SUGGESTED SOLUTION

SYJC EXAM

SUBJECT- SECRETARIAL PRACTICE

Test Code – SYJ 6039 A

BRANCH - () (Date :)

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ANSWER-1

ANSWER-A **(3 MARKS)**

1. Finance manager
2. Huge
3. An increase

ANSWER-B **(2 MARKS)**

a-1
b-2

ANSWER-C **(5 MARKS)**

1. Financial planning
2. Fixed capital
3. Profit maximization
4. Capital gearing
5. Capital structure

ANSWER-2 **(5 MARKS)**

1.

Sr no.	Points	Fixed Capital	Working Capital
1	Meaning	Fixed capital refers to any kind of physical capital i.e. fixed assets.	Working capital refers to current assets minus current liabilities.
2	Nature	It stays in business almost permanently i.e. for more than one accounting year.	Working capital is circulating capital.
3	Purpose	It is not used up in production of product but invested in fixed assets such as land building, equipment, etc.	Working capital is invested in short term assets such as cash, account receivable, inventory, etc.
4	Sources	Fixed capital funding can come from selling shares, debentures, long term loans, bonds, etc.	Working capital can be funded with short term loans, deposits, trade credit, etc.
5	Objective of investor	Investor invests money in fixed capital hoping to make future profit.	Investor invests money in working capital for getting immediate return.
6	Risk involved	Investment in fixed capital implies a risk.	Investment in working capital is less risky.
7	Authority	Generally Top level Management decides on matters related to fixed capital Investment	Middle level or lower level managers can decide on matters related to working capital needs.
8	Factors Affecting	It depends upon such various factors such as size of business nature of machinery required,	It depends upon various factors such as seasonal fluctuation, production cycle, requirement of

		expansion etc.	cash etc.

ANSWER-3 **(5 MARKS)**

1. **Functions/Role of financial management**

The functions of financial management can be divided into two types

(A) Routine functions
(B) Executive functions

(A) Routine functions

1. Record keeping and reporting
2. Preparation of various financial statements
3. Cash planning
4 Credit management
5 Providing information to Board of Directors on current financial position for making decisions of purchases, marketing, pricing, etc.

(B) Executive Functions:

1. **Forecasting Financial requirements :** Financial needs have to be carefully estimated in business. Money may be required for long term purpose i.e. Fixed capital and for short term purpose i.e working capital. A careful forecasting of such funds must be made.

   Forecasting of Finance means projection of financial needs of business for some time ahead. It is nothing but budgeting Financial needs of the expected programmes.

   Forecasting is not only concerned with amount of money required for a programme but also includes.

   a) Durations of funds (5 years, 10 years, etc.)
   b) Timing of supply of funds
   c) Kinds of funds (owned or borrowed, etc.)

2. **Deciding sources of funds :** Once the need of Finance is revealed, various sources of funds must be considered. Different type of securities like shares, debentures etc. can be issued to raise funds. Funds may also be borrowed from financial institutions and lenders. An utmost care is to be taken while selecting the sources of funds. There should be a proper balance between long term funds and short term funds. The funds raised from owners and outsiders have to be in certain proportion. If a firm has committed to finance from lenders, the terms and conditions of credit should be borne in mind. Thus, Financial decisions should be exercised with great care and caution.

3. **Investment decisions :** Investment decisions refer to the decisions regarding utilization of funds raised by the firm. It relates to the selection of assets in which funds are to be invested. The funds can be invested in two types of assets, namely-

a) Long term assets or fixed assets
b) Short term assets or current assets.

   A large portion of initial funds is invested in fixed assets such as land, building, machinery', equipments and furniture, etc. This decision making is popularly known as 'capital budgeting'.

The aspect of investment decisions relating to current assets is known as ‘working capital management’. Cash, account receivables, and inventory form the element of current assets. A finance manager has to ensure efficient utilization of every current asset to maintain control on cash inflow and cash outflow'.

4. **Dividend policy :** A business firm is basically a profit earning organization. The earnings of a Firm depend upon efficient utilization of funds. Financial management is also concerned with the decision to declare dividend. A finance manager has to decide what portion of profit is to be retained in the business and balance is to be distributed among shareholders. The shareholders are generally more interested in getting higher rate of dividend while Board of Directors wants to retain earnings for future expansion. The finance manager balances the expectations of investors and use of retained earnings to acquire additional assets.

5. **Checking and analysis of financial performance** : The checking and analyzing financial performance is very essential to carry out Financial functions smoothly. For this various financial statements are prepared and analyzed. This is of great value in improving techniques of financial control.

6. **Advising Board of Directors :** A finance manager gives advice to Board of Directors in respect of financial matters. He suggests various solutions for any financial difficulty. Normally finance manager gives advice on important matters such as pricing, expansion, acquisition, dividend policy etc.

2. **Importance of financial planning** : The finance manager gets entire information about the firms activities. On this basis he prepares financial plan. In his efforts to construct financial plan, he is able to build up information. This information is useful for other functions for decision making. An excellent management information system is an asset which serves as ‘guide’ for overall activities of firm.

Significance of financial planning with the following points –

1. **Elimination of waste :** Due to financial planning, it is possible to eliminate the wasteful expenditure. There are several factors such as change in government policy on taxes, fluctuating interest rates, etc. which can be anticipated and tackled with the help of financial planning. Many organizations have suffered irreversible damage due to wasteful expenditure because of lack of financial planning.
2. **Co-ordination** : Co-ordination is the most vital part of management. Finance holds the key to all activities of organization such as production, distribution, marketing and personnel. These activities will hamper if not supported by proper financial planning. It is responsibility of finance manager to bring about co-ordination among all departmental heads of organization. In other words, financial planning should match production planning, distribution planning, personnel planning and overall corporate planning.
3. **Dynamism :** Financial planning is a demanding exercise, which requires dynamism on the part of finance manager. It means finance manager must take initiative and face various changing financial situations as and when they arise. Accurate forecast of future trends are required for effective planning. Unprofitable ventures can be

avoided while profitable projects can be undertaken when such forecasts are available. Thus, dynamism becomes an integral part of effective financial planning.

4. **Communication** : Communication is an effective tool of management. Financial planning enables the finance manager to communicate various aspects of financial plan to the executives of other departments. Detailed policies and procedures must be made known to every' one in the organization, so that there is no wastage of time, goodwill and financial resources. Effective financial planning helps finance manager to communicate easily with others in the organization.
5. **Decision making :** it is necessary for a firm to take appropriate and timely decisions to achieve its objectives. Financial planning prepares itself for attainment of these objectives. Any scheme, how so ever effective, cannot go through unless budgetary' provision is made in the financial planning.
6. **Integration :** Financial planning gives a fairly good idea to the firm about its available resources. Financial planning is to be completed in full consultation and co-operation of other departments. This promotes team spirit among all executives. The financial planning assists in integration of firm's activities.
7. **Futuristic** : Financial planning is effective when it foresees events. It means, it must take into account not only present but also future developments. This futuristic element of financial plan helps for advance programming.

ANSWER-4 **(5 MARKS)**

1. <u>**This statement is FALSE.**</u>

Maximization of wealth is real and complete motive.

Reasons :

(a) According to Prof. Solomon Ezra, the ultimate goal of financial management should be the maximization of owner's wealth,

(b) Maximization of profit is unreal and half motive. Business is an activity which is run in order to earn profit. The main aim of business is to earn profit,

(c) No doubt that profit maximization and wealth maximization are two basic objects of financial management. Without profit no business can continue its function,

(d) Without profit it is difficult for any business to survive. It is accepted as a standard for measuring the success or efficiency of business enterprise,

(e) But the term profit is an ambiguous concept which is not having precise connotation1. Profit can be for long term short term, before tax or after tax.

(f) If profit maximization is accepted as a real and complete motive, it totally ignores the risk factor. It does not consider interest of workers, shareholders, consumers, society and ethical trade practices,

(g) Profit maximization at the cost of social and moral obligation is short sighted policy,

(h) Wealth maximization is value maximization of its owners i.e. to increase market value of shares is real and complete motive.

2. **<u>This statement is FALSE.</u>**

There is no hard and fast rule for the proportions of owned funds and borrowed funds.

Reasons :

(a) Capital structure and financial policies are the two important aspects of financial planning,

(b) Capital is an amount invested in business by raising owned funds and borrowed capital,

(c) Capital is investment of funds and structure means arrangement of components i.e. equity share capital and debt capital in proper proportion.

(d) Owned funds includes amount collected through equity shares, preference shares and retained earnings. Shareholders are paid dividend on their investment,

(e) Borrowed funds includes debentures, term loan who gets fixed interest,

(f) The proportion of owned funds and borrowed funds is not fixed for any kind of business but it varies from business to business.

(g) The combination of owned and borrowed funds depends on availability of funds, types of borrowers, size and nature of business, and other internal as well as external factors.

Hence, there is no hard and fast rule for the proportion of owned funds and borrowed funds.

ANSWER-5 **(5 MARKS)**

1. Business firms are profit oriented organizations. Their objectives are expressed in terms of money. The basic objectives of financial management are as follows:

a) Profit maximisation
b) Wealth maximisation

A. Profit maximisation

Profit maximisation is a basic principle of any business activity. According to this principle, all functions of business aim at profit. 'The principle of ‘profit maximisation’ is a traditional concept. It is based on assumption that ‘profit is a tool of measuring the success of business firm’. In simple words, the business firm should undertake only such, activities that increase profit. The business activities which decrease profit should be avoided.

Profit maximization is considered to be the most important business objective because of the following reasons

1. It is difficult for business to survive without profit.
2. Profit is a tool of measuring the success of a business firm.
3. High level profitability results in better returns (dividend) to the shareholders.
4. High level profitability can generate funds, which can be used for future expansion of business firm.
5. Profit maximization has to be achieved for socio-economic welfare.

B. Wealth maximisation :

According to Prof. Soloman EZRA the ultimate goal of financial management should be the maximization of owners' wealth.

According to him, maximization of profit is unreal and half motive. The proper aim of financial management is wealth maximization of equity shareholders.

Wealth maximization is also known as 'value maximization.' It means maximising net present value of a firm.

The focus of financial management is on wealth maximization of its owners' i.e. suppliers of equity capital. The wealth shareholders is reflected in market value of the shares. So wealth maximisation means the maximisation of market price of shares. The wealth of equity shareholders is maximised only when market value of equity shares is maximized.

Equity shares are traded in a share market. The share price of a company, quoted in share market index, is a reflection of its earning capacity, dividend and retention policy.

Financial decision making should aim at maximising market value of equity share of company.

2. The concept of 'fixed capital' was first theoretically analyzed by economist David Recardo

It refers to any kind of real or physical capital i.e. fixed assets. It is not used for the production of goods. Fixed capital is that portion of total capital which is invested in fixed assets such as land, building, equipment, etc.

According to Karl Marks

'Fixed capital also circulates, except that the circulation time is much longer".

Factors affecting requirement of Fixed Capital

Factors affecting requirement of Fixed Capital

- Nature of business
- Size of business
- Growth and expansion of business
- Stages of development of business
- Business cycle

1. **Nature of business :** The nature of business certainly plays a vital role in determining fixed capital requirement. For e.g. Rail, Road and other public utility services have large fixed investment. They need to invest in huge sum in fixed assets. Their working capital requirements are nominal, because they supply services and not product. They deal in cash sales only.
2. **Size of business :** The size of business also affects fixed capital needs. A general rule applies that the bigger the business, the higher the need of fixed capital. Size of firm, either in terms of its assets or sales, affects the need of fixed capital.

3. **Growth and expansion :** A growing firm may need to invest money in fixed assets in order to sustain its growing production and turnover.
4. **Stage of development of business** : The requirement of fixed capital for a new undertaking is greater than that of an established business.
5. **Business cycle :** When there is boom period in the economy, additional investment in permanent assets may be made by firm to increase their production capacity. Hence the need of fixed capital increases .

ANSWER-6 **(10 MARKS)**

1. WORKING CAPITAL

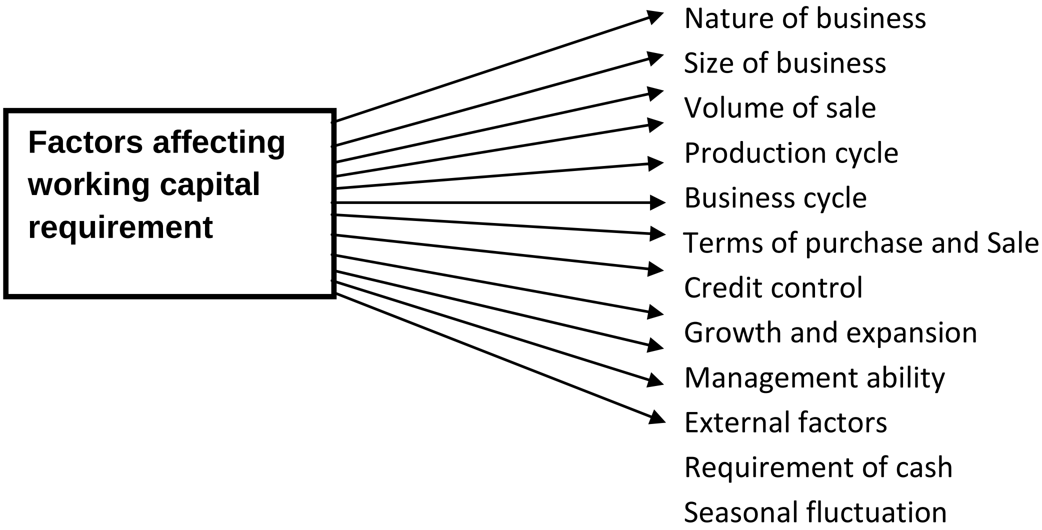
Meaning

In broad sense, the term working capital is defined as follows

Western and Brigham

'Working capital refers to a firm's investment in short term assets cash, short term securities, account receivable and inventories".

This approach has broader application. It takes into consideration all current resources of the company. It refers to 'gross working capital.'



1. **Nature of business** : The working capital requirements are highly influenced by the nature of business. Industrial and manufacturing enterprises, trading firms require large sum of working capital. Big retail stores need a large amount of working capital as they have to maintain large stock of variety' of goods. It is because they have to satisfy varied and continuous demand of consumers.
2. **Size of business :** The size of business also affects the requirement of working capital. Size of the firm may be estimated in terms of scale of operation. A firm with large scale operation will require more working capital.
3. **Volume of sale :** This is the most important factor affecting size of working capital. The volume of sale and the size of working capital are directly related with each other. If the volume of sales increases, there is an increase in amount of working capital.
4. **Production cycle** : The process of converting raw material into finished goods is called 'production cycle.'

If the production cycle period is longer, the firm needs more amount of working capital. If the manufacturing cycle is short, it requires less working capital.

5. **Business cycle** : When there is upward-swing in economy, sales will increase. This will lead to increase in investment in stock. This act will require additional working capital.
During recession period, sales will decline and consequently the need of working capital will also decrease.

6. **Terms of purchase and sales :** If credit terms of purchases are favourable and terms of sales are less liberal, then requirement of cash will be less. Thus working capital requirement will be reduced. A firm gets more time for payment to suppliers. A firm which enjoys more credit facilities needs less working capital.
On the other hand, if firm does not get proper credit for purchases and adopts liberal credit policy for sales, requires more working capital.

7. **Credit control :** Credit control includes the factors such as volume of credit sales, the terms of credit sales, the collection policy, etc. If credit control policy is sound, it is possible for the company to improve its cash flow. If credit policy is liberal, it creates a problem of collection of funds. It can increase possibility of bad debt. A firm selling on easy credit terms requires more working capital. The firm making cash sales requires less working capital.

8. **Growth and expansion activities :** The working capital requirement of a firm will increase with growth of firm. The growth of firm is in terms of sales or even fixed assets.
A growing company needs funds continously to support large scale operation.

9. **Management ability :** The requirement of working capital is reduced if there is proper co-ordination in production and distribution of goods.
A film stocking on heavy inventory calls for higher level of working capital.

10. **External factors :** If the financial institutions and banks provide funds to the firm as and when required, the need of working capital is reduced.

11. **Requirement of cash :** The working capital requirement is also influenced by the amount of cash required by firm for various purposes.
If the requirement of cash is more then company needs higher amount of working capital.

12. **Seasonal fluctuations :** The demand for products may he of seasonal nature. During certain season the size of working capital may be bigger than that in another period for e.g. Before rainy season umbrella and raincoat manufacturing companies need more working capital to manufacture above goods so that they can put these goods before monsoon starts.

2. Capital structure constitutes two words i.e. capital and structure. Capital refers to investment of funds in the business while structure means arrangement of different components in proper proportion. Thus capital structure means ‘mix-up of various sources of funds in desired proportion’.

   Once the capital requirement of firm is decided, attention is given to the kind of capital sources which can be raised to meet this need.

   A company can raise its capital from different sources i.e. owned capital or borrowed capital or both. The owned capital consists of equity share capital, preference share capital, reserves and surplus. On the other hand, borrowed sources arc debentures, loans, etc. Proportion of different sources are used in capital structure.

To decide capital structure means, to decide upon the ratio of different securities in total capital. It is nothing but 'composition of capital'.

Definition :

Weston and Bringham

"Capital structure is the permanent financing of firm represented by long term debt, preferred stock and net worth."

The pattern of capital structure of various firms varies widely. There is no hard and fast rule for the proportion of owned funds and borrowed funds. So to determine the best pattern of capital structure many factors are to be borne in mind. The factors which play vital role in capital structure determination arc divided into two

A) Internal factors

B) External Factors

A. Internal Factors

1. **Requirement of capital :** When a new business is started, it cannot issue variety of securities. This is because there is considerable risk involved at initial stages of new company. The ideal structure for new company is to raise capital through equity shares.

   Other types of securities may be issued by company in future. The company may require additional funds for expansion or modernization, etc.

2. **Size and nature of business :** The size of business has great impact on its capital structure. Large manufacturing companies have huge investments in fixed assets such as land, machinery, building etc. Further these fixed assets can be offered as securities against issue of debentures. Hence, these firms may raise funds by issue of equity shares along with debentures.

   On the other hand trading concerns require more working capital. They can raise funds by issue of equity as well as preference shares.

   In case of small companies capital requirement is less. They have less capacity to raise funds from external sources.

3. **Growth of business firm :** Different capital structures may be required at various stages of development of company.

   At initial stages of development, equity capital and short term loans are the main sources of finance. When a company grows in size, it can utilize sources of finance such as preference shares, debt capital, etc.

   The well-established concerns with goodwill and reputation can acquire funds from various sources.

4. **Adequate and stable earning :** The business firms with stable earning will have 'stable earnings per share' (i.e. EPS). Such companies can utilize source of debt capital as they can easily pay a fixed rate of interest. Therefore, developed companies usually employ more amount of loan capital.

   The business firm with unstable earning should not opt debt in their capital structure, as they may face difficulty in meeting fixed amount of interest.

5. **Cash position :** The companies expecting large and stable cash inflow in future, can utilize large amount of debt capital in their capital structure.

It is quite risky for those companies whose cash inflow is unstable and unpredictable to have debt capital. It is because when company raises loan capital it becomes compulsory to pay interest on that. If company fails to pay interest, this may cause situation of financial insolvency for the company.

6. **Period of finance :** While framing capital structure the 'period for which finance is needed', should also be considered.
   If funds are required on regular basis, the company should raise funds through issue of equity shares.
   If funds are required for short period of time the firm should raise funds through issue of debentures or redeemable preference shares.
7. **Future plan and development :** while designing capital structure, management should keep in mind the future development and expansion plans.
   Equity capital can be issued in the beginning. The debentures and preference shares may he issued in future to finance developmental plans.
8. **Trading on equity :** The use of borrowed capital for financing a firm is known as Trading on equity. The policy of 'Trading on equity' is based on premise that, if the rate of interest on debt is lower than rate of companies earning, the equity shareholder will enjoy advantage in the form of additional profit. Higher rate of dividend to equity shareholders improves goodwill of the company. It increases market value of shares. This improves creditworthiness of the company and company will be able to raise further loan at lower rate of interest.
   But if company earnings are not sufficient, it may face financial crises. The interest on debt has to be paid even in case of loss. The whole earnings may exhaust in payment of interest.
   No dividend would be declared to shareholders. This will affect goodwill and creditworthiness of the company. It will not be able to raise further loans.
   Thus, trading on equity is double edged sword. It may increase income of shareholders if the things go right. On the other hand, it increases risk of loss under adverse conditions.
9. **Capital gearing :** It is a ratio between debt capital (fixed interest) and equity capital (variable dividend). If the proportion of debt capital is high as compared to equity share capital, it is high gearing. On the other hand, if the proportion of debt capital is less as compared to equity share capital, it is a state of low gearing. A proper mix of various types of finance should be maintained in capital structure, so that the interest of equity shareholders is protected.
10. **Attitude of Management :** The capital structure is influenced by the attitude of persons in the management. The management's attitude towards 'control of firm', should be noted minutely. If the management has strong will of exclusive control, then preference shares and debt capital are used as source of finance.

B. External Factors

1. **Market conditions :** The pattern of capital is also influenced by prevailing market conditions. Readiness of investors to purchase shares, interest rate, stages of business cycle, tax, risk of investment, etc. together form market conditions.
   The various methods of financing should be considered in the prevailing market conditions. For eg: If share market is in a declining situation, a company should not

issue equity shares but issue debt. On the other hand, during the period of boom in share market, it should issue equity shares to raise capital.

2. **Attitude of investors :** Attitude of investors also plays an important role in determination of capital structure. The investors who are ready to take risk and expect higher returns prefer equity shares for investment. On the contrary, cautious investors, who are interested in safe and assured income, invest in debentures.

3. **Cost of capital:** Cost of capital is one of the important factors while designing capital structure. The cost of capital is the minimum return expected by its investor. The expected return depends upon the degree of risk. The high degree of risk is assumed by shareholders than debt holders. In case of debt holder, rate of interest is fixed, while rate of dividend given to shareholders is not fixed. The loan of debt holder is repaid within the prescribed period whereas shareholders get back their capital only when company is liquidated. Thus 'debt' is a cheaper source of capital than equity. The preference share capital is also cheaper but not cheap as debt. However, it should be realized that company cannot minimize cost of capital by employing only debt.

   At a particular point beyond which, debt becomes more expensive because of increased risk of excessive debt.

4. **Government rules and regulations :** Statutory obligations play important role in capital structure decision. The SEBI has prescribed debt : equity ratio norm of 2:1. A higher debt-equity ratio of 3:1 has been permitted for large capital intensive project. The small industrial projects are given concession and aid by government to avail more debt capital as compared to equity capital.

5. **Attitude of financial institutions :** It is another factor which is to be considered while determining capital structure.

   If financial institutions prescribe high terms of lending, then management has to move to other source of financing.

   If financial institutions prescribe easy terms of lending, it would be advantageous to obtain funds at cheaper rate.

6. **Rate of interest :** The prevailing rate of interest plays vital role in determining capital structure. If prevailing interest rates are higher, firms will delay debt financing. On the other hand, if prevailing interest rates are lower, firm will opt for debt financing.

7. **Taxation :** Interest paid against debt is tax deductable expenditure. Dividend is not considered as tax deductable expenditure for the company. As such, issue of debt capital is more advantageous than issue of share capital.

   The companies with higher taxes employ debt capital as it is tax deductable expense.

8. **Competition :** The firms which are facing cut-throat competition prefer to issue equity shares, because their earnings are not certain and adequate. But the companies which have monopolies may issue debt capital because of certainty' of earnings.