



## **PAPER – 6:** **FINANCIAL MANAGEMENT AND STRATEGIC MANAGEMENT**

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### **6A: FINANCIAL MANAGEMENT**



#### **QUESTIONS**

##### **Division A: Case Scenario**

##### **Investment Decision**

1. Mr. Ronak, a doctor by profession, has his own private hospital at Goa having specialization in cardiac treatments. However, now-a-days, Goa not only being a place for the tourists, but is also a place for business delegates, cultural people, politicians, students and other classes of people. Gradually, Goa is opening new windows for businesses and getting recognition as an important tourist and leisure hub in South West India.

There are a number of hotels and resorts at Goa. However, the need still exists for more hotel services, in particular with the excellent service, and because of the large number of visitors from all over the country and all walks of life always favour Goa state for their recreation.

Mr. Ronak although being a doctor by profession is contemplating to establish a five-star hotel at Goa. The hotel will consist of 5 floors. The hotel will include 40 normal rooms and 8 deluxe suites, as well as a restaurant and couple of conference rooms with a small wedding hall on the ground floor. Following are the estimated occupancy rate including

fare composition in the Table 1. Being a five-star hotel, breakfast would be complementary but lunch and dinner are on a-la-carte basis.

Table 1: Hotel accommodation, estimated occupancy rate and fare.

Types of Facility	Numbers	Occupancy Rate	Average Rent Per Room Per Day	Growth Rate in Rent
Normal Room	40	33% or 120 Days	₹ 8000	12%
Deluxe Suites	8	33% or 120 Days	₹ 25,000	9%
Conference with Wedding Hall	2	40 days	₹ 3,00,000	9%
Restaurant	1	All days	₹ 27,000 sales per day	8%

For the sake of simplicity in calculation, growth rate to be applied only once after completion of 10 years.

The estimated cost of land will be ₹ 250 million and the construction cost will be ₹ 100 million. The estimated salvage value at the end of 15<sup>th</sup> year will be 25% of the cost of construction. The cost of furniture will be of ₹ 1,50,000 for each normal room and ₹ 3,80,000 for each deluxe suite. The cost of the furniture for the conference room with wedding hall will be ₹ 7,00,000 each and for restaurant it will be 10,00,000. In addition, the hotel will require 4 elevators at different locations and will be costing around ₹ 35,00,000 each. The cost of buying and installing electronic appliances like TV sets, Air conditioners, Fridge etc. will be around ₹ 35 million. Elevators would be depreciated at a rate of 5% p.a. Electronic appliances will have a salvage value of 15% of its acquisition cost at the end of 15 years.

The hotel will be built by renowned builder named '**Harihar Infrastructure**'. The builder estimated that building will survive for 15 years. The required furniture will be supplied by the local reputed furniture company named **Veru Furnishings Ltd.** They ensured that furniture will go for 10 years very smoothly. At the end of tenth year, new furniture for normal rooms and deluxe suites will be bought and old

furniture for the same will be sold by the hotel owner. The owner of the hotel estimates that he would be able to purchase the required furniture at 15% higher price than the previous purchase price. The salvage values of the furniture at the end of tenth year will be 5% of their purchase prices with no book value remaining. Furniture at restaurant, conference and wedding hall will not require any major changes as such except for minor renovation which will cost ₹ 20,00,000 in total at the end of 12<sup>th</sup> year. Any scrap generated on account of such renovation will be sold at ₹ 1,75,000.

In order to boost the tourism industry at Goa, the state govt will be granting subsidy of 15% on the initial capex incurred, it will be paid at the time of cost incurred and additional subsidy of 10% on annual revenue expenses for the first 3 years of operation, but will be credited directly in the bank account only at the end of 5<sup>th</sup> year and the same shall be non-taxable.

The total annual recurring expenses will be ₹ 1,80,00,000/-. It includes salaries to managers, staff and employees, utilities expenses, house keeping and security services' contract, AMC for electronic appliances, restaurant supplies and materials, other miscellaneous expenses, etc.

After the end of 10 years, annual recurring expenses will increase at a rate of 10% which is to be applied once. Furthermore, the hotel authority is determined to provide the best and professional hotel services to the clients by offering training to the employees. They decided to spend ₹ 5,00,000 per year for the purpose of training of the employees.

The hotel project will be entitled to enjoy tax holiday for the first five years after which the corporate tax rate of 25% will also be applied for the hotel. The Cost of equity for the company is 12% and the estimated hurdle rate by considering the structure of capital of the proposed hotel is fixed at 15%.

**(Depreciation to be taken on SLM basis and assume 360 days in a year. Ignore depreciation on furniture used in restaurant, conference and wedding hall)**

Based on above, please answer to the following MCQs.

- (i) The amount of net initial investment required is:
- (a) ₹ 41.044 Crores
  - (b) ₹ 34.887 Crores
  - (c) ₹ 6.156 Crores
  - (d) ₹ 40.74 Crores
- (ii) NPV of the project is:
- (a) ₹ 7.0532 Cr
  - (b) ₹ 8.4029 Cr
  - (c) ₹ 8.4935 Cr
  - (d) ₹ 2.4700 Cr
- (iii) Pay Back period of the project to recover the initial investment is:
- (a) 5.12 years
  - (b) 12.02 years
  - (c) 11.80 years
  - (d) 4.46 years
- (iv) Estimated Recurring accounting profit/(loss) for first three years are:
- (a) ₹ 7.0928 Cr p.a
  - (b) ₹ 6.9078 Cr p.a
  - (c) ₹ 6.9937 Cr p.a
  - (d) ₹ 9.6120 Cr p.a
- (v) IRR of the project is:
- (a) 16.25%
  - (b) 19.39%
  - (c) 15%
  - (d) 12%

**Ratio Analysis**

2. KT Ltd.'s opening stock was ₹ 2,50,000 and the closing stock was ₹ 3,75,000. Sales during the year were ₹ 13,00,000 and the gross profit ratio was 25% on sales. Average accounts payable are ₹ 80,000. Creditors Turnover Ratio =?
- (a) 13.33  
(b) 14.33  
(c) 14.44  
(d) 13.75

**Leverage**

3. A firm has sales of ₹ 75,00,000, variable cost of ₹ 42,00,000 and fixed cost of ₹ 6,00,000.
- It has a debt of ₹ 45,00,000 at 9% and equity of ₹ 55,00,000. Does it have favourable financial leverage?
- (a) ROI is less than interest on loan funds and hence it has no favourable financial leverage.  
(b) ROI is equal to interest on loan funds and hence it has favourable financial leverage.  
(c) ROI is greater than interest on loan funds and hence it has favourable financial leverage.  
(d) ROI is greater than interest on loan funds and hence it has unfavourable financial leverage.

**Division B: Descriptive Questions****Ratio Analysis**

4. Following are the data in respect of LP enterprises for the year ended 31<sup>st</sup> March, 2024:
- |                                 |   |      |
|---------------------------------|---|------|
| Debt to Total assets ratio      | : | 0.40 |
| Long-term debts to equity ratio | : | 30%  |
| Gross profit margin on sales    | : | 20%  |

Accounts receivables period	:	36 days
Quick ratio	:	0.9
Inventory holding period	:	60 days
Cost of goods sold	:	₹ 64,00,000

Liabilities	₹	Assets	₹
Equity Share Capital	20,00,000	Fixed assets	
Reserves & surplus		Inventories	
Long-term debts		Accounts receivable	
Accounts payable		Cash	
Total	50,00,000	Total	

**Required:**

COMPLETE the Balance Sheet of LP enterprises as on 31<sup>st</sup> March, 2024. All calculations should be in nearest Rupee. Assume 360 days in a year.

**Cost of Capital**

5. BS Ltd. has the following capital structure at book-value as on 31<sup>st</sup> March, 2024:

Particulars	(₹)
Equity share capital (10,00,000 shares)	3,00,00,000
11.5% Preference shares	60,00,000
10% Debentures	1,00,00,000
	4,60,00,000

The equity shares of the company are sold for ₹ 300. It is expected that the company will pay next year a dividend of ₹ 15 per equity share, which is expected to grow by 5% p.a. forever. Assume a 35% corporate tax rate.

**Required:**

- (i) COMPUTE weighted average cost of capital (WACC) of the company based on the existing capital structure.
- (ii) COMPUTE the new WACC, if the company raises an additional ₹ 50 lakhs debt by issuing 10 years 12% debentures but the yield on debentures of similar maturity and risk class is 13%; flotation cost is 2%. Face value of the debenture is ₹100. This would result in increasing the expected equity dividend to ₹ 20 and leave the growth rate unchanged, but the price of equity share will fall to ₹ 250 per share.

**Capital Structure**

6. Company XYZ is unlevered and has a cost of equity of 20 percent and a total market value of ₹ 10,00,00,000. Company ABC is identical to XYZ in all respects except that it uses debt finance in its capital structure with a market value of ₹ 4,00,00,000 and a cost of 10 percent. FIND the market value of equity, weighted average cost of capital and cost of equity of ABC if the tax advantage of debt is 25 percent.
7. The following data relate to two companies belonging to the same risk class:

Particulars	A Ltd.	B Ltd.
Expected Net Operating Income	₹ 18,00,000	₹ 18,00,000
12% Debt	₹ 54,00,000	-
Equity Capitalization Rate	-	18

**Required:**

- (a) DETERMINE the total market value, Equity capitalization rate and weighted average cost of capital for each company assuming no taxes as per M.M. Approach.
- (b) DETERMINE the total market value, Equity capitalization rate and weighted average cost of capital for each company assuming 40% taxes as per M.M. Approach.

**Leverage**

8. Following data of PC Ltd. under Situations 1, 2 and 3 and Financial Plan A and B is given:

Installed Capacity (units)		3,600
Actual Production and Sales (units)		2,400
Selling price per unit (₹)		30
Variable cost per unit (₹)		20
Fixed Costs (₹):	Situation 1	3,000
	Situation 2	6,000
	Situation 3	9,000

**Capital Structure:**

Particulars	Financial Plan	
	A	B
Equity	₹ 15,000	₹ 22,500
Debt	₹ 15,000	₹ 7,500
Cost of Debt	12%	12%

**Required:**

- CALCULATE the operating leverage and financial leverage.
- FIND out the combinations of operating and financial leverage which give the highest value and the least value.

**Dividend Decision**

9. The following information is taken from Gamma Ltd.

Net Profit for the year	₹ 30,00,000
12% Preference share capital	₹ 1,00,00,000
Equity share capital (Share of ₹ 10 each)	₹ 60,00,000
Internal rate of return on investment	22%
Cost of Equity Capital	18%



Retention Ratio 75%

CALCULATE the market price of the share using:

- (1) Gordon's Model
- (2) Walter's Model

**Working Capital**

10. TMT Limited is commencing a new project for manufacture of electric toys. The following cost information has been ascertained for annual production of 60,000 units at full capacity:

		Amount per unit (₹)
Raw materials		20
Direct labour		15
Manufacturing overheads:		
	₹	
Variable	15	
Fixed	<u>10</u>	25
Selling and Distribution overheads:		
	₹	
Variable	3	
Fixed	<u>1</u>	<u>4</u>
Total cost		64
Profit		<u>16</u>
Selling price		<u>80</u>

In the first year of operations expected production and sales are 40,000 units and 35,000 units respectively. To assess the need of working capital, the following additional information is available:

- (i) Stock of Raw materials 3 months consumption.
- (ii) Credit allowable for debtors 1½ months.
- (iii) Credit allowable by creditors 4 months.

- (iv) Lag in payment of wages 1 month.
- (v) Lag in payment of overheads  $\frac{1}{2}$  month.
- (vi) Cash in hand and Bank is expected to be ₹ 60,000.
- (vii) Provision for contingencies is required @ 10% of working capital requirement including that provision.

You are required to PREPARE a projected statement of working capital requirement for the first year of operations. Debtors are taken at cost.

11. Banu Limited is considering relaxing its present credit policy and is in the process of evaluating two proposed policies. Currently, the firm has annual credit sales of ₹ 225 lakhs and accounts receivable turnover ratio of 5 times a year. The current level of loss due to bad debts is ₹ 7,50,000. The firm is required to give a return of 20% on the investment in new accounts receivables. Policy option II requires a manager to manage the receivables with salary of ₹ 50,000 per month. The company's variable costs are 60% of the selling price. Given the following information, which is a better option?

(Amount in lakhs)

	Present Policy	Policy Option I	Policy Option II
Annual credit sales (₹)	225	275	350
Accounts receivable turnover ratio	5	4	3
Bad debt losses (₹)	7.5	22.5	47.5

### Miscellaneous

12. (a) EXPLAIN the advantages and disadvantages of both profit maximization and wealth maximization goals
- (b) EXPLAIN in brief the features of various types of preference shares.



## SUGGESTED ANSWERS/HINTS

### Division A: Case Scenario

1. (i) (b) ₹ 34.887 Crores

Amount Initial Investment required:

**(A) Cost of Land & Construction Cost** = 250 + 100 = 350  
million i.e 35,00,00,000

**(B) Furniture Cost**

Normal Rooms = 40 x 1,50,000 = 60,00,000

Suite rooms = 8 x 3,80,000 = 30,40,000

Conference and wedding halls = 2 x 7,00,000

= 14,00,000

Restaurant = 10,00,000

**(C) Elevators** = 4 x 35,00,000 = 1,40,00,000

**(D) Electronic Appliances** = 3,50,00,000

**Gross Investment Required** = ₹ 41,04,40,000

**Less:** 15% Govt Subsidy on Capex = ₹ (6,15,66,000)

**Net Initial Investment to be incurred by Hotel**  
**= ₹ 34,88,74,000**

(ii) (a) ₹ 7.0532 Cr

PV of Cash Inflow = ₹ 42.2317 Cr

**As per WN - 2**

(-) PV of Cash Outflow = ₹ 35.1785 Cr

**As per WN - 1**

NPV = 7.0532 CR

**Note:** Discounting Rate would be the hurdle rate and not cost of equity as hurdle rate means the overall cost of capital

**WN 1 - Calculation of PV of Cash Outflows**

		(₹)	DF @ 15%	PV (₹)
<b>Year 1</b>	Initial Net Investment	4,88,74,000	1.0000	34,88,74,000
<b>At the end of 10th Year</b>				
<b>Year 10</b>	Purchase of new furniture (At 15% higher price)			
	Normal Rooms	69,00,000	0.2472	17,05,680
	Suite Rooms	34,96,000	0.2472	8,64,211
<b>At the end of 12th Year</b>				
<b>Year 12</b>	Renovation at restaurant, conference and wedding halls (Net)	18,25,000	0.1869	3,41,093
				<b>35,17,84,983</b>

**WN – 2: Calculation of PV of Cash Inflows**

	Year 1 to 5 (₹)	Year 6 to 10 (₹)	Year 11 to 15 (₹)
<b>Sales</b>			<b>(Apply growth rate here)</b>
Normal Rooms	3,84,00,000	3,84,00,000	4,30,08,000
Suites	2,40,00,000	2,40,00,000	2,61,60,000
Conf & Hall	2,40,00,000	2,40,00,000	2,61,60,000
Restaurant	97,20,000	97,20,000	1,04,97,600
<b>Total Sales (A)</b>	<b>9,61,20,000</b>	<b>9,61,20,000</b>	<b>10,58,25,600</b>
<b>Less:</b>			
Annual Recurring Exp (Excl Depreciation)	1,80,00,000	1,80,00,000	1,98,00,000

Training Exp	5,00,000	5,00,000	5,00,000
<b>Depreciation</b>			
Building	50,00,000	50,00,000	50,00,000
Elevators	7,00,000	7,00,000	7,00,000
Electronic App	19,83,333	19,83,333	19,83,333
Furniture (Old)	8,58,800	8,58,800	
Furniture (New)			10,39,600
<b>TOTAL EXP (B)</b>	<b>2,70,42,133</b>	<b>2,70,42,133</b>	<b>2,90,22,933</b>
NPBT (A - B)	6,90,77,867	6,90,77,867	7,68,02,667
(-) Tax	Nil (Tax Holiday)	1,72,69,466	1,92,00,666
NPAT	6,90,77,867	5,18,08,400	5,76,02,000
(+) Depreciation	85,42,133	85,42,133	87,22,933
(+) Cash Inflows from Operation	7,76,20,000	6,03,50,533	6,63,24,933
PVAF@ 15%	3.3522	1.6666	0.8285
PV of Cash Inflows from Operations	26,01,97,764	10,05,80,199	5,49,50,207

**(+) PV of Other Cash Inflows**

In year 5 - Govt Subsidy on first 3 years of =  $55,50,000 \times 0.4972$   
= ₹ 27,59,460

**Annual Revenue Exp**

In year 10 - Salvage Value of Old Furniture =  $4,52,000 \times 0.2472$   
= ₹ 1,11,734

In year 15 - Salvage of building and electronic appliance =  $3,02,50,000 \times 0.1229$   
= ₹ 37,17,725

Therefore, **Total PV of Cash Inflows** = ₹ 42,23,17,089

(iii) (d) 4.46 years

Total Net Initial Investment Incurred = ₹ 34,88,74,000

**Cumulative of Total Cash Inflows (not discounted cash inflows)**

Year	Total Cash Inflows (₹)	Cumulative of Cash Inflows (₹)
1.	7,76,20,000	7,76,20,000
2.	7,76,20,000	15,52,40,000
3.	7,76,20,000	23,28,60,000
4.	7,76,20,000	31,04,80,000
5.	8,31,70,000 (Govt Subsidy of 55,50,000 added here)	39,36,50,000
6.	6,03,50,533	45,40,00,533

From the above table, it can be seen that the initial net investment incurred is getting recovered after 4<sup>th</sup> year but before the end of 5<sup>th</sup> year i.e. somewhere between 4<sup>th</sup> & 5<sup>th</sup> Year.

$$\text{Payback period} = 4 + \frac{3,83,94,000}{8,31,70,000}$$

$$= 4 + 0.46 = 4.46 \text{ years}$$

(iv) (a) ₹ 7.0928 Cr p.a.

**Accounting profit = NPAT + Govt Subsidy on Revenue Expense**

$$= 6,90,77,867 + (1,85,00,000 \times 10\%)$$

$$= 6,90,77,867 + 18,50,000$$

$$= 7,09,27,867 \text{ per annum}$$

(v) (b) 19.39%

DF @ 15%

$$\text{NPV} = ₹ 7.0532 \text{ Cr}$$

DF @ 20%

$$\text{NPV} = 34,10,68,926.17 - 35,07,57,719.00$$

$$= (₹ 0.9688 \text{ Cr})$$

$$\begin{aligned} \text{IRR} &= \text{Lower Rate \%} + \\ &\quad \left\{ \frac{\text{NPV @ Lower rate \%} \times (\text{Higher Rate \%} - \text{Lower Rate \%})}{\text{NPV @ Lower rate \%} - \text{NPV @ Higher Rate \%}} \right\} \\ \text{IRR} &= 15 + (7.0532 * 5 / 8.0220) \\ &= 15 + 4.396 \\ &= 19.396\% \end{aligned}$$

**2. (d) 13.75**

$$\begin{aligned} \text{Creditors Turnover Ratio} &= \text{Purchases} / \text{Average Accounts Payable} \\ \text{Cost of Goods Sold} &= \text{Opening Stock} + \text{Purchases} - \text{Closing Stock} \end{aligned}$$

$$\text{Purchases} = \text{Cost of Goods Sold} + \text{Closing Stock} - \text{Opening Stock}$$

$$\text{Purchases} = ₹ 9,75,000 + ₹ 3,75,000 - ₹ 2,50,000$$

$$\text{Purchases} = ₹ 11,00,000$$

$$\text{Average Accounts Payable} = ₹ 80,000$$

$$\text{Creditors Turnover Ratio} = \text{Purchases} / \text{Average Accounts Payable}$$

$$\text{Creditors Turnover Ratio} = ₹ 11,00,000 / ₹ 80,000$$

$$\text{Creditors Turnover Ratio} = 13.75$$

Therefore, the Creditors Turnover Ratio is 13.75.

**3. (c)** ROI is greater than interest on loan funds and hence it has favourable financial leverage.

$$\text{EBIT} = 75,00,000 - 42,00,000 - 6,00,000 = 27,00,000,$$

$$\text{ROI} = 27,00,000 / (45,00,000 + 55,00,000) = 27\%,$$

Rate of Interest lower than Return on investment.

Therefore, there is favourable leverage.

**Division B: Descriptive Questions****4. Working Notes:**

$$(1) \text{ Total liability} = \text{Total Assets} = ₹ 50,00,000$$

- Debt to Total Asset Ratio = 0.40
- $$\frac{\text{Debt}}{\text{Total Assets}} = 0.40$$
- $$\frac{\text{Debt}}{50,00,000} = 0.40$$
- So, Debt = 20,00,000**
- (2) Total Liabilities = ₹ 50,00,000
- Equity share Capital + Reserves + Debt = ₹ 50,00,000
- So, Reserves = ₹ 50,00,000 - ₹ 20,00,000 - ₹ 20,00,000
- So, Reserves & Surplus = ₹ 10,00,000**
- (3)  $\frac{\text{Long term Debt}}{\text{Equity Shareholders' Fund}} = 30\%$
- $$\frac{\text{Long term Debt}}{(20,00,000 + 10,00,000)} = 30\%$$
- Long Term Debt = ₹ 9,00,000**
- (4) So, Accounts Payable = ₹ 20,00,000 - ₹ 9,00,000
- Accounts Payable = ₹ 11,00,000**
- (5) Gross Profit to sales = 20%
- Cost of Goods Sold = 80% of Sales = ₹ 64,00,000
- Sales =  $\frac{100}{80} \times 64,00,000 = 80,00,000$**
- (6) Inventory Turnover =  $\frac{360}{60}$
- $$\frac{\text{COGS}}{\text{Closing inventory}} = \frac{360}{60}$$
- $$\frac{64,00,000}{\text{Closing inventory}} = \frac{360}{60}$$
- Closing inventory = 10,66,667**
- (7) Accounts Receivable period = 36 days



- $$\frac{\text{Accounts Receivable}}{\text{Credit sales}} \times 360 = 36$$
- $$\text{Accounts Receivable} = \frac{36}{360} \times \text{credit sales}$$
- $$= \frac{36}{360} \times 80,00,000 \text{ (assumed all sales are on credit)}$$
- Accounts Receivable = ₹ 8,00,000**
- (8) Quick Ratio = 0.9
- $$\frac{\text{Quick Assets}}{\text{Current liabilities}} = 0.9$$
- $$\frac{\text{Cash + Debtors}}{11,00,000} = 0.9$$
- $$\text{Cash + 8,00,000} = ₹ 9,90,000$$
- Cash = ₹ 1,90,000**
- (9) Fixed Assets = Total Assets - Current Assets = 50,00,000 – (10,66,667 + 8,00,000 + 1,90,000)
- (10) = **29,43,333**

**Balance Sheet of LP enterprises as on 31<sup>st</sup> March 2024**

Liabilities	(₹)	Assets	(₹)
Share Capital	20,00,000	Fixed Assets	29,43,333
Reserved surplus	10,00,000	Current Assets:	
Long Term Debt	9,00,000	Inventory	10,66,667
Accounts Payable	11,00,000	Accounts Receivables	8,00,000
		Cash	1,90,000
Total	50,00,000	Total	50,00,000

(\*Note: Equity shareholders' fund represent equity in 'Long term debts to equity ratio'. The question can be solved assuming only share capital as 'equity')

5. (i) **Computation of Weighted Average Cost of Capital based on existing capital structure**

Source of Capital	Existing Capital structure (₹)	Weights (a)	After tax cost of capital (%) (b)	WACC (%) (a) × (b)
Equity share capital (W.N.1)	3,00,00,000	0.652	10.00	6.52
11.5% Preference share capital	60,00,000	0.130	11.50	1.50
10% Debentures (W.N.2)	1,00,00,000	0.218	6.50	1.42
Total	4,60,00,000	1.000		9.44

**Working Notes:**

1. Cost of Equity Capital:

$$\begin{aligned}
 K_e &= \frac{\text{Expected dividend}(D_1)}{\text{Current Market Price}(P_0)} + \text{Growth}(g) \\
 &= \frac{₹ 15}{₹ 300} + 0.05 \\
 &= 10\%
 \end{aligned}$$

2. Cost of 10% Debentures

$$\begin{aligned}
 K_d &= \frac{\text{Interest}(1-t)}{\text{Net proceeds}} \\
 &= \frac{₹ 10,00,000(1-0.35)}{₹ 1,00,00,000} \\
 &= 0.065 \text{ or } 6.5\%
 \end{aligned}$$

(ii) Computation of Weighted Average Cost of Capital based on new capital structure

Source of Capital	New Capital structure (₹)	Weights (a)	After tax cost of capital (%) (b)	WACC (%) (a) x (b)
Equity share capital (W.N.3)	3,00,00,000	0.588	13.00	7.64
11.5% Preference share capital	60,00,000	0.118	11.50	1.36
10% Debentures (W.N.2)	1,00,00,000	0.196	6.50	1.27
12% Debentures (W.N.4)	50,00,000	0.098	9.21	0.90
Total	5,10,00,000	1.000		11.17

**Working Notes:**

3. Cost of Equity Capital:

$$K_e = \frac{₹ 20}{₹ 250} + 0.05$$

$$= 13\%$$

4. Cost of 12% Debentures

$$K_d = \frac{I(1-t) + \left(\frac{RV - NP}{n}\right)}{\frac{RV + NP}{2}}$$

$$= \frac{₹ 12(1-0.35) + \left(\frac{₹ 100 - ₹ 90.31^*}{10 \text{ years}}\right)}{\frac{₹ 100 + ₹ 90.31^*}{2}}$$

$$= \frac{₹ 8.769}{₹ 95.155} = 0.0921$$

\*Since yield on similar type of debentures is 13 per cent, the company would be required to offer debentures at discount.

Market price of debentures (approximation method)

$$= ₹ 12 \div 0.13 = ₹ 92.31$$

Sale proceeds from debentures = ₹ 92.31 – ₹ 2 (i.e., floatation cost) = ₹ 90.31

### 6. Computation of Market Value of Equity of Company ABC

Total market value of Company ABC

$$V_{ABC} = V_{XYZ} + Bt \dots \dots \dots (i)$$

Where,

$V_{ABC}$  = Market value of leveraged company.

$V_{XYZ}$  = Market value of unleveraged company.

B = Market value of debt.

t = Tax rate.

Now, given

$$V_{xyz} = ₹ 10,00,00,000$$

$$B = ₹ 4,00,00,000$$

$$t = 25\%$$

By substituting values in equation (i) above, we have

$$\begin{aligned} V_{ABC} &= ₹ 10,00,00,000 + ₹ 4,00,00,000 \times 0.25\% \\ &= ₹ 11,00,00,000 \end{aligned}$$

The Market Value of Equity (s) of Company ABC,

$$= ₹ 11,00,00,000 - ₹ 4,00,00,000$$

$$= ₹ 7,00,00,000$$

### Weighted Average Cost of Capital of Company ABC

$$WACC_{ABC} = WACC_{XYZ} [1 - Bt/V_{ABC}]$$

$$= 20\% \left[ 1 - \frac{4,00,00,000}{11,00,00,000} \times 0.25 \right]$$

$$= 18.18\%$$

Where,

$WACC_{ABC}$  is the weighted average cost of capital of the levered company ABC

$WACC_{XYZ}$  is the weighted average cost of capital of the unlevered company XYZ.

### Cost of Equity of company ABC

$$R_{Eabc} = R_{Exyz} + [(1 - t)B/E(R_{Exyz} - R_B)]$$

$$20\% + [(1 - .25)4,00,00,000/7,00,00,000(.20 - .10)]$$

$$24.28\% \text{ approx.}$$

Where,

$R_{EABC}$  is the cost of equity in the levered Company ABC.

$R_{Exyz}$  is the cost of equity in the unlevered Company XYZ.

E is the market value of equity.

B is the market value of debt.

$R_B$  is the cost of debt

### 7. (a) Assuming no tax as per MM Approach.

Calculation of Value of Firms 'A Ltd.' and 'B Ltd' according to MM Hypothesis

Market Value of 'B Ltd' [Unlevered(u)]

$$\text{Total Value of Unlevered Firm } (V_u) = [ \text{NOI}/k_e ] = 18,00,000/.18$$

$$= ₹ 1,00,00,000$$

$K_e$  of Unlevered Firm (given) = 0.18

$K_o$  of Unlevered Firm (Same as above =  $k_e$  as there is no debt)  
= 0.18

Market Value of 'A Ltd' [Levered Firm (l)]

$$\begin{aligned} \text{Total Value of Levered Firm } (V_L) &= V_u + (\text{Debt} \times \text{Nil}) = ₹ 1,00,00,000 \\ &+ (54,00,000 \times \text{nil}) \\ &= ₹ 1,00,00,000 \end{aligned}$$

**Computation of Equity Capitalization Rate and Weighted Average Cost of Capital (WACC)**

	Particulars	A Ltd.	B Ltd.
A	Net Operating Income (NOI)	18,00,000	18,00,000
B	Less: Interest on Debt (I)	6,48,000	-
C	Earnings of Equity Shareholders (NI)	11,52,000	18,00,000
D	Overall Capitalization Rate ( $k_o$ )	0.18	0.18
E	Total Value of Firm ( $V = \text{NOI}/k_o$ )	1,00,00,000	1,00,00,000
F	Less: Market Value of Debt	54,00,000	-
G	Market Value of Equity (S)	46,00,000	1,00,00,000
H	Equity Capitalization Rate [ $k_e = \text{NI} / S$ ]	0.2504	0.18
I	Weighted Average Cost of Capital [WACC] ( $k_o$ )	0.18	0.18

**Assuming 40% taxes as per MM Approach**

**Calculation of Value of Firms 'A Ltd.' and 'B Ltd' according to MM Hypothesis Approach**

Market Value of 'B Ltd' [Unlevered(u)]

$$\text{Total Value of unlevered Firm } (V_u) = [\text{NOI}(1 - t)/k_e] = 18,00,000 (1 - 0.40) / 0.18$$

$$= ₹ 60,00,000$$

$$K_e \text{ of unlevered Firm (given)} = 0.18$$

$$K_o \text{ of unlevered Firm (Same as above} = k_e \text{ as there is no debt)} = 0.18$$

Market Value of 'A Ltd' [Levered Firm (l)]

$$\begin{aligned} \text{Total Value of Levered Firm (V}_L) &= V_u + (\text{Debt} \times \text{Tax}) \\ &= ₹ 60,00,000 + (54,00,000 \times 0.40) \\ &= ₹ 81,60,000 \end{aligned}$$

**Computation of Weighted Average Cost of Capital (WACC) of 'B Ltd.'**

$$= 18\% \text{ (i.e. } K_e = K_o)$$

**Computation of Equity Capitalization Rate and Weighted Average Cost of Capital (WACC) of A Ltd**

Particulars	A Ltd.
Net Operating Income (NOI)	18,00,000
Less: Interest on Debt (I)	6,48,000
Earnings Before Tax (EBT)	11,52,000
Less: Tax @ 40%	4,60,800
Earnings for equity shareholders (NI)	6,91,200
Total Value of Firm (V) as calculated above	81,60,000
Less: Market Value of Debt	54,00,000
Market Value of Equity (S)	27,60,000
Equity Capitalization Rate [ $k_e = NI/S$ ]	.2504
Weighted Average Cost of Capital ( $k_o$ )*	13.23

\*Computation of WACC A Ltd

Component of Capital	Amount	Weight	Cost of Capital	WACC
Equity	27,60,000	0.338	0.2504	0.0846
Debt	54,00,000	0.662	0.072*	0.0477
Total	81,60,000			0.1323

$$*K_d = 12\% (1 - 0.4) = 12\% \times 0.6 = 7.2\%$$

$$\text{WACC} = 13.23\%$$

## 8. (i) Operating Leverage

	Situation 1	Situation 2	Situation 3
	(₹)	(₹)	(₹)
Sales (S)			
2,400 units @ ₹ 30 per unit	72,000	72,000	72,000
Less: Variable Cost (VC) @ ₹ 20 per unit	48,000	48,000	48,000
Contribution (C)	24,000	24,000	24,000
Less: Fixed Cost (FC)	3,000	6,000	9,000
EBIT	21,000	18,000	15,000
Operating Leverage $= \frac{C}{EBIT}$	$\frac{₹ 24,000}{₹ 21,000}$ = 1.14	$\frac{₹ 24,000}{₹ 18,000}$ = 1.33	$\frac{₹ 24,000}{₹ 15,000}$ = 1.60

## Financial Leverage

	Financial Plan	
	A (₹)	B (₹)
<b>Situation 1</b>		
EBIT	21,000	21,000
Less: Interest on debt (₹ 15,000 x 12%); (₹ 7,500 x 12%)	1,800	900
EBT	19,200	20,100
Financial Leverage = $\frac{EBIT}{EBT}$	$\frac{₹ 21,000}{₹ 19,200} = 1.09$	$\frac{₹ 21,000}{₹ 20,100} = 1.04$
<b>Situation 2</b>		
EBIT	18,000	18,000
Less: Interest on debt	1,800	900
EBT	16,200	17,100
Financial Leverage = $\frac{EBIT}{EBT}$	$\frac{₹ 18,000}{₹ 16,200} = 1.11$	$\frac{₹ 18,000}{₹ 17,100} = 1.05$



<b>Situation 3</b>		
EBIT	15,000	15,000
Less: Interest on debt	1,800	900
EBT	13,200	14,100
Financial Leverage = $\frac{EBIT}{EBT}$	$\frac{₹ 15,000}{₹ 13,200} = 1.14$	$\frac{₹ 15,000}{₹ 14,100} = 1.06$

**(ii) Combined Leverages**

$$CL = OL \times FL$$

		<b>Financial Plan</b>	
		<b>A (₹)</b>	<b>B (₹)</b>
(a)	Situation 1	$1.14 \times 1.09 = 1.24$	$1.14 \times 1.04 = 1.19$
(b)	Situation 2	$1.33 \times 1.11 = 1.48$	$1.33 \times 1.05 = 1.40$
(c)	Situation 3	$1.60 \times 1.14 = 1.82$	$1.60 \times 1.06 = 1.70$

The above calculations suggest that the highest value is in Situation 3 financed by Financial Plan A and the lowest value is in the Situation 1 financed by Financial Plan B.

**9. Market price per share by-**

**(1) Gordon's Model:**

$$\text{Present market price per share } (P_0)^* = \frac{D_0(1+g)}{K_e - g}$$

**OR**

$$\text{Present market price per share } (P_0) = \frac{D_1}{K_e - g}$$

Where,

$P_0$  = Present market price per share.

$g$  = Growth rate (br) =  $0.75 \times 0.22 = 0.165$

$b$  = Retention ratio (i.e., % of earnings retained)

$r$  = Internal rate of return (IRR)

E = Earnings per share

$$P_o = \frac{0.75(1+0.165)}{0.18-0.165} = \frac{0.874}{0.015} = ₹ 58.27 \text{ approx.}$$

**(2) Walter's Model:**

$$P = \frac{D + \frac{r}{K_e}(E-D)}{K_e}$$

$$= \frac{0.75 + \frac{0.22}{0.18}(3-0.75)}{0.18} = ₹ 19.44$$

**Workings:**

**1. Calculation of Earnings per share**

Particulars	Amount (₹)
Net Profit for the year	30,00,000
Less: Preference dividend (12% of ₹ 1,00,00,000)	(12,00,000)
Earnings for equity shareholders	18,00,000
No. of equity shares (₹ 60,00,000/₹ 10)	6,00,000
Therefore, Earnings per share ( $\frac{\text{Earning for equity shareholders}}{\text{No. of equity shares}}$ )	₹ 18,00,000/6,00,000 = ₹ 3.00

**2. Calculation of Dividend per share (D<sub>0</sub>)**

Particulars	
Earnings per share	₹ 3
Retention Ratio (b)	75%
Dividend pay-out ratio (1-b)	25%
Dividend per share (Earnings per share x Dividend pay-out ratio)	₹ 3 x 0.25 = ₹ 0.75

10. Statement Showing Cost and Sales for the First Year

Annual Production Capacity	60,000 units
Production	40,000 units
Sales	35,000 units

Particulars	₹
Sales Revenue (₹ 80 × 35,000)	28,00,000
Cost of Production:	
Materials @ ₹ 20 per unit	8,00,000
Direct Labour @ ₹ 15 per unit	6,00,000
Manufacturing Overheads	
Variable @ ₹ 15 per unit	6,00,000
Fixed (based on production capacity 60,000 units × ₹ 10)	<u>6,00,000</u>
Cost of Production	26,00,000
Less: Closing Stock (40,000 – 35,000 = 5,000 units)	
$\left( ₹ \frac{26,00,000}{40,000} \times 5,000 \text{ units} \right)$	<u>3,25,000</u>
Cost of Goods Sold	22,75,000
Add: Selling & Distribution Overheads	
Variable @ ₹ 3 × 35,000 units = 1,05,000	
Fixed (Re. 1 × 60,000 units) = 60,000	<u>1,65,000</u>
Cost of Sales	<u>24,40,000</u>
<b>Profit</b>	<u>3,60,000</u>

Statement Showing Working Capital Requirement

A.	Current Assets	₹
	Stock of Raw Materials (₹ 8,00,000 × 3/12)	2,00,000
	Stock of Finished Goods	3,25,000
	Debtors at Cost (₹ 24,40,000 × 3/24)	3,05,000

	Cash and Bank	<u>60,000</u>
	<b>Total (A)</b>	<u>8,90,000</u>
<b>B.</b>	<b>Current Liabilities</b>	
	Creditors for Materials (₹ 10,00,000 × 4/12)	3,33,333
	Creditors for Expenses (₹ 13,65,000 × 1/24)	56,875
	Outstanding Wages (₹ 6,00,000 × 1/12)	<u>50,000</u>
	<b>Total (B)</b>	<u>4,40,208</u>
	Working Capital Requirement before Contingencies <b>(A – B)</b>	4,49,792
	Add: Provision for Contingencies (₹ 4,49,792 × 1/9)	<u>49,977</u>
	Estimated Working Capital Requirement	<u>4,99,769</u>

**Workings Notes:**

Purchase of Raw Material during the first year	₹
Raw Material consumed during the year	8,00,000
Add: Closing Stock of Raw Materials (3 months consumption)	<u>2,00,000</u>
	10,00,000
Less: Opening Stock of Raw Material	<u>Nil</u>
Purchases during the year	<u>10,00,000</u>

**11. Statement showing Evaluation of Credit Policies (Amount in lakhs)**

	Particulars	Present Policy (₹)	Proposed Policy I (₹)	Proposed Policy II (₹)
A	Expected Profit:			
	(a) Credit Sales	225.00	275.00	350.00
	(b) Total Cost other than Bad Debts:			
	Variable Costs other than manager salary	135.00	165.00	210.00

	(c) Salary of Manager	-	-	6
	(d) Bad Debts	7.50	22.50	47.50
	(e) Expected Profit [(a)-(b)-(c)-(d)]	82.50	87.50	86.50
B	Opportunity Cost of Investment in Receivables*	5.40	8.25	14.40
C	Net Benefits [A-B]	77.10	79.25	72.10

**Recommendation:** The Proposed Policy I should be adopted since the net benefits under this policy is higher than those under other policies.

**Working Note:**

**\*Calculation of Opportunity Cost of Average Investments**

$$\text{Opportunity Cost} = \text{Total Cost} \times \frac{\text{Collection Period}}{12} \times \frac{\text{Rate of Return}}{100}$$

$$\text{Present Policy} = ₹ 135 \text{ lakhs} \times 2.4/12 \times 20\% = ₹ 5.40 \text{ lakhs}$$

$$\text{Proposed Policy I} = ₹ 165 \text{ lakhs} \times 3/12 \times 20\% = ₹ 8.25 \text{ lakhs}$$

$$\text{Proposed Policy II} = ₹ 216 \text{ lakhs} \times 4/12 \times 20\% = ₹ 14.40 \text{ lakhs}$$

12. (a) The table below highlights some of the advantages and disadvantages of both profit maximization and wealth maximization goals:

Goal	Objective	Advantages	Disadvantages
Profit Maximization	Large amount of profits	(i) Easy to calculate profits (ii) Easy to determine the link between financial decisions and profits.	(i) Emphasizes the short term gains (ii) Ignores risk or uncertainty (iii) Ignores the timing of returns (iv) Requires immediate resources.

Shareholders Wealth Maximisation	Highest market value of shares.	<ul style="list-style-type: none"> <li>(i) Emphasizes the long term gains</li> <li>(ii) Recognises risk or uncertainty</li> <li>(iii) Recognises the timing of returns</li> <li>(iv) Considers shareholders' return.</li> </ul>	<ul style="list-style-type: none"> <li>(i) Offers no clear relationship between financial decisions and share price.</li> <li>(ii) Can lead to management anxiety and frustration.</li> </ul>
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**(b) Various types of Preference shares can be as below:**

Sl. No.	Type of Preference Shares	Salient Features
1.	Cumulative	Arrear Dividend will accumulate.
2.	Non-cumulative	No right to arrear dividend.
3.	Redeemable	Redemption should be done.
4.	Participating	Can participate in the surplus which remains after payment to equity shareholders.
5.	Non-Participating	Cannot participate in the surplus after payment of fixed rate of dividend.
6.	Convertible	Option of converting into equity shares.

## 6B: STRATEGIC MANAGEMENT



### QUESTIONS

#### Multiple Choice Questions

1. Once upon a time in the land of sun, sand, and vibrant cultures, there existed a company named "MuseoGoa" - a company that managed museums in the beautiful state of Goa. MuseoGoa had a vision to celebrate the rich history and culture of Goa, but their journey was not without its fair share of challenges.

MuseoGoa had chosen a picturesque location in a quaint village to build their first museum. However, this initial enthusiasm was met with an uproar from the local communities. The villagers were concerned about the impact on their way of life and traditions. They worried that the influx of tourists might disrupt their peaceful existence.

To address this challenge, MuseoGoa applied Mendelow's matrix, identifying the local communities as key stakeholders. They decided to engage in open dialogues, understanding and respecting the villagers' concerns. MuseoGoa initiated community-building activities, such as involving locals in museum operations, supporting local artisans, and organizing cultural events that showcased the village's heritage. Slowly but steadily, the company transformed from being perceived as a threat to a valued partner within the community.

While MuseoGoa had successfully resolved their initial issues with the local community, they faced another challenge. Their location, although idyllic, was a bit off the beaten path. Tourists typically preferred the bustling beaches closer to the city, and this posed a real challenge. MuseoGoa decided to employ a pricing strategy. They priced their tickets affordably, significantly cheaper than the city's attractions. This strategy attracted budget-conscious tourists who were looking for unique experiences in Goa without burning a hole in their pockets. As

word spread about the cultural gem tucked away in the village, visitors started flocking in, drawn not just by the museum's charm but also the economical ticket prices.

In the age of social media, MuseoGoa knew that word-of-mouth was no longer limited to whispers. They tapped into the power of social media to promote their unique museum experience. MuseoGoa ran interactive campaigns, encouraging visitors to share their experiences on various platforms. One particular Instagram post featuring a vibrant Goan mural in the museum went viral. This was the turning point. The picture-perfect aesthetics of the museum attracted influencers, bloggers, and travel enthusiasts, making MuseoGoa a social media sensation. Visitors came pouring in, not just from India but from across the globe, eager to capture their own moments at the "Instagrammable Museum of Goa."

With success came ambition. MuseoGoa decided to expand its footprint beyond Goa. To guide this expansion, they conducted a strategy audit and trend analysis. They identified emerging cultural and tourism trends and found potential markets in Pune and Trivandrum.

In Pune, MuseoGoa curated a special exhibition that celebrated the fusion of Goan and Maharashtrian cultures. They strategically partnered with local influencers and travel agencies to market the new experience. The expansion into Pune was met with resounding success.

For Trivandrum, MuseoGoa recognized the importance of local traditions and the distinct flavor of Kerala. They tailored their offerings to harmonize with the regional culture. MuseoGoa became the gateway for tourists to explore Kerala's rich heritage, with the museum acting as a bridge between Goa and Kerala's cultural tapestry.

MuseoGoa's journey from initial uproar to expansion was a testament to their commitment to community building, strategic pricing, social media savvy, and a keen eye for trends. The company continued to flourish, celebrating the diverse cultural tapestry of India and making history come alive in every location they touched.



**Based on the above Case Scenario, answer the Multiple Choice Questions.**

- (i) Which strategic management concept did MuseoGoa use to address the initial concerns of the local community?
  - (a) SWOT analysis
  - (b) Mendelow's matrix
  - (c) Cost leadership strategy
  - (d) Porter's Five Forces model
  
- (ii) MuseoGoa's idyllic location in a quaint village posed a challenge as tourists preferred beaches closer to the city. To attract visitors, MuseoGoa priced their tickets affordably, cheaper than city attractions, drawing budget-conscious tourists looking for unique experiences. What business strategy did MuseoGoa employ to attract more tourists?
  - (a) Cost leadership strategy
  - (b) Differentiation strategy
  - (c) Focus strategy
  - (d) Diversification strategy
  
- (iii) How did MuseoGoa approach its expansion into new markets such as Pune and Trivandrum?
  - (a) Outsourcing strategy
  - (b) Franchising strategy
  - (c) Product diversification strategy
  - (d) Market development strategy
  
- (iv) Which element of the 7S McKinsey model is demonstrated by MuseoGoa's strategic use of social media and pricing strategies to attract visitors?
  - (a) Style
  - (b) Strategy

- (c) Shared Values
  - (d) Skills
- (v) What played a crucial role in MuseoGoa's success in Pune and Trivandrum?
- (a) Strategic partnerships
  - (b) Aggressive advertising
  - (c) Product differentiation
  - (d) Vertical integration
2. Jaago Lights, a successful brand from Jalandhar, aimed to enter the Middle East market by teaming up with major industry players. They needed to reorganize internal operations and refine product designs, facing pressure to expand quickly and turbulence in existing operations. What is the primary limitation of strategic management highlighted in the business case?
- (a) Lack of senior management support
  - (b) Time-consuming and complex nature
  - (c) Inability to adapt to market changes
  - (d) Excessive focus on short-term goals
3. A traditional desi ghee company modernized its production and introduced pro-biotic desi ghee, facing initial market doubts. Aggressive marketing campaigns highlighted its benefits, gaining acceptance. During which stage of the product life cycle did the desi ghee company face doubts but gained acceptance through aggressive marketing campaigns?
- (a) Introduction stage
  - (b) Growth stage
  - (c) Maturity stage
  - (d) Decline stage
4. A small tech company focused on enhancing their main product, which became crucial across various industries due to its increased power and

adaptability. Their early partnerships and smart decisions facilitated rapid growth, leading to a \$5 billion valuation in just five years. According to C.K. Prahalad and Gary Hamel, which area represents the tech company's core competency?

- (a) Customer Value
  - (b) Competitor Differentiation
  - (c) Product Differentiation
  - (d) Application to Other Markets
5. A women's clothing brand recognized new opportunities and researched emerging trends and consumer preferences. They introduced a new clothing line, received positive feedback from initial trials, and grew through strategic partnerships and targeted advertising. What strategic choice best describes this approach?
- (a) Product Development
  - (b) Market Development
  - (c) Market Penetration
  - (d) Diversification
6. For over a hundred years, the KDH business has thrived by leveraging strategic control as a cornerstone of its strategic approach. Regular evaluations of goals and performance ensured they stayed responsive to shifting market trends and evolving customer needs. Which type of strategic control is highlighted here?
- (a) Premise Control
  - (b) Special Alert Control
  - (c) Implementation Control - Milestone Reviews
  - (d) Implementation Control - Monitoring Strategic Thrusts

**Descriptive Questions****Chapter 1-Introduction to Strategic Management**

7. Tech Innovators Inc., a rapidly expanding technology company, aims to lead in artificial intelligence (AI) and machine learning (ML). With recent growth, the company is evaluating which organizational structure will best support its vision for innovation and leadership in AI technologies. They are considering three options: the Functional and Divisional Relationship for specialization, the Horizontal Relationship for flat, collaborative management, and the Matrix Relationship for cross-functional teams. Which of these relationships—Functional and Divisional, Horizontal, or Matrix—will most effectively achieve Tech Innovators Inc.'s strategic goals, and why?
8. Strategic management helps an organization to work through changes in the environment to gain competitive advantage. In light of statement discuss its benefits.

**Chapter 2-Strategic Analysis: External Environment**

9. A company has recently launched a new product in the market. Initially, it faced slow sales growth, limited markets, and high prices. However, over time, the demand for the product expanded rapidly, prices fell, and competition increased. Identify the stages of the product life cycle (PLC) that the company went through.
10. Rajiv Arya owns an electrical appliance company specializing in the manufacture of domestic vacuum cleaners. The market is competitive, with four other manufacturers offering similar products and achieving comparable sales volumes. Additionally, these rival firms hold several patents related to the vacuum cleaner technology. The supplier base for raw materials is extensive, with multiple suppliers available. Identify and explain the significant forces from Porter's Five Forces framework that are relevant to Rajiv Arya's company.

**Chapter 3-Strategic Analysis: Internal Environment**

11. In spite of high commodity inflation, shortage of components and the threat of third wave of COVID-19 pandemic in India, manufacturers of packaged goods, home appliances and consumer electronics are

expecting the business to grow by 12 to 25 percent in the coming months. After one-and-a-half years of disruption, manufacturers are now confident about managing their inventories better, keeping their supply channels well-stocked and preparing themselves to minimize the impact of any COVID related restrictions even as they gear up for the festive season, which usually accounts for 25 to 35 percent of their yearly sales.

The home appliances sector could be an example. After a dismal April-June quarter in the year 2021, producers of air conditioners, refrigerators and washing machines are expecting their business to grow by 15-20 percent in the months to come. All the companies operating in the sector have geared up to grab the opportunities available in the market.

A leading company in the home appliances domain, XXP India, is planning to launch various innovative product designs and offer loyalty programmes to lure consumers.

With reference to Michael Porter's generic strategies, identify which strategy XXP India has planned for? Explain how this strategy will be advantageous to the company to remain profitable?

12. How can Mendelow's Matrix be used to analyze and manage the stakeholders effectively?

#### Chapter 4-Strategic Choices

13. Pizza Galleria was India's first pizza delivery chain enjoying monopoly for several years. However, after the entry of Modino and Uncle Jack it is struggling to compete. Both Modino and Uncle Jack have opened several eateries and priced the product aggressively. In the last four years the chain has suffered significant losses. The chain wishes to know whether they should go for a turnaround strategy. List out components of action plan for turnaround strategy.
14. Distinguish between Concentric Diversification and Conglomerate Diversification. "

**Chapter 5-Strategy Implementation and Evaluation**

15. A Mumbai-based conglomerate, PQR Ltd., has announced a major restructuring of its business operations. The company has decided to split its business into four separate units: Manufacturing, Retail, Services, and Technology. Each unit will operate as a separate business, with delegated responsibility for day-to-day operations and strategy to the respective unit managers. Identify the organization structure that PQR Ltd. has planned to implement. Discuss any four attributes and the benefits the firm may derive by using this organization structure.
16. Why Strategic Performance Measures are essential for organizations?



**SUGGESTED ANSWERS/HINTS**

MCQ No.	Answer	
1.	(i)	(b)
	(ii)	(a)
	(iii)	(d)
	(iv)	(b)
	(v)	(a)
2.		(b)
3.		(a)
4.		(d)
5.		(a)
6.		(c)

7. The Matrix Relationship is the most effective structure for Tech Innovators Inc. to achieve its vision of leadership in AI technologies. This structure promotes cross-functional collaboration, essential for managing complex AI projects and fostering innovation. By integrating expertise from various departments into temporary, task-based teams,

the Matrix Relationship supports dynamic project management and aligns well with the company’s strategic goals for advancing AI technologies. Despite its complexity, this approach provides the flexibility and collaboration necessary for a leading-edge AI and ML focus.

Relationship	Benefits	Drawbacks	Suitability for AI Leadership
<b>Functional and Divisional</b>	Specialization, clear management of functions and products.	Potential for departmental isolation, limited collaboration.	Less effective for cross-functional AI projects.
<b>Horizontal</b>	Open communication, encourages innovation and fast idea sharing.	Hard to scale, unclear roles and responsibilities.	Suitable for startups, less for large AI initiatives.
<b>Matrix</b>	Facilitates cross-functional collaboration, flexible resource management for complex projects.	Complex reporting structures, potential conflicts.	Ideal for managing diverse, innovative AI projects.

8. Strategic management involves developing the company’s vision, environmental scanning, strategy formulation, implementation, evaluation and control. It emphasizes the monitoring and evaluation of external opportunities and threats in the light of a company’s strengths and weaknesses and designing strategies for survival and growth. It helps in the creation of a competitive advantage to outperform the competitors and also guides the company successfully through all changes in the environment.

The major benefits of strategic management are:

- ◆ Strategic management gives directions to the company to move ahead. It defines the goals and mission.
  - ◆ It helps organisations to be proactive instead of reactive in shaping their future.
  - ◆ It provides frameworks for all major decisions of an enterprise such as decisions on businesses, products, markets, manufacturing facilities, investments and organisational structure. It provides better guidance to the entire organisation on the crucial point - what it is trying to do.
  - ◆ It helps organisations to identify the available opportunities and identify ways and means to achieve them.
  - ◆ It serves as a corporate defence mechanism against mistakes and pitfalls.
  - ◆ It helps to enhance the longevity of the business.
  - ◆ It helps the organisation to develop certain core competencies and competitive advantages that would facilitate survival and growth.
9. The company went through the following stages of the product life cycle (PLC):
- Introduction stage:** Initially, the company faced slow sales growth, limited markets, and high prices, which are characteristic of the introduction stage. During this stage, competition is almost negligible, and customers have limited knowledge about the product.
- Growth stage:** Over time, the demand for the product expanded rapidly, prices fell, and competition increased. These are typical features of the growth stage in the PLC. In this stage, the product gains market acceptance, and customers become more aware of the product's benefits and show interest in purchasing it.
10. The competitive rivalry will be a significant force in case of company of Rajiv Arya as all the rivals are similar in sizes and are manufacturing similar products. It is difficult for any single manufacturer to dominate the market. Large number of patents will make it difficult for new



entrants to break into the market. Further, as there are a large number of small suppliers the power that suppliers can exert will also be low.

There is no information relating to substitutes and bargaining power of customers in the information given in scenario. However, a domestic vacuum cleaner will directly compete with other options such as house maids. Availability of house maids at low cost can significantly disturb the sales of products.

Further, as the products are similar customers can easily shift from one company to another. This will only enhance competitive rivalry.

11. According to Michael Porter, strategies allow organizations to gain competitive advantage from three different bases: cost leadership, differentiation, and focus. Porter called these base generic strategies.

XXP India Ltd. has planned for Differentiation Strategy. The company is planning to launch various innovative product designs and offer loyalty programmes to lure customers.

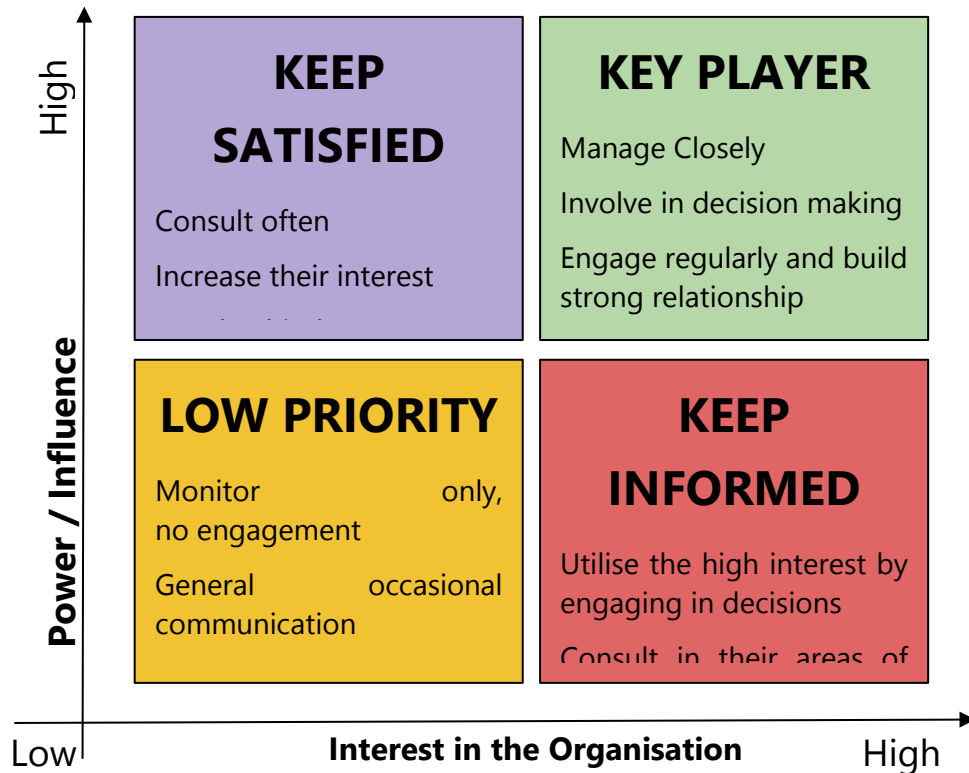
Differentiation strategy should be pursued only after a careful study of buyers' needs and preferences to determine the feasibility of incorporating one or more differentiating features into a unique product that features the desired attributes. A successful differentiation strategy allows a firm to charge a higher price for its product and to gain customer loyalty, because consumers may become strongly attached to the differentiated features.

#### **Advantages of Differentiation Strategy**

A differentiation strategy may help an organisation to remain profitable even with rivalry, new entrants, suppliers' power, substitute products, and buyers' power.

1. **Rivalry** - Brand loyalty acts as a safeguard against competitors. It means that customers will be less sensitive to price increases, as long as the firm can satisfy the needs of its customers.
2. **Buyers** – They do not negotiate for price as they get special features, and they have fewer options in the market.

3. **Suppliers** – Because differentiators charge a premium price, they can afford to absorb higher costs of supplies as the customers are willing to pay extra too.
  4. **Entrants** – Innovative features are an expensive offer. So, new entrants generally avoid these features because it is tough for them to provide the same product with special features at a comparable price.
  5. **Substitutes** – Substitute products can't replace differentiated products which have high brand value and enjoy customer loyalty.
12. Mendelow's Matrix can be used effectively to analyze and manage stakeholders through a grid-based approach by the following steps:
1. **Identify Stakeholders:** Begin by identifying all relevant stakeholders for your project or organization. This includes individuals, groups, or organizations that may be impacted by or have an impact on your activities.
  2. **Assess Power and Interest:** For each stakeholder, assess their power to influence your project or organization and their level of interest in its success. Power can be assessed based on factors such as authority, resources, and expertise, while interest can be gauged by their level of involvement, expectations, and potential benefits or risks.
  3. **Plot Stakeholders on the Grid:** Create a grid with Power on one axis and Interest on the other. Plot each stakeholder on the grid based on your assessment. Stakeholders with high power and high interest are placed in the "Key Players" quadrant, those with high power but low interest are in the "Keep Satisfied" quadrant, those with low power but high interest are in the "Keep Informed" quadrant, and those with low power and low interest are in the "Low Priority" quadrant.



4. **Develop Strategies for each Quadrant:** Based on the placement of stakeholders in the grid, develop specific strategies for managing each quadrant:

- **Key Players:** Fully engage with these stakeholders, seek their input, and keep them informed. They are crucial for the success of your project, so their needs and expectations should be a top priority.
- **Keep Satisfied:** These stakeholders have significant power but may not be as interested in your project. Keep them satisfied by providing regular updates and addressing any concerns they may have to prevent them from becoming detractors.

- **Keep Informed:** While these stakeholders may not have much power, they are highly interested in your project. Keep them informed to ensure they remain supportive and to leverage their insights and feedback.
- **Low Priority:** These stakeholders have low power and interest. Monitor them for any changes but allocate minimal resources to managing their expectations.

5. **Monitor and Adapt:** Continuously monitor the power and interest of stakeholders and adjust your strategies accordingly. Stakeholders may move between quadrants based on changing circumstances, so it's important to remain flexible and responsive.

By using Mendelow's Matrix as a grid-based tool, you can effectively analyze and manage stakeholders by tailoring your engagement strategies to their specific needs and expectations, ultimately increasing the likelihood of project success.

13. Pizza Chain may choose to have turnaround strategy if there are:

- ◆ Persistent negative cash flow from business.
- ◆ Uncompetitive products or services.
- ◆ Declining market share.
- ◆ Deterioration in physical facilities.
- ◆ Over-staffing, high turnover of employees, and low morale.
- ◆ Mismanagement.

For turnaround strategies to be successful, it is imperative to focus on the short and long-term financing needs as well as on strategic issues. The chain may attempt to leverage the potential Indian market by engaging a new logistics partner. It may bring innovation in food items, as well as quality and improvements in the overall dine-in and delivery experience. During the turnaround, the "product mix" may be changed, requiring the organization to do some repositioning.

A workable action plan for turnaround would involve:

**Stage One – Assessment of current problems:** The first step is to assess the current problems and get to the root causes and the extent of damage the problem has caused.

**Stage Two – Analyze the situation and develop a strategic plan:** Before making any major changes; determine the chances of the business's survival. Identify appropriate strategies and develop a preliminary action plan.

**Stage Three – Implementing an emergency action plan:** If the organization is in a critical stage, an appropriate action plan must be developed to stop the bleeding and enable the organization to survive. A positive operating cash flow must be established as quickly as possible and enough funds to implement the turnaround strategies must be raised.

**Stage Four – Restructuring the business:** The financial state of the organization's core business is particularly important. If the core business is irreparably damaged, then the outlook for the entire organization may be bleak. Efforts to be made to position the organization for rapid improvement.

**Stage Five – Returning to normal:** In the final stage of turnaround strategy process, the organization should begin to show signs of profitability, return on investments and enhancing economic value-added. Emphasis is placed on a number of strategic efforts such as carefully adding new products and improving customer service, creating alliances with other organizations, increasing the market share, etc.

14. The following are the principal points of distinction between concentric diversification and conglomerate diversification:
- (i) Concentric diversification occurs when a firm adds related products or markets. On the other hand, conglomerate diversification occurs when a firm diversifies into areas that are unrelated to its current line of business.
  - (ii) In concentric diversification, the new business is linked to the existing businesses through process, technology or marketing. In

conglomerate diversification, no such linkages exist; the new business/product is disjointed from the existing businesses/products.

- (iii) The most common reasons for pursuing concentric diversification are that opportunities in a firm's existing line of business are available. However, common reasons for pursuing a conglomerate growth strategy are that opportunities in a firm's current line of business are limited or opportunities outside are highly lucrative.

- 15.** PQR Ltd. has planned to implement the Strategic Business Unit (SBU) structure. Very large organisations, particularly those running into several products, or operating at distant geographical locations that are extremely diverse in terms of environmental factors, can be better managed by creating strategic business units. SBU structure becomes imperative in an organisation with increase in number, size and diversity.

The attributes of an SBU and the benefits a firm may derive by using the SBU Structure are as follows:

- ◆ A scientific method of grouping the businesses of a multi – business corporation which helps the firm in strategic planning.
- ◆ An improvement over the territorial grouping of businesses and strategic planning based on territorial units.
- ◆ Strategic planning for SBU is distinct from rest of businesses. Products/ businesses within an SBU receive same strategic planning treatment and priorities.
- ◆ Each SBU will have its own distinct set of competitors and its own distinct strategy.
- ◆ The CEO of SBU will be responsible for strategic planning for SBU and its profit performance.
- ◆ Products/businesses that are related from the standpoint of function are assembled together as a distinct SBU.
- ◆ Unrelated products/ businesses in any group are separated into separate SBUs.

- ◆ Grouping the businesses on SBU lines helps in strategic planning by removing the vagueness and confusion.
  - ◆ Each SBU is a separate business and will be distinct from one another on the basis of mission, objectives etc.
16. Strategic performance measures are essential for organizations for several reasons:
- ◆ **Goal Alignment:** Strategic performance measures help organizations align their strategies with their goals and objectives, ensuring that they are on track to achieve their desired outcomes.
  - ◆ **Resource Allocation:** Strategic performance measures provide organizations with the information they need to make informed decisions about resource allocation, enabling them to prioritize their efforts and allocate resources to the areas that will have the greatest impact on their performance.
  - ◆ **Continuous Improvement:** Strategic performance measures provide organizations with a framework for continuous improvement, enabling them to track their progress and make adjustments to improve their performance over time.
  - ◆ **External Accountability:** Strategic performance measures help organizations demonstrate accountability to stakeholders, including shareholders, customers, and regulatory bodies, by providing a clear and transparent picture of their performance.





