 12 days
(c) 14 days (d) 16 days

98. Calculate the finished goods conversion period if:

| | (Rs. lakh) |
|---|---|
| Finished goods opening stock | 525 |
| Finished goods closing stock | 850 |
| Cost of production | 8,000 |
| Administrative expenses | 2,250 |
| Excise duty | 3,000 |

(a) 18.42 days (b) 19.42 days
(c) 20.42 days (d) 21.42 days

99. Firm uses 1,100 units of a raw material per annum, the price of which is Rs.1,500 per unit. The order cost per order is Rs. 150 and the carrying cost of the inventory is Rs. 200 per unit. Find the EOQ
(a) 40 days (b) 41 days
(c) 42 days (d) 45 days

100. Based on the above question, calculate the number of orders that are to be made during the year.
(a) 27 (b) 28
(c) 30 (d) 32

101. A factory uses 40,000 tonnes of raw material priced at Rs. 50 per tonne. The holding cost is Rs. 10 per tonne of inventory. The order cost is Rs. 200 per order. Find the EOQ.
(a) 1200 (b) 1230
(c) 1250 (d) 1265

102. Based on the above question, what is the total cost that the company has to bear with EOQ level.
(a) 12,000 (b) 12,500
(c) 12,565 (d) 12,650

103. Based on the above question, what is the total cost in case the supplier introduces 5% discount if the order lot is 2000 tonnes or more
(a) 12,000 (b) 12,500
(c) 12,565 (d) 12,650

104. Below is the data :

| | | |
|---|---|---|
| Normal usage | : | 100 units per week |
| Maximum usage | : | 150 units per week |
| Minimum usage | : | 50 units per week |
| Re-order quantity (EOQ) 500 | : | units |
| Lag in time | : | 5 to 7 weeks |

Calculate Re-order Level?
(a) 450 units, (b) 1050 units
(c) 875 units (d) 1300 units

105. Based on the above data, calculate maximum level?
(a) 450 units (b) 1050 units
(c) 875 units (d) 1300 units

106. Based on the above data, calculate minimum level?
(a) 450 units (b) 1050 units x
(c) 875 units (d) 1300 units

107. Based on the above data, calculate average level?
(a) 450 units (b) 1050 units
(c) 875 units (d) 1300 units

108. EOQ determines the order size that will minimize the total.
(a) Working capital cost (b) Inventory cost
(c) Fixed Asset cost (d) Idle cost

109. Technical tools used in inventory management is:.
    (a) ABC analysis
    (b) Economic Order Quantity (EOQ)
    (c) Inventory turnover analysis
    (d) All of the above

**ANSWER**

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **1** | (c) | **2** | (d) | **3** | (b) | **4** | (b) | **5** | (b) | **6** | (d) |
| **7** | (a) | **8** | (b) | **9** | (c) | **10** | (b) | **11** | (d) | **12** | (a) |
| **13** | (c) | **14** | (b) | **15** | (c) | **16** | (d) | **17** | (d) | **18** | (a) |
| **19** | (b) | **20** | (b) | **21** | (a) | **22** | (d) | **23** | (b) | **24** | (d) |
| **25** | (b) | **26** | (a) | **27** | (d) | **28** | (a) | **29** | (a) | **30** | (a) |
| **31** | (b) | **32** | (c) | **33** | (d) | **34** | (b) | **35** | (c) | **36** | (d) |
| **37** | (b) | **38** | (c) | **39** | (b) | **40** | (a) | **41** | (a) | **42** | (d) |
| **43** | (a) | **44** | (a) | **45** | (d) | **46** | (a) | **47** | (c) | **48** | (c) |
| **49** | (d) | **50** | (d) | **51** | (a) | **52** | (a) | **53** | (a) | **54** | (c) |
| **55** | (d) | **56** | (d) | **57** | (a) | **58** | (d) | **59** | (a) | **60** | (b) |
| **61** | (c) | **62** | (b) | **63** | (d) | **64** | (a) | **65** | (b) | **66** | (a) |
| **67** | (c) | **68** | (c) | **69** | (d) | **70** | (a) | **71** | (b) | **72** | (a) |
| **73** | (a) | **74** | (a) | **75** | (b) | **76** | (d) | **77** | (c) | **78** | (a) |
| **79** | (a) | **80** | (d) | **81** | (a) | **82** | (c) | **83** | (a) | **84** | (d) |
| **85** | (c) | **86** | (b) | **87** | (d) | **88** | (a) | **89** | (a) | **90** | (c) |
| **91** | (d) | **92** | (c) | **93** | (c) | **94** | (d) | **95** | (b) | **96** | (a) |
| **97** | (c) | **98** | (b) | **99** | (b) | **100** | (a) | **101** | (d) | **102** | (d) |
| **103** | (a) | **104** | (b) | **105** | (d) | **106** | (a) | **107** | (c) | **108** | (b) |
| **109** | (d) | | | | | | | | | | |

# 8. WORKING CAPITAL

## MULTIPLE CHOICE QUESTIONS

1. …………… is defined as instruments issued by seekers of funds in the investment market to the providers of funds in lieu of funds.
   (a) Investment (b) Securities
   (c) Speculation (d) Gambling

2. Securities include:
   (a) shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature (b) Government securities
   (c) Derivatives (d) All of the above

3. Securities include "security receipt as defined in clause (zg) of Section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002."
   (a) True (b) False

4. ……………… is the employment of funds on assets with the aim of- earning income or capital appreciation
   (a) Investment (b) Securities
   (c) Speculation (d) Gambling

5. Investment has the following attribute:
   (a) Time (b) Risk
   (c) Both (a) and (b) (d) None of the above

6. Investment and Speculation are one and the same thing
   (a) True (b) False

7. …………….. is an act of conducting a risky financial transaction, in the hope of substantial profit
   (a) Investment (b) Securities
   (c) Speculation (d) Gambling

8: Time horizon of Specualtion is:
   (a) Short Term (b) Long Term
   (c) Both (a) and (b) (d) None of the above

9. Time horizon of Investment is:
   (a) Short Term (b) Long Term
   (c) Both (a) and (b) (d) None of the above

10. Risk in speculation is:
   (a) Low (b) Moderate
   (c) High (d) Nil

11. Which of the following statement is not correct?
    (a) Risk in case of investment is moderate as compared to speculation
    (b) Expected rate of return is moderate in case of investment as compared to speculation
    (c) Time horizon is short term in case of investment as compared to speculation
    (d) The purchase of an asset with the hope of getting returns is called investment

12 ................ is the game of chance in which return is dependent upon a particular event happening.
    (a) Investment (b) Securities
    (c) Speculation (d) Gambling

13. Which of the following statement is not correct?
    (a) In case of gambling, decision is based on rumours
    (b) Normally, gambling is ah unplanned activity
    (c) Safety of principal and stability of returns is the motive for gambling
    (d) None of the above

14. Risk in security analysis is generally associated with the possibility that the realized returns will be ............... than the returns that were expected
    (a) More (b) Less
    (c) Constant (d) Nil

15. Risk can be:
    (a) Systematic risk (b) Unsystematic risk
    (c) Both (a) and (b) (d) None of the above

16. Those forces that are uncontrollable, external and broad in their effect are called sources of .....................
    (a) Systematic risk (b) Unsystematic risk
    (c) Both (a) and (b) (d) None of the above

17. Systematic risk is due to the influence of ................ factors on an organization
    (a) Internal (b) External
    (c) Both (a) and (b) (d) None of the above

18. Systematic risk is a macro in nature as it affects a large number of organizations operating under a similar stream or same domain.'
    (a) True
    (b) False

19. Systematic risk can be planned by the organization.
    (a) True (b) False

20. Type of systematic risk include:
    (a) Interest rate risk (b) Market risk
    (c) Purchasing power or inflationary risk (d) All of the above

21. Economic, political and sociological changes are sources of ……………..
    (a) Systematic risk (b) Unsystematic risk
    (c) Both (a) and (b) (d) None of the above

22. Unsystematic risk is due to the influence of …………. factors prevailing within an organization
    (a) Internal (b) External
    (c) Both (a) and (b) (d) None of the above

23. Type of systematic risk include:
    (a) Business or liquidity risk (b) Financial or credit risk
    (c) Both (a) and (b) (d) None of the above

24 ……………… originates from the sale and purchase of securities affected by business cycles, technological changes, etc.
    (a) Business or liquidity risk (b) Financial or credit risk
    (c) Both (a) and (b) (d) None of the above

25. arises due to change in the capital structure of the organization
    (a) Business or liquidity risk (b) Financial or credit risk
    (c) Both (a) and (b) (d) None of the above

26. Total return for any security is defined as:
    (a) Total return = Current return
    (b) Total return = Capital return
    (c) Total return = Current return + Capital return
    (d) Total return - Current return - Capital return

27. ………………… is the periodic cash flow (income), such as dividend or interest, generated by the investment.
    (a) Current Return (b) Capital Return
    (c) Both (a) and (b) (d) None of the above

28 ………………… is the price appreciation (or depreciation) divided by the beginning price of the asset.
    (a) Current Return (b) Capital Return
    (c) Both (a) and (b) (d) None of the above

29. Which of the following formula is correct?
    (a) Holding Period Return = (End of Period Value - Initial Value) / Initial Value
    (b) Holding Period Return = Income + (End of Period Value - Initial Value) / Initial Value
    (c) Holding Period Return = Income I Initial Value
    (d) None of the above

30. Holding period return is calculated on the basis of total returns from the asset or portfolio - i.e. income plus changes in value
    (a) True
    (b) False

31. Mr. A invested Rs. 10,000 in shares of XYZ Company 10 years ago, and that his shares (including reinvested dividends) are currently worth Rs. 23,800. Using this information, calculate total investment return of Mr. A.
(a) 100% (b) 38%
(c) 138% (d) 238%

32. What is the annualised return of Mr A based on the data of above question?
(a) 8% (b) 9.06%
(c) 10% (d) 11%

33. Mr. X invested Rs. 10,000 in shares of XYZ Company 20 years ago, and that his shares (including reinvested dividends) are currently worth Rs. 18,800. Using this information, calculate total investment return of Mr. A.
(a) 100% (b) 38%
(c) 58% (d) 88%

34. Approach to valuation of. security can be:
(a) Fundamental Approach (b) Technical Approach
(c) Efficient Capital Market Theory (d) All of the above

35. The ……………..suggests that every stock has an intrinsic value and the intrinsic value is more than the market value, the fundamentalists recommend buying of the security and vice versa.
(a) Fundamental Approach (b) Technical Approach
(c) Efficient Capital Market Theory (d) None of the above

36 ………………… (ECMH) is based on the assumption that in efficient capital markets prices of traded securities always fully reflect all publicly available information concerning those securities.
(a) Fundamental Approach (b) Technical Approach
(c) Efficient Capital Market Theory (d) None of the above

37. The ………………… endeavours to predict future price levels of stocks by examining one or many series of past data from the market itself.
(a) Fundamental Approach (b) Technical Approach
(c) Efficient Capital Market Theory (d) None of the above

38. Which of the following is correct?
(a) Fundamental approach say that a security is worth the present value (discounted) of a stream of future income to be received from the security
(b) Technical approach assert that the price trend data should be studied regardless of the underlying data
(c) Efficient market approach contend that a share of stock is generally worth whatever it is selling for
(d) All of the above

39 ……………. of the security is the denominating value. It is also called the nominal value.
(a) Book value (b) Face value
(c) Market value (d) Intrinsic value

40. Money has a "time value."
(a) True (b) False

41. The investor seeks to arrive at the real value or the intrinsic value of a security through the process of ………………..
(a) Value Analysis (b) Market Analysis
(c) Price Analysis (d) Security Analysis

42. An investor is holding 1000 shares of Right Choice Ltd. The current rate of dividend paid by the company is Rs. 5/- per share. The long term growth rate is expected to be 10% and the expected rate of return is19.62%. Find the current market price of the share.
(a) Rs. 50 (b) Rs. 57.17
(c) Rs. 60.17 (d) Rs. 65

43. Fundamental analysis is a ………………… level systematic process that analyse the overall external and internal environment of the company before placing a value on its shares.
(a) Two (b) Three
(c) Four (d) Five

44. The level /analysis at which the fundamental analysis is carried out before placing a value on its shares is:
(a) Analysis of the economy (b) Industry Level Analysis
(c) Company Analysis (d) All of the above

45. If the country has an improving GDP growth rate, controlled inflation and increasing investment activity then chances are that the valuation of securities shall be liberal.
(a) True (b) False

46. Industry level analysis focuses on:
(a) Economy (b) Particular industry
(c) Particular company (d) All of the above

47. Which of the following is not the assumption of Technical analysis?
(a) The inter-play of demand and supply determines the market value of shares
(b) Stock values tend to move in trends that persist for a reasonable time
(c) These trends do not change as a result of change in demand-supply equilibrium.
(a) Chart patterns tend to repeat themselves and this repetition can be used to forecast future price movements.

48. Dow Jones Theory was given by:
(a) Charles H, Dow (b) Charles K. Dow
(c) Chris H. Dow (d) Chris K. Dow

49. According to Dow Jones Theory, share prices demonstrate a pattern over …………..
(a) Four to five years (b) One year
(c) One to two years (d) Ten to Twenty years

50. Share price demonstrate a pattern over a period of time as per Dow Jones Theory. Pattern can be:
(a) Primary Trend (b) Secondary or intermediate trend
(c) Minor Trend (d) All of the above

51. If the primary trend is upward, it is called as:
(a) Bullish phase of the market (b) Bearish phase of the market
(c) Constant phase of the market (d) None of the above

52. In Dow theory, a ……………… is the main direction in which the market is moving.
(a) Primary Trend (b) Secondary or intermediate trend
(c) Minor Trend (d) None of the above

53. As per Dow Jones Theory, a secondary trend moves in the same direction of the primary trend.
(a) True (b) False

54. As per Dow Jones Theory, minor trends are changes occurring every day within a narrow range and are not decisive of any major movement
(a) True (b) False

55. Technical Analysts use following type of tool for their analysis:
(a) Technical Charts (b) Technical Price Indicators
(c) Both (a) and (b) (d) None of the above

56. A ……….. is a style of chart that is created by connecting a series of past prices together with a line.
(a) Bar Chart (b) Candle Stick Chart
(c) Point and Figure Chart (d) Line Chart

57. Which of the statement is correct?
(a) Bar chart is made up of a series of vertical lines that represent the price range for a given period with a horizontal dash on each side that represents the open and closing prices.
(b) Candle Stick charts have a thin vertical line showing the price range for a given period that is shaded different colors based on whether the stock ended higher or lower.
(c) In Point and Figure Chart, emphasis is laid on charting price changes only and time and volume elements are ignored
(d) All of the above

58. A …………….. indicates the bottom which the share values are unable to pierce.
(a) Support Level (b) Resistance Level
(c) Both (a) and (b) (d) None of the above

59. A …………. is that level after which the share price refuses to move up in repeated efforts.
(a) Support Level (b) Resistance Level
(c) Both (a) and (b) (d) None of the above

60. Double Top Formation represents a bearish development, signaling that the price is expected to …………………..
(a) Rise (b) Fall
(c) Remain constant (d) None of the above

61. Double bottom Formation represents a bearish development, signaling, that the price is expected to ……………………..
(a) Rise (b) Fall
(c) Remain constant (d) None of the above

62. Which of the following is the limitation of charts while analysing price of a share?
(a) Interpretation of charts is prone to subjective analysis
(b) Often contradictory analysis being derived from the same charts.
(c) Decisions are made on the basis of chart alone and other factors are ignored
(d) All of the above

63. Which of the following is an example of technical price indicators?
(a) Advance Decline Ratio (b) Market Breadth Index
(c) Moving Averages (d) All of the above

64. Advance Decline ratio is the ratio of the number of stocks that increase to the number of stocks that have declined.
(a) True (b) False

65. If the Advance Decline ratio is more than one, the trend is assumed to be ……….
(a) Bullish (b) Bearish
(c) Constant (d) None of the above

66. A moving average is the average of share values of a set of consecutive number of ……………
(a) Weeks (b) Months
(c) Years (d) Days

67. If share value is below the moving average, it has scope for appreciation.
(a) True (b) False

68. According to the …………………, share prices will rise and fall on the whims and fancies of manipulative individuals. As such, the movement in share values is absolutely random and there is no need to study the trends and movements prior to making investment decisions.
(a) Random walk Theory (b) Random Cake Theory
(c) Fundamental analysis Theory (d) Technical Analysis Theory

69. Efficient market hypothesis accords supremacy to
(a) Internal forces (b) Employees
(c) Market forces (d) Equity market

70. As per Efficient market hypothesis, a market is treated as efficient when all known information is immediately discounted by all investors and reflected in share prices and the only price changes that occur are those resulting from new information.
(a) True (b) False

71. Major requirement for an efficient securities market include:
    (a) Prices must be efficient so that new inventions and better products will cause a firms' securities prices to rise and motivate investors to buy the stocks.
    (b) Information must be discussed freely and quickly across the nations so that all investors can react to the new information.
    (c) Transaction costs such as brokerage on sale and purchase of securities are ignored.
    (d) All of the above

72. Which of the following is not the category of Efficient Capital Market Hypothesis (ECMH)?
    (a) the strong form of Efficiency (b) the semi-strong form of Efficiency
    (c) the weak form theory of Efficiency (d) The Nil form theory of Efficiency

73 ............... holds that the prices reflect all information that is known and contemplates that even the corporate officials cannot benefit from the inside information of the company.
    (a) the strong form of Efficiency (b) the semi-strong form of Efficiency
    (c) the weak form theory of Efficiency (d) The Nil form theory of Efficiency

74. The .................. is that part of the capital markets that deals with the issuance of new securities.
    (a) Primary Market (b) Secondary Market
    (c) Both (a) and (b) (d) None of the above

75. ................ market enables participants who held securities to adjust their holdings in response to changes in their assessment of risks and returns.
    (a) Primary Market (b) Secondary Market
    (c) Both (a) and (b) (d) None of the above

76. Suppose one has bought a share of PQR Limited, at Rs. 224 one year back. Over the last year PQR has distributed dividend of Rs. 8 per share. If the share of PQR sells at Rs. 250 today, what is the return in ?
    (a) 7 8 (b) 7 26
    (c) 7 34 (d) 7 50

77. Based on the above question, what is the annual return in percentage terms?
    (a) 11.6% (b) 14%
    (c) 15.18% (d) 16%

78. Based on the above question, if the share is trading at Rs. 220 today, what is the return earned?
    (a) 1% (b) 1.79%
    (c) 1.89% (d) 2%

79. Financial statement analysis helps in :
    (a) Evaluating past performance and financial position
    (b) Predicting future performance
    (c) Estimating risk, cost of capital and capitalization rate
    (d) All of the above

80. The major techniques of financial statement analysis are:
(a) Trend Analysis (b) Comparative analysis
(c) Ratio analysis (d) All of the above

81. A price weighted index is an arithmetic mean of:
(a) Future prices (b) Current prices
(c) Quarter prices (d) None of these

82. Which type of market efficiency declares that current security prices totally reflect all information, equally public and private?
(a) Weak (b) Semi-strong
(c) Strong (d) None of these

83. Equity does not include
(a) cash and paid-in capital
(b) common stock and paid-in capital
(c) paid-in capital and retained earnings
(d) common stock, paid-in capital and retained earnings

84. Dow Jones theory shows that share prices demonstrate a pattern over four to five years,
(a) True (b) False

85. Which of the following statement is not correct?
(a) Investment is conscious act of deployment of money in securities issued by firms.
(b) Gambling and betting are games of chance in which return is dependent upon a particular event happening.
(c) Speculation also involves deployment of funds but it is not backed by a conscious analysis of pros and cons.
(d) None of the above

86. "A" buy one share of SBI at the beginning of the year for Rs. 500. He hold the stock for one year. Rs. 20 in dividends is collected at year-end, and the share is sold for Rs. 530. Calculate the return in ?
(a) Rs. 20 (b) Rs. 30
(c) Rs.40 (d) Rs. 50

87. Based on the above question, calculate the return in percentage terms?
(a) 5% (b) 8%
(c) 10% (d) 12%

88. ……………… is the primary motivating force that drives investment?
(a) Return (b) Risk
(c) Time (d) None of the above

89. One of the important property of a security that the investors are concerned with is the return that can be expected from holding a security.
(a) True (b) False

90. Which of the following statement is correct?
 (a) Total Return = Current Return + Capital Return
 (b) Current Return > Capital Return
 (c) Capital Return > Current Return
 (d) All of the above

# Answer

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **1** | (b) | **2** | (d) | **3** | (a) | **4** | (a) | **5** | (c) | **6** | (b) |
| **7** | (c) | **8** | (a) | **9** | (a) | **10** | (c) | **11** | (c) | **12** | (d) |
| **13** | (c) | **14** | (b) | **15** | (c) | **16** | (a) | **17** | (b) | **18** | (a) |
| **19** | (b) | **20** | (d) | **21** | (a) | **22** | (a) | **23** | (c) | **24** | (a) |
| **25** | (b) | **26** | (c) | **27** | (a) | **28** | (b) | **29** | (b) | **30** | (a) |
| **31** | (c) | **32** | (b) | **33** | (d) | **34** | (d) | **35** | (a) | **36** | (c) |
| **37** | (b) | **38** | (d) | **39** | (b) | **40** | (a) | **41** | (d) | **42** | (b) |
| **43** | (b) | **44** | (d) | **45** | (a) | **46** | (b) | **47** | (c) | **48** | (a) |
| **49** | (a) | **50** | (d) | **51** | (a) | **52** | (a) | **53** | (b) | **54** | (a) |
| **55** | (c) | **56** | (d) | **57** | (d) | **58** | (a) | **59** | (b) | **SO** | (b) |
| **61** | (a) | **62** | (d) | **63** | (d) | **64** | (a) | **65** | (a) | **66** | (d) |
| **67** | (a) | **68** | (a) | **69** | (c) | **70** | (a) | **71** | (d) | **72** | (d) |
| **73** | (a) | **74** | (a) | **75** | (b) | **76** | (c) | **77** | (c) | **78** | (b) |
| **79** | (d) | **80** | (d) | **81** | (b) | **82** | (c) | **83** | (a) | **84** | (a) |
| **85** | (d) | **86** | (d) | **87** | (c) | **88** | (a) | **89** | (a) | **90** | (a) |

# 9. PORTFOLIO MANAGEMENT

## Multiple Choice Questions

1. ……………….. is the art and science of making decision about investment mix.
   (a) Portfolio Management (b) Strategic Management
   (c) Both (a) and (b) (d) None of the above

2. ……………….. is the policy matching investment to objectives, asset allocation and balancing risk against performance.
   (a) Strategic Management (b) Portfolio management
   (c) Both (a) and (b) (d) None of the above

3. Who defined Portfolio Management as not a science, more an art and involves lots of judgment?
   (a) Neil Woodford (b) Kenneth Fisher
   (c) Hammer

4. Tasks involved in investment process are
   (a) Security analysis (b) Portfolio selection
   (c) Both of the above (d) None of the above

5. Process that focuses on assessing the risk and return characteristics of the available investment alternatives
   (a) Security analysis (b) Portfolio selection
   (c) Both of the above (d) None of the above

6. Process that involves choosing the best possible portfolio from the set of feasible portfolios
   (a) Security analysis (b) Portfolio selection
   (c) Both of the above (d) None of the above

7. …………….. is the combination of securities.
   (a) Portfolio (b) Investment
   (c) Both of the above (d) None of the above

8. …………………..management thus refers to managing efficiently the investment in the securities by diversifying the investments across industry lines or market types.
   (a) Portfolio (b) Financial
   (c) Strategic (d) Resource

9. Portfolio theory was originally proposed by
   (a) Harry Markowitz (b) Henry Fayol
   (c) Peter Drucker (d) Kenneth Fisher

10. According to Markowitz, investor attitudes towards portfolio depend upon
   (a) Expected return and risk (b) Quantification of risk
   (c) Both of the above (d) None of the above

11 ……………….. and ……………. are conceptually analogous in the sense that both of them reflect the degree of co-movements between two variables.

(a) Covariance, Correlation (b) Coefficient, Correlation
(c) Covariance, Coefficient (d) Standard deviation, Correlation

12. the ………….. the correlation of securities in the portfolio, the ……………. Risky the portfolio will be

(a) Lower, Less (b) Higher, Less
(c) Lower, More (d) Higher, More

13. Portfolio risk is sensitive to

(a) Proportions of funds devoted to each stock
(b) Standard deviation of each stock
(c) Covariance between the two stocks.
(d) All of the above

14. Who developed the first modern portfolio analysis model?

(a) Dr. Harry M. Markowitz (b) Peter Drucker
(c) Kenneth Fisher (d) None of the above

15. A portfolio is efficient when it yields ……………. return for a particular level of risk or …………… risk for a specified level of expected return.

(a) Highest, Minimizes (b) Lowest, Minimizes
(c) Highest, Maximizes (d) Lowest, Maximizes

16. The Markowitz model makes the following assumptions regarding investor behaviour:

(a) Investors consider each investment alternative as being represented by a probability distribution of expected returns over some holding period.
(b) Investors maximize one period expected utility and possess utility curve, which demonstrates diminishing marginal utility of wealth.
(c) Individuals estimate risk on the basis of variability of expected returns.
(d) All of the above

17. Utility is:

(a) Expected return of the portfolio minus a risk penalty.
(b) Expected return of the portfolio plus a risk penalty.
(c) Expected return of the portfolio multiply a risk penalty.
(d) None of the above

18. Risk penalty = Risk squared/Risk tolerance

(a) True (b) False

19. ……………… is the variance of return of the portfolio

(a) Risk penalty (b) Risk tolerance
(c) Risk squared (d) None of the above

20. The size of the risk tolerance number reflects the investor's willingness to. bear more risk for more return and Low (high) tolerance indicates low (high) willingness.

(a) True (b) False

21. If a portfolio's expected return is 13 percent, variance of return (risk squared) is 225 percent, and the investor's risk tolerance is 50, then the risk penalty is ............
(a) 4% (b) 4.5%
(c) 5% (d) 5.5%

22. Based on the data of above question, calculate the utility?
(a) 6% (b) 7.5%
(c) 8.5% (d) 17.5%

23. Limitation of Markowitz Model include:
(a) the amount of calculations required to be done becomes enormous
(b) in the real world, portfolio analysts do not keep track of correlations between stocks of diverse industries.
(c) Both (a) and (b)
(d) None of the above

24. The Capital Asset Pricing Model is developed by:
(a) William F Sharpe, John Linter and Jan Mossin
(b) William S Sharpe
(c) Bow Jones
(d) Key Jones

25. Beta is the ............ risk in a portfolio.
(a) Diversifiable (b) Non-Diversifiable
(c) Both(a) and (b) (d) None of the above

26 .............. measures the relative risk associated with any individual portfolio as measured in relation to the risk of the market portfolio
(a) Alpha (b) Beta
(c) Gamma (d) None of the above

27. Beta is arrived by

$$\text{Beta} = \frac{\text{Non}-\text{diversifiable riskof asset or portfolio}}{\text{Risk of market portfolio}}$$

(a) True (b) False

28. If Beta is more than 1, then:
(a) the stock is riskier than the market (b) the stock is not riskier than the market
(c) asset of average risk (d) None of the above

29. if Beta is less than one, then:
(a) the stock is riskier than the market (b) market is riskier than stock
(c) asset of average risk (d) None of the above

30. A ................ describes the expected return for all assets and portfolios of assets, efficient or not.
(a) Security market line (b) Interest market line
(c) Risk free market line (d) Exchange market line

31. As per Security Market Line, difference between the expected return on any two assets can be related simply to their difference in .............
    (a) Market condition (b) Risk
    (c) Beta (d) Alpha

32. The higher beta is for any security, the lower must be its expected return
    (a) True (b) False

33. The relationship between beta and expected return is linear.
    (a) True (b) False

34. Beta is an index of ..............
    (a) Systematic Risk (b) Unsystematic Risk
    (c) Both (a) and (b) (d) None of the above

35. CAPM is based on various assumptions except:
    (a) Investors are risk averse and use the expected rate of return and standard deviation of return as appropriate measures of risk and return for their portfolio.
    (b) Investors make their investments decisions based on a single period horizon which is the immediate next time period.
    (c) Transaction costs are either absent or so low that these can be ignored
    (d) Taxes do affect the choice of buying assets

36. In the CAPM, the expected rate of return is equal to the required rate of return because the market is in .............
    (a) Risk (b) Safe
    (c) Equilibrium (d) None of the above

37. The risk premium can be calculated as:
    (a) the sum of Beta and market risk premium
    (b) the difference of Beta and market risk premium
    (c) the product of Beta and market risk premium
    (d) None of the above

38. The risk premium can be calculated as:
    (a) Sum of expected rate of return and risk-free rate of return
    (b) difference between expected rate of return and risk-free rate of return
    (c) Product of expected rate of return and risk-free rate of return
    (d) None of the above

39. The capital asset pricing model (CAPM) asserts that only a single number i.e. a security's beta against the market is required to measure risk
    (a) True (b) False

40. The major assumption of Sharpe's single-index model is that all the co-variation of security returns can be explained by a .............
    (a) Single factor (b) Two factors
    (c) Three factors (d) Multiple factors

41. Below formula is as per:
Ri = a, β Rm + e.
Where R, = Expected return on a security
a, = Alpha Coefficient
β = Beta Coefficient
Rm = Expected Return in market (an Index)
e = Error term with a mean of zero and a constant standard deviation.
(a) CAPM Model (b) Single Index Model
(c) Multi Index Model (d) None of the above

42. Single Index Model assumes that stocks move together only because of a common co-movement with the market.
(a) True (b) False

43. A multi-index model augments the single index model by incorporating these extra market factors as additional independent variables.
(a) True (b) False

44. The ………………. is a risk-adjusted measure of return that is often used to evaluate the performance of a portfolio.
(a) Sharpe ratio (b) Index Ratio
(c) Both (a) and (b) (d) None of the above

45. Economic Value Added (EVA) is a measurement tool that provides a clear picture of whether a business is creating, or destroying shareholder wealth.
(a) True (b) False

46 …………… .measures the firm's ability to earn more than the true cost of capital.
(a) Economic Value Added (b) Profit and Loss Statement
(c) Balance Sheet (d) Cash Flow Statement

47. If a firm's earnings exceed the true cost of capital it is creating wealth for its shareholders.
(a) True (b) False

48. Investor made a Rs. 20,000 capital investment in company. Company's operating profit, after taxes, is Rs. 10,000. The opportunity cost of that investment is 10%. Calculate EVA.
(a) Rs. 6,000 (b) Rs. 8,000
(c) Rs. 10,000 (d) Rs. 20,000

49. You have been asked to estimate the beta of a high-technology firm which has three divisions with the following characteristics

| Division | Beta | Market Value |
|---|---|---|
| Personal Computers | 1.60 | Rs. 100 million |
| Software | 2.00 | Rs. 150 million |
| Computer | 1.20 | Rs. 250 million |

What is the beta of the equity of the firm?

(a) 1 (b) 1.2
(c) 1.52 (d) 1.6

50. Dhanpat, an investor, is seeking the price to pay for a security, whose standard deviation is 5%. the correlation coefficient for the security with the market is 0.75 and the market standard deviation is 4%. The return from risk-free securities is 6% and from the market portfolio is 11 %. Dhanpat knows that only by calculating the required rate of return, he can determine the price to pay for the security. What is the required rate of return on the security?
(a) 10% (b) 10.7%
(c) 11% (d) 11.7%

51. the market portfolio has a historically based expected return of 0.10 and a standard deviation of 0.04 during a period when risk-free assets yielded 0.03. The 0.07 risk premium is thought to be constant through time. Riskless investments may now be purchased to yield 0.09. A security has a standard deviation of 0.08 and a co-efficient of correlation with the market portfolio is 0.85. The market portfolio is now expected to have a standard deviation of 0.04. You are required to find market's return-risk trade-off.
(a) 1 (b) 1.25
(c) 1.5 (d) 1.75

52. Calculate security beta based on the above data?
(a) 1.4 (b) 1.5
(c) 1.6 (d) 1.7

53. Calculate equilibrium required expected return of the security based on the above data?
(a) 20% (b) 20.9%
(c) 21.2% (d) 23%

54. The security market line(SML) graphs the expected relationship between:
(a) Business risk and financial risk
(b) Systematic risk and unsystematic risk .
(c) Risk and return
(d) None of the above

55. Modern portfolio theory assumes that most investors are:
(a) Risk averse (b) Risk neutral
(c) Risk tolerant (d) None of the above

56. An individual who selects the investment that offers greater certainty when everything else is the same is known as a risk averse investor.
(a) True (b) False

57. Although derivatives can be used as speculative instruments, businesses most often use them to:
(a) Hedge (b) Offset debt
(c) Appease stakeholders (d) Attract customers

58. Which of the following statements regarding risk averse investors are true?
    (a) They only accept risky investments that offer risk premiums over the risk-free rate
    (b) They accept investments that are fair games.
    (c) They only care about the rate of return.
    (d) They are willing to accept lower returns and high risk.

59. Olivia is a risk-averse investor. Alex is a less risk-averse investor than Olivia. Therefore,
    (a) For the same risk, Alex requires a higher rate of return than Oliva.
    (b) For the same return, Alex tolerates higher risk than Olivia.
    (c) For the same risk, Oliva requires a lower rate of return than Alex.
    (d) Cannot be determined.

60. This type of risk is avoidable through proper diversification:
    (a) Portfolio risk (b) Systematic risk
    (c) Unsystematic risk (d) Total risk

61. A statistical measure of the degree to which two variables (e.g., securities' returns) move together:
    (a) Coefficient of variation (b) Variance
    (c) Covariance (d) Certainty equivalent

62. An "aggressive" common stock would have a "beta":
    (a) Equal to zero (b) Greater than one
    (c) Equal to one (d) Less than one

63. The risk-free security has a beta equal to ..............while the market portfolio's beta is equal to ......................
    (a) One; more than one (b) One; less than one
    (c) Zero; one (d) Less than zero; more than zero

64 ............... is a measure of "risk per unit of expected return."
    (a) Standard deviation (b) Coefficient of variation
    (c) Correlation coefficient (d) Beta

65. The greater the beta, the ............... of the security involved
    (a) Greater the unavoidable risk (b) Greater the avoidable risk
    (c) Less the unavoidable risk (d) Less the avoidable risk

66. Plaid Pants, Inc. common stock has a beta of 0.90. The expected return on the market is 10 percent, and the risk-free rate is 6 percent. According to the capital-asset pricing model (CAPM) and making use. of the information above, the required return on Plaid Pants' common stock should be:
    (a) 3.6% (b) 9.6%
    (c) 9.0% (d) 14.0%

67. Acme Dynamite Company common stock has a beta of 1.80. The expected return on the market is 10 percent, and the risk-free rate is 6 percent. According to the capital-

asset pricing model (CAPM) and making use of the information above, the required return on common stock should be:

(a) 7.2% (b) 13.2%
(c) 18.0% (d) 23.0%

68. The beta of the market portfolio is:
(a) Zero (b) One
(c) Ten (d) Negative

69. The market risk premium is 15% and the risk-free rate is 5%. The beta of Asset D is 0.2. What is Asset D's expected return under the CAPM?
(a) 5% (b) 7%
(c) 8% (d) 10%

70. The beta of the risk-free asset is:
(a) Zero (b) One
(c) Ten (d) Negative

71. Two alternative expected returns are compared with help of:
(a) coefficient of variation (b) coefficient of deviation
(c) coefficient of standard (d) coefficient of standard

72. Dollar return is divided by amount invested is used to calculate:
(a) Rate of return (b) Return amount
(c) Investment rate (d) Received amount

73. Yield on bond is 7% and market required return is 14% then market risk premium is:
(a) 2% (b) 21%
(c) 5% (d) 7%

74. Yield on bond is 10% and market required return is 18% then market risk premium is:
(a) 10% (b) 28%
(c) 5% (d) 8%

75. Risk which affects firms with factors such as war, recessions, inflation and high interest rates is classified as:
(a) Diversifiable risk (b) Market risk
(c) Stock risk (d) Portfolio risk

76. You invest 55% of your money in security A with a beta of 1.4 and the rest of your money in security B with a beta of 0.9. The beta of the resulting portfolio is:
(a) 1.12 (b) 0.97
(c) 1.08 (d) 1.18

77. You invest 60% of your money in security A with a beta of 1.2 and the rest of your money in security B with a beta of 0.8. The beta of the resulting portfolio is:
(a) 1.04 (b) 1.08
(c) 1.12 (d) 1.16

78. The risk-free rate is 4 percent. The expected market rate of return is 11 percent. If you expect CAT with a beta of 1.0 to offer a rate of return of 13 percent, you should
   (a) buy GAT because it is overpriced.
   (b) sell short CAT because it Is overpriced.
   (c) sell stock short CAT because it is underpriced.
   (d) buy CAT because it is underpriced

79. The risk-free rate is 4 percent. The expected market rate of return is 11 percent. If you expect CAT with a beta of 1.0 to offer a rate of return of 10 percent, you should
   (a) buy CAT because it is overpriced.
   (b) sell short CAT because it is overpriced.
   (c) sell stock short CAT because it is underpriced.
   (d) buy CAT because it is underpriced.

80. You invest $600 in a security with a beta of 1.2 and $400 in another security with a beta of 0.90. The beta of the resulting portfolio is
   (a) 1.40 (b) 1.00
   (c) 0.36 (d) 1.08

81. In a well diversified portfolio
   (a) market risk is negligible. (b) systematic risk is negligible.
   (c) unsystematic risk is negligible. (d) risk does not exist.

82. The risk-free rate and the expected market rate of return are 5.6% and 12.5%, respectively. According to the capital asset pricing model (CAPM), the expected rate of return on a security with a beta of 1.25 is equal to
   (a) 14.2% (b) 14.5%
   (c) 15% (d) 15.5%

83. The risk-free rate and the expected market rate of return are 6% and 12%, respectively. According to the capital asset pricing model (CAPM), the expected rate of return on security X with a beta of 1.2 is equal to:
   (a) 10% (b) 12%
   (c) 13.2% (d) 14.2%

84. Assume that a Security is fairly priced and has an expected rate of return of 0.17. The market expected rate of return is 0.11 and the risk-free rate is 0.04. The beta of the stock is:
   (a) 1.25 (b) 1.86
   (c) 1 (d) 0

85. You invest 50% of your money in security A with a beta of 1.6 and the rest of your money in security B with a beta of 0.7. The beta of the resulting portfolio is:
   (a) 1.40 (b) 1.15
   (c) 0.36 (d) 1

86. You invest $200 in security A with a beta of 1.4 and $800 in security B with a beta of 0.3. The beta of the resulting portfolio is:
   (a) 1.40 (b) 1
   (c) 0.52 (d) 1.1

87. You invest $200 in security A with a beta of 1.4 and $800 in security B with a beta of 0.3. The beta of the resulting portfolio is:
(a) 1.25 (b) 1.7
(c) 0.7 (d) 1

88. In the context of the Capital Asset Pricing Model (CAPM) the relevant measure of risk is:
(a) Unique risk (b) Beta
(c) Standard deviation of return (d) Variance of return

89. No matter how large the number of stocks in the portfolio is, the risk that cannot be diversified away is the:
(a) Systematic Risk (b) Unsystematic risk
(c) Both (a) and (b) (d) None of the above

90. CAPM stands for:
(a) Capital assets for Pricing & Monitoring
(b) Capital assets for Pricing Model
(c) Capital Account and Pricing Mechanism
(d) None of the above

91. A portfolio comprises two securities and the expected return on them is 12% and 16% respectively. Determine return of portfolio if first security constitutes 40% of total portfolio?
(a) 12.4% (b) 13.4%
(c) 14.4% (d) 15.4%

92. Security A has a higher standard deviation of returns than Security B. We would expect that _ ................
I. Security A would have a higher risk premium than Security B
II. The likely range of returns for Security A in any given year would be higher than the likely range of returns for Security B
III. The Sharpe measure of A will be higher than the Sharpe measure of B.
(a) I only (b) I and II only
(c) II and III only (d) I, Hand III

93. Other things equal, diversification is most effective when
(a) securities'returns are uncorrected.
(b) securities' returns are positively correlated.
(c) securities'returns are high.
(d) securities' returns are negatively correlated.

94. Assume that CAPM is true and alive and the expected market return is 15% and the expected return on a stock with a beta of 2 is 22%. What is the risk-free rate?
(a) 2% (b) 4%
(c) 8% (d) 10%

95. Which of the following sayings illustrates the concept of diversification? .
(a) Don't throw the baby out with the bath water.

(b) A stitch in time saves nine.
(c) Neither a borrower nor a lender be.
(d) Don't put all your eggs in one basket.

96. Consider the CAPM. The risk-free rate is 5% and the expected return on the market is 15%. What is the beta on a stock with an expected return of 17%?
(a) 0.5 (b) 0.7
(c) 1 (d) 1.2

97. You have a $50,000 portfolio consisting of Intel, GE and Con Edison. You put $20,000 in Intel, $12,000 in GE and the rest in Con Edison. Intel, GE and Con Edison have betas of 1.3, 1.0 and 0.8 respectively. What is your portfolio beta?
(a) 1.048 - (b) 1.033
(c) 1.000 (d) 1.037

98. Security X has an expected rate of return of 13% and a beta of 1.15. The risk-free rate is 5% and the market expected rate of return is 15%. According to the capital asset pricing model, security. X is
(a) fairly priced (b) overpriced
(c) underpriced (d) None of the above

99. iSecurity X has an expected rate of return of 18% and a beta of 1.15. The risk-free rate is 5% and the market expected rate of return is 15%. According to the capital asset pricing model, security X is
(a) fairly priced (b) overpriced
(c) underpriced (d) None of the above

100. In the CAPM, the expected rate of return is equal to the required rate of return because the market is in equilibrium.
(a) True
(b) False

## Answer

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| **1** | (a) | **2** | (b) | **3** | (a) | **4** | (c) | **5** | (a) | **6** | (b) |
| **7** | (a) | **8** | (a) | **9** | (a) | **10** | (C) | **11** | (a) | **12** | (a) |
| **13** | (d) | **14** | (a) | **15** | (a) | **16** | (d) | **17** | (a) | **18** | (a) |
| **19** | (c) | **20** | (a) | **21** | (b) | **22** | (c) | **23** | (c) | **24** | (a) |
| **25** | (b) | **26** | (b) | **27** | (a) | **28** | (a) | **29** | (b) | **30** | (a) |
| **31** | (c) | **32** | (b) | **33** | (a) | **34** | (a) | **35** | (d) | **36** | (c) |
| **37** | (c) | **38** | (b) | **39** | (a) | **40** | (a) | **41** | (b) | **42** | (a) |
| **43** | (a) | **44** | (a) | **45** | (a) | **46** | (a) | **47** | (a) | **48** | (b) |
| **49** | (c) | **50** | (b) | **51** | (d) | **52** | (d) | **53** | (b) | **54** | (c) |
| **55** | (a) | **56** | (a) | **57** | (a) | **58** | (a) | **59** | (b) | **30** | (c) |
| **81** | (c) | **62** | (b) | **63** | (c) | **64** | (b) | **65** | (a) | **56** | (b) |
| **67** | (b) | **68** | (b) | **69** | (c) | **70** | (a) | **71** | (a) | **72** | (a) |
| **73** | (d) | **74** | (d) | **75** | (b) | **76** | (d) | **77** | (a) | **78** | (c) |
| **79** | (b) | **80** | (d) | **81** | (c) | **82** | (a) | **83** | (c) | **84** | (b) |
| **85** | (b) | **86** | (c) | **87** | (d) | **88** | (b) | **89** | (a) | **90** | (b) |
| **91** | (c) | **92** | (b) | **93** | (d) | **94** | (c) | **95** | (d) | **96** | (d) |
| **97** | (a) | **98** | (b) | **99** | (c) | **100** | (a) | | | | |