CBSE Test Paper - 01

Chapter - 9 Financial Management

1. Which of the following is not concerned with the Long term investment decision **(1)**
    a. Inventory management
    b. Research and Development Programme
    c. Opening a new branch
    d. Management of fixed capital
2. Shareholders funds refer to ________________ **(1)**
    a. All of these
    b. Reserves
    c. Share capital
    d. Surpluses and Retained Earnings
3. Long term investment decision is also known as _____________ **(1)**
    a. Working Capital
    b. None of these
    c. Capital Budgeting
    d. Dividend Decision
4. Which of the following is not a financial Decision? **(1)**
    a. Investment Decision
    b. Financing Decision
    c. Staffing Decision
    d. Dividend Decision
5. Canara Bank wants to open a new branch of its bank. What is this decision called? **(1)**
6. Name any two essential ingredients of sound working capital management. **(1)**
7. Identify the decision taken in financial management which affects the liquidity as well as the profitability of business. **(1)**

8. State the concept by which increases the return on equity shares with a change in the capital structure of a company? **(1)**
9. State any three points of importance of financial planning. **(3)**
10. How does working capital affect both the liquidity as well as profitability of a business? **(3)**
11. What is meant by financial planning? **(4)**
12. What is meant by financial planning? **(4)**
13. Explain briefly any four factors affecting the fixed capital requirements of an organisation. **(5)**
14. Explain any four points that highlight the importance of financial planning. **(5)**
15. Explain the following as factors affecting dividend decision
    i. Stability of earnings
    ii. Growth opportunities
    iii. Cash flow position
    iv. Taxation policy **(6)**

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Answer

1. a. Inventory management
   Explanation:
   Long term investment decisions are also called capital budgeting decisions which include purchase of land and building, plant and machinery,change of technology, research and development and expenditure of advertising campaign etc. Inventory management comes under working capital management decisions.
2. a. All of these
   Explanation:
   The funds which remain invested in the business for a longer period of time and generally, not refunded during the life of the bisiness. For example equity shares, retained earnings, reserves etc.
3. c. Capital Budgeting
   Explanation:
   Long term investment decision involves committing the finance on a long term basis. It is also known as capital budgeting decision.
4. c. Staffing Decision
   Explanation:
   Financial decisions include:
   - Investment decision
   - Financing decision
   - Dividend decision
5. This decision is termed as Investment decision.
6. The two essential ingredients of sound working capital management are Inventory and debtors.
7. “Short-term Investment Decision” or Working Capital Decision

8. "Trading on equity or financial leverage" increases the return on equity shares with a change in the capital structure of a company.

9. **Financial planning** helps you determine your short and long-term **financial** goals and create a balanced **plan** to meet those goals.

   Its importance can be highlighted from the following factors:

   i. Adequate funds have to be ensured.
   ii. Financial Planning helps in ensuring a reasonable balance between outflow and inflow of funds so that stability is maintained.
   iii. Financial Planning ensures that the suppliers of funds are easily investing in companies which exercise financial planning.

10. Working capital can be defined as the excess of current assets over current liabilities. Working capital of a business plays important role in the smooth day-to-day operations of the business. Working capital affects both the liquidity as well as the profitability of a business. Increase in working capital will increase the liquidity of the business. For example, when cash in hand or at bank increases, the capacity to make day to day payments also increases. A decrease in working capital will decrease the liquidity and profitability of the business as the firm is not in a position to pay off the day to day expenses and thus utilises the capital for it which further reduces the profitability of the business. Thus, the working capital should be such that a balance is maintained between the profitability and liquidity.

11. i. Financial planning is essentially preparation of a financial blueprint of an organisation's future operations.

    ii. The process of estimating the fund requirement of a business and specifying the sources of funds is called financial planning.

    iii. The objective of financial planning is to ensure that enough funds are available at right time.

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13. **The main factors affecting the requirement of fixed capital are discussed below:**

    i. **Nature of Business:** The type of business Co. is involved in is the first factor which helps in deciding the requirement of fixed capital. A manufacturing company needs more fixed capital as compared to a trading company, as trading company does not need plant, machinery, etc.
    ii. **Scale of Operation:** The companies which are operating at large scale require more fixed capital as they need more machineries and other assets whereas small scale enterprises need less amount of fixed capital.
    iii. **Technique of Production:** Companies using capital-intensive techniques require more fixed capital whereas companies using labour-intensive techniques require less capital because capital-intensive techniques make use of plant and machinery and company needs more fixed capital to buy plants and machinery.
    iv. **Technology Up-gradation:** Industries in which technology up-gradation is fast need more amount of fixed capital as when new technology is invented old machines become obsolete and they need to buy new plants and machinery whereas companies where technological up-gradation is slow they require less fixed capital as they can manage with old machines.

14. Financial planning helps in determining the objectives, policies, procedures, programmes and budgets to deal with the financial activities of an enterprise. Various importance of financial planning:

    i. **Helps to face the eventualities** It forecasts the future business situations which helps in preparing alternative financial plans to face the eventual situations.
    ii. **Helps in avoiding business shocks and surprises** Proper provision regarding shortage or surplus of funds is made by anticipating future receipts and payments. Hence, it helps in avoiding business shocks and surprises.
    iii. **Helps in coordination** It helps in coordinating various business activities, such as sales, purchase, production, finance, etc.

iv. **Helps in avoiding wastage of finance** In the absence of financial planning, wastage of financial resources may take place. This arises due to the complex nature of business operations such as, excessively over or under estimation of finance for a particular business operation. Such type of wastages can be avoided through financial planning.

15. Dividend decision relates to how much of the company's net profit is to be distributed to the shareholders and how much of it is to be retained in the business. Factors affecting dividend decision are:

i. **Stability of earnings-** Stability of earnings of a business unit affects the dividend decision. Stability of Earnings is when the company is able to earn reasonable amount of profits every year. A company having stable earnings can declare a higher dividend whereas a company having unstable earnings is likely to pay smaller dividend.
ii. **Growth opportunity-** Companies which are intended to grow and diversify its operations in new lines of business, generally pay less dividend and retain more money out of profits to invest in profitable projects. On the contrary, companies which are not intended to grow and continue with the same line of business having enough earnings and cash can pay higher dividends.
iii. **Cash Flow position-** Dividend involves an outflow of cash. Availability of enough cash is necessary for payment of declaration of dividends. If the cash flow position is strong dividends can be paid. If cash flow position is weak it is difficult to pay dividends.
iv. **Taxation policy-** The decision is affected by the tax treatment of dividends and capital gains. For a company, It is better to pay less by dividends when the tax rate on the dividend is higher and pay more as dividends when the tax rate is lower. This is because dividends are tax-free in the hands of shareholders, dividends distribution tax is levied on the company. Payment of tax on the dividend is an added expense for the company to be paid apart from the dividends that are distributed.