Mock Test Paper - Series II: April, 2025

Date of Paper: 7th April, 2025

Time of Paper: 10 A.M. to 1 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

Ashrav Machines Private Limited (AMPL) was started as Joint venture company in 2017 by a leading group head quartered at Mumbai, engaged into the business of automatic washing machine product segment. The company received state-of-the-art technological know-how from a well-known Japanese company named Suzutsu Inc which was its JV partner. The company had acquired superior technology through JV, and its sales were expected to grow at 10 per cent per annum. The Company has two types of customer base, retail customers and dealership customers. The company experienced a significant growth in its sales during the first 5 years of its operations, and its actual growth rate averaged about 30 per cent per annum. The company had cost and technological advantages, and therefore, could keep its prices significantly lower as compared to its competitors. Over this period, the company established its name, and its products became well-known in the market.

As the competition intensified in the washing machine market, and the general market slow-down conditions engulfed the entire economy, AMPL started experiencing a decline in its sales

from the beginning of FY 2022. The company identified poor inventory management on the retail front like piling up of inventory stocks, very high import of raw material, high selling price, etc. & poor receivables management on the dealership front like poor credit policy & collection process, bad debts, etc. as a major issue causing financial problems and decline. The company decided to work out a plan to reduce the inventory levels and rejig the receivables process and come out with feasible solutions. The concerned leadership teams in the company presented the following plans:

(1) Exploring selling the washing machines at discounted price. The company plans to offer a 5% average discount on its current price thereby resulting in a discounted price of ₹ 15,675 per machine. However, this didn't create any significant impact on sales as expected. The previous studies on market behavior to price responses in this category of product suggested less sensitivity to price reduction or discounts in the lower range. However, a price reduction above 10 per cent indicated a significant association with the increase in demand. Using these findings as the basis of their argument, the marketing team proposed a plan to provide discounts of up to 12 per cent. It provided an estimate of about 1,000 units to be sold every quarter during the year after implementing the suggestion of proposed discount.

(2) Owing to the recent trends observed in the exchange-sales scheme in the television and other electronic segments, the company wants to explore this scheme for the washing machine segment as well. Upon subsequent research, the marketing team argued that there was a good chance of an exchange scheme becoming popular provided the customers were offered an attractive exchange scheme as most of the existing machines owned by the households did not have new features which the company's product offered. The marketing team gave an estimate of selling about 4,650 units in the next one year, provided the scheme offered, off-setting ₹ 3,000 to ₹ 4,000 of the prices to customers who purchase the company's product in exchange for their existing machines. The actual deduction, however, would depend on the condition of the machines and for that, the company estimated that an average offset of ₹ 3,500 per machine would be needed.

(3) The third proposal pertains to an all-round reduction in inventory levels. If the production takes place as per the sales plan, the total inventory holding period of the company works out about 3½ months. Of this, the finished goods holding period alone is 2 to 2½ months. The company, therefore, must hold finished goods for this period to sell its products in the market. Recently, due to a slow-down in the market, this period had increased to 4 – 4½ months. As a result, the working capital requirements of the company have increased significantly. The company recently explored the possibility of selling the goods to its customers under a scheme which would deliver the machine after 1½ months of placing the order. A pilot test was carried out with a select group of customers. Based on the

results of this pilot study, the proposed scheme would offer the following package to a customer: on paying an advance of ₹ 3,000, the customer could order the product which would be delivered after 1½ months of time. As per the terms and conditions of the scheme, the customer would pay ₹ 9,500 at the time of delivery of the product. Through this scheme, the customer would get a benefit of ₹ 4,500 for this waiting period. The field tests had indicated that a section of customers would not mind waiting for 1 to 1½ months and taking this benefit. The marketing team gave an estimate that about 400 machines could be sold per month through this scheme.

(4) The current dealership sales of the company are ₹ 3,65,00,000 and it has a present policy of extending 60 days credit but most of its dealers in the recent period have stretched payments and the average collection period was about 120 days. Ninety per cent of the firm's sales are on a credit basis. Out of this, 15 per cent is sold to the customers whose financial position is not very sound and the entire bad debt losses amount to about 2 per cent of sales to these customers. The cost of Sales is 80% and the current collection expenses amount to ₹ 5,00,000 per year. After consulting the marketing and accounting staff and analyzing the status of the competition, the company has decided to change its credit policy for the dealership customers.

Policy A : To offer cash discount to motivate customers to pay early. The new credit terms would be "2/15, net 60". A quick study of sample customers indicated that about two-thirds of them might like to avail cash discounts. This change in policy would not change the expected sales, but the average collection period is likely to be reduced to 80 days for the remaining customers. There will be no changes in bad debts, but the collection cost will be reduced by 30% to the existing collection expense.

Policy B : To relax its credit standards by 20 Days to expand its sales. This is expected to increase sales by 10 per cent. The marginal customers, which would also include new customers, are not expected to take advantage of cash discounts and are likely to continue to take on an average of 150 days to pay. In the case of these customers, bad debt losses are expected to increase to 2.5 per cent on the sales to financially unsound customers, which will remain the same in proportion. The company would enforce collections with more vigour and diligence. It is expected that collection expenses will increase by ₹ 1,00,000 per annum.

The company generally requires a rate of return of 15 per cent from its investments and assume 360 days in a year.

Based on the above scenario, answer to the following MCQs:

1. Incremental benefit of adopting credit Policy A to the company is _____

   (a) ₹ 6,24,500

(b) ₹ 58,500

(c) ₹ 46,57,450

(d) ₹ (-) 6,24,500

2. Incremental benefit of adopting credit Policy B to the company is _____

(a) ₹ 27,294

(b) ₹ 8,70,444

(c) ₹ 46,84,744

(d) ₹ 2,31,444

3. Evaluate all the proposed options of inventory management and select the best sequence as per their rankings based on benefit analysis to the company in the form of sales.

(a) Proposal 1, 2 & 3

(b) Proposal 2, 3 & 1

(c) Proposal 2, 1 & 3

(d) Proposal 3, 2 & 1

4. What are the bad debt expenses of policy A and policy B?

(a) ₹ 98,550 and ₹ 98,550

(b) ₹ 1,35,506 and ₹ 98,550

(c) ₹ 98,550 and ₹ 1,35,506

(d) ₹ 1,35,506 and ₹ 1,35,506

5. The optimum combination of inventory and credit policy comes out to be _____

(a) Proposal 3 & Credit Policy 'A'

(b) Proposal 3 & Credit Policy 'B'

(c) Proposal 2 & Credit Policy 'B'

(d) Proposal 2 & Credit Policy 'A' **(5 x 2 = 10 Marks)**

6. Mr. A is holding 2,00,000 shares of ABC Ltd. It is presently trading on NSE at cum dividend price of ₹ 100 per share. Mr. A has a policy to re-invest the amount of any dividend received into the shares of ABC Ltd. again. If ABC Ltd. has declared

a dividend of ₹ 20 per share, determine the no. of shares that Mr. A would hold after he invests dividend in the shares of ABC Ltd.

(a) 1,00,000

(b) 2,50,000

(c) 2,80,000

(d) 50,000 **(2 Marks)**

7. The details of XYZ Ltd. are as follows:

Variable Cost Ratio = 60%

Operating Leverage = 5

Combined Leverage = 15

EBIT = ₹ 30,000

Tax Rate = 30%

Calculate the amount of interest.

(a) ₹ 40,000

(b) ₹ 30,000

(c) ₹ 20,000

(d) ₹ 24,000 **(2 Marks)**

8. Out of the following information, calculate Risk free rate:

Rm = 10%

Ke = 15%

β = 2

(a) 5%

(b) 7.5%

(c) 10%

(d) 15% **(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) A firm can make investment in either of the following two projects. The firm anticipates its cost of capital to be 10%. The pre-tax cash flows of the projects for five years are as follows:

Year	0	1	2	3	4	5
Project A (₹)	(2,00,000)	35,000	80,000	90,000	75,000	20,000
Project B (₹)	(2,00,000)	2,18,000	10,000	10,000	4,000	3,000

Ignore Taxation.

An amount of ₹ 35,000 will be spent on account of sales promotion in year 3 in case of Project A. This has not been taken into account in calculation of pre-tax cash flows.

The discount factors are as under:

Year	0	1	2	3	4	5
PVF (10%)	1	0.91	0.83	0.75	0.68	0.62

You are required to CALCULATE for each project:

(i) The Discounted Payback period

(ii) Desirability factor

(iii) Net Present Value **(5 Marks)**

(b) Bhanu Limited has issued 50,000; 10% convertible bonds of ₹ 100 each with a maturity period of 5 years. At the maturity, the bondholders will have an option to convert the bonds into the equity shares in the ratio of 1:4 (i.e 4 equity shares for each debenture). The equity shares of Bhanu Limited are listed and are currently traded at ₹ 30 each and historically the growth of the company's share has been 5% per annum over the years.

Of the total number of convertible bonds issued, 75% opt in for converting their bonds to the common stock at an agreed price which shall be at 5% premium to the intrinsic price at that point in time. However, the investors need to hold the shares for at least 2 years from the date of conversion.

The balance bonds would be redeemed by the company at a premium of 25% with a redemption cost of 2% incurred additionally at the time of redemption. Tax rate applicable to the company is at 25%. COMPUTE the cost of the convertible bonds using Approximation Method as well as the YTM method. **(5 Marks)**

(c) CALCULATE the operating leverage, financial leverage and combined leverage from the following data under Situation I and II and Financial Plan A and B:

Installed Capacity	4,000 units
Actual Production and Sales	75% of the Capacity
Selling Price	₹ 30 per unit
Variable Cost	₹ 15 per unit

Fixed Cost:

Under Situation I	₹ 15,000
Under Situation-II	₹ 20,000

Capital Structure:

	Financial Plan	
	A (₹)	**B (₹)**
Equity	10,000	15,000
Debt (Rate of Interest at 20%)	10,000	5,000
	20,000	20,000

(5 Marks)

2. (a) The following information is supplied to you:

	(₹)
Total Earnings	2,00,000
No. of equity shares (of ₹ 100 each)	20,000
Dividend paid	1,50,000
Price/ Earnings ratio	12.5

Applying Walter's Model:

(i) ANALYSE whether the company is following an optimal dividend policy.

(ii) COMPUTE P/E ratio at which the dividend policy will have no effect on the value of the share.

(iii) Will your decision change if the P/E ratio is 8 instead of 12.5? ANALYSE.

(4 Marks)

(b) Zordon Ltd. has net operating income of ₹ 5,00,000 and total capitalization of ₹ 50,00,000 during the current year. The company is contemplating to introduce debt financing in capital structure and has various options for the same. The following information is available at different levels of debt value:

Debt value (₹)	Interest rate (%)	Equity capitalization rate (%)
0	-	10.00
5,00,000	6.0	10.50
10,00,000	6.0	11.00
15,00,000	6.2	11.30
20,00,000	7.0	12.40
25,00,000	7.5	13.50
30,00,000	8.0	16.00

Assuming no tax and that the firm always maintains books at book values, you are REQUIRED to calculate:

(i) Amount of debt to be employed by firm as per traditional approach.

(ii) Equity capitalization rate, if MM approach is followed. **(6 Marks)**

3. (a) Following information and ratios are given in respect of Simandhar Limited for the year ended 31.03.2025:

Particulars	Ratio
Liquid Ratio	2.0
Cash Asset Ratio	0.36
Current Ratio	3.50
Receivables Collection Period	30 days
Proprietary Ratio	0.72
Equity Dividend	₹ 2,50,000
Equity Dividend Coverage Ratio	2.10
Non - Current Assets turnover Ratio	0.80
EPS	₹ 3.0 per share
Stock Turnover Ratio	6.0 times
GP Ratio	1/5th of Sales

Assume 360 days in a year. Closing inventory is 20% more than opening inventory.

You are required to COMPLETE the Balance Sheet as of 31st March, 2025.

BALANCE SHEET

As on 31st March, 2025

Liabilities	**Amount ₹**	**Assets**	**Amount ₹**
Equity Share Capital (Face Value ₹ 10)	???	Fixed Assets	???
Reserves	???	Receivables	???
Long term Debentures	???	Inventory	???
Current Liabilities	2,80,000	Cash & Bank balance	???
		Short term advances	???
Total	**????**	**Total**	**????**

(8 Marks)

(b) WRITE a short note on internal rate of return. **(2 Marks)**

4. (a) EXPLAIN following types of leases:

(i) Sales and Lease Back

(ii) Leveraged Lease

(iii) Sales-Aid Lease

(iv) Close-Ended and Open-Ended Leases **(4 Marks)**

(b) EXPLAIN any four Features of Debentures or Bonds. **(4 Marks)**

(c) DISCUSS the conflicts in Profit versus Wealth maximization principle of the firm. **(2 Marks)**

OR

(c) EXPLAIN in brief the concept of Over Capitalisation. **(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 answers.*

PART I – Case scenario based MCQs (15 Marks)

1. (A) (Compulsory)

Founded with a dream to bring the world's finest spices to kitchens worldwide, Rachini Group has evolved into a diversified conglomerate, spanning industries from spices to car dealerships and real estate. This case study delves into the journey of Rachini Group.

Rachini Group's clear objective from its inception was to become a leading player in the spice trade industry. They aimed to source, package, and distribute the highest quality spices to homes and businesses globally. This unwavering focus on quality and customer satisfaction allowed them to establish themselves as a trusted brand, defining their path to success. The company, under the strict stewardship of Mangat Singh, emphasized quality control, adherence to core values, and a disciplined approach to business. While this management style limited creativity within middle management, it ensured consistency and quality throughout the organization, especially in their core spice business.

Recognizing the potential for growth and value addition, Rachini Group expanded by investing in acquiring spice farms and processing facilities, ensuring a robust supply chain. This allowed them to control quality and costs, creating a significant competitive advantage. As a result of their expansion and diversification, Rachini Group began generating positive cash flows. These financial gains provided the necessary resources for further expansion and allowed the company to venture beyond its spice business.

In their quest for expansion, Rachini Group forged strategic partnerships and alliances with influential politicians and royal families in Arabia. These connections provided valuable insights, eased market entry, and facilitated regulatory approvals, giving the company a competitive edge. The group diversified into other sectors like car dealerships and real estate, seeking to tap into lucrative markets and reduce dependency on a single industry.

Despite their success, Rachini Group faced backlash from social groups who believed that the concentration of wealth in the hands of a few was dangerous for

society. They were accused of worsening income inequality. This criticism prompted the company to reevaluate its approach and consider the broader impact of its business activities. In response, the family-owned business initiated a philanthropic arm, focusing on improving the living conditions, education, and healthcare in the communities they operated. This philanthropic endeavor aimed to balance their business success with social responsibility, nurturing a more positive image and addressing the criticisms they faced.

Rachini Group continues to thrive with a remarkable compound annual growth rate (CAGR) of 12%. Their diversified business portfolio, including car dealerships and real estate, now constitutes 40% of their total group revenue. The company remains committed to its spice trade roots while exploring new opportunities. Their plan to go public in 2026 is a testament to their ambition and determination to remain a key player in the global business landscape.

Rachini Group's remarkable evolution serves as a compelling case study in the world of business, showcasing the power of clear objectives, and adaptability in the face of social challenges. As they move towards their IPO in 2026, they continue to be a fascinating story of business success with a commitment to the greater good.

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

(i) How did Rachini Group control quality and costs in their spice business?

(a) By reducing their workforce - Human Resource Management

(b) By outsourcing production - Organizational Structure Planning

(c) By investing in spice farms and processing facilities - Vertical Integration

(d) By cutting prices - Best Cost Provider Strategy **(2 Marks)**

(ii) Rachini Group’s emphasis on acquiring spice farms and processing facilities to gain supply chain control aligns with which ‘S’ in McKinsey’s 7S Framework?

(a) Systems

(b) Structure

(c) Strategy

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

(iii) How did Rachini Group gain a competitive edge in their expansion efforts?

(a) Through extensive marketing campaigns

(b) By entering new international markets

(c) By forging strategic partnerships and alliances

(d) By increasing their workforce **(2 Marks)**

(iv) The strategic alliances with royal families and politicians most likely helped Rachini Group reduce the threat of:

(a) Substitute products

(b) Bargaining power of buyers

(c) New entrants

(d) Industry rivalry **(2 Marks)**

(v) What was Rachini Group's initial Vision when it was founded?

(a) To diversify quickly into unrelated businesses

(b) To become a leading player in the spice trade industry

(c) To establish a philanthropic arm

(d) To go public by 2026 **(2 Marks)**

(B) Compulsory Application Based Independent MCQs

(i) A multinational corporation is debating whether to invest significant time and resources into developing a new strategic plan. Some argue it diverts attention from current operations, while others believe it is essential for long-term success. Despite being resource-intensive, it remains crucial for sustained growth. What does this situation best illustrate?

(a) Strategic management ensures immediate profitability

(b) Strategic management is time-consuming but necessary

(c) Operational efficiency is more important than strategic planning

(d) Short-term focus leads to long-term success **(2 Marks)**

(ii) A group of environmental activists consistently raises concerns about a company's environmental impact. While their opinions are acknowledged, they lack the authority to directly influence company decisions. The company monitors their concerns and engages with them when necessary

to maintain its reputation. Which quadrant of Mendelow's Matrix best categorizes these stakeholders?

(a) High Interest, Low Power

(b) Low Interest, Low Power

(c) High Interest, High Power

(d) Low Interest, High Power **(2 Marks)**

(iii) ABC Corp., a pharmaceutical company, faces strict regulatory approvals before launching a new drug. Meanwhile, government policies promote local drug manufacturing, and digital advancements are transforming research. Which PESTLE factor is most relevant to the regulatory approvals for new drugs?

(a) Political

(b) Legal

(c) Technological

(d) Economic **(1 Mark)**

PART II – Descriptive Questions (35 Marks)

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

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

1. (a) ABC Tech, a leading smartphone manufacturer, is navigating a highly competitive market where innovation and cost efficiency are key. Customers prioritize battery life, camera quality, and seamless software integration when choosing a brand. To stay ahead, ABC Tech invests heavily in research and development, optimizes its supply chain for cost-effective production, and enhances customer service. Identify the *Key Success Factors (KSFs*) for ABC Tech based on the industry conditions described. How can the company achieve a *sustainable competitive advantage* by leveraging these factors? **(5 Marks)**

(b) *EcoTrend,* a growing e-commerce company, competes with industry giants by offering premium, eco-friendly products at high prices, targeting environmentally conscious consumers. Meanwhile, its competitor, *BudgetBazaar*, focuses on providing the lowest prices by optimizing costs and streamlining operations. Another player, *VogueVista*, differentiates itself through exclusive, fashion-forward designs that attract trend-savvy customers. Identify the generic strategies

used by *EcoTrend, BudgetBazaar,* and *VogueVista* based on Michael Porter's Generic Strategies framework. Explain how each company gains a competitive advantage. **(5 Marks)**

(c) *Nexora Innovations*, a mid-sized IT services firm, decided to implement a cloud-based project management system to enhance collaboration and streamline operations. However, many employees resisted the shift, fearing job redundancies and struggling to adapt to the new system. Despite initial communication, productivity dipped, and frustration grew among staff. What key change management strategies should *Nexora Innovations* adopt to ensure a smooth digital transformation and minimize disruption? **(5 Marks)**

2. (a) NovaTech Pvt. Ltd. is a well-established educational technology (EdTech) company in the India. The company has been performing well in the online learning industry. The management of NovaTech Pvt. Ltd. has now decided to expand its business by launching a luxury skincare brand named "GlowNova." Identify and explain the growth strategy adopted by NovaTech Pvt. Ltd. **(5 Marks)**

(b) Aarav is planning to launch his new organic food brand. He is evaluating different cities across the country to establish his business in the most suitable environment. One promising option is Pune, a city known for its health-conscious consumers, strong distribution networks, and government initiatives supporting sustainable businesses. With favorable policies, tax benefits, and access to experienced mentors, Pune seems like an ideal choice for Aarav to launch and scale his organic food brand successfully. Define the term Business Environment with respect to the above scenario. Explain how a business's interaction with its environment can contribute to the development of a successful strategy. **(5 Marks)**

3. (a) Major core competencies are identified in three areas - competitor differentiation, customer value and application to other markets. Discuss. **(5 Marks)**

(b) '*Innovation leads to unnecessary expenses that do not give as many returns.*' Do you agree with the statement? Give reasons in support of your answer. **(5 Marks)**

4. (a) Differentiate between Strategy Formulation and Strategy Implementation. **(5 Marks)**

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

OR

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

Mock Test Paper - Series II: April, 2025

Date of Paper: 7th April, 2025

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INTERMEDIATE: GROUP – II

PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A : FINANCIAL MANAGEMENT

Suggested Answers/ Hints

PART I – Case Scenario based MCQs.

1. (a) ₹ 6,24,500

Calculation of Incremental Benefit Statement (Current Policy v/s Policy A)

	Current Policy (₹)	**Policy 'A' (₹)**
Credit Sales (365 lakhs X 0.9)	3,28,50,000	3,28,50,000
(-) Cost Of Sales @ 0.8	2,62,80,000	2,62,80,000
Operating Profit	65,70,000	65,70,000
(-) Bad Debts Exp (Wn-1)	98,550	98,550
(-) Collection Exp	5,00,000	3,50,000 (30% Reduction)
(-) Cash Discount Exp (Wn-2)	-	4,38,000
(-) Opportunity Cost of Carrying Debtors (Wn – 3)	13,14,000	4,01,500
Net Benefit	**46,57,450**	**52,81,950**

Incremental Benefit in Policy 'A' = ₹ 6,24,500

WN – 1: Calculation of Bad debts expense

Of the total credit sales, 15% are sold to the customers who are not financially sound and 2% of such sales is bad debts.

Bad debts = ₹ 3,28,50,000 x 0.15 x 0.02 = ₹ 98,550 (same under Policy A as well)

WN – 2: Calculation of Cash Discount under Policy A

Credit Sales made to 2/3 of the customer's avail Cash discount @ rate of 2% as they would be paying their dues within maximum of 15 days.

Cash Discount = ₹ 3,28,50,000 x 2/3 x 2% = ₹ 4,38,000

WN – 3: Calculation of Opportunity Cost of Carrying Debtors assuming Debtors are valued at Cost of Sales

Current Policy -

a) Average Debtors = Cost of Sales x Avg Collection Period / 360

= (₹ 3,28,50,000 x 80%) x 120 / 360

= ₹ 87,60,000

b) Apply Rate of Return on above debtors calculated

= ₹ 87,60,000 X 0.15 = ₹ 13,14,000

Policy 'A'

Total Cost of Sales = ₹ 2,62,80,000

2/3 Customers

Cost of Sales = ₹ 1,75,20,000

Avg Collection Period = 15 days

Debtors = 1,75,20,000 x 15/360

= ₹ 7,30,000

Opportunity Cost = ₹ 7,30,000 x 0.15 = ₹ 1,09,500

1/3 Customers

Cost of Sales = ₹ 87,60,000

Avg Collection Period = 80 days

Debtors = 87,60,000 x 80/360 = ₹ 19,46,667

Opportunity Cost = ₹ 19,46,667 x 0.15 = ₹ 2,92,000

Total Opportunity Cost = ₹ 1,09,500 + ₹ 2,92,000 = ₹ 4,01,500

2. (a) ₹ 27,294

Calculation of Incremental Benefit Statement (Current Policy v/s Policy B)

	Current Policy (₹)	Policy 'B' (₹)
Credit Sales (365 lakhs X 0.9)	3,28,50,000	3,61,35,000 (10% Increase)
(-) Cost Of Sales @ 0.8	2,62,80,000	2,89,08,000
Operating Profit	65,70,000	72,27,000
(-) Bad Debts Exp (Wn-1)	98,550	1,35,506
(-) Collection Exp	5,00,000	6,00,000
(-) Opportunity Cost of Carrying Debtors (Wn – 3)	13,14,000	18,06,750
Net Benefit	**46,57,450**	**46,84,744**

Incremental Benefit in Policy 'B' = ₹ 27,294

WN – 1: Calculation of Bad debts expense under Policy 'B'

Of the total credit sales, 15% are sold to the customers who are not financially sound (As proportion of those customer to remain same) and 2.5% of such sales is bad debts.

Bad debts = ₹ 3,61,35,000 x 0.15 x 0.025 = ₹ 1,35,506.25

WN – 3: Calculation of Opportunity Cost of Carrying Debtors assuming Debtors are valued at Cost of Sales under Policy 'B'.

Average Debtors = Cost of Sales x Avg Collection Period / 360

= ₹ 2,89,08,000 x 150 / 360

= ₹ 1,20,45,000

Therefore, Opportunity Cost of Carrying Debtors = ₹ 1,20,45,000 x 0.15 = ₹ 18,06,750

3. (b) Proposal 2, 3 & 1

Evaluating Proposal, I - Selling washing machine at discount

Selling price (with 5% discount) = ₹ 15,675

Therefore, Selling Price (Without Discount) = ₹ 15,675 / 0.95 = ₹ 16,500 per unit.

To increase the demand, a minimum of 10% discount is necessary and the marketing team has proposed a 12% discount to get a competitive advantage.

Thus, the New Selling Price = ₹ 16,500 – 12% = ₹ 14,520 per unit.

Total Sales @ new Selling Price = 1,000 Units x 4 Quarters x ₹ 14,520

= ₹ 5,80,80,000

Evaluating Proposal II - Exchange-sales scheme

Total Sales (Units)	= 4,650
Selling Price per unit	= ₹ 16,500
(-) Exchange off set price	= ₹ 3,500
Net Proceeds	= ₹ 13,000
Total Sales	= 4,650 x ₹ 13,000
	= ₹ 6,04,50,000

Evaluating Proposal III - All-round reduction in Inventory levels

Selling Price = ₹ 3,000 advance + ₹ 9,500 on delivery = ₹ 12,500

Total Sales = 400 x 12 x ₹ 12,500

= ₹ 6,00,00,000

Rankings: Rank 1 – Proposal 2

Rank 2 – Proposal 3

Rank 3 – Proposal 1

NOTE: In absence of other info, we would be considering the benefits in the form sales and decide on the proposal to be selected

4 (c) ₹ 98,550 and ₹ 1,35,506

5. (d) The best combination of Inventory proposal and Credit policies comes to Proposal 2 & Credit Policy 'A'.

6. (b) 2,50,000 shares

Ex-dividend price is ₹ 80 (100 – 20).

The total amount of dividend received is ₹ 40,00,000 (2,00,000 shares x ₹ 20 per share) which is re-invested at the rate of ₹ 80 per share.

Thus, additional shares purchased would be ₹ 40,00,000/₹ 80 = 50,000 shares

So, Mr. A would now hold 2,50,000 shares i.e. (2,00,000 + 50,000)

7. (c) ₹ 20,000

Combined Leverage = Operating Leverage x Financial Leverage

15 = 5 x Financial Leverage

Financial Leverage = 3

Now, Financial Leverage = $\frac{\text{EBIT}}{\text{EBIT - Interest}}$

Or 3 = $\frac{30,000}{30,000 - \text{Interest}}$

90,000 – 3 Interest = 30,000

3 Interest = 60,000

So, Interest = ₹ 20,000

8. (a) 5%

Ke = Rf + β (Rm – Rf)

15 = Rf + 2(10 – Rf)

15 = Rf + 20 - 2Rf

Rf = 5

PART II – Descriptive Questions

1. (a) Calculation of Present Value of cash flows

Year	PV factor @ 10%	Project A		Project B	
		Cash flows (₹)	Discounted Cash flows (₹)	Cash flows (₹)	Discounted Cash flows (₹)
0	1.00	(2,00,000)	(2,00,000)	(2,00,000)	(2,00,000)
1	0.91	35,000	31,850	2,18,000	1,98,380
2	0.83	80,000	66,400	10,000	8,300
3	0.75	55,000(90,000-35,000)	41,250	10,000	7,500
4	0.68	75,000	51,000	4,000	2,720
5	0.62	20,000	12,400	3,000	1,860
Net Present Value			2,900		18,760

(i) Discounted Payback period for the projects:

Project-A: The cumulative discounted cash inflows upto year 4 is ₹1,90,500 and remaining amount required to equate the cash outflow is ₹ 9,500 i.e. (₹ 2,00,000 – ₹ 1,90,500) which will be recovered from year-5 cash inflow. Hence, Payback period will be calculated as below:

$$4 \text{ years} + \frac{₹\,9,500}{₹\,12,400} = 4.766 \text{ years Or 4 years 9.19 months Or 4 years 9 months and 6 days.}$$

Project-B: The cash inflow in year-1 is ₹1,98,380 and remaining amount required to equate the cash outflow is ₹ 1,620 i.e. (₹ 2,00,000 – ₹ 1,98,380) which will be recovered from year-2 cash inflow. Hence, Payback period will be calculated as below:

$$1 \text{ year} + \frac{₹1,620}{₹\ 8,300} = 1.195 \text{ years Or 1 Year 2.34 months Or 1 Year 2 months and 10 days.}$$

(ii) Desirability factor of the projects

$$\text{Desirability Factor (Profitability Index)} = \frac{\text{Discounted value of Cash Inflows}}{\text{Discounted value of Cash Outflows}}$$

$$\textbf{Project A} = \frac{₹\,2,02,900}{₹\,2,00,000} = 1.01$$

$$\textbf{Project B} = \frac{₹\,2,18,760}{₹\,2,00,000} = 1.09$$

(iii) Net Present Value (NPV) of the projects:

Please refer the above table.

Project A- ₹ 2,900

Project B- ₹ 18,760

(b) (A) Approximation Method:

(i) Calculation of Cost of Bonds - 75% Opting for the conversion

Value of equity shares at the end of 5th year will be calculated using the concept of time value of money.

$FV = PV (1 + r)^n$

$= 30 (1 + 0.05)^5$

$= 38.29$

Consideration Value (Agreed Price) = 38.29 + 5% premium

= ₹ 40.20 for each equity share

Each bond holder will receive 4 equity shares for each bond converted.

∴ ₹ that each bond holder will receive on conversion would be,

₹ 40.20 x 4 = ₹ 160.80

So, RV = ₹ 160.80, NP = ₹ 100, Int = ₹ 10, n = 5 years

$$\text{Cost of Bonds (Kd)} = \frac{I(1-t)+\frac{(RV-NP)}{n}}{\frac{(RV+NP)}{2}}$$

$$\therefore Kd = \frac{10(1-0.25)+\frac{(160.8-100)}{5}}{\frac{(160.8+100)}{2}}$$

∴ Kd = 15.08%

(ii) Calculation of Cost of Bonds - Not Opting for the conversion

RV = 100 + 25% (Premium) = 125

Add: Redemption cost = (125 x 2%) = 2.5

Gross RV = 127.50

$$\text{Cost of Bonds (Kd)} = \frac{I(1-t)+\frac{(RV-NP)}{n}}{\frac{(RV+NP)}{2}}$$

$$\therefore Kd = \frac{10(1-0.25)+\frac{(127.5-100)}{5}}{\frac{(127.5+100)}{2}}$$

∴ Kd = 11.43%

(B) Yield To Maturity (YTM) Method:

(i) Calculation of Cost of Bonds - 75% Opting for the conversion

Year	Cash Flows (₹)	DF @ 10%	Present Value (₹)	DF @ 18%	Present Value (₹)
0	(100)	1.000	(100)	1.000	(100)
1	7.5	0.909	6.818	0.847	6.353
2	7.5	0.826	6.195	0.718	5.385
3	7.5	0.751	5.633	0.609	4.568
4	7.5	0.683	5.123	0.515	3.863
5	7.5 + 160.80	0.621	104.514	0.437	73.547
	NPV		28.283		- 6.284

YTM (IRR) $= L + \frac{NPV_L}{NPV_L - NPV_H}(H - L)$

H = Higher rate = 18%

L = Lower rate = 10%

$\therefore$ IRR $= 10 + \frac{28.283}{28.283 - (-6.284)}(18 - 10)$

Kd = 16.54%

(ii) Calculation of Cost of Bonds - Not Opting for the conversion

Year	Cash Flows (₹)	DF @ 10%	Present Value (₹)	DF @ 15%	Present Value (₹)
0	(100)	1.000	(100)	1.000	(100)
1	7.5	0.909	6.818	0.87	6.525
2	7.5	0.826	6.195	0.756	5.67
3	7.5	0.751	5.633	0.658	4.935
4	7.5	0.683	5.123	0.572	4.29
5	7.5 + 127.50	0.621	83.835	0.497	67.095
	NPV		7.604		-11.485

YTM (IRR) $= L + \frac{NPV_L}{NPV_L - NPV_H}(H - L)$

H = Higher rate = 15%

L = Lower rate = 10%

$\therefore$ IRR $= 10 + \frac{7.604}{7.604 - (-11.485)}(15 - 10)$

Kd = 12%

(c) (i) Operating leverages:

Particulars	**Situation-I (₹)**	**Situation-II (₹)**
Sales (3,000 units @ ₹ 30/- per unit)	90,000	90,000
Less: Variable Cost (VC) @ ₹ 15 per unit	(45,000)	(45,000)
Contribution (C)	45,000	45,000
Less: Fixed Cost (FC)	15,000	20,000
EBIT	30,000	25,000
Operating Leverage $\left(\frac{C}{EBIT}\right)$	$\frac{45,000}{30,000}$	$\frac{45,000}{25,000}$
	= 1.5	= 1.8

(ii) Financial Leverages:

	A (₹)	**B (₹)**
Situation I:		
EBIT	30,000	30,000
Less: Interest on debt	(2,000)	(1,000)
EBT	28,000	29,000
Financial Leverage $\left(\frac{EBIT}{EBT}\right)$	$\frac{30,000}{28,000}$	$\frac{30,000}{29,000}$
	= 1.07	= 1.03
Situation-II:		
EBIT	25,000	25,000
Less: Interest on debt	(2,000)	(1,000)

EBT	23,000	24,000
Financial Leverage $\left(\frac{EBIT}{EBT}\right)$	$\frac{25,000}{23,000}$	$\frac{25,000}{24,000}$
	= 1.09	= 1.04

(iii) Combined Leverages:

	A (₹)	B (₹)
(a) Situation I	1.5 × 1.07 = 1.61	1.5 × 1.03 = 1.55
(b) Situation II	1.8 × 1.09 = 1.96	1.8 × 1.04 = 1.87

2. (a) (i) The EPS of the firm is ₹ 10 (i.e., ₹ 2,00,000/ 20,000) and r = 2,00,000/ (20,000 shares × ₹100) = 10%. The P/E Ratio is given at 12.5 and the cost of capital, K_e, may be taken at the inverse of P/E ratio. Therefore, K_e is 8 (i.e., 1/12.5). The firm is distributing total dividends of ₹ 1,50,000 among 20,000 shares, giving a dividend per share of ₹ 7.50. the value of the share as per Walter's model may be found as follows:

$$P = \frac{D + \frac{r}{K_e}(E - D)}{K_e} = \frac{7.5 + \frac{0.1}{0.08}(10 - 7.5)}{0.08} = ₹\ 132.81$$

The firm has a dividend payout of 75% (i.e., ₹ 1,50,000) out of total earnings of ₹ 2,00,000. Since, the rate of return of the firm, r, is 10% and it is more than the K_e of 8%, therefore, by distributing 75% of earnings, the firm is not following an optimal dividend policy. The optimal dividend policy for the firm would be to pay zero dividend and in such a situation, the market price would be-

$$= \frac{0 + \frac{0.1}{0.08}(10 - 0)}{0.08} = ₹\ 156.25$$

So, theoretically the market price of the share can be increased by adopting a zero payout.

(ii) The P/E ratio at which the dividend policy will have no effect on the value of the share is such at which the K_e would be equal to the rate of return, r, of the firm. The K_e would be 10% (= r) at the P/E ratio of 10. Therefore, at the P/E ratio of 10, the dividend policy would have no effect on the value of the share.

(iii) If the P/E is 8 instead of 12.5, then the K_e which is the inverse of P/E ratio, would be 12.5 and in such a situation $k_e > r$ and the market price, as per Walter's model would be:

$$P = \frac{D + \frac{r}{K_e}(E - D)}{K_e} = \frac{7.5 + \frac{0.1}{0.125}(10 - 7.5)}{0.125} = ₹\ 76$$

So, the market price will come down to ₹ 76.

(b) (i) Amount of debt to be employed by firm as per traditional approach

Calculation of Equity, W_d and W_e

Total Capital (₹)	Debt (₹)	W_d	Equity value (₹)	W_e
(a)	(b)	(b)/(a)	(c) = (a) - (b)	(c)/(a)
50,00,000	0	-	50,00,000	1.0
50,00,000	5,00,000	0.1	45,00,000	0.9
50,00,000	10,00,000	0.2	40,00,000	0.8
50,00,000	15,00,000	0.3	35,00,000	0.7
50,00,000	20,00,000	0.4	30,00,000	0.6
50,00,000	25,00,000	0.5	25,00,000	0.5
50,00,000	30,00,000	0.6	20,00,000	0.4

Statement of Weighted Average Cost of Capital (WACC)

K_e	W_e	K_d	W_d	$K_e W_e$	$K_d W_d$	K_o
(1)	(2)	(3)	(4)	(5) = (1) x (2)	(6) = (3) x (4)	(7) = (5) + (6)
0.100	1.0	-	-	0.100	-	0.100
0.105	0.9	0.060	0.1	0.095	0.006	0.101
0.110	0.8	0.060	0.2	0.088	0.012	0.100
0.113	0.7	0.062	0.3	0.079	0.019	0.098
0.124	0.6	0.070	0.4	0.074	0.028	0.102
0.135	0.5	0.075	0.5	0.068	0.038	0.106
0.160	0.4	0.080	0.6	0.064	0.048	0.112

So, amount of Debt to be employed = ₹ 15,00,000 as WACC is minimum at this level of debt i.e. 9.8%.

(ii) As per MM approach, cost of the capital (K_o) remains constant and cost of equity increases linearly with debt.

$$\text{Value of a firm} = \frac{\text{Net Operating Income (NOI)}}{K_0}$$

$$₹\ 50,00,000 = \frac{₹\ 5,00,000}{K_o}$$

$$K_o = \frac{₹\ 5,00,000}{₹\ 50,00,000} = 10\%$$

Statement of Equity Capitalization rate (k_e) under MM approach

Debt (₹)	Equity (₹)	Debt/Equity	K_o	K_d	$K_o - K_d$	$K_e = K_o + (K_o - K_d)\frac{\text{Debt}}{\text{Equity}}$
(1)	(2)	(3) = (1)/(2)	(4)	(5)	(6) = (4) -(5)	(7) = (4) + (6) x (3)
0	50,00,000	0	0.10	-	0.100	0.100
5,00,000	45,00,000	0.11	0.10	0.060	0.040	0.104
10,00,000	40,00,000	0.25	0.10	0.060	0.040	0.110
15,00,000	35,00,000	0.43	0.10	0.062	0.038	0.116
20,00,000	30,00,000	0.67	0.10	0.070	0.030	0.120
25,00,000	25,00,000	1.00	0.10	0.075	0.025	0.125
30,00,000	20,00,000	1.50	0.10	0.080	0.020	0.130

3. (a) WN-1: Calculation of Total Current Assets using Current Ratio

$$\text{Current Ratio} = \frac{CA}{CL}$$

$$3.5 = \frac{CA}{2,80,000}$$

$$\therefore CA = ₹\ 9,80,000$$

WN-2: Calculation of Inventory using Liquid Ratio

$$\text{Liquid Ratio} = \frac{\text{CA- Inventory}}{CL}$$

$$2 = \frac{₹\ 9,80,000 - \text{Inventory}}{₹\ 2,80,000}$$

$$\therefore \text{Inventory} = ₹\ 4,20,000$$

WN-3: Calculation of Cash & Bank balance using Cash Asset Ratio

Cash asset ratio is nothing but just the cash ratio of the company

$$\text{Cash ratio} = \frac{\text{Cash \& Cash Equivalents + Marketable securities}}{\text{CL}}$$

$$0.36 = \frac{\text{Cash \& Cash Equivalents + 0}}{₹\ 2{,}80{,}000}$$

∴ Cash & Cash Equivalents = ₹ 1,00,800

WN-4: Calculation of Sales using Inventory turnover ratio

$$\text{Inventory turnover ratio} = \frac{\text{COGS}}{₹\ \text{Avg Inventory}}$$

$$\text{Avg Inventory} = \frac{\text{Opening + Closing}}{2}$$

Now, let the opening inventory be 'x' and as mentioned closing inventory would be 20% more than the opening inventory i.e. 1.2x

$$\therefore \text{Opening inventory} = \frac{₹\ 4{,}20{,}000 \times x}{(1.2x)}$$

∴ Opening inventory = ₹ 3,50,000

$$\therefore \text{Avg Inventory} = \frac{₹\ 4{,}20{,}000 + ₹\ 3{,}50{,}000}{2}$$

∴ Avg Inventory = ₹ 3,85,000

Now, using inventory turnover ratio

$$6 = \frac{\text{COGS}}{₹\ 3{,}85{,}000}$$

∴ COGS = ₹ 23,10,000

Sales = COGS + GP

x = ₹ 23,10,000 + 0.20x

∴ Sales = ₹ 28,87,500

WN-5: Calculation of Receivables using Receivables collection period

Receivables Collection Period $= \frac{\text{Receivables}}{\text{Credit Sales}} \times 360$

30 $= \frac{\text{Receivables}}{₹\ 28,87,500} \times 360$

∴ Receivables = ₹ 2,40,625

WN-6: Calculation of Short-term Advances

Current Assets = Inventory + Receivables + Cash & Cash equivalents + Short term advances

₹ 9,80,000 = ₹ 4,20,000 + ₹ 2,40,625 + ₹ 1,00,800 + x

∴ Short term advances = ₹ 2,18,575

WN-7: Calculation of Non-current Assets (Fixed asset) using non-current assets turnover ratio

Non-current asset turnover ratio = Sales / Non-current assets

0.80 $= \frac{₹\ 28,87,500}{x}$

∴ Non-current asset (Fixed assets) = ₹ 36,09,375

WN-8: Calculation of Net profit available for Equity shareholders using Equity dividend coverage ratio

Equity dividend coverage ratio $= \frac{\text{Net Profit for Equity shareholders}}{\text{Equity Dividend}}$

2.10 $= \frac{x}{₹\ 2,50,000}$

∴ Net Profit for Equity shareholders = ₹ 5,25,000

WN-9: Calculation of No of equity shares and amount of equity share capital

EPS $= \frac{\text{Net Profit for Equity shareholders}}{\text{No of equity shares}}$

3 $= \frac{₹\ 5,25,000}{x}$

∴ No of equity shares = ₹ 1,75,000

∴ Amount of Equity Share capital = 1,75,000 x ₹ 10 = ₹ 17,50,000

WN-10: Calculation of Reserves using Proprietary ratio

Proprietary Ratio $= \frac{\text{Proprietor's funds}}{\text{Total Assets}}$

Total assets = Non-current assets + Current Assets

= ₹ 36,09,375 + ₹ 9,80,000

= ₹ 45,89,375

0.72 $= \frac{\text{Proprietor's funds}}{₹\ 45,89,375}$

∴ Proprietor's funds = ₹ 33,04,350

∴ Reserves = ₹ 33,04,350 (-) ₹ 17,50,000

∴ Reserves = ₹ 15,54,350

Balance Sheet as of 31/03/2025

Liabilities	**Amount (₹)**	**Assets**	**Amount (₹)**
Equity Share Capital (Face Value ₹ 10) **(WN-9)**	17,50,000	Fixed Assets **(WN-7)**	36,09,375
Reserves **(WN-10)**	15,54,350	Receivables **(WN-5)**	2,40,625
Long term Debentures **(Bal. figure)**	10,05,025	Inventory **(WN-2)**	4,20,000
Current Liabilities	2,80,000	Cash & Bank balance **(WN-3)**	1,00,800
		Short term advances **(WN-6)**	2,18,575
TOTAL	**45,89,375**	**TOTAL**	**45,89,375**

(b) **Internal Rate of Return:** It is that rate at which discounted cash inflows are equal to the discounted cash outflows. In other words, it is the rate which discounts the cash flows to zero. It can be stated in the form of a ratio as follows:

$$\frac{\text{Cash inflows}}{\text{Cash Outflows}} = 1$$

This rate is to be found by trial and error method. This rate is used in the evaluation of investment proposals. In this method, the discount rate is not known but the cash outflows and cash inflows are known.

In evaluating investment proposals, internal rate of return is compared with a required rate of return, known as cut-off rate. If it is more than cut-off rate the project is treated as acceptable; otherwise project is rejected.

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

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

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

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

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

(b) Features of Debentures or Bonds:

(i) Face Value: Debentures or bonds are denominated with some value, this denominated value is called face value of the debenture. Interest is calculated on the face value of the debenture. E.g. if a company issue 9% non- convertible debentures of ₹100 each, this means the face value is ₹ 100 and the interest @ 9% will be calculated on this face value.

(ii) Interest (Coupon) Rate: Each debenture bears a fixed interest (coupon) rate (except Zero coupon bond and Deep discount bond). Interest (coupon) rate is applied to face value of debenture to calculate interest, which is payable to the holders of debentures periodically (annually, semi-annually, etc.).

(iii) Maturity period: Debentures or Bonds has a fixed maturity period for redemption. However, in case of irredeemable debentures maturity period is not defined and it is taken as infinite.

(iv) Redemption Value: Redeemable debentures or bonds are redeemed on its specified maturity date. Based on the debt covenants, the redemption value is determined. Redemption value may vary from the face value of the debenture.

(v) Benefit of tax shield: The payment of interest to the debenture holders are allowed as expenses for the purpose of corporate tax determination. Hence, interest paid to the debenture holders save the tax liability of the company. Saving in the tax liability is also known as tax shield.

(c) Conflict in Profit versus Wealth Maximization Principle of the Firm: Profit maximisation is a short-term objective and cannot be the sole objective of a company. It is at best a limited objective. If profit is given undue importance, a number of problems can arise like the term profit is vague, profit maximisation has to be attempted with a realisation of risks involved, it does not take into account the time pattern of returns and as an objective it is too narrow.

Whereas, on the other hand, wealth maximisation, as an objective, means that the company is using its resources in a good manner. If the share value is to stay high, the company has to reduce its costs and use the resources properly. If the company follows the goal of wealth maximisation, it means that the company will promote only those policies that will lead to an efficient allocation of resources.

OR

(c) It is a situation where a firm has more capital than it needs or in other words assets are worth less than its issued share capital, and earnings are insufficient to pay dividend and interest. This situation mainly arises when the existing capital is not effectively utilized on account of fall in earning capacity of the company while company has raised funds more than its requirements. The chief sign of over-capitalisation is the fall in payment of dividend and interest leading to fall in value of the shares of the company.

PAPER 6B: STRATEGIC MANAGEMENT

ANSWERS

PART I

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

PART II PART II – Descriptive Questions

1. (a) The **Key Success Factors (KSFs)** for ABC Tech include:

- **Product Innovation:** Superior battery life, camera quality, and seamless software integration are crucial attributes influencing customer choice.
- **Cost Efficiency:** Optimizing the supply chain ensures competitive pricing and higher profit margins.
- **Customer Experience:** High-quality customer service builds brand loyalty and differentiation.

To gain a sustainable competitive advantage, ABC Tech should:

1. **Focus on continuous R&D** to introduce advanced features that set its products apart.
2. **Streamline its supply chain** to maintain cost leadership while ensuring product quality.
3. **Enhance customer engagement** through superior after-sales service and ecosystem integration.

By excelling in these KSFs, ABC Tech can establish a distinct market position and outperform competitors in the long run.

(b) Michael Porter's Generic Strategies framework includes **Cost Leadership, Differentiation, and Focus Strategies**. Based on the caselet:

1. **EcoTrend – Differentiation Focus Strategy**
    - Targets a niche market (**environmentally conscious consumers**) with **premium, eco-friendly products**.
    - Gains a competitive advantage through **product uniqueness and sustainability**.

2. **BudgetBazaar – Cost Leadership Strategy**
    - Focuses on **offering the lowest prices** by optimizing costs and streamlining operations.
    - Gains a competitive advantage through **operational efficiency and economies of scale**.
3. **VogueVista – Differentiation Strategy**
    - Differentiates itself with **exclusive, fashion-forward designs** that appeal to style-conscious customers.
    - Gains a competitive advantage through **unique product offerings and strong brand image**.

Each company applies a distinct **generic strategy** to establish a strong position in the market.

(c) To ensure a successful digital transformation, *Nexora Innovations* should adopt the following change management strategies:

1. **Begin at the Top:** Leadership must demonstrate commitment, clearly communicate the benefits of the change, and promotes a culture that embraces transformation.
2. **Ensure the Change is Necessary and Desired:** The company should explain the long-term benefits of the cloud-based system and address employees' concerns about job security.
3. **Reduce Disruption:**
    - Communicate the transition **early** and set expectations.
    - Provide **proper training and resources** to help employees adapt.
    - Empower **change agents** (team leaders, project managers) to guide employees through the process.
4. **Encourage Communication:** Establish **open feedback channels** where employees can voice concerns and seek assistance. Regular updates will keep everyone aligned with the transformation goals.
5. **Recognize Change as a Continuous Process:** Instead of a one-time project, digital transformation should be seen as **an ongoing adaptation** where employees are encouraged to develop a mindset of continuous learning and improvement.

By implementing these strategies, *Nexora Innovations* can overcome resistance, enhance adoption, and maximize the benefits of its digital transformation initiative.

2. **(a)** Currently, **NovaTech Pvt. Ltd.** operates in the **educational technology industry**, offering digital learning solutions. However, its management has decided to expand into an entirely different sector by launching **GlowNova, a luxury skincare brand.** Since there is no connection between their existing EdTech business and the new skincare venture in terms of **customer groups, customer needs, or technologies used,** NovaTech Pvt. Ltd. has opted for **conglomerate diversification.**

In **conglomerate diversification**, a company expands into a completely unrelated industry where its new products or services have no direct link to its existing business. There is no overlap in technology, market, or product functions. This type of diversification helps companies **spread risk, enter new markets, and explore new revenue streams.**

NovaTech Pvt. Ltd.'s decision to launch a skincare brand while operating in the EdTech sector demonstrates a strategic move toward unrelated diversification, allowing the company to tap into an entirely different consumer market.

(b) Business **Environment** refers to the external factors, influences, and conditions that impact a business's decisions, strategies, and operations. In Aarav's case, the business environment includes the evolving consumer preferences, government policies, and market dynamics in Pune, which will play a crucial role in shaping his organic food brand's strategy.

Benefits of Interaction with the Business Environment

- **Determine Opportunities and Threats:** Aarav can assess market demand for organic products, emerging health trends, and regulatory frameworks. This will help him identify potential opportunities for expansion and anticipate challenges such as competition and supply chain disruptions.
- **Give Direction for Growth:** By understanding consumer behavior and industry trends, Aarav can align his business with the growing demand for organic and sustainable food options. This insight will help him expand strategically and introduce innovative product offerings.
- **Continuous Learning:** Regular engagement with the business environment will encourage Aarav and his team to stay updated with **nutrition trends, technological advancements in food processing, and changing consumer preferences.** This knowledge will help them remain competitive and adapt to industry shifts effectively.
- **Image Building:** Responding to environmental and social expectations, such as **sustainable sourcing, eco-friendly packaging, and ethical farming practices**, will enhance the brand's reputation. A socially

responsible business is more likely to attract loyal customers and gain market trust.

- **Meeting Competition:** Aarav can analyze competitors' strategies and differentiate his brand through **unique selling propositions (USPs), better distribution networks, or customer engagement initiatives.** Understanding the competitive landscape will enable him to position his business effectively and stay ahead in the market.

By actively interacting with the business environment, Aarav can leverage opportunities, mitigate risks, and build a sustainable, customer-centric organic food brand in Pune.

3. (a) 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.

(b) The statement *"Innovation leads to unnecessary expenses that do not give as many returns"* is often debated, but evidence strongly suggests that innovation is crucial for long-term business growth and success. I **disagree** with the statement for several reasons:

Innovation offers the following for a business to grow long term:

- **Helps to solve complex problems:** A business strives to find opportunities in existing problems of society, and it does so through planned innovation in areas of expertise. This guided innovation helps solve complex problems by developing customer centric sustainable solutions.
- **Increases productivity:** Innovation leads to simplification and in most cases automation of existing tasks. Companies are willing to spend millions on increasing their productivity. Innovation, by automating repetitive tasks and simplifying the long chain of processes, adds to productivity of teams and thereby the organization as a whole.
- **Gives competitive advantage:** Being ahead of competition is a need and businesses spend majority of their strategic time building solutions to achieve this advantage. The faster a business innovates, the farther it goes from its competitor's reach. Innovative products need less marketing as they aim to provide added satisfaction to consumers, thus creating a competitive advantage. Innovation not only helps retain its existing customers but helps acquire new ones with ease too.

4. (a) Although inextricably linked, strategy implementation is fundamentally different from strategy formulation. Summarized are the key distinctions between strategy formulation and strategy implementation:

Strategy Formulation Vs. Strategy Implementation

Strategy Formulation	Strategy Implementation
Strategy Formulation includes planning and decision-making involved in developing organization's strategic goals and plans.	Strategy Implementation involves all those means related to executing strategic plans.
In short, Strategy Formulation is **placing the forces before the action**.	In short, Strategy Implementation is **managing forces during the action**.
An **entrepreneurial activity** based on strategic decision-making.	An **administrative task** based on strategic and operational decisions.
Emphasizes on **effectiveness**.	Emphasizes on **efficiency**.
Primarily an **intellectual and rational process**.	Primarily an **operational process**.
Requires co-ordination among few individuals at the top level.	Requires co-ordination among many individuals at the middle and lower levels.

Requires a great deal of **initiative, logical skills, conceptual intuitive and analytical skills.**	Requires specific **motivational and leadership traits**.
Strategic Formulation precedes Strategy Implementation.	Strategy Implementation follows Strategy Formulation.

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

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

Essentials of a strategic vision

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

The best-worded vision statement **clearly illuminates the direction** in which the organization is headed.

OR

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.