

Mid Semester Test: August-2017

Financial Management

## GUJARAT NATIONAL LAW UNIVERSITY GANDHINAGAR

Course: Financial Management  
Semester-V (Batch: 2015-20)

Mid Semester Test: August-2017

Date: 24<sup>th</sup> August, 2017

Duration: 2 hours

Max. Marks: 30

### Instructions:

- Read the questions properly and write the answers in the given answer book.
- The respective marks for each question are indicated in-line.
- Do not write any thing on the question paper.
- Indicate correct question numbers in front of the answers.
- No questions or clarifications can be sought during the exam period, answer as it is, giving reason, if any.
- Scientific calculators are permitted in the examination hall.

- |   | Marks            |
|---|------------------|
| Q.1 Answer the following questions.   | (2+2+4<br>+2=10) |
| (a) Explain the difference between capital budgeting and financing decision   |                  |
| (b) Why should managers act in shareholders' interests?   |                  |
| (c) Write a brief note on problems associated with IRR as an investment criteria  |                  |
| (d) Suppose you own a small company that is contemplating setting up of a commercial space. The cost of buying the land and constructing the building is Rs 600000. Your company has cash in the bank to finance construction. Your business adviser forecasts a shortage of office space and predicts that you will for sure be able to sell next year for Rs 700000. You can invest in the project, or pay cash out to shareholders, who can invest on their own. We assume that shareholders can earn a 10 percent profit by investing for one year in safe assets, Government of India securities. Or they can invest in the stock market, which is risky but offers an average return of 14 percent. |                  |
| (i) What is the opportunity cost of capital in the given case?  |                  |
| (ii) Shall you go ahead with investment in the project? Why?  |                  |
| Q.2 Assume that you are a winner of a competition and you will have to choose one of the following prizes:  | (10)             |
| i. Rs 500000 now  |                  |
| ii. Rs 1000000 at the end of 6 years  |                  |
| iii. Rs 60000 a year forever  |                  |
| iv. Rs 100000 per year for 10 years   |                  |
| v. Rs 35000 next year and rising thereafter by 5 percent per year forever.  |                  |
| If the interest rate (r) is 10 percent, which prize will you choose?  |                  |

If the interest rate ( $r$ ) is 10 percent, which prize will you choose?

Page 1 of 2

Mid Semester Test: August-2017

Financial Management

Q.3 Your friend approaches you with two projects, M and N. Each project requires an initial (10)  
outlay of Rs 5 million. The expected cash inflow from these projects are:

Year	Project M (Rs in million)	Project N (Rs in million)
1	11	38
2	19	22
3	32	-18
4	-37	10

If the cost of the capital is 12 percent,

- What is the NPV for each of the projects?
- What is the Modified IRR (MIRR) for each of the projects?
- What is the discounted payback period for each of the projects?
- What is the Benefit Cost Ratio for each of the projects?
- If you have to guide your friend, which project will you recommend him? Why?

\*\*\*\*

