Mock Test Paper - Series I: March, 2024

Date of Paper: 16 March, 2024

Time of Paper: 2 P.M. to 5 P.M.

INTERMEDIATE: GROUP – II

PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A : FINANCIAL MANAGEMENT

Suggested Answers/ Hints

PART I

1. I. (b) ₹ 35,55,556

II. (c) ₹ 30,03,733

III. (a) ₹ 8,83,200

IV. (d) ₹ 4,83,200

V. (a) 16.09%

Working Note

Particulars	**(₹)**
Total Sales	₹ 200 lakhs
Credit Sales (80%)	₹ 160 lakhs
Receivables for 40 days	₹ 80 lakhs
Receivables for 120 days	₹ 80 lakhs
Average collection period [(40 x 0.5) + (120 × 0.5)]	80 days
Average level of Receivables (₹ 1,60,00,000 × 80/360)	₹ 35,55,556
Factoring Commission (₹ 35,55,556 × 2/100)	₹ 71,111
Factoring Reserve (₹ 35,55,556 × 10/100)	₹ 3,55,556
Amount available for advance {₹ 35,55,556 - (3,55,556 + 71,111)}	₹ 31,28,889
Factor will deduct his interest @ 18%: Interest = $\frac{₹31,28,889 \times 18 \times 80}{100 \times 360}$	₹ 1,25,156
Advance to be paid (₹ 31,28,889 – ₹ 1,25,156)	₹ 30,03,733

(i) Statement Showing Evaluation of Factoring Proposal

		₹
A.	**Annual Cost of Factoring to the Company:**	
	Factoring commission (₹ 71,111 × 360/80)	3,20,000
	Interest charges (₹ 1,25,156 × 360/80)	5,63,200
	Total	8,83,200

B.	**Company's Savings on taking Factoring Service:**	₹
	Cost of credit administration saved	2,40,000
	Bad Debts (₹ 160,00,000 x 1/100) avoided	1,60,000
	Total	4,00,000
C.	Net Cost to the company (A – B) (₹ 8,83,200 – ₹ 4,00,000)	4,83,200

Effective cost of factoring = $\frac{₹\ 4,83,200}{₹30,03,733} \times 100$ = 16.09%

2. B. ₹ 3,20,513; ₹ 8.33

$$\frac{(EBIT - I)(1 - t) - D_p}{N_1} = \frac{(EBIT - I)(1 - t) - D_p}{N_2}$$

$$\frac{(x - 0)(1 - 0.35)}{25,000} = \frac{(x - 1,00,000)(1 - 0.35) - 60,000}{10,000}$$

x = EBIT = ₹ 3,20,513

At EBIT of ₹ 3,20,513, EPS under both options will be the same i.e., ₹ 8.33 per share

3. D. 1.15

FL= % change in NP/%change in EBIT=6.9/6=1.15

4. C. 3 years

These deposits may be accepted for a period of six months to three years.

PART II

1. (a)

Particulars	(₹' in lakhs)
Net Profit	54
Less: Preference dividend	24
Earnings for equity shareholders	30
Earnings per share	30/2 = ₹ 15

Let, the dividend per share be D to get share price of ₹ 120.

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

Where,

P = Market price per share.

E = Earnings per share = ₹ 15

D = Dividend per share

R = Return earned on investment = 22%

K_e = Cost of equity capital = 15%

$$120 = \frac{D + \frac{0.22}{0.15}(15\text{-}D)}{0.15}$$

$$18 = \frac{0.15D + 3.3 - 0.22D}{0.15}$$

$$0.07D = 3.3 – 2.7$$

$$D = 8.57$$

$$\text{D/P ratio} = \frac{DPS}{EPS} \times 100 = \frac{8.57}{15} x\ 100 = 57.13\%$$

So, the required dividend pay-out ratio will be = 57.13%

(b) Value of AN Ltd. = $\frac{NOI}{K_o} = \frac{₹\ 10,00,000}{20\%}$ = ₹ 50,00,000

(i) Return on Shares of Mr. R on AN Ltd.

Particulars	**Amount (₹)**
Value of the company	50,00,000
Market value of debt (50% x ₹ 50,00,000)	25,00,000
Market value of shares (50% x ₹ 50,00,000)	**25,00,000**
Particulars	**Amount (₹)**
Net operating income	10,00,000
Interest on debt (10% × ₹ 25,00,000)	2,50,000
Earnings available to shareholders	**7,50,000**
Return on 8% shares (8% × ₹ 7,50,000)	**60,000**

(ii) Implied required rate of return on equity of AN Ltd. = $\frac{₹\ 7,50,000}{₹\ 25,00,000}$ = **30%**

(c)

ANVY Ltd

Balance Sheet as on 31st March, 2023

Liabilities	**₹**	**Assets**	**₹**
Equity share capital	2,00,000	Fixed assets	1,40,000
Current debt	60,000	Cash (balancing figure)	1,00,000
Long term debt	60,000	Inventory	80,000
	3,20,000		3,20,000

Working Notes

1. Total debt = 0.60 x Equity share capital = 0.60 × ₹ 2,00,000 = ₹ 1,20,000

   Further, Current debt to total debt = 0.50. So, current debt = 0.50 x ₹1,20,000 = ₹ 60,000, Long term debt = ₹1,20,000 - ₹60,000= ₹ 60,000

2. Fixed assets = 0.70 × Equity share Capital = 0.70 × ₹ 2,00,000 = ₹ 1,40,000

3. Total assets to turnover = 2.5 Times: Inventory turnover = 10 Times

Hence, Inventory /Total assets = 2.5/10=1/4, Total assets = ₹ 3,20,000

Therefore Inventory = ₹ 3,20,000/4 = ₹ 80,000

2. (a) Cash inflows after tax (CFAT)

Particular	**₹**
Current production (units per week)	5,000 units
New capacity (units per week)	15,000 units
Demand (units per week)	10,000 units
Increase in sales (units per week) A.	5,000 units
Contribution per unit (₹ 30,000 x 0.10) B.	3,000
Increase in contribution A x B x 56	84 crores
Less: Additional fixed cost	10 crores
Increase in profit	74 crores
Less: Tax @ 40%	29.6 crores
Profit after tax	44.4 crores

Tax shield due to depreciation

Year	**Depreciation (₹ in Crore)**	**Tax Shield (₹ in Crore)**	**PV Factor @ 20%**	**Total Present Value (₹ in Crore)**
1	25.00	10	0.83	8.33
2	18.75	7.5	0.69	5.18
3	14.06	5.62	0.58	3.26
4	10.55	4.22	0.48	2.03
5	7.91	3.16	0.40	1.27
Total				20.07

Tax shield on capital loss = (23.73-20.00) x 30% = ₹ 1.12 crores

Net Present Value (NPV)

Particulars	**Year**	**Cash Flow (₹ in Crores)**	**PVAF @ 20%**	**Present Value (₹ in Crores)**
Initial Investment	0	(100)	1	(100)
Working capital	0	(3)	1	(3)
Profit after tax	1-5	44.4	2.99	132.76
Salvage value	5	20	0.40	8.00

Tax shield on Depreciation	1-5			20.07
Tax shield on capital loss	5	1.12	0.40	0.45
Release of Working Capital	5	3	0.40	1.20
NPV				59.47

The company is advised to replace the old machine since the NPV of the new machine is positive.

(b) **Cut-off Rate:** It is the minimum rate which the management wishes to have from any project. Usually this is based upon the cost of capital. The management gains only if a project gives return of more than the cut - off rate. Therefore, the cut - off rate can be used as the discount rate or the opportunity cost rate.

3. **(a)** **Working Note:**

Let the rate of Interest on debenture be x

∴ Rate of Interest on loan = 1.4x

$$\therefore k_d \text{ on debentures} = \frac{Int\,(1-t) + \frac{RV - NP}{n}}{\frac{RV + NP}{2}}$$

$$= \frac{100x(1-0.30) + \frac{100-98}{4}}{\frac{100+98}{2}}$$

$$= \frac{70x + 0.5}{99}$$

∴ K_d on bank loan = 1.4 x (1 – 0.30) = 0.98x

$$K_e = \frac{EPS}{MPS} = \frac{1}{MPS/EPS} = \frac{1}{PE} = \frac{1}{4} = 0.25$$

K_e = 0.25

Computation of WACC

Capital	Amount	Weights	Cost	Product
Equity	20,00,000	0.2	0.25	0.05
Reserves	30,00,000	0.3	0.25	0.075
Debentures	30,00,000	0.3	(70x+0.5)/99	(21x+0.15)/99
Bank Loan	20,00,000	0.2	0.98x	0.196x
	1,00,00,000	1		0.125+0.196x $+\frac{21x+0.15}{99}$

WACC = 16%

$\therefore$ 0.125+0.196x+$\frac{21x+0.15}{99}$= 0.16

$\therefore$ 12.375+19.404x+21x+0.15 = (0.16)(99)

$\therefore$ 40.404x = 15.84 – 12.525

$\therefore$ 40.404x = 3.315

$\therefore$ x = $\frac{3.315}{40.404}$

$\therefore$ x = 8.20%

(i) Rate of interest on debenture = x = 8.20%

(ii) Rate of interest on Bank loan = 1.4x = (1.4)(8.20%) = 11.48%.

(b) In dividend price approach, cost of equity capital is computed by dividing the expected dividend by market price per share. This ratio expresses the cost of equity capital in relation to what yield the company should pay to attract investors. It is computed as:

$$K_e = \frac{D_1}{P_0}$$

Where,

K_e= Cost of equity

D = Expected dividend (also written as D_1)

P_0 = Market price of equity (ex- dividend)

4. **(a)** Limitations of Profit Maximisation objective of financial management.

(i) **The term profit is vague. It does not clarify what exactly it means.** It conveys a different meaning to different people. For example, profit may be in short term or long term period; it may be total profit or rate of profit etc.

(ii) **Profit maximisation has to be attempted with a realisation of risks involved.** There is a direct relationship between risk and profit. Many risky propositions yield high profit. Higher the risk, higher is the possibility of profits. If profit maximisation is the only goal, then risk factor is altogether ignored. This implies that finance manager will accept highly risky proposals also, if they give high profits. In practice, however, risk is very important consideration and has to be balanced with the profit objective.

(iii) **Profit maximisation as an objective does not take into account the time pattern of returns.** Proposal A may give a higher amount of profits as compared to proposal B, yet if the returns of proposal A begin to flow say 10 years later, proposal B may be preferred which may have lower overall profit but the returns flow is more early and quick.

(iv) **Profit maximisation as an objective is too narrow.** It fails to take into account the social considerations as also the obligations to various interests of workers, consumers, society, as well as ethical trade practices. If these factors are ignored, a company cannot survive for long. Profit maximization at the cost of social and moral obligations is a short sighted policy.

(b) Some common methods of venture capital financing are as follows:

(i) **Equity financing:** The venture capital undertakings generally require funds for a longer period but may not be able to provide returns to the investors during the initial stages. Therefore, the venture capital finance is generally provided by way of equity share capital. The equity contribution of venture capital firm does not exceed 49% of the total equity capital of venture capital undertakings so that the effective control and ownership remains with the entrepreneur.

(ii) **Conditional loan:** A conditional loan is repayable in the form of a royalty after the venture is able to generate sales. No interest is paid on such loans. In India venture capital financiers charge royalty ranging between 2 and 15 per cent; actual rate depends on other factors of the venture such as gestation period, cash flow patterns, risk and other factors of the enterprise. Some Venture capital financiers give a choice to the enterprise of paying a high rate of interest (which could be well above 20 per cent) instead of royalty on sales once it becomes commercially sound.

(iii) **Income note:** It is a hybrid security which combines the features of both conventional loan and conditional loan. The entrepreneur has to pay both interest and royalty on sales but at substantially low rates. IDBI's VCF provides funding equal to 80 – 87.50% of the projects cost for commercial application of indigenous technology.

(iv) **Participating debenture:** Such security carries charges in three phases — in the start-up phase no interest is charged, next stage a low rate of interest is charged up to a particular level of operation, after that, a high rate of interest is required to be paid.

(c) **Optimum Capital Structure:** The capital structure is said to be optimum when the firm has selected such a combination of equity and debt so that the wealth of firm is maximum. At this capital structure, the cost of capital is minimum and the market price per share i.e. value of the firm is maximum.

OR

Financial leverage indicates the use of funds with fixed cost like long term debts and preference share capital along with equity share capital which is known as trading on equity. The basic aim of financial leverage is to increase the earnings available to equity shareholders using fixed cost fund.

A firm is known to have a positive/favourable leverage when its earnings are more than the cost of debt. If earnings are equal to or less than cost of debt, it will be an negative/unfavourable leverage. When the quantity of fixed cost fund is relatively high in comparison to equity capital it is said that the firm is **''trading on equity".**

INTERMEDIATE COURSE: GROUP II

PAPER 6B: STRATEGIC MANAGEMENT

ANSWERS

PART I

1. (A)	**(i)**	**(a)**	**(ii)**	**(b)**	**(iii)**	**(c)**	**(iv)**	**(b)**	**(v)**	**(c)**
1. (B)	**(i)**	**(c)**	**(ii)**	**(b)**	**(iii)**	**(b)**				

PART II

1. **(a)** Swati operates at the functional level of management, specifically as the marketing manager at a software company. Functional managers like Swati oversee specific departments or functions within an organization, such as marketing, finance, or operations. Their primary responsibilities include implementing corporate strategies and policies within their area of expertise and ensuring that daily operations are conducted efficiently and effectively.

In Swati's case, as a marketing manager, her role involves developing and executing marketing strategies for the company's products. This includes leading a team of marketing professionals, collaborating with product development and sales teams, and analyzing market trends and customer feedback to refine strategies. By working closely with these teams, Swati ensures that the company's products are effectively promoted in the market and that marketing efforts align with overall business goals.

Functional managers like Swati play a critical role in the organization by bridging the gap between corporate strategy and daily operations. They are responsible for translating high-level strategic goals into actionable plans for their departments and ensuring that these plans are executed effectively. Additionally, they are often key decision-makers within their areas of responsibility, making strategic choices that impact on the company's success. Overall, Swati's role as a marketing manager exemplifies the importance of functional managers in driving the success of their organizations.

(b) The PESTLE framework can help ABC Corp assess the external factors affecting its decision to expand into a new country by considering the following aspects:

- **Political Factors**: These include the stability of the government, government policies on foreign investment, trade agreements, and regulatory frameworks. By analyzing these factors, ABC Corp can assess the political risks associated with entering the new market.
- **Economic Factors**: Economic factors such as GDP growth rate, inflation rate, exchange rates, and economic stability can impact ABC Corp's decision. By analyzing these factors, the company can

understand the economic environment of the new market and its potential impact on business operations.

- **Social Factors**: Social factors such as cultural norms, demographics, and lifestyle trends can influence consumer behavior and demand for ABC Corp's products. Understanding these factors can help the company tailor its marketing strategies to the new market.
- **Technological Factors**: Technological factors such as infrastructure, technological advancements, and the level of technology adoption in the new market can impact ABC Corp's operations. By assessing these factors, the company can determine the technological requirements for entering the new market.
- **Legal Factors**: Legal factors such as laws and regulations related to foreign investment, intellectual property rights, and labor laws can impact ABC Corp's decision. By analyzing these factors, the company can ensure compliance with legal requirements in the new market.
- **Environmental Factors**: Environmental factors such as climate change, environmental regulations, and sustainability practices can impact ABC Corp's operations and reputation. By considering these factors, the company can assess the environmental risks and opportunities in the new market.

Overall, the PESTLE framework can provide ABC Corp with a comprehensive analysis of the external factors that could impact its decision to expand into a new country, helping the company make informed and strategic decisions.

(c) To help the small manufacturing company navigate its digital transformation successfully, we would recommend the following strategy:

1. **Begin at the top:** The leadership team should be united and committed to the digital transformation. They should communicate a clear vision for the future of the company and lead by example.
2. **Ensure that the change is necessary and desired:** Before implementing any changes, the company should assess its current state and identify areas where digital transformation can add value. It's important to involve employees in this process to ensure their buy-in.
3. **Reduce disruption:** Employee perceptions of change can vary, so it's important to minimize disruption. This can be done by communicating early and often about the changes, providing training and support for employees, and empowering change agents within the organization.

4. **Encourage communication:** Create channels for employees to ask questions and provide feedback. Encourage collaboration between departments to share ideas and innovations. Effective communication can help alleviate fears and keep everyone aligned.

5. **Recognize that change is the norm:** Digital transformation is not a one-time project but an ongoing process. The company should be prepared to adapt to new technologies and market conditions continuously.

By following these best practices, the small manufacturing company can successfully navigate its digital transformation and position itself for future growth and success.

2. (a) The retail company can develop a strategic approach that is both proactive and reactive to address the challenge of increasing competition from online retailers. To achieve this, the company can:

- **Proactive Strategy:** The company can proactively analyze market trends and customer preferences to identify opportunities for growth. For example, it can invest in market research to understand what customers value in a retail experience and tailor its offerings to meet those needs. This proactive approach can help the company stay ahead of competitors and attract new customers.

- **Reactive Strategy:** In addition to proactive measures, the company should also be prepared to react to changes in the market environment. For example, if a competitor launches a new online shopping platform, the company should quickly assess the impact on its business and develop a response. This reactive strategy can help the company adapt to changing market conditions and maintain its competitiveness.

By combining proactive and reactive strategies, the retail company can develop a comprehensive approach to addressing the challenge of increasing competition from online retailers. This approach will allow the company to capitalize on opportunities for growth while also mitigating risks and responding to threats in the market.

(b) To target tech-savvy consumers for the new smartphone model, the tech company can develop a marketing strategy based on customer behavior. Consumer behaviour may be influenced by a number of things. These elements can be categorised into the following conceptual domains:

- **External Influences:** Utilize online platforms and tech forums to generate buzz around the new smartphone. Partner with tech influencers and bloggers to review the product and create awareness among tech-savvy consumers.

- **Internal Influences:** Appeal to the desire for innovation and advanced features among tech-savvy consumers. Highlight the unique selling points of the new smartphone, such as its cutting-edge technology, performance, and design.

- **Decision Making:** Recognize that tech-savvy consumers are early adopters who value functionality and performance. Provide detailed specifications and comparisons with other smartphones to help them make an informed decision.

- **Post-decision Processes:** Offer excellent customer service and support to address any technical issues or concerns. Encourage customers to provide feedback and reviews to build credibility and trust among tech-savvy consumers.

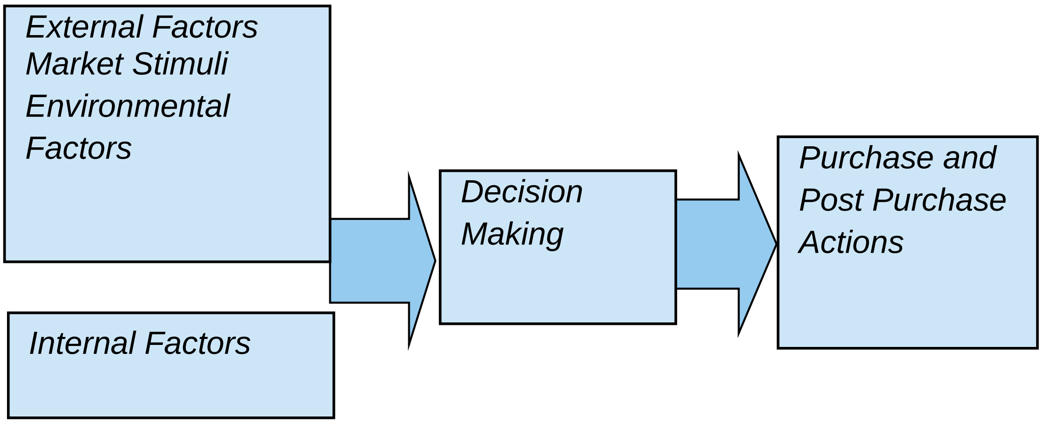


Figure: Process of consumer behaviour

By understanding the behavior of tech-savvy consumers and aligning the marketing strategy with their preferences, the tech company can effectively promote the new smartphone and attract this demographic.

3. **(a)** To study the market position of rival companies in the energy drink segment, the strategic manager can use **strategic group mapping.** This tool helps identify strategic groups, which consist of rival firms with similar competitive approaches and positions in the market. The procedure for implementing strategic group mapping effectively is as follows:

1. **Identify the competitive characteristics** that differentiate firms in the industry typical variables that are price/quality range (high, medium, low); geographic coverage (local, regional, national, global); degree of vertical integration (none, partial, full); product-line breadth (wide, narrow); use of distribution channels (one, some, all); and degree of service offered (no-frills, limited, full).

2. **Plot the firms on a two-variable map** using pairs of these differentiating characteristics.

3. **Assign firms that fall in about the same strategy space** to the same strategic group.

4. **Draw circles around each strategic group** making the circles proportional to the size of the group's respective share of total industry sales revenues.

By following these steps, the strategic manager can gain valuable insights into the competitive landscape of the energy drink segment and identify potential positioning strategies for the new line of energy drinks targeted at health-conscious consumers.

(b) A workable action plan for turnaround of the textile mill would involve:

- **Stage One – Assessment of current problems**: In the first step, assess the current problems and get to the root causes and the extent of damage.
- **Stage Two – Analyze the situation and develop a strategic plan:** Identify major problems and opportunities, develop a strategic plan with specific goals and detailed functional actions after analyzing strengths and weaknesses in the areas of competitive position.
- **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.
- **Stage Four – Restructuring the business**: 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.

4. (a) 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.

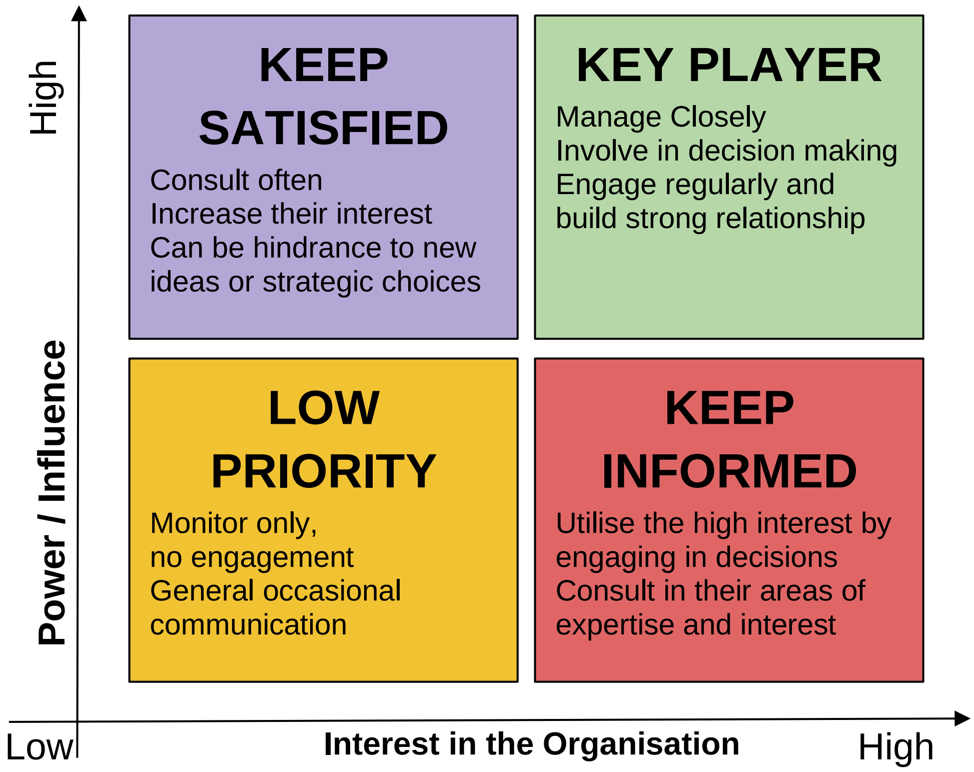
- ♦ **External Accountability:** Strategic performance measures help organizations demonstrate accountability to stakeholders, including shareholders, customers, and regulatory bodies, by providing a clear and transparent picture of their performance.

(b) 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.

OR

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.

Mock Test Paper - Series II: April, 2024

Date of Paper: 15 April, 2024

Time of Paper: 2 P.M. to 5 P.M.

INTERMEDIATE: GROUP – II

PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A : FINANCIAL MANAGEMENT

Suggested Answers/ Hints

PART I – Case Scenario based MCQs

1. 1. (d) 14.99%

B = retention ratio=0.6, r=return on equity=20%, DPS=D0=20 x 0.4= 8,

MPS = P0 = EPS x PE = 20 x 15=300

G = b.r =0.6 x 20% = 12%

D1 = D0(1+g) = 8 (1.12) = 8.96

Ke = D1/P0 + g = 8.96/300 + 0.12 = 14.99%

2. (c) 90.58

Price of debentures= PV of future cash flows for investor discounted at their yield

= 8 x PVAF(9.5%,10 years)+ 100 x PVF(9.5%, 10 years)

= 8 x 6.2788 + 100 x 0.4035

=50.2304 + 40.35

=90.58

3. (a) 7.64%

NP = 90.58 x 96% = 86.96, RV = 100, Interest = 8, t = 0.27, n = 10

$$Kd = \frac{Int(1-t)+(RV-NP)/n}{(RV+NP)/2}$$

$$= \frac{8(1-0.27)+(100-86.96)/10}{(100+86.96)/2}$$

= 7.64%

4. (b) 9.77%

$$Kp = \frac{PD+(RV-NP)/n}{(RV+NP)/2}$$

$$= \frac{100+(1100-1050)/10}{(1100+1050)/2}$$

= 9.77%

5. (a) 10.52%

	Existing	Total	Additional	
Equity Funds	1,60,00,000	2,00,00,000	40,00,000	
Preference Shares		24,00,000	24,00,000	
Debt		56,00,000	56,00,000	
	1,60,00,000	2,80,00,000	1,20,00,000	
Capital gearing =	0.4			
(PSC + Debt)/Equity =	0.4			
(Total Funds -Equity)/ Equity = 0.4				
(2.8 crores-Equity)/ equity = 0.4				
Equity =	2 crores			
Weighted avg cost of marginal capital		**Weights**	**Cost**	**W.C**
Equity Funds	40,00,000	0.333333333	14.99%	5.00%
Preference Shares	24,00,000	0.2	9.77%	1.952%
Debt	56,00,000	0.466666667	7.64%	3.565%
Total	**1,20,00,000**			**10.52%**

2. (a) 9.74%

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

$$K_d = \left[\frac{10(0.7) + \frac{110 - 85}{10}}{97.5}\right]$$

= 9.50/97.5 = 9.74%

3. (c) 2.5

Margin of safety = (sales – BEP sales)/sales x 100

= 40%

Degree of operating leverage = 1/MOS

= 1/40% = 2.5

4. (a) 20%

Payback Reciprocal = $\frac{\text{Average annual cash in flow}}{\text{Initial investment}}$

= $\frac{₹\ 4,000 \times 100}{₹\ 20,000}$ = 20%

PART II – Descriptive Questions

1. (a) (i) Working Notes:

(i) Computation of Annual Cash Cost of Production	**(₹)**
Material consumed	12,00,000
Wages	9,60,000
Manufacturing expenses	12,00,000
Total cash cost of production	**33,60,000**
(ii) Computation of Annual Cash Cost of Sales:	**(₹)**
Total Cash cost of production as in (i) above	33,60,000
Administrative Expenses	3,60,000
Sales promotion expenses	1,20,000
Total cash cost of sales	**38,40,000**
Add: Gross Profit @ 20% on sales (25% on cost of sales)	9,60,000
Sales Value	**48,00,000**

Statement of Working Capital requirements (cash cost basis)

	(₹)	**(₹)**
A. Current Assets		
Inventory:		
- Raw materials $\left(\frac{₹\ 12,00,000}{12\ \text{months}} \times 2\ \text{months}\right)$	2,00,000	
- Finished Goods $\left(\frac{₹\ 33,60,000}{12\ \text{months}} \times 2\ \text{months}\right)$	5,60,000	
Receivables (Debtors) $\left(\frac{₹\ 38,40,000}{12\ \text{months}} \times 3\ \text{months}\right)$	9,60,000	
Sales Promotion expenses paid in advance $\left(\frac{₹1,20,000}{12\ \text{months}} \times 1\ \text{month}\right)$	10,000	
Cash balance	1,00,000	18,30,000

	Gross Working Capital		18,30,000
B.	**Current Liabilities:**		
	Payables:		
	- Creditors for materials $\left(\frac{₹\,12,00,000}{12\,months}\times 2\ months\right)$	2,00,000	
	Wages outstanding $\left(\frac{₹\,9,60,000}{12\,months}\times 1\ month\right)$	80,000	
	Manufacturing expenses outstanding $\left(\frac{₹\,12,00,000}{12\,months}\times 1\ month\right)$	1,00,000	
	Administrative expenses outstanding $\left(\frac{₹\,3,60,000}{12\,months}\times 1\ month\right)$	30,000	4,10,000
	Net working capital (A - B)		14,20,000
	Add: Safety margin @ 15%		2,13,000
Total Working Capital requirements			16,33,000

(b) (i) Calculation of market price per share

According to Miller – Modigliani (MM) Approach:

$$P_o = \frac{P_1 + D_1}{1 + K_e}$$

Where,

Existing market price (P_o) = ₹ 600

Expected dividend per share (D_1) = ₹ 40

Capitalization rate (k_e) = 0.20

Market price at year end (P_1) = ?

a. If expected dividends are declared, then

600=(P1+40)/(1+0.2)

600 x 1.2 = P1+40

P1 = 680

b. If expected dividends are not declared, then

600 = (P1+0)/(1 + 0.2)

600 x 1.2 = P1

P1= 720

(ii) Calculation of number of shares to be issued

	(a)	(b)
	Dividends are declared (₹ lakh)	**Dividends are not Declared (₹ lakh)**
Net income	1500	1500
Total dividends	(400)	-
Retained earnings	1100	1500
Investment budget	2000	2000
Amount to be raised by new issues	900	500
Relevant market price (₹ per share)	680	720
No. of new shares to be issued (in lakh) (₹ 900 ÷ 680; ₹ 500 ÷ 720)	1.3235	0.6944

(iii) Calculation of market value of the shares

	(a)	(b)
Particulars	**Dividends are declared**	**Dividends are not Declared**
Existing shares (in lakhs)	10.00	10.00
New shares (in lakhs)	1.3235	0.6944
Total shares (in lakhs)	11.3235	10.6944
Market price per share (₹)	680	720
Total market value of shares at the end of the year (₹ in lakh)	11.3235 × 680 = 7,700 (approx.)	10.6944 × 720 = 7,700 (approx.)

Hence, it is proved that the total market value of shares remains unchanged irrespective of whether dividends are declared, or not declared.

(c) Calculation of Cash Flow after Tax

	Year 1	Year 2	Year 3	Year 4	Year 5
Capacity	50%	65%	80%	100%	100%
Units	1,50,000	1,95,000	2,40,000	3,00,000	3,00,000
Contribution p.u.	360	360	360	360	360
(600 x 60%)					
Total Contribution	5,40,00,000	7,02,00,000	8,64,00,000	10,80,00,000	10,80,00,000
Less: Fixed Asset	2,00,00,000	3,50,00,000	5,00,00,000	5,00,00,000	5,00,00,000
Less: Depreciation (W.N.)	4,00,00,000	2,40,00,000	1,44,00,000	86,40,000	51,84,000

PBT	(60,00,000)	1,12,00,000	2,20,00,000	4,93,60,000	5,28,16,000
Less: Tax	(18,00,000)	33,60,000	66,00,000	1,48,08,000	1,58,44,800
PAT	(42,00,000)	78,40,000	1,54,00,000	3,45,52,000	3,69,71,200
Add: Depreciation	4,00,00,000	2,40,00,000	1,44,00,000	86,40,000	51,84,000
CFAT	3,58,00,000	3,18,40,000	2,98,00,000	4,31,92,000	4,21,55,200

Calculation of NPV

Year	Description	Cash Flow	PVF @12%	PV
0	Initial Investment	(10,00,00,000)	1	(10,00,00,000)
0	WC introduced	(1,50,00,000)	1	(1,50,00,000)
3	WC introduced	(2,00,00,000)	0.7118	(1,42,36,000)
1	CFAT	3,58,00,000	0.8929	3,19,65,820
2	CFAT	3,18,40,000	0.7972	2,53,82,848
3	CFAT	2,98,00,000	0.7118	2,12,11,640
4	CFAT	4,31,92,000	0.6355	2,74,48,516
5	CFAT	4,21,55,200	0.5674	2,39,18,860
5	WC released	3,50,00,000	0.5674	1,98,59,000
5	Scrap Sale	2,00,00,000	0.5674	1,13,48,000
	Net Present Value			**3,18,98,684**

Working Notes (W.N.)

Calculation of Depreciation

Year	Opening WDV	Depreciation	Closing WDV
1	10,00,00,000	4,00,00,000	6,00,00,000
2	6,00,00,000	2,40,00,000	3,60,00,000
3	3,60,00,000	1,44,00,000	2,16,00,000
4	2,16,00,000	86,40,000	1,29,60,000
5	1,29,60,000	51,84,000	77,76,000

2. (a) Income statement

Particulars		P	Q
		(₹)	**(₹)**
	Sales	50,00,000	48,00,000
(–)	Variable Cost	33,50,000	24,00,000
	Contribution	16,50,000	24,00,000
	Fixed Cost	8,25,000	16,00,000
	EBIT	8,25,000	8,00,000
(–)	Interest	5,50,000	6,00,000
	EBT	2,75,000	2,00,000

(–)	Tax	82,500	60,000
	EAT	1,92,500	1,40,000
(÷)	No. of Shares	1,00,000	70,000
	EPS	**₹ 1.93**	**₹ 2.00**

Working Note :

1. Financial Leverage	**=**	EBIT / EBT	**=**	EBIT / (EBIT – Int.)
Let the EBIT be X				
	P		**Q**	
	3 = X/(X – 5,50,000) 3(X – 5,50,000) = X 3X – 16,50,000 = X 2X = 16,50,000		4 = X/(X – 6,00,000) 4(X – 6,00,000) = X 4X – 24,00,000 = X 3X = 24,00,000	
	X = 8,25,000		**X = 8,00,000**	
2. Operating Leverage **=** Contribution/EBIT				
Let the Contribution be X				
	P		**Q**	
	2 = X/8,25,000 **X = 16,50,000**		3= X/8,00,000 **X = 24,00,000**	

3. Sales

Let the Sales be 100

Sales – Variable Cost = Contribution

	P		Q
Contribution **=**	100 – 67	=	100 – 50
=	33	=	50
Sales **=**			
	P		**Q**
For 33	= 16,50,000	For 50	= 24,00,000
For 100	**= 50,00,000**	For 100	**= 48,00,000**

(b) Expected return on capital employed

Capital Employed = Debt + Equity

= (₹ 63,00,000 + ₹ 54,00,000) + (₹ 70,00,000 + ₹ 1,30,00,000)

= ₹ 3,17,00,000

Return on capital employed/ROI = $\left(\frac{\text{EBIT}}{\text{Capital employed}}\right)$ x 100

At present:

$$= \left(\frac{54,00,000}{3,17,00,000}\right) \times 100$$

= 17.03%

Now company expects 2% more as ROI

So, Expected ROI = 17.03% + 2%

= 19.03%

Proposed EBIT = Proposed Capital Employed x Return on capital employed

= (₹ 3,17,00,000 + ₹ 50,00,000) x 19.03% = ₹ 69,84,010

(i) Market Price per Share:

Particular	**Financial Options**	
	Option – I **12% term loan of ₹ 50,00,000**	**Option II** **1,00,000 equity shares @ ₹ 20 and 11% debentures of ₹ 30,00,000**
	(₹)	**(₹)**
EBIT	69,84,010	69,84,010
Less: Interest		
- 10% on old debentures	6,30,000	6,30,000
- 11% on new debentures	-	3,30,000
- 12% on old term loan	6,48,000	6,48,000
- 12% on new term loan	6,00,000	
Total Interest	18,78,000	16,08,000
EBT	51,06,010	53,76,010
Less Tax @ 30%	15,31,803	16,12,803
EAT	35,74,207	37,63,207
No. of equity shares	7,00,000	8,00,000
Earnings per share	**5.11**	**4.70**
P/E ratio	10	10
Market Price per Share = EPS x P/E ratio	**51.06**	**47.04**

(ii) **Recommendation:**

The option I is better and may be opted as both EPS and MPS are higher.

3. (a) Inventory Turnover = $\frac{\text{Inventory}}{\text{COGS}} \times 365$ = $\frac{38,60,000 \times 365}{76,40,000}$ = 184.41 days = 185 days (apx)

Receivables Turnover = $\frac{\text{Receivables}}{\text{Sales}} \times 365 = \frac{39,97,000 \times 365}{1,25,00,000}$ = 116.71 = 117 days (apx)

Equity to Reserves = 1

Reserves = 1 x 30,00,000 = 30,00,000

Projected profit = 30,00,000 - 18,00,000 = 12,00,000

Net Profit Margin = 15%

12,00,000/ Sales = 0.15

Sales = 80,00,000

Gross Profit = 80,00,000 x 50% = 40,00,000

COGS = 80,00,000 - 40,00,000 = 40,00,000

Projected Debtors Turnover = 100 days = $\frac{\text{Closing Receivables}}{\text{Sales}}$ x 365

$$100 = \frac{\text{Closing Receivables}}{80,00,000} \text{ x } 365$$

$$\text{Closing Receivables} = \frac{80,00,000 \text{ x } 100}{365} = 21,91,781$$

Projected Closing Inventory = 70% of opening inventory = 70% of 38,60,000 = 27,02,000

Projected Creditor Turnover= 100 days = $\frac{\text{Closing Creditors}}{\text{COGS}}$x365

Closing Creditors = $\frac{\text{COGS}}{365}$x100

Closing Creditor = $\frac{40,00,000}{365}$x100 = 10,95,890

Equity Share Capital + Reserves = 30,00,000 + 30,00,000 = 60,00,000

Long Term Debt to Equity = 0.5

$$\frac{\text{LTD}}{60,00,000} = 0.5$$

Long Term Debt = 0.5 x 60,00,000

Long Term Debt = 30,00,000

(b) Financial Instruments in the International Market

Some of the various financial instruments dealt with in the international market are:

(a) Euro Bonds

(b) Foreign Bonds

(c) Fully Hedged Bonds

(d) Medium Term Notes

(e) Floating Rate Notes

(f) External Commercial Borrowings

(g) Foreign Currency Futures

(h) Foreign Currency Option

(i) Euro Commercial Papers.

4. (a) Inter-relationship between Investment, Financing and Dividend Decisions: The finance functions are divided into three major decisions, viz., investment, financing and dividend decisions. It is correct to say that these decisions are inter-related because the underlying objective of these three decisions is the same, i.e. maximisation of shareholders' wealth. Since investment, financing and dividend decisions are all interrelated, one has to consider the joint impact of these decisions on the market price of the company's shares and these decisions should also be solved jointly. The decision to invest in a new project needs the finance for the investment. The financing decision, in turn, is influenced by and influences dividend decision because retained earnings used in internal financing deprive shareholders of their dividends. An efficient financial management can ensure optimal joint decisions. This is possible by evaluating each decision in relation to its effect on the shareholders' wealth.

The above three decisions are briefly examined below in the light of their inter-relationship and to see how they can help in maximising the shareholders' wealth i.e. market price of the company's shares.

Investment decision*:* The investment of long term funds is made after a careful assessment of the various projects through capital budgeting and uncertainty analysis. However, only that investment proposal is to be accepted which is expected to yield at least so much return as is adequate to meet its cost of financing. This have an influence on the profitability of the company and ultimately on its wealth.

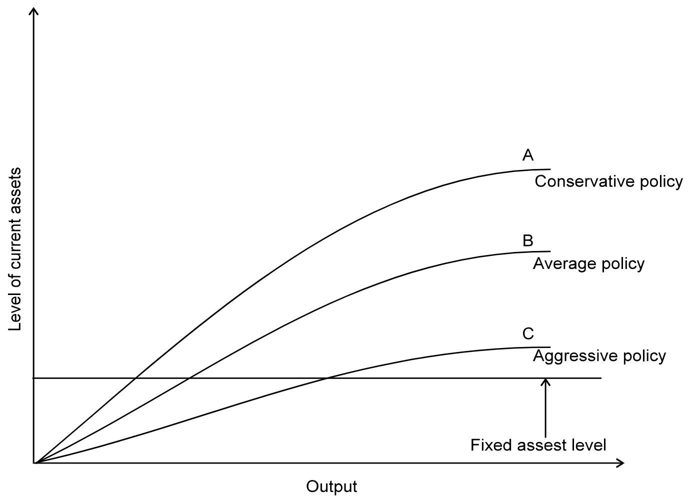
Financing decision*:* Funds can be raised from various sources. Each source of funds involves different issues. The finance manager has to maintain a proper balance between long-term and short-term funds. With the total volume of long-term funds, he has to ensure a proper mix of loan funds and owner's funds. The optimum financing mix will increase return to equity shareholders and thus maximise their wealth.

***Dividend decision**:* The finance manager is also concerned with the decision to pay or declare dividend. He assists the top management in deciding as to what portion of the profit should be paid to the shareholders by way of dividends and what portion should be retained in the business. An optimal dividend pay-out ratio maximises shareholders' wealth.

The above discussion makes it clear that investment, financing and dividend decisions are interrelated and are to be taken jointly keeping in view their joint effect on the shareholders' wealth.

(b) Liquidity versus Profitability Issue in Management of Working Capital

Working capital management entails the control and monitoring of all components of working capital i.e. cash, marketable securities, debtors, creditors etc. Finance manager has to pay particular attention to the levels of current assets and their financing. To decide the level of financing of current assets, the risk return trade off must be taken into account. The level of current assets can be measured by creating a relationship between current assets and fixed assets. A firm may follow a conservative, aggressive or moderate policy.



A conservative policy means lower return and risk while an aggressive policy produces higher return and risk. The two important aims of the working capital management are profitability and solvency. A liquid firm has less risk of insolvency i.e. it will hardly experience a cash shortage or a stock out situation. However, there is a cost associated with maintaining a sound liquidity position. So, to have a higher profitability the firm may have to sacrifice solvency and maintain a relatively low level of current assets.

(c) Concept of Discounted Payback Period

Payback period is time taken to recover the original investment from project cash flows. It is also termed as break even period. The focus of the analysis is on liquidity aspect and it suffers from the limitation of ignoring time value of money and profitability. Discounted payback period considers present value of cash flows, discounted at company's cost of capital to estimate breakeven period i.e. it is that period in which future discounted cash flows equal the initial outflow. The shorter the period, better it is. It also ignores post discounted payback period cash flows.

OR

(c) **Concept of Indian Depository Receipts:** The concept of the depository receipt mechanism which is used to raise funds in foreign currency has been applied in the Indian capital market through the issue of Indian Depository Receipts (IDRs). Foreign companies can issue IDRs to raise funds from Indian market on the same lines as an Indian company uses ADRs/GDRs to raise foreign capital. The IDRs are listed and traded in India in the same way as other Indian securities are traded.

INTERMEDIATE COURSE: GROUP II

PAPER 6B: STRATEGIC MANAGEMENT

ANSWERS

PART I - Case Scenario based MCQs

1. (A)	**(i)**	**(b)**	**(ii)**	**(c)**	**(iii)**	**(b)**	**(iv)**	**(b)**	**(v)**	**(b)**
(B)	**(i)**	**(c)**	**(ii)**	**(b)**	**(iii)**	**(b)**				

PART II - Descriptive Questions

1. (a) The retail chain is employing a strategy that combines both proactive and reactive elements. Monitoring consumer trends and adjusting product offerings accordingly demonstrates a proactive approach to anticipate and meet customer needs. On the other hand, maintaining a flexible supply chain to respond quickly to changes in demand reflects a reactive strategy to address unforeseen shifts in the market.

This combination allows the retail chain to both anticipate future trends and react effectively to immediate market changes, making its strategy partly proactive and partly reactive. This dual strategy of proactive trend monitoring and reactive supply chain flexibility enables the retail chain to anticipate market shifts and adapt to them effectively, ensuring its competitiveness and customer satisfaction.

(b) 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.

(c) Competition from new sustainable fashion brands falls under the "Threat of New Entrants" category of Porter's Five Forces Model for Competitive Analysis. These new entrants pose a threat to existing sustainable clothing retailers like *GreenThrift Inc.* by increasing competition and potentially eroding market share. The emergence of these brands, focusing on using organic and recycled materials along with ethical manufacturing practices, aligns with the values of environmentally conscious consumers, making them strong competitors in the sustainable fashion market.

2. (a) Each organization has to build its competitive advantage over the competitors in the business warfare in order to win. This can be done only by following the process of strategic management. Strategic Management is very important for the survival and growth of business organizations in dynamic business environments. Other major benefits of strategic management are as follows:

- ♦ Strategic management helps organizations to be more proactive rather than reactive in dealing with its future. It facilitates to work within vagaries of environment and remains adaptable with the turbulence or uncertain future. Therefore, they are able to control their own destiny in a better way.
- ♦ It provides better guidance to entire organization on the crucial point – what it is trying to do. Also provides frameworks for all major business decisions of an enterprise such as on businesses, products, markets, organizational structures, etc.
- ♦ It facilitates to prepare the organization to face the future and act as pathfinder to various business opportunities. Organizations are able to identify the available opportunities and identify ways and means as how to reach them.
- ♦ It serves as a corporate defence mechanism against mistakes and pitfalls. It helps organizations to avoid costly mistakes in product market choices or investments.

- ♦ Over a period of time strategic management helps organization to evolve certain core competencies and competitive advantages that assist in the fight for survival and growth.

(b) To maintain a competitive edge in the face of increased competition, *Reshuffle Corp* can differentiate its products in several ways:

- **Tangible and Intangible Aspects:** *Reshuffle Corp* can focus on the tangible aspects of its products, such as using high-quality materials and innovative designs to create furniture that is both functional and aesthetically pleasing. Additionally, they can emphasize the intangible aspects of their products, such as excellent customer service and a strong brand reputation for reliability and durability.
- **Pricing Strategies:** While market prices are often dictated by competition, *Reshuffle Corp* can work on cost optimization to maintain profitability. They can also consider offering value-added services, such as free installation or extended warranties, to justify a higher price point.
- **Product Features:** By continually optimizing their product features based on customer feedback and market trends, *Reshuffle Corp* can ensure that their products deliver maximum satisfaction to their target customers. This may include features that enhance functionality, design, quality, and overall user experience.
- **Product Centric Approach:** *Reshuffle Corp* should keep their products at the center of their strategic activities, ensuring that all business processes, from production to sales and marketing, are aligned to meet customer needs and expectations.
- **Product Life Cycle Management:** *Reshuffle Corp* should be aware of the life cycle of their products and plan for reinvention or replacement accordingly. They can introduce new product lines or upgrade existing ones to keep up with changing customer preferences and market trends.

3. **(a)** SWOT Analysis for *EasyLife Corporation's* New Smart Home Devices Venture:

Strengths	**Weaknesses**
• Strong brand reputation in consumer electronics. • Established distribution network. • Access to technological expertise for product development.	• Limited experience in the smart home devices market. • May require additional investments in research and development.

• Financial resources to support product launch and marketing.	• Potential challenges in integrating a new product line with existing offerings. • Lack of established customer base for smart home devices.
Opportunities • Growing market for smart home devices due to increasing consumer interest in home automation. • Possibility of partnering with existing smart home platform providers. • Potential to leverage brand loyalty from existing customers. • Ability to differentiate through innovative features and design.	**Threats** • Intense competition from established players in the smart home devices market. • Rapid technological advancements lead to short product life cycles. • Potential for cybersecurity threats in connected devices. • Economic factors impacting consumer spending on discretionary items.

The SWOT analysis highlights that while *EasyLife Corporation* has several strengths that can support the launch of a new smart home devices line, there are also significant weaknesses and threats to consider. To maximize the chances of success, *EasyLife Corporation* should focus on leveraging its brand reputation and distribution network while carefully addressing the weaknesses and threats identified. Additionally, staying informed about technological developments and consumer trends will be essential for maintaining competitiveness in the dynamic smart home devices market.

(b) The concept of forward and backward linkages between strategy formulation and implementation in strategic management highlights the interconnected nature of these two phases and their impact on the overall strategic decision-making process of an organization.

Forward Linkages: Forward linkages refer to the impact of strategy formulation on strategy implementation. When an organization formulates a new strategy or revises an existing one, it sets the direction for the organization's future actions. For example, if a company decides to expand its product line to target a new market segment, this decision will require changes in the organization's structure, resources allocation, and possibly its leadership style. These changes are necessary to align the organization's operations with the new strategic direction. Thus, the formulation of strategies has forward linkages with their implementation, as it sets the stage for how the strategy will be executed.

Backward Linkages: Backward linkages, on the other hand, refer to the impact of implementation on strategy formulation. As an organization implements its strategies, it gains valuable insights and feedback from the implementation process. This feedback can influence future strategic decisions. For example, if a company faces unexpected challenges or discovers new opportunities during the implementation of a strategy, it may need to reevaluate its strategic choices. Similarly, past strategic actions and their outcomes can also influence the formulation of future strategies. Over time, these incremental changes in strategy and implementation take the organization from its current state to where it aims to be, reflecting the dynamic nature of strategic management.

In conclusion, the forward and backward linkages between strategy formulation and implementation highlight the iterative and interconnected nature of strategic management. By understanding and leveraging these linkages, organizations can enhance their strategic decision-making process and improve their overall performance.

4. (a) Strategic Performance Measures (SPM) are metrics used by organizations to evaluate and track the effectiveness of their strategies in achieving strategic goals and objectives. SPM provides a framework for measuring the performance of key areas critical to the success of the organization's strategy. These measures help in assessing whether the organization is progressing towards its desired outcomes and allow for adjustments to be made to improve performance.

Types of Strategic Performance Measures

There are various types of strategic performance measures, including:

- **Financial Measures**: Financial measures, such as revenue growth, return on investment (ROI), and profit margins, provide an understanding of the organization's financial performance and its ability to generate profit.
- **Customer Satisfaction Measures**: Customer measures, such as customer satisfaction, customer retention, and customer loyalty, provide insight into the organization's ability to meet customer needs and provide high-quality products and services.
- **Market Measures**: Market measures, such as market share, customer acquisition, and customer referrals, provide information about the organization's competitiveness in the marketplace and its ability to attract and retain customers.
- **Employee Measures**: Employee measures, such as employee satisfaction, turnover rate, and employee engagement, provide insight into the organization's ability to attract and retain talented employees and create a positive work environment.

- ♦ **Innovation Measures:** Innovation measures, such as research and development (R&D) spending, patent applications, and new product launches, provide insight into the organization's ability to innovate and create new products and services that meet customer needs.
- ♦ **Environmental Measures:** Environmental measures, such as energy consumption, waste reduction, and carbon emissions, provide insight into the organization's impact on the environment and its efforts to operate in a sustainable manner.

(b) The strategy adopted by *StarTech Solutions* is Focused differentiation. This strategy involves targeting a specific segment of the market with unique products or services that are perceived as valuable by customers in that segment. By specializing in serving unique, high-end clients, *StarTech* is able to differentiate itself from competitors and create a competitive advantage.

Advantages of Focused Differentiation:

- **Strong Customer Loyalty:** By catering to a specific niche market, *StarTech* can build strong relationships with its customers, leading to higher customer loyalty and retention.
- **Higher Profit Margins:** Serving a niche market allows *StarTech* to command higher prices for its specialized products or services, leading to higher profit margins.
- **Reduced Competition:** By focusing on a niche market that other firms are not targeting, *StarTech* faces less competition, allowing it to establish itself as a leader in that segment.
- **Better Resource Allocation:** Focusing on a specific market segment allows *StarTech* to allocate its resources more efficiently, concentrating on areas that will provide the greatest return on investment.

Disadvantages of Focused Differentiation:

- **Limited Market Size:** The niche market that StarTech is targeting may be limited in size, restricting the company's potential for growth.
- **Risk of Market Changes:** Changes in the market or customer preferences could impact on the demand for *StarTech's* specialized products or services, leading to potential revenue loss.
- **Higher Costs:** Serving a niche market may require specialized resources and expertise, leading to higher costs of operation.
- **Imitation by Competitors:** If *StarTech's* success in the niche market attracts competitors, they may attempt to imitate its strategy, eroding its competitive advantage.

Overall, the focused differentiation strategy adopted by *StarTech Solutions* has allowed it to differentiate itself in a competitive industry and build a strong position in the market. However, the company must be aware of the potential challenges and risks associated with this strategy and continue to innovate and adapt to maintain its competitive edge.

OR

Strategic alliances are formed if they provide an advantage to all the parties in the alliance. These advantages can be broadly categorised as follows:

(i) **Organizational:** Strategic alliances may be formed to learn necessary skills and obtain certain capabilities from the strategic partner. Strategic partners may also help to enhance productive capacity, provide a distribution system, or extend supply chain. A strategic partner may provide a good or service that complements each other, thereby creating a synergy. If one partner is relatively new or untried in a certain industry, having a strategic partner who is well-known and respected will help add legitimacy and creditability to the venture.

(ii) **Economic:** Alliances can reduce costs and risks by distributing them across the members of the alliance. Partners can obtain greater economies of scale in an alliance, as production volume increase, causing the cost per unit to decline. Finally, partners can take advantage of co-specialization, where specializations are bundled together, creating additional value.

(iii) **Strategic:** Organizations may join to cooperate instead of compete. Alliances may also create vertical integration where partners are part of supply chain. Strategic alliances may also be useful to create a competitive advantage by the pooling of resources and skills. This may also help with future business opportunities and the development of new products and technologies. Strategic alliances may also be used to get access to new technologies or to pursue joint research and development.

(iv) **Political:** Sometimes there is need to form a strategic alliance with a local foreign business to gain entry into a foreign market either because of local prejudices or legal barriers to entry. Forming strategic alliances with politically-influential partners may also help improve overall influence and position.

Mock Test Paper - Series I: July, 2024

Date of Paper: 3rd August, 2024

Time of Paper: 2 P.M. to 5 P.M.

INTERMEDIATE: GROUP – II

PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A : FINANCIAL MANAGEMENT

Suggested Answers/ Hints

DIVISION A

1. (c) 18.65%, 16.58%

Ke under two approaches

Calculation of Ke (Using Gordon's Model)

Ke = $\frac{D1}{Po} + g$

Share Price has grown from 150 to 301 in 5 years,

$150 (1 + g)^5 = 301.$

$(1 + g)^5 = 2.01$

Therefore, g = 15%, (From Annuity table – Re 1 after 5 years becomes ₹ 2.01 at rate of 15%)

D1 = 8 + 15% of 8 = 9.2

Po = Average of 52 weeks High price in last 5 years

Po = (195 + 210 +252 +325 +280) / 5

= 252.40

Ke = 9.2 / 252.40 + 0.15

= 18.65%

Calculation of Ke (Using CAPM)

Ke = Rf + (Rm – Rf) X Beta

= 8 + (11 x 0.78)

= 16.58%

2. (a) 17.82%

Overall Ke for the company

Approach	Cost of Equity (k)	Weight (w)	K x w
Gordon's	18.65%	0.6	11.19%
CAPM	16.58%	0.4	6.63% **Total Ke = 17.82%**

3. (b) 12%

Intrinsic Value of Debentures today is ₹ 9,740

WN 1 – Calculation of the Pattern of Future Cash flows

YR	PRINCIPAL (I)	INTEREST (II) = Coupon Rate = 9.5% (7.5% + 2%)	PV OF (I + II) @ 10%	PV OF (I + II) @ 15%
1	1,500	997.50	2270.45	2171.74
2	1,500	855	1946.28	1780.72
3	1,500	712.5	1662.28	1454.75
4	1,500	570	1413.84	1183.53
5	1,500	427.50	1196.83	958.31
6	1,500	285	1007.59	771.70
7	1,500	142.50	842.86	617.48
			10340.13	8938.23

$$= 10\% + \frac{(10{,}340.13 - 9{,}740)}{(10{,}340.13 - 8{,}938.23)} x5\% = 12.14\% = 12\% \text{ (approx.)}$$

4. (c) 16.07%, ₹ 87,75,000

Ko = Wd x Kd + We x Ke

= 0.3 X 12 + 0.7 X 17.82

= 16.07%

Purchase Consideration using M-Cap method

= 1,30,000 eq shares x 45 MPS x 1.5X

= ₹ 87,75,000

5. (d) ₹ 66,58,997

It is to be paid equally over 5 years and first instalment is to be paid immediately at Yr 0

Discount rate will be the Ko calculated as above of the company and not 15% which is Ko of Prestige Limited

Year	Amount each year	PV @ 16.07%	PV (₹)
0	17,55,000	1.0000	17,55,000
1	17,55,000	0.8615	15,11,933
2	17,55,000	0.7423	13,02,737
3	17,55,000	0.6395	11,22,323
4	17,55,000	0.5510	9,67,005
	TOTAL PV		**66,58,997**

6. (d) 19.5%

Financial Leverage (FL) indicates % impact in EPS, if EBIT is affected by 12%

FL = Combined Leverage (CL) /Operating Leverage (OL)

CL = 6.5 (Measure of total risk)

OL = 1 / Margin of Safety

Margin of Safety (MOS) = $\frac{\text{Actual Sales} - \text{B.E Sales}}{\text{Actual Sales}}$

MOS = 20 lakhs – 15 lakhs / 20 lakhs = 0.25

Therefore, OL = 1 / 0.25 = 4

So, FL = 6.5 / 4 = 1.625

So % Change in EPS = 12 x 1.625 = 19.5%

7. (c) 1:2

Item	Cost	Weight	Product
Debt	8%	W	8W
Equity	11%	1 – W	11 – 11W
			WACC = 10

Wd = 1/3 and We = 2/3 Debt Equity Ratio = 1/2

8. (c) ₹ 350 Lakhs

Value of Equity = 30 Lakhs ÷ 15% = ₹ 200 Lakhs

Value of Debt = ₹ 150 Lakhs

Value of Firm = 200 Lakhs + 150 Lakhs = ₹ 350 Lakhs

DIVISION B – Descriptive Questions

1. (a) 1. Cost of Goods Sold = Sales – Gross Profit

= ₹ 7,20,000 – 25% x ₹ 7,20,000 = ₹ 5,40,000

2. Stock Turnover $= \frac{\text{Cost of Goods Sold}}{\text{Average Stock}} = \frac{₹\ 5{,}40{,}000}{\text{Average Stock}}$ = 5 times.

Average Stock $= \frac{₹\ 5{,}40{,}000}{5}$ = ₹ 1,08,000

3. Let Opening Stock be x.

Closing Stock is ₹ 30,000 more than Opening Stock.

Closing Stock = (x + 30,000)

Average Stock $= \frac{x + x + 30{,}000}{2}$ = 1,08,000.

2x = 2,16,000 – 30,000

x $= \frac{1{,}86{,}000}{2}$ = 93,000 = Opening Stock.

Closing Stock = x + 30,000

= 93,000 + 30,000 = ₹ 1,23,000

4. Liquid Ratio $= \frac{\text{Liquid Assets}}{\text{Current Liabilities}} = \frac{\text{Liquid Assets}}{2{,}40{,}000}$ = 1.25.

Liquid Assets = ₹ 3,00,000

5. Current Assets = Liquid Assets + Closing Stock

= ₹ 3,00,000 + ₹ 1,23,000 = ₹ 4,23,000

(b) Calculation of slab wise Overall Cost of Capital

(i)

Project Cost	**Capital Source**	**Weights (w)**	**Cost (k)**	**w x k (%)**
Upto 5 Lakhs	Debt	0.3	10	3
	Equity	0.7	12	8.4
			Ko	**11.4**
Above 5 lakhs upto 10 lakhs	Debt	0.3	12	3.6
	Equity	0.7	13.5	9.45
			Ko	**13.05**
Above 10 lakhs upto 20 lakhs	Debt	0.3	13	3.9
	Equity	0.7	15	10.5

			Ko	**14.4**
Above 20 lakhs	Debt	0.3	14	4.2
	Equity	0.7	16	11.2
			Ko	**15.4**

Cost of Raising funds for Project I

Total Capital	Ko(%)	Total Cost (in ₹)
5,00,000	11.40	57,000
5,00,000	13.05	65,250
5,00,000	14.40	72,000
15,00,000		**1,94,250**

Overall COC (%) = Total Cost (in ₹) / Total Capital

= 1,94,250/15,00,000 * 100

= 12.95 %

Cost of Raising funds for Project II

Total Capital	Ko(%)	Total Cost (in ₹)
5,00,000	11.4	57,000
5,00,000	13.05	65,250
10,00,000	14.4	1,44,000
6,00,000	15.4	92,400
26,00,000		**3,58,650**

Overall COC (%) = 358650 / 2600000 * 100 **= 13.79%**

(ii) If any project is expected to give an after-tax return of 13%, it can be accepted only if the maximum Overall COC (%) of that project equals 13% or less, as at 13%, project would be at break-even i.e earning 13% from the project and incurring 13% COC.

So, under that scenario, Project I can be taken as its COC is 12.95% whereas Project II can't be taken as its COC is 13.79%.

Maximum Value of the Project that can be taken at 13% is approx. (Using IRR technique Interpolation)

At 15 Lakhs Ko = 12.95%

At 26 Lakhs Ko = 13.79%

By interpolation, maximum value of Project at 13% will be

15 Lakhs + {(0.05 x 11)/0.84}

= 15.6548 lakhs

(c) Income Statement

$$DFL = \frac{EBIT}{EBT} = \frac{EBT + Interest}{EBT} = \frac{EBT + 2,000}{EBT} = \frac{2}{1}.$$

EBT + ₹ 2000 = 2 EBT.

EBT = ₹ 2,000

EBIT = EBT + Interest = ₹ 2000 + ₹ 2000 = ₹ 4,000.

Contribution $\frac{Contribution}{EBIT} = \frac{Contribution}{4,000} = \frac{3}{1}$

Sales $\frac{Contribution}{PVR} = \frac{12,000}{25\%}$	48,000
Less: Variable Cost Given = 75%	(36,000)
Contribution	12,000
Less: Fixed Cost(Contribution - EBIT = ₹ 12,000 – ₹ 4,000)	(8,000)
EBIT	4,000
Less: Interest	(2,000)
EBT	2,000
Less: Tax at 30%	(600)
EAT	1,400

2. (a)

Particulars	Result
Current liabilities	1,56,000
Total Variable expenses = Purchases & Operating Expenses	1,56,000 ÷ 60 × 360 = 9,36,000
Variable expenses % of Sales	9,36,000 ÷ 12,00,000 × 100 = 78%

Particulars	Present	Proposed
1. Sales	1 Lakh ÷ 30 × 360 = 12,00,000	12 Lakhs + 1/3rd = 16,00,000
2. Variable Cost at 78%	9,36,000	12,48,000
3. Cash Discount	12 Lakh × 50% × 1% = 6,000	16 Lakh × 80% × 2% = 25,600
4. Bad debts	12 Lakh × 1.5% = 18,000	16 Lakh × 2% = 32,000
5. Profit before Tax	2,40,000	2,94,400
6. Tax @ 30%	72,000	88,320
7. Profit after Tax	1,68,000	2,06,080

Particulars	Present	Proposed
8. Opportunity Cost of Invest. in Debtors	9,36,000 × 30/360 × 70% ×15% = 8,190	12,48,000 × 20/360 × 70% × 15% = 7,280
9**. Net Benefit**	**1,59,810**	**1,98,800**

Advise: Proposed policy should be adopted since the net benefit is increased by (₹ 1,98,800 - 1,59,810) = ₹ 38,990.

(b) **(i)** As per **Gordon's Model**, Price per share is computed using the formula:

$$P_0 = \frac{E_1(1-b)}{K_e - br}$$

Where,

P_0 = Price per share

E_1 = Earnings per share

Payout ratio = 45/180 = 25%

b = Retention ratio; (1 - b = Pay-out ratio) = 1-0.25 = 0.75

K_e = Cost of capital

r = IRR

br = Growth rate (g)

Applying the above formula, price per share

$$P_0 = \frac{180(1-0.75)}{0.17-0.75\times 0.2} = \frac{45}{0.02} = ₹\ 2,250$$

(ii) **As per Walter's Model, Price per share is computed using the formula:**

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

Where,

P = Market Price of the share.

E = Earnings per share.

D = Dividend per share.

K_e = Cost of equity/ rate of capitalization/ discount rate.

r = Internal rate of return/ return on investment

Applying the above formula, price per share

$$P = \frac{45+\frac{0.20}{0.17}(180-45)}{0.17}$$

$$\text{Or,} \quad P = \frac{45+158.82}{0.17} = ₹\ 1,200 \text{ (approx..)}$$

3. (a) Calculation of Present value of cash inflows (PVCI)

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Savings in cost due to Production Delays	-	3,50,000	3,50,000	3,50,000	3,50,000	3,50,000
Savings in Salaries	-	21,00,000	21,00,000	21,00,000	21,00,000	21,00,000
Reduction in lost sales	-	1,75,000	1,75,000	1,75,000	1,75,000	1,75,000
Gain due to timely billing	-	3,25,000	3,25,000	3,25,000	3,25,000	3,25,000
	-	29,50,000	29,50,000	29,50,000	29,50,000	29,50,000
Less:						
Salary of AI specialists	-	13,00,000	13,00,000	13,00,000	13,00,000	13,00,000
Annual Maint. & Op Cost	-	1,80,000	2,00,000	1,20,000	1,10,000	1,30,000
NPBDT	-	14,70,000	14,50,000	15,30,000	15,40,000	15,20,000
(-) Depreciation	-	9,20,000	5,52,000	3,31,200	1,98,720	1,19,232
NPBT	-	5,50,000	8,98,000	11,98,800	13,41,280	14,00,768
(-) Tax @ 25%	-	1,37,500	2,24,500	2,99,700	3,35,320	3,50,192
NPAT	-	4,12,500	6,73,500	8,99,100	10,05,960	10,50,576
(+) Depreciation	-	9,20,000	5,52,000	3,31,200	1,98,720	1,19,232
(+) Annual Maint. & Op Cost	-	1,80,000	2,00,000	1,20,000	1,10,000	1,30,000
Gross Cash Inflows	-	15,12,500	14,25,500	13,50,300	13,14,680	12,99,808
(-) Annual Maint. & Op Cost actually paid	1,80,000	2,00,000	1,20,000	1,10,000	1,30,000	-
Net Cash Inflows	-1,80,000	13,12,500	13,05,500	12,40,300	11,84,680	12,99,808
(+) Sale Value at the end of life	-	-	-	-	-	1,90,000
	-1,80,000	13,12,500	13,05,500	12,40,300	11,84,680	14,89,808
PV Factor @ 12%	1	0.8929	0.7`972	0.7118	0.6355	0.5674
PV of Cash Inflows	-1,80,000	11,71,875	10,40,737	8,82,821	7,52,886	8,45,357
Total PV of Cash Inflows	45,13,675					

Calculation of Present value of cash outflows (PVCO)

As mentioned in the question, 75% of the depreciable value will be paid at the beginning. Depreciable value means purchase price plus the installation cost.

	Year 0	Year 1
Purchase Price & Installation Cost	17,25,000	5,75,000
PV Factor @ 12%	1	0.8929
PVCO	17,25,000	5,13,418

(2) Total PVCO = 22,38,418

(3) PV of Tax on Capital Gains (Only asset in the block) - 5th Year end

Capital Gains = Sale Price (-) Closing WDV at 5th year

= 1,90,000 (-) 1,78,848

= 11,152

Tax @ 20% on above = 2230.40

PV = 2,230.40 x 0.5674 = 1,266

Net PVCI = PVCI - PV of Tax on Capital Gains

= 45,13,675 - 1,266 = 45,12,409

NPV = Net PVCI – PVCO

= 45,12,409 - 22,38,418

= 22,73,991

(II) PI = PVCI / PVCO = 45,12,409/ 22,38,418 = 2.0158

(III) ARR = Average NPAT / Initial Investment

= 8,08,327.2/23,00,000 x 100 = 35.145**%**

Note – ARR is calculated based on Initial Investment, similarly it can be calculated based on Average Investment

(b) Lintner's model has two parameters:

i. The target payout ratio,

ii. The spread at which current dividends adjust to the target.

4. (a) Normally it is considered that the trade credit does not carry any cost. However, it carries the following costs:

(i) **Price:** There is often a discount on the price that the firm undergoes when it uses trade credit, since it can take advantage of the discount only if it pays immediately. This discount can translate into a high implicit cost.

(ii) **Loss of goodwill:** If the credit is overstepped, suppliers may discriminate against delinquent customers if supplies become short. As with the effect of any loss of goodwill, it depends very much on the relative market strengths of the parties involved.

(iii) **Cost of managing:** Management of creditors involves administrative and accounting costs that would otherwise be incurred.

(iv) **Conditions:** Sometimes most of the suppliers insist that for availing the credit facility the order should be of some minimum size or even on regular basis.

(b) (i) **Fully Hedged Bonds:** In foreign bonds, the risk of currency fluctuations exists. Fully hedged bonds eliminate the risk by selling in forward markets the entire stream of principal and interest payments.

(ii) **Medium Term Notes (MTN):** Certain issuers need frequent financing through the Bond route including that of the Euro bond. However, it may be costly and ineffective to go in for frequent issues. Instead, investors can follow the MTN programme. Under this programme, several lots of bonds can be issued, all having different features e.g. different coupon rates, different currencies etc. The timing of each lot can be decided keeping in mind the future market opportunities. The entire documentation and various regulatory approvals can be taken at one point of time.

(iii) **Floating Rate Notes (FRN):** These are issued up to seven years maturity. Interest rates are adjusted to reflect the prevailing exchange rates. They provide cheaper money than foreign loans.

(iv) **Euro Commercial Papers (ECP):** ECPs are short term money market instruments. They have maturity period of less than one year. They are usually designated in US Dollars.

(c) DOL can never be between zero and one. It can be zero or less or it can be one or more.

When Sales is much higher than BEP sales, DOL will be slightly more than one. With decrease in sales, DOL will increase. At BEP, DOL will be infinite. When sales is slightly less than BEP, DOL will be negative infinite. With further reduction in sale, DOL will move towards zero. At zero sales, DOL will also be zero.

OR

The finance executive of an organisation plays an important role in the company's goals, policies, and financial success. His responsibilities include:

(a) **Financial analysis and planning:** Determining the proper amount of funds to employ in the firm, i.e. designating the size of the firm and its rate of growth.

(b) **Investment decisions:** The efficient allocation of funds to specific assets.

(c) **Financing and capital structure decisions:** Raising funds on favourable terms as possible i.e. determining the composition of liabilities.

(d) **Management of financial resources** (such as working capital).

(e) **Risk management:** Protecting assets.

PAPER 6B: STRATEGIC MANAGEMENT

ANSWERS

PART I

1. (A) **(i)** **(b)** **(ii)** **(d)** **(iii)** **(c)** **(iv)** **(c)** **(v)** **(b)**

1. (B) **(i)** **(c)** **(ii)** **(c)** **(iii)** **(c)**

PART II

1. **(a)** The HealthPlus brand of wellness supplements may have the following vision and mission:

Vision: Vision implies the blueprint of the company's future position. It describes where the organization wants to land. Mr. Arun should aim to position "HealthPlus" as India's leading wellness supplements brand. It may have the vision to be India's largest wellness supplements company that enhances health, promotes extraordinary well-being, and brings happiness to people.

Mission: Mission delineates the firm's business, its goals, and ways to reach the goals. It explains the reason for the existence of the firm in society. It is designed to help potential shareholders and investors understand the purpose of the company. Mr. Arun may identify the mission in the following lines:

- To be in the business of wellness supplements to enhance the lives of people and give them the confidence to lead a healthy life.
- To protect health by providing supplements that counteract harmful elements in the environment.
- To produce wellness supplements using natural ingredients in an environmentally sustainable manner.

(b) GreenGardens should conduct a SWOT analysis to strategically plan for future growth. This analysis will help them understand their internal strengths and weaknesses, as well as external opportunities and threats.

SWOT Analysis Grid for GreenGardens:

Strengths	**Weaknesses**
High-quality, pesticide-free produce	Limited distribution channels
Strong brand reputation for organic products	Small scale of operations
Dedicated and knowledgeable workforce	Limited marketing and sales reach
Opportunities	**Threats**
Rising demand for organic products	Unpredictable weather conditions

Potential to expand into new markets	Intense competition from larger farms
Increased consumer awareness of health and sustainability	Regulatory changes affecting organic farming

By systematically evaluating these areas, GreenGardens can leverage its strengths, address its weaknesses, capitalize on opportunities, and mitigate threats. This strategic planning will guide them toward sustainable growth and success in the organic farming industry.

(c) FreshDelight is employing a **market development strategy** to expand its market presence. This approach involves introducing their existing organic fruit juices to new markets, specifically targeting countries where the demand for organic products is on the rise. To achieve this, FreshDelight is launching targeted marketing campaigns and partnering with local distributors to effectively introduce their products to these new regions. Additionally, they are adapting their product packaging and marketing messages to align with local preferences and regulations, ensuring their offerings resonate with the new customer base. By entering these emerging markets, FreshDelight aims to increase its customer base and drive sales growth, leveraging the growing popularity of organic products.

2. **(a)** A workable action plan for turnaround of the textile mill would involve:

- **Stage One – Assessment of current problems**: In the first step, assess the current problems and get to the root causes and the extent of damage.
- **Stage Two – Analyze the situation and develop a strategic plan:** Identify major problems and opportunities, develop a strategic plan with specific goals and detailed functional actions after analyzing strengths and weaknesses in the areas of competitive position.
- **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.
- **Stage Four – Restructuring the business**: 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.

(b) In matrix structure, functional and product forms are combined simultaneously at the same level of the organization. Employees have two superiors, a product / project manager and a functional manager. The "home" department - that is, engineering, manufacturing, or marketing - is usually functional and is reasonably permanent. People from these functional units are often assigned temporarily to one or more product units or projects.

The product units / projects are usually temporary and act like divisions in that they are differentiated on a product-market basis. The matrix structure may be very appropriate when organizations conclude that neither functional nor divisional forms, even when combined with horizontal linking mechanisms like strategic business units, are right for the implementation of their strategies. Matrix structure was developed to combine the stability of the functional structure with flexibility of the product form. It is very useful when the external environment (especially its technological and market aspects) is very complex and changeable.

A matrix structure is most complex of all designs because it depends upon both vertical and horizontal flows of authority and communication. It may result in higher overhead costs due to more management positions.

The matrix structure is often found in an organization when the following three conditions exist:

1. Ideas need to be cross-fertilized across projects or products;
2. Resources are scarce; and
3. Abilities to process information and to make decisions need to be improved.

3. (a) Competitive landscape is a business analysis which identifies competitors, either direct or indirect. Competitive landscape is about identifying and understanding the competitors and at the same time, it permits the comprehension of their vision, mission, core values, niche market, strengths and weaknesses.

An in-depth investigation and analysis of a firm's competition allows it to assess the competitors' strengths and weaknesses in the marketplace and helps it to choose and implement effective strategies that will improve its competitive advantage.

Steps to understand the competitive landscape for building competitive advantage are:

(i) **Identify the competitor:** The first step to understanding the competitive landscape is to identify the competitors in the firm's industry and have actual data about their respective market share.

(ii) **Understand the competitors:** Once the competitors have been identified, the strategist can use market research report, internet, newspapers, social media, industry reports, and various other sources to understand the products and services offered by them in different markets.

(iii) **Determine the strengths of the competitors:** What are the strengths of the competitors? What do they do well? Do they offer great products? Do they utilize marketing in a way that comparatively reaches out to more consumers? Why do customers give them their business?

(iv) **Determine the weaknesses of the competitors:** Weaknesses (and strengths) can be identified by going through consumer reports and reviews appearing in various media. After all, consumers are often willing to give their opinions, especially when the products or services are either great or very poor.

(v) **Put all of the information together:** At this stage, the strategist should put together all information about competitors and draw inference about what they are not offering and what the firm can do to fill in the gaps. The strategist can also know the areas which need to be strengthened by the firm.

(b) The role of Chief Executive Officer pertains to corporate level.

The corporate level of management consists of the Chief Executive Officer (CEO) and other top-level executives. These individuals occupy the apex of decision making within the organization.

The role of Chief Executive Officer is to:

1. oversee the development of strategies for the whole organization;
2. defining the mission and goals of the organization;
3. determining what businesses, it should be in;
4. allocating resources among the different businesses;
5. formulating, and implementing strategies that span individual businesses;
6. providing leadership for the organization;
7. ensuring that the corporate and business level strategies which company pursues are consistent with maximizing shareholders wealth; and
8. managing the divestment and acquisition process.

4. (a) Buyers of an industry's products or services can sometimes exert considerable pressure on existing firms to secure lower prices or better services. This is evident in situations where buyers enjoy a superior position than the seller of the product. This leverage is particularly evident when:

(i) Buyers have full knowledge of the sources of products and their substitutes.

(ii) They spend a lot of money on the industry's products, i.e., they are big buyers.

(iii) The industry's product is not perceived as critical to the buyer's needs and buyers are more concentrated than firms supplying the product. They can easily switch to the substitutes available.

(b) According to C.K. Prahalad and Gary Hamel, major core competencies are identified in three areas - competitor differentiation, customer value, and application to other markets.

- **Competitor differentiation:** The company can consider having a core competence if the competence is unique and it is difficult for competitors to imitate. This can provide a company an edge compared to competitors. It allows the company to provide better products or services to market with no fear that competitors can copy it.

- **Customer value:** When purchasing a product or service it has to deliver a fundamental benefit for the end customer in order to be a core competence. It will include all the skills needed to provide fundamental benefits. The service or the product has to have real impact on the customer as the reason to choose to purchase them. If customer has chosen the company without this impact, then competence is not a core competence.

- **Application of competencies to other markets:** Core competence must be applicable to the whole organization; it cannot be only one particular skill or specified area of expertise. Therefore, although some special capability would be essential or crucial for the success of business activity, it will not be considered as core competence, if it is not fundamental from the whole organization's point of view. Thus, a core competence is a unique set of skills and expertise, which will be used throughout the organisation to open up potential markets to be exploited.

OR

Organizations should consider the following factors when choosing strategic performance measures:

1. **Relevance:** The measure should be relevant to the organization's goals and objectives, providing actionable and meaningful information. This ensures that the performance measures are directly aligned with what the organization aims to achieve, and that the information obtained can drive improvements and strategic decisions.

2. **Data Availability:** The measure should be based on data that is readily available and can be collected and analyzed in a timely manner. This is important to ensure that the organization can efficiently gather and utilize data without significant delays or obstacles.

3. **Data Quality:** The measure should be based on high-quality data that is accurate and reliable. Accurate and reliable data are crucial for making informed decisions and assessing the true performance of the organization.
4. **Data Timeliness:** The measure should be based on data that is current and up-to-date. Timely data allows organizations to make informed decisions quickly, enabling them to respond promptly to changes and emerging challenges.

These factors are important because they provide a framework for organizations to assess the success of their strategies, identify areas for improvement, and make informed decisions about resource allocation and strategic adjustments. Effective strategic performance measures should be relevant, meaningful, easy to understand, and regularly reviewed and updated to ensure their continued alignment with the organization's goals and objectives.

Mock Test Paper - Series II: August, 2024

Date of Paper: 23rd August, 2024

Time of Paper: 2 P.M. to 5 P.M.

INTERMEDIATE: GROUP – II

PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A : FINANCIAL MANAGEMENT

Suggested Answers/ Hints

PART I – Case Scenario based MCQs

1. **(d)**

2. **(b)**

Particulars	Computation	Result
Sales	100 × 5,00,000	5,00,00,000
Less Variable cost	100 × 4,50,000	4,50,00,000
Contribution		**50,00,000**
Less Fixed cost		25,00,000
EBIT		**25,00,000**
Less Interest	15% × 40,00,000	6,00,000
EBT		**19,00,000**

Operating leverage = Contribution ÷ EBIT = 50 Lakhs ÷ 25 Lakhs = 2 times

Operating leverage = % Change in EBIT ÷ % Change in Sales i.e. if sales increase by 10%, EBIT increase by 20%.

Financial leverage = EBIT ÷ EBT = 25 Lakhs ÷ 19 Lakhs = 1.315 times

Combined leverage = Operating leverage × Financial leverage = 2 × 1.315 = 2.63 times

3. **(b)**

Particulars	Weights	Cost in %	Weights × Cost
Share Capital	40,00,000	5 + 1.9 × (10 – 5) = 14.5	5,80,000
Reserves & Surplus	25,00,000	14.5	3,62,500
Preference Share Capital	12,00,000	12	1,44,000
15% Debentures	20,00,000	15 × (1 – 25%) = 11.25	2,25,000
Total	**97,00,000**	**Total Cost**	**13,11,500**

Discount rate = WACC = 13,11,500 ÷ 97,00,000 × 100 = 13.52%

4. (b)

Particulars	Computation	Result
Savings in Tea cost	200 Employees × 200 days × 3 times × ₹ 10	12,00,000
Less: Annual maintenance		(25,000)
Less: Cost of Electricity	500 units × ₹ 24 per unit × 12 months	(1,44,000)
Less: Consumables		(8,00,000)
Less: Depreciation	5,00,000 ÷ 5 years	(1,00,000)
Profit before tax		**1,31,000**
Less: Tax	1,31,000 × 25%	32,750
Profit after tax		**98,250**
Add: Depreciation		1,00,000
Cash flow after tax	98,250 + 1,00,000	**1,98,250**

5. (b)

Year	Particulars	Cash flow	PVF@13.52%	PV
0	Initial investment	5,00,000	1	(5,00,000)
1 to 5	Savings	1,98,250	3.473	6,88,522
	Net present value			**1,88,522**

6. (b) ROCE = EBIT / Total Capital Employed

Total Capital Employed = Total Assets – Current Liabilities

= 50 lakhs – 10 lakhs

= 40 lakhs

EBIT = 40 lakhs x 15%

= 6 lakhs

Now, OL of 3.5 = Contribution / EBIT

Therefore Contribution = 6 Lakhs X 3.5 = 21 lakhs

Sales = **Contribution / PV Ratio = 21 lakhs / 0.7 = 30 lakhs**

7. (d) Calculation: Cost of Debt = (Interest Payment/ Market Price of Bond)

= (8,000 / 95,000) = 8.42%

8. (d) Cost of equity will increase. As the company increases its debt ratio, the financial risk increases, which typically leads to an increase in the cost of equity as equity investors demand a higher return for the additional risk.

PART II – Descriptive Questions

1. (a) **Let the EBIT at the Indifference Point level be E**

Particulars	Alternative 1	Alternative 2
Description	**Fully Equity of 84 Lakhs**	**Debt = 56 Lakhs, Equity = 28 Lakhs**
EBIT	E	E
Less: Interest at 12% of ₹ 56 Lakhs	Nil	6.72
EBT	E	E – 6.72
Less: Tax at 30%	0.3 E	0.3 E – 2.016
EAT	0.7 E	0.7 E – 4.704
Less: Preference Dividend	Nil	Nil
Residual Earnings	0.7 E	0.7 E – 4.704
No. of Equity Shares (Face Value ₹ 10)	8.4 Lakh Shares	2.8 Lakh Shares
EPS = $\frac{\text{Residual Earnings}}{\text{No. of Equity Shares}}$	$\frac{0.7\text{ E}}{8.4\text{ Lakh Shares}}$	$\frac{0.7\text{ E} - 4.704}{2.8\text{ Lakh Shares}}$

For indifference between the above alternatives, EPS should be equal.

So, $\frac{0.7\text{ E}}{8.4\text{ Lakh Shares}} = \frac{0.7\text{ E} - 4.704}{2.8\text{ Lakh Shares}}$

On cross multiplication and simplification, 2.1 E – 14.112 = 0.7 E. So, 1.4 E = 14.112

So, E = $\frac{14.112}{1.4}$ = 10.08

So, for same EPS, required EBIT = ₹ 10.08 Lakhs. EPS at that level = ₹ 0.84

Note: Presentation of solution may differ.

(b) **Computation of PV of Future Cash Flows**

Year	Nature	Cash Flow	DF @ 12%	DCF
1	Dividends (₹ 100 × 20%)	20	0.893	17.86
2	Dividends (₹ 100 × 20%)	20	0.797	15.94
3	Dividends (₹ 100 × 20%)	20	0.712	14.24
4	Dividends (₹ 100 × 20%)	20	0.636	12.72
5	Dividends (₹ 100 × 1.2 × 20%)	24	0.567	13.61
6	Dividends (₹ 100 × 1.2 × 20%)	24	0.507	12.17
7	Dividends (₹ 100 × 1.2 × 20%)	24	0.452	10.85
7	Net Sale Proceeds (₹ 900 × 1.2 – 5%)	1,026	0.452	463.75

	Present Value of Cash Inflows			561.14
0	Less: Initial Investment (₹ 500 + 5%)	525	1	525.00
	Net Present Value			36.14

Note: At the end of Year 4, Anand will have 1.2 Share i.e. 1 Bought Share + 1/5th Bonus Share.

(c) i. No of Eq. Shares (before buyback) = Total Earnings (before buyback)/EPS

= 18,00,000/(270/18)

= 1,20,000 shares

ii. Buyback price = 270 + 10% premium = 297

iii. No of Eq. shares (after buyback) = 1,20,000 (-) 20,000 = 1,00,000 shares

iv. Total Book Value of Equity (after buyback) = 1,00,000 X 193.20 = 1,93,20,000

Now,

Total BV of Eq. (after buyback) = Total BV of Eq.(before buyback) (-) Amt of buyback

1,93,20,000 = x (-) (20,000 X 297)

Therefore x = Total BV (before buyback)

= 2,52,60,000

BV per share (before buyback) = 2,52,60,000 / 1,20,000

= 210.50 per share

2. **(a)** Evaluation of Factoring Proposal -

	PARTICULARS	**₹**	**₹**
(A)	**Savings (Benefit) to the firm**		
	Administration Cost	45,000	45,000
	Bad Debts Cost (On Recourse basis) In House – 75 lakhs X 1% Factoring – 75 lakhs X 0.5% **Net Savings in bad debts cost**	(75 lakhs X 0.5%)	37,500
	Cost of Carrying Debtors Cost	**(WN – 1)**	1,06,750
	TOTAL		**1,89,250**
(B)	**Cost to the Firm:**		

	Factor Commission [Annual credit Sales × % of Commission]	75 lakhs X 1.5%	1,12,500
	Interest Cost on Net advances	**(See WN – 1)**	53,100
	TOTAL		**1,65,600**
(C)	**Net Benefits to the Firm (A – B)**		**23,650**

Advice: Since the savings to the firm exceed the cost due to factoring, the proposal is acceptable.

WN-1 : Calculation of Savings in Interest Cost of Carrying Debtors

(I) In house Management:

Interest Cost = Credit Sales X Avg Collection Period / 360 X Interest (%) p.a

= 75,00,000 x 60/360 x 10%

= 1,25,000

(II) If Factoring services availed: If factoring services are availed, then Sukrut Limited must raise the funds blocked in receivables to the extent which is not funded by the factor (i.e amount of factor reserve **(+)** amount of factor commission for 30 days **(+)** 20% of net advances)

Calculation of Net Advances to the firm -

Debtors = 75 lakhs x 30/360 = 6,25,000

(-) Factor Reserve = 10% of above = (62,500)

(-) Factor Commission = 1.5% of Debtors = (9,375)

Net Advance = 5,53,125

Advance from Factor = 5,53,125 x 80% = 4,42,500

Int cost on Advance from Factor = 4,42,500 x 12% = 53,100

Now, the amount that is not funded by the factor (6,25,000 - 4,42,500) needs to be funded by Sukrut Limited from overdraft facility at 10%

Therefore, Int cost on Overdraft (Cost of carrying debtors) = **1,82,500 x 10% = 18,250**

Net Savings in Interest Cost of Carrying Debtors = 1,25,000 (-) 18,250 = 1,06,750

(b) Level of investment depends on the various factors listed below:

(a) Nature of Industry: Construction companies, breweries etc. requires large investment in working capital due long gestation period.

(b) Types of products: Consumer durable has large inventory as compared to perishable products.

(c) **Manufacturing Vs Trading Vs Service:** A manufacturing entity has to maintain three levels of inventory i.e. raw material, work-in-process and finished goods whereas a trading and a service entity has to maintain inventory only in the form of trading stock and consumables respectively.

(d) **Volume of sales:** Where the sales are high, there is a possibility of high receivables as well.

(e) **Credit policy:** An entity whose credit policy is liberal has not only high level of receivables but may require more capital to fund raw material purchases as that will depend on credit period allowed by suppliers.

3. (a) **WN-1 : Calculation of Cost of Debt (Kd)**

$$\text{Approximation Method} = \frac{\text{Int (1-t)+(RV – NP)/N}}{\text{(RV + NP) / 2}}$$

RV = 100 + 10% = 110, NP = 105 - 4% = 100.8

$$= \frac{10\ (1\text{- }0.25)+(110 - 100.8)/10}{(110 + 100.8) / 2} = 7.99\%$$

YTM Method:

CMP (Po) (-) Floatation Cost = {Int(1-t) × PVAF (r%,10years)} + {RV × PVIF (r%,10^{th} Year)}

105 - 4% = {10 (1 – 0.25) × PVAF (r%,10 years)} + {110 × PVIF (r%,10^{th} year)}

Using trial and error method, NPV at 5% & 10%

Year	Cash flows	Disc Factor @ 5%	PV (₹)	Disc Factor @ 10%	PV (₹)
0	-100.8	1	-100.8	1	-100.8
1 to 10	7.5	7.7217	57.91275	6.1446	46.0845
10	110	0.6139	67.529	0.3855	42.405
			24.64175		**-12.3105**

$$\text{IRR} = 5+\frac{24.64175}{24.64175\text{-}(-12.3105)} \text{ X } (10\text{-}5) = \mathbf{8.33\%}$$

Therefore overall cost of debt (Kd) = (7.99 + 8.33) / 2 = 8.16%

WN-2 : Calculation of Cost of Preference (Kp)

$$\text{Approximation Method} = \frac{\text{Pref. Div.+(RV – NP)/N}}{\text{(RV + NP) / 2}}$$

RV = 100 NP = 115 - 2% = 112.7

$$= \frac{12 +(100 - 112.7)/10}{(100 + 112.7) / 2} = \mathbf{10.09\%}$$

YTM Method:

CMP (Po) (-) Floatation Cost = {Pref Div × PVAF (r%,10years)} + {RV × PVIF (r%,10^{th} Year)}

115 - 2% = {12 × PVAF (r%,10 years)} + {100 × PVIF (r%,10^{th} year)}

Using trial and error method, NPV at 5% & 10%

Year	Cash flows	Disc Factor @ 5%	PV (₹)	Disc Factor @ 10%	PV (₹)
0	-112.7	1	-112.7	1	-112.7
1 to 10	12	7.7217	92.6604	6.1446	73.7352
10	100	0.6139	61.39	0.3855	38.55
			41.3504		**-0.4148**

IRR = $5 + \frac{41.3504}{41.3504 - (-0.4148)}$ X (10-5) = **9.95%**

Therefore, overall cost of debt (Kp) = (10.09 + 9.95) / 2 = 10.02%

WN-3 : Calculation of Cost of equity (Ke)

Ke = {D1 / (Po - Floatation)} + G

= {2+9% / 27 – 4.5} + 0.09

= 18.69%

Calculation of WACC using market value weights

Source of Capital	Working	Market Value	Weigh ts	Cost (K)	WACC (Ko)
		(₹)	**(A)**	**(B)**	**(A x B)**
Equity	27 x 150000	40,50,000	0.7377	18.69	13.7877
Reserves	Included in equity	-	-	-	-
Preference	115 x 7500	8,62,500	0.1571	10.02	1.5741
Debentures	105 x 5500	5,77,500	0.1052	8.16	0.8584
		54,90,000	**1**		**16.22%**

WACC (Ko) = 16.22%

(b) **Change in Reserve & Surplus = ₹ 25, 00,000 – ₹ 20,00,000 = ₹ 5,00,000**

So, Net profit = ₹ 5, 00,000

(i) Net Profit Ratio = 8%

$\therefore$ Sales = $\frac{5,00,000}{8\%}$ = ₹ 62,50,000

(ii) Cost of Goods sold

= Sales – Gross profit Margin

= ₹ 62, 50,000 – 20% of ₹ 62, 50,000

= ₹ 50, 00,000

(iii) Fixed Assets = $\frac{₹\ 30,00,000}{40\%} = ₹\ 75,00,000$

(iv) Stock = $\frac{\text{Cost of Goods Sold}}{\text{STR}} = \frac{50,00,000}{4} = ₹\ 12,50,000$

(v) Debtors = $\frac{62,50,000}{360} \times 90 = ₹\ 15,62,500$

(vi) Cash Equivalent = $\frac{50,00,000}{12} \times 1.5 = ₹\ 6,25,000$

Balance Sheet as on 31st March 2024

Liabilities	**(₹)**	**Assets**	**(₹)**
Share Capital	50,00,000	Fixed Assets	75,00,000
Reserve and Surplus	25,00,000	Sundry Debtors	15,62,500
Long-term loan	30,00,000	Closing Stock	12,50,000
Sundry Creditors (Balancing Figure)	4,37,500	Cash in hand	6,25,000
	1,09,37,500		1,09,37,500

4. (a) Though in a sole proprietorship firm, partnership etc., owners participate in management but in corporates, owners are not active in management so, there is a separation between owner/ shareholders and managers. In theory managers should act in the best interest of shareholders however in reality, managers may try to maximise their individual goal like salary, perks etc., so there is a **principal agent relationship between managers and owners, which is known as Agency Problem**. In a nutshell, Agency Problem is the chances that managers may place personal goals ahead of the goal of owners. Agency Problem leads to Agency Cost. Agency cost is the additional cost borne by the shareholders to monitor the manager and control their behaviour so as to maximise shareholders wealth. Generally, Agency Costs are of four types (i) monitoring (ii) bonding (iii) opportunity (iv) structuring.

Addressing the agency problem

The agency problem arises if manager's interests are not aligned to the interests of the debt lender and equity investors. The agency problem of debt lender would be addressed by imposing negative covenants i.e. the managers cannot borrow beyond a point. This is one of the most important concepts of modern day finance and the application of this would be applied in the Credit Risk Management of Bank, Fund Raising, Valuing distressed companies.

Agency problem between the managers and shareholders can be addressed if the interests of the managers are aligned to the interests of the share- holders. It is easier said than done.

However, following efforts have been made to address these issues:

- Managerial compensation is linked to profit of the company to some extent and also with the long term objectives of the company.
- Employee is also designed to address the issue with the underlying assumption that maximisation of the stock price is the objective of the investors.
- Effecting monitoring can be done.

(b) **(i)** **Sales and Lease Back:** Under this type of lease, the owner of an asset sells the asset to a party (the buyer), who in turn leases back the same asset to the owner in consideration of a lease rentals. Under this arrangement, the asset is not physically exchanged but it all happen in records only. The main advantage of this method is that the lessee can satisfy himself completely regarding the quality of an asset and after possession of the asset convert the sale into a lease agreement.

Under this transaction, the seller assumes the role of lessee (as the same asset which he has sold came back to him in the form of lease) and the buyer assumes the role of a lessor (as asset purchased by him was leased back to the seller). So, the seller gets the agreed selling price and the buyer gets the lease rentals.

(ii) **Leveraged Lease:** Under this lease, a third party is involved besides lessor and the lessee. The lessor borrows a part of the purchase cost (say 80%) of the asset from the third party i.e., lender and asset so purchased is held as security against the loan. The lender is paid off from the lease rentals directly by the lessee and the surplus after meeting the claims of the lender goes to the lessor. The lessor is entitled to claim depreciation allowance.

(iii) **Sales-aid Lease:** Under this lease contract, the lessor enters into a tie up with a manufacturer for marketing the latter's product through his own leasing operations, it is called a sales-aid lease. In consideration of the aid in sales, the manufacturer may grant either credit or a commission to the lessor. Thus, the lessor earns from both sources i.e. From lessee as well as the manufacturer.

(iv) **Close-ended and Open-ended Leases:** In the close-ended lease, the assets get transferred to the lessor at the end of lease, the risk of obsolescence, residual value etc., remain with the lessor being the legal owner of the asset. In the open-ended lease, the lessee has the option of purchasing the asset at the end of the lease period.

(c) The basic objective of financial management is to design an appropriate capital structure which can provide the highest wealth, i.e., highest MPS, which in turn depends on EPS.

Given a level of EBIT, EPS will be different under different financing mix depending upon the extent of debt financing. The effect of leverage on the EPS emerges because of the existence of fixed financial charge i.e., interest on debt, financial fixed dividend on preference share capital. The effect of fixed financial charge on the EPS depends upon the relationship between the rate of return on assets and the rate of fixed charge. If the rate of return on assets is higher than the cost of financing, then the increasing use of fixed charge financing (i.e., debt and preference share capital) will result in increase in the EPS. This situation is also known as favourable financial leverage or Trading on Equity. On the other hand, if the rate of return on assets is less than the cost of financing, then the effect may be negative and, therefore, the increasing use of debt and preference share capital may reduce the EPS of the firm.

The fixed financial charge financing may further be analysed with reference to the choice between the debt financing and the issue of preference shares. Theoretically, the choice is tilted in favour of debt financing for two reasons: (i) the explicit cost of debt financing i.e., the rate of interest payable on debt instruments or loans is generally lower than the rate of fixed dividend payable on preference shares, and (ii) interest on debt financing is tax-deductible and therefore the real cost (after-tax) is lower than the cost of preference share capital.

OR

(c) When the cost of 'fixed cost fund' is less than the return on investment, financial leverage will help to increase return on equity and EPS. The firm will also benefit from the saving of tax on interest on debts etc. However, when cost of debt will be more than the return it will affect return of equity and EPS unfavourably and as a result firm can be under financial distress. Therefore, financial leverage is also known as "**double edged sword".**

Effect on EPS and ROE:

When, ROI > Interest – Favourable – Advantage

When, ROI < Interest – Unfavourable – Disadvantage

When, ROI = Interest – Neutral – Neither advantage nor disadvantage

PAPER 6B: STRATEGIC MANAGEMENT

ANSWERS

PART I

1. (A)	**(i)**	**(c)**	**(ii)**	**(b)**	**(iii)**	**(c)**	**(iv)**	**(a)**	**(v)**	**(c)**
1. (B)	**(i)**	**(a)**	**(ii)**	**(c)**	**(iii)**	**(a)**				

PART II

1. (a) The collaboration between TechNova, a software development firm, and ElectroWave, an electronics and hardware manufacturing company, represents a **co-generic merger**. This type of external growth strategy involves the merger of companies from related but non-competing industries, allowing them to leverage complementary strengths and diversify their product offerings.

TechNova specializes in creating cutting-edge software, while ElectroWave focuses on manufacturing advanced electronic devices. By joining forces, they can combine their expertise to design innovative laptops and smartphones, creating products that neither company could have developed as effectively on their own. This strategic partnership allows them to enter new markets, enhance their competitive advantage, and explore synergies between software and hardware.

The co-generic merger provides significant opportunities for both companies to capitalize on shared technologies, streamline their operations, and expand their customer base. It is a strategic move that enables them to diversify while maintaining a strong focus on their core competencies, ultimately helping them to grow and compete more effectively in the global market.

(b) Vikram Patel is facing declining sales due to a significant shift of customers toward online platforms. Although he employs strategic management tools, they cannot always overcome every obstacle or guarantee success. The limitations of strategic management in Vikram's situation include:

- The environment in which strategies are developed is highly complex and unpredictable. The entry of online bookstores, a new type of competitor, introduced a different dynamic to the book retail industry. These online platforms, with their extensive reach and pricing power, have dominated the market, posing a formidable challenge to traditional bookstores.
- Another limitation of strategic management is the difficulty in forecasting future developments. Despite his strategic management efforts, Vikram Patel did not anticipate the extent to which online bookstores would impact his sales.
- While strategic management is a time-consuming process, it is crucial for Vikram to continue managing strategically. These

challenging times demand increased effort and adaptability on his part.

- Strategic management can be costly. Vikram Patel might consider hiring experts to understand customer preferences better and adjust his strategies to offer more personalized services. These customized offerings could be difficult for online stores to replicate, giving him a competitive edge.
- The bookstores owned by Vikram Patel are much smaller in scale compared to online stores. This makes it challenging for him to predict how online platforms will manoeuvre strategically.

(c) The scenario being referred to is the organizational culture at *Orion Tech Solutions Pvt. Ltd.* A strong culture encourages effective strategy execution when there is alignment and drives performance even when there is minimal alignment. A culture rooted in values, practices, and behavioural norms that align with the requirements for successful strategy execution energizes employees across the organization to perform their roles in a manner that supports the strategy. Orion's culture, built around principles such as listening to customers, encouraging employees to take pride in their work, and providing a high degree of decision-making autonomy, is highly conducive to successfully executing a strategy focused on delivering superior software solutions.

A strong strategy-supportive culture at Orion makes employees feel genuinely better about their jobs, work environment, and the organization's goals. It motivates them to embrace the challenge of realizing the company's vision, perform their duties competently and enthusiastically, and collaborate effectively with others.

2. (a) As industry's Key Success Factors (KSFs) are those things that most affect industry members' ability to prosper in the marketplace – the particular strategy elements, product attributes, resources, competencies, competitive capabilities and business outcomes that spell the difference between profit & loss and ultimately, between competitive success or failure. KSFs by their very nature are so important that all firms in the industry must pay close attention to them. They are the prerequisites for industry success, or, to put it in another way, KSFs are the rules that shape whether a company will be financially and competitively successful.

(b) Channels represent the **distribution system** through which organizations distribute their products or provide services to customers. They play a pivotal role in reaching target markets, maximizing sales, and establishing competitive advantages.

Channel analysis is important when the business strategy is to scale up and expand beyond the current geographies and markets. When a business plans to grow to newer markets, they need to develop or leverage existing channels to get to new customers. Thus, analysis of channels that suit one's products and customers is of utmost importance.

There are typically three channels that should be considered: sales channel, product channel and service channel.

- **The sales channel** - These are the intermediaries involved in selling the product through each channel and ultimately to the end user. The key question is: Who needs to sell to whom for your product to be sold to your end user? **For example**, many fashion designers use agencies to sell their products to retail organizations, so that consumers can access them.
- **The product channel** - The product channel focuses on the series of intermediaries who physically handle the product on its path from its producer to the end user. This is true of Australia Post, who delivers and distributes many online purchases between the seller and purchaser when using eBay and other online stores.
- **The service channel** - The service channel refers to the entities that provide necessary services to support the product, as it moves through the sales channel and after purchase by the end user. The service channel is an important consideration for products that are complex in terms of installation or customer assistance. **For example**, a Bosch dishwasher may be sold in a Bosch showroom, and then once sold it is installed by a Bosch contracted plumber.

3. (a) A strategic vision serves as a roadmap for a company's future, detailing the specifics of technology, customer focus, geographic and product markets, and the capabilities the organization aims to develop. It answers the critical question, "Where are we going?" and provides a compelling rationale for the chosen direction, ensuring it aligns with the company's long-term objectives.

A strategic vision outlines the organization's aspirations, offering a broad, panoramic view of where it aims to be. It provides a clear direction, charts a strategic path for future endeavors, and helps in shaping the organizational identity.

Essentials of a strategic vision

- The entrepreneurial challenge in developing a strategic vision is **to think creatively about how to prepare a company for the future.**
- Forming a strategic vision is **an exercise in intelligent entrepreneurship**.
- A well-articulated strategic vision **creates enthusiasm among the members of the organization.**
- The best-worded vision statement **clearly illuminates the direction** in which organization is headed.

(b) The strategy in question is the **growth/expansion** strategy.

The Growth/Expansion strategy involves redefining the business, expanding its scope, and significantly increasing investments. This dynamic and vigorous approach is synonymous with promise and success. It entails a substantial reformulation of goals, major initiatives, and strategic moves, including investments, exploration into new products, technologies, and markets, and innovative decision-making. While promising growth, this strategy navigates the enterprise through relatively unknown and risky paths, rich with potential but also pitfalls.

Major Reasons for Adopting Growth/Expansion Strategy:

- It may become imperative when environment demands increase in pace of activity.
- Strategists may feel more satisfied with the prospects of growth from expansion; chief executives may take pride in presiding over organizations perceived to be growth-oriented.
- Expansion may lead to greater control over the market vis-a-vis competitors.
- Advantages from the experience curve and scale of operations may accrue.
- Expansion also includes intensifying, diversifying, acquiring and merging businesses.

4. (a) **Implementation or execution** is an operations-oriented, activity aimed at shaping the performance of core business activities in a strategy-supportive manner. In most situations, strategy-execution process includes the following principal aspects:

- ♦ **Developing budgets** that steer ample resources into those activities that are critical to strategic success.
- ♦ **Staffing the organization with the needed skills and expertise**, consciously building and strengthening strategy-supportive competencies and competitive capabilities and organizing the work effort.
- ♦ **Ensuring that policies and operating procedures facilitate** rather than impede effective execution.
- ♦ **Using the best-known practices to perform core business activities** and pushing for continuous improvement.
- ♦ **Installing information and operating systems** that enable company personnel to better carry out their strategic roles day in and day out.
- ♦ **Motivating people to pursue the target objectives energetically.**
- ♦ **Creating culture and climate conducive** to successful strategy implementation and execution.
- ♦ **Exerting the internal leadership** needed to drive implementation forward and keep improving strategy execution.

(b) The PESTLE framework assists in analyzing the macro-environment by systematically evaluating six external factors that impact an organization's operations and strategy.

1. **Political Factors:** This includes government policies, regulations, political stability, and taxation. Understanding these factors helps organizations anticipate regulatory changes and government interventions that could affect their business environment.
2. **Economic Factors:** This involves assessing economic conditions such as interest rates, inflation, exchange rates, and economic growth. These factors influence business costs, consumer purchasing power, and overall market conditions.
3. **Social Factors:** This examines demographic trends, lifestyle changes, cultural norms, and consumer attitudes. Insights into social factors help businesses align their products and services with evolving consumer preferences and societal trends.
4. **Technological Factors:** This includes technological advancements, innovation rates, and technological infrastructure. These factors impact production processes, product development, and competitive positioning.
5. **Legal Factors:** This involves understanding business laws, employment regulations, health and safety standards, and compliance requirements. Legal factors are crucial for ensuring regulatory compliance and avoiding legal risks.
6. **Environmental Factors:** This covers ecological issues, sustainability practices, and environmental regulations. Awareness of environmental factors helps businesses adapt to climate change and meet sustainability goals.

By analyzing these factors, the PESTLE framework provides a comprehensive understanding of the macro-environment, helping organizations anticipate changes, adapt strategies, and make informed decisions.

OR

A tool to identify the market positions of rival companies by grouping them into like positions is ***strategic group mapping.*** A strategic group consists of those rival firms which have similar competitive approaches and positions in the market.

The **procedure for constructing a strategic group map** and deciding which firms belong in which strategic group are as follows:

1. **Identify the competitive characteristics** that differentiate firms in the industry typical variables that are price/quality range (high, medium, low); geographic coverage (local, regional, national, global); degree of vertical integration (none, partial, full); product-line breadth (wide, narrow); use of distribution channels (one, some, all); and degree of service offered (no-frills, limited, full).

2. **Plot the firms on a two-variable map** using pairs of these differentiating characteristics.
3. **Assign firms that fall in about the same strategy space** to the same strategic group.
4. **Draw circles around each strategic group** making the circles proportional to the size of the group's respective share of total industry sales revenues.