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CA Intermediate 2024 Suggested Answers · Paper 6 Financial Management and Strategic Management

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Suggested Answers

SUBJECT
Paper 6 Financial Management and Strategic Management

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PAPER – 6: FINANCIAL MANAGEMENT AND STRATEGIC MANAGEMENT

SECTION A: FINANCIAL MANAGEMENT

PART - I

Case Scenario 1

RS Limited is manufacturing selling soft drinks in India. The production process involves one important process which increases the shelf life of the soft drinks. Presently, the machine used for this purpose is an old one, in which wastage due to breakage of glass bottles is considerably high and due to its limited capacity, the company is not in a position to increase its production.

The production manager has approached the CEO of RS Limited for purchasing an automated machine, which will drastically reduce the wastage due to breakage during the process of increasing shelf life of soft drinks. The automated machine will support increase in production. The production manager is confident that acquisition of the automated machine will be beneficial for the company.

Other information is as under :

- *With the introduction of automated machine, additional sales and related costs over the next five years would be as follows:*

Year	Additional Sales Unit	Selling price per unit (₹)	Variable Manufacturing, Selling and Distribution cost per unit (₹)	Additional fixed Selling & Distribution Cost (₹)
1	20,000	30	20	25,000
2	25,000	30	20	30,000
3	30,000	35	20	30,000
4	32,000	35	22	35,000
5	28,000	35	22	35,000

SUGGESTED ANSWER **INTERMEDIATE EXAMINATION: SEPTEMBER 2024**

- *Cost of acquisition of automated machine is ₹ 5,00,000. Residual value of the automated machine at the end of its life of 5 years will be ₹ 50,000. Depreciation on automated machine will be under Straight line method.*

  Depreciation is not included in the cost stated above.

- *The Production Manager has estimated the cost savings (before tax) due to reduction in breakages as under:*

	Year 1	Year 2	Year 3	Year 4	Year 5
Savings Cost due reduction in breakages	₹ 15,000	₹ 15,000	₹ 20,000	₹ 20,000	₹ 20,000

- *The machine which is being used at present has zero written down value and if sold, would fetch an amount of ₹ 10,000 only.*

- *The cost of capital of the company is 10%. The tax rate applicable for the company is 30%. Ignore capital gain taxes.*

  P.V Factors of ₹ 1 at year end at 10%:

	Year 1	**Year 2**	**Year 3**	**Year 4**	**Year 5**
P.V Factor of ₹ 1	0.909	0.826	0.751	0.683	0.621

You are required to answer the following Questions 1 to 5 :

1. *What is the Profit before Taxes for the Year 2, Year 3 and Year 4 of the investment proposal ?*

   (A) ₹ 2,35,000, ₹ 4,40,000, ₹ 4,01,000

   (B) ₹ 1,45,000, ₹ 3,50,000, ₹ 3,11,000

   (C) ₹ 2,05,000, ₹ 4,10,000, ₹ 3,66,000

   (D) ₹ 1,40,000, ₹ 3,60,000, ₹ 3,31,000

2. *What is the Cash Inflow after Taxes for the Year 1, Year 2 and Year 3 of the investment proposal ?*

   (A) ₹ 1,50,000, ₹ 1,85,000, ₹ 3,45,000

   (B) ₹1,65,000, ₹ 1,95,500, ₹ 3,55,000

   (C) ₹ 1,60,000, ₹ 1,91,500, ₹ 3,35,000

(D) ₹ 1,70,000, ₹ 1,90,000, ₹ 3,40,000

3. What is the Discounted Cash Inflow after Taxes for the Year 1, Year 2 and Year 3 of the investment proposal ?

(A) ₹ 1,49,985, ₹ 1,61,483, ₹ 2,66,605

(B) ₹ 1,36,350, ₹ 1,52,810, ₹ 2,59,095

(C) ₹ 1,54,530, ₹ 1,56,940, ₹ 2,55,340

(D) ₹ 1,45,440, ₹ 1,58,179, ₹ 2,51,585

4. What is the Net Present Value of the investment proposal?

(A) ₹ 3,78,990.30

(B) ₹ 4,54,980.60

(C) ₹ 4,74,890.40

(D) ₹ 3,89,260.70

5. What is the Discounted Payback period of the investment proposal ?

(A) 2.74 years

(B) 2.87 years

(C) 2.38 years

(D) 2.48 years

6. A company has sales of ₹ 6,00,000, variable cost of ₹ 2,40,000, fixed operating cost of ₹ 2,70,000. The financial leverage is 2.5. The company wants to double its EBIT. The percentage change in ales required in order to double its EBIT will be :

(A) 50%

(B) 25%

(C) 40%

(D) 80%

7. The capital structure of KPS Limited includes 5,00,000 equity shares of ₹ 10 each. The market price of equity share (cum-dividend) is ₹ 75 per share. The company has declared to pay dividend on equity shares @ ₹ 6 per share

which will be paid within next three days. The company has a history of consistent growth in its dividends. It has been predicted that in the next year KPS Limited will pay dividend on its equity shares@ ₹ 7.59 per share. The rate of dividend growth will be maintained in foreseeable future. The cost of equity is calculated as:

(A) 36.5%

(B) 34.5%

(C) 37.5%

(D) 38.5%

8. *ZX Limited has total assets of ₹ 7,20,000 and its Shareholders' equity is ₹ 4,50,000. The net profit margin of ZX Limited is 12.5% and asset turnover ratio is 1.5. Using the DuPont model, the return on equity of ZX Limited is calculated as :*

(A) 7.03%

(B) 50%

(C) 11.72%

(D) 30%

Answer Key

Question No.	Answer
1.	(B)
2.	(C)
3.	(D)
4.	(C)
5.	(A)
6.	(B)
7.	(C)
8.	(D)

SUGGESTED ANSWER

FINANCIAL MANAGEMENT AND STRATEGIC MANAGEMENT

SECTION – B: STRATEGIC MANAGEMENT

PART - I

Case Scenario 2

Quick N Safe Logistics is one of the prominent transporters of goods for more than two decades. It has its own fleets and also has business arrangement with Railways.

Competition with existing players and threat from new entrants are increasing regularly. Customer preferences and expectations are also changing. Need for considering new and improved means of transportation seems inevitable.

Current philosophy of the company is 'to bring the best user experience to its customers through timely and safe delivery of goods'. While keeping this philosophy in mind, it desires to keep ahead and reap the benefits of first mover advantages in the industry. In order to achieve its growth target, company is exploring available other options so as to have a strong presence in supply chain management.

The company is of a considered view that 'we learn as we grow'. It knows that the overall per mile operating cost decreases due to increase in efficiency and cumulative volume of services. Since the company will have a cost advantage over the competitors due to reduced cost of services, it can develop and adopt a penetrative pricing strategy by setting a low price to attract more customers.

It is also observed that arrangement of transportation through railways is becoming a concern. Growth rate is slow and market for areas being covered by this means of transport is by and large stabilized. Profit margin is coming down due to stiff competition. Company has to work out an action plan to maintain the stability.

On the other side, one of the customer segments is looking for fast delivery of its goods in major cities all across the country. The prime consideration of such customers is quick and safe delivery of their products, irrespective of cost for the same. The target market of such services is very large and also increasing very fast. In view of the same, the company wants to reform its operation, by engaging a dedicated team to perform with a niche marketing strategy for transporting such goods through airways on an assurance of 'delivery by next day'.

SUGGESTED ANSWER INTERMEDIATE EXAMINATION: SEPTEMBER 2024

In view of the given case scenario, answer MCQs from 9 to 13 with correct option.

9. *The strategy in which the company wants to keep ahead and reap the first mover advantages in the industry, is known as:*

   (A) Adaptive strategy

   (B) Reactive strategy

   (C) Proactive strategy

   (D) Responsive strategy

10. *In context to service in transportation through railways, the company is analyzing a relationship between volume of business on one axis with respect to time on another axis. As per Product Life Cycle (PLC), which stage this service is passing through:*

   (A) Introduction

   (B) Maturity

   (C) Growth

   (D) Decline

11. *In Strategic Management, the concept of decrease in the overall per mile operating cost due to increase in efficiency and cumulative volume of services is depicted as:*

   (A) Experience curve

   (B) Ansoff's growth matrix

   (C) Strategic surveillance

   (D) Value chain analysis

12. *As per strategies propagated by Michael Porter, niche marketing strategy for transporting goods through airways for a large customer segment on an assurance of 'delivery by next day', is known as:*

   (A) Cost leadership strategy

   (B) Differentiation strategy

   (C) Focus differentiation strategy

(D) *Focus cost leadership strategy*

13. *The philosophy of the company stated as, 'to bring the best user experience to its customers through timely and safe delivery of goods', is indicating towards:*

(A) *Vision statement*

(B) *Mission statement*

(C) *Goals of the company*

(D) *Objectives of the company*

14. *Super Products Ltd. is having four divisions, i.e. Alpha, Beta, Cos and Theta. All the divisions are independent product center and are also integral part of product Gama of the company. Each division contains its own set of activities under the control of respective general manager. Each general manager is responsible for his respective product line and its profitability. While having own set of competitors, each center has its own competitive advantages with the resources and capabilities they develop. Such structure is known as:*

(A) *Network structure*

(B) *Divisional structure*

(C) *Multi divisional structure*

(D) *Strategic business unit*

15. *Always Ahead Ltd. is an established player in FMCG, Herbs, Health care and White goods. Company has classified its portfolio on investments in different businesses in four quadrants as suggested by Boston Consulting Group. On further analysis of relationship between market growth rate and relative market share for White goods business, it is found that opportunities to increase its market share are there. Emphasis need to be given to make a strong future with large market share even by foregoing short-term earnings for this business. Which strategy is being pursued by the company for White goods segment:*

(A) *Build*

(B) *Hold*

(C) *Harvest*

(D) Divest

16. *The correct sequence of the stages as per Kurt Lewin's model of change is:*

(A) Changing to the new situation, Unfreezing the situation and Refreezing

(B) Unfreezing the situation, Refreezing and Changing to the new situation

(C) Refreezing, Unfreezing the situation and Changing to the new situation

(D) Unfreezing the situation, Changing to the new situation and Refreezing

Answer Key

Question No.	Answer
9.	(C)
10.	(B)
11.	(A)
12.	(C)
13.	(B)
14.	(D)
15.	(A)
16.	(D)

PAPER – 6: FINANCIAL MANAGEMENT AND STRATEGIC MANAGEMENT

SECTION A: FINANCIAL MANAGEMENT

Part II

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

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

In case, any candidate answers extra question(s)/ sub-question(s) over and above the required number, then only the requisite number of questions first answered in the answer book shall be valued and subsequent extra question(s) answered shall be ignored.

Working notes should form part of the answer.

Question 1

(a) Financial information for the year 2023-24 of two companies, N Limited and C Limited are as under:

Details	*N Limited*	*C Limited*
Equity share capital (₹ 100 each)	*₹ 10,00,000*	*₹ 8,00,000*
Debt	*₹ 5,00,000@10%*	*₹ 7,00,000@8%*
Fixed Cost	*3,00,000*	*3,36,000*
Combined Leverage	*8*	*4.5*
Financial Leverage	*2*	*1.5*

You are required to calculate:

(i) Contribution for N Ltd. and C Ltd.

(ii) Margin of safety in % for N Ltd. and C. Ltd.

(iii) Sales of C Ltd. ***(5 Marks)***

SUGGESTED ANSWER INTERMEDIATE EXAMINATION: SEPTEMBER 2024

(b) *The following information is available for SK Limited for the year ended on 31st March,2024:*

Particulars	₹
Cost of production	*15,48,000*
Cost of goods sold	*14,61,000*
Average stock of work-in-progress	*94,600*
Average stock of finished goods	*2,43,500*
Administration and Selling expenses	*4,14,000*
Receivables collection period	*36 days*
Raw Material Storage period	*65 days*
Creditors payment period	*63 days*

You are required to calculate the working capital requirement by operating cycle method. Assume a 360 days year. ***(5 Marks)***

(c) *Following information relates to MNP Limited for the year ended on 31sMarch, 2024:*

Inventory turnover ratio (based on cost of goods sold)	*7.5 times*
Total assets turnover ratio	*2.5 times*
Long term debt to Shareholders' fund	*0.6:1*
Debtors collection period	*30 days*
Gross profit ratio	*25% on sales*
Current Ratio	*2.9:1*

Balance Sheet as on 31st March,2024

Liabilities	₹	*Assets*	₹
Equity share capital	*6,00,000*	*Fixed Assets*	*?*
Reserves & Surplus	*3,00,000*	*Inventories*	*?*
Long term debt	*?*	*Debtors*	*?*
Creditors	*3,00,000*	*Cash*	*?*
Total		*Total*	

SUGGESTED ANSWER — **FINANCIAL MANAGEMENT AND STRATEGIC MANAGEMENT**

You are required to complete the Balance Sheet of MNP Limited as on 31st March,2024. Assume a 360 days year and all sales are credit sales.

(5 Marks)

Answer

(a) (i) Calculation of Contribution

N Limited	**C Limited**
Financial Leverage (FL) $= \frac{EBIT}{EBT}$ or $\frac{EBIT}{EBIT - Interest}$	
$2 = \frac{EBIT}{EBIT - 50,000}$	$1.5 = \frac{EBIT}{EBIT - 56,000}$
2 EBIT – 1,00,000 = EBIT	1.5 EBIT – 84,000 = EBIT
EBIT = ₹ 1,00,000	**EBIT = ₹ 1,68,000**
EBT = ₹ 50,000	EBT = ₹ 1,12,000
Combined Leverage (CL) $= \frac{Contribution}{EBT}$	
8 = Contribution / 50,000	4.5 = Contribution / 1,12,000
Contribution= ₹ 4,00,000	**Contribution= ₹ 5,04,000**

(ii) Calculation of Margin of safety (MOS) in %

$$MOS = \frac{Contribution - Fixed\ Cost}{Contribution} = \frac{EBIT}{Contribution}$$

N Limited	**C Limited**
MOS = 1,00,000/4,00,000 **= 25%**	MOS = 1,68,000/5,04,000 **= 33.33%**

Part (ii) can also be presented in following way:

Calculation of Margin of safety (MOS) in %

MOS = 1/operating leverage (OL)

OL = CL/FL

N Limited	C Limited
OL = 8/2 = 4	OL = 4.5/1.5 = 3
MOS = 1/4 **= 25%**	MOS = 1/3 **= 33.33%**

(iii) Sales of C Limited

Let assume that PV ratio is 40%

$$\textbf{PV Ratio} = \frac{\text{Contribution}}{\text{Sales OR Sales}} = \frac{\text{Contribution}}{\text{PV Ratio}}$$

$$\textbf{Sales} = \frac{5,04,000}{0.40} = \textbf{₹ 12,60,000}$$

Part (iii) of the solution can be solved by any alternative assumption.

(b) Operating Cycle = R + W + F + D – C

Where,

R = Raw material storage period = 65 days

W = Work-in-progress inventory* holding period

F = Finished goods storage period

D = Receivables (Debtors) collection period = 36 days

C = Credit period allowed by suppliers (Creditors) = 63 days

Work-in-progress inventory holding period (W)

$$= \frac{\text{Average Work-in-progress inventory}}{\text{Average Cost of Production per day}}$$

$$= \frac{₹\,94,600}{₹\,15,48,000 \div 360\,\text{days}} = \textbf{22 days}$$

Finished Goods storage period (F)

$$= \frac{\text{Average stock of finished goods}}{\text{Average Cost of Goods Sold per day}}$$

$$= \frac{₹2,43,500}{₹14,61,000 \div 360\,\text{days}} = \textbf{60 days}$$

Net Operating Cycle = 65+22+60+36-63 = **120 days**

Number of Operating Cycles in a year

$$= \frac{\text{No. of days in a year}}{\text{Operating Cycle period}}$$

$$= \frac{360\,\text{days}}{120\,\text{days}} = \textbf{3 times}$$

Amount of Working Capital Required

$$= \frac{\text{Annual Operating Cost}}{\text{Number of Operating Cycles}} = \frac{₹\,14,61,000 + ₹\,4,14,000}{3} = ₹\,6,25,000$$

(c) Working Notes:

Long term debt to Shareholder's fund	= 0.6:1	
Long term debt	= 0.6 x ₹ 9,00,000	= ₹ 5,40,000
Total Assets		= ₹ 17,40,000
Total Asset turnover ratio	$= \frac{\text{Sales}}{\text{TotalAssets}}$	= 2.5 times
Sales	= 2.5 x ₹ 17,40,000	= ₹ 43,50,000
Current ratio	$= \frac{\text{Current Assets}}{\text{Current Liabilities}}$	= 2.9:1
Current Assets	= 2.9 x ₹ 3,00,000	= ₹ 8,70,000
Fixed Assets	= Total Assets - Current Assets	
	= ₹ 17,40,000 – ₹ 8,70,000 = ₹ 8,70,000	
Gross profit ratio	= 25% on sales	
Gross Profit (GP)	= ₹ 43,50,000 x 0.25 = ₹ 10,87,500	
Cost of Good Sold (COGS)	= Sales – GP	
	= ₹ 43,50,000 - ₹ 10,87,500	
	= ₹ 32,62,500	
Inventory Turnover Ratio	$= \frac{\text{Cost of Goods Sold}}{\text{Average Inventory}}$ = 7.5 times	

Inventory = ₹ 32,62,500/7.5 = ₹ 4,35,000

Debtor Collection Period = $\frac{\text{Average Accounts Receivables}}{\text{Average Daily Credit Sales}}$ = 30 days

Receivables = 30 days x ₹ 43,50,000/360 days = ₹ 3,62,500

Balance Sheet as on 31st March 2024

Liabilities	(₹)	Assets	(₹)
Share Capital	6,00,000	Fixed Assets	8,70,000
Reserve and Surplus	3,00,000	Inventories	4,35,000
Long-term loan	5,40,000	Debtors	3,62,500
Creditors	3,00,000	Cash (Balancing Figure)	**72,500**
	17,40,000		17,40,000

Question 2

(a) Capital structure of T Limited as on 1st April,2024 is as under:

	₹
Equity Share Capital (₹ 10 per share)	*50,00,000*
10% Debentures (₹ 100 per Debenture)	*40,00,000*
12% Preference Share Capital (10,000 shares of ₹ 100 each)	*10,00,000*

Additional Information:

(1) The risk free rate of return is 10%. The Beta of T Ltd. is 1.75 and the return on market portfolio is 12%. The Equity shares have a current market price of ₹ 70 per share.

(2) The debentures are trading at a market price of ₹ 80 per debenture. The Debentures are to be redeemed after 5 years at par.

(3) Preference shares are redeemable after 5 years at a premium of 5%, presently selling at ₹ 104 per share.

(4) The Company pays tax at a rate of 30%.

(5) The Cost of Debentures are to be calculated on Yield to Maturity approach.

(6) The present value factors at 10% and 14% are:

Year	*1*	*2*	*3*	*4*	*5*
$PVIF_{0.10,t}$	*0.909*	*0.826*	*0.751*	*0.683*	*0.621*
$PVIF_{0.14,t}$	*0.877*	*0.769*	*0.675*	*0.592*	*0.519*

You are required to calculate Weighted Average Cost of Capital (after tax) of T Limited using Market value weights. ***(8 Marks)***

(b) Explain Angel Financing. ***(2 Marks)***

Answer

(a) Cost of Equity Share Capital using Capital Asset Pricing Model (CAPM) Approach

$K_e = R_f + ß (R_m - R_f)$

$K_e = 0.10 + 1.75 (0.12 - 0.10)$

$= 0.10 + 1.75 (0.02) = 0.135$ or **13.5%**

Cost of Redeemable Debentures using Yield to Maturity (YTM) Approach

Step-1: Identification of relevant cash flows

Year	Cash flows
0	Current market price (P_0) = ₹ 80
1 to 5	Interest net of tax [I(1-t)] = 10% of ₹ 100 (1-0.30) = ₹ 7
5	Redemption value (RV) = Face value i.e. ₹ 100

Step- 2: Calculation of NPVs at two discount rates

Year	Cash flows (₹)	Discount factor @ 10% (L)	Present Value (₹)	Discount factor @ 14% (H)	Present Value (₹)
0	80	1.000	(80.000)	1.000	(80.000)
1 to 5	7	3.790	26.530	3.432	24.024
5	100	0.621	62.100	0.519	51.900
NPV			**+8.630**		**-4.076**

Step- 3: Calculation of Cost of Debentures (Kd)

$$Kd = L + \frac{NPVL}{NPVL-NPVH}(H-L) = 10\% + \frac{₹\ 8.630}{₹\ 8.630 - (₹-4.076)}(14\%-10\%) = \mathbf{12.72\%}$$

Cost of Redeemable Preference Share Capital using approximation method

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

$$K_p = \frac{12 + \left(\frac{105 - 104}{5}\right)}{\left(\frac{105 + 104}{2}\right)}$$

$$= \mathbf{11.67\%}$$

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)
Equity Share Capital (₹ 70 x 5,00,000 equity shares)	3,50,00,000	0.8919	0.1350	**0.1204**
10% Debentures (₹ 80 × 40,000)	32,00,000	0.0816	0.1272	**0.0104**
12% Preference Share Capital (₹ 104 × 10,000 shares)	10,40,000	0.0265	0.1167	**0.0031**
	3,92,40,000	1.000		**0.1339**

WACC (K_o) = 0.1339 or 13.39%

(b) Angel Financing is a form of an equity-financing in which individual or a group of individuals provides capital to entrepreneurs and early-stage businesses, or start-ups, in exchange for an ownership/equity in the company.

They may provide a one-time investment or an ongoing capital injection via a series of investments, Angel investors are looking for a higher rate of return than what is given by traditional investment

Question 3

(a) *AB Enterprises deals in hardware materials having current turnover ₹ 30 Lakhs per annum. All sales are on credit and average collection period is 30 days with zero bad debts. The customers are requesting to increase the credit period. As a result of increase in credit period sales will also increase. Other information is as under:*

Credit policy	***Increase in collection period (days)***	***Increase in sales (₹)***	***Bad debts anticipated***
A	*15*	*3,00,000*	*1%*
B	*30*	*5,00,000*	*3.5%*

The Selling price is ₹ 100/- per unit. Variable cost per unit is ₹ 50/- and fixed cost is ₹ 5,00,000. Required rate of return on additional investment is 20%. Creditors for variable cost are ready to give 15 days extra credit for the additional cost incurred. Assume a 360 days year.

You are required to analyse the present and proposed credit policies using the "Total Approach" method and recommend the credit policy to be adopted.

(5 Marks)

(b) *ER Private Limited has a paid-up capital ₹ 2,50,000 consisting of 25,000 Equity shares of ₹ 10 each. The Market price per share is ₹ 24 with PE ratio of 8. The company is planning to purchase a plant which will cost ₹ 5,00,000. This plant is expected to yield earnings before interest and taxes of ₹ 2,00,000 per annum. It has two alternatives to finance the plant:*

Alternatives	*Equity*	*Debt*
A	*100%*	*-*
B	*50%*	*50%*

Other information is as under:

(i) Cost of debt is 12%.

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(ii) Equity shares of face value of ₹ 10 each will be issued at a premium of ₹ 10 per share.

(iii) PE ratio of Leveraged company will be 7.

(iv) Tax rate -40%.

Advise which alternative is the most suitable to raise the funds for additional capital, keeping in mind to maximize the benefit to its Shareholders.

(5 Marks)

Answer

(a) A. Statement showing the Evaluation of Credit Policies (Total Approach)

Particulars		Present Credit Policy	Proposed Credit Policy	
			A	B
	Credit Period (in days)	30	45	60
	Units sold	30,000	33,000	35,000
		₹	₹	₹
A	**Expected Profit:**			
	(a) Credit Sales @ ₹ 100 per unit	30,00,000	33,00,000	35,00,000
	(b) Total Cost other than Bad Debts			
	(i) Variable Costs @ ₹ 50 per unit	15,00,000	16,50,000	17,50,000
	(ii) Fixed Costs	5,00,000	5,00,000	5,00,000
		20,00,000	21,50,000	22,50,000
	(c) Bad Debts	-	33,000	1,22,500
	(d) Expected Profit [(a) – (b) – (c)]	**10,00,000**	**11,17,000**	**11,27,500**

B	**Opportunity Cost of Investments in Receivables (i)-(ii)**	**33,333**	**52,500**	**72,917**
C	**Net Benefits (A – B)**	**9,66,667**	**10,64,500**	**10,54,583**

Recommendation: The Proposed Policy A (i.e. increase in collection period by 15 days or total 45 days) should be adopted since the net benefits under this policy are higher as compared to other policies.

Working Notes:

(i) Calculation of Opportunity Cost of Average Investment in Receivables

Particulars		**Present Credit Policy**	**Proposed Credit Policy**	
			A	**B**
	Credit Period (in days)	30	45	60
		₹	₹	₹
(a)	Cost of Sales (Variable Cost + Fixed Cost)	20,00,000	21,50,000	22,50,000
(b)	Average Debtors = Cost of Sales × (Credit period) / 360	1,66,667	2,68,750	3,75,000
(c)	Average Creditors for extra variable cost [(Variable Cost) x 15/360]	-	6,250	10,417
(d)	**Average Investment in Receivables or Net Working Capital = (b) – (c)**	1,66,667	2,62,500	3,64,583
(e)	**Opportunity Cost @20% of average Investments in Receivables**	33,333	52,500	72,917

(b) Calculation of No. of Equity Shares and Existing Earnings before Interest and Taxes

Particulars	Existing	Alternative A: Issue Equity shares only	Alternative B: Issue Equity Shares and 12% Debentures of equal amount
Number of Equity Shares			
- Existing	25,000	25,000	25,000
- Newly issued		25,000 $\left(\frac{₹\ 5,00,000}{₹\ (10+10)}\right)$	12,500 $\left(\frac{₹\ 2,50,000}{₹(10+10)}\right)$
Total no. of Equity Shares	25,000	50,000	37,500
Calculation of Existing Earnings before Interest and Taxes (EBIT)			
Market Price per share (MPS)	₹ 24		
Price-Earnings Ratio (PE Ratio)	8 times	8 times	7 times
Earning per share (EPS) = MPS/PE Ratio	3		
Earnings after Tax (EAT) = EPS x No. of Equity shares	**75,000**		
Earning before Tax (EBT) = EAT/0.6 (or EBIT as Interest nil)	1,25,000		

Calculation of EPS and MPS under two financial alternatives

Particulars	Existing	Alternative A	Alternative B
Earnings before Interest and Tax:			
- Existing EBIT	1,25,000	1,25,000	1,25,000
- From New Project		2,00,000	2,00,000
	1,25,000	3,25,000	3,25,000
Less: Interest on 12% Debentures	-	-	30,000
Earnings before Tax (EBT)	1,25,000	3,25,000	2,95,000
Less: Tax @ 40%	50,000	1,30,000	1,18,000
Earnings after Tax (EAT)	**75,000**	**1,95,000**	**1,77,000**
EPS = EAT/ No. of Equity Shares	**3.00**	**3.90**	**4.72**
Market Price per share (MPS) = EPS x Price-Earning Ratio	**24.00**	**31.20**	**33.04**

Advise: Alternative B i.e., issue of 12% Debentures is most suitable to maximize the market price per share.

Alternatively, Solution can also be presented in following way:

Calculation of EPS and MPS under two financial alternatives

Particulars	Existing	Alternative A	Alternative B
Earnings before Interest and Tax:		2,00,000	2,00,000
- From New Project		2,00,000	2,00,000
Less: Interest on 12% Debentures	-	-	30,000
Earnings before Tax (EBT)		2,00,000	1,70,000
Less: Tax @ 40%		80,000	68,000
Earnings after Tax (EAT) from new project		1,20,000	1,02,000

Earnings from Existing (PAT)	75,000	75,000	75,000
Total Earnings After Tax (EAT)	75,000	1,95,000	1,77,000
Number of Shares	25,000	50,000	37,500
EPS = EAT/ No. of Equity Shares	**3.00**	**3.90**	**4.72**
Market Price per share (MPS) = EPS x Price-Earning Ratio	**24.00**	**31.20**	**33.04**

Advise: Alternative B i.e., issue of 12% Debentures is most suitable to maximize the market price per share.

Question 4

Answer the following:

(a) Discuss any 2 advantages and 2 disadvantages of raising finance by issue of debentures. ***(4 Marks)***

(b) List any four assumptions of Gorden's Model. ***(4 Marks)***

(c) What is Leveraged Lease? Explain. ***(2 Marks)***

OR

(d) What are the remedies for over-capitalisation? ***(2 Marks)***

Answer

(a) Advantages of raising finance by issue of debentures are:

(i) The cost of debentures is much lower than the cost of preference or equity capital as the interest is tax-deductible. Also, investors consider debenture investment safer than equity or preferred investment and, hence, may require a lower return on debenture investment.

(ii) Debenture financing does not result in dilution of control.

(iii) In a period of rising prices, debenture issue is advantageous. The fixed monetary outgo decreases in real terms as the price level increases. In other words, the company has to pay a fixed rate of interest.

Disadvantages of debenture financing are:

(i) Debenture interest and the repayment of its principal amount is an obligatory payment.

(ii) The protective covenants associated with a debenture issue may be restrictive.

(iii) Debenture financing enhances the financial risk associated with the firm because of the reasons given in point (i).

(i) Since debentures need to be paid at the time of maturity, a large amount of cash outflow is needed at that time.

(b) Gordon's model is based on the following assumptions:

- Firm is an all equity firm i.e. no debt.
- IRR will remain constant, because change in IRR will change the growth rate and consequently the value will be affected. Hence this assumption is necessary.
- K_e will remain constant, because change in discount rate will affect the present value.
- Retention ratio (b), once decide upon, is constant i.e. constant dividend payout ratio will be followed.
- Growth rate (g = br) is also constant, since retention ratio and IRR will remain unchanged and growth, which is the function of these two variable will remain unaffected.
- $K_e > g$, this assumption is necessary and based on the principles of series of sum of geometric progression for 'n' number of years.
- All investment proposals of the firm are to be financed through retained earnings only.

(c) **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.

OR

(c) Following steps may be adopted to avoid the negative consequences of over-capitalisation:

(i) Company should go for thorough reorganization.

(ii) Buyback of shares.

(iii) Reduction in claims of debenture-holders and creditors.

(iv) Value of shares may also be reduced. This will result in sufficient funds for the company to carry out replacement of assets.

SECTION – B: STRATEGIC MANAGEMENT

Part II

*Question paper comprises of **4** questions, Answer Question No. **5** which is compulsory and any **2** out of the remaining **3** questions.*

Question 5

(a) *M/s. MTS Ltd, is one of the mobile telephone service providers in India. It has its own mobile network, towers and distribution channels. It operates through its team of network operation, technicians, marketing, sales and after sales services. Currently all the team members are on its roll.*

Company knows that market is densely competitive. The environment is quite unstable and likely to remain so. Customer's taste and preferences are changing very fast. There is a strong need for innovation and quick response. While eliminating in-house business functions, company is considering outsourcing major activities and focusing on its core competencies.

In the given situation identify the organizational structure suitable for the company. Also outline the merits and demerits in going for the identified structure. ***(5 Marks)***

(b) *Symergy Ltd. is manufacturing a product since year 2010. The company was doing well till year 2022. After that its market share started declining. Accumulated losses started mounting and in turn carried a persistent negative impact on its cash flow. As a result morale of the employees was not up to mark.*

The Board of Directors (BoD) of the company thought it proper to continue in business by placing emphasis on improvement in internal efficiency. In view of the same, the BoD is evolving a workable action plan with intent to ensure a radical change in direction in strategy which includes revamping in top management.

Which retrenchment strategy company should adopt in the given situation? Also state the stages in the action plan for the strategy. ***(5 Marks)***

(c) *Market for baby care, readymade garments for new born, toys and strollers meant for babies are there. M/s. Maa ki Pasand is desirous to introduce new*

products for existing customers and new customers as well. The market for such products is narrow. On one side there are customers who are price conscious and on the other side there are customers who are ready to pay premium charges for an upscale product. The company wants to charge low price, relative to other firms that compete within the target market for customers who are price sensitive and also wants to charge premium based on uniqueness for rest of its products.

Which of the strategy is being considered by the company, out of strategies as suggested by Michael Porter at business level. Also outline the advantages and disadvantages using such strategy. ***(5 Marks)***

Answer

(a) The suitable organizational structure for **MTS Ltd** is the **Network Organizational Structure**. A company with such a structure is often called a **Virtual Organization.**

Merits of the Network Structure:

1. **Flexibility and Adaptability**: The structure allows for rapid technological changes and shifting competition patterns. This enables the company to adapt quickly to the unstable environment and changing customer preferences.
2. **Focus on Core Competencies**: The company can concentrate on its distinctive competencies while outsourcing non-core functions to specialized firms, which can perform them more efficiently.
3. **Cost Efficiency**: Through subcontracting and outsourcing, MTS Ltd can reduce the costs associated with maintaining in-house teams.
4. **Decentralized Operations**: The network structure scatters business functions across various geographical locations, reducing the need for a large central headquarters and ensuring responsiveness in different regions.

Demerits of the Network Structure:

1. **Loss of Synergies**: Contracting out functions may prevent MTS Ltd from discovering synergies that could emerge from combining internal activities.

2. **Over-Specialization Risk**: By focusing on only a few functions, the company may risk choosing the wrong functions, leading to a loss of competitiveness.
3. **Stress and Learning Challenges**: The flatter structure and increased need for personal interactions may create stress for employees, especially those who lack the confidence for active participation in organization-sponsored learning programs.

(b) In the given situation, the suitable retrenchment strategy for **Symergy Ltd.** is the **Turnaround Strategy**. This strategy is designed to reverse the company's decline and restore it to profitability, particularly when the company is facing challenges such as declining market share, negative cash flows, and low employee morale.

Stages in the Action Plan for Turnaround Strategy:

- **Stage One - Assessment of Current Problems**: The first step is to assess and diagnose the root causes of the company's decline, such as uncompetitive products, poor cash flow, or internal inefficiencies. This stage involves determining the extent of the damage caused by these problems.
- **Stage Two - Analyze the Situation and Develop a Strategic Plan**: Evaluate the chances of the company's survival and develop a strategic plan that outlines the corrective actions to be taken. This includes identifying appropriate strategies to address internal inefficiencies, improve competitiveness, and enhance employee morale.
- **Stage Three - Implementing an Emergency Action Plan**: If the situation is critical, an immediate action plan must be executed to stabilize the business. This may involve cutting costs, ensuring positive cash flow, raising necessary funds, and addressing short-term operational issues.
- **Stage Four - Restructuring the Business**: Focus on restructuring the company's core business operations, especially if they have been significantly affected. This stage involves efforts to improve efficiency, restructure finances, and position the company for long-term recovery and growth.

- **Stage Five - Returning to Normal**: In the final stage, the company should begin showing signs of profitability and improving financial performance. Strategic efforts such as introducing new products, improving customer service, and forming alliances should be emphasized to restore market share and build long-term sustainability.

  By following these stages, **Symergy Ltd.** can develop a comprehensive turnaround plan to regain its financial stability, improve operational efficiency, and rebuild its competitive position in the market.

(c) The company, M/s. Maa ki Pasand, is adopting a **focus strategy** that incorporates both **focused cost leadership** and **focused differentiation** strategies. In the given case, M/s. Maa ki Pasand aims to target price-conscious customers by charging low prices relative to other firms within the narrow market of baby care products. This aligns with **focused cost leadership**, where the firm competes based on price within a targeted niche.

For the segment of customers willing to pay more for premium, unique products, the company follows a **focused differentiation strategy**. It caters to this specific niche by offering high-end, differentiated products, which is a key feature of focused differentiation.

Advantages of using a Focus Strategy:

1. **Premium prices**: For the differentiated segment, the company can charge higher prices for its upscale products.
2. **Expertise in niche markets**: M/s. Maa ki Pasand can develop expertise in both price-sensitive and premium segments, making it difficult for rivals to compete effectively.

Disadvantages of Using a Focus Strategy:

1. **Distinctive competencies required**: The firm needs to have strong competencies in both cost control and product differentiation to succeed. Otherwise, it may struggle to pursue the focus strategy effectively.
2. **High costs**: Serving a narrow market can lead to higher costs due to limited demand, which could pose challenges in maintaining profitability, especially in the premium segment.

3. **Disappearance in long run**: In the long run, the niche goods can disappear or be taken over by large competitors by acquiring the same distinctive competencies.

In conclusion, M/s. Maa ki Pasand is adopting a **focus strategy** by targeting specific customer niches with both cost leadership and differentiation. While this strategy offers opportunities for premium pricing and market expertise, it also comes with challenges related to cost control and distinctive competencies.

Question 6

(a) Explain in brief the term 'objectives' as part of strategic intent. Also outline the characteristics, the objectives of a company must possess to be meaningful and to serve the intended role. ***(5 Marks)***

(b) Value Chain Analysis consist two activities: Primary activities and Support activities. As per Michael Porter both the activities are intertwined. Do you agree with the statement? Also delineate the main areas in which primary activities of any organization are grouped. ***(5 Marks)***

Answer

(a) Objectives are an **organization's performance targets** – the results and outcomes it wants to achieve. They **function as yardstick** for tracking an organization's performance and progress. Objectives with strategic focus relate to outcomes that strengthen an organization's overall business position and competitive vitality.

Objectives, to be meaningful to serve the intended role, must possess the following characteristics:

- Objectives should define the organisation's relationship with its environment.
- They should be facilitative towards achievement of mission and purpose.
- They should provide the basis for strategic decision-making.
- They should provide standards for performance appraisal.
- They should be concrete and specific.

- They should be related to a time frame.
- They should be measurable and controllable.
- They should be challenging.
- Different objectives should correlate with each other.
- Objectives should be set within the constraints of organisational resources and external environment.

(b) Yes, I agree with the statement that Value Chain Analysis consist of two activities: Primary activities and Support activities. As per Michael Porter both the activities are intertwined. It is a tool used to examine the activities that create value in an organization, helping to enhance efficiency and build competitive advantage. It breaks down a business's operations to identify areas for improvement in value creation.

The **primary activities** of an organization are categorized into five areas:

1. **Inbound logistics**: Activities related to receiving, storing, and distributing inputs (e.g., materials handling, stock control, and transport).
2. **Operations**: Transforming inputs into final products or services (e.g., machining, packaging, assembly).
3. **Outbound logistics**: Collecting, storing, and delivering products to customers (e.g., warehousing, transport).
4. **Marketing and sales**: Promoting and selling the product or service, including advertising and sales administration.
5. **Service**: Enhancing or maintaining product value (e.g., installation, repair, training).

Question 7

(a) Explain the four specific criteria of sustainable competitive advantages that a company can use to determine the capabilities that are core competencies. ***(5 Marks)***

(b) Start-ups rarely aim for stability strategy. While agreeing with the statement or otherwise, support your point of view by briefly stating as to when the stability strategy is meaningful. State the major reasons for

considering stability strategy as one of the corporate strategies by a company. ***(5 Marks)***

Answer

(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 require 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 this. 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) **Agree with the given statement.** Start-ups rarely aim for a stability strategy because they are in the **early stages of ideation and development**, where **speed and agility** are critical. Stability strategy is more relevant for businesses that have reached maturity, where maintaining current operations and market share becomes a priority. Start-ups, however, focus on rapid growth and market penetration, and

stability is usually considered when a business has expanded to full capacity.

A stability strategy is meaningful in the following scenarios:

- When a firm continues serving the same markets with the same products and services.
- Firms whose products are in the maturity stage of the product life cycle or who have a substantial market share may opt for stability to retain their position.
- Stability helps consolidate gains after rapid expansion, optimize returns on committed resources, and enhance functional efficiencies.

Major reasons for choosing a stability strategy include:

- Maturity of products in the life cycle.
- Comfort of staff with fewer changes and risks.
- Stable external environment.
- A need to consolidate after rapid growth or expansion.
- Where it is not advisable to expand as it may be perceived as threatening.

Question 8

(a) In light of the five forces as propagated by Michael Porter, explain the common barriers which may cause restrain for the keenness of new entrepreneurs. ***(5 Marks)***

(b) Strategic performance measures are key indicators that organizations use to track the effectiveness of their strategies and make informed decisions about resource allocation. In light of the statement, state various types of Strategic performance measures. ***(5 Marks)***

OR

(b) Explain the pointers for navigating change during digital transformation.

(5 Marks)

SUGGESTED ANSWER

FINANCIAL MANAGEMENT AND STRATEGIC MANAGEMENT

Answer

(a) In light of Michael Porter's Five Forces, new entrepreneurs often face significant barriers that restrain their keenness to enter an industry. These barriers increase the competitiveness of existing firms and discourage new entrants, impacting industry profitability.

Common barriers that may restrain new entrepreneurs include:

(i) Capital Requirements: When a large amount of capital is required to enter an industry, firms lacking funds are effectively barred from the industry, thus enhancing the profitability of existing firms in the industry.

(ii) Economies of Scale: Many industries are characterized by economic activities driven by economies of scale. Economies of scale refer to the decline in the per-unit cost of production (or other activity) as volume grows.

(iii) Product Differentiation: Product differentiation refers to the physical or perceptual differences, or enhancements, that make a product special or unique in the eyes of customers.

(iv) Switching Costs: To succeed in an industry, new entrant must be able to persuade existing customers of other companies to switch to its products. When such switching costs are high, buyers are often reluctant to change.

(v) Brand Identity: The brand identity of products or services offered by existing firms can serve as another entry barrier. Brand identity is particularly important for infrequently purchased products that carry a high unit cost to the buyer.

(vi) Access to Distribution Channels: The unavailability of distribution channels for new entrants poses another significant entry barrier. Despite the growing power of the internet, many firms may continue to rely on their control of physical distribution channels to sustain a barrier to entry to rivals.

(vii) Possibility of Aggressive Retaliation: Sometimes the mere threat of aggressive retaliation by incumbents can deter entry by other firms into an existing industry.

(b) Strategic performance measures are key indicators used by organizations to track the effectiveness of their strategies and make informed decisions about resource allocation. These measures provide a snapshot of performance, enabling leaders to assess whether their strategies align with organizational goals and make necessary adjustments for improvement.

Types of strategic performance measures include:

1. **Financial Measures**: These include revenue growth, return on investment (ROI), and profit margins, which help in understanding the financial performance and profitability of the organization.
2. **Customer Satisfaction Measures**: Metrics like customer satisfaction, retention, and loyalty give insights into how well the organization meets customer needs and the quality of its products and services.
3. **Market Measures**: Market share, customer acquisition, and referrals indicate the organization's competitiveness and ability to attract and retain customers in the marketplace.
4. **Employee Measures**: Employee satisfaction, turnover rate, and engagement provide insights into the organization's ability to create a positive work environment and retain talent.
5. **Innovation Measures**: These include R&D spending, patent applications, and new product launches, reflecting the organization's capacity to innovate and meet evolving customer demands.
6. **Environmental Measures**: Environmental measures such as energy consumption, waste reduction, and carbon emissions offer insights into the organization's impact on the environment. These measures help track sustainability efforts and ensure that the organization is operating in an eco-friendly and socially responsible manner.

   These measures help organizations ensure their strategies are effectively executed, aligned with their objectives, and adaptable to changes in both market and environmental contexts.

Or

Any organisation may find the work of digital transformation challenging and overwhelming. To ensure that a digital transition is effective, change

management is essential. Here are some pointers for navigating change during the digital transformation:

1. **Specify the digital transformation's aims and objectives:** What is the intended outcome? What are the precise objectives that must be accomplished? It will be easier to make sure that everyone is on the same page and pursuing the same aims if everyone has a clear grasp of the goals.
2. **Always, always, always communicate:** It might be challenging for people to accept change and adjust to it. Ensure that you routinely and honestly discuss the objectives of the digital transformation and how they will affect stakeholders, including employees, clients, and other parties.
3. **Be ready for resistance:** Even when a change is for the better, it can be challenging for people to embrace it. Have a strategy in place for dealing with any resistance that may arise.
4. **Implement changes gradually:** Changes should ideally be implemented gradually rather than all at once. In order to avoid overwhelming individuals with too much change at once, this will give people time to become used to the new way of doing things.
5. **Offer assistance and training:** Workers will need guidance in the new procedures, software applications, etc.

In conclusion, effective completion of the massive project known as digital transformation depends on meticulous planning and change management. Digital transformation efforts are more likely to fail without change management. Organizations can successfully integrate a new digital system by planning for and managing the changes that must take place. Any project involving digital transformation must include it.