Unit 9
FINANCIAL MANAGEMENT

SHORT ANS.WER QUESTIONS (3 / 4 MKS)

1. State the Current assets in the order of their liquidity.

Ans. a) cash in hand/bank
b) Marketable securities
c) Bills receivable
d) Debtors
e) Finished goods Inventory
f) Work in progress inventory
g) Raw materials
h) Prepaid expenses

2. "To avoid the problem of shortage and surplus of funds, what is required in Financial management? Name the concept and explain four points of importance.

Ans..Financial Planning is required to avoid shortage or surplus of finance.
It is important because-
a) By planning utilization of finance, it reduces waste ,duplication of efforts and gaps in the planning.
b) It helps in coordinating the various business activities such as sales, purchases, production, finance etc.
c) Financial planning helps in setting up standard performance and thereafter it is compared with the actual performance. The deviations, if any are analysed, Causes found out and corrective action is taken. Thus it is a technique of control.
d) It helps in avoiding shocks and surprises as proper provision regarding shortage or surplus is made in advance by anticipating future receipts and payments.

3. State how 'Leasing' affects the requirement of fixed capital.

Ans. If a company, instead of purchasing the fixed asset, acquires it on lease will require less working capital. Thus the huge funds will not be blocked and by paying the lease rent periodically, the benefit of the Asset can be acquired without owning it The fund saved can be utilised at more significant urgent long term projects.

4. Explain the role of 'Operational efficiency' in the determination of working capital requirement.

Ans. The firm with a better operational efficiency has to invest less in Debtors and stock (Working capital) because-
a) they convert raw materials quickly into finished goods, and sell them at their earliest. i.e converts stock into sales quickly.

b) Promptly collects debts from debtors and bills receivable.

5. Discuss how Working capital affects both the liquidity and profitability of a business.

Ans. Short term Investment decisions, also called working capital decisions are concerned with the decisions about the level of cash, inventory and debtors.

Efficient cash management, Inventory management and receivable management are essential ingredients of sound working capital management.

The working capital should be neither more or less than required. Both the situations are harmful. If the amount of working capital is more than required, it will no doubt increase the liquidity but decrease the profitability. Similarly if there is a shortage of working capital, it will face the problem of meeting day to day requirements.

Thus optimum amount of current assets and current liabilities should be determined so that the profitability of the business remains intact and there is no fall in the liquidity.

6. How does 'Interest coverage ratio' affects the capital structure.

Ans. The interest coverage ratio refers to the number of times earnings before interest and taxes of a company covers the interest obligations.

Interest coverage ratio = EBIT/Interest

Higher the ratio, better is the position of the firm to pay its interest obligations, so it should issue debt. On the other hand if it is low, the firm should avoid using debt as interest is to be paid irrespective of profits.

7. State four reasons why Capital budgeting decisions are more significant and should be taken rationally.

Ans. The long term Investment decision is called capital budgeting. It is more important due to the following reasons-

a) Long term growth and affects : As capital budgeting decisions involve investment in long term fixed assets, it affects the long term growth.
b) Large amount of funds involved : As huge amount of fund is blocked for a long period, the decision should be taken rationally.
c) Risk involved : As such a decision affects the returns of the firm as a whole, it involves more risk.