**Mock Test Paper - Series I: July, 2024**

**Date of Paper: 3rd August, 2024**

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

**INTERMEDIATE: GROUP – II**

**PAPER – 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)**

## 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)**

**Mock Test Paper - Series I: July, 2024**

**Date of Paper: 3rd August, 2024**

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

**INTERMEDIATE: GROUP – II**

**PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT**

**PAPER 6A : FINANCIAL MANAGEMENT**

**Suggested Answers/ Hints**

**DIVISION A**

**1. (c) 18.65%, 16.58%**

Ke under two approaches

**Calculation of Ke (Using Gordon's Model)**

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

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

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

$(1 + g)^5 = 2.01$

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

D1 = 8 + 15% of 8 = 9.2

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

Po = (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%<br>**Total Ke = 17.82%** |

**3. (b) 12%**

Intrinsic Value of Debentures today is ₹ 9,740

**WN 1 – Calculation of the Pattern of Future Cash flows**

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

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

**4. (c) 16.07%, ₹ 87,75,000**

Ko = Wd x Kd + We x Ke

= 0.3 X 12 + 0.7 X 17.82

**= 16.07%**

**Purchase Consideration using M-Cap method**

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

**= ₹ 87,75,000**

**5. (d) ₹ 66,58,997**

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

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

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

**6. (d) 19.5%**

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

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

CL = 6.5 (Measure of total risk)

OL = 1 / Margin of Safety

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

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

Therefore, OL = 1 / 0.25 = 4

So, FL = 6.5 / 4 = 1.625

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

**7. (c) 1:2**

| Item | Cost | Weight | Product |
|---|---:|---:|---:|
| Debt | 8% | W | 8W |
| Equity | 11% | 1 – W | 11 – 11W |
| | | | **WACC = 10** |

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

**8. (c) ₹ 350 Lakhs**

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

Value of Debt = ₹ 150 Lakhs

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

## DIVISION B – Descriptive Questions

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

$$= ₹\ 7{,}20{,}000 - 25\% \times ₹\ 7{,}20{,}000 = ₹\ 5{,}40{,}000$$

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

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

3. Let Opening Stock be x.

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

Closing Stock = (x + 30,000)

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

2x = 2,16,000 – 30,000

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

Closing Stock = x + 30,000

= 93,000 + 30,000 = ₹ 1,23,000

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

Liquid Assets = ₹ 3,00,000

5. Current Assets = Liquid Assets + Closing Stock

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

**(b)** Calculation of slab wise Overall Cost of Capital

**(i)**

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

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

**Cost of Raising funds for Project I**

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

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

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

= 12.95 %

**Cost of Raising funds for Project II**

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

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

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

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

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

At 15 Lakhs Ko = 12.95%

At 26 Lakhs Ko = 13.79%

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

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

**= 15.6548 lakhs**

**(c) Income Statement**

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

EBT + ₹ 2000 = 2 EBT.

EBT = ₹ 2,000

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

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

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

**2. (a)**

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

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

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

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

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

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

Where,

$P_0$ = Price per share

$E_1$ = Earnings per share

Payout ratio = 45/180 = 25%

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

$K_e$ = Cost of capital

r = IRR

br = Growth rate (g)

Applying the above formula, price per share

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

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

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

Where,

P = Market Price of the share.

E = Earnings per share.

D = Dividend per share.

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

r = Internal rate of return/ return on investment

Applying the above formula, price per share

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

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

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) - $5^{th}$ Year end

Capital Gains = Sale Price (-) Closing WDV at $5^{th}$ year

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

= 11,152

Tax @ 20% on above = 2230.40

PV = 2,230.40 x 0.5674 = 1,266

Net PVCI = PVCI - PV of Tax on Capital Gains

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

NPV = Net PVCI – PVCO

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

= 22,73,991

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

(III) ARR = Average NPAT / Initial Investment

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

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

**(b)** Lintner's model has two parameters:

i. The target payout ratio,

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

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

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

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

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

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

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

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

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

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

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

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

**OR**

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

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

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

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

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

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

# PAPER 6B: STRATEGIC MANAGEMENT

## ANSWERS

## PART I

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

## PART II

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

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

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

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

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

**SWOT Analysis Grid for GreenGardens:**

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

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

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

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

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

- **Stage One – Assessment of current problems**: In the first step, assess the current problems and get to the root causes and the extent of damage.
- **Stage Two – Analyze the situation and develop a strategic plan:** Identify major problems and opportunities, develop a strategic plan with specific goals and detailed functional actions after analyzing strengths and weaknesses in the areas of competitive position.
- **Stage Three – Implementing an emergency action plan**: If the organization is in a critical stage, an appropriate action plan must be developed to stop the bleeding and enable the organization to survive.
- **Stage Four – Restructuring the business**: If the core business is irreparably damaged, then the outlook for the entire organization may be bleak. Efforts to be made to position the organization for rapid improvement.
- **Stage Five – Returning to normal**: In the final stage of turnaround strategy process, the organization should begin to show signs of profitability, return on investments and enhancing economic value-added.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

The role of Chief Executive Officer is to:

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

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

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

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

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

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

- **Competitor differentiation:** The company can consider having a core competence if the competence is unique and it is difficult for competitors to imitate. This can provide a company an edge compared to competitors. It allows the company to provide better products or services to market with no fear that competitors can copy it.
- **Customer value:** When purchasing a product or service it has to deliver a fundamental benefit for the end customer in order to be a core competence. It will include all the skills needed to provide fundamental benefits. The service or the product has to have real impact on the customer as the reason to choose to purchase them. If customer has chosen the company without this impact, then competence is not a core competence.
- **Application of competencies to other markets:** Core competence must be applicable to the whole organization; it cannot be only one particular skill or specified area of expertise. Therefore, although some special capability would be essential or crucial for the success of business activity, it will not be considered as core competence, if it is not fundamental from the whole organization's point of view. Thus, a core competence is a unique set of skills and expertise, which will be used throughout the organisation to open up potential markets to be exploited.

**OR**

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

1. **Relevance:** The measure should be relevant to the organization's goals and objectives, providing actionable and meaningful information. This ensures that the performance measures are directly aligned with what the organization aims to achieve, and that the information obtained can drive improvements and strategic decisions.
2. **Data Availability:** The measure should be based on data that is readily available and can be collected and analyzed in a timely manner. This is important to ensure that the organization can efficiently gather and utilize data without significant delays or obstacles.

3. **Data Quality:** The measure should be based on high-quality data that is accurate and reliable. Accurate and reliable data are crucial for making informed decisions and assessing the true performance of the organization.

4. **Data Timeliness:** The measure should be based on data that is current and up-to-date. Timely data allows organizations to make informed decisions quickly, enabling them to respond promptly to changes and emerging challenges.

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