MODEL TEST PAPER 1

INTERMEDIATE: GROUP – II

PAPER – 6A : FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A: FINANCIAL MANAGEMENT

Time Allowed – 3 Hours (Total time for 6A and 6B) Maximum Marks – 50

1. The question paper comprises two parts, Part I and Part II.

2. Part I comprises Case Scenario based Multiple Choice Questions (MCQs)

3. Part II comprises questions which require descriptive type answers.

4. Working note should form part of the answer. Wherever necessary, suitable assumptions may be made by the candidates and disclosed by way of note. However, in answers to Questions in Division A, working notes are not required.

PART I – Case Scenario based MCQs (15 Marks)

Write the most appropriate answer to each of the following multiple choice questions by choosing one of the four options given. All questions are compulsory.

1. NV Industries Ltd. is a manufacturing industry which manages its accounts receivables internally by its sales and credit department. It supplies small articles to different industries. The total sales ledger of the company stands at ₹ 200 lakhs of which 80% is credit sales. The company has a credit policy of 2/40, net 120. Past experience of the company has been that on average out of the total, 50% of customers avail of discount and the balance of the receivables are collected on average in 120 days. The finance controller estimated, bad debt losses are around 1% of credit sales.

   With escalating cost associated with the in-house management of the debtors coupled with the need to unburden the management with the task so as to focus on sales promotion, the CFO is examining the possibility of outsourcing its factoring service for managing its receivables. Currently, the firm spends about ₹ 2,40,000 per annum to administer its credit sales. These are avoidable as a factoring firm is prepared to buy the firm's receivables. The main elements of the proposal are : (i) It will charge 2% commission (ii) It will pay advance against receivables to the firm at an interest rate of 18% after withholding 10% as reserve.

   Also, company has option to take long term loan at 15% interest or may take bank finance for working capital at 14% interest.

   You were also present at the meeting; being a financial consultant, the CFO has asked you to be ready with the following questions:

   Consider year as 360 days.

   I. What is average level of receivables of the company?

      a. ₹ 53,33,333

b. ₹ 35,55,556

c. ₹ 44,44,444

d. ₹ 71,11,111

II. How much advance factor will pay against receivables?

a. ₹ 31,28,889

b. ₹ 39,11,111

c. ₹ 30,03,733

d. ₹ 46,93,333

III. What is the annual cost of factoring to the company?

a. ₹ 8,83,200

b. ₹ 4,26,667

c. ₹ 5,51,823

d. ₹ 4,00,000

IV. What is the net cost to the company on taking factoring service?

a. ₹ 4,00,000

b. ₹ 4,26,667

c. ₹ 3,50,000

d. ₹ 4,83,200

V. What is the effective cost of factoring on advance received?

a. 16.09%

b. 13.31%

c. 12.78%

d. 15.89% **(5 x 2 = 10 Marks)**

2. Ramu Ltd. wants to implement a project for which ₹ 25 lakhs is required. Following financing options are at hand:

Option 1:

Equity Shares	25,000 @ ₹ 100

Option 2:

Equity Shares	10,000 @ ₹ 100
12% Preference Shares	5,000@ ₹ 100
10% Debentures	10,000@ ₹ 100

What is the indifference point & EPS at that level of EBIT assuming corporate tax to be 35%.

(a) ₹ 2,94,872; ₹ 11.80

(b) ₹ 3,20,513; ₹ 8.33

(c) ₹ 2,94,872; ₹ 7.67

(d) ₹ 3,20513; ₹ 12.82 **(2 Marks)**

3. "If EBIT increases by 6%, net profit increases by 6.9%. If sales increase by 6%, net profit will increase by 24%.

   Financial leverage must be -…………"

   (a) 1.19

   (b) 1.13

   (c) 1.12

   (d) 1.15 **(2 Marks)**

4. What is the maximum period for which company can accept Public Deposits?

   (a) 1 year

   (b) 6 months

   (c) 3 years

   (d) 5 years **(1 Marks)**

PART II – Descriptive Questions (35 Marks)

*Question No. **1** is compulsory.*

*Attempt any **two** questions out of the remaining **three** questions.*

1. (a) The following figures have been extracted from the annual report of Xee Ltd.:

Net Profit	₹ 54 lakhs
Outstanding 12% preference shares	₹ 200 lakhs
No. of equity shares	2 lakhs
Return on Investment	22%
Cost of capital i.e. (K_e)	15%

COMPUTE the approximate dividend pay-out ratio so as to keep the share price at ₹ 120 by using Walter's model?

(Decimal may be taken up to 2 units) **(5 Marks)**

(b) Capital structure (in market-value terms) of AN Ltd is given below:

Company	Debt	Equity
AN Ltd.	50%	50%

The borrowing rate for the company is 10% in a no-tax world and capital markets are assumed to be perfect.

Required:

(i) If Mr. R, owns 8% of the equity shares of AN Ltd., DETERMINE his return if the Company has net operating income of ₹ 10,00,000 and the overall capitalization rate of the company (K_o) is 20%.

(ii) CALCULATE the implied required rate of return on equity of AN Ltd.

(5 Marks)

(c) ANVY Ltd. has furnished the following ratios and information for the year end 31st March, 2023:

Equity share capital	₹ 2,00,000
The relevant ratios of the company are as follows:	
Current debt to total debt	0.50
Total debt to Equity share capital	0.60
Fixed assets to Equity share capital	0.70
Total assets turnover	2.5 Times
Inventory turnover	10 Times

You are required to PREPARE the Balance Sheet of ANVY Ltd. as on 31st March, 2023. **(5 Marks)**

2. (a) NC Ltd. Is considering purchasing a new machine to increase its production facility. At present, it uses an old machine which can process 5,000 units of TVs per week. NC could replace it with new machine, which is product specific and can produce 15,000 units per week. New machine cost ₹ 100 crores and requires the working capital of ₹ 3 crores, which will be released at the end of 5th year. The new machine is expected to have a salvage value of ₹ 20 crores.

The company expects demand for TVs to be 10,000 units per week. Each TV sells for ₹ 30,000 and has Profit Volume Ratio (PV) of 0.10. The company works for the 56 weeks in the year. Additional fixed costs (excluding depreciation) are estimated to increase by ₹ 10 crores. The company is subject to a 40% tax rate and its after-tax cost of capital is 20%. The relevant rate of depreciation is 25 % for both taxation and accounts. The company uses the WDV method of depreciation. The existing machine will have no scrap value.

You are required to:

ADVISE whether the company should replace the old machine.

(Decimal may be taken up to 2 units) **(8 Marks)**

(b) WRITE a short note on “Cut-off Rate”. **(2 Marks)**

3. (a) Ram Ltd evaluates all its capital projects using discounting rate of 16%. Its capital structure consists of equity share capital, retained earnings, bank term loan and debentures redeemable at par. Rate of interest on bank term loan is 1.4 times that of debenture. Remaining tenure of debenture and bank loan is 4 years and 6 years respectively. Book value of equity share capital, retained earnings and bank loan is ₹ 20,00,000, ₹ 30,00,000 and ₹ 20,00,000 respectively. Debentures which are having book value of ₹ 30,00,000 are currently trading at ₹ 98 per debenture. The ongoing PE multiple for the shares of the company stands at 4.

You are required to:

(i) CALCULATE the rate of interest on bank loan and

(ii) CALCULATE the rate of interest on debentures

Tax rate applicable is 30%. **(8 Marks)**

(b) DISCUSS the dividend-price approach to estimate cost of equity capital.

(2 Marks)

4. (a) EXPLAIN the limitations of profit maximization objective of Financial Management. **(4 Marks)**

(b) WHAT are the methods of venture capital financing? **(4 Marks)**

(c) WHAT is 'Optimum Capital Structure'? **(2 Marks)**

OR

EXPLAIN the concept of Financial Leverage as 'Trading on Equity'.

(2 Marks)

MODEL TEST PAPER 2

INTERMEDIATE GROUP – II

PAPER – 6A : FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A: FINANCIAL MANAGEMENT

Time Allowed – 3 Hours (Total time for 6A and 6B) Maximum Marks – 50

1. *The question paper comprises two parts, Part I and Part II.*
2. *Part I comprises Case Scenario based Multiple Choice Questions (MCQs)*
3. *Part II comprises questions which require descriptive type answers.*
4. *Working note should form part of the answer. Wherever necessary, suitable assumptions may be made by the candidates and disclosed by way of note. However, in answers to Questions in Division A, working notes are not required.*

PART I – Case Scenario based MCQs (15 Marks)

Write the most appropriate answer to each of the following multiple choice questions by choosing one of the four options given. All questions are compulsory.

1. Tiago Ltd is an all-equity company engaged in manufacturing of batteries for electric vehicles. There has been a surge in demand for their products due to rising oil prices. The company was established 5 years ago with an initial capital of ₹ 10,00,000 and since then it has raised funds by IPO taking the total paid up capital to ₹ 1 crore comprising of fully paid-up equity shares of face value ₹ 10 each. The company currently has undistributed reserves of ₹ 60,00,000. The company has been following constant dividend payout policy of 40% of earnings. The retained earnings by company are going to provide a return on equity of 20%. The current EPS is estimated as Rs 20 and prevailing PE ratio on the share of company is 15x. The company wants to expand its capital base by raising additional funds by way of debt, preference and equity mix. The company requires an additional fund of ₹ 1,20,00,000. The target ratio of owned to borrowed funds is 4:1 post the fund-raising activity. Capital gearing is to be kept at 0.4x.

   The existing debt markets are under pressure due to ongoing RBI action on NPAs of the commercial bank. Due to challenges in raising the debt funds, the company will have to offer ₹ 100 face value debentures at an attractive yield of 9.5% and a coupon rate of 8% to the investors. Issue expenses will amount to 4% of the proceeds.

   The preference shares will have a face value of ₹ 1000 each offering a dividend rate of 10%. The preference shares will be issued at a premium of 5% and redeemed at a premium of 10% after 10 years at the same time at which debentures will be redeemed.

   The CFO of the company is evaluating a new battery technology to invest the above raised money. The technology is expected to have a life of 7 years. It will generate a after tax marginal operating cash flow of ₹ 25,00,000 p.a. Assume marginal tax rate to be 27%.

1. Which of the following is best estimate of cost of equity for Tiago Ltd?
   (a) 12.99%
   (b) 11.99%
   (c) 13.99%
   (d) 14.99%
2. Which of the following is the most accurate measure of issue price of debentures?
   (a) 100
   (b) 96
   (c) 90.58
   (d) 95.88
3. Which of the following is the best estimate of cost of debentures to be issued by the company? (Using approximation method)
   (a) 7.64%
   (b) 6.74%
   (c) 4.64%
   (d) 5.78%
4. Calculate the cost of preference shares using approximation method
   (a) 10.23%
   (b) 9.77%
   (c) 12.12%
   (d) 12.22%
5. Which of the following best represents the overall cost of marginal capital to be raised?
   (a) 10.52%
   (b) 17.16%
   (c) 16.17%
   (d) 16.71% **(5 x 2 = 10 Marks)**

2. Ranu & Co. has issued 10% debenture of face value 100 for ₹ 10 lakh. The debenture is expected to be sold at 5% discount. It will also involve floatation costs of ₹ 10 per debenture. The debentures are redeemable at a premium of 10% after 10 years. Calculate the cost of debenture if the tax rate is 30%.
   (a) 9.74%
   (b) 9.56%

(c) 8.25%

(d) 10.12% **(2 Marks)**

3. Given Data: Sales is ₹ 10,00,000, Break even sales is ₹ 6,00,000.

   What is the Degree of operating leverage?

   (a) 3

   (b) 2

   (c) 2.5

   (d) 2.2 **(2 Marks)**

4. A project requires an initial investment of ₹ 20,000 and it would give annual cash inflow of ₹ 4,000. The useful life of the project is estimated to be 10 years. What is payback reciprocal/Approximated IRR?

   (a) 20%

   (b) 15%

   (c) 25%

   (d) 12% **(1 Mark)**

PART II – Descriptive Questions (35 Marks)

*Question No. **1** is compulsory.*

*Attempt any **two** questions out of the remaining **three** questions.*

1. (a) The below information for Lever Ltd is provided on annual basis:

	₹
Sales at 3 months credit	48,00,000
Materials consumed (suppliers extend 2 months credit)	12,00,000
Wages paid (one month lag in payment)	9,60,000
Cash manufacturing expenses (paid on month in arrear)	12,00,000
Administrative expense (one month lag in payment)	3,60,000
Sales promotion expense (paid monthly in advance)	1,20,000

The Company sells its products at a gross profit of 20%.

The Company keeps two months stock of raw materials and two months stock of finished goods.

Depreciation is considered as a part of cost of production.

Cash balance is retained at ₹ 1,00,000,

Assuming a 15% margin, COMPUTE the working capital requirements of the Company on cash cost basis. Ignore work-in progress.

(5 Marks)

(b) SOC Ltd has 10 lakh equity shares outstanding at the beginning of the accounting year 2024. The existing market price per share is Rs 600. Expected dividend is Rs 40 per share. The rate of capitalization appropriate to the risk class to which the company belongs is 20%.

(i) CALCULATE the market price per share by the end of the year when expected dividends are: (a) declared, and (b) not declared, based on the Miller – Modigliani approach.

(ii) CALCULATE the number of shares to be issued by the company at the end of the accounting year on the assumption that the net income for the year is Rs 15 crore; investment budget is Rs 20 crores, when (a) Dividends are declared, and (b) Dividends are not declared.

(iii) PROVE that the market value of the shares at the end of the accounting year will remain unchanged irrespective of whether (a) Dividends are declared, or (ii) Dividends are not declared.

(5 Marks)

(c) An existing profitable company, RMC World Ltd. is considering a new project for manufacture of home automation gadget involving a capital expenditure of ₹ 1000 Lakhs and working capital of ₹ 150 Lakhs. The capacity of the plants for an annual production of 3 lakh units and capacity utilization during 5 year life of the project is expected to be as indicated below:

Year	1	2	3	4	5
Capacity Utilization (%)	50	65	80	100	100

The average price per unit of product is expected to be ₹600 netting a contribution of 60 percent. The annual fixed costs, excluding depreciation, are estimated to be ₹500 Lakhs per annum from the third year onwards. For the first and second year, it would be ₹ 200 lakhs and ₹ 350 lakhs respectively.

Scrap value of the capital asset at the end of 5th year is ₹ 200 Lakhs. Depreciation on capital asset is provided on written down value basis @ 40% p.a. for income tax purpose. The rate of income tax may be taken at 30%. The cost of capital is 12%. At end of the third year an additional investment of ₹ 200 lakhs would be required for working capital. There is no capital gain tax applicable.

COMPUTE the NPV of the project. RMC World Ltd. is about to make a presentation to Secure Venture Capital Firm. Secure Venture Capital Firms will invest in any project if the net addition to shareholder wealth from the project is above ₹ 100 lakhs. **(5 Marks)**

2. (a) From the following PREPARE Income statement of company P and Q.

	P	Q
No. of Equity Shares	1,00,000	70,000
Financial leverage	3 : 1	4 : 1
Operating Leverage	2 : 1	3 : 1
Variable cost to sales	67%	50%
Interest	₹ 5,50,000	₹ 6,00,000
Income tax rate	30%	30%

Also CALCULATE EPS of the company. **(4 Marks)**

(b) The GT Limited is willing to expand its business for which it requires an additional finance of ₹ 50,00,000. At present, the capital structure of the company is as under:

- 7,00,000 Equity shares of ₹ 10 each
- 10% Debentures ₹ 63,00,000
- 12% Term loan ₹ 54,00,000
- Retained earnings ₹ 1,30,00,000

At present, the company's EBIT is ₹ 54,00,000. However, the company, after expansion, expects ROI 2% greater than the present ROI, Income Tax Rate is 30%.

Following two options, for getting additional finance, are available-

(a) To raise funds as term loan @ 12%

(b) To raise funds by issuing 1,00,000 equity shares at ₹ 20 per share and balance by issuing 11% debentures at par.

Required:

(i) FIND out the market price of shares, if the P/E ratio is 10.

(ii) RECOMMEND the suitable option of raising funds with reason.

(6 Marks)

3. (a) EOC Ltd is a listed company and has presented the below abridged financial statements below.

Statement of Profit and Loss	₹	₹
Sales		1,25,00,000
Cost of goods sold		(76,40,000)
Gross Profit		48,60,000
Less: Operating Expenses		
Administrative Expenses	13,20,000	
Selling and Distribution Expenses	15,90,000	(29,10,000)

Operating Profit		19,50,000
Add: Non Operating Income		3,28,000
Less: Non Operating Expenses		(1,27,000)
Profit before Interest and taxes		21,51,000
Less: Interest		(4,39,000)
Profit before tax		17,12,000
Less: Taxes		(4,28,000)
Profit after Tax		12,84,000

Balance Sheet

Sources of Funds	**₹**	**₹**
Owned Funds		
Equity Share Capital	30,00,000	
Reserves and Surplus	18,00,000	48,00,000
Borrowed Funds		
Secured Loan	10,00,000	
Unsecured Loan	4,30,000	14,30,000
Total Funds Raised		**62,30,000**
Application of Funds		
Non-Current Assets		
Building	7,50,000	
Machinery	2,30,000	
Furniture	7,60,000	
Intangible Assets	50,000	17,90,000
Current Assets		
Inventory	38,60,000	
Receivables	39,97,000	
ST investments	3,00,000	
Cash and Bank	2,30,000	83,87,000
Less: Current Liabilities		
Creditors	25,67,000	
ST loans	13,80,000	(39,47,000)
Total Funds Employed		**62,30,000**

The company has set certain standards for the upcoming year financial status.

All the ratios are based on closing figures in financial statements.

Equity SC to Reserves=	1	
Net Profit Ratio=	15%	
Gross Profit Ratio=	50%	
Long Term Debt to Equity=	0.5	
Debtor Turnover=	100	Days
Creditor Turnover (based on COGS)=	100	Days
Inventory=	70%	of Opening inventory

Cash Balance is assumed to remain same for next year

You are required to -

(1) CALCULATE inventory turnover ratio in days for current year

(2) CALCULATE receivables turnover ratio in days for current year

(3) CALCULATE the projected receivables, inventory, payables and long term debt **(8 Marks)**

(b) NAME the various financial instruments dealt with in the International market. **(2 Marks)**

4. (a) WRITE short notes on Inter relationship between investment, financing and dividend decisions. **(4 Marks)**

(b) DISCUSS the liquidity vs. profitability issue in management of working capital. **(4 Marks)**

(c) EXPLAIN the concept of discounted payback period. **(2 Marks)**

OR

(c) EXPLAIN the concept of Indian depository receipts. **(2 Marks)**

MODEL TEST PAPER 3

INTERMEDIATE GROUP – II

PAPER – 6A : FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A: FINANCIAL MANAGEMENT

Time Allowed – 3 Hours (Total time for 6A and 6B)   Maximum Marks – 50

1. *The question paper comprises two parts, Part I and Part II.*
2. *Part I comprises Case Scenario based Multiple Choice Questions (MCQs)*
3. *Part II comprises questions which require descriptive type answers.*
4. *Working note should form part of the answer. Wherever necessary, suitable assumptions may be made by the candidates and disclosed by way of note. However, in answers to Questions in Division A, working notes are not required.*

PART I – Case Scenario based MCQs (15 Marks)

Write the most appropriate answer to each of the following multiple choice questions by choosing one of the four options given. All questions are compulsory.

1. Twigato Ltd is an all equity financed company in the food delivery business and is considering an expansion into quick grocery delivery business segment. It is the market leader in the current food delivery business with a valuation of ₹ 5750 crores. From the discussion in the recent fund-raising meeting with the venture capitalists, it has been noted that the quick delivery business is expected to be run for 6 years, after which it will be sold to another entity for a target valuation of 2 times of the investment made in the business segment. The new segment will be funded by debt, preference and equity shares in the ratio of 3:2:5. The quick grocery delivery would require ₹ 30 crores of investment to start with and subsequently it will require additional infusion of ₹ 20 crores in start of year 2 and ₹ 25 crores of fund infusion in start of year 4. The operating financials of the business is expected to be on following lines for the 1st year of operation.

   No of quick orders = 10000 per day

   No of overnight orders = 2000 per day

   Ticket sizes quick orders: 5000 orders below ₹ 500, 3000 orders between ₹ 500 and ₹ 1000 and 2000 orders above ₹ 1000 with average ticket size being ₹ 700 per order.

   Delivery charges are applicable for orders below ₹ 500, which is flat ₹ 40 per order.

   The company would charge 5% of invoice value from the seller of the quick delivery products and 7% in case of overnight delivery.

   Overnight deliveries would be available to only subscription-based customers and subscription charges are ₹ 5000 p.a. Each overnight order is expected to be having an average ticket size of ₹ 750 per order. Each subscription-based customer is expected to place order every alternate day on an average.

The quantity of orders is expected to be growing at a rate of 20%, 15%,10%, 5% for 1^{st} 4 years of operations. Beyond this it is expected to be remaining constant. The proportion of orders is expected to remain unchanged.

To attract the prospective customers, it is likely to spend heavily on advertising in initial years. The advertising and promotional activities would cost ₹ ₹ 7 crores, ₹ 8 crores and ₹ 10 crores in year 1,2 and 3 respectively.

Remuneration to delivery partners will be ₹ 15000 p.m. fixed plus ₹ 20 per delivery. Each delivery partner can deliver an average of 30 orders per day. An additional provision of 50% of extra delivery partners to be made to consider the unexpected spike in orders on special occasions and holidays. The IT infrastructure and customer care expenses would amount to ₹ 8 crores each year.

Income Tax allows 20% p.a. depreciation on straight line basis for any fresh investments. Applicable tax rate can be taken as 25%. The after-tax cost of debt, preference share, and equity share would amount to 10%, 11% and 15% respectively.

Assume 365 days in a year.

1. Which of the following is the best estimate of discounting rate for the project?

   (a) 12.00%

   (b) 11.55%

   (c) 12.70%

   (d) 13.75%

2 Which of the following is the best measure of delivery partners required in year 1?

   (a) 600

   (b) 720

   (c) 828

   (d) 911

3. Which of the following is the best measure of total revenue in year 3?

   (a) 30 crores

   (b) 25.78 crores

   (c) 33.66 crores

   (d) 25.91crores

4. Which of the following years best represents the years of loss?

   (a) Year 1 only

   (b) Year 1 and 2 only

(c) Year 1,2 and 3 only

(d) Year 1,2,3 and 4 only

5. Which of the following in the best measure of NPV of the project?

(a) 39.35 crores

(b) -25.63 crores

(c) 23.76 cores

(d) -35.67 crores **(5 x 2 = 10 Marks)**

2. If EBIT increases by 6%, taxable income increases by 6.9%. If sales increase by 6%, taxable income will increase by 24%.

Financial leverage must be -………….

(a) 1.19

(b) 1.13

(c) 1.12

(d) 1.15 **(2 Marks)**

3. The earning per share of the company is ₹10. It has an internal rate of return of 15%& capitalisation rate of the same risk class is 12.5%if the walters model is used, what should be the price of a share of optimum payout.

(a) 92

(b) 94

(c) 96

(d) 98 **(2 Marks)**

4. Packing credit by an exporter is required to be liquidated within

(a) 12 months

(b) 3 months

(c) 90 days

(d) 180 days **(1 Mark)**

PART II – Descriptive Questions (35 Marks)

*Question No. **1** is compulsory.*

*Attempt any **two** questions out of the remaining **three** questions.*

1. (a) As a financial analyst of a large electronics company, you are required to DETERMINE the weighted average cost of capital of the company using (a) book value weights and (b) market value weights. The following information is available for your perusal.

The Company's present book value capital structure is:

Debentures (₹ 100 per debenture)	₹ 8,00,000
Preference shares (₹ 100 per share)	2,00,000
Equity shares (₹ 10 per share)	10,00,000
	20,00,000

All these securities are traded in the capital markets. Recent prices are:

Debentures, ₹ 110 per debenture, Preference shares, ₹ 120 per share, and Equity shares, ₹ 22 per share

Anticipated external financing opportunities are:

(i) ₹ 100 per debenture redeemable at par; 10 year maturity, 11 per cent coupon rate, 4 per cent flotation costs, sale price, ₹ 100

(ii) ₹ 100 preference share redeemable at par; 10 year maturity, 12 per cent dividend rate, 5 per cent flotation costs, sale price, ₹ 100.

(iii) Equity shares: ₹ 2 per share flotation costs, sale price = ₹ 22.

In addition, the dividend expected on the equity share at the end of the year is ₹ 2 per share, the anticipated growth rate in dividends is 7 per cent and the firm has the practice of paying all its earnings in the form of dividends. The corporate tax rate is 35 per cent. **(5 Marks)**

(b) A Company had the following Balance Sheet as on March 31, 2023:

Liabilities and Equity	₹ (in crores)	Assets	₹ (in crores)
Equity Share Capital (Ten crore shares of ₹ 10 each)	100	Fixed Assets (Net)	250
		Current Assets	150
Reserves and Surplus	20		
15% Debentures	200		
Current Liabilities	80		
	400		400

The additional information given is as under:

Fixed Costs per annum (excluding interest)	₹ 80 crores
Variable operating costs ratio	65%
Total Assets turnover ratio	2.5
Income-tax rate	40%

Required:

CALCULATE the following and comment:

(i) Earnings per share

(ii) Operating Leverage

(iii) Financial Leverage

(iv) Combined Leverage. **(5 Marks)**

(c) From the following information, PREPARE a summarised Balance Sheet as at 31st March, 2023:

Working Capital	₹ 2,40,000
Bank overdraft	₹ 40,000
Fixed Assets to Proprietary ratio	0.75
Reserves and Surplus	₹ 1,60,000
Current ratio	2.5
Liquid ratio	1.5

(5 Marks)

2. (a) Akash Limited provides you the following information:

	₹
Profit (EBIT)	2,80,000
Less Int. on Debt@10%	40,000
EBT	2,40,000
Less Income Tax@50%	1,20,000
	1,20,000
No. of Equity Shares (₹ 10 each)	30,000
Earning per share (EPS)	4
Price /EPS (PE) Ratio	10

The company has reserves and surplus of Rs, 7,00,000 and needs ₹ 4,00,000 further for expansion. There is no change in Return on Capital Employed. You are informed that a debt (debt/ debt +equity) ratio higher than 40% will push the P/E ratio down to 8 and raise the interest rate on additional borrowings (debentures) to 12%. You are required to ASCERTAIN the probable price of the share.

(i) If the additional funds are raised as debt; and

(ii) If the amount is raised by issuing equity shares at ruling market price. **(6 Marks)**

(b) A firm had been paid dividend at ₹ 2 per share last year. The estimated growth of the dividends from the company is estimated to be 5% p.a. DETERMINE the estimated market price of the equity share if the estimated growth rate of dividends (i) rises to 8%, and (ii) falls to 3%. Also COMPUTE the present market price of the share, given that the required rate of return of the equity investors is 15.5%. **(4 Marks)**

3. A company is considering its working capital investment and financial policies for the next year. Estimated fixed assets and current liabilities for the next year are ₹ 2.60 crores and ₹ 2.34 crores respectively. Estimated Sales and EBIT depend on current assets investment, particularly inventories and book-

debts. The financial controller of the company is examining the following alternative Working Capital Policies:

(₹ Crores)

Working Capital Policy	Investment in Current Assets	Estimated Sales	EBIT
Conservative	4.50	12.30	1.23
Moderate	3.90	11.50	1.15
Aggressive	2.60	10.00	1.00

After evaluating the working capital policy, the Financial Controller has advised the adoption of the moderate working capital policy. The company is now examining the use of long-term and short-term borrowings for financing its assets. The company will use ₹ 2.50 crores of the equity funds. The corporate tax rate is 35%. The company is considering the following debt alternatives.

(₹ Crores)

Financing Policy	Short-term Debt	Long-term Debt
Conservative	0.54	1.12
Moderate	1.00	0.66
Aggressive	1.50	0.16
Interest rate-Average	12%	16%

You are required to CALCULATE the following:

(1) Working Capital Investment for each policy:

(a) Net Working Capital position

(b) Rate of Return

(c) Current ratio

(2) Financing for each policy:

(a) Net Working Capital position.

(b) Rate of Return on Shareholders' equity.

(c) Current ratio. **(10 Marks)**

4. (a) The profit maximization is not an operationally feasible criterion." COMMENT on it. **(4 Marks)**

(b) "Financing a business through borrowing is cheaper than using equity." Briefly EXPLAIN**.** **(4 Marks)**

(c) WHAT is meant by weighted average cost of capital? **(2 Marks)**

OR

(c) EXPLAIN in brief the assumptions of Modigliani-Miller theory.**(2 Marks)**

MODEL TEST PAPER 4

INTERMEDIATE: GROUP – II

PAPER – 6A : FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A: FINANCIAL MANAGEMENT

Time Allowed – 3 Hours (Total time for 6A and 6B)   Maximum Marks – 50

1. *The question paper comprises two parts, Part I and Part II.*
2. *Part I comprises Case Scenario based Multiple Choice Questions (MCQs)*
3. *Part II comprises questions which require descriptive type answers.*
4. *Working note should form part of the answer. Wherever necessary, suitable assumptions may be made by the candidates and disclosed by way of note. However, in answers to Questions in Division A, working notes are not required.*

PART I – Case Scenario based MCQs (15 Marks)

Write the most appropriate answer to each of the following multiple choice questions by choosing one of the four options given. All questions are compulsory.

Kaivalyabodhi Limited **(KbL)** has completed 35 years of operations in India. It has many subsidiary & associate companies in more than 100 countries. KbL's business s include home and personal care, foods and beverages, and industrial, agricultural and other products. It is one of the largest producers of soaps and detergents in India. The company has grown organically as well as through acquisitions. Over the years, the company has built a diverse portfolio of powerful brands, some being household names.

It is planning to acquire one of its competitors named Prestige Limited, which would enhance the growth of 'KbL'. The consideration amount will be 1.5X of its average Market Capitalization. Prestige limited has 1,30,000 outstanding equity shares and its shares were traded at an average market price of ₹ 45 as on the valuation date. The consideration amount will be paid equally in 5 years where the first installment is to be paid immediately. Prestige Limited has Ko of 15%

KbL will raise the funds required through debt and equity in the ratio of 30:70. The company requires the cost of capital estimates for evaluating its acquisitions, investment decisions and the performance of its businesses.

KbL's share price has grown from ₹ 150 to ₹ 301 in the last 5 years and it will continue to grow at the same rate. KbL pays dividends regularly. The company has recently paid a dividend of ₹ 8. For the calculation of equity, an average of 52 weeks high market price in the last 5 years is to be considered, which is as follows:

Yr 1	Yr 2	Yr 3	Yr 4	Yr 5
MPS 185	MPS 210	MPS 252	MPS 325	MPS 280

Ke calculated as per growth model holds a weight of 0.6.

The company also wishes to calculate the equity's expectation using CAPM which holds a weight of 0.4. The risk-free rate is assumed as the yield on long-term government bonds that the company regards as about 8%. KbL regards the market-risk premium to be equal to 11 per cent. Its estimation on the Beta is 0.78.

KbL will issue debentures with FV of ₹ 10,500 which is to be amortised equally over the life of 7 years. The company considers the effective rate of interest applicable to an 'AAA' rated company with a markup of 200 basis points as its coupon rate. It thinks that considering the trends over the years, 'AAA' rate is 7.5%.

Ignore taxation. Based on the above details, answer the question 1 to 5:

1. Calculate the cost of equity under both the methods
   (a) 11%, 16%
   (b) 18.65%, 10.34%
   (c) 18.65%, 16.58%
   (d) 16.5%, 9%
2. Calculate the overall cost of equity
   (a) 17.82%
   (b) 17.63%
   (c) 15.37%
   (d) 35.25%
3. Calculate the cost of debt, if the intrinsic value of debenture today is close to ₹ 9,740
   (a) 15%
   (b) 12%
   (c) 9.5%
   (d) 7.5%
4. Calculate the WACC & the amount of purchase consideration
   (a) 18%, ₹ 90,00,000
   (b) 15.21%, ₹ 87,75,000
   (c) 16.07%, ₹ 87,75,000
   (d) 15.94%, ₹ 58,50,000

5. Present Value of Purchase consideration is close to ₹

(a) 58,83,032

(b) 67,65,487

(c) 57,35,680

(d) 66,58,997 **(5 x 2 = 10 Marks)**

6. X ltd has actual Sales of ₹ 20 lakhs and its Break-even sales are at ₹ 15 lakhs. The degree of total risk involved in the company is 6.5. Calculate the % impact on EPS, if EBIT is affected by 12%.

(a) 40%

(b) 78%

(c) 312%

(d) 19.5% **(2 Marks)**

7. Assuming Ke = 11%, Kd = 8% and Ko = 10%, Debt Equity ratio of the company

(a) 2:3

(b) 3:2

(c) 1:2

(d) 2:1 **(2 Marks)**

8. Given:

Earnings available to the equity shareholders ₹ 30 Lakhs,

Cost of equity is 15%,

Debt outstanding ₹ 150 Lakhs

Value of the firm will be –

(a) ₹ 200 Lakhs

(b) ₹ 250 Lakhs

(c) ₹ 350 Lakhs

(d) ₹ 300 Lakhs **(1 Mark)**

PART II – Descriptive Questions (35 Marks)

*Question No. **1** is compulsory.*

*Attempt any **two** questions out of the remaining **three** questions.*

1. (a) You are required to CALCULATE the Total Current Assets of Ananya Limited from the given information:

Stock Turnover	= 5 times
Sales (All credit)	= ₹ 7,20,000
Gross Profit Ratio	= 25%
Current Liabilities	= 2,40,000
Liquidity Ratio	= 1.25

Stock at the end is ₹ 30,000 more than stock in the beginning.

(5 Marks)

(b) Gitarth Limited has a current debt equity ratio of 3:7. The company is presently considering several alternative investment proposals costing less than ₹ 25 lakhs. The company will always raise the funds required without disturbing its current capital structure ratio.

The cost of raising debt and equity are as follows-

Cost of Project	**Kd**	**Ke**
Upto 5 lakhs	10%	12%
Above 5 lakhs & upto 10 lakhs	12%	13.5%
Above 10 lakhs & upto 20 lakhs	13%	15%
Above 20 lakhs	14%	16%

Corporate tax rate is 30%, CALCULATE:

i) Cut off rate for two Projects I & Project II whose fund requirements are 15 lakhs & ₹ 26 lakhs respectively.

ii) If a project is expected to give an after-tax return of 13%, determine under what conditions it would be acceptable. **(5 Marks)**

(c) From the following details of X Ltd, PREPARE the Income Statement for the year ended 31st December:

Financial Leverage	2
Interest	₹ 2,000
Operating Leverage	3
Variable Cost as a Percentage of Sales	75%
Income Tax Rate	30%

(5 Marks)

2. (a) The financial statements of Gurunath Ltd is furnished below –

Balance Sheet as at 31st March

	Particulars as at 31st March	**Note**	**₹**
I	**EQUITY AND LIABILITIES:**		
(1)	Shareholders' Funds:		10,00,000
(2)	Non–Current Liabilities: 10% Debt		6,00,000
(3)	Current Liabilities		1,56,000
	Total		17,56,000
II	**ASSETS**		
(1)	Non–Current Assets		16,56,000
(2)	Current Assets – Trade Receivables		1,00,000
	Total		17,56,000

Additional Information:

1. The existing credit terms are 1/10, net 45 days and average collection period is 30 days. The current bad debts loss is 1.5%. In order to accelerate the collection process further as also to increase sales, the company is contemplating liberalization of its existing credit terms to 2/10, net 45 days.

2. It is expected that sales are likely to increase by 1/3 of existing sales, bad debts increase to 2% of sales and average collection period to decline to 20 days.

3. Credit period allowed by the supplier is 60 days. Generally, operating expenses are paid 2 months in arrears. Total Variable expenses of the company constitute Purchases of stock in trade and operating expenses only.

4. Opportunity cost of investment in receivables is 15%. 50% and 80% of customers in terms of sales revenue are expected to avail cash discount under existing and liberalization scheme respectively. The tax rate is 30%.

5. The Company considers only the relevant or variable costs for calculating the opportunity costs on the funds blocked in receivables. Assume 360 days in a year and 30 days in a month.

Should the company change its credit terms? **(6 Marks)**

(b) The following information is given for QB Ltd.

Earnings per share	₹ 180
Dividend per share	₹ 45
Cost of capital	17%
Internal Rate of Return on investment	20%

CALCULATE the market price per share using -

(a) Gordon's formula

(b) Walter's formula **(4 Marks)**

3. (a) Parmarth Limited is a manufacturer of computers. Owing to recent developments in Artificial Intelligence (AI), it is planning to introduce AI in its computer process. This would result into an estimated annual savings as follows:

(i) Savings of ₹ 3,50,000 in production delays caused by inventory problem.

(ii) Savings in Salaries of 5 employees with an annual pay of ₹ 4,20,000 per annum

(iii) Reduction in Lost sales of ₹ 1,75,000

(iv) Gain due to timely billing is ₹ 3,25,000

The project would result in annual maintenance and operating costs as follows, which are to be paid in advance (at the beginning)

YEAR	1	2	3	4	5
COST	1,80,000	2,00,000	1,20,000	1,10,000	1,30,000

Furthermore, the new system would need 2 AI specialists' professional drawing salaries of ₹ 6,50,000 per annum per person. The purchase price of the new system for installing AI into computers would involve an outlay of ₹ 21,50,000 and installation cost of ₹ 1,50,000.

75% of the total value for depreciation would be paid in the year of purchase and the balance would be paid at the end of the 1st year. The new system will be sold for ₹ 1,90,000. This is the only asset in the block for Income tax purpose.

The life of the system would be 5 years with the hurdle rate of 12%. Depreciation will be charged at 40% on WDV basis, corporate tax rate is 25% and capital gains tax rate is at 20%.

CALCULATE NPV and advise the management on the acceptability of the proposal. Also calculate ARR & PI. **(8 Marks)**

(b) DISCUSS the parameters of Lintner's Model. **(2 Marks)**

4. (a) DISCUSS the Costs of Availing Trade Credit **(4 Marks)**

(b) Briefly EXPLAIN the following –

i. Fully Hedged Bonds

ii. Medium Term Notes

iii. Floating Rate Notes

iv. Euro Commercial Papers **(4 Marks)**

(c) WHAT is the range of DOL? **(2 Marks)**

OR

DISCUSS the role of a chief financial officer. **(2 Marks)**

MODEL TEST PAPER 5

INTERMEDIATE GROUP – II

PAPER – 6A : FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A: FINANCIAL MANAGEMENT

Time Allowed – 3 Hours (Total time for 6A and 6B) Maximum Marks – 50

1. *The question paper comprises two parts, Part I and Part II.*
2. *Part I comprises Case Scenario based Multiple Choice Questions (MCQs)*
3. *Part II comprises questions which require descriptive type answers.*
4. *Working note should form part of the answer. Wherever necessary, suitable assumptions may be made by the candidates and disclosed by way of note. However, in answers to Questions in Division A, working notes are not required.*

PART I – Case Scenario based MCQs (15 Marks)

Write the most appropriate answer to each of the following multiple choice questions by choosing one of the four options given. All questions are compulsory.

Mathangi Ltd. is a News broadcasting channel having its broadcasting Centre in Chennai. There are total 200 employees in the organisation including top management. As a part of employee benefit expenses, the company serves tea to its employees, which is outsourced from a third-party. The company offers tea three times a day to each of its employees. The third-party charges ₹ 10 for each cup of tea. The company works for 200 days in a year.

Looking at the substantial amount of expenditure on tea, the finance department has proposed to the management an installation of a master tea vending machine from Nirmal Ltd which will cost ₹ 5,00,000 with a useful life of five years. Upon purchasing the machine, the company will have to incur annual maintenance which will require a payment of ₹ 25,000 every year. The machine would require electricity consumption of 500 units p.m. and current incremental cost of electricity for the company is ₹ 24 per unit. Apart from these running costs, the company will have to incur ₹ 8,00,000 for consumables like milk, tea powder, paper cup, sugar etc. The company is in the 25% tax bracket. Straight line method of depreciation is allowed for the purpose of taxation.

Nirmal Ltd sells 100 master tea vending machines. Variable cost is ₹ 4,50,000 per machine and fixed operating cost is ₹ 25,00,000. Capital Structure of Mathangi Ltd and Nirmal Ltd consists of the following –

Particulars	Mathangi Ltd.	Nirmal Ltd.
Equity Share Capital (Face value ₹ 10 each)	40,00,000	40,00,000
Reserves & Surplus	25,00,000	50,00,000
12% Preference Share Capital	12,00,000	Nil
15% Debentures	20,00,000	40,00,000

Risk free rate of return = 5%, Market return = 10%, Beta of the Mathangi Ltd. = 1.9

You are required to answer the following five questions based on the above details:

1. If sales of Nirmal Ltd are up by 10%, impact on its EBIT is
   (a) 30%
   (b) 60%
   (c) 5%
   (d) 20%
2. Combined leverage of Nirmal Ltd is
   (a) 1.63
   (b) 2.63
   (c) 1.315
   (d) 2
3. Discount rate that can be applied for making investment decisions of Mathangi Ltd is
   (a) 12%
   (b) 13.52%
   (c) 15%
   (d) 20%
4. Incremental cash flow after tax per annum attributable to Mathangi Ltd due to investment in the machine is
   (a) ₹ 2,39,438
   (b) ₹ 1,98,250
   (c) ₹ 98,250
   (d) ₹ 1,31,000
5. Net present value of investment in the machine by Mathangi Ltd is
   (a) ₹ 6,88,522
   (b) ₹ 1,88,522
   (c) ₹ 9,91,250
   (d) ₹ 4,91,250 **(5 x 2 = 10 Marks)**

6. Total Assets & Current liabilities of the Vitrag Limited are 50 lakhs & 10 lakhs respectively. ROCE is 15%, measure of business operating risk is at 3.5 & P/V ratio is 70%. Calculate Sales.

   (a) 21 lakhs

   (b) 30 lakhs

   (c) 37.50 lakhs

   (d) 40 lakhs **(2 Marks)**

7. A company has issued bonds with a face value of ₹ 100,000 at an annual coupon rate of 8%. The bonds are currently trading at 95% of their face value. What is the approximate cost of debt for the company before taxes.

   (a) 9.00%

   (b) 7.65%

   (c) 8.00%

   (d) 8.42% **(2 Marks)**

8. A company is considering changing its capital structure by increasing its debt ratio from 40% to 55%. What is the likely impact on the company's cost of equity, assuming all other factors remain constant?

   (a) Cost of equity will be unaffected by debt ratio

   (b) Cost of equity will remain unchanged

   (c) Cost of equity will decrease

   (d) Cost of equity will increase **(1 Mark)**

PART II – Descriptive Questions (35 Marks)

*Question No. **1** is compulsory.*

*Attempt any **two** questions out of the remaining **three** questions.*

1. (a) X Ltd is willing to raise funds for its New Project which requires an investment of ₹ 84 Lakhs. The Company has two options:

   Option I: To issue Equity Shares (₹ 10 each) only

   Option II: To avail Term Loan at an interest rate of 12%. But in this case, as insisted by the Financing Agencies, the Company will have to maintain a Debt–Equity proportion of 2:1.

   The Corporate Tax Rate is 30%. FIND out the point of indifference for the project. **(5 Marks)**

   (b) Mr. Anand is thinking of buying a Share at ₹ 500 whose Face Value per share is ₹ 100. He is expecting a bonus at the ratio 1 : 5 at the end of the fourth year. Annual expected dividend is 20% and the same rate is expected to be maintained on the expanded capital base. He intends to sell the Shares at the end of seventh year at an expected price of ₹ 900 each. Incidental Expenses for purchase and sale of Shares are estimated to be 5% of the Market Price. Assuming a Discount rate of 12% per annum, COMPUTE the Net Present Value from the acquisition of the shares. **(5 Marks)**

(c) Paarath Limited had recently repurchased 20,000 equity shares at a premium of 10% to its prevailing market price. The book value per share (after repurchasing) is ₹ 193.20.

Other Details of the company are as follows:

Earnings of the company (before buyback) = ₹ 18,00,000

Current MPS is ₹ 270 with a P/E Ratio of 18.

CALCULATE the Book Value per share of the company before the re-purchase. **(5 Marks)**

2. (a) Sukrut Limited has annual credit sales of ₹ 75,00,000/-. Actual credit terms are 30 days, but its management of receivables has been poor, and the average collection period is about 60 days. Bad debt is 1 per cent of total sales.

A factor has offered to take over the task of debt administration and credit checking, at an annual fee of 1.5 per cent of credit sales.

Sukrut Limited estimates that it would save ₹ 45,000 per year in administration costs as a result. Due to the efficiency of the factor, the average collection period would come back to the original credit offered of 30 days and bad debts would come to 0.5% on recourse basis.

The factor would pay net advance of 80 percent to the company at an annual interest rate of 12 per cent after withholding a reserve of 10%. Sukrut Limited is currently financing its receivables from an overdraft costing 10 per cent per year and will continue to finance the balance fund needed (which is not financed by factor) through the overdraft facility

If occurrence of credit sales is throughout the year, COMPUTE whether the factor's services should be accepted or rejected. Assume 360 days in a year. **(7 Marks)**

(b) Determining the amount to be invested in current assets as working capital is a crucial policy decision for any entity. What FACTORS should a company consider when deciding the level of investment in working capital? **(3 Marks)**

3. (a) Calculate the WACC using the following data by using Market Value weights:

Particulars	₹
Equity Shares (₹ 10 per equity share)	15,00,000
Reserves & Surplus	5,00,000
Preference Shares (₹ 100 per preference share)	7,50,000
Debentures (₹ 100 per debenture)	5,50,000

The market prices of these securities are:

Debentures - ₹ 105 per debenture,

Preference shares - ₹115 per preference share

Equity shares - ₹ 27 per equity share

Additional information:

(1) ` 100 FV per debenture redeemable at premium of 10%, 10% coupon rate, 4% floatation costs, 10-year maturity.

(2) ` 100 FV per preference share redeemable at par, 12% coupon rate, 2% floatation cost and 10-year maturity.

(3) Equity shares have ₹ 4.5 floatation cost and market price of 27 per share.

The last dividend paid by the company was ` 2 which is expected to grow at an annual growth rate of 9%. The firm has the practice of paying all earnings as a dividend.

The corporate tax rate is 25%. To calculate the overall cost of debt & preference shares, take the average of their respective costs using YTM & approximation method. **(6 Marks)**

(b) EPL Ltd. has furnished the following information relating to the year ended 31st March 2023 and 31st March, 2024:

	31st March, 2023	**31st March, 2024**
Share Capital	50,00,000	50,00,000
Reserve and Surplus	20,00,000	25,00,000
Long term loan	30,00,000	30,00,000

- Net profit ratio: 8%
- Gross profit ratio: 20%
- Long-term loan has been used to finance 40% of the fixed assets.
- Stock turnover with respect to cost of goods sold is 4.
- Debtors represent 90 days sales.
- The company holds cash equivalent to 1½ months cost of goods sold.
- Ignore taxation and assume 360 days in a year.

You are required to PREPARE Balance Sheet as on 31st March 2024 in following format:

Liabilities	**(₹)**	**Assets**	**(₹)**
Share Capital	-	Fixed Assets	-
Reserve and Surplus	-	Sundry Debtors	-
Long-term loan	-	Closing Stock	-
Sundry Creditors	-	Cash in hand	-

(4 Marks)

4. (a) The agency problem is one of the key concepts in corporate governance and financial management. On the light of this statement, EXPLAIN agency problem, consequences of agency problem and how to overcome the issue. **(4 Marks)**

(b) Operating leases and financial leases are traditionally the most important types of leases in financial management. However, in recent years, other types of leases have also gained significance due to their unique benefits and applications. IDENTIFY AND EXPLAIN at least four other types of leases that have become increasingly important in modern business practices. **(4 Marks)**

(c) EXPLAIN the Relationship between EBIT-EPS-MPS **(2 Marks)**

OR

(c) EXPLAIN Financial Leverage as a 'Double edged Sword' **(2 Marks)**

MODEL TEST PAPER 6

INTERMEDIATE GROUP – II

PAPER – 6A : FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A: FINANCIAL MANAGEMENT

Time Allowed – 3 Hours (Total time for 6A and 6B) Maximum Marks – 50

1. *The question paper comprises two parts, Part I and Part II.*
2. *Part I comprises Case Scenario based Multiple Choice Questions (MCQs)*
3. *Part II comprises questions which require descriptive type answers.*
4. *Working note should form part of the answer. Wherever necessary, suitable assumptions may be made by the candidates and disclosed by way of note. However, in answers to Questions in Division A, working notes are not required.*

PART I – Case Scenario based MCQs (15 Marks)

Write the most appropriate answer to each of the following multiple choice questions by choosing one of the four options given. All questions are compulsory.

Case Scenario I:

Small bus Company is into manufacturing mini buses. Since its establishment it has seen a phenomenal growth in both its market share and profitability. The financial statements (Statement of P&L and Balance Sheet) are shown below. The company enjoys the confidence of its shareholders who have been rewarded with growing dividends year after year. Last year too, the company had announced 20 per cent dividend, which was the highest in the automobile sector. The company has never defaulted on its loan payments and enjoys a favourable face with its lenders, which include financial institutions, commercial banks and other private debenture holders. The competition in the bus industry has increased in the past few years and the company foresees further intensification of competition with the entry of several foreign bus manufacturers; many of whom are market leaders in their respective countries. The mini bus segment especially, will witness entry of foreign majors in the near future, with latest technology being offered to the Indian customer. Small bus company's management realises the need for large scale investment in upgradation of technology and improvement of manufacturing facilities to beat competition.

While on one hand, the competition in the industry has been intensifying, on the other hand, there has been a slowdown in the Indian economy, which has not only reduced the demand for buses, but also led to adoption of price cutting strategies by various bus manufacturers.

The Company needs ₹ 3,12,50,000 for the investment in technology and improvement of manufacturing facilities. Company has three options for the funds:

I The Company may issue 31,25,000 equity shares at ₹ 10 per share.

II The Company may issue 15,62,500 equity shares at ₹ 10 per share and 1,56,250 debentures of ₹ 100 denomination bearing an 9% rate of interest.

III The Company may issue 15,62,500 equity shares at ₹ 10 per share and 1,56,250 preference shares at ₹ 100 per share bearing an 10% rate of dividend.

The company's earnings before interest and taxes after investment is ₹ 37,50,000. Income tax rate applicable to the company is 40%.

Based on the above facts, the management of the company asked you to answer the following questions (MCQs 1 to 5):

1. What is the EPS under financial plan I?

   (a) ₹ 0.50

   (b) ₹ 0.62

   (c) ₹ 0.72

   (d) ₹ 0.44

2. What is the EPS under financial plan II?

   (a) ₹ 0.70

   (b) ₹ 0.90

   (c) ₹ 0.42

   (d) ₹ 1.10

3. What is the EPS under financial plan III?

   (a) ₹ 0.44

   (b) ₹ 0.70

   (c) ₹ 0.85

   (d) ₹ 1.20

4. What is the EBIT-EPS indifference points by formulae between Financing Plan I and Plan II?

   (a) ₹ 28,12,500.00

   (b) ₹ 29,00,000.00

   (c) ₹ 32,50,666.66

   (d) ₹ 45,15,253.56

5. What is the EBIT-EPS indifference points by formulae between Financing Plan I and Plan III?

   (a) ₹ 36,36,666.66

   (b) ₹ 45,25,000.00

   (c) ₹ 28,56,256.25

   (d) ₹ 52,08,333.33 **(5 x 2 = 10 Marks)**

6. A company has a degree of operating leverage is 2 and degree of financial leverage is 3. If the sales of the company increase by 5% during the next quarter, the Earning Per Share (EPS) will increase by?

   (a) 20%

   (b) 30%

   (c) 50%

   (d) 60% **(2 Marks)**

7. Following are the data on a capital project being evaluated by the management of Aman Ltd.

Particulars	Project A
Annual cost saving	₹ 1,80,000
Useful life	5 years
Internal rate of return	10%
Salvage value	0
PVAF (15,4 years)	3.79

   Based upon the information, the payback period of the project will be

   (a) 2.652

   (b) 2.850

   (c) 3.790

   (d) 3.855 **(2 Marks)**

8. Under Modigliani and Miller's Dividend Irrelevance Theory, a company has ₹1,00,000 to distribute. If it chooses to retain the earnings instead of paying dividends, what happens to shareholder wealth?

   (a) Increases due to reinvestment opportunities.

   (b) Decreases due to lower immediate returns.

   (c) Remains unchanged because value depends on earnings and investment policy.

   (d) Depends on the dividend payout ratio **(1 Mark)**

PART II – Descriptive Questions (35 Marks)

*Question No. **1** is compulsory.*

*Attempt any **two** questions out of the remaining **three** questions.*

1. (a) ABC Industries is a mid-sized company manufacturing consumer goods. Last quarter, the company reported sales of ₹ 2,00,000. The production process involves significant variable costs, which account for 50% of the sales value. Additionally, the company incurs ₹ 40,000 as fixed operating costs for rent, utilities, and management expenses. ABC Industries has also borrowed funds, leading to ₹ 10,000 as annual interest on long-term debt.

The company is currently planning to launch a new marketing campaign aimed at boosting sales by 10%. As a financial analyst at ABC Industries, you are required to:

1. CALCULATE the combined leverage.
2. ILLUSTRATE the impact of the 10% sales increase using the combined leverage. **(5 Marks)**

(b) P Ltd. has the following capital structure at book-value as on 31st March, 2024:

Particulars	**(₹)**
Equity share capital (1,00,000 shares)	10,00,000
12% Preference shares	15,00,000
10% Debentures	15,00,000
	40,00,000

Additional Information:

1. The equity shares of P Ltd. are currently traded at ₹ 100 per share.
2. The company expects to pay a dividend of ₹ 5 per equity share next year, with dividends projected to grow perpetually at a rate of 5% p.a.
3. The corporate tax rate is 35%.

Requirements:

1. CALCULATE the Weighted Average Cost of Capital (WACC) based on the current capital structure.
2. RECALCULATE the WACC if the company raises an additional ₹ 5 lakhs of debt by issuing 12% debentures. This change will result in:
   - An increase in the expected equity dividend to ₹ 7 per share while the growth rate remains constant at 5%.
   - A decrease in the market price of equity shares to ₹90 per share **(5 Marks)**

(c) Vyom Limited, an IT conglomerate, is planning to take over Aryayash Limited, a startup company incorporated 2 years ago but holding a lot of prospects. To determine the buyout consideration, Vyom Limited has approached you as a Finance controller to estimate the fair value of the startup company today based on future earnings estimates. Following details of the startup company are as below -

Expected Sales in the coming year are ₹ 25 lakhs with P/V ratio of 40%. The sales are expected to grow at a rate of 20% for the next 2 years, to 40% for another 2 years, 25% in the 6^{th} year and thereafter cash flows will grow at a steady rate of 10%. Fixed cost for the upcoming year is expected to be 12 lakhs for the first two years, ₹ 10 lakhs thereafter. Loss in any year can be set-off only against the profits of the immediate next year.

Corporate taxes applicable are 25% & 20% to Vyom Limited & Aryayash Limited respectively. Vyom Limited's desired rate of return is 15% & Cost of Capital of Aryayash Limited is 17%.

As a finance controller, CALCULATE the Fair value of Aryayash Limited.

(5 Marks)

2. (a) From the following information pertaining to M/s Anya Co. Ltd., PREPARE its trading, Profit & Loss Account for the year ended on 31 March, 2024 and a summarized Balance Sheet as at that date:

	Amt in ₹
Current Ratio	2.5
Quick Ratio	1.3
Proprietary Ratio (Fixed Assets/ Proprietary Fund)	0.6
Gross Profit to Sale Ratio	10%
Debtors Velocity	40 days
Sales	730,000
Working Capital	120,000
Bank Overdraft	15,000
Share Capital	2,50,000

Closing Stock is 10% more than opening Stock.

Net Profit is 10% of Proprietary Funds. **(6 Marks)**

(b) Paras TMT Ltd. is a TMT manufacturing company with a face value of ₹ 10 per share.

The following information is given about the company:

- The company is expected to grow @ 10% p.a. for next four years then 5% for an indefinite period.
- Rate of return expected by the shareholders on their share investments is 15%.

- Company paid ₹ 4 as dividend per share for the current Financial Year.

FIND out the intrinsic value per share **(4 Marks)**

3. Zomo Ltd. currently has a turnover of ₹ 120 lakhs, 75% of which is on credit. The variable cost ratio is 80%, and the credit terms offered are 2/10, net 30. On the current sales volume, the bad debts are 1%, and the company spends ₹ 1,20,000 annually on administering its credit sales, including staff salaries for credit checking and collection. These costs are avoidable.

In addition:

- 60% of customers avail of the 2% cash discount, and the remaining customers take 60 days on average to pay after the date of sale.
- The book debts are financed by a mix of bank borrowings and owned funds in a 1:1 ratio, with annual costs of 15% and 14%, respectively.

However, Zomo Ltd. is also considering dynamic discounting for its cash customers, which might incentivize more customers to pay earlier by increasing the discount rate. This could lead to a potential reduction in bad debts to 0.8% but may also increase the cost of the discount offered to 2.5%.

A factoring firm has proposed a deal with the following terms: (i) Factor reserve: 12% (ii) Guaranteed payment: 25 days (iii) Interest charges: 15% (iv) Commission: 4% of receivables.

In addition, the company also has the option to extend the credit period for its remaining customers (who do not avail of the discount) to 75 days, which might increase sales by 10% but could result in an increase in bad debts to 1.5%.

Given:

1. The cost of funds is expected to rise to 16% next year.
2. Zomo Ltd. plans to introduce late payment penalties (for customers who take more than 60 days) at 5% of outstanding receivables after 60 days.

Assume a 360-day year.

Required:

- SHOULD Zomo Ltd. opt for dynamic discounting or the factoring firm's offer?
- ANALYZE the impact of extending the credit period on the company's finances.

COMPARE all options and RECOMMEND whether to continue with in-house management, dynamic discounting, or accept the factoring firm's offer.

(10 Marks)

4. (a) A company is evaluating two options for financing its current assets: using short-term loans or long-term loans. HOW should the company balance risk and return in making this decision, and WHAT factors should it consider to ensure optimal financing? **(4 Marks)**

(b) You are a financial consultant for a company that has a very high capital base but low earnings per share (EPS). EXPLAIN over-capitalization. What are the causes and consequences of over-capitalization?"

(4 Marks)

(c) "XYZ Corp. has adopted a strategy to maximize short-term profits by increasing product prices significantly. ANALYZE why this might not be a feasible operational criterion for sustainable growth." **(2 Marks)**

OR

(c) DEFINE Modified Internal Rate of Return method. **(2 Marks)**

MODEL TEST PAPER 7

INTERMEDIATE GROUP – II

PAPER – 6A : FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A: FINANCIAL MANAGEMENT

Time Allowed – 3 Hours (Total time for 6A and 6B) Maximum Marks – 50

1. *The question paper comprises two parts, Part I and Part II.*
2. *Part I comprises Case Scenario based Multiple Choice Questions (MCQs)*
3. *Part II comprises questions which require descriptive type answers.*
4. *Working note should form part of the answer. Wherever necessary, suitable assumptions may be made by the candidates and disclosed by way of note. However, in answers to Questions in Division A, working notes are not required.*

PART I – Case Scenario based MCQs (15 Marks)

Write the most appropriate answer to each of the following multiple choice questions by choosing one of the four options given. All questions are compulsory.

Case Scenario I:

MNP Ltd. is a multinational company having its operations spread mostly in India and neighbouring countries of India. The promotors of the company believed that capital structure of a company must be kept flexible and balanced, where proper mix should always be maintained between debt and equity. Such mix of debt and equity should be reviewed from time to time keeping in mind the changing situation of India and the global scenario.

The capital structure of MNP Ltd. is as under:

9% Debentures	Rs. 2,75,000
11% Preference shares	Rs. 2,25,000
Equity shares (face value: Rs. 10 per share)	Rs. 5,00,000
Total capital of the company	Rs. 10,00,000

The following are some of the additional information provided by MNP Ltd. relating to the above mentioned capital structure.

(i) Rs. 100 per debenture redeemable at par has 2% floatation cost and 10 years of maturity. The market price per debenture is Rs. 105.

(ii) Rs. 100 per preference share redeemable at par has 3% floatation cost and 10 years of maturity. The market price per preference share is Rs. 106.

(iii) Equity share has Rs. 4 floatation cost and market price per share of Rs. 24. The next year expected dividend is Rs. 2 per share with an annual growth of 5%. The firm has a practice of paying all earnings in the form of dividends.

(iv) Corporate Income-tax rate is 35%.

Since the company is a multinational company market value weights are preferred over book value weights when calculating the Weighted Average Cost of Capital (WACC) for several reasons. The company believes that market values reflect the current market perception of a company's financial health and future prospects. This is more relevant for calculating the cost of capital today, as investors base their decisions on current market conditions. Book values, based on historical accounting principles, may not accurately represent the true economic value of the company's capital components. Market values capture the actual cost that a company would incur if it were to raise new capital in the current market. Book values might not reflect the true cost of debt due to factors like changes in interest rates or creditworthiness. Similarly, book value of equity might not reflect the current investor expectations for future dividends and growth. Market values are readily available through stock prices and market interest rates. Obtaining accurate book values, especially for intangible assets, can be a complex and time-consuming process.

On the basis of this information provided above you are required to answer the following MCQs (1 to 5):

1. Calculate the cost of equity and choose the correct answer from the following?

    (a) 14%

    (b) 15%

    (c) 16%

    (d) 17%

2. Calculate the cost of debt and choose the correct answer from the following?

    (a) 6.11%

    (b) 5.48%

    (c) 9%

    (d) 10.55%

3. Calculate the cost of preference shares and choose the correct answer from the following?

    (a) 10.57 %

    (b) 5.11%

    (c) 9%

    (d) 10%

4. Calculate the WACC using market value weights and choose the correct answer from the following?

    (a) 12.80 %

(b) 5.11%

(c) 9%

(d) 10.55%

5. What will be the current market price of MNP Ltd.'s equity shares if Ke = 10%, expected dividend is Rs. 2 per share and annual growth rate is 5% from the following options:

(a) 40 per share

(b) 20 per share

(c) 30 per share

(d) 45 per share **(5 x 2 = 10 Marks)**

6. EBIT = 4,00,000

EBT = 3,00,000

Sales = 16,00,000

Which of the following is / are correct?

1. DFL is 1.33

2. Interest coverage ratio is 3

3. Operating profit margin is 25%

Select the correct answer using the code given below:

(a) 1, 2 and 3

(b) 1 and 2 only

(c) 1 and 3 only

(d) 3 only **(2 Marks)**

7. If velocity of stock is 3 months, annual sales amount to Rs.6 lakh at 20% gross profit margin and opening stock is Rs.90,000; what is the closing stock value?

(a) Rs. 90,000

(b) Rs. 70,000

(c) Rs. 1,50,000

(d) Rs. 1,00,000 **(2 Marks)**

8. Margin of safety is affected if:

1. P/V ratio changes

2. Fixed cost changes

3. Volume of sales changes

(a) 1 only

(b) 1 and 2 only

(c) 2 and 3 only

(d) 1, 2 and 3 **(1 Mark)**

PART II – Descriptive Questions (35 Marks)

*Question No. **1** is compulsory.*

*Attempt any **two** questions out of the remaining **three** questions.*

1. (a) The financial statement and operating results of Alpha Limited revealed the following position as on 31st March, 2023:

—	Equity share capital (Rs. 10 fully paid share)	Rs. 20,00,000
—	Working capital	Rs. 6,00,000
—	Bank overdraft	Rs. 1,00,000
—	Current ratio	2.5 : 1
—	Liquidity ratio	1.5 : 1
—	Proprietary ratio (Net fixed assets/Proprietary fund)	.75 : 1
—	Cost of sales	Rs. 14,40,000
—	Debtors velocity	2 months
—	Stock turnover based on cost of sales	4 times
—	Gross profit ratio	20% of sales
—	Net profit ratio	15% of sales

Closing stock was 25% higher than the opening stock. There were also free reserves brought forward from earlier years. Current assets include stock, debtors and cash only. The current liabilities expect bank overdraft treated as creditors.

Expenses include depreciation of Rs. 90,000.

The following information was collected from the records for the year ended 31st March, 2024:

— Total sales for the year were 20% higher as compared to previous year.

— Balances as on 31st March, 2024 were : Stock Rs. 5,20,000, Creditors Rs. 4,15,000, Debtors Rs. 4,95,000 and Cash balance Rs. 3,10,000.

— Percentage of Gross profit on turnover has gone up from 20% to 25% and ratio of net profit to sales from 15% to 16%.

— A portion of Fixed assets was very old (book values Rs. 1,80,000) disposed for Rs. 90,000. (No depreciations to be provided on this item).

— Long-term investments were purchased for Rs. 2,96,600.

— Bank overdraft fully discharged.

— Percentage of depreciation to Fixed assets to be provided at the rate in the previous year.

PREPARE Balance Sheet as on 31st March, 2023 and 31st March, 2024.

(5 Marks)

(b) Theta Limited is expecting an annual earning of Rs. 3 Lakhs before paying any interest and taxes. The company has Rs. 10 lakhs of 10% debentures in its capital structure. The capitalisation rate is 12.5%. You are required to calculate the value of Theta Limited as per the NI approach. Also, COMPUTE the overall cost of capital. **(5 Marks)**

(c) The following data relates to Beta Limited:

	Rs.
Sales	2,00,000
Less: Variable Expenses (30%)	60,000
Contribution	1,40,000
Fixed operating expenses	1,00,000
EBIT	40,000
Less: Interest	5,000
EBT	35,000

(i) CALCULATE by what percentage will EBT increase if sales increases by 6 percent.

(ii) CALCULATE by what percentage will EBIT increase if there is 10 per cent increase in sales?

(iii) CALCULATE by what percentage EBT increase if EBIT increases by 6 per cent? **(5 Marks)**

2. (a) ABC Ltd., a newly formed company has applied to the Private Bank for the first time for financing it's Working Capital Requirements. The following information is available about the projections for the current year: Estimated Level of Activity Completed Units of Production 31,200.

Raw Material Cost	Rs 40 per unit
Direct Wages Cost	Rs 25 per Unit
Overhead	Rs 40 per Unit (Incl Rs 10 of Depreciation)
Selling Price	Rs 150 per unit
GP Ratio (Cash Cost)	30%
Net Profit Ratio	25% (On Total cost)
Raw Material in Stock	Avg of 30 days consumption
Work in Progress Stock at 30% of FG Produced Units	****Valued at Prime Cost** Material – 90% into process

	Relevant Conversion Cost – 60% completed
Finished Goods Stock	2,500 units
Credit Allowed by the supplier	30 Days
Credit Allowed to Purchasers	45 Days
Direct Wages [Lag in payment]	15 Days
Expected Cash Balance	1,25,000

Safety margin is to be kept at 15% of the net working capital required inclusive of the margin amount. Assume that production is carried on evenly throughout the year (360 days) and wages and overheads accrue similarly. All sales are on the credit basis. You are required to CALCULATE the Net Working Capital Requirement. **(6 Marks)**

(b) Return on Equity (ROE) is Satva Limited is 15% and the capitalization rate applicable to the company is at 20%. Satva Limited's Book Value per share (BVPS) is Rs 125. Calculate the intrinsic value of the share today using Gordon's model and Walter's model if the company's policy is to retain 65% of the earning**.** **(4 Marks)**

3. Hemsparsh Private Limited is globally recognized consultancy firm having its presence in various countries across the globe and is currently headquartered at Ahmedabad, India.

It plans to commence a new branch in the Australia owing to the untapped opportunities available there in the outsourcing business. The company hired a professional for the preparation of the Project report and the fee paid was Rs 2,00,000. The company also incurred Rs 5,00,000 in the form R&D costs. As per the project report, the Company will require an initial fund outlay of Rs 25 crores for buying property & setting up the other infrastructure. It will also require working capital amounting to Rs 5 crore. The company is planning to operate for a very long period of time, however for the sake of simplicity, calculations shall end at the end of the 10th year. The Earnings before tax but after deducting Interest Exp (EBT) estimated would be as follows –

YEAR	**EBT (Amount in Rs)**
1	2,00,00,000
2	2,50,00,000
3	4,00,00,000
4	4,75,00,000
5	6,00,00,000
6	6,40,00,000
7	6,15,00,000
8	5,25,00,000
9	3,80,00,000
10	2,90,00,000

The above amounts also include an allocated common cost of Rs 12,50,000. Company will distribute 10% dividends every year on post-tax earnings. Company intends to borrow funds of 3 crores at a post-tax Interest rate of 6.5% in India. As per the tax treaty between India & Australia (Tax Agreement between two nations), first 3 years are tax free and from 4th year 75% of corporate taxes are to be paid in the country where it is headquartered and balance in the other nation. Total Corporate tax rate applicable to the company is 30%. However, tax on capital gains is to be paid at 15%, only in the headquarters. Salvage value for depreciation purpose is estimated at Rs. 90,00,000. The assets would be disposed of in the market at Rs. 3,50,00,000 at the end. Hemsparsh Private Limited desires a premium of 3% to the current MCLR of 12% (Marginal Cost of Funds based Lending Rate). Assume no other assets in the block.

CALCULATE NPV for the project and advise only from Indian law perspective.

If the company wishes to recoup its investment within 3.5 years, STATE any two measures that the company shall take. **(10 Marks)**

4. (a) EXPLAIN the difference between factoring and forfaiting **(4 Marks)**

   (b) DESCRIBE some of the tasks that demonstrate the importance of good financial management **(4 Marks)**

   (c) EXPLAIN the concept of Drop – Lock Bond (DL Bonds) **(2 Marks)**

   OR

   (c) MENTION any one advantage of stock dividend – to the company as well as to the investor **(2 Marks)**

MODEL TEST PAPER 8

INTERMEDIATE GROUP – II

PAPER – 6A : FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A: FINANCIAL MANAGEMENT

Time Allowed – 3 Hours (Total time for 6A and 6B) Maximum Marks – 50

1. *The question paper comprises two parts, Part I and Part II.*
2. *Part I comprises Case Scenario based Multiple Choice Questions (MCQs)*
3. *Part II comprises questions which require descriptive type answers.*
4. *Working note should form part of the answer. Wherever necessary, suitable assumptions may be made by the candidates and disclosed by way of note. However, in answers to Questions in Division A, working notes are not required.*

PART I – Case Scenario based MCQs (15 Marks)

Write the most appropriate answer to each of the following multiple choice questions by choosing one of the four options given. All questions are compulsory.

1. KGF Chemicals Ltd., a prominent player in the chemical industry, faces the challenge of determining its growth trajectory and dividend policy to maximize shareholder value. With expectations of significant growth in the near term and stabilization in the long run, the company must strategically manage its resources to align with investor expectations.

   KGF Chemicals Ltd. is a leading manufacturer and supplier of specialty chemicals catering to diverse industries such as pharmaceuticals, agriculture, and manufacturing. Established with a commitment to innovation and quality, the company has garnered a strong market presence over the years.

   The company is projected to experience robust growth at a rate of 14% per annum for the next four years. Subsequently, the growth rate is expected to stabilize at the national economy's rate of 7% indefinitely. This forecast reflects both the company's expansion plans and the broader economic landscape.

   KGF Chemicals Ltd. paid a dividend of ₹ 2 per share last year (Do = 2). The management faces the crucial decision of balancing dividend payouts with reinvestment opportunities to sustain growth and meet shareholders' expectations. The dividend policy must strike a delicate balance between rewarding shareholders and retaining earnings for future investments.

   The required rate of return on equity shares is 12%, indicating investors' expected return given the company's risk profile and market conditions. Management must carefully assess investment opportunities to ensure they meet or exceed this threshold, thereby generating value for shareholders over the long term.

   In navigating the dynamic landscape of the chemical industry, KGF Chemicals Ltd. must adopt a proactive approach to managing growth and dividend policy.

By aligning strategic decisions with investor expectations and market dynamics, the company can position itself for sustainable success while maximizing shareholder value. Continual evaluation and adaptation will be essential to capitalize on growth opportunities and maintain competitiveness in the evolving marketplace.

You are required to answer the following on the basis of above information:

1. What is the expected dividend at the end of 4th Year?

   (A) ₹ 2.1097

   (B) ₹ 2.1483

   (C) ₹ 2.9631

   (D) ₹ 3.3779

2. What is the present value of Expected Dividends to be received in next four years?

   (A) ₹ 11.2202

   (B) ₹ 8.3655

   (C) ₹ 9.8423

   (D) ₹ 6.2176

3. Determine the Market Price of shares at the end of 4th Year?

   (A) ₹ 72.28

   (B) ₹ 67.55

   (C) ₹ 50.67

   (D) ₹ 77.34

4. Determine the Present Value of Market Price of shares at the end of 4th Year?

   (A) ₹ 49.18

   (B) ₹ 32.22

   (C) ₹ 45.79

   (D) ₹ 42.96

5. Calculate today's market price of the share.

   (A) ₹ 59.03

   (B) ₹ 54.33

   (C) ₹ 57.01

   (D) ₹ 57.54 **(5 x 2 = 10 Marks)**

2. A company has a cost of equity of 10% and a interest rate of 6%. The company's debt-to-equity ratio is 1.5, and the corporate tax rate is 40%. What is the company's weighted average cost of capital?

   (A) 7.20%

(B) 6.16%

(C) 7.60%

(D) 8.40% **(2 Marks)**

3. Output (units) = 3,00,000 Fixed cost = ₹ 3,50,000 Unit variable cost = ₹ 1.00 Interest expenses = ₹ 25,000
Unit selling price = ₹ 3.00 Applicable tax rate is 35% Calculate Financial Leverage.

(A) 1.11

(B) 2.40

(C) 2.67

(D) 1.07 **(2 Marks)**

4. External Commercial Borrowings can be accessed through _______

(A) only automatic route

(B) only approval route

(C) both automatic and approval route

(D) neither automatic nor approval route **(1 Mark)**

PART II – Descriptive Questions (35 Marks)

Question No. **1** is compulsory.

Attempt any **two** questions out of the remaining **three** questions.

1. (a) Alpha Limited issued 40,000 12% redeemable preference share of ₹ 100 each at a premium of ₹ 5 each, redeemable after 10 years at a premium of ₹ 10 each. The floatation cost of each share is ₹ 2. You are required to CALCULATE cost of preference share capital ignoring dividend tax.

(5 Marks)

(b) Cello Limited is considering buying a new machine which would have a useful economic life of five years, a cost of ₹ 1,25,000 and a scrap value of ₹ 30,000, with 80 per cent of the cost being payable at the start of the project and 20 per cent at the end of the first year. The machine would produce 50,000 units per annum of a new product with an estimated selling price of ₹ 3 per unit. Direct costs would be ₹ 1.75 per unit and annual fixed costs, including depreciation calculated on a straight- line basis, would be ₹ 40,000 per annum.

In the first year and the second year, special sales promotion expenditure, not included in the above costs, would be incurred, amounting to ₹ 10,000 and ₹ 15,000 respectively.

CALCULATE NPV of the project for investment appraisal, assuming that the company's cost of capital is 10 percent. **(5 Marks)**

(c) A firm's details are as under:

Sales (@100 per unit)	₹ 24,00,000
Variable Cost	50%
Fixed Cost	₹ 10,00,000

It has borrowed ₹ 10,00,000 @ 10% p.a. and its equity share capital is ₹ 10,00,000 (₹ 100 each).

Consider tax @ 50 %.

CALCULATE:

(a) Operating Leverage

(b) Financial Leverage

(c) Combined Leverage

(d) Return on Investment

(e) If the sales increases by ₹ 6,00,000; what will the new EBIT?

(5 Marks)

2. Following information is forecasted by the Puja Limited for the year ending 31st March, 2023:

	Balance as at 1st April, 2022 (₹)	**Balance as at 31st March, 2023 (₹)**
Raw Material	45,000	65,356
Work-in-progress	35,000	51,300
Finished goods	60,181	70,175
Debtors	1,12,123	1,35,000
Creditors	50,079	70,469
Annual purchases of raw material (all credit)		4,00,000
Annual cost of production		7,50,000
Annual cost of goods sold		9,15,000
Annual operating cost		9,50,000
Annual sales (all credit)		11,00,000

You may take one year as equal to 365 days.

You are required to CALCULATE:

(i) Net operating cycle period.

(ii) Number of operating cycles in the year.

(iii) Amount of working capital requirement using operating cycles.

(10 Marks)

3. (a) Shahji Steel Limited requires ₹ 25,00,000 for a new plant. This plant is expected to yield earnings before interest and taxes of ₹ 5,00,000. While deciding about the financial plan, the company considers the objective of maximizing earnings per share. It has three alternatives to finance the project - by raising debt of ₹ 2,50,000 or ₹ 10,00,000 or ₹ 15,00,000 and the balance, in each case, by issuing equity shares. The company's share is currently selling at ₹ 150 but is expected to decline to ₹ 125 in case the funds are borrowed in excess of ₹ 10,00,000. The funds can be borrowed at the rate of 10 percent upto ₹ 2,50,000, at 15 percent over ₹ 2,50,000 and upto ₹ 10,00,000 and at 20 percent over ₹ 10,00,000. The tax rate applicable to the company is 50 percent. ANALYSE which form of financing should the company choose? **(6 Marks)**

(b) Following information are available for Navya Ltd. along with various ratios relevant to the particular industry it belongs to. APPRAISE your comments on strength and weakness of Navya Ltd. comparing its ratios with the given industry norms.

Navya Ltd.

Balance Sheet as at 31.3.2023

Liabilities	**(₹)**	**Assets**	**(₹)**
Equity Share Capital	48,00,000	Fixed Assets	24,20,000
10% Debentures	9,20,000	Cash	8,80,000
Sundry Creditors	6,60,000	Sundry debtors	11,00,000
Bills Payable	8,80,000	Stock	33,00,000
Other current Liabilities	4,40,000		-
Total	77,00,000	Total	77,00,000

Statement of Profitability

For the year ending 31.3.2023

Particulars	**(₹)**	**(₹)**
Sales		1,10,00,000
Less: Cost of goods sold:		
Material	41,80,000	
Wages	26,40,000	
Factory Overhead	12,98,000	81,18,000
Gross Profit		28,82,000
Less: Selling and Distribution Cost	11,00,000	
Administrative Cost	12,28,000	23,28,000
Earnings before Interest and Taxes		5,54,000
Less: Interest Charges		92,000
Earning before Tax		4,62,000
Less: Taxes @ 50%		2,31,000
Net Profit (PAT)		2,31,000

Industry Norms

Ratios	Norm
Current Ratio	2.5
Receivables Turnover Ratio	8.0
Inventory Turnover Ratio (based on Sales)	9.0
Total Assets Turnover Ratio	2.0
Net Profit Ratio	3.5%
Return on Total Assets (on EBIT)	7.0%
Return on Net worth (Based on Net profit)	10.5%
Total Debt/Total Assets	60.0%

(4 Marks)

4. (a) WRITE short notes on the following:

Inter relationship between investment, financing and dividend decisions.

(4 Marks)

(b) DISCUSS the risk-return considerations in financing of current assets.

(4 Marks)

(c) WHAT is 'Optimum Capital Structure'? **(2 Marks)**

OR

(c) DISCUSS the dividend-price approach to estimate cost of equity capital.

(2 Marks)

MODEL TEST PAPER 1

PAPER 6B: STRATEGIC MANAGEMENT

1. The question paper comprises two parts, Part I and Part II.

2. Part I comprises case scenario based multiple choice questions (MCQs)

3. Part II comprises questions which require descriptive type answers.

PART I – Case scenario based MCQs (15 Marks)

Question 1.(A) (Compulsory)

1. (A) In the fiercely competitive automotive industry, Zing, a promising newcomer, set out on a strategic journey with ambitions of making a substantial impact. Recognizing the significance of a robust distribution network early on, Zing forged partnerships with established dealerships, offering them attractive margins. This strategic move significantly enhanced Zing's reach, with a presence in 80% of the nation's dealerships by 2022, expanding its coverage significantly.

To differentiate themselves from competitors, Zing adopted two key strategies. Firstly, they prioritized product design, investing heavily in aesthetics and incorporating innovative features and environmentally friendly technologies. This focus on design led to their vehicles receiving excellent reviews and achieving an impressive 15% year-on-year growth in sales.

Secondly, Zing implemented switching costs to discourage customers from switching to other brands. Their vehicles featured branded software, making it both expensive and cumbersome for customers to transition to alternative brands. This strategic move effectively protected Zing's market share.

Zing's overarching goal was to position itself as a premium automotive brand, blending luxury with sustainability. However, their execution fell down as they challenged with maintaining consistent quality and service levels, resulting in mixed customer reviews.

Despite their best efforts, Zing's differentiation strategy fell short due to issues with inconsistent quality and service. Negative word-of-mouth and declining customer satisfaction scores tarnished their brand image, leading to stagnating sales. This failure to deliver on their brand promise proved to be a significant setback.

As Zing's reputation suffered from execution failures, securing additional funds for international expansion became challenging. Consequently, they made the difficult decision to postpone their global ambitions for the next five years, focusing instead on stabilizing their finances and rebuilding their brand image.

In summary, Zing's strategic journey illustrates the importance of not only crafting a compelling differentiation strategy but also executing it flawlessly. In the competitive automotive landscape, maintaining consistent quality and service is paramount to sustaining brand loyalty and achieving long-term success.

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

(i) What key strategic approach did Zing use to expand its market presence in the automotive industry?

(a) Product innovation and design

(b) Cost leadership strategy

(c) Entering new international markets

(d) Vertical integration **(2 Marks)**

(ii) How did Zing protect its market share from potential competitors?

(a) Price-cutting strategy

(b) Branded software and switching costs

(c) Aggressive marketing campaigns

(d) International expansion **(2 Marks)**

(iii) Why did Zing's differentiation strategy fall short in the market?

(a) Intense price competition

(b) Poor marketing strategy

(c) Inconsistent quality and service

(d) Lack of international expansion **(2 Marks)**

(iv) Forging partnerships with established dealerships to enhance its distribution network falls under which level of strategy?

(a) Corporate level strategy

(b) Business level strategy

(c) Functional level strategy

(d) Competitive level strategy **(2 Marks)**

(v) How did Zing initially expand its market presence across the nation?

(a) Aggressive marketing campaigns

(b) Developing low-cost vehicles

(c) Partnering with established dealerships

(d) Launching a luxury brand **(2 Marks)**

(B) Compulsory Application Based Independent MCQs

(i) TechMex Inc., a leading technology company, offers a diverse portfolio of products ranging from established cash cows to promising question marks. As part of its strategic planning process, the company aims to assess its product portfolio's performance and allocate resources effectively. In which quadrant of the BCG Matrix would TechMex's new innovative product, recently launched in a rapidly growing market, likely fall into?

(a) Cash Cow

(b) Dog

(c) Question Mark

(d) Star **(2 Marks)**

(ii) BlueSky Enterprises, a multinational corporation specializing in renewable energy solutions, is undergoing a strategic transformation to enhance its competitive position in the market. As part of this initiative, the company is reevaluating its organizational structure, processes, and culture. Which aspect of the McKinsey 7S Model is most relevant for BlueSky Enterprises during this strategic transformation?

(a) Strategy

(b) Structure

(c) Systems

(d) Skills **(2 Marks)**

(iii) The threat of substitutes is high when:

(a) There are few substitute products available

(b) Switching costs are low

(c) Suppliers have high bargaining power

(d) There is strong brand loyalty **(1 Mark)**

PART II – Descriptive Questions (35 Marks)

*Question No. **1** is compulsory.*

*Attempt any **two** questions out of the remaining **three** questions.*

1. (a) Swati is the marketing manager at a software company. She is responsible for developing and implementing marketing strategies for the company’s products. Swati leads a team of marketing professionals and works closely with the product development and sales teams to ensure that the company's products are effectively promoted in the market. She also analyzes market trends and customer feedback to refine the marketing strategies. Which level is she working at, discuss the roles and responsibilities of this level in organization? **(5 Marks)**

(b) ABC Corp, a multinational consumer electronics company, is planning to expand its operations into a new country. The company's senior management is evaluating the potential risks and opportunities of entering this new market. As part of their analysis, they decide to use the PESTLE framework to assess the external factors that could impact their decision. How can the PESTLE framework help ABC Corp assess the external factors affecting its decision to expand into a new country? **(5 Marks)**

(c) Imagine you are a consultant advising a small manufacturing company embarking on a digital transformation journey. The company's leadership is concerned about managing the change effectively. Using the best practices for managing change in small and medium-sized businesses, outline a strategy to help the company navigate this transformation successfully. **(5 Marks)**

2. (a) Imagine you are a strategic consultant advising a retail company that is facing increasing competition from online retailers. The company is considering several strategic options to improve its market position. Using the concept that strategy is partly proactive and partly reactive, explain how the company can develop a strategic approach to address this challenge. **(5 Marks)**

(b) You are a strategic manager for a tech company launching a new smartphone model. The company wants to target tech-savvy consumers who value innovation and cutting-edge technology. Using the concept of customer behavior, develop a marketing strategy to promote the new smartphone. **(5 Marks)**

3. (a) A beverage company is launching a new line of energy drinks targeted at health-conscious consumers. The strategic manager wants to study the market position of rival companies in the energy drink segment. Which tool can be used for this analysis, and what is the procedure to implement it effectively? **(5 Marks)**

(b) The CEO of a textile mill believes that his company, currently operating at a loss, can be turned around. Develop an action plan outlining steps the CEO can take to achieve this turnaround. **(5 Marks)**

4. (a) Why Strategic Performance Measures are essential for organizations?

(5 Marks)

(b) How can Mendelow's Matrix be used to analyze and manage the stakeholders effectively?

OR

Distinguish between Concentric Diversification and Conglomerate Diversification. **(5 Marks)**

MODEL TEST PAPER 2

PAPER 6B: STRATEGIC MANAGEMENT

1. The question paper comprises two parts, Part I and Part II.

2. Part I comprises case scenario based multiple choice questions (MCQs)

3. Part II comprises questions which require descriptive type answers.

PART I – Case scenario based MCQs (15 Marks)

Question 1.(A) (Compulsory)

1. (A) Café Delight, a thriving restaurant chain known for its unique blend of Australian and Indian culinary experiences, embarked on a remarkable journey from its humble beginnings as a small café in Australia to becoming a renowned player in the Indian restaurant industry. This case study digs into the strategic decisions and market dynamics that fueled Café Delight's growth, highlighting its transition from a single café in Powai, Mumbai, to a flourishing chain with a presence in five cities and over 25 stores. It explores how Café Delight effectively leveraged social media and adapted its pricing strategy to compete with global brands while maintaining a healthy profit margin.

In 2005, Café Delight was founded in Melbourne, Australia, by a passionate entrepreneur with a vision to bring the flavors of Australia and India together. The first café established in Powai, Mumbai, received accolades for its unique menu, blending Australian coffee culture with Indian culinary traditions. Over the course of five years, Café Delight expanded to three stores in Mumbai, driven by exceptional mouth publicity, customer loyalty, and consistent quality.

As the social media landscape evolved, Café Delight recognized the power of online platforms in reaching a wider audience. By effectively utilizing social media and online marketing, Café Delight expanded its presence to five cities across India and established over 25 stores. Customer engagement through social media platforms enabled the brand to create a strong and vibrant community, driving organic growth.

Café Delight's customer-centric approach involved continuously evolving its menu to cater to the changing tastes and dietary preferences of its patrons. By understanding the evolving needs of its customers, Café Delight could offer personalized menu items, seasonal specials, and dietary alternatives. This approach created a sense of loyalty and engagement among customers, strengthening the brand's appeal. Not just customers but High-power, low-interest stakeholders, including regulatory authorities, were addressed with careful compliance and adherence to industry standards. Low-power, high-interest stakeholders, like potential customers and local communities, were engaged through targeted marketing campaigns and community involvement initiatives. This meticulous stakeholder analysis allowed Café Delight to build and maintain strong relationships with each group, effectively managing their influence and impact on the brand.

With its expanding presence and increasing popularity, Café Delight underwent a shift in its pricing strategy. It transitioned from a pocket-friendly pricing model to a skimming strategy, capitalizing on its unique blend of Australian and Indian flavors to position itself as a premium restaurant. Café Delight faced stiff competition from global brands entering the Indian market but maintained a profit margin of approximately 30% through menu engineering and targeted pricing.

In one of its kind, using strategic tools enabled Café Delight to identify and act on opportunities while mitigating threats, contributing to its long-term success in the highly competitive restaurant industry.

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

(i) Café Delight effectively leveraged social media and adapted its pricing strategy as it stepped into which phase of business life cycle of operations?

(a) Introduction Stage

(b) Growth Stage

(c) Maturity Stage

(d) Decline Stage **(2 Marks)**

(ii) What stakeholder group did Café Delight engage through targeted marketing campaigns and community involvement initiatives?

(a) High-power, high-interest stakeholders

(b) Low-power, low-interest stakeholders

(c) Low-power, high-interest stakeholders

(d) High-power, low-interest stakeholders **(2 Marks)**

(iii) What best describes Café Delight's initial expansion strategy when it expanded from one café to three in Mumbai?

(a) Aggressive price reduction

(b) Leveraging customer loyalty and word-of-mouth publicity

(c) Extensive online marketing

(d) Embracing global branding strategies **(2 Marks)**

(iv) At which level of strategic management does Café Delight's transition from a pocket-friendly pricing model to a skimming strategy fit?

(a) Corporate level

(b) Business level

(c) Functional level

(d) Operational level **(2 Marks)**

(v) What type of strategy did Café Delight use to differentiate itself from competitors in the Indian restaurant industry?

(a) Cost leadership strategy

(b) Focused differentiation strategy

(c) Cost focus strategy

(d) Hybrid strategy **(2 Marks)**

(B) Compulsory Application Based Independent MCQs

(i) Shamita joined GlobalX Consulting firm as an Analyst in financial fraud mitigation. In her very first assignment she faced an integrity dilemma where her subordinates had missed calling out a potential financial risk which could impact the overall fraud rating of the organisation. She quickly reached out to her seniors who appreciated her diligence and immediately reported the same to senior management. In this scenario which element, soft or hard, is acting in favor of GlobalX?

(a) Strategy

(b) Systems

(c) Shared Value

(d) Staff **(2 Marks)**

(ii) Chocopo, an ice cream company run by Shri Shyam Kumar since 1985, now had its management change to his two daughters, who came in and wanted to experiment with a lot of flavors. They introduced 21 new flavors in a span of 6 months while not losing out of 2 legendary flavors of their dad i.e. Stick Kulfi and Mango Bar. After year 1 of operations, 9 out of the 21 flavors had to be stopped, while 10 flavors were still kept, extending the experimentation. The early sense from market was that they would have to be stopped too, but the sisters decided to extend their timelines. What category as per BCG Matrix would the 10 flavors fall into?

(a) Cash Cow

(b) Dog

(c) Question Mark

(d) Star **(2 Marks)**

(iii) A company negotiating the best prices and quality from its suppliers to add to customer's delight is an example of?

(a) Value Creation by improving primary activity

(b) Value Creation by improving support activity

(c) Competitive Advantage Creation

(d) Stakeholder Management **(1 Mark)**

PART II – Descriptive Questions (35 Marks)

*Question No. **1** is compulsory.*

*Attempt any **two** questions out of the remaining **three** questions.*

1. (a) ABC retail chain regularly monitors consumer trends and supply chain flexibility. The retail chain tracks consumer trends to adjust its offerings, ensuring they meet customer needs. Simultaneously, it maintains a flexible supply chain to respond swiftly to demand fluctuations. This strategy enables ABC retail chain to anticipate market shifts and adapt to them effectively, ensuring its competitiveness and customer satisfaction. Which type of strategy is the retail chain employing?

(5 Marks)

(b) A Mumbai-based conglomerate, PQR Ltd., has announced a major restructuring of its business operations. The company has decided to split its business into four separate units: Manufacturing, Retail, Services, and Technology. Each unit will operate as a separate business, with delegated responsibility for day-to-day operations and strategy to the respective unit managers. Identify the organization structure that PQR Ltd. has planned to implement. Discuss any four attributes and the benefits the firm may derive by using this organization structure. **(5 Marks)**

(c) *GreenThrift Inc.,* a sustainable clothing retailer, is experiencing a surge in popularity due to the growing awareness of environmental issues among consumers. The company specializes in selling second-hand clothing and upcycled garments, offering an eco-friendly alternative to traditional fast fashion.

A major concern for GreenThrift Inc. is the emergence of new sustainable fashion brands in the market. These brands focus on using organic and recycled materials, as well as ethical manufacturing practices, which align with the values of environmentally conscious consumers.

Identify and explain that competition from new sustainable fashion brands falls under which category of Porter's Five Forces Model for Competitive Analysis? **(5 Marks)**

2. (a) *"*Each organization must build its competitive advantage keeping in mind the business warfare. This can be done by following the process of strategic management." Considering this statement, explain major benefits of strategic management. **(5 Marks)**

   (b) *Reshuffle Corp* is a company that manufactures and sells office furniture. They offer a range of products, from desks and chairs to cabinets and shelves. Recently, the company has been facing increased competition from online retailers offering similar products at lower prices.

   Analyzing the characteristics of products in the furniture industry, discuss how *Reshuffle Corp* can differentiate its products to maintain a competitive edge in the market. **(5 Marks)**

3. (a) *EasyLife Corporation,* a leading manufacturer of consumer electronics, is considering launching a new line of smart home devices. As a strategic manager, conduct a SWOT analysis for *EasyLife Corporation* to assess the feasibility and potential success of this new venture. Consider both internal and external factors that could impact the success of the new product line. **(5 Marks)**

   (b) Explain the concept of forward and backward linkages between strategy formulation and implementation in strategic management, using relevant examples. How do these linkages impact the overall strategic decision-making process of an organization? **(5 Marks)**

4. (a) Define Strategic Performance Measures (SPM). Explain various types of strategic performance measures. **(5 Marks)**

   (b) *StarTech Solutions*, an aerospace technology firm, operates in a highly competitive industry. Despite the fierce competition in the aerospace sector, *StarTech* has carved out a niche for itself by focusing on serving unique, high-end clients. Unlike its competitors, *StarTech* has chosen not to diversify its target market and instead specializes in providing cutting-edge solutions to this niche market.

   Identify and explain the strategy adopted by *StarTech Solutions*. Discuss the advantages and disadvantages of this strategy.

   OR

   Strategic alliances are formed if they provide an advantage to all the parties in the alliance. Do you agree? Explain in brief the advantages of a strategic alliance. **(5 Marks)**

MODEL TEST PAPER 3

PAPER 6B: STRATEGIC MANAGEMENT

1. *The question paper comprises two parts, Part I and Part II.*
2. *Part I comprises case scenario based multiple choice questions (MCQs)*
3. *Part II comprises questions which require descriptive type answers.*

PART I – Case scenario based MCQs (15 Marks)

Question 1.(A) (Compulsory)

1. (A) Dr. Mikesh Gupta, Agriculture Management Guru at a leading management school in Patna, has been driving the business of E-Bandhu with seven of his students since 2017. This business has two core objectives: first, sustainable farming awareness and second, seasonal availability of agricultural inputs. It is a technology driven business wherein they have a one stop shop for all agricultural products available to farmers at competitive prices. Business is quite challenging, given the fact that farmers in the region are not well aware of the use of technology.

In the summer of 2019, the team decided to redefine their business strategy to succeed in the agricultural sector. They formulated a new definition and made strategic decisions to leverage their core competencies.

Firstly, they shifted their target market from directly serving farmers to onboarding wholesalers and retailers into the system and selling products to them. This strategic move was based on the understanding that wholesalers and retailers could influence technology adoption among farmers.

Secondly, they outsourced logistics to MaalGaadi, a rural supply chain management company. This decision helped E-Bandhu reduce asset procurement costs and corresponding debt, thus strengthening their position in the market.

Thirdly, they introduced a new service-based product, ChaaraVidya, in their application. ChaaraVidya aims to educate farmers about the latest sustainable farming practices being implemented around the world. This addition could potentially be a game-changer for E-Bandhu in the agro startup circle, further enhancing their core competency in promoting sustainable farming practices and technology adoption.

The team is enthusiastic about the strategic changes brought in by Dr. Mikesh and anticipates a more sustainable future for their idea.

Based on the above case scenario, answer the multiple-choice questions.

(i) Switching from direct selling to marketing through wholesalers and retailers was a strategic decision taken by the management. Such decisions help an organization to be more of which of the following?

(a) Authoritative

(b) Futuristic

(c) Proactive

(d) Regularised **(2 Marks)**

(ii) ChaaraVidya was brought into the market to increase farmer awareness of soil quality and the latest sustainable farm practices from around the world? What kind of growth strategy will it fall under?

(a) Market penetration

(b) Market development

(c) Product development

(d) Diversification of business **(2 Marks)**

(iii) One of the most strategically advantageous decisions for E-Bandhu was to get into a contract with MaalGaadi. Which of the following could not be an advantage for E-Bandhu from this alliance?

(a) Cost savings

(b) Reduced delivery time

(c) Improved customer satisfaction

(d) Increased inventory of products **(2 Marks)**

(iv) How does E-Bandhu utilize Michael Porter's Five Forces model in its strategic decision-making process?

(a) By focusing on industry rivalry and competitive pricing

(b) By analyzing the bargaining power of suppliers and buyers

(c) By assessing the threat of new entrants and substitutes

(d) All of the above **(2 Marks)**

(v) What are the core objectives of E-Bandhu, as mentioned in the case study?

(a) Sustainable farming awareness and seasonal availability of agricultural inputs

(b) Technology-driven solutions and competitive pricing

(c) Onboarding wholesalers and retailers into the system

(d) All of the above **(2 Marks)**

(B) Compulsory Application Based Independent MCQs

(i) Swabhaav, a social media marketing firm introduced an AI based management tool that has the capabilities of managing teams across functions all while being creative. What is the most likely organisational structure post this implementation?

(a) Divisional Structure

(b) Matrix Structure

(c) Hourglass Structure

(d) Network Structure **(2 Marks)**

(ii) A tea farm owners plan to open tea cafes in tourist spots and to sell their own premium tea to build a brand. Which of the following can this be termed as?

(a) Backward Integration

(b) Forward Integration

(c) Diversification

(d) Horizontal Integration **(2 Marks)**

(iii) The process of creating, maintaining, and enhancing strong, value-laden relationships with customers and other stakeholder is:

(a) Social marketing

(b) Augmented marketing

(c) Direct marketing

(d) Relationship marketing **(1 Mark)**

PART II – Descriptive Questions (35 Marks)

*Question No. **1** is compulsory.*

*Attempt any **two** questions out of the remaining **three** questions.*

1. (a) In his pursuit to expand the family business to Dubai, Dharam Veer Singh, the successor of the renowned architect Late Shri Lala Ram Pal Singh, faced a dilemma. Despite receiving positive feedback from various potential investors, a common trend emerged where the emphasis was primarily on swift construction, neglecting the importance of structural longevity. Dharam finds himself at a crossroads. What strategic approach could assist him in formulating a robust and coherent business roadmap that aligns with his vision for sustainable growth?

(5 Marks)

(b) Ravi and Arjun are two friends who are partners in their business of manufacturing premium coffee. Ravi believes in making profits through selling higher volumes of products, hence he advocates for charging lower prices to customers. Arjun, however, believes that higher prices should be charged to create an image of exclusivity and proposes that the product undergo some changes to justify this pricing.

Analyze the nature of the generic strategy used by Ravi and Arjun.

(5 Marks)

(c) Due to the reoccurrence of various variants of the coronavirus, XYZ Corporation is facing an unstable environment and has begun unbundling and disintegrating its activities. It has also started relying on outside vendors to perform these activities. Identify the organizational structure XYZ Corporation is shifting to. Under what circumstances does this structure become useful? **(5 Marks)**

2. (a) There are four specific criteria of sustainable competitive advantage that firms can use to determine those capabilities that are known as core competencies. Explain. **(5 Marks)**

(b) XYZ Electronics has discovered that its products have reached their maturity stage, and the company is experiencing overcapacity. Consequently, it focuses on maintaining the operational efficiency of its manufacturing facilities. Identify the strategy implemented by XYZ Electronics and provide the reasons for this strategy. **(5 Marks)**

3. (a) Yummy Foods and Tasty Foods are successfully competing in the business of ready to eat snacks in Patna. Yummy has been pioneer in introducing innovative products. These products will give them good sale. However, Tasty Foods will introduce similar products in reaction to the products introduced by the Yummy Foods taking away the advantage gained by the former.

Discuss the strategic approach of two companies. Which is superior?

(5 Marks)

(b) Why is change management crucial during digital transformation, and what are some key strategies for navigating change effectively?

(5 Marks)

4. (a) Write a short note on the Product Life Cycle (PLC) and its significance in portfolio diagnosis. **(5 Marks)**

(b) Distinguish between Micro Environment and Macro Environment.

OR

Distinguish between Operational Control and Management Control.

(5 Marks)

MODEL TEST PAPER 4

PAPER 6B: STRATEGIC MANAGEMENT

1. *The question paper comprises two parts, Part I and Part II.*
2. *Part I comprises case scenario based multiple choice questions (MCQs)*
3. *Part II comprises questions which require descriptive type answers.*

PART I – Case scenario based MCQs (15 Marks)

Question 1. (A) (Compulsory)

1. (A) Kriti Pvt. Ltd. has been importing French gourmet cheeses under the brand name of 'Fromage' since 2017. The company was amongst the first in India to introduce innovative unbreakable cheese packaging. Their affiliate, a French company owning Fromage, had entered into a progressive deal, wherein products would be sourced to India via their logistics, and all marketing expenditures would be covered by them. However, customer management and nationwide distribution would be taken care of by Kriti Pvt. Ltd. This required an English-speaking skilled workforce, which has been a constant challenge for the company in India.

The owners of Kriti Pvt. Ltd. have been regular attendees at industry-relevant conclaves, both national and international. Leaders of the company are passionate readers of business magazines. Following that, it was observed that the recent sentiment of the country towards 'Vocal for Local' could disrupt their French brand's marketability. An extraordinary meeting was set up, and the steps ahead were planned.

The outcome of the meeting was to partner with local producers of traditional Indian cheeses in phase one of the change strategy. For this, seven state governments were approached. The team was successful in taking contracts from all the government departments of these seven states and could position themselves fairly in the market. To fund this new investment, they have planned to slowly sell off their French business assets as well as the brand, to probable buyers.

This timely shift is proving to be a game-changer for the company, and the leadership is quite happy with better than before earnings and a much greater response from the customers. They find it easier to operate with domestic producers and vendors, and a sense of patriotism is instilled in the consumers' minds.

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

(i) Which of the following actions taken by Kriti Pvt. Ltd. is an example of a proactive strategy?

(a) Selling off their French business assets.

(b) Responding to the 'Vocal for Local' sentiment by partnering with local cheese producers.

(c) Managing customer relations and nationwide distribution.

(d) Covering all marketing expenditures for 'Fromage' in India.

(2 Marks)

(ii) Which of the following types of strategic control did the owners and leadership of Kriti Pvt. Ltd. deploy that eventually turned out to be one of the most effective strategic decisions for the company?

(a) Premise control

(b) Special alert control

(c) Implementation control

(d) Strategic surveillance **(2 Marks)**

(iii) 'Vocal for Local' is a market sentiment that changed customers' preferences for the majority of products across all industries. Based on that, Kriti Pvt. Ltd. gauged the competition it might face in the coming months and agreed to change its own product. Which of the following forces, as per Michael Porter's five forces of competitive analysis, is most relevant in this case?

(a) Threat of new entrants

(b) Nature of rivalry in the industry

(c) Threat of substitutes

(d) Bargaining power of the buyer **(2 Marks)**

(iv) Which of the following aspects of value chain analysis was the most challenging for Kriti Pvt. Ltd. at the time of selling the Fromage brand?

(a) Manufacturing

(b) Outsourcing

(c) Customer service

(d) Procurement **(2 Marks)**

(v) To strategically revamp their business, partnerships were done with Indian local producers from seven states, and to fund it, the existing arm of the business was to be sold off. Which of the following strategies has Kriti Pvt. Ltd. opted for?

(a) Turnaround strategy

(b) Divestment strategy

(c) Liquidation strategy

(d) Intensification strategy **(2 Marks)**

(B) **Compulsory Application Based Independent MCQs**

(i) TechWave, a software development firm, aims to gain a competitive edge in the rapidly evolving tech industry. To achieve this, they focus on building their strength in artificial intelligence (AI) and machine learning (ML). TechWave invests heavily in R&D, hires top talent with specialized skills, and forms partnerships with leading AI research institutions. They also provide continuous training for their employees to keep them updated with the latest advancements. By developing these, TechWave can create innovative AI-driven solutions that differentiate them from competitors and attract a growing number of clients seeking cutting-edge technology. What strategy is TechWave using to gain a competitive edge in the tech industry?

(a) Market segmentation

(b) Diversification

(c) Core competency building

(d) Cost leadership **(2 Marks)**

(ii) StreamlineCo is examining its internal capabilities to ensure that employees possess advanced knowledge of emerging technologies crucial for the company's future success. This involves investing in specialized training programs and updating job roles to match the latest industry standards. Which aspect of StreamlineCo is being enhanced through specialized training and updated job roles?

(a) Structure

(b) Systems

(c) Skills

(d) Style **(2 Marks)**

(iii) XYZ Corporation has launched AlphaTech to enter the consumer electronics industry with a focus on offering high-performance devices and innovative features at competitive prices. Which competitive strategy is AlphaTech employing?

(a) Differentiation strategy

(b) Cost leadership strategy

(c) Best-cost provider strategy

(d) Focus strategy **(1 Mark)**

PART II – Descriptive Questions (35 Marks)

*Question No. **1** is compulsory.*

*Attempt any **two** questions out of the remaining **three** questions.*

1. (a) Mr. Arun has been hired as the CEO by ABC Ltd, a pharmaceutical company that has diversified into affordable wellness supplements. The company intends to launch the HealthPlus brand of supplements. ABC wishes to enhance the well-being of people with its products that are beneficial for health and are produced in an environmentally sustainable manner using natural ingredients. Draft a vision and mission statement that may be formulated by Arun. **(5 Marks)**

   (b) GreenGardens, a small but growing organic farm, is assessing its business environment to strategically plan for future growth. The farm boasts high-quality, pesticide-free crops, but faces challenges with its limited distribution channels. As the demand for organic products continues to rise, GreenGardens recognizes the potential to broaden its market reach. However, unpredictable weather conditions and competition from larger farms present significant obstacles. To effectively navigate these challenges and opportunities, GreenGardens needs to conduct a comprehensive evaluation. Identify the type of analysis GreenGardens should conduct to strategically plan for its future growth and outline the grid. **(5 Marks)**

   (c) FreshDelight, renowned for its organic fruit juices, aims to expand its market presence by identifying emerging markets in countries where organic products are gaining popularity. To achieve this, FreshDelight launches targeted marketing campaigns and partners with local distributors to introduce its juices to these new regions. This strategy involves adapting product packaging and marketing messages to align with local preferences and regulations. By entering these new markets, FreshDelight hopes to increase its customer base and drive sales growth. What strategy is FreshDelight using to expand its market presence? **(5 Marks)**

2. (a) The CEO of a textile mill is convinced that his loss-making company can be turned around. Suggest an action plan for a turnaround to the CEO.

   (5 Marks)

   (b) Write a short note on Matrix Structure. **(5 Marks)**

3. (a) "Understanding the competitive landscape is important to build upon a competitive advantage". Explain. **(5 Marks)**

(b) XYZ Corporation operates in a diverse range of industries, including fashion, lifestyle products, furniture, real estate, and electrical goods. The company is seeking to hire a suitable Chief Executive Officer. As the HR consultant for XYZ Corporation, you have been tasked with outlining the activities involved in the role of the Chief Executive Officer. Identify the strategic level associated with this role and list the activities it encompasses. **(5 Marks)**

4. (a) Buyers can exert considerable pressure on business. Do you agree? Discuss. **(5 Marks)**

(b) Major core competencies are identified in three areas - competitor differentiation, customer value and application to other markets. Discuss.

OR

What factors should organizations consider when choosing strategic performance measures, and why are these factors important?

(5 Marks)

MODEL TEST PAPER 5

PAPER 6B: STRATEGIC MANAGEMENT

1. *The question paper comprises two parts, Part I and Part II.*
2. *Part I comprises case scenario based multiple choice questions (MCQs)*
3. *Part II comprises questions which require descriptive type answers.*

PART I – Case scenario based MCQs (15 Marks)

Question 1. (Compulsory)

1. (A) Sneha Rao, founder and CEO of DEF Technologies, is renowned for her technological insight and visionary leadership style. She cultivates a culture of collaboration, continuous learning, and innovative problem-solving, encouraging her employees to think outside the box and embrace new challenges. Her exceptional ability to foresee technological trends and navigate complex market dynamics has propelled DEF Technologies to impressive growth over the past decade.

Sneha started DEF Technologies in 2010 as a small software development firm. With a vision to transform DEF Technologies into a leading tech company, she initially focused on developing custom software solutions for local businesses. However, intense competition and limited market demand led to financial difficulties. Undeterred, Sneha pivoted the business towards developing cloud-based solutions, leveraging the growing trend of digital transformation. This strategic shift, along with aggressive marketing, helped DEF Technologies capture a significant market share and become a leader in cloud services, setting new industry standards.

In 2015, Sneha's brother, Raj, joined the company, and together they crafted an ambitious expansion strategy. DEF Technologies entered the global market, partnering with international tech firms to launch a new line of AI-driven cybersecurity solutions. This venture was highly successful, establishing DEF Technologies as a global brand and a key player in the cybersecurity industry.

Raj then led the company's diversification into the healthcare sector with a new brand, MedTech Solutions. Recognizing the potential for technology to revolutionize healthcare, Sneha and Raj focused on developing affordable telemedicine platforms and AI-driven diagnostic tools. Their approach disrupted the market, providing high-quality healthcare solutions at lower costs and gaining widespread trust from healthcare providers and patients alike. MedTech Solutions experienced rapid growth, especially during the COVID-19 pandemic, as demand for remote healthcare services surged.

At the beginning of 2023, DEF Technologies launched another new business, GreenTech Innovations, to address environmental challenges through technology. DEF Technologies continues to explore new opportunities and ventures to stay at the forefront of the tech industry.

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

(i) Sneha Rao's vision to transform DEF Technologies into a leading tech company illustrates which type of strategic intent?

(a) Goal

(b) Mission

(c) Vision

(d) Objective **(2 Marks)**

(ii) Sneha's leadership style, which promotes collaboration, continuous learning, and innovative problem-solving, can best be described as:

(a) Transactional leadership

(b) Transformational leadership

(c) Autocratic leadership

(d) Laissez-faire leadership **(2 Marks)**

(iii) When DEF Technologies expanded into the global market with AI-driven cybersecurity solutions, which of Porter's Five Forces was most likely mitigated by forming partnerships with international tech firms?

(a) Threat of Substitute Products or Services

(b) Bargaining Power of Suppliers

(c) Threat of New Entrants

(d) Intense Rivalry Among Existing Competitors **(2 Marks)**

(iv) By entering the global market and launching AI-driven cybersecurity solutions, DEF Technologies pursued which expansion strategy from Ansoff's Product-Market Growth Matrix?

(a) Diversification

(b) Market Penetration

(c) Product Development

(d) Market Development **(2 Marks)**

(v) MedTech Solutions' focus on developing affordable telemedicine platforms and AI-driven diagnostic tools reflects which of the following competitive strategies?

(a) Differentiation strategy

(b) Cost leadership strategy

(c) Best-cost provider strategy

(d) Focus Strategy **(2 Marks)**

(B) Compulsory Application Based Independent MCQs

(i) A traditional desi ghee company modernized its production and introduced pro-biotic desi ghee, facing initial market doubts. Aggressive marketing campaigns highlighted its benefits, gaining acceptance. During which stage of the product life cycle did the desi ghee company face doubts but gained acceptance through aggressive marketing campaigns?

(a) Introduction stage

(b) Growth stage

(c) Maturity stage

(d) Decline stage **(2 Marks)**

(ii) ValueMart is a discount retail chain that targets budget-conscious consumers by offering a wide range of products at the lowest possible prices. The company achieves this by sourcing goods in bulk, negotiating lower prices with suppliers, and maintaining lean operations. ValueMart's goal is to dominate the market by attracting price-sensitive customers from competitors. Which of Michael Porter's Generic Strategies is ValueMart primarily employing?

(a) Differentiation

(b) Focused Cost Leadership

(c) Cost Leadership

(d) Focused Differentiation **(2 Marks)**

(iii) A women's clothing brand recognized new opportunities and researched emerging trends and consumer preferences. They introduced a new clothing line, received positive feedback from initial trials, and grew through strategic partnerships and targeted advertising. What strategic choice best describes this approach?

(a) Product Development

(b) Market Development

(c) Market Penetration

(d) Diversification **(1 Mark)**

PART II – Descriptive Questions (35 Marks)

*Question No. **1** is compulsory.*

*Attempt any **two** questions out of the remaining **three** questions.*

1. (a) *TechNova,* a leading software development firm known for its cutting-edge operating systems, is developing a groundbreaking new platform. *ElectroWave,* an emerging player in the electronics and hardware industry, specializes in manufacturing advanced devices. *TechNova* and *ElectroWave* have decided to join forces to design innovative laptops

and smartphones, aiming to tap into new markets and broaden their business horizons. What kind of external growth strategy is being considered by *TechNova* and *ElectroWave*? **(5 Marks)**

(b) Vikram Patel owns a chain of ten bookstores across the Mumbai region. Three of these stores were launched in the past two years. He has always believed in strategic management and enjoyed robust sales of books, magazines, and educational materials until about five years ago. However, with the increasing preference for online shopping, the sales at his physical stores have declined by approximately sixty percent over the last five years. Analyze Vikram Patel's current position in light of the limitations of strategic management. **(5 Marks)**

(c) Orion Tech Solutions Pvt. Ltd. is renowned for its ability to launch groundbreaking software products. Despite the relaxed and casual work environment at Orion, there is a strong commitment to meeting deadlines. Employees at Orion believe in the "work hard, play hard" ethic. The company has shifted from a formal, hierarchical structure to a more results-oriented approach. Employees are deeply committed to the company's strategies and work diligently to achieve them. They safeguard innovations and maintain strict confidentiality and secrecy in their operations. Their work culture is closely aligned with the organization's values, practices, and norms. What aspects of an organization are being discussed? Explain. **(5 Marks)**

2. (a) Analyze the role of Key Success Factors (KSFs) in determining competitive success within an industry. **(5 Marks)**

(b) What are distribution channels, and why is analyzing them crucial for business expansion? Describe the three main types of channels explaining their roles in ensuring products reach customers efficiently and with the necessary support. **(5 Marks)**

3. (a) What is a strategic vision, and what are the essential components that make it an effective tool for guiding an organization's future? **(5 Marks)**

(b) Which strategy is implemented by redefining the business, by enlarging its scope of business and substantially increasing investment in the business? Explain the major reasons for adopting this strategy. **(5 Marks)**

4. (a) Describe the principal aspects of strategy-execution process, which are included in most situations. **(5 Marks)**

(b) How does the PESTLE framework assist in analyzing the macro-environment?

OR

A manufacturing company is in direct competition with fifteen companies at the national level. The head of marketing department of this company wishes to study the market position of rival companies by grouping them into like positions. Name the tool that may be used by him/her. Explain the procedure that may be used to implement the techniques. **(5 Marks)**

MODEL TEST PAPER 6

PAPER 6B: STRATEGIC MANAGEMENT

1. *The question paper comprises two parts, Part I and Part II.*
2. *Part I comprises case scenario based multiple choice questions (MCQs)*
3. *Part II comprises questions which require descriptive type answers.*

PART I – Case scenario based MCQs (15 Marks)

Question 1. (A) (Compulsory)

1. (A) EcoForge, a startup specializing in eco-friendly building materials crafted from agricultural waste, entered the highly competitive manufacturing industry with a vision of promoting sustainability. Despite its innovative approach, the company faced significant challenges as a new entrant, including high production costs, limited market visibility, regulatory hurdles, and fierce competition from established players. However, through strategic planning and effective execution, EcoForge successfully navigated these obstacles and positioned itself for sustainable growth.

The company's leadership recognized the importance of understanding its internal strengths and weaknesses, along with external opportunities and threats. This analysis revealed EcoForge's core advantage in sustainability and innovation, contrasted with scalability issues and market pressure from cheaper alternatives. Additionally, market analysis uncovered the potential of urban housing projects as an opportunity, while intense competition posed a significant threat.

EcoForge's leadership focused on creating unique value propositions by emphasizing its eco-friendly materials. This differentiation helped the company appeal to environmentally conscious builders and developers. To expand its market reach, EcoForge adopted strategies to deepen its presence in existing markets and explore new ones. Concurrently, it analyzed the industry landscape and identified the critical influence of regulatory policies and socio-cultural factors shaping consumer preferences.

Internally, EcoForge implemented structural and cultural changes to enhance its operational efficiency and responsiveness. By adopting a Strategic Business Unit (SBU) model, the company streamlined its decision-making process, allowing each product line to adapt quickly to market demands.

Recognizing the need for collaborative leadership, EcoForge's CEO, Ms. Aarti Mehra, invested in leadership training programs for senior managers. This shifted the company's culture from hierarchical to team-driven, encouraging innovation and cross-functional collaboration.

To enhance its competitiveness, EcoForge optimized its production and supply chain processes by addressing inefficiencies and partnering with technology providers. These efforts significantly reduced costs and improved product quality. Simultaneously, the company pursued green certifications and localized marketing efforts to build brand recognition, attracting environmentally conscious clients. Over three years, these initiatives enabled EcoForge to expand into new markets, secure partnerships with leading developers, and increase its revenue by 40%.

By integrating market analysis, operational improvements, and a focus on cost efficiency, EcoForge transitioned from a struggling startup to a leader in sustainable building materials, setting a benchmark for innovation and environmental stewardship in the industry.

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

(i) The SBU model adopted by EcoForge is an example of strategic decision-making at which level?

- (a) Corporate Level
- (b) Business Level
- (c) Functional Level
- (d) Operational Level **(2 Marks)**

(ii) EcoForge's strategy of appealing to environmentally conscious builders and developers by emphasizing its eco-friendly materials is an example of which type of generic strategy by Michael Porter?

- (a) Cost Leadership
- (b) Differentiation
- (c) Focussed Cost Leadership
- (d) Focussed Differentiation **(2 Marks)**

(iii) The case mentions EcoForge identifying "critical influence of regulatory policies and socio-cultural factors shaping consumer preferences." Which strategic analysis framework is most relevant here?

- (a) SWOT Analysis
- (b) Value Chain Analysis
- (c) PESTLE Analysis
- (d) Ansoff's Matrix **(2 Marks)**

(iv) EcoForge's strategy to deepen its presence in existing markets and explore new ones corresponds to which growth strategy in Ansoff's Matrix?

- (a) Market Penetration
- (b) Market Development
- (c) Product Development
- (d) Diversification **(2 Marks)**

(v) Which key industry force, as per Porter's Five Forces, is reflected in EcoForge's challenges from cheaper alternatives and intense competition?

(a) Threat of New Entrants

(b) Bargaining Power of Suppliers

(c) Bargaining Power of Buyers

(d) Threat of Substitutes **(2 Marks)**

(B) Compulsory Application Based Independent MCQs

(i) The CEO of GoFlyHigh Airlines has built a high-performance team over five years by closely monitoring performance metrics, setting clear expectations, and motivating employees through rewards and structured improvement plans. Her disciplined and results-focused approach has driven organizational success by fostering accountability and maintaining high standards. This leadership style emphasizes achieving defined goals through a structured framework, balancing performance recognition with corrective measures for sustained excellence. What strategic leadership style does the CEO exhibit?

(a) Entrepreneur Leadership

(b) Transformational Leadership

(c) Transactional Leadership

(d) Intrapreneur Leadership **(2 Marks)**

(ii) UN&T reached out to Mukesh S, an entrepreneur from India to get his team to work on a mega solar energy project and enter India's deccan plateau which enjoys an abundance of sunshine. What strategy is UN&T trying to implement?

(a) Market Penetration

(b) Market Development

(c) Strategic Alliance

(d) Diversification **(2 Marks)**

(iii) Urbankey has a unique capability in rapid prototyping, allowing them to bring new products to market faster than the competitors. Such an advantage can be termed as?

(a) Market Expansion Strategy

(b) Core Competency

(c) Cost Leadership Strategy

(d) Appropriate SWOT Analysis **(1 Mark)**

PART II – Descriptive Questions (35 Marks)

*Question No. **1** is compulsory.*

*Attempt any **two** questions out of the remaining **three** questions.*

1. (a) *Chic Threads*, a boutique fashion brand renowned for its commitment to sustainability and ethical practices, has recently launched a new line of eco-friendly clothing made from recycled materials. The brand recognizes the growing influence of environmentally conscious consumers who actively shape industry standards through their advocacy and purchasing decisions. These consumers align with *Chic Threads'* values and have a significant impact on its market position and reputation. How should *Chic Threads* effectively manage its relationship with environmentally conscious consumers, considering their high power and high interest in shaping the brand's success? **(5 Marks)**

   (b) You are a strategic manager for a tech company launching a new smartphone model. The company wants to target tech-savvy consumers who value innovation and cutting-edge technology. Using the concept of customer behavior, develop a marketing strategy to promote the new smartphone. **(5 Marks)**

   (c) *GreenEdge Solutions*, a mid-sized technology company, has implemented a new strategic plan focused on achieving sustainable growth and strengthening its market presence. The leadership team is determined to monitor the effectiveness of their strategies to ensure they align with the organization's overall goals and objectives. They seek a systematic approach to assess key performance areas critical to their success. What are Strategic Performance Measures (SPM), and how can *GreenEdge Solutions* effectively use them to evaluate and enhance the success of their strategic plan? **(5 Marks)**

2. (a) *Connect Group* was one of the leading makers of the mobile handsets till a few years ago and which went at the bottom of the heap. *Connect Group* didn't adapt to the current market trends, which eventually led to its downfall. Which would have helped *Connect Group* to change, adapt and survive? Explain the steps to initiate the change. **(5 Marks)**

   (b) Define strategic management. Also discuss the limitations of strategic management. **(5 Marks)**

3. (a) *Easy Access* is a marketing services company providing consultancy to a range of business clients. *Easy Access* and its rivals have managed to persuade the Government to require all marketing services companies to complete a time-consuming and bureaucratic registration process and to comply with an industry code of conduct. Do you think that by doing this *Easy Access* and its rivals has an advantage in some ways to fight off competitors? Explain. **(5 Marks)**

   (b) Explain in brief the various basis of differentiation strategies. **(5 Marks)**

4. (a) *Leatherite Ltd.* was started as a leather company to manufacture footwear. Currently, they are in the manufacturing of footwears for males and females. The top management desires to expand the business in leather manufacturing goods. To expand they decided to purchase more machines to manufacture leather bags for males and females. Identify and explain the strategy opted by the top management of *Leatherite Ltd.*

(5 Marks)

(b) Major core competencies are identified in three areas - competitor differentiation, customer value and application to other markets. Discuss.

OR

Differentiation between Strategic Planning and Operational Planning.

(5 Marks)

MODEL TEST PAPER 7

PAPER 6B: STRATEGIC MANAGEMENT

1. *The question paper comprises two parts, Part I and Part II.*
2. *Part I comprises case scenario based multiple choice questions (MCQs)*
3. *Part II comprises questions which require descriptive type answers.*

PART I – Case scenario based MCQs (15 Marks)

Question 1. (A) (Compulsory)

1. (A) Galaxy Enterprises Limited (GEL) operates as a diversified conglomerate with a significant presence in various industries, including electronics, packaged foods, textiles, heavy machinery, and renewable energy. Leveraging its substantial free reserves of ₹85,000 crores, GEL has built a strong brand reputation, largely driven by its market leadership across multiple sectors.

In the renewable energy sector, GEL has been the industry leader for over 15 years. The division's recent performance has been exceptional. A significant market development occurred when two competitors, Nova Green Energy Limited and Zenith Solar Limited – previously ranked second and third in market share, respectively – merged to create a new entity, Synergy Renewables Ltd (SRL). Following the merger, SRL has claimed the top spot in market share, intensifying competition.

Against this backdrop, the Chairman of GEL convened a strategic meeting with the Board of Directors, divisional heads, marketing executives, and the Group CFO. The meeting focused on formulating growth strategies for the renewable energy division, identifying opportunities for diversification, and announcing an interim dividend in honour of GEL's platinum jubilee celebrations.

Mr. Arvind Malhotra, CEO of the renewable energy division, emphasized the industry's slow pace of modernization compared to global standards. He highlighted the potential in emerging product categories, such as next-generation solar panels, energy storage systems, and advanced wind turbines. He proposed a modernization initiative requiring an investment of ₹7,000 crores. This transformation is projected to reduce operational costs by 20% and minimize wastage by 12%.

The CFO presented an analysis revealing that competitors are unlikely to invest in significant upgrades or expansions for the next 6–8 years due to financial constraints. In response, the Board approved the modernization initiative and allocated an additional ₹1,500 crores to strengthen the division's supply chain.

Another proposal discussed was GEL's entry into the electric vehicle (EV) segment. The Board approved this diversification strategy, allocating ₹8,000 crores to establish a foothold in this rapidly growing market. Additionally, the Board authorized the distribution of an interim dividend of ₹75 per share to commemorate GEL's platinum jubilee.

In preparing for these strategic initiatives, the Board also evaluated key stakeholders to determine their influence and interest. Shareholders and the Board of Directors emerged as primary stakeholders with both high influence and interest, necessitating active engagement to secure their support. Regulatory authorities were recognized as influential but less interested in the immediate plans, requiring regular updates to ensure compliance. Customers and employees, while not as powerful, were identified as highly interested stakeholders, particularly concerning the renewable energy division's modernization and the entry into the EV market.

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

(i) GEL has approved significant investments in modernizing its renewable energy division and entering the electric vehicle segment. Analyze the level of strategy these decisions represent and identify the correct justification for your answer.

(a) Functional level, as these are related to operational improvements within the renewable energy division.

(b) Business level, as these initiatives align with the goals of a single division to gain a competitive edge.

(c) Corporate level, as they involve decisions impacting the overall portfolio and diversification of GEL.

(d) Operational level, as these focus on day-to-day activities within the divisions. **(2 Marks)**

(ii) With the merger of Nova Green Energy Limited and Zenith Solar Limited into Synergy Renewables Ltd (SRL), how does this development influence GEL's strategic priorities in the renewable energy sector under Porter's Five Forces framework?

(a) The merger reduces the threat of substitutes by consolidating competing technologies.

(b) It increases the bargaining power of buyers by providing them with a stronger alternative supplier.

(c) It heightens the intensity of industry rivalry by creating a stronger competitor with greater market share.

(d) The merger strengthens the bargaining power of suppliers due to greater reliance on key inputs. **(2 Marks)**

(iii) GEL's decision to enter the EV market represents a diversification strategy. Evaluate which type of diversification strategy is being pursued and the reasoning behind this classification.

(a) Concentric diversification, as the EV market shares synergies with renewable energy technologies.

(b) Vertical integration, as GEL seeks to integrate upstream or downstream activities in the automotive value chain.

(c) Horizontal diversification, as GEL expands into a market unrelated to its existing renewable energy operations.

(d) Conglomerate diversification, as GEL enters an entirely unrelated and independent business segment. **(2 Marks)**

(iv) GEL identified shareholders and the Board of Directors as key stakeholders. Analyze the rationale for classifying them as both high influence and high interest and how this influences strategic communication.

(a) They directly impact compliance with regulatory standards, necessitating regular updates.

(b) Their vested interest in dividends and long-term value creation makes their engagement essential for approval of key initiatives.

(c) They represent the end consumers whose perceptions directly influence GEL's market reputation.

(d) Their role in operational execution requires constant communication and support for strategy implementation. **(2 Marks)**

(v) By approving modernization in renewable energy and diversification into EVs, what corporate strategy is GEL pursuing, and how does it position the company as per Ansoff's product market growth matrix?

(a) Cost leadership, to lower operational expenses and offer competitive pricing.

(b) Product differentiation, by leveraging innovation in both existing and new markets.

(c) Market penetration, through deeper investments in existing product lines.

(d) Market expansion and diversification, to capture growth opportunities across unrelated industries. **(2 Marks)**

(B) Compulsory Application Based Independent MCQs

(i) Harish, a middle manager, is confused about the difference between flexibility and resilience while working around an uncertain situation in the organization. Can you help find the right difference between the two?

(a) Flexibility is about adapting to new things quickly, while resilience is about holding on to the current position of the things for the short-term as the organisation is confident of its efficiencies.

(b) Flexibility is a subset of resilience, and to be flexible means to be resilient.

(c) Flexibility is the opposite of resilience, where, if the organisation is flexible, it changes and if it is resilient it doesn't change at all.

(d) Both are the same. **(2 Marks)**

(ii) Suman, the marketing head of Jalwa Music Co., was doing research on the online music streaming business in India for her new age music for youngsters. She analyzed that though the players in the market were innovating rapidly, it was difficult to maintain a sustainable competitive advantage. Which aspect of strategic management best reflects this challenge?

(a) The need for continuous innovation.

(b) The importance of understanding the competitive landscape.

(c) The dynamic and unpredictable nature of the industry.

(d) The difficulty in estimating competitors' responses. **(2 Marks)**

(iii) During which stage of the Product Life Cycle would you typically expect the highest marketing expenditure per unit sold as companies aggressively promote their product?

(a) Maturity

(b) Introduction

(c) Growth

(d) Decline **(1 Mark)**

PART II – Descriptive Questions (35 Marks)

*Question No. **1** is compulsory.*

*Attempt any **two** questions out of the remaining **three** questions.*

1. (a) *Jupiter Electronics Ltd.* is known for its ability to come out with path-breaking products. Though the work environment at Jupiters is relaxed and casual, there is a very strong commitment to deadlines. The employees believe in a “work hard play hard" ethic. The organisation has moved away from formal and hierarchical set up to a more results-driven approach. Employees are committed to strategies and work towards achieving them. They guard innovations, maintain confidentiality and secrecy in their work. They are closely related to values, practices, and norms of organisations. What aspects of an organization are being discussed? Explain. **(5 Marks)**

(b) *Reshuffle Corp* is a company that manufactures and sells office furniture. They offer a range of products, from desks and chairs to cabinets and shelves. Recently, the company has been facing increased competition from online retailers offering similar products at lower prices.

Analyzing the characteristics of products in the furniture industry, discuss how *Reshuffle Corp* can differentiate its products to maintain a competitive edge in the market. **(5 Marks)**

(c) A business consultancy firm focuses on providing specialized services in environmental management consultancy. It assists client companies in establishing robust environmental management accounting systems for the measurement, recording, and analysis of environmental costs. A significant portion of the firm's operations involve conducting environmental audits to verify compliance with international assurance standards in environmental management—an exclusive service not offered by its competitors. While the firm also undertakes other management consultancy projects, these constitute only a minor share of its total annual revenue. Identify the strategy categories by Michael Porter which best describes the strategy of this firm. **(5 Marks)**

2. (a) Analyze the role of Key Success Factors (KSFs) in determining competitive success within an industry. **(5 Marks)**

   (b) How the 'Strategic Business Unit' (SBU), structure becomes imperative in an organization with increase in number, size and diversity of divisions? **(5 Marks)**

3. (a) Rohit Patel has a small chemist shop in the central part of Ahmedabad. What kind of competencies Rohit can build to gain competitive advantage over online medicine sellers? **(5 Marks)**

   (b) Distinguish between Vision and Mission. **(5 Marks)**

4. (a) Vikram Patel owns a chain of ten bookstores across the Mumbai region. Three of these stores were launched in the past two years. He has always believed in strategic management and enjoyed robust sales of books, magazines, and educational materials until about five years ago. However, with the increasing preference for online shopping, the sales at his physical stores have declined by approximately sixty percent over the last five years. Analyze Vikram Patel's current position in light of the limitations of strategic management. **(5 Marks)**

   (b) Explain the strategic implications of each of the following types of business in a corporate portfolio:

   (a) Stars (b) Question Marks (c) Cash Cows (d) Dogs

   OR

   Strategic alliances are formed if they provide an advantage to all the parties in the alliance. Do you agree? Explain in brief the advantages of a strategic alliance. **(5 Marks)**

MODEL TEST PAPER 8

PAPER 6B: STRATEGIC MANAGEMENT

1. *The question paper comprises two parts, Part I and Part II.*
2. *Part I comprises case scenario based multiple choice questions (MCQs)*
3. *Part II comprises questions which require descriptive type answers.*

PART I – Case scenario based MCQs (15 Marks)

Question 1. (A) (Compulsory)

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

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

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

While MuseoGoa had successfully resolved their initial issues with the local community, they faced another challenge. Their location, although idyllic, was a bit off the beaten path. Tourists typically preferred the bustling beaches closer to the city, and this posed a real challenge. MuseoGoa decided to employ a pricing strategy. They priced their tickets affordably, significantly cheaper than the city's attractions. This strategy attracted budget-conscious tourists who were looking for unique experiences in Goa without burning a hole in their pockets. As word spread about the cultural gem tucked away in the village, visitors started flocking in, drawn not just by the museum's charm but also the economical ticket prices.

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

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

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

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

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

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

(i) Which strategic management concept did MuseoGoa use to address the initial concerns of the local community?

(a) SWOT analysis

(b) Mendelow's matrix

(c) Cost leadership strategy

(d) Porter's Five Forces model **(2 Marks)**

(ii) MuseoGoa's idyllic location in a quaint village posed a challenge as tourists preferred beaches closer to the city. To attract visitors, MuseoGoa priced their tickets affordably, cheaper than city attractions, drawing budget-conscious tourists looking for unique experiences. What business strategy did MuseoGoa employ to attract more tourists?

(a) Cost leadership strategy

(b) Differentiation strategy

(c) Focus strategy

(d) Diversification strategy **(2 Marks)**

(iii) How did MuseoGoa approach its expansion into new markets such as Pune and Trivandrum?

(a) Outsourcing strategy

(b) Franchising strategy

(c) Product diversification strategy

(d) Market development strategy **(2 Marks)**

(iv) Which element of the 7S McKinsey model is demonstrated by MuseoGoa's strategic use of social media and pricing strategies to attract visitors?

(a) Style

(b) Strategy

(c) Shared Values

(d) Skills **(2 Marks)**

(v) What played a crucial role in MuseoGoa's success in Pune and Trivandrum?

(a) Strategic partnerships

(b) Aggressive advertising

(c) Product differentiation

(d) Vertical integration **(2 Marks)**

(B) Compulsory Application Based Independent MCQs

(i) Jaago Lights, a successful brand from Jalandhar, aimed to enter the Middle East market by teaming up with major industry players. They needed to reorganize internal operations and refine product designs, facing pressure to expand quickly and turbulence in existing operations. What is the primary limitation of strategic management highlighted in the business case?

(a) Lack of senior management support

(b) Time-consuming and complex nature

(c) Inability to adapt to market changes

(d) Excessive focus on short-term goals **(2 Marks)**

(ii) A traditional desi ghee company modernized its production and introduced pro-biotic desi ghee, facing initial market doubts. Aggressive marketing campaigns highlighted its benefits, gaining acceptance. During which stage of the product life cycle did the desi ghee company face doubts but gained acceptance through aggressive marketing campaigns?

(a) Introduction stage

(b) Growth stage

(c) Maturity stage

(d) Decline stage **(2 Marks)**

(iii) Alpha Corp is undergoing a shift to foster a culture that encourages innovative thinking and team collaboration. To achieve this, the company is focusing on how leaders interact with their teams and set examples for behavior, aiming to align leadership practices with desired cultural outcomes. Which aspect of AlphaCorp is being adjusted to foster a culture of innovation and collaboration?

(a) Structure

(b) Systems

(c) Skills

(d) Style **(1 Mark)**

PART II – Descriptive Questions (35 Marks)

*Question No. **1** is compulsory.*

*Attempt any **two** questions out of the remaining **three** questions.*

1. (a) Tech Innovators Inc., a rapidly expanding technology company, aims to lead in artificial intelligence (AI) and machine learning (ML). With recent growth, the company is evaluating which organizational structure will best support its vision for innovation and leadership in AI technologies. They are considering three options: the Functional and Divisional Relationship for specialization, the Horizontal Relationship for flat, collaborative management, and the Matrix Relationship for cross-functional teams. Which of these relationships—Functional and Divisional, Horizontal, or Matrix—will most effectively achieve Tech Innovators Inc.'s strategic goals, and why? **(5 Marks)**

(b) Rajiv Arya owns an electrical appliance company specializing in the manufacture of domestic vacuum cleaners. The market is competitive, with four other manufacturers offering similar products and achieving comparable sales volumes. Additionally, these rival firms hold several patents related to the vacuum cleaner technology. The supplier base for raw materials is extensive, with multiple suppliers available. Identify and explain the significant forces from Porter's Five Forces framework that are relevant to Rajiv Arya's company. **(5 Marks)**

(c) A Mumbai-based conglomerate, PQR Ltd., has announced a major restructuring of its business operations. The company has decided to split its business into four separate units: Manufacturing, Retail, Services, and Technology. Each unit will operate as a separate business, with delegated responsibility for day-to-day operations and strategy to the respective unit managers. Identify the organization structure that PQR Ltd. has planned to implement. Discuss any four attributes and the benefits the firm may derive by using this organization structure. **(5 Marks)**

2. (a) Strategic management helps an organization to work through changes in the environment to gain competitive advantage. In light of statement discuss its benefits. **(5 Marks)**

(b) A company has recently launched a new product in the market. Initially, it faced slow sales growth, limited markets, and high prices. However, over time, the demand for the product expanded rapidly, prices fell, and competition increased. Identify the stages of the product life cycle (PLC) that the company went through. **(5 Marks)**

3. (a) What do you understand by Strategic Alliance? Discuss its advantages. **(5 Marks)**

   (b) Why Strategic Performance Measures are essential for organizations? **(5 Marks)**

4. (a) Distinguish between Concentric Diversification and Conglomerate Diversification. **(5 Marks)**

   (b) What are channels? Why is channel analysis important? Explain the different types of channels?

OR

How can Mendelow's Matrix be used to analyze and manage the stakeholders effectively? **(5 Marks)**

ANSWERS OF MODEL TEST PAPER 1

INTERMEDIATE: GROUP – II

PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A : FINANCIAL MANAGEMENT

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)	<u>4,83,200</u>

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%

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

18	$= \frac{0.15D + 3.3 - 0.22D}{0.15}$
0.07D	= 3.3 – 2.7
D	= 8.57
D/P ratio	$= \frac{DPS}{EPS} \times 100 = \frac{8.57}{15} \times 100 = 57.13\%$

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%

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

∴ 12.375+19.404x+21x+0.15 = (0.16)(99)

∴ 40.404x = 15.84 – 12.525

∴ 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".**

ANSWERS OF MODEL TEST PAPER 2

INTERMEDIATE: GROUP – II

PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A : FINANCIAL MANAGEMENT

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%

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

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

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 $\left(\frac{₹\ 12,00,000}{12\ months} \times 2\ months\right)$	2,00,000	
- Finished Goods $\left(\frac{₹\ 33,60,000}{12\ months} \times 2\ months\right)$	5,60,000	
Receivables (Debtors) $\left(\frac{₹\ 38,40,000}{12\ months} \times 3\ months\right)$	9,60,000	
Sales Promotion expenses paid in advance $\left(\frac{₹1,20,000}{12\ months} \times 1\ month\right)$	10,000	
Cash balance	1,00,000	18,30,000
Gross Working Capital		18,30,000

B. Current Liabilities:		
Payables:		
- Creditors for materials $\left(\frac{₹12,00,000}{12 \text{months}} \times 2 \text{ months}\right)$	2,00,000	
Wages outstanding $\left(\frac{₹9,60,000}{12 \text{months}} \times 1 \text{ month}\right)$	80,000	
Manufacturing expenses outstanding $\left(\frac{₹12,00,000}{12 \text{months}} \times 1 \text{ month}\right)$	1,00,000	
Administrative expenses outstanding $\left(\frac{₹3,60,000}{12 \text{months}} \times 1 \text{ month}\right)$	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) Dividends are declared (₹ lakh)	(b) 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	**=**	$\frac{\text{EBIT}}{\text{EBT}}$	**=**	$\frac{\text{EBIT}}{(\text{EBIT} - \text{Int.})}$

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	3= X/8,00,000
	X = 16,50,000	**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

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

At present:

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

= 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

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

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

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.

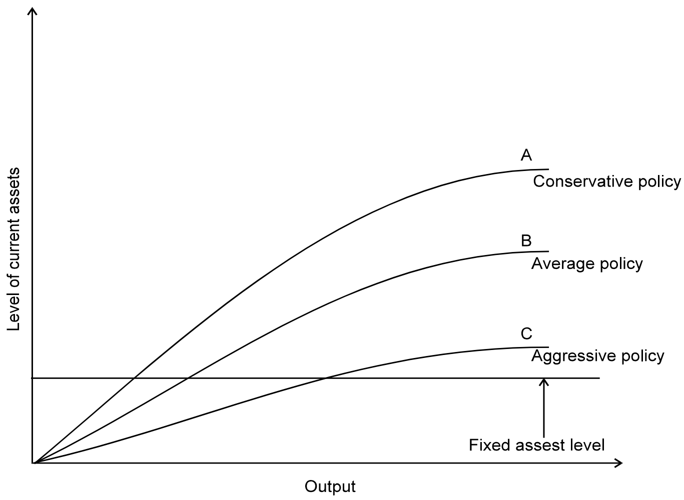
***Financing decision**:* Funds can be raised from various sources. Each source of funds involves different issues. The finance manager has to maintain a proper balance between long-term and short-term funds. With the total volume of long-term funds, he has to ensure a proper mix of loan funds and owner's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

ANSWERS OF MODEL TEST PAPER 3

INTERMEDIATE: GROUP – II

PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A : FINANCIAL MANAGEMENT

PART I – Case Scenario based MCQs

1. 1. (c) Calculation of cost of capital

Capital	Weight	Cost	Product
Debt	0.3	10%	3.00%
Preference	0.2	11%	2.20%
Equity	0.5	15%	7.50%
	Ko=		**12.70%**

2. (a)

3. (c)

4. (d)

5. (a)

Calculation of CFAT

Year		1	2	3	4	5	6
A) No. of quick deliveries p.d.		10,000	12,000	13,800	15,180	15,939	15,939
B) No. of overnight deliveries p.d.		2,000	2,400	2,760	3,036	3,188	3,188
C) No. of quick deliveries p.a.		36,50,000	43,80,000	50,37,000	55,40,700	58,17,735	58,17,735
D) No. of overnight deliveries p.a.		7,30,000	8,76,000	10,07,400	11,08,140	11,63,547	11,63,547
E) Chargeable quick deliveries		18,25,000	21,90,000	25,18,500	27,70,350	29,08,868	29,08,868
F) No. of delivery partners	1.5x(A+B)/ 30	600	720	828	911	956	956
Revenue (in crores)							
From quick deliveries (QD)	(E x 40)	7.30	8.76	10.07	11.08	11.64	11.64
From QD seller commission	(C x 700 x 5%)	12.775	15.330	17.630	19.392	20.362	20.362
From Overnight delivery subscription	(B/2 x 5000)	0.500	0.600	0.690	0.759	0.797	0.797

From OD seller commission	(C x 750 x 7%)	3.83	4.60	5.29	5.82	6.11	6.11
Total Revenue		**24.41**	**29.29**	**33.68**	**37.05**	**38.90**	**38.90**
Cost (in crores)							
Advertising		7	8	10	0	0	0
IT and customer care		8	8	8	8	8	8
Delivery partner salary	(F x 15000)	0.90	1.08	1.24	1.37	1.43	1.43
Delivery partner commission	(C+D) x 20	8.76	10.51	12.09	13.30	13.96	13.96
Depreciation	on investment in year 0	6	6	6	6	6	
	on investment in year 2		4	4	4	4	4
	on investment in year 4				5	5	5
Total Cost		**30.66**	**37.59**	**41.33**	**37.66**	**38.40**	**32.40**
PBT		-6.25	-8.30	-7.65	-0.61	0.51	6.51
Less: Tax		1.56	2.08	1.91	0.15	-0.13	-1.63
PAT		-4.69	-6.23	-5.74	-0.46	0.38	4.88
Add: Depreciation		6.00	10.00	10.00	15.00	15.00	9.00
CFAT		**1.31**	**3.77**	**4.26**	**14.54**	**15.38**	**13.88**

Computation of NPV

Year	Particulars		Cash Flows (in crores)	PVF @ 12.7%	PV (in crores)
0	Investment		-30	1	-30
1	Investment		-20	0.887	-17.75
3	Investment		-25	0.699	-17.46
1	Operating CFAT		1.31	0.887	1.16
2	Operating CFAT		3.77	0.787	2.97
3	Operating CFAT		4.26	0.699	2.98
4	Operating CFAT		14.54	0.620	9.01
5	Operating CFAT		15.38	0.550	8.46
6	Operating CFAT		13.88	0.488	6.77
6	Sale Proceeds	(30+20+25)x2	150	0.488	73.21
	NPV				**39.35**

2. **(d)** FL=%change in NP/%change in EBIT=6.9/6=1.15

3. **(c)** Since IRR of projects of company is greater than its cost of capital, the company should retain all ist earnings i.e. DPR = 0. As per walter Po = [0 + (0.15/0.125)10]/0.125 = 96

4. **(d)** 180 days

PART II – Descriptive Questions

1. **(a)** Determination of specific costs

(i) Cost Debt (K_d) $= \dfrac{\text{Interest}(1-t)+\dfrac{(RV-NP)}{N}}{\dfrac{(RV+NP)}{2}} = \dfrac{₹11(1-0.35)+\dfrac{(₹100-₹96)}{10\text{ years}}}{\dfrac{(₹100+₹96)}{2}}$

$= \dfrac{₹7.15+₹0.4}{₹98}$ = 0.077 or 7.70%

(ii) Cost of Preference Shares (K_p) = $\dfrac{PD+\dfrac{(RV-NP)}{N}}{\dfrac{(RV+NP)}{2}} = \dfrac{₹12+\dfrac{(₹100-₹95)}{10\text{ years}}}{\dfrac{(₹100+₹95)}{2}}$

$= \dfrac{₹12+₹0.5}{₹97.5}$ = 0.1282 or 12.82%

(iii) Cost of Equity shares (K_e) = $\dfrac{D_1}{P_0}+G = \dfrac{₹2}{₹22-₹2}+0.07$ = 0.17 or 17%

I – Interest, t – Tax, RV- Redeemable value, NP- Net proceeds, N- No. of years, PD- Preference dividend, D_1- Dividend at the end of the year, P_0- Price of share (net)

Using these specific costs we can calculate the book value and market value weights as follows:

(a) Weighted Average Cost of Capital (K_0) based on Book value weights

Source of capital	**Book value (BV)**	**Specific cost (k) (%)**	**Total costs [BV (×) k]**
Debentures	₹ 8,00,000	7.7	₹ 61,600
Preferences shares	2,00,000	12.8	25,600
Equity shares	10,00,000	17.0	1,70,000
	20,00,000		2,57,200
K_0 = ₹ 2,57,200/₹ 20,00,000 = 12.86 per cent			

(b) Weighted Average Cost of Capital (K_0) based on market value weights

Source of Capital	Market Value (MV)	Specific cost (k) (%)	Total costs [MV (×) k]
Debentures	₹ 8,80,000	7.7	₹ 67,760,
Preference shares	2,40,000	12.8	30,720
Equity shares	22,00,000	17.0	3,74,000
Total capital	33,20,000		4,72,480
K_0 = ₹ 4,72,480/₹ 33,20,000 = 14.23 per cent			

(b) Total Assets = ₹ 400 crores

Total Asset Turnover Ratio = 2.5

Hence, Total Sales = 400 × 2.5 = ₹ 1000 crores

Computation of Profits after Tax (PAT)

	(₹ in crores)
Sales	1000
Less: Variable operating cost @ 65%	650
Contribution	350
Less: Fixed cost (other than Interest)	80
EBIT	270
Less: Interest on debentures (15% × 200)	30
EBT	240
Less: Tax 40%	96
EAT	144

(i) Earnings per share

$$\therefore \text{ EPS} = \frac{\text{₹ 144 crores}}{\text{10 crore equity shares}} = \text{₹ } 14.40$$

(ii) Operating Leverage

$$\text{Operating leverage} = \frac{\text{Contribution}}{\text{EBIT}} = \frac{350}{270} = 1.296$$

It indicates the choice of technology and fixed cost in cost structure. It is level specific. When firm operates beyond operating break-even level, then operating leverage is low. It indicates sensitivity of earnings before interest and tax (EBIT) to change in sales at a particular level.

(iii) Financial Leverage

$$\text{Financial Leverage} = \frac{\text{EBIT}}{\text{EBT}} = \frac{270}{240} = 1.125$$

The financial leverage is very comfortable since the debt service obligation is small vis-à-vis EBIT.

(iv) Combined Leverage

Combined Leverage = $\frac{\text{Contribution}}{\text{EBIT}} \times \frac{\text{EBIT}}{\text{EBT}}$ Or Operating Leverage x Financial Leverage

= 1.296 × 1.125 = 1.458

The combined leverage studies the choice of fixed cost in cost structure and choice of debt in capital structure. It studies how sensitive the change in EPS is vis-à-vis change in sales.

(c) Working notes:

1. Computation of Current Assets and Current Liabilities:

$$\frac{\text{Current Assets}}{\text{Current Liabilities}} = \frac{2.5}{1} \text{ or } \frac{\text{Current Assets}}{2.5} = \frac{\text{Current Liabilities}}{1} = \text{k (say)}$$

Or, Current Assets = 2.5 k and Current Liabilities = k

Or, Working capital = (Current Assets – Current Liabilities)

Or, ₹2,40,000 = k (2.5 – 1) = 1.5 k

Or, k = ₹1,60,000

∴ Current liabilities = ₹1,60,000

Current assets = ₹1,60,000 × 2.5 = ₹4,00,000

2. Computation of Inventories

$$\text{Liquid ratio} = \frac{\text{Liquid assets}}{\text{Current liabilities}}$$

$$\text{Or, } 1.5 = \frac{\text{Current assets - Inventories}}{₹1,60,000}$$

Or, 1.5 × ₹1,60,000 = ₹4,00,000 – Inventories

Or, Inventories = ₹1,60,000

3. Computation of Proprietary fund; Fixed assets; Capital and Trade payables

$$\text{Proprietary ratio} = \frac{\text{Fixed assets}}{\text{Proprietary fund}} = 0.75$$

∴ Fixed assets = 0.75 Proprietary fund

and Net working capital = 0.25 Proprietary fund

Or, ₹2,40,000/0.25	=	Proprietary fund
Or, Proprietary fund	=	₹9,60,000
and Fixed assets	=	0.75 proprietary fund
	=	0.75 × ₹9,60,000
	=	₹7,20,000

Capital	=	Proprietary fund – Reserves & Surplus
	=	₹9,60,000 – ₹1,60,000
	=	₹8,00,000
Trade payables	=	(Current liabilities – Bank overdraft)
	=	(₹1,60,000 – ₹40,000)
	=	₹1,20,000

Construction of Balance sheet

(Refer to working notes 1 to 3)

Balance Sheet as at 31st March, 2023

Liabilities	(₹)	Assets	(₹)
Capital	8,00,000	Fixed assets	7,20,000
Reserves & Surplus	1,60,000	Inventories	1,60,000
Bank overdraft	40,000	Current assets (other than inventories)	2,40,000
Trade Payables	1,20,000		
	11,20,000		11,20,000

2. (a)

Ascertainment of probable price of shares of Akash limited

Particulars	Plan (i) (If ₹ 4,00,000 is raised as debt) (₹)	Plan (ii) If ₹ 4,00,000 is raised by issuing equity shares (₹)
Earnings Before Interest (EBIT)	3,60,000	3,60,000
20% on (14,00,000 +4,00,000)		
Less: Interest on old debentures @ 10% on 4,00,000	40,000 3,20,000	40,000 3,20,000
Less: Interest on New debt @ 12% on ₹ 4,00,000	48,000	––
Earnings Before Tax (After interest)	2,72,000	3,20,000
Less Tax @ 50%	1,36,000	1,60,000
Earnings for equity shareholders (EAIT)	1,36,000	1,60,000
Number of Equity Shares	30,000	40,000
Earnings per Share (EPS)	₹ 4.53	₹ 4.00

Price/ Earning Ratio	8	10
Probable Price Per Share (PE ratio x EPS)	₹ 36.24	₹ 40

Working Notes

		₹
1.	Calculation of Present Rate of Earnings	
	Equity Share capital (30,000x 10)	3,00,000
	10% Debentures $\left(40,000 \times \frac{100}{10}\right)$	4,00,000
	Reserves and Surplus	7,00,000
		14,00,000
	Earnings before interest and tax (EBIT) given	2,80,000
	Rate of Present Earnings = $\frac{2,80,000}{14,00,000} \times 100$	20%
2.	Number of Equity Shares to be issued in Plan	$\frac{4,00,000}{40} = 10,000$
	Thus, after the issue total number of shares	30,000+ 10,000 = 40,000
3.	Debt/Equity Ratio if ₹ 4,00,000 is raised as debt:	
	$\frac{8,00,000}{18,00,000} \times 100 = 44.44\%$	

As the debt equity ratio is more than 40% the P/E ratio shall be 8 in plan (i)

(b) In this case the company has paid dividend of ₹2 per share during the last year. The growth rate (g) is 5%. Then, the current year dividend (D_1) with the expected growth rate of 5% will be ₹ 2.10.

The share price is = $P_o = \frac{D_1}{K_e - g}$

$$= \frac{₹ 2.10}{0.155 - 0.05}$$

= ₹ 20

In case the growth rate rises to 8% then the dividend for the current year. (D_1) would be ₹ 2.16 and market price would be-

$$= \frac{₹ 2.16}{0.155 - 0.08}$$

= ₹ 28.80

In case growth rate falls to 3% then the dividend for the current year (D_1) would be ₹ 2.06 and market price would be-

$$= \frac{₹\ 2.06}{0.155 - 0.03}$$

$= ₹16.48$

So, the market price of the share is expected to vary in response to change in expected growth rate is dividends.

3. Statement showing Working Capital for each policy

(₹ in crores)

	Working Capital Policy		
	Conservative	Moderate	**Aggressive**
Current Assets: (i)	4.50	3.90	2.60
Fixed Assets: (ii)	2.60	2.60	2.60
Total Assets: (iii)	7.10	6.50	5.20
Current liabilities: (iv)	2.34	2.34	2.34
Net Worth: (v)=(iii)-(iv)	4.76	4.16	2.86
Total liabilities: (iv)+(v)	7.10	6.50	5.20
Estimated Sales: (vi)	12.30	11.50	10.00
EBIT: (vii)	1.23	1.15	1.00
(a) Net working capital position: (i)-(iv)	2.16	1.56	0.26
(b) Rate of return: (vii)/(iii)	17.3%	17.7%	19.2%
(c) Current ratio: (i)/(iv)	1.92	1.67	1.11

Statement Showing Effect of Alternative Financing Policy

(₹ in crores)

Financing Policy	**Conservative**	**Moderate**	**Aggressive**
Current Assets: (i)	3.90	3.90	3.90
Fixed Assets: (ii)	2.60	2.60	2.60
Total Assets: (iii)	6.50	6.50	6.50
Current Liabilities: (iv)	2.34	2.34	2.34
Short term Debt: (v)	0.54	1.00	1.50
Long term Debt: (vi)	1.12	0.66	0.16
Equity Capital	2.50	2.50	2.50
Total liabilities	6.50	6.50	6.50
Forecasted Sales	11.50	11.50	11.50
EBIT: (vii)	1.15	1.15	1.15
Less: Interest short-term debt : (viii)	0.06	0.12	0.18
	(12% of ₹ 0.54)	(12% of ₹ 1.00)	(12% of ₹ 1.50)
Long term debt : (ix)	0.18	0.11	0.03
	(16% of ₹ 1.12)	(16% of ₹ 0.66)	(16% of ₹ 0.16)

Earning before tax: (x)-(viii+ix)	0.91	0.92	0.94
Taxes @ 35%	0.32	0.32	0.33
Earning after tax: (xi)	0.59	0.60	0.61
(a) Net Working Capital Position: (i)-[(iv)+(v)]	1.02	0.56	0.06
(b) Rate of return on shareholders Equity capital:(xi)/Equity Capital	23.6%	24%	24.4%
(c) Current Ratio: [(i)/(iv)+(v)]	1.35%	1.17	1.02

4. **(a)** "The profit maximisation is not an operationally feasible criterion." This statement is true because Profit maximisation can be a short-term objective for any organisation and cannot be its sole objective. Profit maximization fails to serve as an operational criterion for maximizing the owner's economic welfare. It fails to provide an operationally feasible measure for ranking alternative courses of action in terms of their economic efficiency. It suffers from the following limitations:

(i) Vague term: The definition of the term profit is ambiguous. Does it mean short term or long term profit? Does it refer to profit before or after tax? Total profit or profit per share?

(ii) Timing of Return: The profit maximization objective does not make distinction between returns received in different time periods. It gives no consideration to the time value of money, and values benefits received today and benefits received after a period as the same.

(iii) It ignores the risk factor.

(iv) The term maximization is also vague.

(b) "Financing a business through borrowing is cheaper than using equity"

(i) Debt capital is cheaper than equity capital from the point of its cost and interest being deductible for income tax purpose, whereas no such deduction is allowed for dividends.

(ii) Issue of new equity dilutes existing control pattern while borrowing does not result in dilution of control.

(iii) In a period of rising prices, borrowing is advantageous. The fixed monetary outgo decreases in real terms as the price level increases.

(c) **Meaning of Weighted Average Cost of Capital (WACC):** The composite or overall cost of capital of a firm is the weighted average of the costs of the various sources of funds. Weights are taken to be in the proportion of each source of fund in the capital structure. While making financial decisions this overall or weighted cost is used. Each investment is financed from a pool of funds which represents the various sources from which funds have been raised. Any decision of investment, therefore, has to be made with reference to the overall cost of capital and not with reference to the cost of a specific source of fund used in the investment decision.

The weighted average cost of capital is calculated by:

(i) Calculating the cost of specific source of fund e.g. cost of debt, equity etc;

(ii) Multiplying the cost of each source by its proportion in capital structure; and

(iii) Adding the weighted component cost to get the firm's WACC represented by K_0.

$K_0 = K_1 W_1 + K_2 W_2 + \ldots\ldots\ldots$

Where,

K_1, K_2 are component costs and W_1, W_2 are weights.

OR

(c) Assumptions of Modigliani – Miller Theory

(a) Capital markets are perfect. All information is freely available and there is no transaction cost.

(b) All investors are rational.

(c) No existence of corporate taxes.

(d) Firms can be grouped into "equivalent risk classes" on the basis of their business risk.

ANSWERS OF MODEL TEST PAPER 4

INTERMEDIATE: GROUP – II

PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A : FINANCIAL MANAGEMENT

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 = (185 + 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% (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

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

EBT + ₹ 2000 = 2 EBT.

EBT = ₹ 2,000

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

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

Sales	$\frac{\text{Contribution}}{\text{PVR}} = \frac{12{,}000}{25\%}$	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
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

$$P_0 = \frac{180(1-0.75)}{0.17-0.75\times0.2} = \frac{45}{0.02} = ₹\ 2,250$$

(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

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

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

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.

ANSWERS OF MODEL TEST PAPER 5

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)**

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

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

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

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**

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

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

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

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	Weights	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

ANSWERS OF MODEL TEST PAPER 6

INTERMEDIATE: GROUP – II

PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A : FINANCIAL MANAGEMENT

Suggested Answers/ Hints

PART I – Case Scenario based MCQs

1. (c) ₹ 0.72

Computation of EPS under financial plan I: Equity Financing

	(₹)
EBIT	37,50,000.00
Interest	-
EBT	37,50,000.00
Less: Taxes 40%	(15,00,000.00)
PAT	22,50,000.00
No. of equity shares	31,25,000.00
EPS	0.72

2. (b) ₹ 0.90

Computation of EPS under financial plan II: Debt – Equity Mix

	(₹)
EBIT	37,50,000.00
Less: Interest	(14,06,250.00)
EBT	23,43,750.00
Less: Taxes 40%	(9,37,500.00)
PAT	14,06,250.00
No. of equity shares	15,62,500.00
EPS	0.90

3. (a) ₹ 0.44

Computation of EPS under financial plan III: Preference Shares – Equity Mix

	(₹)
EBIT	37,50,000.00
Less: Interest	-

EBT	37,50,000.00
Less: Taxes (40%)	(15,00,000.00)
PAT	22,50,000.00
Less: Pref. dividend	(15,62,500.00)
PAT for equity shareholders	6,87,500.00
No. of Equity shares	15,62,500.00
EPS	0.44

4. (a) ₹ 28,12,500

EBIT – EPS Indifference Point- Plan I and Plan II:

$$\frac{(\text{EBIT})\times(1\text{-}T_C)}{N_1}=\frac{(\text{EBIT}-\text{Interest})\times(1-T_C)}{N_2}$$

$$\frac{\text{EBIT}(1-0.40)}{31,25,000}=\frac{(\text{EBIT}-14,06,250)\times(1-0.40)}{15,62,500}$$

0.6EBIT = 1.2 EBIT – 16,87,500

= ₹ 28,12,500

5. (d) ₹ 52,08,333.33

EBIT – EPS Indifference Point: Plan I and Plan III

$$\frac{\text{EBIT}(1-T_c)}{N_1}=\frac{\text{EBIT}(1-T_c)-\text{Pref. Div.}}{N_2}$$

$$\frac{\text{EBIT}(1-0.4)}{31,25,000}=\frac{\text{EBIT}(1-0.4)-15,62,500}{15,62,500}$$

0.6EBIT = 1.2EBIT – 31,25,000

EBIT = ₹ 52,08,333.33

6. (b) 30%

The formula for Degree of Combined Leverage (DCL) is:

DCL=DOL×DFL

DCL=2×3=6

The percentage change in EPS is:

% Δ EPS = DCL × % Δ Sales

% Δ EPS = 6 × 5% = 30%

7. (c) 3.79

Initial Investment = Annual Cost Savings × PVAF

Annual cost savings = ₹ 1,80,000

PVAF (10%, 5 years) = 3.79

Initial Investment = 1,80,000 × 3.79 = 6,82,200

Payback Period = Initial Investment/ Annual Cost Savings

= 6,82,200/1,80,000

= 3.79 years

8. (c) **Remains unchanged because value depends on earnings and investment policy.**

(Explanation: M&M's theory suggests that dividend policy has no impact on shareholder wealth in a perfect market.)

PART II – Descriptive Questions

1. (a) **Statement showing Computation of Combined leverage**

	₹
Sales	2,00,000
Less: Variable costs (50%)	1,00,000
Contribution	1,00,000
Less: Fixed operating costs	40,000
EBIT	60,000
Less: Interest	10,000
Taxable Income (PBT)	50,000

Combined leverage $= \frac{C}{PBT} = \frac{1,00,000}{50,000} = 2$

The combined leverage of '2' indicates that with every increase of ₹ 1 in sales, the taxable income will increase by ₹ 2 (i.e. 1×2). This can be verified by the following computations when the sales increase by 10%

	₹
Sales	2,20,000
Less: variable costs (50%)	1,10,000
Contribution	1,10,000
Less: Fixed operating costs	40,000
EBIT	70,000
Less: Interest	10,000
Taxable Income (PBT)	60,000

It is clear from the above computation that on account of increase in sales by 10%, the profit before tax has increased by 20%.

(b) (i) Computation of Weighted Average Cost of Capital based on existing capital structure

Source of Capital	Existing Capital structure (₹)	Weights (a)	After tax cost of capital (%) (b)	WACC (%) (a) × (b)
Equity share capital (W.N.1)	10,00,000	0.250	10.000	2.500
12% Preference share capital	15,00,000	0.375	12.000	4.500
10% Debentures (W.N.2)	15,00,000	0.375	6.500	2.438
Total	40,00,000	1.000		9.438

Working Notes:

1. Cost of Equity Capital:

$$K_e = \frac{\text{Expected dividend}(D_1)}{\text{Current Market Price}(P_0)} + \text{Growth}(g)$$

$$= \frac{₹\,5}{₹\,100} + 0.05$$

$$= 10\%$$

2. Cost of 10% Debentures

$$K_d = \frac{\text{Interest}(1-t)}{\text{Net proceeds}}$$

$$= \frac{₹\,1,50,000\,(1-0.35)}{₹\,15,00,000}$$

$$= 0.065 \text{ or } 6.5\%$$

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

Source of Capital	New Capital structure (₹)	Weights (a)	After tax cost of capital (%) (b)	WACC (%) (a) x (b)
Equity share capital (W.N.3)	10,00,000	0.222	12.777	2.836
12% Preference share capital	15,00,000	0.334	12.000	4.000
10% Debentures (W.N.2)	15,00,000	0.333	6.500	2.165

12% Debentures (W.N.4)	5,00,000	0.111	7.800	0.866
Total	45,00,000	1.000		9.867

Working Notes:

3. Cost of Equity Capital:

$$K_e = \frac{₹\,7}{₹\,90} + 0.05$$

= 12.777%

4. Cost of 12% Debentures

$$K_d = \frac{₹\,60,000\,(1-0.35)}{₹\,5,00,000}$$

= 0.078 or 7.8%

(c) Fair Value of Company = Present Value all future cash flows discounted at the expected Rate of return of acquiring company.

WN 1 – Calculation of Cash flows **₹ in Lakhs**

YEAR	1	2	3	4	5	6
Contribution (40% on sales)	10	12	14.4	20.16	28.22	35.28
(-) Fixed Cost	-12	-12	-10	-10	-10	-10
NPBT (A)	-2	0	4.4	10.16	18.22	25.28
(-) Losses Set Off	0	0	-2(Setoff)	0	0	0
Taxable Income	0	0	2.4	10.16	18.22	25.28
(-) Tax @ 25% **(B)**	0	0	0.6	2.54	4.55	6.32
Cash Flow (A – B)	**-2**	**0**	**3.8**	**7.62**	**13.66**	**18.96**
PV OF CASH FLOWS @ 15%	-1.740	0	2.50	4.35	6.79	8.19

Total PV of cash flows (yr 1 to 6) = 20.08 lakhs

(+) PV of cash flow at terminal value (end of Year 6) = $\frac{18.96 + 10\%}{0.15 - 0.10}$

= 417.12 Lakhs

Therefore, PV of above = 417.12 X PV factor (15%, 6^{th} Year) = 180.20 lakhs

Total fair value of Aryayash limited = 20.08 + 180.20 = 200.28 Lakhs

Note – 1. Discounting rate should be the desired rate of acquiring company i.e. of Vyom Limited

2. Terminal value of cash flows means the cash flows at that point from where it would grow at constant rate. Here it assumed that from 7^{th} year, Cash flows/NPAT will grow at a constant rate and not sales

2. (a) Working Note:

1. Current Liabilities and Current Assets:

Let Current Liabilities be x

Given Current ratio	= 2.5
Current Assets	= 2.5x
Working Capital	= 2.5x- x =1.5x
or x	= 1,20,000/1.5 = 80,000
So Current Liabilities	= 80,000
And Current Assets	= 80,000 x 2.5 = 2,00,000

2. Closing Stock

Given, Quick Ratio = 1.3

$$\frac{\text{CurrentAssets - Closing Stock}}{\text{CurrentLiabilities - Bank Overdraft}} = 1.3$$

$$\frac{\text{2,00,000 - Closing Stock}}{\text{80,000 - 15,000}} = 1.3$$

or Closing Stock = 2,00,000-84,500 =1,15,500

Opening Stock = 1,15,000 x 100/110 =1,05,000

3. Debtors

Given Debtors Velocity = 40 days

$$\frac{\text{Debtors}}{\text{Sales}} \times 365 = 40$$

$$\text{Debtors} = \frac{7,30,000 \text{x} 40}{365} = 80,000$$

4. Gross Profit = 7,30,000 x 10/100 = 73,000

5. Proprietary Fund:

Proprietary Ratio = 0.6

$$\frac{\text{Fixed Assets}}{\text{Proprietary Fund}} = 0.6$$

$$\frac{\text{Working Capital}}{\text{Proprietary Fund}} \quad 0.4$$

$$\text{Proprietary Fund} = \frac{1,20,000}{0.4} = 3,00,000$$

Fixed Assets = 3,00,000 x 0.6 = 1,80,000

Net Profit = 10% of Proprietary Fund = 30,000

M/s Anya Co Ltd.

Trading and Profit and loss Account for the year ended 31 March 2024

Particulars	**Amount in ₹**	**Particulars**	**Amount in ₹**
To Opening Stock	1,05,000	By Sales	7,30,000
To Purchase (Balancing Fig.)	6,67,500	By Closing Stock	1,15,500
To Gross Profit	73,000		
	8,45,500		**8,45,500**
To Operating Expenses (Balancing Figure)	43,000	By Gross Profit	73,000
To Net Profit	30,000		
	73,000		**73,000**

Balance Sheet as on 31 March 2024

Liabilities	**Amount in ₹**	**Assets**	**Amount in ₹**
Share Capital	2,50,000	Fixed Assets	1,80,000
Reserves & Surplus (Opening bal. + current profit)	50,000		
Current Liabilities		*Current Assets*	
Bank Overdraft	15,000	Stock	1,15,500
Other Current Liabilities	65,000	Debtors	80,000
		Other Current Assets	4,500
	3,80,000		**3,80,000**

(b) As per Dividend discount model, the price of share is calculated as follows:

$$P=\frac{D_1}{(1+K_e)^1}+\frac{D_2}{(1+K_e)^2}+\frac{D_3}{(1+K_e)^3}+\frac{D_4}{(1+K_e)^4}+\frac{D_5}{(K_e-g)}\times\frac{1}{(1+K_e)^4}$$

Where,

P = Price per share

K_e = Required rate of return on equity

g = Growth rate

Calculation PV of Dividends

Year	Dividend per share	PVF @ 15%	PV
1	4.4	0.870	3.828
2	4.84	0.756	3.660
3	5.324	0.658	3.503
4	5.856	0.572	3.350
Total			14.341

PV of Terminal Value = $\frac{₹5.856x1.05}{(0.15-0.05)^1} \times \frac{1}{(1+0.15)^4}$ = 61.488 x .572 = 35.171

Intrinsic value of share = PV of Dividends + PV of terminal value

= 14.341 + 35.171 = ₹ 49.512

3. 1. In-House Management of Receivables (With Dynamic Discounting)

Particulars:

1. **Cash Discount Cost:**
   - Revised discount rate: 2.5%
   - 60% of customers avail discount.
   - **Cost of Discount:** ₹ 90,00,000 × 60% × 2.5% = ₹ 1,35,000
2. **Bad Debts (Reduced to 0.8% due to dynamic discounting):**
   - ₹ 90,00,000 × 0.8% = ₹ 72,000
3. **Administration Cost:** ₹ 1,20,000
4. **Cost of Financing Receivables:**
   - **Working Note 1 (Average Collection Period):** (10 days × 60%) + (60 days × 40%) = 30 days
   - **Working Note 2 (Average Receivables):** ₹ 90,00,000 × (30/360) = ₹ 7,50,000
   - **Working Note 3 (Cost of Financing):**
     - Cost of Bank Funds: ₹ 7,50,000 × 1/2 × 15% = ₹ 56,250
     - Cost of Owned Funds: ₹ 7,50,000 × 1/2 × 14% = ₹ 52,500
     - **Total Cost of Financing Receivables:** ₹ 1,08,750

Total Cost with In-House Receivables Management and Dynamic Discounting:

Particulars	Amount (₹)
Cash Discount (₹ 90,00,000 × 60% × 2.5%)	1,35,000
Bad Debts (₹ 90,00,000 × 0.8%)	72,000
Admin Cost	1,20,000

Cost of Financing Receivables	1,08,750
Total Cost (In-House with Dynamic Discounting):	**4,35,750**

2. Factoring Firm's Offer:

Particulars:

1. **Factoring Commission:** ₹ 90,00,000 × 4% = ₹ 3,60,000
2. **Interest Charges on Receivables:** Factor Reserve: 12%, so financing on 88% of receivables. Interest for 25 days: (₹ 90,00,000-3,60,000) × 88% × 15% × (25/360) = ₹ 79,200
3. **Cost of Owned Funds (Receivables not factored):** ₹ 13,96,800 × 14% × (25/360) = ₹ 13580

Owned Funds: (₹ 90,00,000-3,60,000) × 12% + 3,60,000 = ₹ 13,96,800

Total Cost with Factoring Firm:

Particulars	Amount (₹)
Factoring Commission (₹ 90,00,000 × 4%)	3,60,000
Interest Charges on Receivables	79,200
Cost of Owned Funds	13,580
Total Cost with Factoring:	**4,52,780**

3. Impact of Extending Credit Period:

If Zomo Ltd. extends the credit period to 75 days:

- **Sales increase:** 10% of ₹ 120,00,000 = ₹ 12,00,000

  New total turnover = ₹ 120,00,000 + ₹ 12,00,000 = ₹ 1,32,00,000

  Credit Sales (75%) = ₹ 99,00,000
- **Increased Bad Debts (1.5%):** ₹ 99,00,000 × 1.5% = ₹ 1,48,500
- **Late Payment Penalty:** Customers delaying beyond 60 days (40%): ₹ 99,00,000 × 40% × 5% = ₹ 1,98,000

A. Cash Discount Cost:

- **Discount rate:** 2% (since there's no mention of dynamic discounting in this case)
- **Percentage of customers availing discount:** 60%
- **Calculation:** ₹ 99,00,000 × 60% × 2% = ₹ 1,18,800

B. Bad Debts (Increased to 1.5%):

- **Calculation:** ₹ 99,00,000 × 1.5% = ₹ 1,48,500

C. Administration Costs (Remains the same):

- The administration cost stays fixed at ₹ 1,20,000, as no change in admin structure is mentioned.

D. **Cost of Financing Receivables (Based on the new extended credit period):**

- **Working Note 1 (Average Collection Period):** Credit period has been extended to 75 days for customers who don't take the discount (40% of customers).
    - **Revised Average Collection Period:** (10 days × 60%) + (75 days × 40%) = 36 days
- **Working Note 2 (Average Receivables):** ₹ 99,00,000 × (36/360) = ₹ 9,90,000
- **Working Note 3 (Cost of Financing Receivables):**
    - **Cost of Bank Funds (15%):** ₹ 9,90,000× 1/2 × 15% = ₹ 74,250
    - **Cost of Owned Funds (14%):** ₹ 9,90,000 × 1/2 × 14% = ₹ 69,300
    - **Total Cost of Financing Receivables:** ₹ 74,250 + ₹ 69,300 = ₹ 1,43,550

Revised Bad Debts after Penalty:

- **Bad debts before penalty:** ₹ 1,48,500
- **Penalty earned:** ₹ 1,98,000
- **Net effect on bad debts:** ₹ 1,48,500 - ₹ 1,98,000 = (-₹ 49,500) (Zomo Ltd. would effectively earn ₹ 49,500 from penalties, reducing bad debt cost.)

4. **Total Cost Calculation:**

Now, summing up all the components:

Particulars	Amount (₹)
Cash Discount (₹ 99,00,000 × 60% × 2%)	1,18,800
Net Bad Debts after Penalty (–₹ 49,500)	-49,500
Administration Costs	1,20,000
Cost of Financing Receivables	1,43,550
Total Cost (In-House with Extended Credit Period)	**₹ 3,32,850**

5. **Final Decision:**

Option	Total Cost (₹)
In-House with Dynamic Discounting	4,35,750
Factoring Firm's Offer	4,52,780
In-House with Extended Credit Period	**3,32,850**

Recommendation: Zomo Ltd. should **extend the credit period** and continue in-house management. This option will not only reduce costs (due to lower bad debts offset by penalties) but also increase sales by 10%. Factoring is the least beneficial due to its high commission charges, and dynamic discounting offers only marginal savings compared to the credit extension option.

4. (a) The financing of current assets involves a trade off between risk and return. A firm can choose from short or long term sources of finance. Short term financing is less expensive than long term financing but at the same time, short term financing involves greater risk than long term financing.

Depending on the mix of short term and long term financing, the approach followed by a company may be referred as matching approach, conservative approach and aggressive approach.

In matching approach, long-term finance is used to finance fixed assets and permanent current assets and short term financing to finance temporary or variable current assets. Under the conservative plan, the firm finances its permanent assets and also a part of temporary current assets with long term financing and hence less risk of facing the problem of shortage of funds.

An aggressive policy is said to be followed by the firm when it uses more short term financing than warranted by the matching plan and finances a part of its permanent current assets with short term financing.

(b) Over-capitalization and its Causes and Consequences

It is a situation where a firm has more capital than it needs or in other words assets are worth less than its issued share capital, and earnings are insufficient to pay dividend and interest.

Causes of Over Capitalization

Over-capitalisation arises due to following reasons:

(i) Raising more money through issue of shares or debentures than company can employ profitably.

(ii) Borrowing huge amount at higher rate than rate at which company can earn.

(iii) Excessive payment for the acquisition of fictitious assets such as goodwill etc.

(iv) Improper provision for depreciation, replacement of assets and distribution of dividends at a higher rate.

(v) Wrong estimation of earnings and capitalization.

Consequences of Over-Capitalisation

Over-capitalisation results in the following consequences:

(i) Considerable reduction in the rate of dividend and interest payments.

(ii) Reduction in the market price of shares.

(iii) Resorting to “window dressing”.

(iv) Some companies may opt for reorganization. However, sometimes the matter gets worse and the company may go into liquidation.

(c) “The profit maximisation is not an operationally feasible criterion.” This statement is true because Profit maximisation can be a short-term objective for any organisation and cannot be its sole objective. Profit maximization fails to serve as an operational criterion for maximizing the owner's economic welfare. It fails to provide an operationally feasible measure for ranking alternative courses of action in terms of their economic efficiency. It suffers from the following limitations:

(i) Vague term: The definition of the term profit is ambiguous. Does it mean short term or long term profit? Does it refer to profit before or after tax? Total profit or profit per share?

(ii) Timing of Return: The profit maximization objective does not make distinction between returns received in different time periods. It gives no consideration to the time value of money, and values benefits received today and benefits received after a period as the same.

(iii) It ignores the risk factor.

(iv) The term maximization is also vague.

OR

(c) **Modified Internal Rate of Return (MIRR):** There are several limitations attached with the concept of the conventional Internal Rate of Return. The MIRR addresses some of these deficiencies. For example, it eliminates multiple IRR rates; it addresses the reinvestment rate issue and produces results, which are consistent with the Net Present Value method.

Under this method, all cash flows, apart from the initial investment, are brought to the terminal value using an appropriate discount rate (usually the cost of capital). This results in a single stream of cash inflow in the terminal year. The MIRR is obtained by assuming a single outflow in the zeroth year and the terminal cash inflow as mentioned above. The discount rate which equates the present value of the terminal cash inflow to the zeroth year outflow is called the MIRR.

ANSWERS OF MODEL TEST PAPER 7

INTERMEDIATE: GROUP – II

PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A : FINANCIAL MANAGEMENT

Suggested Answers/ Hints

PART I – Case Scenario based MCQs

1. **(b)** Ke $= \frac{D1}{P0} + g$

$= \frac{2}{20} + 0.05 = 15\%$

2. **(b)** $K_d = \frac{I(1-t) + \frac{(RV-NP)}{n}}{\frac{(RV+NP)}{2}} = \frac{9(1-0.35) + \frac{(100-102.90)}{10}}{\frac{(100+102.90)}{2}} = 5.48\%$

3. **(a)** $K_p = \frac{PD + \frac{(RV-NP)}{n}}{\frac{(RV+NP)}{2}}$

$K_p = \frac{11 + \left(\frac{100-102.82}{10}\right)}{\left(\frac{100+102.82}{2}\right)} = 10.57\%$

4. **(a)** **Calculation of WACC using market value weights**

Source of capital	Market Value	Weights	After tax cost of capital	WACC (K_o)
	(₹)	**(a)**	**(b)**	**(c) = (a)×(b)**
Debentures (₹ 105 per debenture)	2,88,750	0.1672	0.0548	0.0092
Preference shares (₹ 106 per preference share)	2,38,500	0.1381	0.1057	0.0146
Equity shares (₹ 24)	12,00,000	0.6947	0.1500	0.1042
	17,27,250	1.00		0.1280

WACC (K_o) = 12.80%

5. **(a)** Current Market Price $= \frac{D_1}{Ke - g}$

$$= \frac{2}{0.10 - 0.05} = ₹\ 40 \text{ per share}$$

6. **(c)** DFL $= \frac{EBIT}{EBT}$

DFL = 4,00,000/3,00,000 = 1.33

Interest Coverage Ratio $= \frac{EBIT}{\text{Interest Expense}}$

= 4,00,000/1,00,000 = 4

Operating Profit Margin $= \frac{Sales}{EBIT} x100$

Operating Profit Margin = (4,00,000/16,00,000) × 100 = 25%

7. **(c)** COGS = Sales x (1−Gross Profit Margin)

COGS = 6,00,000 x (1−0.20) = 6,00,000 x 0.80 = 4,80,000

The velocity of stock is 3 months.

stock turnovers per year (12/3) = 4

Stock Turnover Ratio = COGS / Average Stock

Average Stock = 4,80,000/4 = 1,20,000

Average Stock = (Opening Stock + Closing Stock)/2

Closing Stock = 1,50,000

8. **(d)** 1, 2 and 3

PART II – Descriptive Questions

1. **(a)** **Balance Sheets of Alpha Limited**

Liabilities	₹		*Assets*	₹	
	31 March 2023	*31 March 2024*		*31 March 2023*	*31 March 2024*
Equity share capital (₹ 10 each fully paid)	20,00,000	20,00,000	Fixed Assets (₹18,90,000– ₹90,000)	18,00,000	15,39,000
Reserve and Surplus (balancing)	1,30,000	1,30,000	Long term investment	–	2,96,600
Profit & Loss A/c (15% of sales)	2,70,000	6,15,600	**Current Assets** (₹ 10,00,000)		

Current Liabilities			Stock	4,00,000	5,20,000
Bank Overdraft	1,00,000	–	Sundry Debtors	3,00,000	4,95,000
Creditors	3,00,000	4,15,000	Cash at Bank (Balancing)	3,00,000	3,10,000
Total	**28,00,000**	**31,60,600**	**Total**	**28,00,000**	**31,60,600**

Calculation for 31st March, 2023

(i) Calculation of Current Liabilities

Suppose that Current Liabilities = x, then current assets will be 2.5 x

Working capital = Current Assets – Current Liabilities

6,00,000 = 2.5x – x

x = 6,00,000 / 1.5 = ₹ 4,00,000 (C.L.)

Other Current Liabilities = Current Liabilities – Bank Overdraft

(Creditors) = 4,00,000 – 1,00,000 = ₹ 3,00,000

Current Assets = 2.5 x 4,00,000 = ₹ 10,00,000

(ii) Liquid Ratio $= \frac{\text{Liquid Assets}}{\text{Current Liabilities}}$

1.5 $= \frac{\text{Liquid Assets}}{4{,}00{,}000}$

Liquid assets = ₹6,00,000

Liquid assets = Current Assets – Stock

6,00,000 = 10,00,000 – Stock

So, Stock = ₹ 4,00,000

(iii) Calculation of fixed assets: Fixed assets to proprietary fund is 0.75, working capital is therefore 0.25 of proprietary fund. So,

Fixed Assets = 6,00,000 / 0.25 x 0.75 = ₹ 18,00,000

(iv) Sales = (14,40,000 / 80) × 100 = ₹ 18,00,000

(v) Debtors $= \frac{2}{12} \text{ x Sales}$

2 / 12 × 18,00,000 = ₹ 3,00,000

(vi) Net profit = 15% of ₹18,00,000 = ₹ 2,70,000

Calculation for the year 31st March, 2024

(vii) Sales = 18,00,000 + (18,00,000 × 0.2) = 21,60,000

(viii) Calculation of fixed assets

	₹		₹
To Opening balance	18,00,000	By Banks (Sale)	90,000
		By Loss on sales of Fixed asset	90,000
		By P & L (Dep.) (5% as in previous year)	81,000
	________	By Balance b/d	15,39,000
Total	18,00,000		18,00,000

(ix) Net profit for the year 2011, 16% × 21,60,000 = ₹ 3,45,600

Total Profit = 2,70,000 + 3,45,600 = ₹ 6,15,600

(b) EBIT = ₹ 3,00,000

Less: Interest = ₹ 10,00,000 × 10% = ₹ 1,00,000

Earnings available to equity shareholders = ₹ 2,00,000

Equity capitalization rate = 12.5%

Market value of equity = $\frac{₹\ 2,00,000}{12.5\%}$ = ₹ 16,00,000

Market value of debt = ₹ 10,00,000

Market value of the firm = ₹ 26,00,000

Overall cost of capital = $\frac{₹\ 3,00,000 \times 100}{₹\ 26,00,000}$ = 11.54%

(c) **(i)** **Increase in taxable income if sales increase by 6%.**

Combined Leverage= $\frac{\text{Contribution}}{\text{EBT}} = \frac{₹\ 1,40,000}{₹\ 35,000} = 4$

If the sales increases by 6%, EBT will increase by 24%. (4 × 6%)

(ii) **Increase in EBIT if sales increase by 10%.**

Operating Leverage= $\frac{\text{Contribution}}{\text{Earnings before interest and tax}} = \frac{₹1,40,000}{₹\ 40,000} = 3.5$

If sales increases by 10%, EBIT will increase by (3.5× 10) 35%.

(iii) **Increase in taxable income if EBIT increase by 6%.**

Financial Leverage = $\frac{\text{Earnings before interest and tax(EBIT)}}{\text{EBT}} = \frac{₹\ 40,000}{₹35,000}$

=1.14

If EBIT increases by 6%, EBT will increase by 6.8%. (1.14 × 6%)

2. **(a)** Problem mentions that the company has applied to the Private Bank for financing its working capital needs. Ideally, banks would not finance for Depreciation cost being a non-cash cost and it would also not finance the profit for you. So, problem needs to be solved using Cash Cost Basis.

Estimation of working capital required (cash cost basis)

	Particulars		Amount
	A) Current Assets		
	A1) Stock of RM	15,84,960 x 30/360	1,32,080.00
	A2) Stock of WIP	(From Cost Statement)	4,77,360.00
	A3) Stock of FG	(From Cost Statement)	2,37,500.00
	A4) Debtors	32,74,686 x 45/360	4,09,335.75
	A5) Cash & Cash Equivalents	(Given)	1,25,000.00
	Gross Working Capital		**13,81,275.75**
Less:	**B) Current Liabilites**		
	B1) Creditors	17,17,040 x 30/360	1,43,086.67
	B2) Lag in Wages Payment	9,20,400 x 15/360	38,350.00
	Excess of Current Assets Over Current Liabilites	(A) - (B)	**11,99,839.08**
Add:	Safety Margin @ 15% Of Net Working Capital		2,11,736.31
	Net Working Capital		**14,11,575.39**

WN -1: Calculation of Profit

Profit = 25% of total cost i.e 20% of sales price

= {(31,200-2,500) x 150} x 20% = Rs. 8,61,000

WN – 2:

	Completed Units	WIP Units
	31,200	9,360
Raw Mat. Consumed	12,48,000	3,36,960
Direct Wages	7,80,000	1,40,400
Overheads	9,36,000	1,68,480
	29,64,000	6,45,840
Gross Factory Cost	**36,09,840**	

Add: Op WIP	-
Less: Cl. WIP **(At Prime Cost**)	4,77,360
Cost of Production	**31,32,480**
Add: Op FG Stock	-
Less: Cl. FG Stock	2,37,500
Cash Cost of Goods Sold	**28,94,980**
Add: Selling & Distribution Expenses (Bal. Figure)	3,79,706
Cost Of Sales	**32,74,686**
Profit*	8,61,000
Sales	**41,35,686**

*It is assumed that profit is unchanged

WN 3 - Calculation of WIP stock (units) and WIP stock amount

WIP UNITS = 30% of FG produced units i.e 30% of 31,200 units

= 9,360 units

WIP amount (at prime cost)

Raw materials = 9,360 x 40 x 90% = 3,36,960

Direct wages = 9,360 x 25 x 60% = 1,40,400

WN 4 - Calculation of purchases from suppliers

Raw Materials Consumed = OP RM Stock + Purchases - Closing RM Stock

15,84,960 = 0 + Purchases – 1,32,080

Purchases = 17,17,040

WN 5 – Calculation of safety margin

Safety Margin = 15% Of Net Working Capital Needs

Excess Of CA Less CL	85	11,99,839.08
Safety Margin	15	2,11,736.31
Net Working Capital	100	1411575.388

(b) EPS = ROE x BVPS (WN 1)

EPS = 0.15 x 125 = ₹ 18.75

Growth = ROE x Retention Ratio

= 0.15 x 0.65

= 9.75%

D1 = Do (1 + g)

$= (18.75 \times 35\%)(1 + 0.0975)$

= ₹ 7.20

Intrinsic Value of share today - Gordon's Formula

$$Po = \frac{D_1}{Ke - g}$$

$$= \frac{7.20}{0.20 - 0.0975}$$

Po = ₹ 70.24

Intrinsic Value of share today - Walter's Model

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

Here D = Do assuming it would remain constant through infinity

$$Po = \frac{6.5625 + \frac{0.15}{0.20}(18.75 - 6.5625)}{0.20}$$

Po = ₹ 78.51

WN 1 - Relationship between ROE-EPS-BVPS

$$ROE = \frac{\text{Earnings for Equity Shareholders}}{\text{Equity shareholders funds}}$$

If we divide the numerator and denominator with "**No of equity shares**"

$$ROE = \frac{\text{Earnings for Equity Shareholders / No of equity shares}}{\text{Equity shareholders funds / No of equity shares}}$$

Therefore, ROE = EPS / BVPS

3. Calculation of NPV (Amount in crores)

Year	1	2	3	4	5	6	7	8	9	10
EBT	2.000	2.500	4.000	4.750	6.000	6.400	6.150	5.250	3.800	2.900
Add: Interest	0.195	0.195	0.195	0.252	0.252	0.252	0.252	0.252	0.252	0.252
Add: Allocated Common Cost	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125
Project Profit Before Tax	2.320	2.820	4.320	5.127	6.377	6.777	6.527	5.627	4.177	3.277
Less: Tax	-	-	-	1.154	1.435	1.525	1.469	1.266	0.940	0.737
Profit After Tax	2.320	2.820	4.320	3.973	4.942	5.252	5.058	4.361	3.237	2.539
Add: Depreciation	2.410	2.410	2.410	2.410	2.410	2.410	2.410	2.410	2.410	-
Cash Inflows	4.730	5.230	6.730	6.383	7.352	7.662	7.468	6.771	5.647	2.539

Add: Release Of Working Capital	-	-	-	-	-	-	-	-	-	5.000
Add: Net Cash Inflow from sale of asset (Net Of Tax) (WN-3)	-	-	-	-	-	-	-	-	-	3.471
Total Cash Inflows	4.730	5.230	6.730	6.383	7.352	7.662	7.468	6.771	5.647	11.010
DF @ 15%	0.870	0.756	0.658	0.572	0.497	0.432	0.376	0.327	0.284	0.247
PV Cash Inflow	4.113	3.955	4.425	3.650	3.655	3.312	2.808	2.213	1.605	2.722

TOTAL PV CI = 32.458 Crores

(-) TOTAL PVCO = 30.000 Crores (Initial Outlay + Working Capital)

NPV = 2.458 Crores

ADVISE - Since NPV is positive, company should go for the project.

Notes - 1. Allocated common costs are to be excluded from cash inflows

2. Dividend distribution are deemed irrelevant for cash flow analysis
3. Discounting rate = MCLR + premium = 12 + 3 = 15%
4. Interest exp is to be excluded from the cash inflows as it is already getting covered in the discounting rate above
5. Professional fees paid for project report and R&D costs being sunk costs are irrelevant for decision making

WN 1 – Calculation of applicable taxes each year

For the first 3 years, tax will be zero and for the next 7 years tax rate applicable would 22.5% (30 x 0.75) as balance tax will be paid in Australia, so it will have no relevance under India perspective calculations.

WN – 2 Calculation of interest expense each year

Since post tax interest rate is given in the question, firstly it needs to be converted to pre-tax rate. However, for the first 3 years of the project, post-tax and pre-tax rate would be same owing to zero taxes

Interest Expense (first 3 years) = 3,00,00,000 X 6.5% = 19,50,000 or 0.195 crores

Interest Expense (next 7 years) = 3,00,00,000 x 8.39% = 25,17,000 or 0.2517 crores

$$\text{Pre-tax Interest Rate} = \frac{\text{Post tax Rate}}{1 - \text{India Tax Rate}}$$

= 6.5 / (1 - 0.225)

= 8.39%

WN 3 – CALCULATION OF CAPITAL GAINS INCOME IN YEAR 10

Cost of Asset remaining in the block at the beginning of Year 10

= 3,31,00,000 (2,41,00,000 + 90,00,000)

(+) New Asset purchased during the year = 0

(-) Sale Value of the Asset = 3,50,00,000

Capital Gains Income before tax = 19,00,000

(-) Capital Gains tax = 19,00,000 x 15% = 2,85,000

Net Cash Inflow after tax = 3,50,00,000- 2,85,000

= 3,47,15,000

B) Current Payback Period = 4 + 1.927 /7.352

= 4.262 years

Target Payback Period = 3.5 years

Some key measures to reduce your Payback period are as follows (Only illustrative):

i. Emphasizing on reduction of operational costs

ii. Improving marketing thereby resulting into higher sales

iii. Incorporate product-led growth strategies

iv. Judicious efforts in bringing down the overall cost of capital thereby reducing the discounting rate and in turn better Payback period.

v. Leveraging out the presence of the fixed cost

4. (a)

Particulars	Factoring	Forfaiting
A) Meaning	**Factoring** involves sales of receivables to the financial institution called factor in exchange for immediate cash payment	**Forfaiting** is a form of export financing where the exporter sells the rights to trade receivables to a forfaiter and receives instant cash
B) Recourse or non-recourse	May be on Recourse or Non-recourse basis	Always non-recourse
C) Amount paid	Firms are generally paid 80% to 90% upfront	100% on the value of exported goods is paid
D) Type of receivables	Receivables may either domestic or international	Receivables are international
E) Cost	Factoring cost in the form of factor commission or fees is to be borne by the seller	Overseas Buyer bears the forfaiting cost, if any

F) Secondary market	Factoring does not involve a secondary market for the receivables, meaning that the transaction is complete once the receivables are sold to the factor.	Forfaiting has a secondary market where the receivables can be traded, enhancing liquidity and providing additional opportunities for investors

(b) Some of the tasks that demonstrate the importance of good financial management

- Taking care not to over invest in fixed assets
- Balancing cash-outflows with cash-inflows
- Ensuring that there is a sufficient level of working capital
- Setting sales revenue targets that will deliver growth
- Increasing the Gross profit by setting the correct pricing for products or services
- Controlling the level of general and administration expenses by finding more cost-efficient ways of running the day-to-day business operations
- Tax Planning that will minimize the taxes a business has to pay

(c) A drop lock is an arrangement whereby the interest rate on a floating-rate note becomes fixed if it falls to a specified level. Above that level the rate floats based on a benchmark market rate, typically with a semi-annual reset. In other words, drop lock bonds marry the attributes of both floating-rate securities and fixed-rate securities. The drop lock effectively sets a floor on the rate and a guaranteed minimum return to

Or

(c) Advantage to the Company - Stock dividends are suitable in the situation of cash crunch and deficiency faced by the company and suitable when restrictions are imposed by lenders to pay the cash dividend

Advantage to the investor – Improves liquidity in the hands of the investors as bonus shares leads to breaking down of higher priced shares into lower priced shares and hence give a choice to shareholders to sell some of the lower priced shares and get some liquidity

ANSWERS OF MODEL TEST PAPER 8

INTERMEDIATE: GROUP – II

PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A : FINANCIAL MANAGEMENT

Suggested Answers/ Hints

PART I – Case Scenario based MCQs

1. **i.** **(D)** **₹ 3.3779**

ii. **(B)** **₹ 8.3655**

iii. **(A)** **₹ 72.28**

iv. **(C)** **₹ 45.79**

v. **(B)** **₹ 54.33**

Intrinsic Value = Sum of PV of Expected Dividends + PV of Share Price at the end of the period

The following steps are required:

A. Determine PV of expected dividends to be received in the next four years.

B. Determine PV share at the end of 4th Year.

C. Add the values of A and B above.

(A)

Year	$D_1 = D_0(1+g)$	PV Discount Factor @ 12%	PV in ₹
1	2(1+14%) =2.28	0.893	2.0364
2	2.28(1+14%) =2.5992	0.797	2.0715
3	2.5992(1+14%) =2.9631	0.712	2.1097
4	2.9631(1+14%) =**3.3779**	0.636	2.1483
(A) Total PV of Expected Dividend			₹ **8.3655**

$$P_4 = \frac{D_5}{K_e - g} = \frac{D_4(1+g)}{K_e - g} = \frac{3.3779(1+7\%)}{12\% - 7\%} = \textbf{₹ 72.28}$$

(B) PV of share at the end of 4th Year = ₹ 72.28 x 0.636 =**₹ 45.97**

(C) Market Price of shares = ₹ 8.3655 + ₹ 45.97=**₹ 54.33**

2. **(B)** **6.16%**

To calculate WACC, we use the formula:

WACC = (E/V) × Re + (D/V) × Rd × (1 - Tc)

Let V be the total value of the firm, then Debt is equal to 1.5/(1+1.5) times the value of the firm and Equity is equal to 1/(1+1.5) times the value of the firm.

So, D/V = 1.5/(1+1.5) = 0.6 and E/V = 1/(1+1.5) = 0.4

WACC = 0.4 × 10% + 0.6 × 6% × (1 - 40%) = 4% + 2.16% = 6.16%

Therefore, the company's weighted average cost of capital is 6.16%.

3. (A) 1.11

EBIT = 3,00,000 x (3-1) – 3,50,000 = 2,50,000,

PBT = 2,50,000 – 25,000 – 2,25,000

FL = 2,50,000/2,25,000 = 1.11

4. (C) both automatic and approval route

PART II – Descriptive Questions

1. (a) Calculation of Cost of Preference Shares (K_p)

Preference Dividend (PD) = 0.12 x 40,000 x 100 = 4,80,000

Floatation Cost = 40,000 x 2 = ₹ 80,000

Net Proceeds (NP) = 42,00,000 – 80,000 = 41,20,000

Redemption Value (RV)= 40,000 x 110 = 44,00,000

Cost of Redeemable Preference Shares = $\dfrac{PD + (RV - NP)/N}{\dfrac{RV + NP}{2}}$

$$K_p = \frac{4,80,000 + (44,00,000 - 41,20,000)/10}{\dfrac{44,00,000 + 41,20,000}{2}}$$

$$= \frac{4,80,000 + (2,80,000)/10}{85,20,000/2}$$

$$= \frac{4,80,000 + 28,000}{42,60,000} = \frac{5,08,000}{42,60,000}$$

= 0.1192

K_p = 11.92%

(**Note:** K_p may be computed alternatively by taking the RV and NP for one unit of preference shares. Final figure would remain unchanged).

(b) Calculation of Net Cash flow

Contribution = (3.00 – 1.75) × 50,000 = ₹ 62,500

Fixed costs = 40,000 – [(1,25,000 – 30,000)/5] = ₹ 21,000

Year	Capital (₹)	Contribution (₹)	Fixed costs (₹)	Adverts (₹)	Net cash flow (₹)
0	(1,00,000)	-	-	-	(1,00,000)
1	(25,000)	62,500	(21,000)	(10,000)	6,500
2	-	62,500	(21,000)	(15,000)	26,500
3	-	62,500	(21,000)	-	41,500

4	-	62,500	(21,000)	-	41,500
5	30,000	62,500	(21,000)	-	71,500

Calculation of Net Present Value

Year	Net cash flow (₹)	10% discount factor	Present value (₹)
0	(1,00,000)	1.000	(1,00,000)
1	6,500	0.909	5,909
2	26,500	0.826	21,889
3	41,500	0.751	31,167
4	41,500	0.683	28,345
5	71,500	0.621	44,402
		NPV	31,712

The net present value of the project is ₹ 31,712.

(c)

	(₹)
Sales	24,00,000
Less: Variable cost	12,00,000
Contribution	12,00,000
Less: Fixed cost	10,00,000
EBIT	2,00,000
Less: Interest	1,00,000
EBT	1,00,000
Less: Tax (50%)	50,000
EAT	50,000
No. of equity shares	10,000
EPS	5

(a) Operating Leverage $= \frac{₹12,00,000}{₹2,00,000} = 6 \text{ times}$

(b) Financial Leverage $= \frac{₹2,00,000}{₹1,00,000} = 2 \text{ times}$

(c) Combined Leverage = OL × FL = 6 × 2 = 12 times.

(d) ROI $= \frac{₹50,000}{₹10,00,000} \times 100 = 5\%$

Here ROI is calculated as ROE i.e. $\frac{\text{EAT - Pref.Dividend}}{\text{Equity shareholders' fund}}$

(e) Operating Leverage = 6

$$6 = \frac{\Delta \text{ EBIT}}{0.25}$$

$$\Delta \text{ EBIT} = \frac{6 \times 1}{4} = 1.5$$

Increase in EBIT = ₹ 2,00,000 × 1.5

= ₹ 3,00,000

New EBIT = ₹ 5,00,000

2. Working Notes:

1. **Raw Material Storage Period (R)**

$$= \frac{\text{Average Stock of Raw Material}}{\text{Annual Consumption of Raw Material}} \times 365$$

$$= \frac{\frac{₹\ 45{,}000 + ₹\ 65{,}356}{2}}{₹\ 3{,}79{,}644} \times 365$$

= 53 days.

Annual Consumption of Raw Material = Opening Stock + Purchases-Closing Stock

= ₹ 45,000 + ₹ 4,00,000 – ₹ 65,356

= ₹ 3,79,644

2. **Work-in-Progress (WIP) Conversion Period (W)**

$$\text{WIP Conversion Period} = \frac{\text{Average Stock of WIP}}{\text{Annual Cost of Production}} \times 365$$

$$= \frac{\frac{₹\ 35{,}000 + ₹\ 51{,}300}{2}}{₹\ 7{,}50{,}000} \times 365$$

= 21 days

3. **Finished Stock Storage Period (F)**

$$= \frac{\text{Average Stock of Finished Goods}}{\text{Cost of Goods Sold}} \times 365$$

$$= \frac{₹\ 65{,}178}{₹\ 9{,}15{,}000} \times 365 \quad = 26 \text{ days.}$$

$$\text{Average Stock} = \frac{₹\ 60{,}181 + ₹\ 70{,}175}{2}$$

= ₹ 65,178.

4. **Debtors Collection Period (D)**

$$= \frac{\text{Average Debtors}}{\text{Annual Credit Sales}} \times 365$$

$$= \frac{₹\ 1{,}23{,}561.50}{₹\ 11{,}00{,}000} \times 365$$

= 41 days

Average debtors = $\frac{₹1,12,123 + ₹1,35,000}{2} = ₹1,23,561.50$

5. **Creditors Payment Period (C)**

$= \frac{\text{Average Creditors}}{\text{Annual Net Credit Purchases}} \times 365$

$= \frac{\left(\frac{₹50,079 + ₹70,469}{2}\right)}{₹4,00,000} \times 365$

= 55 days

(i) Operating Cycle Period

= R + W + F+ D - C

= 53 + 21 + 26 + 41 - 55

= 86 days

(ii) Number of Operating Cycles in the Year

$= \frac{365}{\text{Operating Cycle Period}} = \frac{365}{86} = 4.244$

(iii) Amount of Working Capital Required

$= \frac{\text{Annual Operating Cost}}{\text{Number of Operating Cycles}} = \frac{₹\ 9,50,000}{4.244} = ₹\ 2,\ 23,845.42$

3. (a) Plan I = Raising Debt of ₹ 2.5 lakh + Equity of ₹ 22.5 lakh

Plan II = Raising Debt of ₹ 10 lakh + Equity of ₹ 15 lakh

Plan III = Raising Debt of ₹ 15 lakh + Equity of ₹ 10 lakh

Calculation of Earnings per share (EPS):

Particulars	**FINANCIAL PLANS**		
	Plan I	**Plan II**	**Plan III**
	₹	**₹**	**₹**
Expected EBIT	5,00,000	5,00,000	5,00,000
Less: Interest [(a)]	(25,000)	(1,37,500)	(2,37,500)
Earnings before taxes	4,75,000	3,62,500	2,62,500
Less: Taxes @ 50%	(2,37,500)	(1,81,250)	(1,31,250)
Earnings after taxes (EAT)	2,37,500	1,81,250	1,31,250
Number of shares [(b)]	15,000	10,000	8,000
Earnings per share (EPS)	15.83	18.13	16.41

Financing Plan II (i.e. Raising debt of ₹ 10 lakh and issue of equity share capital of ₹ 15 lakh) is the option which maximises the earnings per share.

Working Notes:

(a) Calculation of interest on Debt

Plan		₹	₹
I	(₹ 2,50,000 ´ 10%)		25,000
II	(₹ 2,50,000 ´ 10%)	25,000	
	(₹ 7,50,000 ´ 15%)	1,12,500	1,37,500
III	(₹ 2,50,000 ´ 10%)	25,000	
	(₹ 7,50,000 ´ 15%)	1,12,500	
	(₹ 5,00,000 ´ 20%)	1,00,000	2,37,500

(b) Number of equity shares to be issued

Plan I $= \dfrac{₹\ 22{,}50{,}000}{₹\ 150\ \text{(Market price of share)}}$ = 15,000 shares

Plan II $= \dfrac{₹\ 15{,}00{,}000}{₹\ 150} = 10{,}000$ shares

Plan III $= \dfrac{₹\ 10{,}00{,}000}{₹\ 125} = 8{,}000$ shares

(b)

Ratios	Navya Ltd.	Industry Norms
1. Current Ratio = $\dfrac{\text{Current Assets}}{\text{Current Liabilities}}$	$\dfrac{₹52{,}80{,}000}{₹19{,}80{,}000} = 2.67$	2.50
2 Receivable Turnover Ratio $= \dfrac{\text{Sales}}{\text{Debtors}}$	$\dfrac{₹1{,}10{,}00{,}000}{₹11{,}00{,}000} = 10.0$	8.00
3. Inventory turnover ratio = $\dfrac{\text{Sales}}{\text{Stock}}$	$\dfrac{₹1{,}10{,}00{,}000}{₹33{,}00{,}000} = 3.33$	9.00
4. Total Asset Turnover ratio $= \dfrac{\text{Sales}}{\text{Total Assets}}$	$\dfrac{₹1{,}10{,}00{,}000}{₹77{,}00{,}000} = 1.43$	2.00
5 Net Profit Ratio = $\dfrac{\text{Net Profit}}{\text{Sales}}$	$\dfrac{₹2{,}31{,}000}{₹1{,}10{,}00{,}000} = 2.10\%$	3.50%
6. Return on Total Asset $= \dfrac{\text{EBIT}}{\text{Total Assets}}$	$\dfrac{₹5{,}54{,}000}{₹77{,}00{,}000} = 7.19\%$	7%

7. Return on Net worth = $\frac{\text{Net Profit}}{\text{Net Worth}}$	$\frac{₹2,31,000}{₹48,00,000} = 4.81\%$	10.5%
8. $\frac{\text{Total Debt}}{\text{Total Assets}}$	$\frac{₹29,00,000}{₹77,00,000} = 37.66\%$	60%

Comments:

1. The position of Navya Ltd. is better than the industry norm with respect to Current Ratio and Receivables Turnover Ratio.
2. However, the Inventory turnover ratio and Total Asset Turnover ratio is poor comparing to industry norm indicating that company is inefficient to utilize its inventory and assets.
3. The firm also has its net profit ratio and return on net worth ratio much lower than the industry norm.
4. Total debt to total assets ratio is lower that the industry standard which suggests that the firm is less levered by debt and more by equity resulting in less risky company.

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) The financing of current assets involves a trade off between risk and return. A firm can choose from short or long term sources of finance. Short term financing is less expensive than long term financing but at the same time, short term financing involves greater risk than long term financing.

Depending on the mix of short term and long term financing, the approach followed by a company may be referred as matching approach, conservative approach and aggressive approach.

In matching approach, long-term finance is used to finance fixed assets and permanent current assets and short term financing to finance temporary or variable current assets. Under the conservative plan, the firm finances its permanent assets and also a part of temporary current assets with long term financing and hence less risk of facing the problem of shortage of funds.

An aggressive policy is said to be followed by the firm when it uses more short term financing than warranted by the matching plan and finances a part of its permanent current assets with short term financing.

(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 is maximum.

Or

(c) In dividend price approach, cost of equity capital is computed by dividing the current dividend by average 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,

D_1 = Dividend per share in period 1

P_0 = Market price per share today

ANSWERS OF MODEL TEST PAPER 1

PAPER 6B: STRATEGIC MANAGEMENT

PART I

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

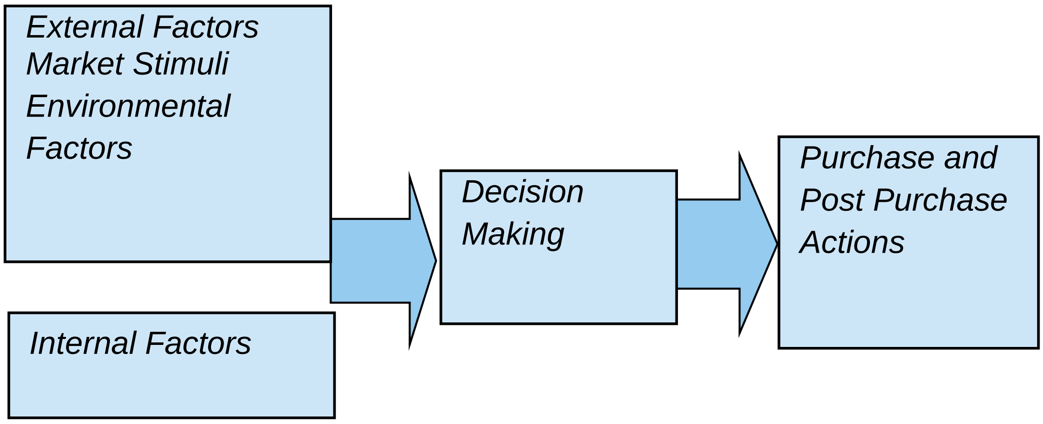


Figure: Process of consumer behaviour

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:

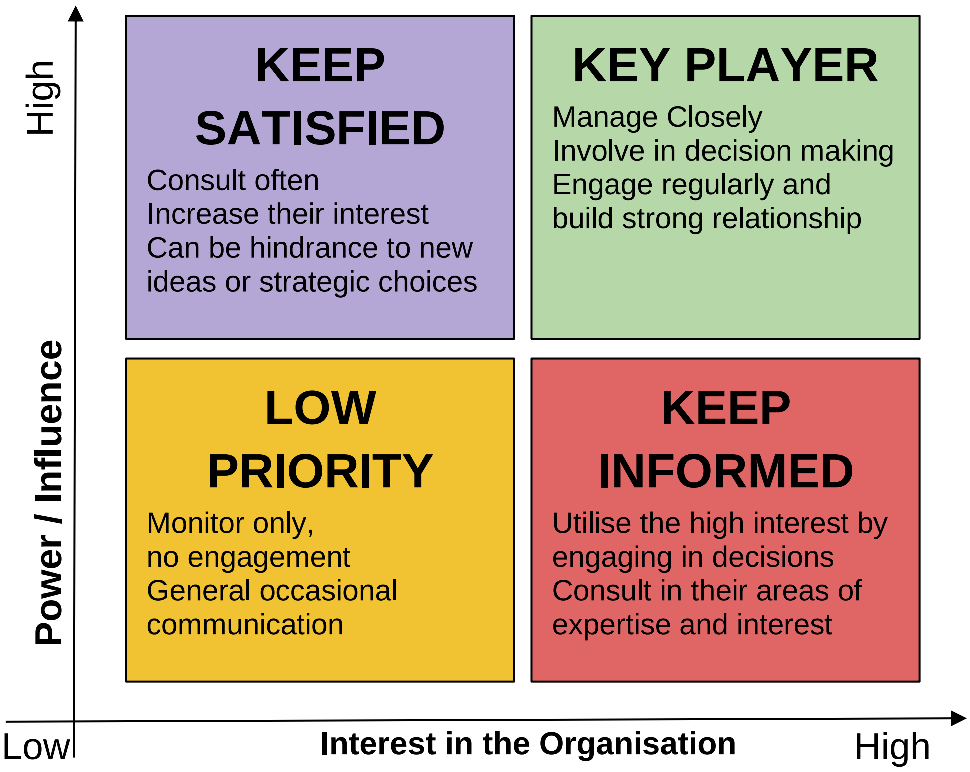
♦ **Goal Alignment:** Strategic performance measures help organizations align their strategies with their goals and objectives, ensuring that they are on track to achieve their desired outcomes.

♦ **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.

ANSWERS OF MODEL TEST PAPER 2

PAPER 6B: STRATEGIC MANAGEMENT

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.

ANSWERS OF MODEL TEST PAPER 3

PAPER 6B: STRATEGIC MANAGEMENT

PART I

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

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

PART II

1. **(a)** In this scenario, the most appropriate strategic approach to help Dharam Veer Singh formulate a robust and coherent business roadmap aligned with his vision for sustainable growth would be to focus on values or a value system. Emphasizing values such as quality, integrity, and sustainability can guide decision-making and attract like-minded investors and clients. By embedding these values into the company's culture and operations, Dharam can differentiate his business in the market, ensuring long-term success and structural longevity in construction projects. This value-driven strategy will also help in building a strong brand reputation and fostering trust among stakeholders.

(b) Considering Porter's generic strategies, there are three different bases: cost leadership, differentiation, and focus. Ravi and Arjun are contemplating pricing for their product.

Ravi is trying to have a low price and high volume, thereby aiming for cost leadership. Cost leadership emphasizes producing standardized products at a very low per unit cost for consumers who are price sensitive.

Arjun desires to create perceived value for the product and charge higher prices. He is trying to adopt differentiation. Differentiation is aimed at producing products and services considered unique industry-wide and directed at consumers who are relatively price insensitive.

(c) XYZ Corporation is shifting to a network structure. This is a newer and more radical organizational design, sometimes referred to as a "non-structure" because it virtually eliminates in-house business functions and outsources many of them. An organization structured in this way is often called a virtual organization, composed of a series of project groups or collaborations linked by constantly changing, non-hierarchical, cobweb-like networks.

The network structure becomes most useful when a firm's environment is unstable and expected to remain so. Under such conditions, there is a strong need for innovation and quick response. Instead of having salaried employees, the company may contract with individuals for specific projects or periods. Long-term contracts with suppliers and distributors replace services the company might otherwise provide through vertical integration. This structure provides increased flexibility and adaptability to cope with rapid technological change and shifting patterns of international trade and competition.

2. (a) Four specific criteria of sustainable competitive advantage that firms can use to determine those capabilities that are core competencies. Capabilities that are valuable, rare, costly to imitate, and non-substitutable are core competencies.

i. **Valuable:** Valuable capabilities are the ones that allow the firm to exploit opportunities or avert the threats in its external environment. A firm created value for customers by effectively using capabilities to exploit opportunities. Finance companies build a valuable competence in financial services. In addition, to make such competencies as financial services highly successful requires placing the right people in the right jobs. Human capital is important in creating value for customers.

ii. **Rare:** Core competencies are very rare capabilities and very few of the competitors possess these. Capabilities possessed by many rivals are unlikely to be sources of competitive advantage for any one of them. Competitive advantage results only when firms develop and exploit valuable capabilities that differ from those shared with competitors.

iii. **Costly to imitate:** Costly to imitate means such capabilities that competing firms are unable to develop easily.

iv. **Non-substitutable:** Capabilities that do not have strategic equivalents are called non-substitutable capabilities. This final criterion for a capability to be a source of competitive advantage is that there must be no strategically equivalent valuable resources that are themselves either not rare or imitable.

(b) XYZ Electronics has opted to implement a Stability strategy. Stability strategies are designed to safeguard the existing interests and strengths of a business. This involves pursuing established and tested objectives, continuing on the chosen path, and maintaining operational efficiency. A stability strategy is pursued when a firm continues to serve the same or similar markets and deals in the same products and services. Although few functional changes are made in the products or markets, it is not a 'do nothing' strategy. This strategy is typical for mature business organizations. Additionally, some small organizations frequently use stability as a strategic focus to maintain a comfortable market or profit position.

Major reasons for a Stability strategy include:

- A product has reached the maturity stage of the product life cycle.
- The staff feels comfortable with the status quo as it involves fewer changes and less risk.
- It is opted for when the environment in which an organization operates is relatively stable.

- Expansion may be perceived as threatening and not advisable.
- After rapid expansion, a firm might want to stabilize and consolidate itself.

3. **(a)** Yummy foods are proactive in its approach. On the other hand, Tasty Food is reactive. Proactive strategy is planned strategy whereas reactive strategy is adaptive reaction to changing circumstances. A company's strategy is typically a blend of proactive actions on the part of managers to improve the company's market position and financial performance and reactions to unanticipated developments and fresh market conditions.

If organisational resources permit, it is better to be proactive rather than reactive. Being proactive in aspects such as introducing new products will give you advantage in the mind of customers.

At the same time, crafting a strategy involves stitching together a proactive/intended strategy and then adapting first one piece and then another as circumstances surrounding the company's situation change or better options emerge-a reactive/adaptive strategy. This aspect can be accomplished by Yummy Foods.

(b) Change management is essential during digital transformation to ensure the success of the process. Here are some key strategies to navigate change effectively:

- **Specify the digital transformation's aims and objectives:** Clearly defining the intended outcomes and objectives helps ensure everyone is aligned and working towards the same goals.
- **Always communicate:** Regular and transparent communication is crucial to help people understand the goals of digital transformation and how it will impact various stakeholders, including employees, clients, and other parties.
- **Be ready for resistance:** Change, even if beneficial, can be met with resistance. Having a strategy in place to address resistance is important for overcoming challenges and ensuring a smooth transition.
- **Implement changes gradually:** Instead of making all changes at once, gradual implementation allows individuals to adapt to new ways of doing things without feeling overwhelmed by too much change simultaneously.
- **Offer assistance and training:** Providing support, guidance, and training for employees is crucial as they navigate new procedures, software applications, and other aspects of digital transformation.

In conclusion, meticulous planning and effective change management are vital for the successful completion of digital transformation projects. Without proper change management, these efforts are more likely to fail, and organizations can enhance the integration of new digital systems by anticipating and managing the necessary changes.

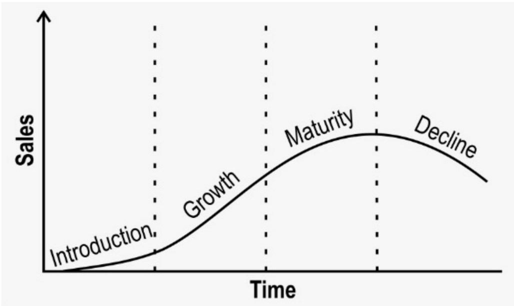
4. **(a)** Product Life Cycle is an important concept in strategic choice and S-shaped curve which exhibits the relationship of sales with respect of time for a product that passes through the four successive stages.

The first stage of PLC is the introduction stage in which competition is almost negligible, prices are relatively high and markets are limited. The growth in sales is also at a lower rate.

The second stage of PLC is the growth stage, in which the demand expands rapidly, prices fall, competition increases, and market expands.

The third stage of PLC is the maturity stage, where in the competition gets tough and market gets stabilized. Profit comes down because of stiff competition.

The fourth stage is the declining stage of PLC, in which the sales and profits fall down sharply due to some new products replacing the existing product.



Product Life Cycle

PLC can be used to diagnose a portfolio of products (or businesses) in order to establish the stage at which each of them exists. Particular attention is to be paid on the businesses that are in the declining stage. Depending on the diagnosis, appropriate strategic choices can be made. For instance, expansion may be a feasible alternative for businesses in the introductory and growth stages. Mature businesses may be used as sources of cash for investment in other businesses which need resources. A combination of strategies like selective harvesting, retrenchment, etc. may be adopted for declining businesses. In this way, a balanced portfolio of businesses may be built up by exercising a strategic choice based on the PLC concept.

(b) The business environment consists of both the macro environment and the micro environment. Following are the differences between the two:

- The micro environment refers to the forces that are very close to the company and affect its ability to do routine functions. Macro environment refers to all forces that are part of the larger periphery and distantly affect organization and micro environment.
- Micro environment includes the company itself, its suppliers, marketing intermediaries, customer markets and competitors. Whereas macro environment includes demography, economy, natural forces, technology, politics, legal and socio-cultural.

- The elements of micro environment are specific to the said business and affects it's working on short term basis. The elements of macro environment are general environment and affect the working of all the firms in an industry.

OR

Differences between Operational Control and Management Control are as under:

(i) The thrust of operational control is on individual tasks or transactions as against total or more aggregative management functions. When compared with operational, management control is more inclusive and more aggregative, in the sense of embracing the integrated activities of a complete department, division or even entire organization, instead or mere narrowly circumscribed activities of sub-units. For example, procuring specific items for inventory is a matter of operational control, in contrast to inventory management as a whole.

(ii) Many of the control systems in organizations are operational and mechanistic in nature. A set of standards, plans and instructions are formulated. On the other hand, the basic purpose of management control is the achievement of enterprise goals – short range and long range – in an effective and efficient manner.

ANSWERS OF MODEL TEST PAPER 4

PAPER 6B: STRATEGIC MANAGEMENT

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.

ANSWERS OF MODEL TEST PAPER 5

PAPER 6B: STRATEGIC MANAGEMENT

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.

ANSWERS OF MODEL TEST PAPER 6

PAPER 6B: STRATEGIC MANAGEMENT

PART I

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

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

PART II

1. (a) According to Mendelow's Matrix, environmentally conscious consumers who influence industry standards fall into the **Key Players** quadrant. These stakeholders possess both high power and high interest, making them crucial to the success of *Chic Threads'* sustainability-focused initiatives. Their high interest stems from their alignment with the brand's ethical and eco-friendly values, while their high power arises from their ability to shape market trends, advocate for sustainable practices, and impact on the brand's reputation through their purchasing decisions and influence within the industry.

As Key Players, these consumers require active engagement. *Chic Threads* must focus on satisfying their expectations by providing regular updates on sustainability efforts, maintaining transparent communication, and incorporating their feedback to ensure continued support. The brand should actively involve these stakeholders in its decision-making processes by seeking their input on product design and sustainability measures. Additionally, building strong relationships through targeted marketing campaigns, collaborations, and awareness initiatives will further solidify their trust and advocacy. Effectively managing this stakeholder group is vital, as their support and satisfaction directly contribute to the success of the brand's eco-friendly clothing line.

(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.

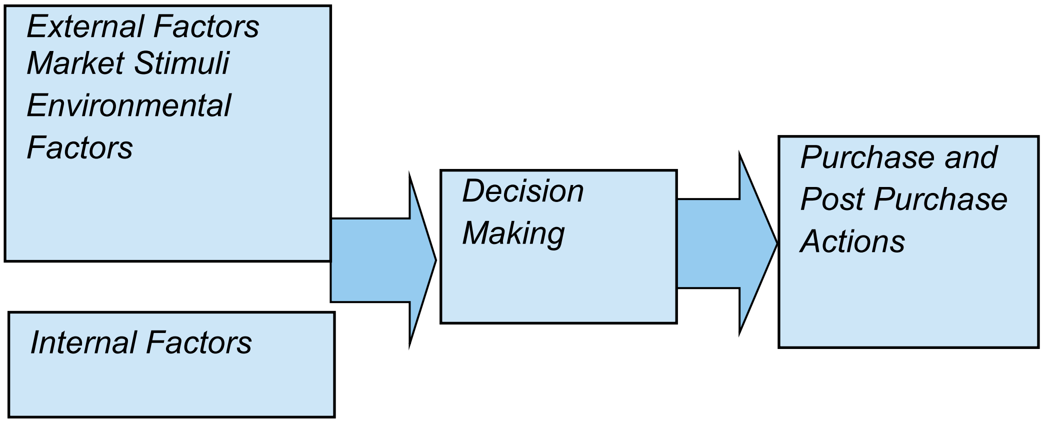


Figure: Process of consumer behaviour

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.

(c) Strategic Performance Measures (SPM) are metrics organizations use to evaluate and track the effectiveness of their strategies in achieving their goals and objectives. SPM provides a framework for monitoring key areas critical to the organization's success, ensuring progress toward desired outcomes and enabling timely adjustments to improve performance. For *GreenEdge Solutions*, various types of SPM can be utilized:

- **Financial Measures:** Metrics like revenue growth, return on investment (ROI), and profit margins help evaluate the company's financial health and profitability.
- **Customer Satisfaction Measures:** Assessments of customer satisfaction, retention, and loyalty indicate how well the company meets customer needs.
- **Market Measures:** Market share, customer acquisition, and referral rates reflect competitiveness and market position.
- **Employee Measures:** Employee satisfaction, engagement, and turnover rate help track workplace culture and talent retention.
- **Innovation Measures:** R&D spending, patent filings, and new product launches gauge the company's innovation capabilities.
- **Environmental Measures:** Monitoring energy consumption, waste reduction, and carbon emissions ensures the company aligns with sustainability goals.

Using these measures, *GreenEdge Solutions* can systematically assess its strategy and make informed decisions to drive sustainable growth and success.

2. (a) *Connect Group* has to make strategic changes for its survival. The changes in the environmental forces often require businesses to make modifications in their existing strategies and bring out new strategies. Strategic change is a complex process that involves a corporate strategy focused on new markets, products, services and new ways of doing business. Unless companies embrace change, they are likely to freeze and unless companies prepare to deal with sudden, unpredictable, discontinuous, and radical change, they are likely to be extinct.

Three steps for initiating strategic change are:

(i) **Recognise the need for change** – The first step is to diagnose the which facets of the present corporate culture are strategy supportive and which are not.

(ii) **Create a shared vision to manage change** – Objectives of both individuals and organisation should coincide. There should be no conflict between them. This is possible only if the management and the organisation members follow a shared vision.

(iii) **Institutionalise the change** – This is an action stage which requires the implementation of the changed strategy. Creating and sustaining a different attitude towards change is essential to ensure that the firm does not slip back into old ways of doing things.

(b) The term '**strategic management'** refers to the managerial process of developing a strategic vision, setting objectives, crafting a strategy, implementing and evaluating the strategy, and initiating corrective adjustments were deemed appropriate.

The presence of strategic management cannot counter all hindrances and always achieve success as there are limitations attached to strategic management. These can be explained in the following lines:

♦ **The environment is highly complex and turbulent.** It is difficult to understand the complex environment and exactly pinpoint how it will shape up in future. The organisational estimate about its future shape may awfully go wrong and jeopardise all strategic plans. The environment affects as the organisationhas to deal with suppliers, customers, governments and other external factors.

♦ **Strategic management is a time-consuming process.** Organisations spend a lot of time preparing, communicating the strategies that may impede daily operations and negatively impact on routine business.

♦ **Strategic management is a costly process.** Strategic management adds a lot of expenses to an organization. Expert strategic planners need to be engaged, efforts are made for analysis of external and internal environments devise strategies and properly implement. These can be really costly for organisations with limited resources particularly when small and medium organisation create strategies to compete.

- **Competition is unpredictable.** In a competitive scenario, where all organisations are trying to move strategically, it is difficult to clearly estimate the competitive responses to the strategies.

3. (a) Yes, *Easy Access* and its rivals get advantage by this move. The new bureaucratic process is making it more complicated for organizations to start up and enter the *Easy Access* market, increasing barriers to entry and thereby reducing the threat of new entrants. New entrants can reduce an industry's profitability, because they add new production capacity, leading to increase in supply of the product, sometimes even at a lower price and can substantially erode existing firm's market share position. However, New entrants are always a powerful source of competition. The new capacity and product range they bring in throws up a new competitive pressure. The bigger the new entrant, the more severe the competitive effect. New entrants also place a limit on prices and affect the profitability of existing players, which is known as Price War.

(b) There are several basis of differentiation, major being: Product, Pricing and Organization.

Product: Innovative products that meet customer needs can be an area where a company has an advantage over competitors. However, the pursuit of a new product offering can be costly – research and development, as well as production and marketing costs can all add to the cost of production and distribution. The payoff, however, can be great as customers' flocks are among the first to have the new product.

Pricing: It fluctuates based on its supply and demand and may also be influenced by the customer's ideal value for a product. Companies that differentiate based on product price can either determine to offer the lowest price or can attempt to establish superiority through higher prices.

Organisation: Organisational differentiation is yet another form of differentiation. Maximizing the power of a brand or using the specific advantages that an organization possesses can be instrumental to a company's success. Location advantage, name recognition and customer loyalty can all provide additional ways for a company to differentiate itself from the competition.

4. (a) *Leatherite Ltd.* is currently manufacturing footwears for males and females and its top management has decided to expand its business by manufacturing leather bags for males and females. Both the products are similar in nature within the same industry. The strategic diversification that the top management of *Leatherite Ltd.* has opted for is concentric in nature. They were in business manufacturing leather footwear and now they will manufacture leather bags as well. They will be able to use existing infrastructure and distribution channels.

Concentric diversification amounts to related diversification.

In concentric diversification, the new business is linked to the existing businesses through process, technology or marketing. The new product is a spin-off from the existing facilities and products/processes. This means that in concentric diversification too, there are benefits of synergy with the current operations.

(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

Strategic planning	**Operational planning**
Strategic planning shapes the organisation and its resources.	Operational planning deals with current deployment of resources.
Strategic planning assesses the impact of environmental variables.	Operational planning develops tactics rather than strategy.
Strategic planning takes a holistic view of the organisation.	Operational planning projects current operations into the future.

Strategic planning develops overall objectives and strategies.	Operational planning makes modifications to the business functions but not fundamental changes.
Strategic planning is concerned with the long-term success of the organisation.	Operational planning is concerned with the short-term success of the organisation.
Strategic planning is a senior management responsibility.	Operational planning is the responsibility of functional managers.

ANSWERS OF MODEL TEST PAPER 7

PAPER 6B: STRATEGIC MANAGEMENT

PART I

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

PART II

1. **(a)** The scenario being referred to is culture in *Jupiter Electronics*. Strong culture promotes good strategy execution when there's fit and impels execution when there's negligible fit. A culture grounded in values, practices, and behavioral norms that match what is needed for good strategy execution helps energize people throughout the organization to do their jobs in a strategy-supportive manner. A culture built around such business principles as listening to customers, encouraging employees to take pride in their work, and giving employees a high degree of decision-making responsibility. This is very conducive to successful execution of a strategy of delivering superior customer service.

A strong strategy-supportive culture makes employees feel genuinely better about their jobs and work environment and the merits of what the company is trying to accomplish. Employees are stimulated to take on the challenge of realizing the organizational vision, do their jobs competently and with enthusiasm, and collaborate with others.

(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.

(c) By concentrating primarily on the market for consultancy services in environmental management, the firm is pursuing a **focus strategy**. Its provision of audit services, which rival firms do not offer, highlights a **differentiation strategy** within this specific market niche. Therefore, the firm is following a **focused differentiation strategy**.

A focused differentiation strategy involves offering unique features that cater to the specific needs of a narrow market segment. As with the focused low-cost strategy, narrow markets can be defined differently depending on the context. For instance, some firms using this strategy focus on a particular sales channel, such as exclusively selling online, while others may target specific demographic groups. Firms that compete on uniqueness while addressing the needs of a narrow market exemplify the **focused differentiation strategy**.

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) SBU is a part of a large business organization that is treated separately for strategic management purposes. The concept of SBU is helpful in creating an SBU organizational structure. It is a separate part of large business serving product markets with readily identifiable competitors. It is created by adding another level of management in a divisional structure after the divisions have been grouped under a divisional top management authority based on the common strategic interests.

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. SBUs helps such organisations by:

- Establishing coordination between divisions having common strategic interest.

- Facilitate strategic management and control.
- Determine accountability at the level of distinct business units.
- Allow strategic planning to be done at the most relevant level within the total enterprise.
- Make the task of strategic review by top executives more objective and more effective.
- Help to allocate resources to areas with better opportunities.

3. (a) Capabilities that are valuable, rare, costly to imitate, and non-substitutable are core competencies. A small chemist shop has a local presence and functions within a limited geographical area. Still, it can build its own competencies to gain competitive advantage. Rohit Patel can build competencies in the areas of:

(i) Developing personal and cordial relations with the customers.

(ii) Providing home delivery with no additional cost.

(iii) Developing a system of speedy delivery that can be difficult to match by online sellers. Being in the central part of the city, he can create a network to supply at wider locations in the city.

(iv) Having extended working hours for convenience of buyers.

(v) Providing easy credit or a system of monthly payments to the patients consuming regular medicines.

(b) The vision describes a future identity while the Mission serves as an on-going and time-independent guide.

The vision statement can galvanize the people to achieve defined objectives, even if they are stretch objectives, provided the vision is specific, measurable, achievable, and relevant and time bound. A mission statement provides a path to realize the vision in line with its values. These statements have a direct bearing on the bottom line and success of the organization.

A mission statement defines the purpose or broader goal for being in existence or in the business and can remain the same for decades if crafted well while a vision statement is more specific in terms of both the future state and the time frame. Vision describes what will be achieved if the organization is successful.

4. (a) 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.

(b) In the BCG growth-share matrix portfolio of investments are represented in two-dimensional space. The vertical axis represents market growth rate, and the horizontal axis represents relative market share. The strategic implications for various business types under BCG in the corporate portfolio are:

Stars are products or businesses that are growing rapidly and are the best opportunity for expansion. *Stars may follow the Build* strategy. They need heavy investments to maintain their position and finance their rapid growth potential.

Cash Cows are low-growth, high market share businesses or products. They generate cash and have low costs. They are established, successful, and need less investment to maintain their market share. *A strategic alternative advocated for cash cows is Harvest.*

Question Marks are low market share businesses in high-growth markets. *A strategic option for them is Hold for which t*hey need heavy investments. Question marks if left unattended are capable of becoming cash traps.

Dogs are low-growth, low-share businesses and products. *The relevant strategy is Divest.* Dogs may generate enough cash to maintain themselves, but do not have much future. Dogs should be minimized by means of divestment or liquidation.

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 increases, 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 competing. Alliances may also create vertical integration where partners are part of the 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.

ANSWERS OF MODEL TEST PAPER 8

PAPER 6B: STRATEGIC MANAGEMENT

PART I

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

1. (B) **(i)** **(b)** **(ii)** **(a)** **(iii)** **(d)**

PART II

1. **(a)** The Matrix Relationship is the most effective structure for Tech Innovators Inc. to achieve its vision of leadership in AI technologies. This structure promotes cross-functional collaboration, essential for managing complex AI projects and fostering innovation. By integrating expertise from various departments into temporary, task-based teams, the Matrix Relationship supports dynamic project management and aligns well with the company's strategic goals for advancing AI technologies. Despite its complexity, this approach provides the flexibility and collaboration necessary for a leading-edge AI and ML focus.

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

(b) The competitive rivalry will be a significant force in case of company of Rajiv Arya as all the rivals are similar in sizes and are manufacturing similar products. It is difficult for any single manufacturer to dominate the market. Large number of patents will make it difficult for new entrants to break into the market. Further, as there are a large number of small suppliers the power that suppliers can exert will also be low.

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

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

(c) 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.

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

The major benefits of strategic management are:

- Strategic management gives directions to the company to move ahead. It defines the goals and mission.
- It helps organisations to be proactive instead of reactive in shaping their future.
- It provides frameworks for all major decisions of an enterprise such as decisions on businesses, products, markets, manufacturing facilities, investments and organisational structure. It provides better guidance to the entire organisation on the crucial point - what it is trying to do.
- It helps organisations to identify the available opportunities and identify ways and means to achieve them.
- It serves as a corporate defence mechanism against mistakes and pitfalls.
- It helps to enhance the longevity of the business.
- It helps the organisation to develop certain core competencies and competitive advantages that would facilitate survival and growth.

(b) The company went through the following stages of the product life cycle (PLC):

Introduction stage: Initially, the company faced slow sales growth, limited markets, and high prices, which are characteristic of the introduction stage. During this stage, competition is almost negligible, and customers have limited knowledge about the product.

Growth stage: Over time, the demand for the product expanded rapidly, prices fell, and competition increased. These are typical features of the growth stage in the PLC. In this stage, the product gains market acceptance, and customers become more aware of the product's benefits and show interest in purchasing it.

3. (a) A strategic alliance is a relationship between two or more businesses that enables each to achieve certain strategic objectives which neither would be able to achieve on its own. The strategic partners maintain their status as independent and separate entities, share the benefits and control over the partnership, and continue to make contributions to the alliance until it is terminated. The advantages of strategic alliance can be broadly categorised as follows:

(a) **Organizational:** Strategic alliance helps to learn necessary skills and obtain certain capabilities from strategic partners. Strategic partners may also help to enhance productive capacity, provide a distribution system, or extend supply chain.

(b) **Economic:** There can be reduction in costs and risks by distributing them across the members of the alliance. Greater economies of scale can be obtained in an alliance, as production volume can increase, causing the cost per unit to decline. The partners can also take advantage of co-specialization, creating additional value.

(c) **Strategic:** Rivals can join together to cooperate instead of competing. 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.

(d) **Political:** Sometimes strategic alliances are formed with a local foreign business to gain entry into a foreign market either because of local prejudices or legal barriers to entry.

(b) 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.

4. (a) 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.

(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.

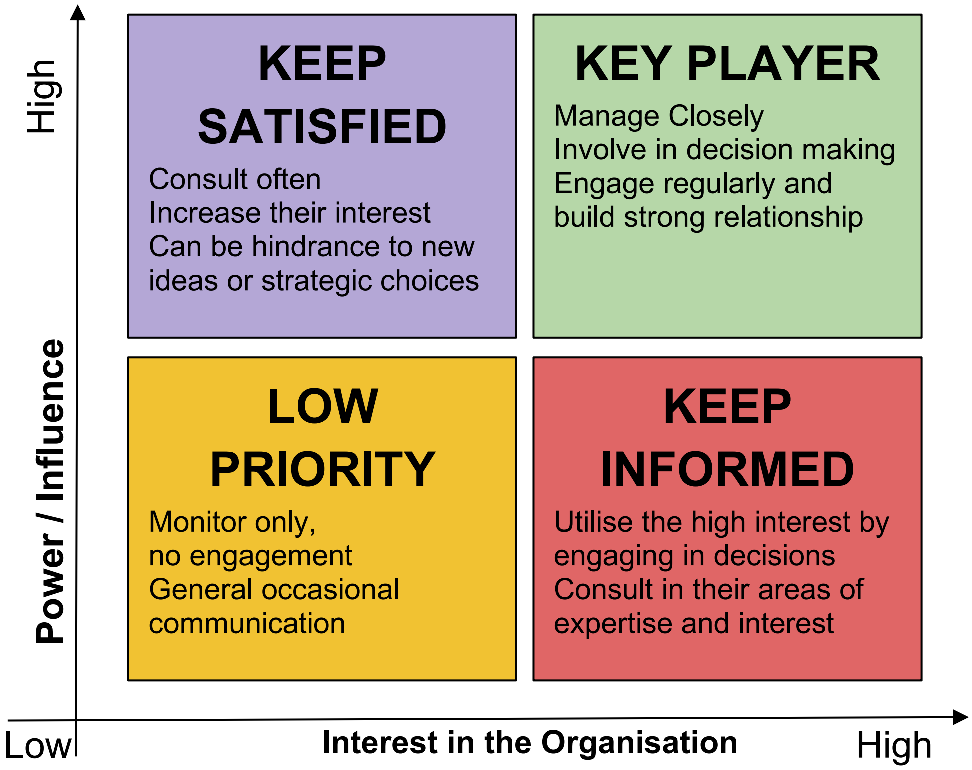
OR

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.