



BUDDHA SERIES

(Unit Wise Solved Question & Answers)

Course - MBA

COLLEGE - BUDDHA INSTITUTE OF MANAGEMENT (C.C-1212)

Department of Business Administration

SUBJECT: STRATEGIC FINANCIAL MANAGEMENT

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Subject Code: BMB FM05

UNIT I

Strategic Financial Management & Valuation of Securities

1. What is Strategic Financial Management? Explain its objectives and functions.

Answer

Strategic Financial Management (SFM) refers to the management of financial resources of a company in a way that supports the long-term goals and strategy of the organization.

It focuses on planning, organizing, directing and controlling financial activities such as procurement and utilization of funds.

Objectives of Strategic Financial Management

1. Wealth Maximization
The main objective is to maximize shareholders' wealth by increasing the market price of shares.
2. Profit Maximization
Increasing profitability through effective financial decisions.
3. Efficient Utilization of Funds
Ensuring optimal use of financial resources.
4. Maintaining Liquidity
Ensuring that the firm has sufficient funds for daily operations.
5. Financial Stability
Maintaining an appropriate balance between debt and equity.

Functions of Strategic Financial Management

1. Financial Planning
Estimating capital requirements and determining financial policies.
2. Investment Decision
Selecting profitable investment opportunities.
3. Financing Decision
Determining the best mix of debt and equity.
4. Dividend Decision
Deciding how much profit should be distributed to shareholders.
5. Risk Management
Managing financial risks associated with investments and financing.

Strategic financial management plays a crucial role in ensuring long-term growth and sustainability of the firm.

2. Explain the concept and importance of valuation of securities.

Answer

Valuation of securities refers to determining the fair market value of financial instruments such as shares, bonds and preference shares.

Investors use valuation techniques to decide whether a security is underpriced or overpriced.

Importance of Valuation

1. Helps investors make investment decisions.
2. Useful in mergers and acquisitions.
3. Helps determine market price of securities.
4. Useful in portfolio management.
5. Helps in financial planning.

Valuation is based on future income potential and risk associated with the security.

3. Explain different approaches to corporate valuation.

Answer

Corporate valuation refers to determining the total value of a company.

1 Asset Based Approach

Under this method, value of a company is calculated as:

Firm Value = Total Assets – Total Liabilities

This approach is used in liquidation or asset-intensive businesses.

2 Income Based Approach

The company is valued based on its expected future income or cash flows.

Example methods:

- Discounted Cash Flow (DCF)
- Capitalization of earnings

3 Market Based Approach

Value is determined by comparing with similar companies in the market.

Example:

Price Earnings Ratio method.

4 Economic Value Added Approach

Measures value created beyond the cost of capital.

$EVA = NOPAT - \text{Cost of Capital}$

These approaches help determine true business value for investment decisions.

4. Explain valuation of equity shares using dividend approach.

Answer

The dividend approach states that the value of an equity share equals the present value of expected future dividends.

Dividend Discount Model Formula

$$P_0 = D_1 / (K_e - g)$$

Where:

P_0 = Current share price

D_1 = Expected dividend

K_e = Cost of equity capital

g = Growth rate of dividend

Example

Dividend = ₹5

Cost of equity = 12%

Growth rate = 4%

$$P_0 = 5 / (0.12 - 0.04)$$

$$P_0 = ₹62.5$$

Advantages

- Considers time value of money
- Useful for stable dividend companies

5. Explain valuation of equity shares using earnings approach.

Answer

Under this approach, value of a share depends on the earning capacity of the company.

Formula

Value of Share = Earnings per Share / Capitalization Rate

Example

EPS = ₹12

Capitalization Rate = 10%

Value of Share

= 12 / 0.10

= ₹120

Merits

1 Reflects profitability of company

2 Simple to calculate

Limitations

- Ignores dividend policy
- Earnings may fluctuate

6. Explain valuation of equity shares using cash flow approach.

Answer

In the cash flow approach, share value is determined based on future cash flows expected from the company.

Discounted Cash Flow Model

$$PV = CF / (1+r)^n$$

Where

CF = Future cash flow

r = Discount rate

n = Time period

Advantages

- Considers time value of money
- Based on future earning potential

Limitations

- Difficult to estimate future cash flows.

7. Explain valuation of debt securities.

Answer

Debt securities such as bonds provide fixed interest payments and repayment of principal.

The value of debt is the present value of future interest payments and principal repayment.

Formula

Bond Value = PV of Interest + PV of Principal

Factors affecting bond value

- 1 Market interest rate
- 2 Coupon rate
- 3 Time to maturity
- 4 Credit rating

If market interest rates increase, bond value decreases.

8. Explain valuation of preference shares.

Answer

Preference shares provide fixed dividend and have priority over equity shares.

Formula

Value of Preference Share

$$P = D / K_e$$

Where

D = Annual dividend

K_e = Required rate of return

Example

Dividend = ₹8

Required return = 10%

Value

= $8 / 0.10$

= ₹80

9. Explain the concept of shareholder wealth maximization.

Answer

Shareholder wealth maximization means maximizing the market value of shareholders' investment.

It considers:

- Time value of money
- Risk and return
- Future cash flows

This objective is superior to profit maximization because it focuses on long-term value creation.

10. Explain limitations of valuation methods.

Answer

Major limitations include:

- 1 Difficult to predict future earnings
- 2 Market fluctuations affect values
- 3 Requires many assumptions
- 4 Lack of reliable financial data
- 5 Economic uncertainty

Therefore valuation results should be used carefully with multiple methods.

UNIT II

Capital Structure and Leverage

1. Explain the concept of capital structure and its importance.

Answer

Capital structure refers to the proportion of different sources of finance used by a firm, mainly:

- Equity shares
- Preference shares
- Debentures
- Long-term loans

Importance

- 1 Minimizes cost of capital
- 2 Maximizes firm value
- 3 Maintains financial stability
- 4 Improves profitability
- 5 Supports business growth

An optimal capital structure balances risk and return.

2. Explain factors affecting capital structure decisions.

Answer

Several factors influence capital structure decisions.

1 Cost of Capital

Firms prefer sources with lower cost.

2 Business Risk

Companies with higher business risk prefer less debt.

3 Financial Risk

High debt increases risk of bankruptcy.

4 Flexibility

Companies need flexibility for future financing.

5 Control Considerations

Issuing equity may dilute ownership control.

6 Market Conditions

Interest rates and capital market conditions affect financing choices.

3. Explain Net Income (NI) approach of capital structure.

Answer

The Net Income approach was proposed by David Durand.

Assumptions

- 1 Cost of debt is less than cost of equity
- 2 Cost of debt remains constant
- 3 No corporate taxes

Conclusion

Increasing debt decreases overall cost of capital and increases firm value.

Thus firms should use maximum debt.

4. Explain Net Operating Income (NOI) approach.

Answer

The NOI approach states that capital structure does not affect firm value.

Assumptions

- 1 Cost of capital remains constant
- 2 Market value depends on operating income
- 3 No taxes

Conclusion

Firm value is independent of capital structure.

5. Explain traditional theory of capital structure.

Answer

Traditional theory suggests that an optimum capital structure exists.

According to this theory

- 1 Moderate debt reduces cost of capital
- 2 Excess debt increases financial risk

Therefore cost of capital first decreases then increases.

6. Explain operating leverage.

Answer

Operating leverage measures the effect of fixed operating costs on profits.

Formula

$$DOL = \text{Contribution} / \text{EBIT}$$

Importance

- 1 Measures business risk
- 2 Shows impact of sales change on profit

High operating leverage indicates high business risk.

7. Explain financial leverage.

Answer

Financial leverage measures the effect of debt financing on earnings per share.

Formula

$$DFL = \text{EBIT} / \text{EBT}$$

Importance

- 1 Improves EPS when profits are high
- 2 Increases financial risk

High financial leverage means higher fixed interest obligations.

8. Explain combined leverage.

Answer

Combined leverage measures the combined effect of operating and financial leverage.

Formula

$$DCL = DOL \times DFL$$

It measures impact of sales change on EPS.

9. Explain EBIT-EPS analysis.

Answer

EBIT-EPS analysis is used to select the best financing alternative.

It compares financing plans such as

- Debt financing
- Equity financing
- Preference shares

Objective

To choose the plan that maximizes earnings per share (EPS).

10. Explain ROI and ROE analysis.

Answer

Return on Investment (ROI)

ROI measures efficiency of investment.

Formula

$$ROI = \text{Net Profit} / \text{Total Investment}$$

Return on Equity (ROE)

ROE measures profitability for shareholders.

Formula

ROE = Net Profit / Shareholders Equity

Importance

- 1 Evaluates financial performance
- 2 Helps investors assess profitability
- 3 Useful for financial decision making



UNIT III

Dividend Policy

1. What is Dividend Policy? Explain its objectives.

Answer

Dividend policy refers to the decision of a company regarding how much of its profits should be distributed to shareholders as dividends and how much should be retained for future growth.

Dividend policy plays an important role in maximizing shareholder wealth and maintaining investor confidence.

Objectives of Dividend Policy

1. Maximization of Shareholder Wealth
Ensuring shareholders receive reasonable returns.
2. Stability of Dividends
Maintaining regular dividend payments to build investor confidence.
3. Financing Future Growth
Retaining sufficient earnings for expansion and investment.
4. Maintaining Market Price of Shares
Stable dividends increase investor trust and share value.
5. Balancing Retention and Distribution
Achieving an optimal balance between dividends and retained earnings.

Thus, dividend policy is an important financial decision that affects company growth and shareholder satisfaction.

2. Explain the factors affecting dividend decisions.

Answer

Several factors influence the dividend policy of a company.

1. Profitability of the Company

Companies with higher profits can pay higher dividends.

2. Liquidity Position

Dividend payment requires cash availability.

3. Growth Opportunities

Companies with expansion plans prefer retaining profits.

4. Legal Restrictions

Government regulations may limit dividend payments.

5. Access to Capital Markets

Companies with easy access to external funds can pay higher dividends.

6. Taxation Policy

Dividend tax affects the dividend decision.

7. Shareholder Expectations

Investors prefer stable dividend income.

8. Stability of Earnings

Companies with stable earnings maintain stable dividends.

These factors determine the appropriate dividend policy for a firm.

3. Explain Walter's Model of dividend policy.

Answer

Walter's model explains the relationship between dividend policy and firm value.

According to Walter, the dividend policy affects the market price of shares.

Formula

$$P = [D + (r/K_e) (E - D)] / K_e$$

Where:

P = Market price of share

D = Dividend per share

E = Earnings per share

r = Internal rate of return

K_e = Cost of equity

Implications

1. If $r > K_e$, firm should retain earnings.
2. If $r < K_e$, firm should distribute dividends.
3. If $r = K_e$, dividend policy does not affect firm value.

Limitations

- Assumes constant rate of return
- Assumes all investments are financed through retained earnings.

4. Explain Gordon's Model of dividend policy.

Answer

Gordon's model is also known as the Dividend Capitalization Model.

It states that dividends influence the value of a firm.

Formula

$$P = E(1 - b) / (K_e - br)$$

Where:

P = Market price of share

E = Earnings per share

b = Retention ratio

r = Rate of return

K_e = Cost of equity

Assumptions

1. Firm is an all-equity firm.
2. No external financing.
3. Constant rate of return.

Conclusion

Investors prefer certain dividends over uncertain future gains, which is known as the Bird in Hand Theory.

5. Explain Modigliani and Miller dividend theory.

Answer

Modigliani and Miller (MM) proposed the Dividend Irrelevance Theory.

According to this theory, dividend policy does not affect the value of the firm.

Assumptions

- 1 No taxes
- 2 Perfect capital market
- 3 Rational investors
- 4 No transaction costs

Conclusion

Firm value depends only on investment decisions, not dividend decisions.

Limitations

- 1 Assumptions are unrealistic
- 2 Taxes and market imperfections exist in reality.

6. Explain corporate dividend behavior.

Answer

Corporate dividend behavior refers to the pattern of dividend distribution followed by companies.

Features

- 1 Companies prefer stable dividend policy.
- 2 Dividends are changed gradually.
- 3 Firms avoid reducing dividends.
- 4 Dividend decisions depend on future earnings expectations.

Companies generally follow a conservative dividend policy to maintain investor confidence.

7. Explain stability of dividend policy.

Answer

A stable dividend policy means maintaining consistent dividend payments over time.

Types of Dividend Stability

1. Constant Dividend Per Share
Same dividend every year.
2. Constant Payout Ratio
Fixed percentage of earnings paid as dividend.

3. Stable Dividend with Extra Dividend
Regular dividend plus additional dividend during good years.

Advantages

- Builds investor confidence
- Stabilizes share price
- Attracts long-term investors

8. Explain legal provisions relating to dividend in India.

Answer

Dividend payments in India are governed by the Companies Act 2013.

Major Legal Provisions

- 1 Dividends can be paid only from profits.
- 2 Company must provide depreciation before dividend declaration.
- 3 Dividend must be approved by shareholders in AGM.
- 4 Dividend must be paid within 30 days of declaration.
- 5 Unpaid dividend must be transferred to Unpaid Dividend Account.

These provisions ensure protection of investors' interests.

9. Explain procedural aspects of dividend declaration.

Answer

The procedure for dividend declaration involves several steps.

Steps

- 1 Preparation of financial statements
- 2 Recommendation by Board of Directors
- 3 Approval by shareholders in AGM
- 4 Declaration of dividend
- 5 Payment of dividend to shareholders
- 6 Transfer of unpaid dividend to special account

This process ensures transparency and legal compliance.

10. Explain types of dividends.

Answer

Companies may distribute different types of dividends.

Types

1 Cash Dividend

Paid in cash to shareholders.

2 Stock Dividend (Bonus Shares)

Additional shares given to shareholders.

3 Property Dividend

Paid in form of assets.

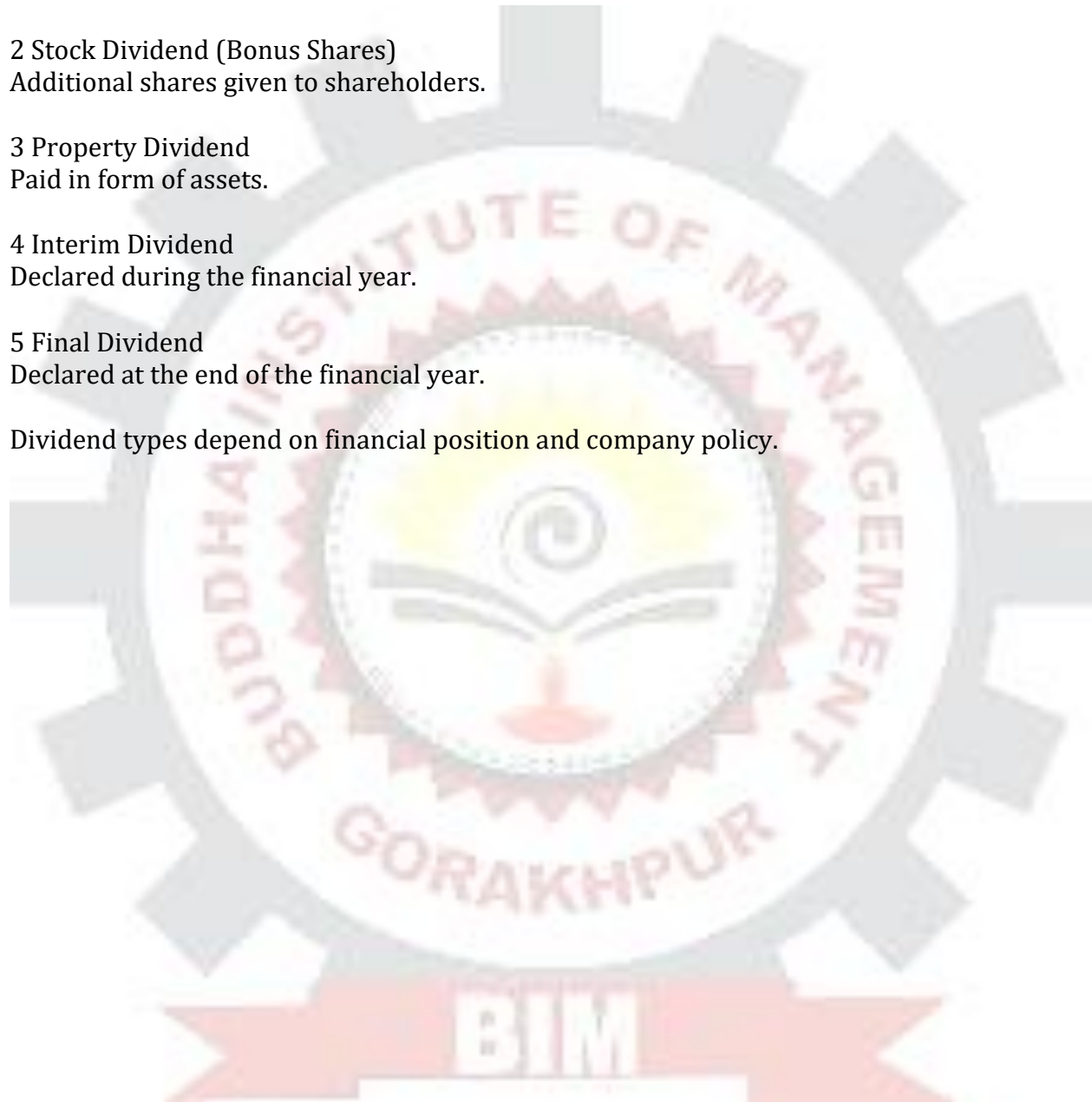
4 Interim Dividend

Declared during the financial year.

5 Final Dividend

Declared at the end of the financial year.

Dividend types depend on financial position and company policy.



UNIT IV

Institutional Setup for Finance and Venture Capital

1. Explain the role of financial institutions in term finance.

Answer

Term finance refers to long-term financial assistance provided to businesses for capital investment.

Financial institutions provide funds for:

- expansion
- modernization
- infrastructure projects

Major Term Lending Institutions in India

- 1 IFCI
- 2 IDBI
- 3 ICICI
- 4 SIDBI
- 5 State Financial Corporations

Functions

- Providing long-term loans
- Project appraisal
- Financial consultancy
- Industrial development support

These institutions promote industrial growth and economic development.

2. Explain the role of commercial banks in business finance.

Answer

Commercial banks provide short-term and medium-term finance to businesses.

Functions

- 1 Accepting deposits
- 2 Providing loans and advances

- 3 Financing trade and commerce
- 4 Providing working capital loans
- 5 Providing overdraft and cash credit facilities

Banks play an important role in supporting business operations and economic growth.

3. Explain the functions of Non-Banking Financial Companies (NBFCs).

Answer

NBFCs are financial institutions that provide bank-like services without a banking license.

Functions

- 1 Providing loans and advances
- 2 Leasing and hire purchase
- 3 Asset financing
- 4 Investment services
- 5 Microfinance

NBFCs help improve financial inclusion and credit availability.

4. Explain the concept of working capital.

Answer

Working capital refers to funds required for day-to-day operations of a business.

Formula

Working Capital = Current Assets – Current Liabilities

Importance

- 1 Ensures smooth business operations
- 2 Helps maintain liquidity
- 3 Improves operational efficiency

5. Explain venture capital and its importance.

Answer

Venture capital refers to financing provided to new or high-growth startups with high risk but high potential returns.

Importance

- 1 Encourages entrepreneurship
- 2 Supports innovation
- 3 Promotes technological development
- 4 Generates employment

Venture capital is essential for startup ecosystem development.

6. Explain stages of venture capital financing.

Answer

Venture capital financing occurs in different stages.

1 Seed Stage

Initial funding for idea development.

2 Start-up Stage

Funding for product development.

3 Expansion Stage

Funding for business growth.

4 Bridge Stage

Funding before public issue.

7. Explain elements of a business plan.

Answer

A business plan is a document describing business goals and strategies.

Elements

- 1 Executive summary
- 2 Business description
- 3 Market analysis
- 4 Marketing strategy
- 5 Financial plan
- 6 Management team
- 7 Risk analysis

A well-prepared business plan attracts venture capital investors.

8. Explain the process of venture capital financing.

Answer

The venture capital financing process includes:

- 1 Submission of business plan
- 2 Initial screening
- 3 Detailed evaluation
- 4 Negotiation and agreement
- 5 Investment decision
- 6 Monitoring and support
- 7 Exit strategy

9. Explain methods of venture capital financing.

Answer

Methods include:

- 1 Equity financing
- 2 Conditional loans
- 3 Participating debentures
- 4 Convertible securities

These methods allow investors to share both risks and rewards.

10. Explain future prospects of venture capital financing in India.

Answer

Venture capital has strong growth prospects in India due to:

- 1 Growing startup ecosystem
- 2 Government initiatives like Startup India
- 3 Increasing technology innovation
- 4 Rising digital economy
- 5 Global investment interest

Venture capital will play a major role in India's entrepreneurial development.

UNIT V

Project Planning and Analysis

1. What is a Project? Explain the meaning and concept of project planning.

Answer

A project is a temporary activity undertaken to create a unique product, service, or result within a specified time, cost, and scope.

In business and finance, a project generally involves investment of capital to generate future benefits.

Examples of projects include:

- Establishing a new manufacturing plant
- Launching a new product
- Infrastructure development projects

Project Planning

Project planning refers to the systematic process of defining project objectives, determining resources, estimating costs, and scheduling activities required for project completion.

It helps ensure that the project is completed efficiently and successfully.

Objectives of Project Planning

1. Proper utilization of resources
2. Completion of project within time and budget
3. Risk reduction
4. Better coordination among departments
5. Achievement of project goals

Thus, project planning is essential for successful implementation and management of projects.

2. Explain the characteristics and importance of a project.

Answer

Characteristics of a Project

1. Specific Objective
Every project has a clearly defined objective.
2. Limited Duration
Projects have a fixed starting and ending time.
3. Unique Nature
Each project is different from others.
4. Resource Requirement
Projects require financial, human, and technical resources.
5. Risk and Uncertainty
Future outcomes are uncertain.

Importance of Projects

1. Promotes economic development
2. Encourages industrial growth
3. Creates employment opportunities
4. Supports innovation and technological development
5. Improves infrastructure and services

Projects are therefore an important tool for economic and organizational development.

3. Explain the project life cycle.

Answer

The project life cycle refers to the stages through which a project passes from initial idea to completion.

Stages of Project Life Cycle

1. Project Identification

Ideas for potential projects are generated.

Example:

- New product development
- Expansion of business

2. Project Formulation

Detailed project planning is done including cost estimation and feasibility studies.

3. Project Appraisal

Financial institutions evaluate the project's technical, financial, and economic feasibility.

4. Project Implementation

The project is executed and resources are allocated.

5. Project Monitoring and Control

Performance is evaluated to ensure objectives are achieved.

6. Project Completion

Final evaluation and closure of project.

The project life cycle helps ensure systematic planning and execution of projects.

4. Explain the process of generation of project ideas.

Answer

Project ideas are generated from various sources and opportunities.

Sources of Project Ideas

1. Market Demand

Increasing demand for products creates opportunities.

Example:

Growing demand for electric vehicles.

2. Government Policies

Government incentives encourage new projects.

Example:

Startup India initiatives.

3. Technological Innovations

New technologies create new business opportunities.

4. Natural Resources

Availability of raw materials encourages project development.

5. Entrepreneurial Skills

Creative entrepreneurs generate innovative ideas.

Idea generation is the first step in project planning.

5. Explain project screening and its importance.

Answer

Project screening is the process of evaluating and selecting feasible project ideas from many alternatives.

Objectives of Project Screening

1. Identify viable projects
2. Eliminate non-feasible projects
3. Ensure efficient resource allocation

Screening Criteria

1. Market potential
2. Technical feasibility
3. Financial viability
4. Environmental impact
5. Government regulations

Project screening ensures that only profitable and feasible projects are selected.

6. Explain market and demand analysis in project planning.

Answer

Market and demand analysis studies the market potential and demand for a product or service.

Objectives

1. Estimate demand for the product
2. Analyze customer preferences
3. Identify target market
4. Study competition

Components of Market Analysis

1. Market size

2. Market growth rate
3. Customer segments
4. Competitor analysis
5. Pricing strategy

Market analysis helps determine whether the project will be commercially successful.

7. Explain technical analysis of a project.

Answer

Technical analysis evaluates the technical feasibility of the project.

Components of Technical Analysis

1. Location of Project

Selection of suitable site for project operations.

2. Technology Selection

Choosing appropriate production technology.

3. Plant Capacity

Determining production capacity.

4. Raw Material Availability

Ensuring adequate supply of materials.

5. Machinery and Equipment

Selection of suitable machines.

Technical analysis ensures efficient production and operational feasibility.

8. Explain financial analysis of a project.

Answer

Financial analysis examines the financial viability and profitability of a project.

Objectives

1. Estimate total project cost

2. Determine sources of finance
3. Evaluate project profitability

Components of Financial Analysis

1. Cost of Project

Includes land, building, machinery, and working capital.

2. Means of Finance

Sources such as equity, loans, and venture capital.

3. Projected Financial Statements

Estimated income statement and balance sheet.

4. Profitability Analysis

Using techniques like:

- Net Present Value (NPV)
- Internal Rate of Return (IRR)
- Payback Period

Financial analysis ensures that the project is economically viable.

9. Explain the role of feasibility studies in project planning.

Answer

A feasibility study evaluates whether a project is practical and profitable.

Types of Feasibility Studies

1. Market Feasibility

Analyzes demand and competition.

2. Technical Feasibility

Evaluates production technology and resources.

3. Financial Feasibility

Examines cost, revenue, and profitability.

4. Economic Feasibility

Assesses overall economic benefits.

Feasibility studies reduce project risk and uncertainty.

10. Explain the importance of project evaluation.

Answer

Project evaluation is the systematic assessment of project performance and outcomes.

Objectives

1. Measure project success
2. Compare expected and actual results
3. Identify weaknesses and improvements

Importance

- 1 Ensures efficient resource utilization
- 2 Helps in decision making
- 3 Reduces financial risk
- 4 Improves future project planning
- 5 Enhances accountability

Project evaluation is essential for successful project management and long-term organizational growth.

