**ASSIGNMENT**

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| **Course Code** | **:** | **MMPC-014** |
| **Course Title** | **:** | **Financial Management** |
| **Assignment Code** | **:** | **MMPC-014/TMA/JAN/2026** |
| **Coverage** | **:** | **All Blocks** |

**Note: Attempt all the questions and submit this assignment to the Coordinator of your study centre. Last date of submission for January 2026 session is 30th April, 2026 and for July 2026 session is 31st October, 2026.**

1. "Operating leverage is double edged weapon." Do you agree with this statement? Justify.
2. Why is cost of capital important for a firm? Discuss, with examples, different methods of computing Cost of Equity capital.
3. What is capital budgeting? Why it is needed? Discuss any two methods of capital budgeting.
4. In case of a normal Firm where, r=k, which type of Dividend Policy the firm should follow? Identify the above dividend policy model and explain the model in detail.
5. What do you mean by 'Corporate Restructuring'? Why do firms go for it? Discuss the different modes of Corporate Restructuring.

## 1. "Operating leverage is double edged weapon.” Do you agree with this statement? Justify.

### Answer

Yes, I agree with the statement. Operating leverage can increase the profit of a firm rapidly when sales rise, but the same fixed operating cost can make profit fall sharply when sales decline. This is why it is called a double edged weapon. The effect comes from the cost structure of the business, especially the proportion of fixed operating costs such as factory rent, salaries of permanent staff, depreciation, insurance and fixed maintenance expenses.

### Meaning and measurement of operating leverage

A firm normally has both fixed and variable operating costs. Variable cost changes with output, while fixed cost remains largely unchanged within a relevant range of activity. Once the fixed operating cost has been covered, additional contribution from higher sales goes mainly towards operating profit. Therefore, a small percentage change in sales can cause a much larger percentage change in Earnings Before Interest and Tax (EBIT).

Degree of Operating Leverage (DOL) = Contribution / EBIT

It can also be expressed as: DOL = % change in EBIT / % change in Sales

A high DOL means that EBIT is highly sensitive to a change in sales. A low DOL means that EBIT changes more slowly with sales. Operating leverage is normally high in businesses that require heavy investment in plant, technology, hotels, airlines, telecom networks or other facilities where fixed operating costs are large.

### Favourable side of operating leverage

When sales are above the break-even level and demand is growing, high operating leverage becomes beneficial. Since fixed costs do not increase in the same proportion as sales, a larger part of every additional rupee of contribution increases EBIT. This gives the firm an opportunity to improve operating profit faster than the growth in revenue. It can also improve the return on assets when the installed capacity is used efficiently.

For example, suppose a company sells 10,000 units at Rs. 100 each. Variable cost is Rs. 60 per unit and total fixed operating cost is Rs. 3,00,000. The contribution is Rs. 4,00,000 and EBIT is Rs. 1,00,000. Therefore, DOL is 4. If sales increase by 10 per cent and the cost behaviour remains the same, contribution rises to Rs.