



PAPER – 6: FINANCIAL MANAGEMENT AND STRATEGIC MANAGEMENT

6A: FINANCIAL MANAGEMENT



QUESTIONS

Division A: Case Scenarios

Investment Decision

1. Linty is a small-sized firm manufacturing company. Its manufacturing plant is situated in Chattisgarh. Currently, company is labour oriented due to which there is less production, delay in deliveries and more defects in production. The management of the company is considering the proposal to purchase a new automatic machine which will carry out some operations which are at present performed by manual labour. There are two alternative models of the machine that are available in the market. Machine TMT 1 and TMT 2. If machine is replaced, it would provide labor saving and reduce the defects as well. It is expected to have to have an economic life of 10 years for both the models. The following details are collected:

	Machine	
	TMT 1 (₹)	TMT 2 (₹)
Cost of Machine	45,00,000	50,00,000
Estimated saving in direct wages per annum	15,00,000	20,00,000
Estimated saving in scrap per annum	5,00,000	6,00,000
Estimated additional cost of indirect material per annum	2,00,000	2,00,000

Estimated additional cost of indirect labour per annum	1,50,000	1,80,000
Estimated additional cost of repairs and maintenance per annum	4,00,000	8,00,000

Depreciation is charged using straight line method over the useful life. Company is in 35 percent tax bracket and expected rate of return may be 15 percent.

Being a finance manager of the company, you are required to evaluate the alternatives by answering the followings:

- i. What is the annual saving from Machine TMT 1?
 - A. ₹ 5,20,000
 - B. ₹ 5,98,000
 - C. ₹ 9,70,000
 - D. ₹ 10,98,000
- ii. What is the annual saving from Machine TMT 2?
 - A. ₹ 5,20,000
 - B. ₹ 5,98,000
 - C. ₹ 9,70,000
 - D. ₹ 10,98,000
- iii. What is the payback period of Machine TMT 1 and TMT 2 Respectively?
 - A. 3.60 years and 4.60 years
 - B. 4.25 years and 4.42 years
 - C. 4.63 years and 4.55 years
 - D. 4.55 years and 4.42 years
- iv. What is the Accounting (Average) Rate of Return of Machine TMT 1 and TMT 2 Respectively?
 - A. 20% and 22%

- B. 23.11% and 23.92%
 - C. 22.21% and 23.11%
 - D. 23.92% and 22.21%
- v. What is the Profitability Index (PI) of Machine TMT 1 and TMT 2 Respectively?
- A. 1.10 and 1.05
 - B. 0.98 and 1.01
 - C. 1.19 and 1.08
 - D. 1.08 and 1.10

Financing Decision - Cost of Capital

2. The shares of ACB Ltd. are presently traded at ₹ 51 and the company is expected to pay dividends of ₹ 5 per share with a growth rate expected at 10% per annum. It plans to raise fresh equity share capital. The merchant banker has suggested that an underpricing of ₹ 2 is necessary in pricing the new issue besides involving a cost of ₹ 50 paise per share on miscellaneous expenses. The cost of new equity shares (assuming no change in dividend rate and growth rate) will be:
- (A) 18%
 - (B) 17.5%
 - (C) 18.25%
 - (D) 20.31%

Financing Decision – Leverages

3. RGT Infrastructure Company has a degree of operating leverage of 3 at a sales level of ₹ 7,00,000 and operating income of ₹2,20,000. Fall in sales of the company by 10% will result in decrease in operating income of:
- (A) ₹ 80,000
 - (B) ₹ 55,000
 - (C) ₹ 66,000
 - (D) ₹ 40,000

Division B: Descriptive Questions
Financial Analysis & Planning – Ratio Analysis

4. Using the information given below, PREPARE the Balance Sheet of Navy Private Limited –

Particulars	Details
Stock turnover Ratio	15 times
Cash and Bank balance	10% of Current Assets (net off prepaid exp)
GP Ratio	20%
Creditors turnover (cost of goods sold) ratio	10 times
Debtors turnover ratio	12 times
Net Fixed Assets	25% of Total Liabilities
Depreciation	15% on Opening WDV
Current Ratio	1.6 : 1
Capital Gearing Ratio	0.6 : 1

All Purchases and Sales are assumed to be on credit basis.

Balance Sheet of Navy Private Limited as of 31.03.2025

Particulars	Amount (₹)	Amount (₹)
A] Equities and Long Term Liabilities		
Share Capital	36,00,000	
Reserves and Surplus	??	
14% Bonds	??	???
B] Current Liabilities		
Trade Payables	??	
Outstanding expenses and provisions	??	
(*Net of Prepaid expenses of ₹7,50,000)		45,00,000
TOTAL		?????

C] Fixed Assets		
Opening WDV	??	
(-) Depreciation	??	???
D] Current Assets		
Inventory	??	
Trade Receivables	??	
Cash and Bank Balance	??	
		???
TOTAL		?????

(All the working notes should form part of your answer)

Financing Decision - Cost of Capital

5. Paramhans Limited has a capital structure that consists of Equity share capital, Reserves & Surplus, Bank term loan, Debentures which are redeemable at a premium of 5% and Preference share capital redeemable at premium of 5%. The coupon rate on debentures is 1.5 times of that of bank term loan coupon rate whereas the preference dividend rate is 1.5 times of debentures' interest rate. Tenure for the bank term loan, debentures and preference share capital is 3 years, 5 years and 7 years respectively.

The current book value of the capital structure is as follows –

Particulars	Amount (₹)
Equity Share Capital (FV = ₹ 100)	25,00,000
Reserves And Surplus	10,00,000
Bank Term Loan	10,00,000
Debentures (FV = ₹ 100)	15,00,000
Preference Share Capital (FV = ₹ 100)	20,00,000
TOTAL	80,00,000

Tax rate applicable to the company is 25%.

Debentures are currently selling at a price of ₹ 96 whereas Preference shares are currently selling at ₹ 102. The equity shares of the company are quoted at ₹ 150 per share. The ongoing P/E ratio for the shares of Paramhans Limited is at 6.667 times. Paramhans Limited belongs to a risk class where the overall capitalization and discounting rate of the company is at 20%

CALCULATE –

- (A) Rate of Interest on Bank term Loan & Debentures
- (B) Rate of Preference dividend
- (C) WACC using Market Value weights

Financing Decision - Capital Structure

6. Namra Limited provides you with the following information –

Particulars	Amount (₹)
Operating Profit	6,20,000
Less: Interest on Debentures @ 10%	(80,000)
EBT	5,40,000
Less: Tax @ 20%	(1,08,000)
PAT	4,32,000
Less: 14% Preference Dividend	(1,12,000)
Earnings for Equity Share Holders	3,20,000
No of Equity Shares (₹ 10 Each)	16,000
EPS	20

The Reserves & Surplus of the company is at ₹ 9,00,000 and Namra Limited requires additional funds of ₹ 15,00,000 for modernization and expansion. The current capitalization rate for the equity is 20% and company has a policy to retain 40% of its earnings. The debentures and preference shares are trading at premium of 10% & 25% to its current book value respectively. The fair value of equity shares is calculated by dividing the number of equity shares to the Overall Value of the firm.

New equity shares for expansion will be issued 15% discount to the current fair value price.

Return on Capital Employed (ROCE) which is based on the total value of the firm, will increase by 10% to its current rate after expansion and modernization. If the capital gearing ratio goes above 2.50 then interest rate on additional debt will increase by 200 basis points and dividend on preference shares would increase by half a percentage.

You are required to ADVISE on the below two financial plan to be selected based on earnings.

- (i) Two-third amount is raised through debenture and remaining by preference share.
- (ii) Issue of equity shares only.

Financing Decision – Leverages

7. Details of Kshitij Limited are given below for the year ended 31st March 2025 –

Particulars	Details
Sales	₹ 180 lakhs
Fixed Cost (Excl Interest)	₹ 45 lakhs
B.E.P Sales	₹ 120 lakhs
Equity Share Capital of ₹ 100 Each	₹ 150 lakhs
Income Tax Rate	25%
Cost Of Debt (Kd)	9%
Debt	₹ 90 lakhs

Required to CALCULATE -

- (A) Operating, Financial, Combined Leverage & P/V Ratio
- (B) Return on Capital Employed and EPS
- (C) Does Kshitij Limited have favorable Financial Leverage?
- (D) % Change in EPS, if EBIT increases or decreases by 15%

- (E) At what level of Sales, the PAT will be equal to $\frac{3}{4}$ th of its current value.

Dividend Decision

8. Mr. A had gathered the following information for his analysis –
- (A) A Company pays regular dividend on quarterly basis and the last interim dividend declared for the quarter was ₹ 3 per share
- (B) Owing to a wide market reach and presence, company's turnover has seen an annual compounded growth of 25% (CAGR) in the last 5 years and the turnover is expected to grow at the same rate in the future as well. The company expects the following Rate of Return (ROI) against the probabilities of likely achievement mentioned along with in different situations.

Scenario	ROI	Probability
I	20%	0.30
II	15%	0.60
III	12%	0.50

- (C) The retention ratio over the last 5 years has been 40%, 65%, 50%, 45%, 30% respectively and company plans to retain based on the past average.
- (D) The current interest rate on GOI Treasury bond is at 4.5% and the beta of the company is 1.3 and a market return of 12.5%

You are required to CALCULATE the theoretical market price of the company's share for Mr. A's decision-making using Gordon's model and Walter's model.

Management of Working Capital

9. The management of Parshvam Limited is planning to expand its business at international level and consults you for preparing and estimation of working capital needs so that they can avail the finance from the bank. The estimated data of Parshvam Limited reveal the following information –

Particulars	Amount (₹)
Materials Used	
Domestic on 2 months credit	9,00,000
Imports on 3 months credit **	6,00,000
Lag in Payment of wages - 1 month	6,00,000
Lag in Payment of Manufacturing Overheads – ½ Month	26,40,000
Sales	
Domestic on 1.5 months credit	30,00,000
Export on 3 months credit (sale price 10% below domestic price)	24,80,000
Administrative expenses payable in advance for 2 months	3,60,000
Lag in payment of Selling & Distribution expenses – 1 month	3,00,000

Advance Income tax for ₹25,000 for the quarter falling in the next financial year is paid by the company. Manufacturing overheads is inclusive of depreciation on the new machine purchased for tailor-made export products. The purchase price for the new machine is ₹24,00,000 with a depreciation rate of 10%. Cash Gross profit is at 20% on domestic sales.

However, to promote exports, Export Promotion Council (EPC Board) provides a revenue subsidy of 2.5% for the new machine purchased. Furthermore, Parshvam Limited submits the letter of credit (LOC) to its bank and avails the all-Export Sales value within 1 month. Financial institution charges a fee of 5% for the same.

The company keeps one month stock of raw materials and finished goods each. Goods remain in process for half a month with 90% raw materials introduced in the process. The company believes in keeping cash and bank balance of ₹1,50,000. The management is of the opinion that the safety margin is to be kept at 15%.

**Raw materials imported will attract a custom duty at 20% to be paid up front with a duty drawback of 5% credited upfront. You are required to -

- (A) PREPARE the estimated working capital statement for the next year.
- (B) ADVISE whether Parshvam Limited should continue with the export business or not.

(Requisite assumptions and notes should form part of the solution).

Miscellaneous

10. (a) Explain as to how the wealth maximisation objective is superior to the profit maximisation objective.
- (b) Explain some common methods of venture capital financing.



SUGGESTED ANSWERS

1. i. A. ₹ 5,20,000
- ii. B. ₹ 5,98,000

Working Notes:

$$\begin{aligned}
 \text{Depreciation on Machine TMT 1} &= \frac{45,00,000}{10} \\
 &= ₹ 4,50,000 \\
 \text{Depreciation on Machine TMT 2} &= \frac{50,00,000}{10} \\
 &= ₹ 5,00,000
 \end{aligned}$$

Particulars	Machine TMT 1 (₹)	Machine TMT 2 (₹)
Annual Savings:		
Direct Wages	15,00,000	20,00,000
Scraps	5,00,000	6,00,000
Total Savings (A)	20,00,000	26,00,000

Annual Estimated Cash Cost :		
Indirect Material	2,00,000	2,00,000
Indirect Labour	1,50,000	1,80,000
Repairs and Maintenance	4,00,000	8,00,000
Total Cost (B)	7,50,000	11,80,000
Annual Cash Savings (A-B)	12,50,000	14,20,000
Less: Depreciation	4,50,000	5,00,000
Annual Savings before Tax	8,00,000	9,20,000
Less: Tax @ 35%	2,80,000	3,22,000
Annual Savings /Profits after tax	5,20,000	5,98,000
Add: Depreciation	4,50,000	5,00,000
Annual Cash Inflows	9,70,000	10,98,000

iii. C. 4.63 and 4.55 years

$$\text{Payback Period} = \frac{\text{Total Initial Capital Investment}}{\text{Annual expected after tax net cashflow}}$$

$$\begin{aligned} \text{Machine TMT 1} &= \frac{45,00,000}{9,70,000} \\ &= 4.63 \text{ years} \end{aligned}$$

$$\begin{aligned} \text{Machine TMT 2} &= \frac{50,00,000}{10,98,000} \\ &= 4.55 \text{ years} \end{aligned}$$

iv. B. 23.11% and 23.92%

$$\begin{aligned} \text{Accounting (Average) Rate of Return (ARR)} \\ &= \frac{\text{Average Annual Net Savings}}{\text{Average investment}} \times 100 \end{aligned}$$

$$\begin{aligned} \text{Machine TMT 1} &= \frac{5,20,000}{22,50,000} \times 100 \\ &= 23.11\% \end{aligned}$$

$$\begin{aligned} \text{Machine TMT 2} &= \frac{5,98,000}{25,00,000} \times 100 \\ &= 23.92\% \end{aligned}$$

v. D. 1.08 and 1.10

Present Value Cash Inflow = Annual Cash Inflow x PV factor
at 15% Machine TMT 1

$$= 9,70,000 \times 5.019 = ₹ 48,68,430$$

Machine TMT 2 = 10,98,000 x 5.019 = ₹ 55,10,862

Profitability Index or PV Index = $\frac{\text{Present Value of Cash Inflow}}{\text{Investment}}$

$$\begin{aligned} \text{Machine TMT 1} &= \frac{48,68,430}{45,00,000} \\ &= 1.08 \end{aligned}$$

$$\begin{aligned} \text{Machine TMT 2} &= \frac{55,10,862}{50,00,000} \\ &= 1.10 \end{aligned}$$

2. D. 20.31%

$$K_e = \frac{D_1}{NP} + g$$

Net proceeds per share = P0 - underpricing - Floatation cost
= 51 - 2 - 0.50 = 48.50

$$\begin{aligned} K_e &= \frac{5}{48.50} + 0.10 \\ &= 20.31\% \end{aligned}$$

3. C. ₹ 66,000

% Change in Operating Income = Degree of Operating
Leverage (DOL) × %
Change in Sales

% Change in Operating Income = 3 × (-10%) = -30%

Decrease in Operating Income = 30% of 2,20,000
= ₹ 66,000

4. Balance Sheet of Navy Private Limited as of 31.03.2025

Particulars	Notes	Amount (₹)	Amount (₹)
A] Equities and Long Term Liabilities			
Share Capital		36,00,000	
Reserves and Surplus	WN-7	1,18,750	
14% Bonds	Bal. Fig.	22,31,250	59,50,000
B] Current Liabilities			
Trade Payables	WN-6	40,30,244	
Outstanding expenses and provisions	Bal. Fig.	4,69,756	45,00,000
(*Net of Prepaid expenses of ₹ 7,50,000)			
TOTAL			1,04,50,000
C] Fixed Assets			
Opening WDV	WN-3	32,94,118	
(-) Depreciation	WN-3	(4,94,118)	28,00,000 (WN-2)
D] Current Assets			
Inventory	WN-5	26,86,829	
Trade Receivables	WN-5	41,98,170	
Cash and Bank Balance	WN-4	7,65,000	76,50,000 (WN 1)
TOTAL			1,04,50,000

WN 1 – Calculation of Current Assets using Current Ratio

$$\begin{aligned} \text{Current Ratio} &= \frac{\text{CA}}{\text{CL}} \\ \text{CL} &= 45,00,000 + 7,50,000 \\ &= 52,50,000 \\ 1.6 &= \text{CA} / 52,50,000 \\ \text{Therefore CA} &= 84,00,000 \end{aligned}$$

CA = Inventory + Trade Receivables + Cash Bank Balance + Prepaid Exp
 $84,00,000 = \text{Inventory} + \text{Trade Receivables} + \text{Cash Bank Balance} + 7,50,000$
 Therefore, total of Inventory + Trade Receivables + Cash Bank Balance
 $= 76,50,000$

WN 2 – Calculation of Fixed Assets & Total Assets

Fixed Assets = 25% of Total liabilities or 25% of Total Assets which means

Current Assets = 75% of Total liabilities or 75% of Total Assets

Fixed Assets + Current Assets = Total Assets/Total Liabilities

25 + 75 = 100

Fixed Assets = $84,00,000 \times 25/75 = 28,00,000$

Total Assets = $1,12,00,000$

WN 3 – Calculation of Depreciation and Opening WDV of Fixed Assets

Opening WDV - Depreciation = Closing WDV

100 - 15 = 85

Therefore, Depreciation = $28,00,000 \times 15/85 = 4,94,118$

Opening WDV = $32,94,118$

WN 4 – Calculation of Cash & Bank Balance

Cash & Bank Balance = 10% of (CA – Prepaid Exp)

Cash & Bank balance = 10% of $(84,00,000 - 7,50,000)$

Therefore, cash and bank balance = $7,65,000$

WN 5 – Calculation of Inventory & Trade receivables

Total CA = Inventory + Trade Receivables + Cash Bank Balance + Prepaid Exp

$84,00,000 = \text{Inventory} + \text{Trade Receivables} + 7,65,000 + 7,50,000$

Inventory + Trade Receivables = $68,85,000$

Now, Let Sales be X

$$\text{GP Ratio} = 20\% = 0.2X$$

$$\text{COGS} = 80\% = 0.8X$$

$$\text{Debtors T/O Ratio} = \frac{\text{Net Credit Sales}}{\text{Debtors}}$$

$$12 = \frac{X}{\text{Debtors}}$$

$$\text{Debtors} = X / 12$$

$$\text{Inventory T/O Ratio} = \text{COGS/Inventory}$$

$$15 = 0.8X/\text{Inventory}$$

$$\text{Inventory} = 0.8X/15$$

$$\text{Inventory} + \text{Trade Receivables} = 68,85,000$$

$$0.8X / 15 + X / 12 = 68,85,000$$

$$\text{Therefore X} = \text{Sales} = 5,03,78,050$$

$$\text{COGS} = 4,03,02,440$$

$$\text{Trade Receivables} = 41,98,170$$

$$\text{Inventory} = 26,86,829$$

WN 6 – Calculation of Trade Payables using Creditors Turnover Ratio

$$\text{Creditors T/O Ratio} = \frac{\text{COGS}}{\text{Trade Payables}}$$

$$10 = \frac{4,03,02,440}{\text{Trade Payables}}$$

$$\text{Trade Payables} = 40,30,244$$

WN 7 – Calculation of Reserves and Surplus & 14% Bonds

$$\text{Total Capital Employed} = \text{Share Cap} + \text{R\&S} + \text{Bonds}$$

$$\text{Capital Gearing Ratio} = \frac{\text{Capital bearing Fixed \%}}{\text{Capital not bearing fixed \%}}$$

$$0.6 = \frac{\text{Bonds}}{\text{Share Capital} + \text{R\&S}}$$

$$\text{Therefore, Bonds} = 21,60,000 + 0.6 \text{ R\&S}$$

Substituting the value of bonds in the above equation,

$$\text{Total Capital Employed} = \text{Share Cap} + \text{R\&S} + (21,60,000 + 0.6 \text{ R\&S})$$

$$59,50,000 = 36,00,000 + 1.6 \text{ R\&S} + 21,60,000$$

$$\text{Therefore R\&S} = 1,18,750$$

5. (A) Calculation of Interest rate on Bank term Loan & Debentures

Let the rate of interest on bank term loan be 'X'

$$\text{Therefore, Rate of Interest on debentures} = 1.5X$$

$$\text{Rate of Preference dividend} = 1.5 \times 1.5X = 2.25X \text{ (1.5 times of debentures interest rate)}$$

Now, let's calculate K_d (term loan), K_d (debentures), K_p (Pref. shares) & K_e

$$K_d (\text{Term loan}) = \text{Int} (1 - t)$$

$$= X (1 - 0.25)$$

$$\mathbf{K_d (Term loan) = 0.75X}$$

$$K_d (\text{Debentures}) = \frac{I(1-t) + \frac{(RV-NP)}{n}}{\frac{(RV+NP)}{2}}$$

$$RV = 100 + 5\% = ₹ 105$$

$$NP = \text{Issue Price} / \text{Market price} = ₹ 96$$

$$= \frac{150X(1-0.25) + \frac{(105-96)}{5}}{\frac{(105+96)}{2}}$$

$$\mathbf{K_d (Debentures) = \frac{112.5X + 1.8}{100.5}}$$

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

$$RV = 100 + 5\% = ₹ 105$$

$$NP = \text{Issue price} / \text{Market price} = ₹ 102$$

$$\text{Therefore } K_p = \frac{225X + (105 - 102 / 7)}{(105 + 102) / 2}$$

$$K_p = \frac{225X + 0.4286}{103.5}$$

$$K_e = \frac{1}{\text{PE Ratio}}$$

$$= \frac{1}{6.667}$$

$$\text{Therefore, } K_e = 15\%$$

$$K_r = K_e = 15\% \text{ (In absence of information on opportunity cost)}$$

$$\text{Overall Capitalization rate (} K_o \text{)} = 20\% \text{ (given)}$$

Sources of capital	Amount of capital	Weights (W)	Cost (K)	W x K
Equity share capital	25,00,000	0.3125	15	4.6875
Reserves & surplus	10,00,000	0.1250	15	1.8750
Bank term loan	10,00,000	0.1250	0.75X	0.09375X
Debentures	15,00,000	0.1875	$\frac{112.5X + 1.8}{100.5}$	$\frac{21.094X + 0.3375}{100.5}$
Preference share capital	20,00,000	0.2500	$\frac{225X + 0.4286}{103.5}$	$\frac{56.25X + 0.1072}{103.5}$
	80,00,000	1.0000	Ko /WACC	20%

$$20 = 4.6875 + 1.8750 + 0.09375X + \frac{21.094X + 0.3375}{100.5} + \frac{56.25X + 0.1072}{103.5}$$

On solving the above equation,

$$13.4375 = 0.09375X + \frac{(2183.2X + 34.931 + 5653.125X + 10.774)}{10,401.75}$$

$$1,39,773.52 = 975.16X + 2,183.2X + 5,653.125X + 45.705$$

$$1,39,727.815 = 8,811.485X$$

$$X = \text{Rate of Interest on Bank term Loan} = 15.86\%$$

$$\text{Rate of Interest on Debentures} = 15.86 \times 1.5 = 23.79\%$$

$$\text{Rate of Preference Dividend} = 15.86 \times 2.25 = 35.68\%$$

(B) Calculation of WACC using Market Value weights

Sources	Market value	Weights (W)	Cost (K)	W x K
Equity share capital	37,50,000	0.456	15.000	6.83
Bank term loan	10,00,000	0.122	11.895	1.45
Debentures	14,40,000	0.175	17.843	3.12
Preference share capital	20,40,000	0.248	26.764	6.63
Total	82,30,000	1	Ko /WACC	18.04

WN – Calculation of Market Value of each capital sources

$$\text{MV of Equity} = 25,000 \times 150 = 37,50,000$$

**MV of Reserves & Surplus = Already Included in the Equity Above

$$\text{MV of Term Loan} = 10,00,000$$

MV of Debentures = 15,000 x 96 = 14,40,000

MV of Pref. Shares = 20,000 x 102 = 20,40,000

6.

Particulars	Additional Funds : Debentures = 15,00,000 x 2/3 Pref = 15,00,000 x 1/3	Additional Funds : 100% Equity
Operating Profit Wn - 1	9,55,776	9,55,776
Less: Interest Exp		
Current	(80,000)	(80,000)
Additional (10,00,000 X 12%) Wn - 2	(1,20,000)	-
EBT	7,55,776	8,75,776
Less: Tax @ 20%	(1,51,155)	(1,75,155)
EAT	6,04,621	7,00,621
Less: Preference Dividend		
Current	(1,12,000)	(1,12,000)
Additional (5,00,000 X 14.5%) Wn - 2	(72,500)	-
Earnings for Equity Shareholders	4,20,121	5,88,621
No of Equity Shares		
Current	16,000	16,000
Additional Wn - 3	-	7,550
EPS	26.26	25.00

WN 1 – Calculation of EBIT after expansion

As given in the question, ROCE is based on the total value of firm, so first step would be to calculate the total value of the firm

Value of Firm = Value of Debt + Value of Pref shares + Value of Equity + Value of R/S

Value of Debt (Vd) = $\frac{\text{Interest (₹)}}{\text{Interest \%}} + 10\% \text{ premium}$
 $= \frac{80,000}{0.10} + 10\% \text{ premium}$

$$= ₹ 8,80,000$$

$$\begin{aligned}\text{Value of Preference (Vp)} &= \frac{\text{Pref Div (₹)}}{\text{Pref Div \%}} + 25\% \text{ premium} \\ &= \frac{1,12,000}{0.14} + 25\% \text{ premium} \\ &= 10,00,000\end{aligned}$$

$$\begin{aligned}\text{Value of Equity share capital (Ve)} &= \frac{\text{Dividend}}{K_e} \\ &= \frac{3,20,000 \times 0.6}{0.20} \\ &= 9,60,000\end{aligned}$$

$$\text{Value of R/S} = 9,00,000$$

$$\begin{aligned}\text{Therefore, Value of Firm (Vf)} &= 8,80,000 + 10,00,000 + 9,60,000 + 9,00,000 \\ &= 37,40,000\end{aligned}$$

$$\begin{aligned}\text{ROCE (Before expansion)} &= \frac{\text{EBIT}}{\text{Total value of the firm}} \\ &= \frac{6,20,000}{37,40,000} \\ &= 16.58\%\end{aligned}$$

$$\begin{aligned}\text{ROCE (After expansion)} &= 16.58 + 1.658 \text{ (i.e } 16.58 + 10\%) \\ &= 18.24\%\end{aligned}$$

$$\begin{aligned}\text{EBIT (After expansion)} &= (37,40,000 + 15,00,000) \times 18.24\% \\ &= ₹ 9,55,776\end{aligned}$$

WN 2 – Calculation of Interest on additional debt and Preference dividend on additional Preference share capital

Condition – If the capital gearing ratio goes above 2.50, then additional debt raised would be at higher rate of interest and additional Preference shares would also be raised at higher preference dividend rate

Capital gearing ratio when Additional funds are raised through additional debt and preference share capital.

$$\text{Capital gearing ratio} = \frac{8,00,000 + 8,00,000 + 15,00,000}{1,60,000 + 9,00,000}$$

$$\text{Capital gearing ratio} = 2.92$$

Since it is greater than 2.50, Interest on Debt = 10% + 2% (200 basis points)
= 12%

$$\text{Preference Dividend} = 14\% + 0.5\% = 14.5\%$$

WN 3 – Calculation of Additional No of Equity shares when funds are raised through equity

Fair value of equity shares before issuing new equity share

$$\begin{aligned} &= \frac{\text{Total Value of the firm}}{\text{No of existing equity shares}} \\ &= \frac{37,40,000}{16,000} \\ &= ₹ 233.75 \end{aligned}$$

$$\text{Issue Price} = 233.75 - 15\% \text{ Discount} = ₹ 198.69$$

Therefore, No of New Equity shares to be issued

$$\begin{aligned} &= \frac{\text{Additional Funds to be raised}}{\text{Fair value}} \\ &= \frac{15,00,000}{198.69} \\ &= 7549.45 \text{ shares approx. } 7550 \text{ shares} \end{aligned}$$

Comment – It is advisable for Namra Limited to raise the additional funds through a mix of debentures and preference as EPS is maximum

7.

Particular		Amount (₹)
Sales		180 lakhs
Contribution (180 x 37.5%)	WN - 1	67.50 lakhs
(-) Fixed Cost		(45.00) lakhs
EBIT		22.50 lakhs
(-) Interest Exp	WN - 2	(10.80) lakhs

EBT	11.70 lakhs
(-) Tax @ 25%	(2.925) lakhs
EAT	8.775 lakhs
No of Equity Shares	1.50 lakhs
EPS	₹ 5.85

(A) Calculation of OL, FL, CL & P/V Ratio
WN 1 – Calculation of P/V Ratio

$$\text{B.E.P Sales} = \frac{\text{Fixed Cost}}{\text{PV Ratio}}$$

$$\text{PV Ratio} = 45 / 120 = 37.5\%$$

WN 2 – Calculation of Interest Exp

$$\text{Kd} = \text{Interest} (1 - t)$$

$$9 = \text{Interest} (1 - 0.25)$$

$$\text{Interest} = 12\%$$

$$\text{Interest Exp} = 90 \text{ Lakhs} \times 12\% = ₹ 10.8$$

$$\text{OL} = \frac{1}{\text{Margin of Safety (MOS)}}$$

$$\text{MOS} = \frac{\text{Actual Sales} - \text{BEP Sales}}{\text{Actual Sales}}$$

$$= 60/180$$

$$= 0.3333$$

$$\text{OL} = \frac{1}{0.3333} = 3$$

OR

$$\text{OL} = \frac{\text{Contribution}}{\text{EBIT}}$$

$$= 67.50 / 22.50$$

$$\text{OL} = 3$$

$$\begin{aligned}
 \text{FL} &= \frac{\text{EBIT}}{\text{EBT}} \\
 &= 22.50 / 11.70 \\
 \text{FL} &= 1.9231 \\
 \text{CL} &= \text{OL} \times \text{FL} \\
 &= 3 \times 1.9231 \\
 \text{CL} &= 5.7693
 \end{aligned}$$

(B) ROCE & EPS

$$\text{EPS} = ₹ 5.85 \text{ (From Income statement above)}$$

$$\begin{aligned}
 \text{ROCE} &= \frac{\text{EBIT}}{\text{Capital Employed}} \\
 &= \frac{22.50}{240} \\
 &= 9.375\%
 \end{aligned}$$

$$\begin{aligned}
 \text{Capital Employed} &= \text{Equity} + \text{Debt} \\
 &= 150 + 90 = 240 \text{ lakhs}
 \end{aligned}$$

(C) Since ROCE = 9.375% < Interest = 12%, Kshitij Limited doesn't have a favorable financial leverage.

(D) Financial leverage measures the relationship for % change EPS due to changes in EBIT

$$\begin{aligned}
 \text{FL} &= \frac{\% \text{ change in EPS}}{\% \text{ change in EBIT}} \\
 1.9231 &= \frac{\% \text{ change in EPS}}{15} \\
 &= 28.8465\%
 \end{aligned}$$

Therefore, EPS will increase or decrease by 28.8465%, if EBIT increases or decreases by 15%

(E) **Current PAT = 8.775 lakhs**

$3/4^{\text{th}}$ of current PAT = 6.58125 lakhs

So, it means PAT decreases by 25%

Combined leverage measures the relationship for % change in PAT due to changes in sales

$$CL = \frac{\% \text{ change in PAT}}{\% \text{ change in Sales}}$$

$$5.7693 = \frac{25}{\% \text{ change in Sales}}$$

% Change in Sales = 4.333%

New Sales level = 180 lakhs - 4.33%

New Sales level = ₹172.20 Lakhs

8. Calculation of the theoretical price (intrinsic price) denoted by 'Po' using Gordon's formula

$$P_0 = \frac{D_1}{K_e - g}$$

So we need to calculate 3 variables i.e g, D1 & Ke

(A) $g = \text{Retention Ratio} \times \text{ROI}$

$$\text{Retention ratio} = \frac{40 + 65 + 50 + 45 + 30}{5}$$

$$= 0.46$$

Scenario	ROI	Probability	Expected ROI
I	20%	0.30	$20 \times 0.3 = 6$
II	15%	0.60	$15 \times 0.6 = 9$
III	12%	0.50	$12 \times 0.5 = 6$
			Expected ROI = 21%

Therefore $g = 0.46 \times 21 = 9.66\%$

$$\begin{aligned} \text{(B)} \quad D_1 &= D_0 + g \\ D_0 &= ₹ 3 \text{ per quarter} \times 4 \\ &= ₹ 12 \text{ (Annually)} \end{aligned}$$

$$\begin{aligned} \text{Therefore } D_1 &= 12 + 9.66\% \\ &= ₹ 13.16 \end{aligned}$$

(C) K_e will be calculated using CAPM Model and as per CAPM

$$\begin{aligned} K_e &= R_f + (R_m - R_f) \times \text{Beta} \\ &= 4.5 + (12.5 - 4.5) \times 1.3 \\ &= 14.9\% \end{aligned}$$

$$P_0 = \frac{13.16}{0.149 - 0.0966}$$

$$= ₹ 251.15$$

Calculation of the theoretical price (intrinsic price) denoted by 'Po' using Walter's formula

$$\text{As per Walter} \quad P = \frac{D + \frac{r}{K_e}(E - D)}{K_e}$$

Where 'D' is constant, so no growth would be added

$$\begin{aligned} \text{EPS} &= \text{Dividend} / (1 - \text{Retention ratio}) \\ &= 12 / (1 - 0.46) \\ &= ₹ 22.22 \end{aligned}$$

$$P = \frac{12 + \frac{0.21}{0.149}(22.22 - 12)}{0.149}$$

$$P_0 = ₹ 177.21$$

9. (A) Statement for estimation of Working Capital using Cash Cost Basis

Parshvam Limited

Particulars	Amount (₹)	Amount (₹)
(A) Current Assets		
1. Raw materials $15,90,000 \times 1/12$	1,32,500	
2. WIP		
~ RM $15,90,000 \times 0.5 / 12 \times 90\%$	59,625	
~ Wages $6,00,000 \times 0.5 / 12 \times 50\%$	12,500	
~ Manufacturing OH $23,40,000 \times 0.5 / 12 \times 50\%$	48,750	
~ Other OH $74,472 \times 0.5 / 12 \times 50\%$	1,552	
3. FG (on COGS) $46,04,472 \times 1/12$	3,83,706	
4. Debtors		
~ Domestic $27,61,314 \times 1.5/12$	3,45,164	
~ Export $26,27,158 \times 1/12$ WN - 5	2,18,930	
5. Cash/bank balance (given)	1,50,000	
6. Prepaid admin exp $3,60,000 \times 2/12$	60,000	
7. Income tax paid in advance (given)	25,000	
Gross working capital		14,37,727
(B) Current Liabilities		
1. Creditors		
~ Domestic $9,00,000 \times 2/12$	1,50,000	
~ Import $6,00,000 \times 3/12$	1,50,000	
2. Lag in wages payment $6,00,000 \times 1/12$	50,000	
3. Lag in manufacturing OH $23,40,000 \times 0.5/12$ Lag in other OH $74,472 \times 0.5/12$	97,500 3,103	
4. Lag in S&D exp $3,00,000 \times 1/12$	25,000	
Excess of CA over CL		9,62,124
Add: 15% safety margin $(9,62,124 \times 15\%)$		1,44,319
Net working capital		11,06,443

Notes –

- (a) Working Capital is estimated on Cash Cost Basis
 - (b) Other Overheads are assumed to be the part of production.
 - (c) In absence of information on % completion for wages, manufacturing and other overheads, it is assumed to be 50% complete for the purpose of calculating WIP.
 - (d) Other Overheads are also assumed to be outstanding for a period of $\frac{1}{2}$ month. In absence of specific information, it can also be assumed that nothing is outstanding or prepaid.
- (B)** If just the monetary aspects and factors are considered then, Parshvam limited should discontinue its operations at international level as the Cash Cost of sales for export at ₹ 26,27,158 is higher than the Export sales value which is just ₹ 24,80,000. In reality, non-monetary factors are also considered in decision making; exports will add a new customer base for the company. Furthermore, existence at international level brings on a high credibility and image to the company, etc.

WN 1 - Calculation of gross profit on Export Sales:

Let the domestic selling price be ₹100.

Therefore, Gross profit = ₹20, and cost per unit = ₹ 80

Now as given, Export price is 10% less than the domestic price
 $= 100 - 10\% = ₹ 90$. However, the cost per unit to produce exported goods will remain at ₹ 80 only.

So gross profit on exports will be ₹ 90 - 80 = ₹ 10.

Therefore, Gross profit in % for Export Sales = $10 / 90 = 11.11\%$

	Domestic	Export	Total
Sales	30,00,000	24,80,000	54,80,000
Less: Gross Profit	(6,00,000)	(2,75,528)	(8,75,528)
20% for Domestic			
11.11% for Export			
COGS	24,00,000	22,04,472	46,04,472

Add: Admin Exp (To be Apportioned in the ratio of Sales)	1,97,080	1,62,920	3,60,000
Add: S&D Expense (To be Apportioned in the ratio of Sales)	1,64,234	1,35,766	3,00,000
Add: Bank Fees and charges for providing LOC services	-	1,24,000	1,24,000
Cash Cost of Sales	27,61,314	26,27,158	53,88,472

WN 2 - Preparation of Cost/Income Statement

Particulars	Amount (₹)
Raw Materials	
Domestic	9,00,000
Import WN - 3	6,90,000
Wages	6,00,000
Manufacturing Overheads (Cash) WN - 4	23,40,000
Other Overheads (Bal. Fig)	74,472
Cost of Production/Cost of Goods Sold	46,04,472
Add: Admin Exp	3,60,000
Add: S&D Exp	3,00,000
Add: Bank charges & Fees for L.O.C services	1,24,000
Cost of Sales	53,88,472

WN 3 – Calculation of Raw Materials Purchased - Imports

Purchase Price = ₹ 6,00,000

+ Custom Duty @ 20% = ₹ 1,20,000

(-) Upfront Duty Drawback @ 5% = ₹ (30,000)

Total Value of Raw materials = ₹ 6,90,000

WN 4 – Calculation of Cash Manufacturing Overheads

Manufacturing Overheads = ₹ 26,40,000

Less: Depreciation on Machinery

(24,00,000 x 10%) = ₹ (2,40,000)

Less: Revenue Subsidy from EPC Board ***

(24,00,000 x 2.5%) = ₹ (60,000)

Cash Manufacturing Overheads = ₹ 23,40,000

***Revenue subsidy shall not be capitalized but instead it will result in bringing down your manufacturing expenses which is revenue in nature. Had it been the capital subsidy, then it would have reduced the purchase price of the machine and thereby changing the amount of depreciation.

WN 5 - Credit Period for Export customers

Since the company is availing benefit of Letter of Credit (L.O.C), the funds blocked in export customers would only be for 1 month and not 3 months; as the company would receive the entire Export Sales value in 1 month's time from the financial institution after paying the bank charges and fees.

10. (a) A firm's financial management may often have the following as their objectives:

- (i) The maximisation of firm's profit.
- (ii) The maximisation of firm's value / wealth.

The maximisation of profit is often considered as an implied objective of a firm. To achieve the aforesaid objective various type of financing decisions may be taken. Options resulting into maximisation of profit may be selected by the firm's decision makers. They even sometime may adopt policies yielding exorbitant profits in short run which may prove to be unhealthy for the growth, survival and overall interests of the firm. The profit of the firm in this case is measured in terms of its total accounting profit available to its shareholders.

The value/wealth of a firm is defined as the market price of the firm's stock. The market price of a firm's stock represents the focal

judgment of all market participants as to what the value of the particular firm is. It takes into account present and prospective future earnings per share, the timing and risk of these earnings, the dividend policy of the firm and many other factors that bear upon the market price of the stock.

The value maximisation objective of a firm is superior to its profit maximisation objective due to following reasons.

1. The value maximisation objective of a firm considers all future cash flows, dividends, earning per share, risk of a decision etc. whereas profit maximisation objective does not consider the effect of EPS, dividend paid or any other returns to shareholders or the wealth of the shareholder.
2. A firm that wishes to maximise the shareholders wealth may pay regular dividends whereas a firm with the objective of profit maximisation may refrain from dividend payment to its shareholders.
3. Shareholders would prefer an increase in the firm's wealth against its generation of increasing flow of profits.
4. The market price of a share reflects the shareholders expected return, considering the long-term prospects of the firm, reflects the differences in timings of the returns, considers risk and recognizes the importance of distribution of returns.

The maximisation of a firm's value as reflected in the market price of a share is viewed as a proper goal of a firm. The profit maximisation can be considered as a part of the wealth maximisation strategy.

- (b) Some common methods of venture capital financing are as follows:

- (i) **Equity financing:** The venture capital undertakings generally require funds for a longer period but may not be able to provide returns to the investors during the initial stages. Therefore, the venture capital finance is generally provided by way of equity share capital. The equity contribution of

venture capital firm does not exceed 49% of the total equity capital of venture capital undertakings so that the effective control and ownership remains with the entrepreneur.

- (ii) **Conditional loan:** A conditional loan is repayable in the form of a royalty after the venture is able to generate sales. No interest is paid on such loans. In India venture capital financiers charge royalty ranging between 2 and 15 per cent; actual rate depends on other factors of the venture such as gestation period, cash flow patterns, risk and other factors of the enterprise. Some Venture capital financiers give a choice to the enterprise of paying a high rate of interest (which could be well above 20 per cent) instead of royalty on sales once it becomes commercially sound.
- (iii) **Income note:** It is a hybrid security which combines the features of both conventional loan and conditional loan. The entrepreneur has to pay both interest and royalty on sales but at substantially low rates. IDBI's VCF provides funding equal to 80 – 87.50% of the projects cost for commercial application of indigenous technology.
- (iv) **Participating debenture:** Such security carries charges in three phases — in the start-up phase no interest is charged, next stage a low rate of interest is charged up to a particular level of operation, after that, a high rate of interest is required to be paid.

6B: STRATEGIC MANAGEMENT



QUESTIONS

Multiple Choice Questions

1. DezinFab is a fast-growing clothing brand in India. It started with a clear goal: to make stylish clothes affordable for everyone while also being mindful of the environment. The company strongly believes in three values – inclusivity, sustainability, and innovation in fashion.

DezinFab, a dynamic player in India's bustling clothing industry, offers a compelling example of how astute integration of core business principles can pave the path to triumph.

DezinFab was born with a clear vision: making stylish clothing accessible to every Indian, while minimizing their environmental impact through sustainability initiatives. Their guiding values include inclusivity, sustainability, and a forward-looking approach to fashion.

In the beginning, DezinFab emerged as a humble boutique offering affordable clothing. At that time, the clothing market was rapidly evolving, with consumers seeking affordable yet chic options. Recognizing these shifts in customer behavior, DezinFab evolved its product range, embracing formal wear, active wear, and ethnic wear as the market matured.

Their ability to comprehend customer styles was pivotal. DezinFab conducted comprehensive market research to decode fashion trends and changing consumer preferences. This approach led to the creation of collections that resonated with their target audience. They also monitored social media and customer feedback channels, staying attuned to the evolving tastes and demands of their customers. Notably, they quickly responded to the growing demand for sustainable fashion by launching an eco-friendly clothing line.

To manage their diverse stakeholders effectively, DeZineFabs tactfully classified their stakeholders. Fashion influencers and suppliers were nurtured through strategic partnerships, which not only elevated DeZineFabs' brand image but also endowed them with access to cutting-edge fashion trends and premium materials.

Simultaneously, they maintained transparent and responsive communication with local communities and loyal customers. By actively addressing their concerns and soliciting feedback, DeZineFabs upheld a positive reputation and nurtured customer loyalty.

DeZineFabs' prowess laid in the ability of trend forecasting, efficient supply chain management, and robust vendor relationships. Their design team incessantly innovated to remain ahead of evolving fashion trends, allowing them to design collections that resonated deeply with their customer base. Their streamlined supply chain reduced lead times and operational costs, which translated into competitive pricing and the timely delivery of high-quality products. Strong vendor relationships provided them with a consistent supply of premium materials, further fortifying their core competences.

To fuel sustainable growth, DeZineFabs executed a two-pronged approach encompassing market penetration and diversification. They embarked on a journey into tier 2 and 3 cities within India, capturing the attention of urban and semi-urban demographics. Simultaneously, they ventured into international markets, setting their sights on regions where Indian fashion was gaining traction.

Recognizing that growth necessitates change, DeZineFabs cultivated a corporate culture that celebrated adaptability and innovation. Employees were not merely encouraged but were adequately empowered through specialized training programs, equipping them with the skills needed for seamless adaptation to new product launches and market expansions.

Vigilant strategic control mechanisms underpinned DeZineFabs' growth trajectory, ensuring that their expansion remained harmonized with their values and overarching objectives. Routine performance assessments and evaluative protocols equipped the organization with real-time

insights. These insights empowered informed decision-making, enabling DeZineFabs to adjust their strategies deftly in response to ever-evolving market dynamics, shifting customer behavior, and emerging fashion trends.

DeZineFabs' exceptional journey in India's clothing industry underscores the remarkable outcomes that can be realized through the seamless amalgamation of core business principles. In a world where the fashion landscape evolves ceaselessly, DeZineFabs remains a beacon of affordability, sustainability, and accessibility, ensuring that fashion remains an inclusive pursuit for all.

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

- (i) DeZineFabs, an Indian clothing company, is deeply committed to a specific core value that underpins its business philosophy. This core value plays a pivotal role in guiding their actions and decisions. What is the central core value that defines DeZineFabs' business philosophy?
 - (a) Exclusivity, where they prioritize offering unique and rare clothing items.
 - (b) Sustainability, reflecting their dedication to minimizing environmental impact.
 - (c) Profit maximization, focusing primarily on financial gains.
 - (d) International expansion, aiming to dominate global markets.
- (ii) DeZineFabs embarked on a strategic move to introduce specific product variants at a particular phase of the product life cycle. In which phase did DeZineFabs introduce gluten-free and organic variants of their products?
 - (a) Introduction phase, targeting early market entrants.
 - (b) Growth phase, capitalizing on expanding market demand.
 - (c) Maturity phase, aiming to maintain market share.
 - (d) Decline phase, attempting to revive fading product sales.

- (iii) DeZineFabs showcased agility in adapting to evolving customer preferences. How did they respond to changing customer behavior, as highlighted in the given case?
- (a) By increasing the prices of their products to enhance exclusivity.
 - (b) By introducing a sustainable clothing line in response to a growing demand for eco-friendly fashion.
 - (c) By ignoring customer feedback and focusing solely on their original product range.
 - (d) By reducing the variety of their products to simplify their offerings.
- (iv) In accordance with Mendelow's Matrix, some stakeholder groups possess high power and high interest in a company's operations. Among the options listed below, which stakeholder group typically falls into the category of high power and high interest?
- (a) Local communities with a vested interest in the company's impact on their neighborhoods.
 - (b) Fashion influencers, who can significantly affect brand perception and consumer choices.
 - (c) Loyal customers who consistently purchase the company's products.
 - (d) Low-power suppliers providing non-critical materials.
- (v) The case highlights one of DeZineFabs' core competences, which contributes significantly to their success in the clothing industry. What specific core competence is emphasized in the given case?
- (a) Expertise in automobile manufacturing, unrelated to their clothing business.
 - (b) Expertise in designing luxury watches, a separate industry altogether.
 - (c) Expertise in trend forecasting, which plays a critical role in the fashion industry.

- (d) Expertise in aerospace engineering, unrelated to their clothing business.
2. Innovexa Solutions Ltd. operates in the technology sector and has four divisions: Innovate, Develop, Transform, and Elevate. Each division functions as an independent product center while also contributing to the company's flagship product, TechSphere. Every division has its own set of activities, managed by a respective division head, who is responsible for the product line's performance and profitability. While competing in different market segments, each division leverages its own unique resources and capabilities to maintain a competitive edge. This type of organizational structure is known as:
- (a) Network structure
 - (b) Divisional structure
 - (c) Multi-divisional structure
 - (d) Strategic Business Unit (SBU)
3. AeroGlide Inc., a global aviation company, approached Rajesh K, an Indian entrepreneur, to collaborate with his team on a next-generation aircraft manufacturing project. Their goal is to expand into South Asia, a region with a growing demand for advanced aviation technology. What strategy is AeroGlide Inc. trying to implement?
- (a) Market Penetration
 - (b) Market Development
 - (c) Strategic Alliance
 - (d) Diversification
4. A sportswear brand, Athleon, is introducing a new range of eco-friendly performance shoes for fitness enthusiasts. The strategic manager wants to analyze the market position of competing brands in the sustainable sports footwear segment. Which tool can be used for this analysis?
- (a) SWOT Analysis
 - (b) Strategic Group Mapping
 - (c) BCG Matrix

- (d) Value Chain Analysis
5. XYZ Logistics, a leading transportation company, has been operating in the industry for over a decade. Over the years, the company has expanded its fleet, optimized route planning, and implemented advanced fuel efficiency techniques. As a result, the company's per mile operating cost has significantly decreased due to improved efficiency and cumulative experience in managing large-scale logistics operations. Which strategic management concept best explains this reduction in operating costs?
- (a) Experience curve
(b) Ansoff's growth matrix
(c) Strategic surveillance
(d) Value chain analysis
6. Global Fast Foods Ltd., a multinational restaurant chain, is evaluating whether to enter the packaged food industry by launching its own brand of frozen meals. This decision involves analyzing new markets, potential acquisitions, and overall business portfolio diversification. At what level is this decision likely to be made?
- (a) Business
(b) Corporate
(c) Functional
(d) Operational

Descriptive Questions**Chapter 1-Introduction to Strategic Management**

7. Ramesh Sharma has fifteen stores selling consumer durables in the Delhi Region. Four of these stores have been opened in the last three years. He believes in managing strategically and enjoyed significant sales of refrigerators, televisions, washing machines, air conditioners and like till four years back. With shift to the purchases to online stores, the sales of his stores came down to about seventy per cent in the last four years.

Analyse the position of Ramesh Sharma in light of limitations of strategic management.

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

Chapter 2-Strategic Analysis: External Environment

9. Easy Access is a marketing services company providing consultancy to a range of business clients. *Easy Access* and its rivals have managed to persuade the Government to require all marketing services companies to complete a time-consuming and bureaucratic registration process and to comply with an industry code of conduct. Do you think that by doing this *Easy Access* and its rivals has an advantage in some ways to fight off competitors? Explain.
10. Yash is planning to launch his new tech start-up. He is exploring different locations across the country to establish his company in the right business environment. One option is the city of Bengaluru, the Silicon Valley of India, with an engaging network of entrepreneurs, investors, advisors and mentors. Coupled with various subsidies for new ventures and tax benefits, Bengaluru might be an ideal choice for Yash to establish his company and increase the chances of success.

Define the term Business Environment with respect to the above scenario. Explain the different ways in which the interaction of a business with its environment can be helpful in developing a successful strategy.

Chapter 3-Strategic Analysis: Internal Environment

11. EliteWheels Ltd. is a luxury automobile manufacturer that caters to affluent customers seeking exclusivity and high-end features. The company offers premium vehicles with cutting-edge technology, showed customization options, and top-tier customer service. Unlike mass-market car brands, EliteWheels Ltd. charges a significant premium for its automobiles, ensuring that only a niche segment of customers can afford them. Additionally, the company invests heavily in advanced engineering and innovation to maintain its superior quality and brand prestige. Identify and explain the strategy adopted by EliteWheels Ltd.

12. Write short note on SWOT analysis.

Chapter 4-Strategic Choices

13. Jynklo Ltd. is an established online children gaming company in Japan. They are performing good in the gaming industry. The management of Jynklo Ltd. has decided to expand its business. They decided to start a premium sports drink named JynX for athletes. Identify and explain the growth strategy adopted by Jynklo Ltd.?
14. Write a short note on the role of ADL Matrix in assessing the competitive position of a firm.

Chapter 5-Strategy Implementation and Evaluation

15. EcoPure Ltd., a sustainable packaging manufacturer, faces challenges in goal alignment, resource allocation, and customer satisfaction. As a strategic consultant, analyze how strategic performance measures can address these issues. Propose a structured approach to implementation and explain how goal alignment, continuous improvement, and external accountability will drive long-term success and enhance stakeholder confidence.
16. Distinguish between Strategic Planning and Operational Planning.



SUGGESTED ANSWERS

MCQ No.	Answer	
1.	(i)	(b)
	(ii)	(b)
	(iii)	(b)
	(iv)	(b)
	(v)	(c)
2.		(d)
3.		(c)

4.		(b)
5.		(a)
6.		(b)

7. Ramesh Sharma is facing declining sales on account of the large-scale shift of customers to online stores. While he is using the tools of strategic management, they cannot counter all hindrances and always achieve success. There are limitations attached to strategic management as follows:
- ♦ The environment under which strategies are made is highly complex and turbulent. Entry of online stores, a new kind of competitor brought a different dimension to selling consumer durables. Online stores with their size power could control the market and offer stiff competition to traditional stores.
 - ♦ Another limitation of strategic management is that it is difficult to predict how things will shape-up in future. Ramesh Sharma, although managing strategically failed to see how online stores will impact the sales.
 - ♦ Although strategic management is a time-consuming process, he should continue to manage strategically. The challenging times require more effort on his part.
 - ♦ Strategic management is costly. Ramesh Sharma may consider engaging experts to find out preferences of the customers and attune his strategies to better serve them in a customized manner. Such customized offerings may be difficult to match by the online stores.
 - ♦ The stores owned by Ramesh Sharma are much smaller than online stores. It is very difficult for him to visualize how online stores will be moving strategically.
8. Objectives are an **organization's performance targets** – the results and outcomes it wants to achieve. They **function as yardsticks** for tracking an organization's performance and progress. Objectives with strategic focus relate to outcomes that strengthen an organization's overall business position and competitive vitality.

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

- ◆ Objectives should define the organisation's relationship with its environment.
 - ◆ They should be facilitated towards the achievement of mission and purpose.
 - ◆ They should provide the basis for strategic decision-making.
 - ◆ They should provide standards for performance appraisal.
 - ◆ They should be concrete and specific.
 - ◆ They should be related to a time frame.
 - ◆ They should be measurable and controllable.
 - ◆ They should be challenging.
 - ◆ Different objectives should correlate with each other.
 - ◆ Objectives should be set within the constraints of organisational resources and the external environment.
9. Yes, *Easy Access* and its rivals get advantage from this move. The new bureaucratic process is making it more complicated for organizations to start up and enter the *Easy Access* market, increasing barriers to entry and thereby reducing the threat of new entrants. New entrants can reduce an industry's profitability, because they add new production capacity, leading to increase in supply of the product, sometimes even at a lower price and can substantially erode existing firm's market share position. However, New entrants are always a powerful source of competition. The new capacity and product range they bring in throws up a new competitive pressure. The bigger the new entrant, the more severe the competitive effect. New entrants also place a limit on prices and affect the profitability of existing players, which is known as Price War.
10. Business Environment refers to all external factors, influences, or situations that affect business decisions, plans, and operations. In Yash's case, these factors include the dynamic and evolving conditions in Bengaluru, which impact the strategic decisions for his tech start-up.

Benefits of Interaction with the Business Environment

- ◆ **Determine Opportunities and Threats:** Interaction with the environment helps Yash identify new consumer needs, emerging trends, and potential market opportunities. This insight can guide the development of innovative products and services that meet market demands. Understanding changes in laws, social behaviors, and competitor actions enables Yash to anticipate and mitigate potential threats, ensuring the start-up remains resilient and adaptive.
- ◆ **Give Direction for Growth:** By analyzing the external environment, Yash can pinpoint areas for expansion and growth. Recognizing market trends and technological advancements allows him to strategize effectively, ensuring the start-up scales successfully. Awareness of the changes around the business environment facilitates better planning and strategic decisions, aligning the start-up's goals with the market dynamics.
- ◆ **Continuous Learning:** Continuous interaction with the environment motivates Yash and his team to update their knowledge, understanding, and skills. Staying informed about industry trends and advancements ensures the start-up remains competitive. This ongoing learning process enhances the start-up's ability to adapt to changes, promoting innovation and responsiveness to market shifts.
- ◆ **Image Building:** Understanding and responding to environmental needs help the start-up build a positive image. For instance, adopting sustainable practices or contributing to local initiatives can enhance the company's reputation. Demonstrating sensitivity to the business environment shows that the start-up is responsible and community-focused, attracting customers and partners who value corporate social responsibility.
- ◆ **Meeting Competition:** Interaction with the environment allows Yash to analyze competitors' strategies and adapt accordingly. Understanding competitors' strengths and weaknesses helps in crafting strategies that provide a competitive edge. By leveraging insights from the environment, the start-up can position itself

uniquely in the market, differentiating its offerings from those of competitors.

11. According to Michael Porter, competitive advantage can be derived from three generic strategies: cost leadership, differentiation, and focus.

EliteWheels Ltd. targets a niche market segment by offering unique and high-value automobiles tailored to the needs of affluent consumers. While the company manages its costs efficiently, it does not compromise on the quality or exclusivity of its products. By maintaining superior craftsmanship, advanced technology, and high personalization levels, the brand commands a premium price for its vehicles. Thus, the strategy adopted by EliteWheels Ltd. is **Focused Differentiation**.

A focused differentiation strategy involves offering distinctive features that cater to a specific market segment. Companies employing this strategy may target a specific customer demographic, geographic region, or sales channel. Firms that compete based on uniqueness and focus on a specialized market segment follow a Focused Differentiation Strategy.

12. SWOT analysis is a tool used by organizations for evolving strategic options for the future. The term SWOT refers to the analysis of strengths, weaknesses, opportunities and threats facing a company. Strengths and weaknesses are identified in the internal environment, whereas opportunities and threats are located in the external environment.

- (a) **Strength:** Strength is an inherent capability of the organization which it can use to gain strategic advantage over its competitor.
- (b) **Weakness:** A weakness is an inherent limitation or constraint of the organisation which creates strategic disadvantage to it.
- (c) **Opportunity:** An opportunity is a favourable condition in the external environment which enables it to strengthen its position.
- (d) **Threat:** An unfavourable condition in the external environment which causes a risk for, or damage to the organisation's position.

The major purpose of SWOT analysis is to enable the management to create a firm-specific business model that will best align, fit or

match organisational resources and capabilities to the demands of the environment in which it operates.

13. Currently Jynklo Ltd. is performing in the children's gaming industry. But now its management has decided to expand their business by starting a premium sports drink named JynX for athletes. As there are no links to both products with respect to customer groups, customer functions, or the technologies being used, Jynklo Ltd. have opted **Conglomerate diversification**.

Jynklo Ltd. diversifies in a business that is not related to their existing line of products and can be termed as conglomerate diversification. In conglomerate diversification, the new businesses/ products are disjointed from the existing businesses/products in every way; it is an unrelated diversification. In process/ technology/ function, there is no connection between the new products and the existing ones. Conglomerate diversification has no common threat at all with the firm's present position.

14. The ADL matrix has derived its name from Arthur D. Little which is a portfolio analysis method based on product life cycle. The approach forms a two-dimensional matrix based on stage of industry maturity and the firm's competitive position, environmental assessment and business strength assessment. The role of ADL matrix is to assess the competitive position of a firm based on an assessment of the following criteria:
- ♦ **Dominant:** This is a comparatively rare position and in many cases is attributable either to a monopoly or a strong and protected technological leadership.
 - ♦ **Strong:** By virtue of this position, the firm has a considerable degree of freedom over its choice of strategies and is often able to act without its market position being unduly threatened by its competitors.
 - ♦ **Favourable:** This position, which generally comes about when the industry is fragmented and no one competitor stand out clearly, results in the market leaders a reasonable degree of freedom.
 - ♦ **Tenable:** Although the firms within this category are able to perform satisfactorily and can justify staying in the industry, they

are generally vulnerable in the face of increased competition from stronger and more proactive companies in the market.

- ♦ **Weak:** The performance of firms in this category is generally unsatisfactory although the opportunities for improvement do exist.

15. Strategic performance measures are critical for EcoPure Ltd. as they provide a structured approach to addressing the company's challenges. By implementing these measures, EcoPure Ltd. can enhance efficiency, optimize resources, and improve stakeholder confidence.

- **Goal Alignment** ensures that all departments work towards EcoPure Ltd.'s sustainability and customer satisfaction objectives. By setting clear goals, the company can ensure consistency in decision-making and strategic execution.
- **Resource Allocation** helps the company make informed investment decisions, prioritizing areas like production efficiency, innovation, and supply chain improvements. This enables EcoPure Ltd. to optimize resources while maintaining high-quality standards.
- **Continuous Improvement** allows the company to track key performance indicators such as delivery timelines, product quality, and operational efficiency. Regular analysis and refinements in processes will help the company enhance performance over time.
- **External Accountability** builds trust with stakeholders, including investors, customers, and regulatory bodies. By maintaining transparency in reporting and demonstrating commitment to sustainability, EcoPure Ltd. can strengthen its market reputation.

By leveraging strategic performance measures in these areas, EcoPure Ltd. can overcome its challenges, enhance customer satisfaction, and drive long-term success.

16.

Strategic planning	Operational planning
Strategic planning shapes the organisation and its resources.	Operational planning deals with current deployment of resources.
Strategic planning assesses the impact of environmental variables.	Operational planning develops tactics rather than strategy.
Strategic planning takes a holistic view of the organisation.	Operational planning projects current operations into the future.
Strategic planning develops overall objectives and strategies.	Operational planning makes modifications to the business functions but not fundamental changes.
Strategic planning is concerned with the long-term success of the organisation.	Operational planning is concerned with the short-term success of the organisation.
Strategic planning is a senior management responsibility.	Operational planning is the responsibility of functional managers.