Mock Test Paper - Series II: December, 2024

Date of Paper: 14th December, 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.

Case Scenario I:

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

The capital structure of MNP Ltd. is as under:

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

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

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

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

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

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

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

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

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

   (a) 14%

   (b) 15%

   (c) 16%

   (d) 17%

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

   (a) 6.11%

   (b) 5.48%

   (c) 9%

   (d) 10.55%

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

   (a) 10.57 %

   (b) 5.11%

   (c) 9%

   (d) 10%

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

   (a) 12.80 %

(b) 5.11%

(c) 9%

(d) 10.55%

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

(a) 40 per share

(b) 20 per share

(c) 30 per share

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

6. EBIT = 4,00,000

EBT = 3,00,000

Sales = 16,00,000

Which of the following is / are correct?

1. DFL is 1.33
2. Interest coverage ratio is 3
3. Operating profit margin is 25%

Select the correct answer using the code given below:

(a) 1, 2 and 3

(b) 1 and 2 only

(c) 1 and 3 only

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

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

(a) Rs. 90,000

(b) Rs. 70,000

(c) Rs. 1,50,000

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

8. Margin of safety is affected if:

1. P/V ratio changes
2. Fixed cost changes
3. Volume of sales changes

(a) 1 only

(b) 1 and 2 only

(c) 2 and 3 only

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

PART II – Descriptive Questions (35 Marks)

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

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

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

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

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

Expenses include depreciation of Rs. 90,000.

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

- — Total sales for the year were 20% higher as compared to previous year.
- — Balances as on 31st March, 2024 were : Stock Rs. 5,20,000, Creditors Rs. 4,15,000, Debtors Rs. 4,95,000 and Cash balance Rs. 3,10,000.
- — Percentage of Gross profit on turnover has gone up from 20% to 25% and ratio of net profit to sales from 15% to 16%.
- — A portion of Fixed assets was very old (book values Rs. 1,80,000) disposed for Rs. 90,000. (No depreciations to be provided on this item).
- — Long-term investments were purchased for Rs. 2,96,600.
- — Bank overdraft fully discharged.

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

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

(5 Marks)

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

(c) The following data relates to Beta Limited:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

OR

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

PAPER 6B: STRATEGIC MANAGEMENT

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

PART I – Case scenario based MCQs (15 Marks)

Question 1. (A) (Compulsory)

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(B) Compulsory Application Based Independent MCQs

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

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

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

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

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

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

(a) The need for continuous innovation.

(b) The importance of understanding the competitive landscape.

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

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

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

(a) Maturity

(b) Introduction

(c) Growth

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

PART II – Descriptive Questions (35 Marks)

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

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

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

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

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

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

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

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

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

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

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

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

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

OR

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

Mock Test Paper - Series II: December, 2024
Date of Paper: 13th December, 2024
Time of Paper: 2 P.M. to 5 P.M.

INTERMEDIATE: GROUP – II

PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A : FINANCIAL MANAGEMENT

Suggested Answers/ Hints

PART I – Case Scenario based MCQs

1. **(b)** Ke $= \frac{D1}{P0} + g$

$= \frac{2}{20} + 0.05 = 15\%$

2. **(b)** $K_d = \frac{I(1-t)+\frac{(RV-NP)}{n}}{\frac{(RV+NP)}{2}} = \frac{9(1-0.35)+\frac{(100-102.90)}{10}}{\frac{(100+102.90)}{2}} = 5.48\%$

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

$K_p = \frac{11+\left(\frac{100-102.82}{10}\right)}{\left(\frac{100+102.82}{2}\right)} = 10.57\%$

4. **(a)** **Calculation of WACC using market value weights**

Source of capital	**Market Value**	**Weights**	**After tax cost of capital**	**WACC (K_o)**
	(₹)	**(a)**	**(b)**	**(c) = (a)×(b)**
Debentures (₹ 105 per debenture)	2,88,750	0.1672	0.0548	0.0092
Preference shares (₹ 106 per preference share)	2,38,500	0.1381	0.1057	0.0146
Equity shares (₹ 24)	12,00,000	0.6947	0.1500	0.1042
	17,27,250	1.00		0.1280

WACC (K_o) = 12.80%

5. **(a)** Current Market Price $= \frac{D_1}{Ke-g}$

$$= \frac{2}{0.10 - 0.05} = ₹\ 40 \text{ per share}$$

6. **(c)** DFL $= \frac{EBIT}{EBT}$

DFL = 4,00,000/3,00,000 = 1.33

Interest Coverage Ratio $= \frac{EBIT}{\text{Interest Expense}}$

= 4,00,000/1,00,000 = 4

Operating Profit Margin $= \frac{Sales}{EBIT} x100$

Operating Profit Margin = (4,00,000/16,00,000) × 100 = 25%

7. **(c)** COGS = Sales x (1−Gross Profit Margin)

COGS = 6,00,000 x (1−0.20) = 6,00,000 x 0.80 = 4,80,000

The velocity of stock is 3 months.

stock turnovers per year (12/3) = 4

Stock Turnover Ratio = COGS / Average Stock

Average Stock = 4,80,000/4 = 1,20,000

Average Stock = (Opening Stock + Closing Stock)/2

Closing Stock = 1,50,000

8. **(d)** 1, 2 and 3

PART II – Descriptive Questions

1. **(a)** **Balance Sheets of Alpha Limited**

Liabilities	₹		***Assets***	₹	
	31 March 2023	***31 March 2024***		***31 March 2023***	***31 March 2024***
Equity share capital (₹ 10 each fully paid)	20,00,000	20,00,000	Fixed Assets (₹18,90,000– ₹90,000)	18,00,000	15,39,000
Reserve and Surplus (balancing)	1,30,000	1,30,000	Long term investment	–	2,96,600
Profit & Loss A/c (15% of sales)	2,70,000	6,15,600	**Current Assets** (₹ 10,00,000)		

Current Liabilities			Stock	4,00,000	5,20,000
Bank Overdraft	1,00,000	–	Sundry Debtors	3,00,000	4,95,000
Creditors	3,00,000	4,15,000	Cash at Bank (Balancing)	3,00,000	3,10,000
Total	**28,00,000**	**31,60,600**	**Total**	**28,00,000**	**31,60,600**

Calculation for 31st March, 2023

(i) Calculation of Current Liabilities

Suppose that Current Liabilities = x, then current assets will be 2.5 x

Working capital = Current Assets – Current Liabilities

6,00,000 = 2.5x – x

x = 6,00,000 / 1.5 = ₹ 4,00,000 (C.L.)

Other Current Liabilities = Current Liabilities – Bank Overdraft

(Creditors) = 4,00,000 – 1,00,000 = ₹ 3,00,000

Current Assets = 2.5 x 4,00,000 = ₹ 10,00,000

(ii) Liquid Ratio $= \dfrac{\text{Liquid Assets}}{\text{Current Liabilities}}$

$1.5 = \dfrac{\text{Liquid Assets}}{4{,}00{,}000}$

Liquid assets = ₹6,00,000

Liquid assets = Current Assets – Stock

6,00,000 = 10,00,000 – Stock

So, Stock = ₹ 4,00,000

(iii) Calculation of fixed assets: Fixed assets to proprietary fund is 0.75, working capital is therefore 0.25 of proprietary fund. So,

Fixed Assets = 6,00,000 / 0.25 x 0.75 = ₹ 18,00,000

(iv) Sales = (14,40,000 / 80) × 100 = ₹ 18,00,000

(v) Debtors $= \dfrac{2}{12} \text{ x Sales}$

2 / 12 × 18,00,000 = ₹ 3,00,000

(vi) Net profit = 15% of ₹18,00,000 = ₹ 2,70,000

Calculation for the year 31st March, 2024

(vii) Sales = 18,00,000 + (18,00,000 × 0.2) = 21,60,000

(viii) Calculation of fixed assets

	₹		₹
To Opening balance	18,00,000	By Banks (Sale)	90,000
		By Loss on sales of Fixed asset	90,000
		By P & L (Dep.) (5% as in previous year)	81,000
		By Balance b/d	15,39,000
Total	18,00,000		18,00,000

(ix) Net profit for the year 2011, 16% × 21,60,000 = ₹ 3,45,600

Total Profit = 2,70,000 + 3,45,600 = ₹ 6,15,600

(b) EBIT = ₹ 3,00,000

Less: Interest = ₹ 10,00,000 × 10% = ₹ 1,00,000

Earnings available to equity shareholders = ₹ 2,00,000

Equity capitalization rate = 12.5%

Market value of equity = $\frac{₹\ 2,00,000}{12.5\%}$ = ₹ 16,00,000

Market value of debt = ₹ 10,00,000

Market value of the firm = ₹ 26,00,000

Overall cost of capital = $\frac{₹\ 3,00,000 \times 100}{₹\ 26,00,000}$ = 11.54%

(c) (i) **Increase in taxable income if sales increase by 6%.**

Combined Leverage= $\frac{\text{Contribution}}{\text{EBT}} = \frac{₹\ 1,40,000}{₹\ 35,000} = 4$

If the sales increases by 6%, EBT will increase by 24%. (4 × 6%)

(ii) Increase in EBIT if sales increase by 10%.

Operating Leverage= $\frac{\text{Contribution}}{\text{Earnings before interest and tax}} = \frac{₹1,40,000}{₹\ 40,000} = 3.5$

If sales increases by 10%, EBIT will increase by (3.5× 10) 35%.

(iii) Increase in taxable income if EBIT increase by 6%.

Financial Leverage = $\frac{\text{Earnings before interest and tax(EBIT)}}{\text{EBT}} = \frac{₹\ 40,000}{₹35,000}$

=1.14

If EBIT increases by 6%, EBT will increase by 6.8%. (1.14 × 6%)

2. (a) Problem mentions that the company has applied to the Private Bank for financing its working capital needs. Ideally, banks would not finance for Depreciation cost being a non-cash cost and it would also not finance the profit for you. So, problem needs to be solved using Cash Cost Basis.

Estimation of working capital required (cash cost basis)

	Particulars		Amount
	A) Current Assets		
	A1) Stock of RM	15,84,960 x 30/360	1,32,080.00
	A2) Stock of WIP	(From Cost Statement)	4,77,360.00
	A3) Stock of FG	(From Cost Statement)	2,37,500.00
	A4) Debtors	32,74,686 x 45/360	4,09,335.75
	A5) Cash & Cash Equivalents	(Given)	1,25,000.00
	Gross Working Capital		**13,81,275.75**
Less:	**B) Current Liabilites**		
	B1) Creditors	17,17,040 x 30/360	1,43,086.67
	B2) Lag in Wages Payment	9,20,400 x 15/360	38,350.00
	Excess of Current Assets Over Current Liabilites	(A) - (B)	**11,99,839.08**
Add:	Safety Margin @ 15% Of Net Working Capital		2,11,736.31
	Net Working Capital		**14,11,575.39**

WN -1: Calculation of Profit

Profit = 25% of total cost i.e 20% of sales price

= {(31,200-2,500) x 150} x 20% = Rs. 8,61,000

WN – 2:

	Completed Units	WIP Units
	31,200	9,360
Raw Mat. Consumed	12,48,000	3,36,960
Direct Wages	7,80,000	1,40,400
Overheads	9,36,000	1,68,480
	29,64,000	6,45,840
Gross Factory Cost	**36,09,840**	

Add: Op WIP	-
Less: Cl. WIP **(At Prime Cost)**	4,77,360
Cost of Production	**31,32,480**
Add: Op FG Stock	-
Less: Cl. FG Stock	2,37,500
Cash Cost of Goods Sold	**28,94,980**
Add: Selling & Distribution Expenses (Bal. Figure)	3,79,706
Cost Of Sales	**32,74,686**
Profit*	8,61,000
Sales	**41,35,686**

*It is assumed that profit is unchanged

WN 3 - Calculation of WIP stock (units) and WIP stock amount

WIP UNITS = 30% of FG produced units i.e 30% of 31,200 units

= 9,360 units

WIP amount (at prime cost)

Raw materials = 9,360 x 40 x 90% = 3,36,960

Direct wages = 9,360 x 25 x 60% = 1,40,400

WN 4 - Calculation of purchases from suppliers

Raw Materials Consumed = OP RM Stock + Purchases - Closing RM Stock

15,84,960 = 0 + Purchases – 1,32,080

Purchases = 17,17,040

WN 5 – Calculation of safety margin

Safety Margin = 15% Of Net Working Capital Needs

Excess Of CA Less CL	85	11,99,839.08
Safety Margin	15	2,11,736.31
Net Working Capital	100	1411575.388

(b) EPS = ROE x BVPS (WN 1)

EPS = 0.15 x 125 = ₹ 18.75

Growth = ROE x Retention Ratio

= 0.15 x 0.65

= 9.75%

D1 = Do (1 + g)

= (18.75 x 35%)(1 + 0.0975)

= ₹ 7.20

Intrinsic Value of share today - Gordon's Formula

$$Po = \frac{D_1}{Ke-g}$$

$$= \frac{7.20}{0.20-0.0975}$$

Po = ₹ 70.24

Intrinsic Value of share today - Walter's Model

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

Here D = Do assuming it would remain constant through infinity

$$Po = \frac{6.5625 + \frac{0.15}{0.20}(18.75-6.5625)}{0.20}$$

Po = ₹ 78.51

WN 1 - Relationship between ROE-EPS-BVPS

$$ROE = \frac{\text{Earnings for Equity Shareholders}}{\text{Equity shareholders funds}}$$

If we divide the numerator and denominator with "**No of equity shares**"

$$ROE = \frac{\text{Earnings for Equity Shareholders / No of equity shares}}{\text{Equity shareholders funds / No of equity shares}}$$

Therefore, ROE = EPS / BVPS

3. Calculation of NPV (Amount in crores)

Year	1	2	3	4	5	6	7	8	9	10
EBT	2.000	2.500	4.000	4.750	6.000	6.400	6.150	5.250	3.800	2.900
Add: Interest	0.195	0.195	0.195	0.252	0.252	0.252	0.252	0.252	0.252	0.252
Add: Allocated Common Cost	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125
Project Profit Before Tax	2.320	2.820	4.320	5.127	6.377	6.777	6.527	5.627	4.177	3.277
Less: Tax	-	-	-	1.154	1.435	1.525	1.469	1.266	0.940	0.737
Profit After Tax	2.320	2.820	4.320	3.973	4.942	5.252	5.058	4.361	3.237	2.539
Add: Depreciation	2.410	2.410	2.410	2.410	2.410	2.410	2.410	2.410	2.410	-
Cash Inflows	4.730	5.230	6.730	6.383	7.352	7.662	7.468	6.771	5.647	2.539

Add: Release Of Working Capital	-	-	-	-	-	-	-	-	-	5.000
Add: Net Cash Inflow from sale of asset (Net Of Tax) (WN-3)	-	-	-	-	-	-	-	-	-	3.471
Total Cash Inflows	4.730	5.230	6.730	6.383	7.352	7.662	7.468	6.771	5.647	11.010
DF @ 15%	0.870	0.756	0.658	0.572	0.497	0.432	0.376	0.327	0.284	0.247
PV Cash Inflow	4.113	3.955	4.425	3.650	3.655	3.312	2.808	2.213	1.605	2.722

TOTAL PV CI = 32.458 Crores

(-) TOTAL PVCO = 30.000 Crores (Initial Outlay + Working Capital)

NPV = 2.458 Crores

ADVISE - Since NPV is positive, company should go for the project.

Notes - 1. Allocated common costs are to be excluded from cash inflows

2. Dividend distribution are deemed irrelevant for cash flow analysis

3. Discounting rate = MCLR + premium = 12 + 3 = 15%

4. Interest exp is to be excluded from the cash inflows as it is already getting covered in the discounting rate above

5. Professional fees paid for project report and R&D costs being sunk costs are irrelevant for decision making

WN 1 – Calculation of applicable taxes each year

For the first 3 years, tax will be zero and for the next 7 years tax rate applicable would 22.5% (30 x 0.75) as balance tax will be paid in Australia, so it will have no relevance under India perspective calculations.

WN – 2 Calculation of interest expense each year

Since post tax interest rate is given in the question, firstly it needs to be converted to pre-tax rate. However, for the first 3 years of the project, post-tax and pre-tax rate would be same owing to zero taxes

Interest Expense (first 3 years) = 3,00,00,000 X 6.5% = 19,50,000 or 0.195 crores

Interest Expense (next 7 years) = 3,00,00,000 x 8.39% = 25,17,000 or 0.2517 crores

$$\text{Pre-tax Interest Rate} = \frac{\text{Post tax Rate}}{1 - \text{India Tax Rate}}$$

= 6.5 / (1 - 0.225)

= 8.39%

WN 3 – CALCULATION OF CAPITAL GAINS INCOME IN YEAR 10

Cost of Asset remaining in the block at the beginning of Year 10

= 3,31,00,000 (2,41,00,000 + 90,00,000)

(+) New Asset purchased during the year = 0

(-) Sale Value of the Asset = 3,50,00,000

Capital Gains Income before tax = 19,00,000

(-) Capital Gains tax = 19,00,000 x 15% = 2,85,000

Net Cash Inflow after tax = 3,50,00,000- 2,85,000

= 3,47,15,000

B) Current Payback Period = 4 + 1.927 /7.352

= 4.262 years

Target Payback Period = 3.5 years

Some key measures to reduce your Payback period are as follows (Only illustrative):

i. Emphasizing on reduction of operational costs

ii. Improving marketing thereby resulting into higher sales

iii. Incorporate product-led growth strategies

iv. Judicious efforts in bringing down the overall cost of capital thereby reducing the discounting rate and in turn better Payback period.

v. Leveraging out the presence of the fixed cost

4. (a)

Particulars	Factoring	Forfaiting
A) Meaning	**Factoring** involves sales of receivables to the financial institution called factor in exchange for immediate cash payment	**Forfaiting** is a form of export financing where the exporter sells the rights to trade receivables to a forfaiter and receives instant cash
B) Recourse or non-recourse	May be on Recourse or Non-recourse basis	Always non-recourse
C) Amount paid	Firms are generally paid 80% to 90% upfront	100% on the value of exported goods is paid
D) Type of receivables	Receivables may either domestic or international	Receivables are international
E) Cost	Factoring cost in the form of factor commission or fees is to be borne by the seller	Overseas Buyer bears the forfaiting cost, if any

F) Secondary market	Factoring does not involve a secondary market for the receivables, meaning that the transaction is complete once the receivables are sold to the factor.	Forfaiting has a secondary market where the receivables can be traded, enhancing liquidity and providing additional opportunities for investors

(b) Some of the tasks that demonstrate the importance of good financial management

- Taking care not to over invest in fixed assets
- Balancing cash-outflows with cash-inflows
- Ensuring that there is a sufficient level of working capital
- Setting sales revenue targets that will deliver growth
- Increasing the Gross profit by setting the correct pricing for products or services
- Controlling the level of general and administration expenses by finding more cost-efficient ways of running the day-to-day business operations
- Tax Planning that will minimize the taxes a business has to pay

(c) A drop lock is an arrangement whereby the interest rate on a floating-rate note becomes fixed if it falls to a specified level. Above that level the rate floats based on a benchmark market rate, typically with a semi-annual reset. In other words, drop lock bonds marry the attributes of both floating-rate securities and fixed-rate securities. The drop lock effectively sets a floor on the rate and a guaranteed minimum return to

Or

(c) **Advantage to the Company -** Stock dividends are suitable in the situation of cash crunch and deficiency faced by the company and suitable when restrictions are imposed by lenders to pay the cash dividend

Advantage to the investor – Improves liquidity in the hands of the investors as bonus shares leads to breaking down of higher priced shares into lower priced shares and hence give a choice to shareholders to sell some of the lower priced shares and get some liquidity

PAPER 6B: STRATEGIC MANAGEMENT

ANSWERS

PART I

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

PART II

1. (a) The scenario being referred to is culture in *Jupiter Electronics*. Strong culture promotes good strategy execution when there's fit and impels execution when there's negligible fit. A culture grounded in values, practices, and behavioral norms that match what is needed for good strategy execution helps energize people throughout the organization to do their jobs in a strategy-supportive manner. A culture built around such business principles as listening to customers, encouraging employees to take pride in their work, and giving employees a high degree of decision-making responsibility. This is very conducive to successful execution of a strategy of delivering superior customer service.

A strong strategy-supportive culture makes employees feel genuinely better about their jobs and work environment and the merits of what the company is trying to accomplish. Employees are stimulated to take on the challenge of realizing the organizational vision, do their jobs competently and with enthusiasm, and collaborate with others.

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

- **Tangible and Intangible Aspects:** *Reshuffle Corp* can focus on the tangible aspects of its products, such as using high-quality materials and innovative designs to create furniture that is both functional and aesthetically pleasing. Additionally, they can emphasize the intangible aspects of their products, such as excellent customer service and a strong brand reputation for reliability and durability.
- **Pricing Strategies:** While market prices are often dictated by competition, *Reshuffle Corp* can work on cost optimization to maintain profitability. They can also consider offering value-added services, such as free installation or extended warranties, to justify a higher price point.
- **Product Features:** By continually optimizing their product features based on customer feedback and market trends, *Reshuffle Corp* can ensure that their products deliver maximum satisfaction to their target customers. This may include features that enhance functionality, design, quality, and overall user experience.
- **Product Centric Approach:** *Reshuffle Corp* should keep their products at the center of their strategic activities, ensuring that all

business processes, from production to sales and marketing, are aligned to meet customer needs and expectations.

- **Product Life Cycle Management:** *Reshuffle Corp* should be aware of the life cycle of their products and plan for reinvention or replacement accordingly. They can introduce new product lines or upgrade existing ones to keep up with changing customer preferences and market trends.

(c) By concentrating primarily on the market for consultancy services in environmental management, the firm is pursuing a **focus strategy**. Its provision of audit services, which rival firms do not offer, highlights a **differentiation strategy** within this specific market niche. Therefore, the firm is following a **focused differentiation strategy**.

A focused differentiation strategy involves offering unique features that cater to the specific needs of a narrow market segment. As with the focused low-cost strategy, narrow markets can be defined differently depending on the context. For instance, some firms using this strategy focus on a particular sales channel, such as exclusively selling online, while others may target specific demographic groups. Firms that compete on uniqueness while addressing the needs of a narrow market exemplify the **focused differentiation strategy**.

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

(b) SBU is a part of a large business organization that is treated separately for strategic management purposes. The concept of SBU is helpful in creating an SBU organizational structure. It is a separate part of large business serving product markets with readily identifiable competitors. It is created by adding another level of management in a divisional structure after the divisions have been grouped under a divisional top management authority based on the common strategic interests.

Very large organisations, particularly those running into several products, or operating at distant geographical locations that are extremely diverse in terms of environmental factors, can be better managed by creating strategic business units. SBU structure becomes imperative in an organisation with increase in number, size and diversity. SBUs helps such organisations by:

- Establishing coordination between divisions having common strategic interest.

- Facilitate strategic management and control.
- Determine accountability at the level of distinct business units.
- Allow strategic planning to be done at the most relevant level within the total enterprise.
- Make the task of strategic review by top executives more objective and more effective.
- Help to allocate resources to areas with better opportunities.

3. **(a)** Capabilities that are valuable, rare, costly to imitate, and non-substitutable are core competencies. A small chemist shop has a local presence and functions within a limited geographical area. Still, it can build its own competencies to gain competitive advantage. Rohit Patel can build competencies in the areas of:

(i) Developing personal and cordial relations with the customers.

(ii) Providing home delivery with no additional cost.

(iii) Developing a system of speedy delivery that can be difficult to match by online sellers. Being in the central part of the city, he can create a network to supply at wider locations in the city.

(iv) Having extended working hours for convenience of buyers.

(v) Providing easy credit or a system of monthly payments to the patients consuming regular medicines.

(b) The vision describes a future identity while the Mission serves as an on-going and time-independent guide.

The vision statement can galvanize the people to achieve defined objectives, even if they are stretch objectives, provided the vision is specific, measurable, achievable, and relevant and time bound. A mission statement provides a path to realize the vision in line with its values. These statements have a direct bearing on the bottom line and success of the organization.

A mission statement defines the purpose or broader goal for being in existence or in the business and can remain the same for decades if crafted well while a vision statement is more specific in terms of both the future state and the time frame. Vision describes what will be achieved if the organization is successful.

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

- The environment in which strategies are developed is highly complex and unpredictable. The entry of online bookstores, a new type of competitor, introduced a different dynamic to the book retail industry. These online platforms, with their extensive reach and pricing power, have dominated the market, posing a formidable challenge to traditional bookstores.

- Another limitation of strategic management is the difficulty in forecasting future developments. Despite his strategic management efforts, Vikram Patel did not anticipate the extent to which online bookstores would impact his sales.
- While strategic management is a time-consuming process, it is crucial for Vikram to continue managing strategically. These challenging times demand increased effort and adaptability on his part.
- Strategic management can be costly. Vikram Patel might consider hiring experts to understand customer preferences better and adjust his strategies to offer more personalized services. These customized offerings could be difficult for online stores to replicate, giving him a competitive edge.
- The bookstores owned by Vikram Patel are much smaller in scale compared to online stores. This makes it challenging for him to predict how online platforms will manoeuvre strategically.

(b) In the BCG growth-share matrix portfolio of investments are represented in two-dimensional space. The vertical axis represents market growth rate, and the horizontal axis represents relative market share. The strategic implications for various business types under BCG in the corporate portfolio are:

Stars are products or businesses that are growing rapidly and are the best opportunity for expansion. *Stars may follow the Build* strategy. They need heavy investments to maintain their position and finance their rapid growth potential.

Cash Cows are low-growth, high market share businesses or products. They generate cash and have low costs. They are established, successful, and need less investment to maintain their market share. *A strategic alternative advocated for cash cows is Harvest.*

Question Marks are low market share businesses in high-growth markets. *A strategic option for them is Hold for which t*hey need heavy investments. Question marks if left unattended are capable of becoming cash traps.

Dogs are low-growth, low-share businesses and products. *The relevant strategy is Divest.* Dogs may generate enough cash to maintain themselves, but do not have much future. Dogs should be minimized by means of divestment or liquidation.

OR

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

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

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

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

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