AJA Commerce Academy
CA - Intermediate
Test Series – FINANCIAL MANAGEMENT

Time Allowed – 1.5 Hours | Maximum Marks – 50

Section A – Multiple Choice Questions (10 Marks)

Case Scenario: Financing at ABC Ltd. (6 Marks)

Scenario:
ABC Ltd. is evaluating its sources of capital to raise ₹50 crores for a new project. The company is considering debt financing, preference shares, and equity shares. The CFO is tasked with calculating the cost of capital for each option and determining the weighted average cost of capital (WACC) to decide the optimal mix.

Questions:

1. Which of the following best defines the cost of capital?
   (a) The return expected by providers of funds.
   (b) The amount of principal paid on loans.
   (c) The depreciation charged on assets.
   (d) The cost incurred on new investments.
2. If the company issues 10% debentures at ₹100 each and the tax rate is 30%, the cost of debt (after tax) will be:
   (a) 10%
   (b) 7%
   (c) 13%
   (d) 3%
3. Which of the following is **not a component** of the weighted average cost of capital (WACC)?
   (a) Cost of Debt
   (b) Cost of Equity
   (c) Cost of Retained Earnings
   (d) Gross Profit Ratio
4. What is the formula to calculate the cost of irredeemable preference shares?
   (a) Preference Dividend/Net Proceeds
   (b) Preference Dividend/Market Price
   (c) Net Proceeds/Preference Dividend
   (d) Market Price/Net Proceeds
5. The CAPM formula for calculating the cost of equity is:
   (a) Risk-Free Rate+Beta Coefficient
   (b) Beta Coefficient×Market Rate

   (c) Risk-Free Rate+β(Market Rate−Risk-Free Rate)

(d) Market Rate−Risk-Free Rate

6. Which of the following is **not** a factor affecting the cost of capital?
(a) Risk and Return
(b) Inflation
(c) Marketing Expenses
(d) Exchange Rates

General MCQs (4 Marks)

7. Cost of debt is generally lower than the cost of equity because:
   (a) Debt holders are owners of the company.
   (b) Debt payments are tax-deductible.
   (c) Debt is riskier than equity.
   (d) Debt has a longer maturity period.
8. Weighted Average Cost of Capital (WACC) is calculated using:
   (a) Only the cost of debt.
   (b) The average of all individual capital costs.
   (c) The weighted costs of each source of capital.
   (d) The marginal cost of capital only.
9. The cost of retained earnings is most similar to:
   (a) The cost of equity.
   (b) The cost of preference shares.
   (c) The cost of debt.
   (d) The marginal cost of capital.
10. A company can reduce its WACC by:
   (a) Increasing its reliance on equity financing.
   (b) Reducing its tax rate.
   (c) Increasing the proportion of debt in its capital structure.
   (d) Issuing more preference shares.

Section B – Practical and Descriptive Questions (40 Marks)

Question 1: Cost of Individual Components (10 Marks)

Scenario:
XYZ Ltd. is issuing the following securities:

- 8% irredeemable debentures at ₹90 each, with a face value of ₹100. The tax rate is 30%.
- 10% preference shares at ₹95 each, with a face value of ₹100.
- Equity shares at ₹50 each, with an expected dividend of ₹4 per share and a growth rate of 5%.

(a) Calculate the cost of debt, preference shares, and equity. (6 Marks)
(b) Discuss how these individual costs are used in calculating WACC. (4 Marks)

Question 2: Weighted Average Cost of Capital (10 Marks)

Scenario:
ABC Ltd.'s capital structure consists of:

- ₹20,00,000 in equity shares, with a cost of equity of 12%.
- ₹10,00,000 in preference shares, with a cost of 10%.
- ₹30,00,000 in debt, with an after-tax cost of 6%.

(a) Calculate the Weighted Average Cost of Capital (WACC). (8 Marks)
(b) Explain the importance of WACC in financial decision-making. (2 Marks)

Question 3: Calculation of Marginal Cost of Capital (10 Marks)

Scenario:
XYZ Ltd. plans to raise an additional ₹15,00,000 in the following manner:

- ₹6,00,000 from debt at 9% interest.
- ₹4,00,000 from preference shares at 11%.
- ₹5,00,000 from equity, with an expected return of 14%.

(a) Calculate the marginal cost of capital. (8 Marks)
(b) How does the marginal cost of capital differ from WACC? (2 Marks)

Question 4: Theoretical (10 Marks)

(a) Discuss the significance of calculating the cost of capital for a business. (6 Marks)
(b) What are the limitations of the Weighted Average Cost of Capital? (4 Marks)