0204

MANAGEMENT PROGRAMME

Term-End Examination

June, 2011

MS-42 : CAPITAL INVESTMENT AND FINANCING DECISIONS

Time : 3 hours *Maximum Marks : 100*
(Weightage 70%)

Note : *Attempt **any five** questions. All questions carry **equal** marks. Use of calculator is allowed. Present value tables would be provided if asked for.*

1. What is cost of capital ? Explain how is the cost of long term debt, preference capital, equity capital and retained earnings are calculated ?

2. What do you understand by capital structure of a company ? Discuss the criteria and factors determining and influencing the capital structure.

3. Discuss the concept of project life cycle. Explain the different steps involved in the process of designing and using of Work Breakdown Structure.

4. What is the need for economic appraisal of a project ? Explain process of the economic appraisal of a project.

5. Discuss the various types of ownership securities issued by the corporates to raise funds. What are the benefits of raising funds through debt instrument over share capital ? Discuss.

6. Discuss the Modigliani - Miller hypothesis regarding dividend policy.

7. A company has to make a choice between two projects namely A and B. The initial capital outlay of the two projects are Rs. 1,35,000 and Rs. 2,40,000 respectively. There would be no scrap value at the end of the useful life of both the projects. The opportunity cost of capital of the company is 16%. The annual incomes are as under :

Year	Project A Rs.	Project B Rs.	Discount factor @ 16%
1	-	60,000	.862
2	30,000	84,000	.743
3	1,32,000	96,000	.641
4	84,000	1,02,000	.552
5	84,000	90,000	.476

You are required to calculate :

(a) Discounted pay back period

(b) Profitability index

(c) Net present value for each project

8. ABC. Ltd. is planning to have an access to machine for a period of 5 years. The company can either have an access through the leasing agreement or it can borrow money at 14% to buy the machine. The company pays tax at the rate of 50% of its income.

In case of leasing the company will be required to pay annual lease rent of Rs. 1,20,000 for 5 years at the end of every year. All maintenance, insurance and other costs are to be born by the lessee.

In case of purchase of the machine (which costs Rs. 3,43,000) the company would have to repay 14% five year loan in 5 equal instalments, each instalment becoming due at the end of each year. Machine would be depreciated on a straight line basis, with no salvage value. Advise the company which option it should go for.