FINAL TERM EXAMINATION

Spring 2010
FIN622- Corporate Finance (Session - 1)

Question No: 1 (Marks: 1) - Please choose one

Which of the following statements is TRUE regarding Profitability Index?

► It ignores time value of money

► It ignores future cash flows

► **It ignores the scale of investment**

► It ignores return on investment

Reference: PAGE #36

Disadvantage of PI:

Like IRR it is a percentage and therefore ignores the scale of investment.

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Question No: 2 (Marks: 1) - Please choose one

Which of the following is a tool that identifies the strengths, weaknesses, opportunities and threats of an organization?

► **SWOT Analysis**

► Trend Analysis

► Fundamental Analysis

► Technical Analysis

Ref: PAGE # 1

SWOT stands for:

· Strengths

· Weaknesses

· Opportunities

· Threats

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Question No: 3 (Marks: 1) - Please choose one

If sensitivity analysis concludes that the largest impact on profits would come from changes in the sales level, then which of the following recommendations should be considered?

► Fixed costs should be traded for variable costs

► Variable costs should be traded for fixed costs.

► The project should not be undertaken.

► Additional marketing analysis may be beneficial before proceeding.

Ref: same McQ on following link

http://www1.shift.edu.cn/jrxy/jpkc/html/quizzes/Chpt07.htm?As25=1

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For further see bellow link

http://www.investopedia.com/terms/s/sensitivityanalysis.asp

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Question No: 4 (Marks: 1) - Please choose one

The employment of fixed costs associated with the actual production of goods or services is known as:

► Financial leverage

► Volume discounting

► Operating leverage

► Covariance

Ref: (SLIDE 13)

Due to operating fixed cost is operating leverage

Due to financial fixed cost is financial leverage

Question No: 5 (Marks: 1) - Please choose one

Which one of the following terms refers to the variability of return on stocks or portfolios, associated with changes in return on the market as a whole?

► Unsystematic risk

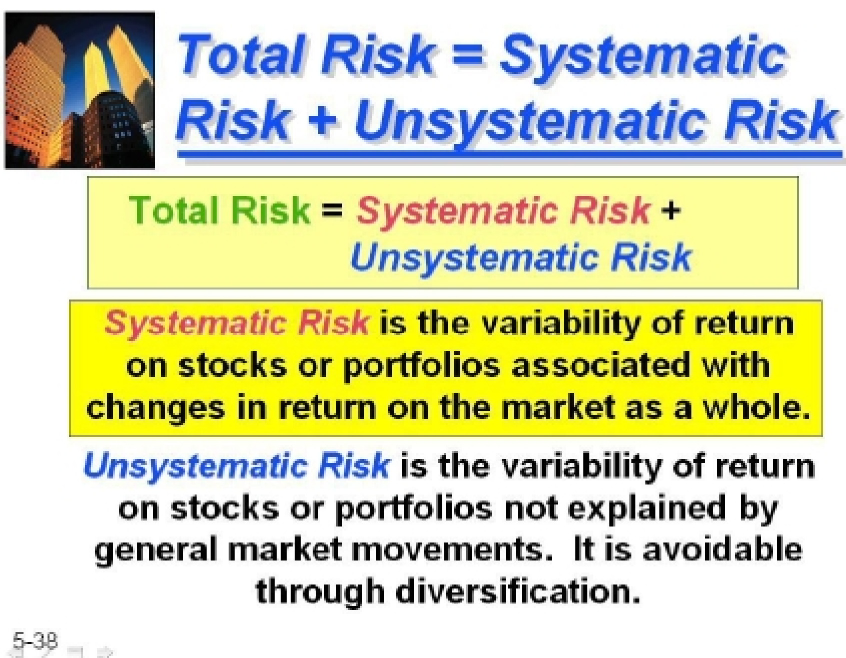
► Unique risk

► Systematic risk

► Company specific risk

Reference: slide # 38 on following link

http://www.slideshare.net/ami_goel/risk-and-return-943136



Question No: 6 (Marks: 1) - Please choose one

What will be the taxable income of an Un-levered firm, if it has Earning Before Interest and Tax (EBIT) equal to Rs.50,000, and its tax rate is 35%?

► Rs.25,000

► Rs.45,000

► **Rs.50,000**

► Rs.60,000

Earnings Before Taxes (EBT) = Taxable Income = Accounting Income (Economic Income)

Question No: 7 (Marks: 1) - Please choose one

Which of the following statements is **TRUE** regarding temporary working capital?

► **Temporary working capital varies with seasonal requirements.**

► Temporary working capital is the constant component of working capital.

► Temporary working capital excludes inventories.

► Temporary working capital should be financed with bonds or common stock

Reference: PAGE 90

Temporary working capital is the amount of investment in current assets that varies according to the seasonal requirements.

OR

Temporary Working capital

The temporary or varying working capital varies with the volume of operations. It fluctuates with the scale of operations. This is the additional working capital required from time to time over and above the permanent or fixed working capital. **During seasons, more production/sales take place resulting in larger working capital needs**. The reverse is true during off-seasons. As seasons vary, temporary working capital requirement moves up and down. Temporary working capital can be financed through short term funds like current liabilities. When the level of temporary working capital moves up, the business might use short-term funds and when the level for temporary working capital recedes, the business may retire its short-term loans

OR

http://www.tutorsonnet.com/homework_help/working_capital_management/permanent_and_temporary_working_capital_online_tutoring.htm

Question No: 8 (Marks: 1) - Please choose one

Which of the following describes the hedging approach to financing?

► Maturity dates of financing instruments are spread over a period of time so that they mature in a steady, predictable fashion.

► Each asset is offset with a financing instrument of the same approximate maturity.

► Each asset is offset with a put or call option.

► The firm takes out insurance to protect itself against uneven cash flows.

(Slide#17 of following link)

http://wps.pearsoned.co.uk/wps/media/objects/1669/1709919/0273685988_ch08.ppt

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Question No: 9 (Marks: 1) - Please choose one

According to the Miller Model, upper limit for cash balance is equal to which of the following?

► Lower limit + Spread

► Spread – Lower limit

► Optimal limit + Lower limit

► Lower limit – Spread

Ref: http://www.themanagementor.com/enlightenmentorareas/finance/cfa/miller.htm

Upper Limit = Lower Limit + 3Z

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Question No: 10 (Marks: 1) - Please choose one

Suppose that the sale (usage rate) on an item gets doubled. The EOQ (Economic Order Quantity) for that item should be:

► Halved

► Unaffected

► Decreased

► Increased

http://books.google.com.pk/books?id=xb8ypJWa8gAC&pg=PA604&lpg=PA604&dq=%22IF+SALES+DOUBLE+EOQ+INCREASE%3F%22&source=bl&ots=Pl2XVKaOPS&sig=9pCLoQmjROYJJe3bI7S4z4YeQhw&hl=en&ei=4uM5TcTULoiJ4AaE1Y3sCg&sa=X&oi=book_result&ct=result&resnum=2&ved=0CB4Q6AEwAQ#v=onepage&q&f=false

Question No: 11 (Marks: 1) - Please choose one

A firm wants to acquire another firm by purchasing its assets. Which of the following methods firm can use to evaluate the financial aspects of this deal?

► Replacement cost method

► Dividend valuation method

► Present value method

► Price earning ratio method

Ref: PAGE # 118

Replacement cost, where you evaluate what it would cost you to replace all of the assets that a firm has today.

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Question No: 12 (Marks: 1) - Please choose one

In which of the following acquisition strategies, a purchaser has complete knowledge of the acquiring firm?

► Management Buy-In

► Management buyout

► Consolidation

► Amalgamation

Reference: PAGE # 123

Management Buyouts

Management buyouts are similar in all major legal aspects to any other acquisition of a company. The particular nature of the MBO lies in the position of the buyers as managers of the company and the practical consequences that follow from that. In particular, the due diligence process is likely to be limited as the buyers **already have full knowledge of the company available to them**. The seller is also unlikely to give any but the most basic warranties to the management, on the basis that the **management knows more about the company** than the sellers do and the Reference ore the sellers should not have to warrant the state of the company. In many cases, the company will already be a private company, but if it is public then the management will take it private.

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Question No: 13 (Marks: 1) - Please choose one

Which one of the following statements is CORRECT regarding exercise price?

► **Exercise price is the price mentioned in the option at which the holder exercises his right**

► Exercise price is the price mentioned in the option at which the holder exercises his obligation

► Exercise price is the price mentioned in the option at which the option seller exercises his right

► Exercise price is the price mentioned in the option at which the option writer exercises his right

Ref: PAGE # 139

Strike or exercise price:

The price mentioned in option at which the holder exercises his right is known as exercise or strike price.

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Question No: 14 (Marks: 1) - Please choose one

Which one of the following statements is CORRECT regarding Options Contacts?

► **A put option gives the holder a right to sell underlying item at a specified price**

► A put option gives its writer the right to sell underlying item at a specified price

► A call option gives its writer a right to sell underlying item

► A call option gives its holder a right to sell underlying item

Reference: PAGE # 139

Features of Options:

- It is a contractual agreement.
- The holder of option exercises his/her right only if it is in his/her favors.
- Option writer is seller and must honor his side of contract. (Sell or buy at agreed price).
- Options like futures are standardized transaction in terms of size & duration.
- Options are Exchange traded
- These agreements are easy to buy & sell

· Options either are call options or put options.

· The option purchase price is called option premium.

· Call option gives its holder a right (not obligation) to buy underlying item at the specified price.

· **Put option gives its holder a right (not obligation) to sell underlying item at specified price.**

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Question No: 15 (Marks: 1) - Please choose one

If market interest rate increases above the agreed rate in an interest rate option, the effective interest rate for the option holder would be:

► **Less than the market rate**

► Greater than market rate

► Equal to the market rate

► Zero

Ref: PAGE # 143

Interest Expense: by the loan amount. This effective interest rate is less than the rate prevailing in the market.

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Question No: 16 (Marks: 1) - Please choose one

Which one of the following techniques can reduce the risks and disadvantages of share purchase method in mergers and acquisitions?

► Spin-off

► **Hive-down**

► Hubris

► Off-shoot

Ref: PAGE # 114

There is a technique called **hivedown** which can reduce the risks and disadvantages of share purchase method.

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Question No: 17 (Marks: 1) - Please choose one

The financial consideration to be paid to target company in mergers can be classified in to the following categories EXCEPT:

► Cash

► **Assets**

► Share – ordinary or preference

► Debt

Ref: PAGE # 114

The financial consideration to be paid to target company in mergers can be classified in to following categories:

- Cash
- Share – ordinary or preferences
- Debt

.

Question No: 18 (Marks: 1) - Please choose one

Which of the following types of dividend policies results in the most volatile dividend payments and stockholder discomfort?

► Target dividend-payout policy

► Low-regular-and-extra dividend policy

► Regular dividend policy

► **Constant payout-ratio dividend policy**

Reference: PAGE # 74

Constant dividend payout (div per share/Eps)

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A fixed %age is paid out as dividend. Under this policy the dividend amount will vary because the

net **income is not constant**. Thus results in variability of return to investors. The **dividends may drop to nil in case of loss**. Market price of share will lower.

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Same McQ on web see below link

http://wps.aw.com/aw_gitman_pmf_12/85/21795/5579564.cw/content/index.html

Question No: 19 (Marks: 1) - Please choose one

Suppose you invested Rs. 8,000 in a savings account paying 5 percent interest a year, compounded annually. How much amount your account will have at the end the end of four years?

► Rs.10,208

► **Rs.9,728**

► Rs.10,880

► Rs.9,624

Solution:

FV = PV(1+i)n

= 8000(1.05)4

= 9728

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Question No: 20 (Marks: 1) - Please choose one

If you deposit Rs. 12,000 per year for 16 years (each deposit is made at the beginning of each year) in an account that pays an annual interest rate of 15%, what will your account be worth at the end of 16 years?

► Rs. 82,168.44

► Rs. 71,450.82

► Rs. 768,901.12

► **Rs. 668,609.67**

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FVA = PMT[(1+I)n-1/i]

= 12000[(1+.15)16-1/.15]

= 668,609.67

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Question No: 21 (Marks: 1) - Please choose one

Which of the following statements would be **CORRECT** regarding nominal interest rate when inflations is expected to occur over the foreseeable future?

► Nonimal interest rate would be equal to real interest rate

► Nonimal interest rate would be more than real interest rate

► Nonimal interest rate would be half of real interest rate

► Nonimal interest rate would be less than the real interest rate

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Question No: 22 (Marks: 1) - Please choose one

Which of the following is a method of evaluating securities by analyzing statistics generated by market activity, such as past prices and volume?

► Technical analysis

► Fundamental analysis

► Common size analysis

► Ratio analysis

Ref: http://www.investopedia.com/terms/t/technicalanalysis.asp

A method of evaluating securities by analyzing statistics generated by market activity, such as past prices and volume. Technical analysts do not attempt to measure a security's intrinsic value, but instead use charts and other tools to identify patterns that can suggest future activity

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Question No: 23 (Marks: 1) - Please choose one

Which of the following statements best describes the term Market Correction?

► Market Correction refers to the situation where equilibrium of supply & demand of shares occurs in the market

► Market correction refers to the situation where shares' intrinsic values becomes equal to face values

► Market Correction refers to the situation when there is a boom in the economy

► Market Correction refers to the situation where inflation rate is above the market interest rate

Ref:

It is about the A drop in the price of a security when that security has been overbought and therefore overpriced. Market corrections are usually short-term and are necessary for the stability of the security. so in my point of view its 1st option is correct

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Question No: 24 (Marks: 1) - Please choose one

Which of the following statements is CORRECT regarding the fundamental analysis?

► Fundamental analysts use only Economic indicators to evaluate a stock

► Fundamental analysts use only financial information to evaluate a company's stocks

► Fundamental analysts use financial and non-financial information to evaluate a company's stocks

► Fundamental analysts use only non-financial information to evaluate a company's stocks

Ref: PAGE # 24

fundamental information that is analyzed can include a company's **financial reports, and non-financial information** such as estimates of the growth of demand for competing products, industry comparisons, analysis of the effects of new regulations or demographic changes, and economy-wide changes.

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Question No: 25 (Marks: 1) - Please choose one

Which of the following could be used to calculate the cost of common equity?

► Interpolation method

► **Dividend discount model**

► YTM (Yield-to-Maturity) method .

► Capital structure valuation

Question No: 26 (Marks: 1) - Please choose one

When faced with mutually exclusive options, which project should be accepted under the 'Payback Method'?

► The one with the longest payback period .

► The one with the shortest payback period

► It doesn't matter because the payback method is not theoretically correct

► None of the given options

http://highered.mcgraw-hill.com/sites/0073382388/student_view0/chapter12/multiple_choice_quiz.html

Question No: 27 (Marks: 1) - Please choose one

Which of the following IAS (International Accounting Standard) deals with cash flow statement?

► IAS 1

► **IAS 7**

► IAS 16

► IAS 28

Ref: PAGE # 82

Cash Flow Statement

This statement is governed by international accounting standard # 7

Question No: 28 (Marks: 1) - Please choose one

Mr. Joseph Steve has changed the working capital policy of his company recently. As a result, the liquidity for the company has decreased but an increase in profitability has been observed alongside. From this information we can conclude that the company must have changed his working capital policy from ________ to ________.

► **Conservative; Aggressive**

► Aggressive; Moderate

► Aggressive; Conservative

► None of the given options

Reference: PAGE # 89

- PROJECTING THE ALL THREE POLICIES

- CONSERVATIVE = A
- MODERATE = B
- AGGRESSIVE = C

	LIQUIDITY	PROFITABILITY	RISK
HIGH	A	C	C
NOR	B	B	B
LOW	C	A	A

Question No: 29 (Marks: 1) - Please choose one

"The firm has very little net working capital sometimes even negative net working capital that can be very risky." The above statement belongs to:

► **Aggressive working capital policy**

► Conservative working capital policy

► Moderate working capital policy

► The statement is not related to any of the working capital policies

Reference: PAGE # 88

AGGRESSIVE WORKING CAPITAL POLICY;

– The firm has very little net working capital. It is more risky.

– May be a negative net working capital. It is very risky

Question No: 30 (Marks: 1) - Please choose one

The amount of current assets that varies with seasonal requirements is referred to as __________ working capital.

► Permanent

► Net

► Temporary

► Gross

Reference: PAGE 90

Temporary working capital is the amount of investment in current assets that varies according to the seasonal requirements.

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Under which of the following concepts, each asset is offset with a financing instrument of the same maturity?

► M&M proposition

► Clientele effect

► Hedging approach

► Baumol Model

Ref: PAGE # 90

Current Assets Financing – Hedging Approach

Under this approach each asset would be offset with a financing instrument of the **same maturity**.

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Question No: 32 (Marks: 1) - Please choose one

Which of the following is NOT one of the common motives of holding cash?

► Personal Motives

► Safety Motives

► Transactions Motives

► Speculative Motives

Reference: PAGE # 94

Motives for Cash holding

Transactions Motive ensures that the firm has enough funds to transact its routine, day-to-day business affairs. **Safety Motive** protects the **firm against being unable to meet unexpected demands for cash**. **Speculative Motive** allows the firm to take advantage of unexpected opportunities that may arise

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Question No: 33 (Marks: 1) - Please choose one

Which of the following is equal to Stock out cost?

► Carrying cost Safety stock

► Holding cost Carrying cost

► **Reordering cost Safety stock**

► Carrying cost Reordering cost

Reference: PAGE # 100
Doubt in answer for further confirmation see PAGE#100

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Question No: 34 (Marks: 1) - Please choose one

Which of the following statement is INCORRECT regarding Just-In-Time (JIT)?

► The inventories are kept near zero level.

► The inventory is acquired in such quantity on daily basis that can support the daily production level.

► The entire inventory acquired move to the production hall.

► **Inventory level is necessarily kept at zero level.**

Reference: PAGE # 100

Just In Time (JIT):

The idea explains that inventories are kept near zero level. This means that inventory is acquired in such quantity on daily basis that can support the daily production level. The Referenceore, there's no inventory lying in store room rather all the inventory acquired move to production hall. The philosophy is to pull inventory through the production processes on as "as-needed" basis rather than pushing inventory through the processes on an "as-produces basis". This requires extreme accurate estimates and there no chance of an error. For example, there's a high probability of running out of stock and that could be disastrous. **JIT does not necessarily mean zero inventory level**. The objective is to minimize the inventories but to increase the productivity, quality and flexibility.

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Question No: 35 (Marks: 1) - Please choose one

Which of the following term refers to the minimum inventory amount needed for an item?

► Stock-out

► Buffer Stock

► Holding Stock

► **Safety Stock**

Ref: PAGE # 100

Safety stock is the minimum inventory amount needed for an item, based on anticipated usage and expected delivery time of materials

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Question No: 36 (Marks: 1) - Please choose one

Which of the following is NOT an objective of Just-In-Time (JIT)?

► To increase the productivity

► **To increase the inventories**

► To increase the quality

► To increase the flexibility

Reference: PAGE # 100

Just In Time (JIT):

The idea explains that inventories are kept near zero level. This means that inventory is acquired in such quantity on daily basis that can support the daily production level. The Referenceore, there's no inventory lying in store room rather all the inventory acquired move to production hall. The philosophy is to pull inventory through the production processes on as "as-needed" basis rather than pushing inventory through the processes on an "as-produces basis". This requires extreme accurate estimates and there no chance of an error. For example, there's a high probability of running out of stock and that could be disastrous. **JIT does not necessarily mean zero inventory level**. The objective is to minimize the inventories but to increase the productivity, quality and flexibility.

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Question No: 37 (Marks: 1) - Please choose one

"If the people are not able to work together, the merger will not succeed." Which of the following cause(s) of failure is(are) being depicted in this statement?

► Lack of planning

► **Corporate culture**

► Talent departure

► All of the given options

Ref: PAGE # 111

Corporate culture:

Even if two companies seem to have all the right ingredients in place for a successful merger, cultural differences can break the deal. It is not enough for two companies to appear to fit well on paper; at the end of the day, **if the people are not able to work together**, the merger will not succeed

.

Question No: 38 (Marks: 1) - Please choose one

Which of the following is an anti takeover strategy in which the target company make significant efforts to resist a takeover bid e.g. by a major acquisition, issue new shares?

► Shark repellent

► Pac-man

► Poison pill

► **Political pressure**

Ref: PAGE # 120

Politics:

Political pressure is an effective anti-take over tool. Two good examples will make you understand better how a government can stop takeover bid.

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Question No: 39 (Marks: 1) - Please choose one

Corporate restructuring involves the restructuring of:

► **All of the given options**

► The assets and liabilities of the company

► The debt to equity structures of the company

► Cost minimization by the company

Ref: PAGE # 121

Corporate Restructuring:

Corporate restructuring and improved corporate governance are essential parts of economic reform programs under way in many countries. How can corporations be restructured to promote growth and reduce excessive debt without placing undue burdens on taxpayers? What framework is needed to promote better corporate governance? CORPORATE Restructuring involves restructuring the **assets and liabilities** of corporations, including their **debt-to-equity structures**, in line with their cash flow needs to promote efficiency, restore growth, and **minimize the cost to taxpayers**.

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Question No: 40 (Marks: 1) - Please choose one

Which of the following terms refer to the acquisition of another company using a significant amount of borrowed money (bonds or loans) to meet the cost of acquisition?

► Management Buyout

► Management Buy-In

► **Leverage Buyout**

► None of the given options

Reference: PAGE # 124

Leveraged Buyout – LBO

The acquisition of another company using a significant amount of borrowed money (bonds or loans) to meet the cost of acquisition. Often, the assets of the company being acquired are used as collateral for the loans in addition to the assets of the acquiring company. The purpose of leveraged buyouts is to allow companies to make large acquisitions without having to commit a lot of capital.

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Question No: 41 (Marks: 1) - Please choose one

Which of the following is NOT among the categories of foreign risk?

► Transaction exposure

► Translation exposure

► **Local exposure**

► Economic exposure

Ref: PAGE # 130

Currency Risks

We can classify foreign risk exposure into three broad categories:

- Transaction exposure
- Translation exposure
- Economic exposure

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Question No: 42 **(Marks: 1)** **- Please choose one**

Which of the following is **NOT** an external method to reduce the transaction exposure?

► **Invoicing in home currency**

► Money market hedges

► Currency futures

► Currency swaps

Ref: PAGE # 131

External methods:

- Forward contract
- Money market hedges
- Currency futures
- Currency options
- Currency swaps

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Question No: 43 **(Marks: 1)** **- Please choose one**

Which of the following is the purpose of a Forward Interest Rate Agreement?

► To fix the interest rate

► To estimate the exchange rate

► To estimate the interest rate

► To fix the foreign exchange rate

Ref: PAGE # 136

Forward Rate Agreements – FRA

This is a contract and a financial instrument that is used has hedge against interest rate adverse fluctuations on deposit or loans starting in near future. This resembles to **forward exchange rate agreements to fix the exchange rates**.

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Question No: 44 (Marks: 1) - Please choose one

Which of the following statements is **INCORRECT** regarding forward contracts?

► Reversing forward contract is difficult.

► Parties have to put an initial margin in forward contracts.

► No size restriction is placed in forward contract.

► Forward contract is made between parties and each party needs to confirm the credit worthiness of each other.

Ref: PAGE # 136

Forward contract vs. Currency future:

In currency futures, commodity exchanges are involved and credit risk is eliminated. However, **a forward contract is made between parties and each party needs to confirm the credit worthiness of each other**. Reversal of currency future is very simple. Large buyers and sellers exist. **Reversing forward contract is difficult**. Original parties have to set off the deal. Future currency contract become a "commodity" and reversing does not require original parties. Size of contract: **no size restriction is placed in forward contract**and is up to parties to deal or contract in the magnitude they like. However, in future currency contract the size is pre-determined or fixed. In this scenario, perfect hedge is not possible. **In forward contract, no margin is required** but in currency future parties have to put an initial margin.

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Question No: 45 (Marks: 1) - Please choose one

If the exercise price of an option is not favorable than the market price of the underlying item, an option would be termed as:

► In the money

► Out of money

► At the money

► None of the given options

Reference: PAGE # 139

Options pricing:

The strike price may be higher, lower or equal to the current market price of underlying item.

For example,

A call option gives the right to its holder to buy x number of shares of y company at Rs 10 per share and the current price could be greater than Rs. 10/-, less than Rs. 10/- or exactly Rs 10/- per share. If the strike price is more favorable than the current market price of underlying asset or item, the option is termed as "in-the-money." **If the strike price is not favorable than the current market price of underlying asset or item, the option is called "out-of-money."** If the strike price and current market price are equal, then it is known as "at-the-money."

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Question No: 46 (Marks: 1) - Please choose one

An investor buys 5 options on shares of at a price of Rs 50 per share. Each option consists of 100 shares and premium paid is Rs. 2 per share. What would be the total option cost for investor if the share price is Rs. 55 at the expiry of option?

► **Rs. 1,000**

► Rs. 1,500

► Rs. 2,500 .

► Rs 25000

Solution:

Total option cost = 500*2 = 1000

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Question No: 47 (Marks: 1) - Please choose one

An investor buys 5 options on shares at a price of Rs 50 per share. Each option consists of 100 shares and premium paid is Rs. 2 per share. What would be the net gain for investor if the share price is Rs. 55 at the expiry of option?

► **Rs. 1,500**

► Rs. 2,500

► Rs. 1,000

► Rs 25000

Solution:

Price at the expiry of option = 55

Price for excesizing option = 52

Difference = 3

Total net gain = 500*3 = 1500

Question No: 48 (Marks: 1) - Please choose one

Which of the following is the CORRECT statement regarding the Law of One Price?

► The law of one price applies to only tradable goods

► The law of one price applies to all goods

► The law of one price applies to immovable goods

► The law of one price applies to services only

Reference: PAGE # 145

There are three caveats with this law of one price.

(1) As mentioned above, transportation costs, barriers to trade, and other transaction costs, can be significant.

(2) There must be competitive markets for the goods and services in both countries.

(3) **The law of one price only applies to tradable goods;** immobile goods such as houses, and many services that are local, are of course not traded between countries.

Explain the main features of a forward rate agreement.

A. Features of FRAs:

- It is in between bank and client for fixing future interest rate on notional amount of loan. The loan is for an affirmed period starting on a particular time in future.
- The size of the notional loan or deposit is decided between the bank and the client.
- FRAs are cash settled.
- On settlement date buyer and seller must settle the agreement.
- The FRA rate for three months loan/deposit starting in a 6 months' time is normally expressed as 6v9 FRA.
- The buyer of a FRA agrees to pay fixed interest rate on notional loan. At the same buyer will receive interest on notional loan at standard rate of interest. On the other side, seller of FRA agrees to pay interest on the notional amount at benchmark rate and receives interest at a fixed rate.

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Question No: 50 (Marks: 3)

Differentiate between Management Buyout and Management Buy-In.

Management Buyouts

Management buyouts are similar in all major legal aspects to any other acquisition of a company. The particular nature of the MBO lies in the position of the buyers as managers of the company and the practical consequences that follow from that. In particular, the due diligence process is likely to be limited as the buyers already have full knowledge of the company available to them. The seller is also unlikely to give any but the most basic warranties to the management, on the basis that the management knows more about the company than the sellers do and therefore the sellers should not have to warrant the state of the company. In many cases, the company will already be a private company, but if it is public then the management will take it private.

Management Buy In (MBI):

Management Buy in (MBI) occurs when a manager or a management team from **outside** the company raises the necessary finance buys it and becomes the company's new management. A management buy-in team often competes with other purchasers in the search for a suitable business. Usually, a manager will lead the team with significant experience at managing director level. The difference to a management buy-out is in the position of the purchaser: in the case of a buy-out, they are already working for the company. In the case of a buy-in, however, the manager or management team is from another source.

Question No: 51 (Marks: 5)

Assume that a bookstore uses up cash at a steady rate of Rs.300,000 per year. The interest rate is 3% and each sale of securities costs Rs.20. Determine the optimal cash balance for the bookstore.

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Optimal level of cash = $\sqrt{(2FT / I)}$

$= \sqrt{[(2 \times 20 \times 300{,}000) / 0.03]}$

$= \sqrt{[12000000 / 0.03]}$

$= \sqrt{400000000}$

= Rs. 20000

Question No: 52 (Marks: 5)

Firm A wants to acquire a private limited company operating in the same industry. What procedure would be followed by the **Firm A** to acquire the target company?

Why exchange rates of two currencies fluctuate? Explain briefly

Following are some factors for fluctuation:

Relative interest rates: One factor that affects exchange rates is the size of the differential between the real interest rates available to investors in the respective countries. The real interest rate is simply the nominal interest rate available to an investor in a high quality short-term investment subtracted by the country's inflation rate.

Trade imbalances: The size of any trade deficit between two countries will also affect those countries' currency exchange rates. This is because they result in an imbalance of currency reserves among the trading partners.

Political stability: If a country's government becomes unstable due to political gridlock, votes of no confidence, revolution or civil war, confidence can quickly be lost. People become less willing to accept paper currency in exchange for their goods and services, primarily because they're unsure whether they'll be able to pass the paper along to the next person.

Government involvement: The relative value of a country's currency is of great importance to its government. The value of a country's currency affects the wealth of its citizens, the competitiveness of domestically produced goods, the relative cost of the country's labor, and the country's ability to compete. As a result, governments often try to influence the relative value of their country's currencies in a number of different ways, including altering their monetary and fiscal policies, and by directly intervening in the currency markets.

Investors: Perhaps the most powerful factor that can influence exchange rates over short time frames is the role that speculators play. Investors typically have tremendous amounts of capital that they can use to either buy or sell any currency. Consequently, their actions can cause the value of such currency to fluctuate, sometimes quite significantly.