Business Finance

Unit 2

Multiple Choice Questions

1. Capital Budgeting is a part of:
   a. **Investment Decision**
   b. Working Capital Management
   c. Marketing Management
   d. Capital Structure
2. Capital Budgeting deals with:
   a. **Long-term Decisions**
   b. Short-term Decisions
   c. Both (a) and (b)
   d. Neither (a) nor (b)
3. Which of the following is not used in Capital Budgeting?
   a. Time Value of Money
   b. Sensitivity Analysis
   c. **Net Assets Method**
   d. Cash Flows
4. Capital Budgeting Decisions are:
   a. Reversible
   b. **Irreversible**
   c. Unimportant
   d. All of the above
5. Which of the following is not incorporated in Capital Budgeting?
   a. Tax-Effect
   b. Time Value of Money
   c. Required Rate of Return
   d. **Rate of Cash Discount**
6. Which of the following is not a capital budgeting decision?
   a. Expansion Programme
   b. Merger
   c. Replacement of an Asset
   d. **Inventory Level**
7. A sound Capital Budgeting technique is based on:
   a. **Cash Flows**
   b. Accounting Profit
   c. Interest Rate on Borrowings
   d. Last Dividend Paid
8. Which of the following is not a relevant cost in Capital Budgeting?
   a. Sunk Cost
   b. Opportunity Cost
   c. Allocated Overheads
   d. **Both (a) and (c) above**
9. Capital Budgeting Decisions are based on:
   a. Incremental Profit
   b. **Incremental Cash Flows**
   c. Incremental Assets
   d. Incremental Capital
10. Which of the following does not effect cash flows proposal?
    a. Salvage Value
    b. Depreciation Amount
    c. Tax Rate Change
    d. **Method of Project Financing**
11. Cash Inflows from a project include:
    a. Tax Shield of Depreciation
    b. After-tax Operating Profits
    c. Raising of Funds
    d. **Both (a) and (b)**
12. Which of the following is not true with reference capital budgeting?
    a. Capital budgeting is related to asset replacement decisions
    b. Cost of capital is equal to minimum required return
    c. **Existing investment in a project is not treated as sunk cost**
    d. Timing of cash flows is relevant.
13. Which of the following is not followed in capital budgeting?
    a. Cash flows Principle
    b. Interest Exclusion Principle
    c. **Accrual Principle**
    d. Post-tax Principle
14. Depreciation is incorporated in cash flows because it:
    a. Is unavoidable cost
    b. Is a cash flow
    c. **Reduces Tax liability**
    d. Involves an outflow

15. Which of the following is not true for capital budgeting?

a. Sunk costs are ignored
b. Opportunity costs are excluded
c. Incremental cash flows are considered
d. Relevant cash flows are considered

16. Which of the following is not applied in capital budgeting?

a. Cash flows be calculated in incremental terms
b. All costs and benefits are measured on cash basis
c. All accrued costs and revenues be incorporated
d. All benefits are measured on after-tax basis.

17. Evaluation of Capital Budgeting Proposals is based on Cash Flows because:

a. Cash Flows are easy to calculate
b. Cash Flows are suggested by SEBI
c. Cash is more important than profit
d. None of the above

18. Which of the following is not included in incremental A flows?

a. Opportunity Costs
b. Sunk Costs
c. Change in Working Capital
d. Inflation effect

19. A proposal is not a Capital Budgeting proposal if it:

a. is related to Fixed Assets
b. brings long-term benefits
c. brings short-term benefits only
d. has very large investment

20. In Capital Budgeting, Sunk cost is excluded because it is:

a. of small amount
b. not incremental
c. not reversible
d. All of the above

21. Savings in respect of a cost is treated in capital budgeting as:

a. An Inflow
b. An Outflow
c. Nil
d. None of the above.

22. Risk in Capital budgeting implies that the decision-maker knows ___________ of the cash flows.

a. Variability
b. Probability
c. Certainty
d. None of the above

23. In Certainty-equivalent approach, adjusted cash flows are discounted at:

a. Accounting Rate of Return
b. Internal Rate of Return
c. Hurdle Rate
d. Risk-free Rate

24. Risk in Capital budgeting is same as:

a. Uncertainty of Cash flows
b. Probability of Cash flows
c. Certainty of Cash flows
d. Variability of Cash flows

25. Which of the following is a risk factor in capital budgeting?

a. Industry specific risk factors
b. Competition risk factors
c. Project specific risk factors
d. All of the above

26. In Risk-Adjusted Discount Rate method, the normal rate of discount is:

a. Increased
b. Decreased
c. Unchanged
d. None of the above

27. In Risk-Adjusted Discount Rate method, which one is adjusted?

a. Cash flows
b. Life of the proposal
c. Rate of discount
d. Salvage value

28. Risk of a Capital budgeting can be incorporated

a. Adjusting the Cash flows
b. Adjusting the Discount Rate
c. Adjusting the life
d. All of the above

29. In Sensitivity Analysis, the emphasis is on assessment of sensitivity of

a. Net Economic Life
b. Net Present Value
c. Both (a) and (b)
d. None of (a) and (b)

30. Most Sensitive variable as given by the Sensitivity Analysis should be:

a. Ignored
b. Given least importance

c. Given the maximum importance
d. None of the above

31. Which of the following is the term that describes the amount of time taken for a capital budgeting project to recover its initial investment?
    a. Investment period
    b. Redemption period
    c. Payback period
    d. Maturity period
32. Which of the following can be a criterion for the acceptance of a project?
    a. The Profitability Index should be greater than unity
    b. The Internal Rate of Return should be greater than the cost of capital
    c. The Net Present Value should be greater than zero
    d. All of the above
33. Which of the following is true for a project with a shorter payback period?
    a. The project will have a lesser risk
    b. The project will have less Net Present Value
    c. The project will have more Net Present Value
    d. The project will have a greater risk
34. Capital Budgeting decisions are evaluated using the _________ and _______ is used for this purpose.
    a. Weighted average, cost of capital
    b. Weighted average, component cost
    c. Unweighted average, cost of capital
    d. None of the above
35. What is the main difference between accounting profit and economic profit?
    a. Economic profit is based on cash flows, while accounting profit is based on specific rules for accountancy
    b. Accounting profit includes the last accounting period, while economic profit includes the entire life of a firm's existence
    c. Accounting profit has a small charge for debt, but economic profit has a small charge for the providers of capital
    d. All of the above
36. Which of the following is a disadvantage of using the payback period?
    a. It does not take into account the cost of capital and timing of return
    b. When compared to the accounting rate of return method, it is more difficult to calculate and understand
    c. It does not take the initial investment into account
    d. All of the above
37. What is the main reason behind the specific required rates of return for different projects?
    a. It does not take into account the cost of capital and timing of return
    b. If a firm is divided, then the units will also have a separate rate of return
    c. Both a and b are correct
    d. None of the above
38. Which of the following would be the best example of a capital budgeting decision?
    a. Purchasing new machinery to replace an existing one
    b. Transferring money to your creditor's account
    c. Payment of electricity bill for your factory
    d. None of the above
39. Which of the following decisions affects the size of assets, the profitability and competitiveness of a firm?
    a. Dividend decision
    b. Working capital decision
    c. Capital Budgeting decision
    d. None of the above
40. Which of the following is not incorporated within the capital budgeting decision for a company?
    a. The rate of cash discount
    b. Time value of money
    c. The required rate of return
    d. None of the above

41. The values of the future net incomes discounted by the cost of capital are called

a. Average capital cost
b. Discounted capital cost
c. Net capital cost
d. Net present values

42. The decision to accept or reject a capital budgeting project depends on –

a. an analysis of the cash flows generated by the project
b. cost of capital that are invested in business/project.
c. Both (A) and (B)
d. Neither (A) nor (B)

43. The Internal Rate of Return (IRR) criterion for project acceptance, under theoretically infinite funds is: Accept all projects which have –

a. IRR equal to the cost of capital
b. IRR greater than the cost of capital
c. IRR less than the cost of capital
d. None of the above

44. __________ is a project whose cash flows are not affected by the accept/reject decision for other projects.

a. Mutually exclusive project
b. Independent project
c. Low-cost project
d. Risk free project

45. Where capital availability is unlimited and the projects are not mutually exclusive, for the same cost of capital, following criterion is used?

a. Net present value
b. Internal Rate of Return
c. Profitability Index
d. Any of the above

46. ________ is the discount rate which should be used in capital budgeting.

a. Cost of capital
b. Risk free rate
c. Risk premium
d. Beta rate

47. Which of the following represents the amount of time that it takes for a capital budgeting project to recover its initial cost?

a. Maturity period
b. Payback period
c. Redemption period
d. Investment period

48. How ARR is calculated?

a. (Average PAT/Initial Investment) × 100
b. (Average NPV/Investment) × 100
c. (Average PAT/Initial Investment) ÷ 100
d. (Initial Investment/Average PAT) × 100

49. Accept a project if the profitability index is:

a. less than 1
b. positive
c. greater than 1
d. negative

50. Profitability index is a modification of the

a. Payback period method
b. IRR Method
c. Net present value method
d. Risk premium method

51. __________ is a technique used to determine how different values of an independent variable impact a particular dependent variable under a given set of assumptions.

a. Simulation Analysis
b. Single Variable Analysis
c. Sensitivity Analysis
d. Sensex Analysis

52. ________ of a capital budgeting project is the discount rate at which the Net Present Value (NPV) of a project equals zero.

a. External Rate of Return (ERR)
b. Risk Free Rate of Return (RFRR)
c. Price Cost Method (PCM)
d. Internal Rate of Return (IRR)

53. Which of the following capital budgeting techniques considers the incremental accounting income rather than cash flows?

a. Net present value
b. Internal rate of return

c. **Accounting/simple rate of return**
d. Cash payback period

54. Which of the following techniques does not consider the time value of money?
a. Internal rate of return method
b. **Simple cash payback method**
c. Net present value method
d. Discounted cash payback method

55. The current worth of a sum of money to be received at a future date is called:
a. Real value
b. Future value
c. **Present value**
d. Salvage value

56. What is the primary goal of capital structure decisions?
a. To minimize operational costs
b. **To maximize shareholder wealth**
c. To increase employee satisfaction
d. To diversify company assets

57. Which of the following is NOT a component of capital structure?
a. Equity
b. Long-term debt
c. **Inventory**
d. Preferred stock

58. What does a high debt-to-equity ratio indicate about a company's capital structure?
a. Low risk
b. **High risk**
c. High liquidity
d. More equity than debt

59. Which capital structure is considered optimal?
a. The one with the highest possible amount of debt
b. The one with no debt
c. **The one that offers a balance between risk and return**
d. The one with the most equity

60. The pecking order theory suggests that firms prefer to finance with:
a. Debt rather than equity
b. Equity rather than debt
c. **Internal financing before external financing**
d. External financing before internal financing

61. Which factor does NOT directly affect a firm's capital structure?
a. Market conditions
b. Tax rates
c. **The CEO's personal preferences**
d. The cost of debt

62. Optimal capital structure minimizes:
a. The cost of equity
b. The cost of debt
c. **The overall cost of capital**
d. Tax liabilities

63. Which of the following best describes a firm's capital structure?
a. **The mix of long-term debt, preferred stock, and common equity**
b. The division between all assets owned by a firm
c. The organizational layout of a firm's departments
d. The portfolio of investments held by a firm

64. What does EBIT stand for in EBIT-EPS analysis?
a. **Earnings Before Interest and Taxes**
b. Estimated Budget for Interest and Taxes
c. Earnings Before Internal Transactions
d. Entry Balance of Internal Trade

65. What is the primary purpose of conducting EBIT-EPS analysis?
a. To evaluate tax strategies
b. **To determine the impact of different financing options on EPS**
c. To calculate the company’s gross profit
d. To assess operational efficiency

66. Which statement best explains why a company might perform EBIT-EPS analysis?
a. To optimize inventory levels

b. To select between debt and equity financing
c. To calculate interest on bank loans
d. To adjust the company's operational structure