UNIVERSITY OF KELANIYA - SRI LANKA

Centre for Distance and Continuing Education

Faculty of Commerce & Management Studies

Bachelor of Business Management (General) Degree Third Examination (External) – 2024

May - 2026

BMGTE 3065 – Business Finance

Time : 03 hours

Instructions:

I. This question paper consists of 2 Parts (Part A and B)

II. No of Questions:

Part A – 10 (Multiple Choice Questions)

Part B – 04

III. All questions are compulsory.

IV. Attach the answers of Part A to the Answer booklet.

V. Taking Part A of the question paper outside the examination hall is strictly prohibited.

Part A

Underline the correct answer.

1) Which of the following is not a possible goal in Financial Management?

   a) Minimize costs.

   b) Maximize profit.

   c) Maintain rapidly fluctuating earning growth.

   d) Maximize market share.

2) Investment can be defined as,

a) Person's dedication to purchasing a house or flat.

b) Use of capital on assets to receive returns.

c) Usage of money on a production process of products and services.

d) Net additions made to the nation's capital stocks.

3) Which of the following risks is avoidable through diversification?

a) Portfolio risk

b) Systematic risk

c) Unsystematic risk

d) Total risk

4) Which of the following statements regarding risk-averse investors is true?

a) They only care about the rate of return.

b) They accept investments that are fair.

c) They only accept risky investments that offer risk premiums over the risk-free rate.

d) They are willing to accept lower returns and high risk.

5) The time value of money supports the comparison of cash flows recorded at different time periods by,

a) Discounting all cash flows to a common point in time.

b) Using either Compounding or Discounting to get all cash flows to a common point in time.

c) Compounding all cash flows to a common point in time.

d) None of the above.

6) Liquidity and solvency ratios mainly help users to assess a company's ability to,

a) Earn profit from sales and increase market price.

b) Meet short-term and long-term obligations.

c) Pay dividends and reduce share capital.

d) Increase inventory and reduce revenue.

7) Calculate the Degree of Financial Leverage (DFL) for the year 2025.

Year	Sales (Rs.)	EBIT (Rs.)	EPS (Rs.)
2024	3,000	1,000	10
2025	2,400	700	5

a) 1.50

b) 1.67

c) 2.00

d) 2.50

8) A company following a zero-dividend policy is most likely to,

a) Distribute all earnings to shareholders.

b) Pay a fixed dividend every year.

c) Retain earnings for reinvestment opportunities.

d) Increase dividends regardless of profit.

9) Managers may avoid increasing dividends unless the increase is sustainable because,

a) Dividend cuts may send negative signals to the market.

b) Dividends are legally prohibited.

c) Shareholders dislike all dividends.

d) Dividends reduce EPS to zero.

10) Which of the following best explains the purpose of working capital management?

a) To decide the firm's capital structure permanently.

b) To calculate the market price of shares.

c) To determine only the dividend payout ratio.

d) To manage short-term cash inflows, outflows, and financing needs.

(02 Marks x 10 = 20 Marks)

Part B

Question No. 01

a) Differentiate Financial Accounting and Financial Management. **(04 Marks)**

b) Discuss the balance sheet model of the organization and how it relates to financial management. **(06 Marks)**

c) ABC Company is evaluating two new machines to purchase the best machine for production purposes. Each machine cost Rs. 200,000 and both have a life of 5 years. The two machines will be depreciated on a straight-line basis. The scrap values of the two machines are as follows.

Machine	**A**	**B**
Scrap Value	Rs. 20,000	Rs. 25,000

The initial working capital investment of Machine A and B are Rs. 30,000 and Rs. 40,000 respectively. The working capital will be fully recovered at the end of year 5.

Although the first maintenance payment for Machine A is Rs. 22,000, it is expected to rise 9% annually. The annual maintenance cost of machine B will be higher at a rate of Rs. 28,000 in year 1 and it is expected to increase annually by 7%.

As the new machines will likely reduce the variable cost, the contribution will differ depending on the machine used. The contribution from each machine (excluding maintenance cost) is tabulated as follows, with the inflow of funds assumed to be at the end of each year.

Year	**1**	**2**	**3**	**4**	**5**
Contribution - machine A (Rs.'000)	60	75	90	105	120
Contribution – machine B (Rs.'000)	70	85	95	110	125
Discount Rate 12%	0.893	0.797	0.712	0.636	0.567

The Finance Manager expects the Cost of Capital to be around 12%. Tax can be ignored.

You are required to calculate,

I.	Accounting Rate of Return (ARR) of machine A and B	**(04 Marks)**
II.	Net Present Value (NPV) of machine A and B	**(04 Marks)**
III.	Which machine will be selected? Why?	**(02 Marks)**

(Total 20 Marks)

Question No. 02

a) Explain the difference between Systematic risk and Unsystematic risk. **(04 Marks)**

b) Answer the following questions related to the Time Value of Money.

i. On 10th August 2025, Nadun borrowed Rs.15,000 from his employer. If Nadun agrees to pay a 7% annual rate of interest, calculate the total amount he must repay if the loan is for 19 months.

ii. If you deposit Rs. 9,000 into an account paying 12% annual interest compounded quarterly; how much money will be in the account after 12 years?

iii. How much money would you deposit today at 24% annual interest compounded biannually to have Rs.40,000 in the account after 16 months?

(02 Marks x 3 = 06 Marks)

c) Suppose Security M and Security N have experienced the following returns and probabilities in the last four years.

Year	Security M		Security N	
	Probability	Return (%)	Probability	Return (%)
2025	0.10	-17	0.05	-15
2024	0.40	25	0.15	20
2023	0.15	13	0.35	35
2022	0.35	18	0.45	10

You are required to calculate,

i. The Standard Deviation of Security M and N. **(04 Marks)**

ii. Which investment is riskier? Explain. **(02 Marks)**

d) Solve the below questions related to return concepts.

i. Calculate the geometric mean return using the given 7-year sequence of investment returns 88%, -7.5%, 95%, -8.5%, 92%, -5.5% and 50%.

(02 Marks)

ii. Nine years ago, Saman paid Rs. 245.00 per share for 350 shares in the XYZ Company. The current share price has grown by 87% of the purchase price. So far, he has received dividend twelve times. Each amounting to Rs. 16 per share. Calculate the holding period return of Saman.

(02 Marks)

(Total 20 Marks)

Question No. 03

a) Lanka Foods PLC provided the following financial information for the year ended December 31, 2025.

Description	**Amount**
Net Income	120,000
Net Sales	1,200,000
Cost of Goods Sold	720,000
Total Assets — Beginning	750,000
Total Assets — End	850,000
Current Liabilities	150,000
Cash	60,000
Short-term Investments	40,000
Accounts Receivable — Beginning	90,000
Accounts Receivable — End	110,000

Inventory — End	80,000
Total Liabilities	340,000
Total Shareholders' Equity — Beginning	380,000
Total Shareholders' Equity — End	510,000
Ordinary Shares Outstanding	50,000
Market Price per Share	Rs. 36
Annual Dividend per Share	Rs. 4.00
Interest Expense	20,000
Income Tax Expense	40,000

Required:

Using the above information, calculate and interpret the following accounting ratios for Lanka Foods PLC.

i. Acid-Test Ratio (Quick Ratio)

ii. Accounts Receivable Turnover Ratio

iii. Total Asset Turnover Ratio

iv. Interest Coverage Ratio

v. Price-Earnings Ratio

(02 Marks x 05 = 10 Marks)

b) Sunrise Manufacturing PLC follows a Residual Dividend Policy and has provided the following financial details for the upcoming year.

Description	**Amount (Rs.)**
Capital Budget	Rs. 2,000,000
Target Capital Structure	40% Debt, 60% Equity
Forecasted Net Income	Rs. 1,500,000

Required:

i. Calculate the dividend payout amount using the Residual Dividend Model.

(04 Marks)

ii. If the capital budget increases to Rs. 2,400,000, explain how this change would affect the dividend payment.

(02 Marks)

c) Operating leverage and financial leverage both affect firm risk
Briefly distinguish between operating leverage and financial leverage and explain how each can influence a firm's beta.

(04 Marks)

(Total 20 Marks)

Question No. 04

a) Consumer Products PLC has provided the following capital structure and market information.

Description	Amount
Risk-free Rate (Rf)	6%
Market Return (Rm)	14%
Beta (β)	1.1
Cost of Debt before Tax	10%
Corporate Tax Rate	28%
Equity Proportion	55%
Debt Proportion	45%

Required:

i. Compute the Cost of Equity using the Capital Asset Pricing Model (CAPM).

(02 Mark)

ii. Compute the After-Tax Cost of Debt.

(02 Mark)

iii. Compute the Weighted Average Cost of Capital (WACC).

(02 Mark)

iv. If the company changes its capital structure to 60% Equity and 40% Debt, recalculate the WACC and briefly comment whether the company benefits from this change.

(02 Mark)

b) Harbour Mart PLC reported the following for the year 2025.

Description	Amount
Cost of Goods Sold (COGS)	960,000
Average Inventory	120,000
Net Sales	1,440,000
Average Accounts Receivable	160,000
Average Accounts Payable	80,000

Required:

Show workings and assume 365 days.

i. Calculate Inventory Turnover and Inventory Period. **(02 Marks)**

ii. Calculate Receivables Turnover and Debt collection Period. **(02 Marks)**

iii. Calculate Payables Turnover and Debt payment Period. **(02 Marks)**

iv. Calculate the Operating Cycle and Cash Cycle. **(02 Marks)**

c) Compare the Bird-in-the-Hand Theory and the Tax Preference Theory, highlighting their implications for dividend payout decisions.

(04 Marks)

(Total 20 Marks)