[CA] CA-Intermediate

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Financial Management & Strategic Management

Key Highlights

- Coverage of Past Exam Questions Including Nov. 2023 Exam (Solved)
- Chapter-wise [illegible]arks Distribution of Past Papers
- Questions in [illegible] chapter are arranged Sub-Topic-wise
- Solved Mode[illegible] [illegible]per for Practice
- Chapter-wi[illegible] [illegible] Notes with Relevant Formulae

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AS PER NEW SCHEME OF ICAI
APPLICABLE FOR MAY 2024 ONWARD EXAMS
Group-2 Paper-6

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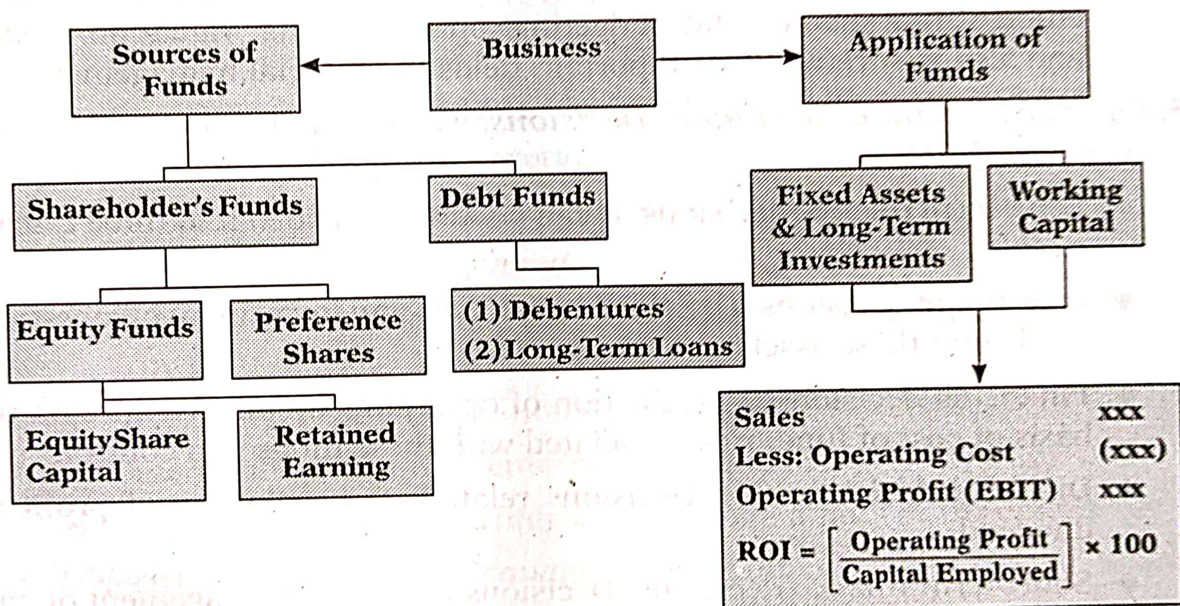
1
CHAPTER

SCOPE AND OBJECTIVES OF FINANCIAL MANAGEMENT

SUMMARY

1. *Financial Management:*

Financial management refers to that managerial activity which is concerned with the arrangement of funds from various sources with consideration of cost, control and risk involved with such sources and application of these funds in an effective manner to maximize shareholders earning and wealth (EPS and MPS).



2. *Sources of Funds*

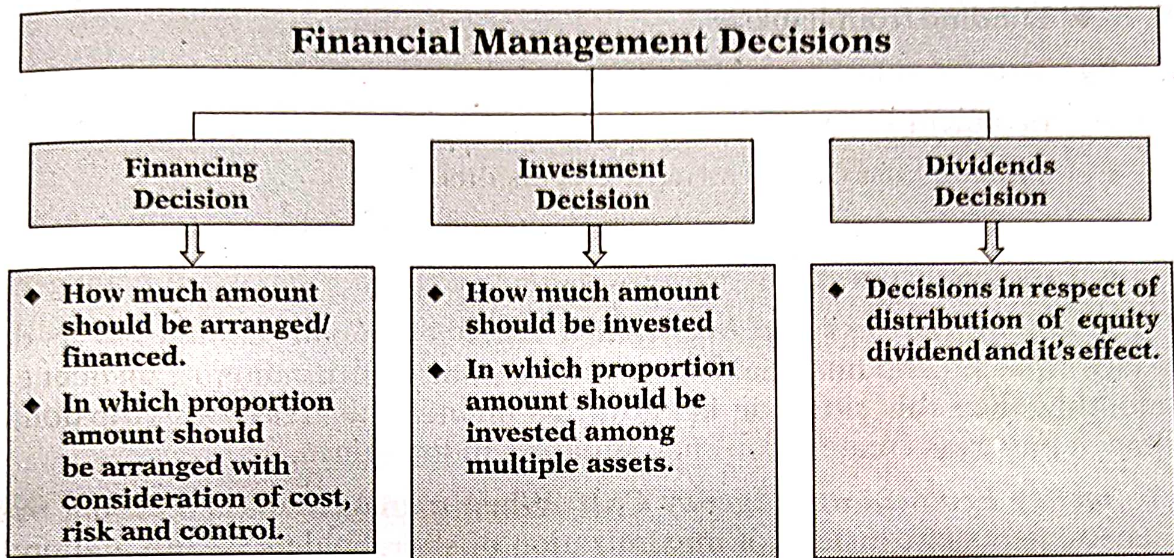
- Equity Share Capital
- Retained Earnings
- Preference Share Capital
- Debentures

- Funding from banks
- International Funding

3. ***Application of Funds:***
   - Investment in Fixed Assets
   - Investment in Working Capital

4. ***Evolution of Financial Management:*** Evolution of financial management took 50 years and can be divided into three stages:
   - The Traditional Phase: In traditional phase, financial management was relevant only for big decisions like: takeovers, mergers, expansion, liquidation, etc.
   - The Transitional Phase: In transitional phase, importance of day to day financial decisions increased, small decisions also got more attention. Like: funds analysis, planning and control etc.
   - The Modern Phase: It is current phase today and is still going on. In today's world importance and scope of financial management greatly increased due to globalization, heavy foreign exchange transfers, capital market transactions, etc. Many new theories have been developed regarding efficient markets, capital budgeting, option pricing, valuation models and also in several other important fields in financial management.

5. ***Finance Functions or Finance Decisions:*** we can classify finance decisions into two categories:
   - Long-term finance decisions: It can be further divided into three categories:
   - Investment decisions (I): Selection of assets and investment of long-term funds into these assets.
   - Financing decisions (F): Selection of optimum capital structure on the basis of cost of fund, risk associated with these funds and control.
   - Dividend decisions (D): Decisions related to distribution of profit as dividend.
   - Short-term finance decisions: Decisions related to management of current assets and current liabilities. It is also known as Working Capital Management (WCM).



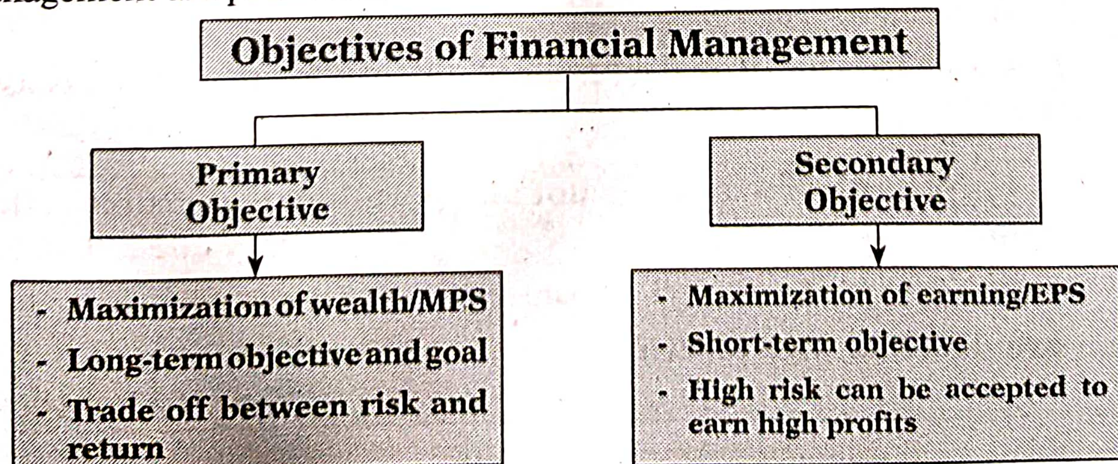
6. *Importance of Financial Management due to following tasks:*

- Look after not to over-invest in fixed assets,
- Maintain balancing of cash outflow with cash inflows,
- Maintaining sufficient level of short-term working capital,
- Preparation of growing sales budget,
- Set correct pricing for products or services to increase gross profit,
- Look after and control general and administrative expenses, and
- Focusing on tax planning to minimize the taxes.

7. *Scope of Financial Management:*

- Determination of size of the enterprise and determination of rate of growth,
- Determining the composition of assets of the enterprise,
- Determining the mix of enterprise's financing,
- Analysis, planning and control of financial affairs of the enterprise.

8. *Objectives of Financial Management*: Main two objectives of financial management are profit maximization and wealth maximization.



9. ***Role of Finance Executive:***

- Financial analysis and planning,
- Investment decisions,
- Financing and capital structure decisions,
- Management of financial resources (such as working capital),
- Risk management.

10. ***Financial Distress and Insolvency:*** When a company cannot pay its day to day expenses and financial expenses like: salaries, rent, interest on debt etc. smoothly, then this situation is known as financial distress. Continuation of financial distress create insolvency situation in long-term.

11. ***Agency Problem and Agency Cost:*** When management is focusing their salaries, perks etc. instead of maximization of shareholders wealth and profit then this situation is known as agency problem. Agency cost is the additional cost borne by the shareholders to monitor the manager and control their behaviour so as to maximise shareholders wealth.

THEORY QUESTIONS

Q1. Elucidate the responsibilities of Chief Financial Officer.
(Nov. 2011, 4 Marks)

Ans. One of the key person of an organisation is chief financial officer, he plays vital role in management, and his main responsibilities are:

1. *Financial analysis and planning:* CFO estimates requirement of amount of funds to be invested in the business, size of business firm and growth of organisation.
2. *Investment decisions:* CFO decides which asset should be purchased and which should not be.
3. *Financial and capital structure decisions:* CFO arranges funds from various sources with consideration of cost, risk and control.
4. *CFO manages short-term financial resources like:* Short-term loan, over-draft, creditors, etc.
5. *Risk Management:* It is the responsibility of CFO that business assets should be risk free.

Q2. "The profit maximization is not an operationally feasible criterion." Comment on it. ***(May 2012, 4 Marks)***

or

What are disadvantage of Project Maximization?
(Nov. 2023, 2 Marks)

Ans. "The profit maximisation is not an operationally feasible criterion." A company cannot follow profit maximisation as its sole objective. Profit maximisation is a short-term objective. When a company focus on profit maximisation it starts to ignore maximizing the owner's economic welfare. It cannot work towards economic efficiency and might be unethical.

Following are the limitations of profit maximisation approach:

1. *Profit is vague term:* What is the meaning of profit? Is it short-term profit or long-term profit? Is it PAT or PBT? Term profit is not clear so company goal to maximise profit is also vague.
2. *Timing of Return is ignored:* Profit maximisation criteria ignores concept of time value of money. If we receives any amount today then it differs from amount receivable at future date.
3. *It avoids the risk factor:* If any organisation wants to earn higher profit then it has to accept higher degree of risk and in case of adverse situation stakeholders will suffer higher losses even in worst situation bankruptcy.
4. *It's as an objective is not ethical:* In today's world corporate social responsibility is very famous term which means apart from government of any country, corporates are also responsible for welfare of country's people. When company wants to maximize its profit, company don't take any step toward CSR even most of the time company take unethical steps.

Q3. Discuss the conflicts in profit verses wealth maximization principle of the firm or Distinguish between Profit maximisation and Wealth maximisation objective of the firm.
(Nov. 2012, May 2015; May 2017, 4 Marks)

Ans. The main two objectives of any business firm are:

A. The maximisation of firm's profit.

B. The maximisation of firm's wealth.

Since every business firm is established to earn profit, therefore profit maximization is as an implied objective of a business firm. To maximise profit, management may take decision which are unethical and risky. Many times results of management decisions leads to financial distress and in worst situation bankruptcy and fails to provide higher profit and growth.

Market price of share indicates value or wealth of a firm. Market price of share of any company is based on various factor like: timely payment of dividend, product or service quality, goodwill of company, CRS activities, research and development steps taken by company, present and future expected income and growth of company, timing of earning and risk associated with business etc.

The value maximisation objective of a firm is superior to its profit maximisation objective due to following reasons:

1. Business firm considers all future cash flows, dividends, earning per share, risk of a decision, etc. for wealth maximisation whereas business firm

does not consider the effect of EPS, dividend paid or any other returns to shareholders or the wealth of the shareholder under profit maximisation objective.

2. To maximise the shareholders wealth firm may pay regular dividends whereas a firm with the objective of profit maximisation may prefer to retain earning instead of dividend payment.
3. Shareholders of any company always prefer increase in value of shares over increase in EPS.
4. Market price of share is based on expectations of shareholders, timing of return, goodwill of company, CSR activities, product and service quality, risk associated with projects, debt equity ratio, timely distribution of income and timing of return etc.
5. The main objective of any firm is wealth maximisation and profit is a part of the wealth maximisation strategy.

Q4. Discuss emerging issues affecting the future role of Chief Financial Officer (CFO) or List the emerging issues (any four) affecting the future role of CFO. ***(May 2014, Nov. 2016, 4 Marks)***

Ans. Future role of Chief Financial Officer (CFO) is affected by the following major emerging issues:

1. *Regulation*: CFOs have to look after personally in day by day increasing regulatory requirements.
2. *Globalisation:* Globalisation creates new financial challenges in front of CFOs. Now CFOs has to develop a finance function to perform effectively on the global stage.
3. *Technology:* Nowadays technology is evolving very fast, and CFOs require to reconfigure finance processes and drive business insight through large data and analytics.
4. *Risk:* Changing nature of the risks, requiring more efficient risk management approaches. CFOs have a role to play in ensuring safeguard of assets.
5. *Transformation:* CFOs have to transform their finance functions to provide a better service to the business without additional cost.
6. *Stakeholder Management:* CFOs become the representative of business firm and responsible to handle stakeholder management and maintain principle agent relationship.
7. *Strategy:* CFOs play a greater role in strategy validation and execution, because of increasing environment complexity and quick changing behaviour.
8. *Reporting:* CFOs are responsible to fulfil increasing reporting requirements.

9. *Talent and Capability:* A person with talent, capability and good behaviour can execute the top finance role.

(Student may write any four in exam)

Q5. Briefly explain the three finance function decisions.
(Nov. 2017, 4 Marks; Nov. 2019, 3 Marks)

Ans. Following are the three long-term financial function decisions in financial management:

1. *Investment decisions (I):* It is related to selection of assets in which long term funds will be employed. Finance manager arranged funds from various sources with consideration of cost, risk and control and invest these funds in various types of business assets. Long-term funds are used to purchase fixed assets and also a portion of fixed asset is used to finance permanent current assets. Finance manager use capital budgeting techniques to evaluate long-term investment proposals.
2. *Financing decisions (F):* Finance manager arranges funds from various sources with consideration of cost, risk and control. Finance manager chooses capital structure for business firm and try to maintain optimum capital structure. Neither these funds should be over nor less, estimation of requirements of funds and accordingly fulfilment of such requirement covered under financing decisions. Funds are arranged to finance fixed assets and working capital. Financing decisions also require a good knowledge of evaluation of risk associated with finance like: excessive debt may lead situation of financial distress and at worst level bankruptcy.
3. *Dividend decisions (D):* Company has two options related to profit available for equity shareholders, first is to distribute profit and second is to retain such profit and reinvest it in business. Dividend decisions are related to balancing between profit distribution and retention of earnings. It is advised to retain profit in business when business is growing *i.e.* internal rate of return is higher than cost of capital. On the other hand is company retain entire profit then in equity investor may disappoint and market value of shares will decrease. Finance manager has to maintain balancing between distribution of profit and retention of profit to maximise shareholders wealth.

Q6. What are the roles of Finance Executive in Modern World?
(May 2018, 2 Marks; Nov. 2020, 4 Marks)

Ans. In today's world apart from accounting, financial reporting and risk management, the role of chief financial officer is much broader. Finance officer is the face of corporate brand and strategic business partner of the firm. In modern world CEO plays a vital role in budgeting, forecasting, managing merger & acquisitions, profitability analysis, pricing analysis, decisions about outsourcing, overseeing the IT function, overseeing the HR function, strategic planning, regulatory compliance and risk management etc.

Q7. What are the two main aspects of the Finance Function?
(May 2018, 2 Marks)

Ans. Two main aspects of Finance function are:

1. *Procurement of Funds:* Finance manager arranges funds from various sources with consideration of cost, risk and control. Finance manager chooses capital structure for business firm and try to maintain optimum capital structure. Neither these funds should be over nor less, estimation of requirements of funds and accordingly fulfilment of such requirement covered under financing decisions. Funds are arranged to finance fixed assets and working capital. Financing decisions also require a good knowledge of evaluation of risk associated with finance like: excessive debt may lead situation of financial distress and at worst level bankruptcy.
2. *Effective Utilization of Funds:* It is related to selection of assets in which long-term funds will be employed. Finance manager arranged funds from various sources with consideration of cost, risk and control and invest these funds in various types of business assets. Long-term funds are used to purchase fixed assets and also a portion of fixed asset is used to finance permanent current assets. Finance manager use capital budgeting techniques to evaluate long-term investment proposals. The Finance Manager has to keep in mind that funds are not kept idle or there is no improper use of funds. The funds are to be invested in a efficient way such that they generate returns higher than the cost of capital to the firm.

Q8. Write two main objectives of financial management.
(Nov. 2018, 2 Marks)

Ans. Two main objectives of financial management are:

1. *Profit Maximisation:* Since every business firm is established to earn profit, therefore profit maximization is as an implied objective of a business firm. To maximise profit, management may take decision which are unethical and risky. Many times results of management decisions leads to financial distress and in worst situation bankruptcy and fails to provide higher profit and growth. Profit maximisation is secondary goal of the company and it helps in wealth maximisation.
2. *Wealth or Value Maximisation:* Market price of share indicates value or wealth of a firm. Market price of share of any company is based on various factor like: timely payment of dividend, product or service quality, goodwill of company, CRS activities, research and development steps taken by company, present and future expected income and growth of company, timing of earning and risk associated with business etc. it is the primary goal of the firm.

Q9. State four tasks involved to demonstrate the importance of good Financial Management. ***(Jan. 2021, 4 Marks)***

Ans. Following are the main task involved to demonstrate the importance of good financial management is to:

1. Look after not to over-invest in fixed assets,
2. Maintain balancing of cash outflow with cash inflows,
3. Maintaining sufficient level of short-term working capital,
4. Preparation of growing sales budget,
5. Set correct pricing for products or services to increase gross profit,
6. Look after and control general and administrative expenses, and
7. Focusing on tax planning to minimize the taxes.

Q10. List out the steps to be followed by the manager to measure and maximize the Shareholder's wealth. ***(July 2021, 2 Marks)***

Ans. We will first like to define what is Wealth/Value Maximization Model. Shareholders wealth are the result of cost benefit analysis adjusted with their timing and risk *i.e.* time value of money.

So,

Wealth = Present value of benefits –Present Value of Costs

It is important that benefits measured by the finance manager are in terms of cash flow. Finance manager should emphasis on Cash flow for investment or financing decisions not on accounting profit. The shareholder value maximization model holds that the primary goal of the firm is to maximize its market value and implies that business decisions should seek to increase the net present value of the economic profits of the firm. So for measuring and maximising shareholders wealth finance manager should follow:

- Cash Flow approach not Accounting Profit
- Cost benefit analysis
- Application of time value of money.

Q11. Explain in brief the phases of the evolution of financial management. ***(Dec. 2021, 2 Marks)***

Ans. Financial management evolved gradually over the past 50 years. The evolution of financial management is divided into three phases. Financial Management evolved as a separate field of study at the beginning of the century. The three stages of its evolution are:

The Traditional Phase: During this phase, financial management was considered necessary only during occasional events such as takeovers, mergers, expansion, liquidation, etc. Also, when taking financial decisions in the organisation, the

needs of outsiders (investment bankers, people who lend money to the business and other such people) to the business was kept in mind.

The Transitional Phase: During this phase, the day-to-day problems that financial managers faced were given importance. The general problems related to funds analysis, planning and control were given more attention in this phase.

The Modern Phase: Modern phase is still going on. The scope of financial management has greatly increased now. It is important to carry out financial analysis for a company. This analysis helps in decision making. During this phase, many theories have been developed regarding efficient markets, capital budgeting, option pricing, valuation models and also in several other important fields in financial management.

Q12. State advantage of 'Wealth Maximization' goals in Financial Management. ***(May 2022, 2 Marks)***

Ans. ***Followings are the advantages of 'wealth Maximization':***

(*a*) Emphasizes the long-term gains

(*b*) Recognises risk or uncertainty

(*c*) Recognises the timing of returns

(*d*) Considers shareholders' return.

Q13. These bonds are issued by non-US Banks and non-US corporation in US. What this bond is called and what are the other features of this Bond? ***(Nov. 2022, 4 Marks)***

Ans. This bond is called as Yankee Bond. Following are the other features of this bond:

(*a*) These bonds are denominated in dollars

(*b*) Bonds issued by non-US banks and non-US corporations

(*c*) Bonds are issued in USA

(*d*) Bonds are to be registered in SEC (Securities and Exchange Commission)

(*e*) Bonds are issued in tranches

(*f*) Time taken can be up to 14 weeks

(*g*) Interest rate is dollar LIBOR (London Interbank Offered Rate

CHAPTER 2

TYPES OF FINANCING

SUMMARY

1. *Types of Finance on the Basis of Term:*

- *Long-term Finance:* Finance for a period exceeding 5-10 years.
- *Medium-term Finance:* Finance for a period exceeding one year but not exceeding 5 years
- *Short-term Finance:* Finance for a short period of time not exceeding one year.

2. *Long-Term Sources of Finance:*

(a) *Equity Capital:* Issue of Equity share shares is primary source of long-term finance.

(b) *Preference Share Capital:* Company can issue preference shares to fulfil its long-term requirement of funds. Preference shareholders receive fixed payment of dividend and priority towards repayment of capital.

(c) *Retained Earnings:* Company can retain and invest some portion of its profit.

(d) *Debentures:* Company can issue non-convertible, fully convertible or partly convertible debentures to arrange long-term funds.

(e) *Bond:* Company (Govt. or PSU) can raise long-term funds through issue of Bond.

3. *Types of Call Bond:*

- *Callable bonds:* Issuer can redeem bond before maturity at prefixed call price.
- *Puttable bonds:* Investor can get its money back before maturity.

4. *Name of Foreign Bonds:*

- Foreign Currency Convertible Bond (FCCB)
- Plain Vanilla Bond
- Convertible Floating Rate Notes (FRN)
- Drop Lock Bond

- Variable Rate Demand Obligations
- Yield Curve Note (YCN)
- Yankee Bond
- Euro Bond
- Samurai Bond
- Bulldog Bond

5. ***Indian Bonds:***
   - Masala Bond
   - Municipal Bonds
   - Government or Treasury Bonds

6. ***Bridge Finance:*** Under bridge finance bank provides short-term loan to a company (which has pre-approved term loan) to fulfil requirements of funds upto date of sanction of term loan.

7. ***Venture Capital Financing:*** Financing of new high risky startups by talented and qualified entrepreneurs who lack experience and funds to shape their ideas into a successful business.

8. ***Characteristics of Venture Capital Financing:***
   - Equity finance in new companies.
   - Long-term investment in growth-oriented small or medium business firms.
   - Provides managerial support also.

9. ***Methods of Venture Capital Financing:***
   - *Equity Financing:* Financial institute purchase equity of business but not more than 49% of the total equity capital of venture capital undertakings.
   - *Conditional Loan:* In case of conditional loan 2 - 15 per cent royalty is payable instead of interest.
   - *Income Note:* It is a combination of normal loan and conditional loan.
   - *Participating Debenture:* During first phase no interest is charged, during second phase a low rate of interest is charged and in last phase a high rate of interest is charged.

10. ***Debt Securitisation :*** It is a process of conversion of existing loans of financial institutions into securities. Existing car loans, credit card, etc. are transferred to special purpose vehicle (SVP), who convert these loans into securities and sold these securities to pension fund, provident fund etc.

11. ***Lease Financing:*** Under lease financing asset is purchased by the investor *viz.* lessor and provide these asset to user *viz.* lessee who pays a specified rent at periodical intervals.

12. *Types of Lease Contracts:*

- *Operating Lease:* Under this lease contract lessee gets right to use the asset for small period and ownership and risk related to asset remains with lessor.
- *Financial Lease:* Under this lease contract lessee gets right to use the asset for long period (generally full economic life of asset) and ownership and risk related to asset remains with lessor.

13. *Other Types of Leases:*

- *Sales and Lease Back:* Legal owner of asset sells asset to second party after this transfer second party leases back it to first party.
- *Leveraged Lease:* Buyer of assets purchases asset against loan (approximately 80% loan) and provides asset to a party on lease. In return lessee pays instalment of loan on behalf of lessor and small amount of rent to lessor.
- *Sales-aid Lease:* Lessor promotes asset of any manufacturer through his own leasing operations and gets commission from manufacturer and rent from lessee.
- *Close-ended and Open-ended Leases:* Under close-ended lease, lessee has to transfer asset to lesser at the end of lease tenure while under open-ended lease, the lessee can purchase asset at the end of lease tenure.

14. *Short-Term Sources of Finance:*

- Trade Credit
- Accrued Expenses and Deferred (Unearned) Income
- Advances from Customers
- Commercial Paper
- Treasury Bills
- Certificates of Deposit (CD)
- Bank Advances through:
  - (*a*) Short-Term Loans
  - (*b*) Overdraft
  - (*c*) Clean Overdrafts
  - (*d*) Cash Credits
  - (*e*) Advances against goods
  - (*f*) Bills Purchased/Discounted
- Financing of Export Trade by Banks:
  - (*a*) Pre-shipment finance *i.e.,* before shipment of goods.
  - (*b*) Post-shipment finance *i.e.,* after shipment of goods.

- Inter Corporate Deposits
- Public Deposits

15. *Types of Packing Credit:*

- *Clean packing credit:* Under this type of credit exporter gets credit by just showing confirm export order or letter of credit. There is no charge or control of bank over raw material or finished goods.
- Packing credit against hypothecation of goods: Under this type of credit goods are hypothecated.
- *Packing credit against pledge of goods:* Under this type of credit the possession of the goods lies with the bank.

16. *Other Sources of Financing:*

- Seed Capital Assistance
- Internal Cash Accruals
- Unsecured Loans
- Deferred Payment Guarantee
- Capital Incentives
- Deep Discount Bonds
- Secured Premium Notes
- Zero Interest Fully Convertible Debentures
- Zero Coupon Bonds
- Option Bonds
- Inflation Bonds
- Floating Rate Bonds

17. *International Financing:*

- Commercial Banks
- Development Banks
- Discounting of Trade Bills
- International Agencies
- International Capital Markets
- Euro Issues by Indian Companies
- Financial Instruments:
  - (*a*) External Commercial Borrowings (ECB)
  - (*b*) Euro Bonds
  - (*c*) Foreign Bonds
  - (*d*) Fully Hedged Bonds

(*e*) Medium Term Notes (MTN)
(*f*) Floating Rate Notes (FRN)
(*g*) Euro Commercial Papers (ECP)
(*h*) Foreign Currency Option (FC)
(*i*) Foreign Currency Futures
(*j*) Foreign Euro Bonds
(*k*) Euro Convertible Bonds
(*l*) Euro Convertible Zero Bonds
(*m*) Euro Bonds with Equity Warrants

18. *American Depository Receipts (ADRs):* If any non-US company wants to sell its securities on New York Stock Exchange then it can be done by issuing ADR. One unit of ADR represents a certain number of a company's regular shares. Non-US Company has to deposits its original shares with custodian bank of US and against these deposited shares ADR will be issued.

19. *Global Depository Receipts (GDRs):* When a company wants to issue its shares in foreign country then it can be done by issuing GDR. One unit of GDR represents a certain number of a company's regular shares. Company who wants to issue its shares has to deposits its original shares with custodian bank of foreign country and against these deposited shares GDR will be issued.

20. *Indian Depository Receipts (IDRs):* If any non-Indian company wants to sell its securities in Indian capital market then it can be done by issuing IDR. One unit of IDR represents a certain number of a company's regular shares. Non-Indian Company has to deposits its original shares with Indian custodian bank against these deposited shares IDR will be issued.

THEORY QUESTIONS

Q1. What is debt securitization? Explain the basic debt securitization process. ***(May 2011, 4 Marks)***

Ans. *Debt Securitisation:* It is a process of conversion of existing loans of financial institutions into securities. Existing car loans, credit card etc. are transferred to special purpose vehicle (SVP), who convert these loans into securities and sold these securities to pension fund, provident fund etc. It is a process of recycling of funds. It supports to financial intermediaries to support the lending volumes. Assets generating steady cash flows are packaged together and against this asset pool, market securities can be issued, e.g. housing finance, auto loans, and credit card receivables. These assets are generally secured by personal or real property such as automobiles, real estate, or equipment loans but in some cases are unsecured.

Process of Debt Securitisation

1. *The origination function*: First a borrower apply for a loan with a finance company, bank, HDFC. The creditworthiness of borrower is evaluated and contract is entered into with repayment schedule structured over the life of the loan.
2. *The pooling function*: An underlying pool of assets is created by clubbing of similar loans on receivables together. The pool is transferred in favour of Special purpose Vehicle (SPV), which acts as a trustee for investors.
3. *The securitisation function*: SPV creates structure and issue securities against asset pool. The securities carry a coupon and expected maturity which can be asset based mortgage based. These are generally sold to investors through merchant bankers. Investors are: pension funds, mutual funds, insurance funds.

Q2. Distinguish between Operating lease and financial lease.
(Nov. 2014, May 2016; Nov. 2011, 4 Marks)

Ans.

Difference between Operating lease and Financial lease

Sl. No.	*Operating Lease*	*Financial Lease*
1	The lessee is only provided the use of the asset for a certain time. Risk incident to ownership belongs only to the lessor.	The risk and reward incident to ownership are passed on the lessee. The lessor only remains the legal owner of the asset.
2	The lessor bears the risk of obsolescence.	The lessee bears the risk of obsolescence.
3	The lease is kept cancellable by the lessor.	The lease is non-cancellable by either party under it.
4	Usually, the lessor bears the cost of repairs, maintenance or operations.	The lessor does not bear the cost of repairs, maintenance or operations.
5	The lease is usually non-payout.	The lease is usually full payout

Q3. Explain Bridge finance. ***(Nov. 2011, Nov. 2016, Dec. 2021, 2 Marks)***

Ans. Under bridge finance bank provides short-term loan to a company (which has pre-approved term loan) to fulfil requirements of funds upto date of sanction of term loan. However, once the loans are approved in principle, firms in order not to lose further time in starting their projects arrange for bridge finance. Such temporary loan is normally repaid out of the proceeds of the principal term loans. It is secured by hypothecation of movable assets, personal guarantees and demand promissory notes. Generally rate of interest on bridge finance is higher as compared with that on term loans.

Q4. What is venture capital financing? Discuss factors that a venture capitalist should consider before financing any risky project.
(May 2012, May 2013, 4 Marks)

Ans. *Venture capital financing:* Financing of new high risky startups by talented and qualified entrepreneurs who lack experience and funds to shape their ideas into a successful business. In broad sense, under venture capital financing, venture capitalist make investment to purchase equity or debt securities from inexperienced entrepreneurs who undertake highly risky ventures with potential to succeed in future.

Factors to be considered by a venture capitalist before financing any risky project are:

1. Management team should be efficient. They are required to show a high level of commitment to the project.
2. Technical team should be able to develop and produce a new product or service.
3. Technical feasibility of the new product or service should be considered.
4. Venture capitalists should be ensured that the prospects for future profits compensate for the risk.
5. Venture capitalists should be ensured that there is a market for the new product. A research must be carried out to ensure.
6. The venture capitalist himself should have the capacity to bear risk or loss, if the project fails.
7. There should be exit routes for venture capitalist.
8. Venture capitalist should have a place on the Board of Directors.

Q5. Write short note on Deep Discount Bonds. ***(May 2012, 2 Marks)***

Ans. Deep Discount Bonds (DDBs) are in the form of zero interest bonds. These bonds are sold at a discounted value and on maturity face value is paid to the investors. In such bonds, there is no interest payout during lock-in period. IDBI was first to issue a Deep Discount Bonds (DDBs) in India in January 1992. The bond of a face value of ₹ 1 lakh was sold for ₹ 2,700 with a maturity period of 25 years.

Q6. "Financing a business through borrowing is cheaper than using equity." Briefly explain. ***(Nov. 2012, 4 Marks)***

Ans. Debt capital is cheaper than equity capital from the point of its cost and interest being deductible for income tax purpose, whereas no such deduction is allowed for dividends. Issue of new equity dilutes existing control pattern while borrowing does not result in dilution of control. In a period of rising prices, borrowing is advantageous. The fixed monetary outgo decreases in real terms as the price level increases.