PAPER – 6: FINANCIAL MANAGEMENT AND STRATEGIC MANAGEMENT

PART – I Multiple Choice Questions

Case Scenario - I

XYZ Ltd. is engaged in manufacturing of an electronic component, to be used by industries producing electronic gadgets for domestic use. The company is a leveraged company, currently paying annual interest of ₹ 33 lakhs on its 11% debt. The company is financially prudent. It has a balance of ₹ 50 lakhs as retained earnings. The company maintains Long-term Debt to Equity ratio of 2: 1. The face value per share of the company is ₹ 10.

Due to operating in a competitive market, the marketing manager of the company has submitted a report exhibiting significant potential for sales growth. The production manager has endorsed the idea and has suggested adopting latest technology at the workplace. In case the company implements new technology, the production efficiency will increase which will bring down the overall cost of production. To procure and install this new technology, the company requires an additional fund of ₹ 3 crores. This additional fund will be arranged in such a manner that it will not impact the present Long-term Debt to Equity ratio. The additional debt will carry interest rate of 12% p.a. As a result of implementing the new technology, it is anticipated that ROI will increase by 3% from present ROI of 15%. Applicable tax rate is 30%.

Based on the facts mentioned above pertaining to XYZ Ltd., you are required to answer the following questions 1 to 5:

1. *What is the equity share capital outstanding before the additional fund is introduced?*

   (A) ₹ 1.00 crores

   (B) ₹ 1.50 crores

   (C) ₹ 0.50 crores

   (D) ₹ 2.00 crores **(2 Marks)**

2. *What is the total capital employed before and after additional financing?*

   (A) ₹ 4.00 crores and ₹7.00 crores

   (B) ₹ 5.00 crores and ₹8.00 crores

   (C) ₹ 4.50 crores and ₹ 7.50 crores

   (D) ₹ 5.50 crores and ₹ 8.50 crores **(2 Marks)**

3. *Compute the EPS after additional financing. What will be the percentage increase in EPS of the company, after introducing the additional fund?*

   (A) ₹ 2.73, 13.04%

   (B) ₹ 2.18, 35.65%

   (C) ₹ 2.73, 11.54%

   (D) ₹ 2.18, 26.28% **(2 Marks)**

4. *What will be the expected MPS after the change in funds, if company expects a P/E ratio of 20?*

   (A) ₹ 43.68

   (B) ₹ 54.60

   (C) ₹ 70.00

   (D) ₹ 47.60 **(2 Marks)**

5. *What will be the post-tax weighted average cost of debt after additional financing?*

   (A) 7.70%

   (B) 8.05%

   (C) 9.00%

   (D) 7.98% **(2 Marks)**

6. *A company has credit sales of ₹ 20,00,000 with an average collection period of 35 days. It wants to liberalize its existing credit terms which are expected to increase sales to ₹ 25,00,000. However, average collection period is expected to decline to 10 days. Profit Volume ratio is 20% and opportunity cost (post-tax) is 6%. Tax rate is 40%. Assume 360 days in a year.*

What is the incremental investment in debtors and its impact on post-tax profitability?

	Incremental Investment in debtors	***Impact on Post -tax profitability***
(A)	*₹ (1,25,000)*	*₹ 7,500*
(B)	*₹ (1,00,000)*	*₹ (6,000)*
(C)	*₹ (1,25,000)*	*₹ (7,500)*
(D)	*₹ (1,00,000)*	*₹ 6,000*

(2 Marks)

7. *FG Ltd. is appraising a one-year investment plan, which requires an initial outlay of ₹ 1,00,000. At the end of term, it will be matured at ₹ 1,25,000. The plan has a beta of 1.3, risk free rate of return 10% and market rate of return 18%. Calculate the required rate of return and decide whether the plan is worthwhile.*

   (A) 25%, The plan is not worthwhile.

   (B) 20.4%, The plan is not worthwhile.

   (C) 20.4%, The plan is worthwhile.

   (D) 25%, The plan is worthwhile. ***(2 Marks)***

8. *Details of a project are given below:*

Initial outlay	*₹ 800 lakhs*
NPV at 16% discount rate	*₹ 50.71 lakhs*
NPV at 20% discount rate	*₹ (26.84) lakhs*

What will be Internal rate of return (IRR) of the project? If cost of capital is 18.50%, should the project be accepted?

(A) 16.00%, Yes

(B) 18.62%, Yes

(C) 18.00%, Yes

(D) 18.62%, No ***(1 Mark)***

Case Scenario - II

Alex Motor Company was born out of crisis in a small garage on the edge of a dusty town. In the early 90s when the fuel prices soared and imported vehicles flooded the market, many automobile companies were forced to shut down their operations. Many employees lost their jobs.

Ajay Sharma, a production engineer at a failing automobile plant along with ten of his colleagues, rented an abandoned garage and a portion of unused equipment from a shutdown factory and decided to start operations. Their main aim was to transform Indian auto industry by providing comprehensive, affordable and fuel-efficient vehicles. Instead of chasing volumes, the company focused on customization-adjustable cargo layouts, fuel efficient engines and easy maintenance to cater demand of narrow market.

Alex Motor Company developed its first commercial model Alex One which was simple but could survive floods, heat waves, bumpy roads, and most importantly was fuel efficient. The customers loved it and hence sales grew steadily.

Ajay made a simple promise that every decision would begin on the factory floor and not in the board-room. Mechanics were encouraged to suggest improvement in design and were rewarded for the best innovations, but success brought a new challenge.

The younger generation demanded technology with higher connectivity, better safety systems and cleaner energy. Due to these matters Alex Motor Company lagged behind from the flashy foreign brands that entered the Indian market.

As a result, sales declined and critics called the company outdated. Ajay, now the CEO of the company, faced defining choice, either to sell the company or reinvent it.

Ajay's team of engineers, through participation, shared their next plan of action to the employees for the further technology upgradation, in order to gain growth and success of business. The team took the initiative to develop the good working culture and code of ethics. They focused on training and various motivational plans for employees so they can be tuned up with new working system. In this way the company made its breakthrough with the launch of Alex Electra; a hybrid vehicle designed specifically for congested urban environment. It was not just the technology that made Electra different, but the mindset. Engineers, designers and *data-analysts worked side by side, decision making became faster and mistakes were treated as learning cost and not failures.*

Alex Motor Company also established company-owned showrooms and service centers to increase their sales and provide free after-sale services which led to improved customer services and brand image.

Today Alex Motor Company's success is studied in business schools as it proved that companies that listen, learn and adapt can outlast any crisis.

Based on the above case scenario, choose the correct answer to questions no. 9 to13:

9. *Identify the initial strategy to gain competitive advantage adopted by Alex Motor Company.*

   (A) Growth strategy emphasizing strong and fuel-efficient vehicles.

   (B) Focused cost leadership strategy emphasizing fuel efficiency and easy maintenance.

   (C) Focused differentiation strategy emphasizing customized commercial vehicles, easy maintenance and fuel efficiency rather than mass production.

   (D) Expansion strategy emphasizing customized vehicles and mass production. ***(2 Marks)***

10. *Use McKinsey's 7S Model to identify the soft elements that change during reinvention.*

    (i) Shared value

    (ii) Style

    (iii) Strategy

    (iv) Staff

    (A) Only (i) and (ii) are correct.

    (B) Only (i), (iii) and (iv) are correct.

    (C) (i), (ii), (iii) and (iv) are correct.

    (D) Only (i), (ii) and (iv) are correct. ***(2 Marks)***

11. *Strategic Management allowed Alex Motor Company to be*

    (A) *More directive towards the cross-functional team to reduce communication barrier.*

    (B) *Partly proactive as the company anticipated future urban mobility needs and partly reactive as the company responded to the declining sales.*

    (C) *More proactive as it readily launched Alex Electra with updated technology to stay competitive.*

    (D) *More authoritative in taking faster decisions.* ***(2 Marks)***

12. *Ajay Sharma undertook a retrenchment strategy to save his company when the sales of his company declined, and his company was called outdated. The action plan undertaken to implement it was*

    (i) *Assessing the current problem*

    (ii) *Providing innovative transport service*

    (iii) *Developing an action plan with specific goals*

    (iv) *Restructuring organizational hierarchy*

    Which of the above actions does not pertain to the strategy undertaken by Ajay Sharma?

    (A) *(ii) and (iv)*

    (B) *(iii) and (iv)*

    (C) *(i), (iii) and (iv)*

    (D) *Only (iii)* ***(2 Marks)***

13. *The mission of Alex Motor Company was:*

    (A) *To adopt new technology such as connectivity, advanced safety features and cleaner energy solutions.*

    (B) *Introducing cross-functional teams so that decision making process becomes faster.*

    (C) *To establish company owned showrooms and service centers to increase their sales and provide after sale services.*

(D) To transform Indian auto industry by providing comprehensive, affordable and fuel-efficient vehicles through present capability and activities. ***(2 Marks)***

14. Altex Ltd. is a company that produces and sells home appliances. However, at present the company is facing stiff competition from the new entrants who are offering similar products at a lower price. To stay competitive the top management of the company decided to adopt the best cost provider strategy. Which of the following actions should the company take to align with their best cost provider strategy?

(A) Reducing the price of their products without making changes in manufacturing process and product features.

(B) Streamlining manufacturing processes to reduce cost, sourcing materials from cost-effective suppliers and adding innovative features to their products.

(C) Streamlining manufacturing processes to reduce cost with no innovation in product feature.

(D) Focusing solely on premium features thereby increasing the cost of the products to reflect the added value. ***(2 Marks)***

15. A fashion retail company is designing a new marketing campaign for Generation Z. During its market survey, the company observes that customers' personal preferences, attitudes, lifestyle, motivation, and perception of quality strongly influence their buying behaviour, even before they are exposed to advertisements or peer opinions. Considering these facts, the company should primarily focus on which conceptual domain of the consumer behaviour?

(A) Cultural influences

(B) Social influences

(C) External influences

(D) Internal influences ***(2 Marks)***

16. *In General Electric (GE) Nine-Cell Matrix, which two dimensions form the basis of portfolio analysis to develop the strategic options?*

    (A) Business Strength and Market Attractiveness

    (B) Company's Strength and Weakness

    (C) Market Share and Market Growth Rate

    (D) Competitive Intensity and Pricing Trends ***(1 Mark)***

Answer Key

MCQ. No.	Correct Answer
1.	(A)
2.	(C)
3.	(A)
4.	(B)
5.	(D)
6.	(D)
7.	(C)
8.	(B)
9.	(C)
10.	(D)
11.	(B)
12.	(A)
13.	(D)
14.	(B)
15.	(D)
16.	(A)

PART – II Descriptive Questions

SECTION A: FINANCIAL MANAGEMENT

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

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

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

Working notes should form part of the answer.

Question 1

(a) Finance manager of A Ltd. noticed that a 5% increase in sales leads to increase of ₹ 9,000 in operating profit. The company operates with a contribution margin of 40%, fixed annual operating cost of ₹1,35,000 and interest obligation of ₹ 30,000.

You are required to calculate:

(i) Current level of sales of the company.

(ii) Operating, financial and combined leverage. ***(2 + 3 = 5 Marks)***

(b) Z Ltd. has issued 8% convertible debentures of ₹ 100 each with a remaining maturity period of five years. The current market price per debenture is ₹ 85. At the time of maturity, debenture holders have an option to either redeem it at a premium of 5% or to convert each debenture into 5 equity shares. Current market price per equity share is ₹16. The company has just paid dividend of ₹ 8.03 per equity share. Seven years ago, it paid dividend of ₹ 5.00 per equity share.

Applicable tax rate is 30%.

Compute the post-tax cost of debentures using present value method.

Year	***1***	***2***	***3***	***4***	***5***	***6***	***7***
$PVIF_{0.10,t}$	*0.909*	*0.826*	*0.751*	*0.683*	*0.621*	*0.564*	*0.513*
$PVIF_{0.12,t}$	*0.893*	*0.797*	*0.712*	*0.636*	*0.567*	*0.507*	*0.452*

Interest Rate	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*
FVIF$_{i,5}$	*1.051*	*1.104*	*1.159*	*1.217*	*1.276*	*1.338*	*1.403*	*1.469*	*1.539*
FVIF$_{i6}$	*1.062*	*1.126*	*1.194*	*1.265*	*1.340*	*1.419*	*1.501*	*1.587*	*1.677*
FVIF$_{i7}$	*1.072*	*1.149*	*1.230*	*1.316*	*1.407*	*1.504*	*1.606*	*1.714*	*1.828*

(5 Marks)

(c) Following information is related to Exe Ltd. for the year ended 31st March, 2026:

Total dividend coverage ratio	*2.863 times*
Dividend yield on the equity shares	*4%*
Market price per equity share	*₹ 40.00*
Equity share capital of 10 each	*12,00,000*
Preference share capital of 10 each	*₹ 3,00,000*
Price-earnings ratio	*8 times*

You are required to calculate:

(i) Total dividend paid to equity shareholders

(ii) Earnings per share

(iii) Rate of preference dividend

(iv) Total profit after tax ***(1 + 1 + 2 + 1 = 5 Marks)***

Answer

(a) (i) Current level of Sales:

Let the present sales be = ₹X

or 5% of Sales×40% = 9,000

or 0.05X x 0.40 = 9,000

or 0.02X = 9,000

Current Sales (X) = ₹ 4,50,000

P/V ratio = Change in profit/ Change in sales

0.40 = 9,000/X

X = 9,000/0.40

= Rs 22,500

Hence, total sales;

= Change in sales/ % change in sales

= ₹ 22,500/0.05

= ₹ 4,50,000

Income Statement

Particulars	**(₹)**
Sales	4,50,000
Contribution (40%)	1,80,000
Less: Fixed annual operating cost	(1,35,000)
EBIT (Earnings before interest and tax)	45,000
Less: Interest	(30,000)
EBT (Earnings before tax)	15,000

(ii) Leverage

Operating Leverage $= \frac{\text{Contribution}}{\text{EBIT}} = \frac{₹1,80,000}{₹45,000} = 4$

Financial Leverage $= \frac{\text{EBIT}}{\text{EBT}} = \frac{₹45,000}{₹15,000} = 3$

Combined Leverage = Operating Leverage × Financial Leverage

= 4 × 3 = 12

Or,

Combined Leverage $= \frac{\text{Contribution}}{\text{EBT}} = \frac{₹1,80,000}{₹15,000} = 12$

(b) Calculation of growth rate in dividend

8.03 $= 5\ (1+g)^7$

1.606 $= (1+g)^7$

g = 7%

Price of share after 5 years

P_5 = 16 x FVIF 7%,5

= 16 x 1.403 = 22.45

Conversion value of shares = 22.45 × 5 = ₹ 112.25 (RV)

Redemption Value of Debenture (RV) = 100+5% premium = ₹ 105

Since, conversion value is higher, debenture holders will prefer conversion.

After-tax Interest = 8(1−0.30) = ₹ 5.60

Year	Cash Inflow (₹)	PVIF @ 10%	PV (₹)	PVIF @12%	PV (₹)
0	85 (Current Market Price)	1	(85)	1	(85)
1-5	5.60 (Interest)	3.79	21.224	3.605	20.188
5	112.25 (Conversion Value)	0.621	69.707	0.567	63.646
Total PV			5.931		-1.166

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

$$= 10\% + \frac{5.931}{5.931-(-1.166)}(12\%-10\%) = 11.67\%$$

(c) Dividend per Equity Share (DPS) = 4 % of ₹40.00 = ₹1.60

No. of Equity Shares = ₹12,00,000 / ₹10 = 1,20,000 shares

(i) Total Dividend Paid to Equity Shareholders

1,20,000 × ₹1.60 = ₹1,92,000

(ii) Calculation of Earnings Per Share (EPS)

P/E ratio = $\frac{MPS}{EPS}$

8 = 40 / EPS

EPS = ₹5

(iii) Rate of Preference Dividend

Profit Available to Equity Shareholders

EPS × No. of Equity Shares = ₹5 × 1,20,000 = ₹6,00,000

Let preference dividend = P

Then, PAT = 6,00,000 + P

Total dividend =Equity Dividend+ Preference Dividend

=1,92,000 + P

Dividend coverage ratio = 2.863

2.863 = $\frac{(6,00,000+P)}{(1,92,000+P)}$

6,00,000+P = 2.863(1,92,000+P)

6,00,000+P = 5,49,696+2.863P

50,304 =1.863P

P = ₹ 27,000

Rate of Preference Dividend= 27,000/3,00,000 x 100=9%

(iv) Total Profit after Tax

PAT = ₹6,00,000 + ₹27000 = ₹6,27,000

Question 2

(a) R Ltd. wants to reduce the dependency of manual workforce in the operation of its factory by adopting automatic machine. It has two options under consideration Machine M and Machine N. Both the machines serve the same job and are also able to satisfy the purpose of the company.

Details of both the machines are given below:

	Machine M	**Machine N**
Purchase cost (₹)	*4,50,000*	*3,50,000*
Estimated useful life	*5 years*	*7 years*
Estimated salvage value (% of cost)	*10%*	*10%*
Annual saving to wages (₹)	*11,00,000*	*12,00,000*
Runing cost per year (excl. depreciation) (₹)	*9,00,000*	*11,00,000*
Annual saving in scrap due to use of machine in place of manual work force (₹)	*1,00,000*	*1,20,000*

The Company's cost of capital is 9%. Corporate tax rate is 25%. Depreciation will be charged on SLM basis.

(i) Calculate NPV and Profitability index for each machine.

(ii) Which machine should be selected on the basis of Equivalent Annualized Criterion?

Year	**1**	**2**	**3**	**4**	**5**	**6**	**7**
PVIF $_{0.09,\ t}$	0.917	0.842	0.772	0.708	0.650	0.596	0.547
PVIA $_{0.09,\ t}$	0.917	1.759	2.531	3.239	3.889	4.485	5.032

(4 + 3 = 7 Marks)

(b) B Ltd. has received an offer to get a discount of 2% on an invoice value of ₹75,000, if payment is made within one month instead of normal credit terms of 3 months. If the company makes early payment, it will need to finance the payment through a bank overdraft of 10% p.a. Tax rate is 30%.

Whether B Ltd. should accept the offer? Support your decision with calculations. ***(3 Marks)***

Answer

(a) Evaluation of Alternatives

Working Notes:

$$\text{Depreciation on Machine M} = \frac{(4{,}50{,}000 - 45{,}000)}{5} = ₹\ 81{,}000$$

Depreciation on Machine N = $\frac{(3,50,000 - 35,000)}{7}$ = ₹ 45,000

(i) NPV and PI for each machine

Particulars	***Machine M (₹)***	***Machine N (₹)***
Annual Savings:		
Direct Wages	11,00,000	12,00,000
Scraps	1,00,000	1,20,000
Total Savings (A)	12,00,000	13,20,000
Annual Running Cost (B)	9,00,000	11,00,000
Annual Cash Savings (A-B)	3,00,000	2,20,000
Less: Depreciation	81,000	45,000
Annual Savings before Tax	2,19,000	1,75,000
Less: Tax @ 25%	54,750	43,750
Annual Savings /Profits after tax	1,64,250	1,31,250
Add: Depreciation	81,000	45,000
Annual Cash Inflows	2,45,250	1,76,250
PVIFA	3.889	5.032
PV of Annual Cash Inflows	9,53,777.25	8,87,890
PV of Salvage Value	45,000 x 0.650 = ₹ 29,250	35,000 x 0.547 = ₹ 19,145
Total PV of Inflows	9,83,027.25	9,06,035
NPV	9,83,027.25- 4,50,000 = ₹ 5,33,027.25	9,06,035- 3,50,000 = ₹ 5,56,035
PV Index = $\frac{\text{Present Value of Cash Inflow}}{\text{Investment}}$	$\frac{9,83,027.25}{4,50,000}$ =2.18	$\frac{9,06,035}{3,50,000}$ =2.59

(ii) Equivalent Annualized NPV

Machine M = $\frac{5,33,027.25}{3.889}$ = ₹ 1,37,060/-

Machine N = $\frac{5,56,035}{5.032}$ = ₹ 1,10,500/-

So machine M should be selected on the basis of Equivalent Annualized Criterion.

(b) Discount on early payment = 2% x 75,000 = ₹1,500

Net Benefit (A) = ₹ 1,500 - Tax (30%) = ₹ 1,050

The company must borrow the discounted invoice amount via a bank overdraft for the 2-month period.

Amount to be Borrowed = 75,000 − 1,500 = ₹ 73,500

Bank overdraft interest for 2 months:

= P × R × T

= 73,500 × 10% × 2/12

= ₹ 1,225

After tax interest cost = 1,225 × (1−0.30)

= 1,225 × 0.70

= ₹ 857.50

Net Saving = Net Benefit – Net Interest Cost

= ₹ 1,050 – ₹ 857.50

= ₹ 192.50 (Net Saving)

Since the company gains a net benefit of ₹ 192.50 by making early payment, B Ltd. should accept the discount offer.

Alternatively, the question can be solved as below:

Annualized benefit of discount

$$= \frac{\text{Discount \%}}{100 - \text{Discount \%}} \times \frac{12 \text{ months}}{\text{Credit Period} - \text{Discount Period}}$$

= 2/98 x 12/2 x 100 =12.245 %

Post tax benefit = 12.245 x (1-0.3) =8.571

Post tax Bank OD rate = 10% x (1-0.3) =7%

Benefit of discount is more than cost of OD. Hence, discount should be accepted.

Question 3

(a) K Ltd. provides the following information:

Net profit	*₹ 50,00,000*
10% Preference share capital @ ₹100 each	*₹ 2,00,00,000*
Number of equity share outstanding	*5,00,000*
Rate of return on investment	*25%*
Cost of equity	*15%*

You are required to:

(i) Calculate EPS and also calculate market price per equity share as per Walter's Model with the retention ratio of 20%.

(ii) If the company aims to keep the market price of its equity share at ₹ 60 each, what retention ratio should be adopted?

(iii) What would be optimum dividend payout ratio as per Gordon's Model?

(2 + 1 + 1 = 4 Marks)

(b) AR Ltd. has given following data for the year ended 31^{st} March, 2026:

- *Receivables are collected on an average after 60 days,*
- *Inventories are held for average period of 90 days before being sold.*
- *The company usually settles its payables with suppliers after 30 days.*
- *The total sales of the company amounts to ₹ 200 lakhs, which is earned evenly throughout the year. All sales are credit sales. Net profit margin is 10%. The company has not incurred any non-operating expenses during the year.*
- *Tax rate is 30%.*
- *Assume 360 days in a year.*
- *Opportunity cost of investment is 12%.*

On the basis of the above data:

(i) Calculate the cash cycle and the minimum cash balance to be maintained to meet its obligations.

(ii) *The company is planning to propose a scheme, whereby it will offer a cash discount of 2% to debtors to reduce the debtors' collection period by 30 days. It is expected that 60% of the debtors will avail the scheme.*

(A) *What will be reduction in the minimum cash to be maintained to meet obligation after the proposed scheme is adopted?*

(B) *What will be net saving due to such scheme?*

(C) *Should the company adopt the scheme?* ***(2 + 4 = 6 Marks)***

Answer

(a)

	(₹) in lakhs
Net Profit	50
Less: Preference dividend	20
Earning for equity shareholders	30

(i) Earning per share = 30,00,000/5,00,000 = ₹ 6.00

Market Price as per Walters model

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

$$P = \frac{4.8 + \frac{0.25}{0.15}(6 - 4.8)}{0.15}$$

P = ₹ 45.33

(ii) Retention ratio when market price is ₹ 60 each

Let, the dividend per share be D to get share price of 6O

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

or 60 $= \dfrac{D + \dfrac{0.25}{0.15}(6 - D)}{0.15}$

or 9 $= \dfrac{0.15D + 1.5 - 0.25D}{0.15}$

or 1.35 $= 0.15D + 1.5 - 0.25D$

or 0.10D = 0.15

D = ₹ 1.50

Retention ratio= 4.5/6 = 0.75 = 75%

(iii) As per Gordon's model, when r > Ke, optimum dividend payout ratio is 'Zero'.

(b) (i) Cash cycle = 60 days + 90 days – 30 days =120 days (4 months)

Cash turnover = 12 months (360 days)/4months (120 days) = 3.

Total Cash Outlay = Sales – Net Profit

= 200 Lakhs − 20 Lakhs = ₹ 180 Lakhs

Minimum operating cash = Total operating annual outlay/cash turnover

= ₹ 180 lakhs/3 = ₹ 60 lakhs.

(ii) (A) Reduction in Minimum Cash Balance

First, we calculate the new average collection period and the new cash cycle.

New Average Collection Period: 30 days

New Cash Cycle: 30 + 90 − 30 = 90 days

New Cash Turnover: 360/90 = 4 times

New Minimum Cash Balance: 180/4 = ₹ 45 Lakhs

Reduction in Cash Balance: 60 Lakhs − 45 Lakhs = ₹ 15 Lakhs

(B) Net Saving Due to Scheme

Opportunity Cost Saving = 12% of reduction in cash balance (15 Lakhs) x (1-0.30) = ₹ 1.26Lakhs

Cost of Cash Discount = 2% of 60 % of Total Sales x (1-0.30)

= $0.02 \times 0.60 \times 200$ Lakhs = ₹ 1.68 Lakhs

Net Saving = 1.26 Lakhs – 1.68 Lakhs = ₹ (0.42 Lakhs)

(C) Recommendation

No, the company should not adopt the scheme.

Solution for part (ii) can be done in following alternative way:

If we assume

- 60% of debtors will pay 30 days early (Collection period = 30 days).
- The remaining 40% of debtors will *not* avail the scheme and will continue to pay after the normal 60 days.

Therefore, the New Average Collection Period:

= (60%×30 days) + (40% × 60 days) = 18 days+24 days = 42 days

Cash Cycle & Cash Balance:

- New Cash Cycle = 90 (Inventory) + 42 (New Debtors) - 30 (Payables) = 102 days
- New Cash Turnover = 360 / 102 = 3.529 times
- New Minimum Cash Balance = ₹ 180 Lakhs / 3.529 = ₹ 51 Lakhs
- Reduction in Cash Balance = ₹ 60 Lakhs - ₹ 51 Lakhs = ₹ 9 Lakhs

(B) Net Savings:

- Opportunity Cost Saving: ₹ 9 Lakhs × 12% × (1 - 0.30) = ₹ 0.756 Lakhs
- Cost of Cash Discount: 2% × 60% × 200 Lakhs × (1 - 0.30) = ₹ 1.68 Lakhs
- Net Saving: ₹ 0.756 Lakhs - ₹ 1.68 Lakhs = (₹ 0.924 Lakhs) or (Net Loss of ₹ 92,400)

(C) No, the company should not adopt the scheme, because it results in a net financial loss of ₹ 0.924 Lakhs.

Question 4

(a) *MM Hypothesis of dividend policy is based on certain assumptions. What are those assumptions without which the hypothesis cannot hold? Explain briefly.* ***(4 Marks)***

(b) *An Indian exporter has shipped goods to a foreign buyer, but the export proceeds are yet to be realised. He approaches the bank for immediate finance assistance.*

(i) *Identify the type of finance involved.*

(ii) *Explain any three forms of such type of finance.* ***(1 + 3 = 4 Marks)***

(c) *How do the concepts of profit maximization and wealth maximization differ in terms of objective, risk, time horizon and sustainability?* ***(2 Marks)***

OR

(c) *What are Junk Bonds and why are they called 'High Yield Bonds'?*

(2 Marks)

Answer

(a) MM hypothesis is based on the following assumptions:

- **Perfect capital markets:** The firm operates in a market in which all investors are rational and information is freely available to all.
- **No taxes:** There are no taxes or no tax discrimination between dividend income and capital appreciation (capital gain). It means there is no difference in taxation of dividend income or capital gain. This assumption is necessary for the universal applicability of the theory, since the tax rates may be different in different countries.
- **Fixed investment policy:** It is necessary to assume that all investment should be financed through equity only, since implication after using debt as a source of finance may be difficult to understand. Further, the impact will be different in different cases.
- **No floatation or transaction cost:** Similarly, these costs may differ from country to country or market to market.

- **Risk of uncertainty does not exist**. Investors are able to forecast future prices and dividend with certainty and one discount rate is appropriate for all securities and all time periods.

(b) Post-shipment Finance is the type of finance involved:

It takes the following forms:

(a) ***Purchase/discounting of documentary export bills****:* Finance is provided to exporters by purchasing export bills drawn payable at sight or by discounting usance export bills covering confirmed sales and backed by documents including documents of the title of goods such as bill of lading, post parcel receipts, or air consignment notes.

(b) ***E.C.G.C. Guarantee:*** Post-shipment finance, given to an exporter by a bank through purchase, negotiation or discount of an export bill against an order, qualifies for post-shipment export credit guarantee. It is necessary, however, that exporters should obtain a shipment or contracts risk policy of E.C.G.C. Banks insist on the exporters to take a contracts shipments (comprehensive risks) policy covering both political and commercial risks. The Corporation, on acceptance of the policy, will fix credit limits for individual exporters and the Corporation's liability will be limited to the extent of the limit so fixed for the exporter concerned irrespective of the amount of the policy.

(c) ***Advance against export bills sent for collection:*** Finance is provided by banks to exporters by way of advance against export bills forwarded through them for collection, taking into account the creditworthiness of the party, nature of goods exported, usance, standing of drawee etc.

(d) ***Advance against duty draw backs, cash subsidy, etc.:*** To finance export losses sustained by exporters, bank advance against duty draw-back, cash subsidy etc., receivable by them against export performance. Such advances are of clean nature; hence necessary precaution should be exercised.

(c)

Particular	Profit Maximization	Wealth Maximisation
Objective	Large amount of profits.	Highest market value of shares.

Risk	Ignores risk or uncertainty	Recognises risk or certainty
Time Horizon	Emphasizes the short term gains.	Emphasizes the long term gains.
Sustainability	Not sustainable in long term. Sustainability is low.	Critical for the very existence of the business enterprise. Sustainability is high.

OR

(c) **High Yield Bonds (or Junk Bonds):** Junk Bond is a bond that is rated below investment grade by credit rating agencies. It has a low credit rating and a high risk of default.

Because of the higher risk, investors are compensated with higher interest rates, which is why junk bonds are also called high-yield bonds.

SECTION – B: STRATEGIC MANAGEMENT

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

Question 5

(a) *Eagle Manufacturing Ltd. has been facing declining productivity due to outdated working methods, rigid routines and workforce inefficiency leading to quality degradation and increasing customer complaints. To enhance operations, productivity, quality and work routines, the Board introduces new technologies and operating procedures to ensure continuous improvement and efficient workflow with operator feedback and performance evaluation.*

The management faces initial backlash from the employees to adopt these new techniques as they are a bit hesitant and scared of change. To cater to their concerns, the management introduces various awareness sessions, capacity building programs and exercises to handhold the operators during this transition while effectively communicating the need for change for future resilience and long-term benefits. Post these training sessions, the new techniques and procedures are gradually implemented in a phase-wise integration with constant support for seamless adoption by the employees in a moderated manner to accept. Finally, the management takes steps to stabilize these new work methods through revised policies, performance measures, and reward systems to ensure that employees do not revert to old practices.

Identify the model being applied by Eagle Manufacturing Ltd. in the above case. Explain the different phases of the process for moving the organization from the present to the future. Is this a one-time Process/ application? ***(1 + 3 + 1 = 5 Marks)***

(b) *Pearl India Ltd. is a major packaged food company which dominates in some sectors like snacks, diary, biscuits and instant meals. It offers high quality and unique products that match the taste and preference of the customers. It always takes steps to enhance brand image and charge a premium price for which buyers do not negotiate. Often the unique features of their products that are not available with their competitors help them to* *gain competitive advantage. Hence, using this strategy, today Pearl India Ltd. is consistently gaining its position in the industry over its competitors.*

Identify and explain Michael Porter's generic strategy being followed by Pearl India Ltd. to gain competitive advantage. What are the disadvantages of following such strategy? ***(1 + 1 + 3 = 5 Marks)***

(c) A well-established MM Company is manufacturing tubeless tyre as one of its major products for quite some time. The product has reached at the maturity stage of the product life cycle. Company is aware about the competitive scenario and fast change in technology. Cost benefit analysis indicates that it would be better to modernise its plant and machinery so as to improve its efficiency and productivity. The basic idea is to remain competitive in the dynamic and volatile business world and at the same time having an objective to preserve their market share.

Suggest the specific corporate strategy to be adopted by the MM Company in the given situation. Also state the reasons why a company should adopt such strategy in general. Justify your opinion about identified strategy in a case of start-up venture. ***(1 + 3 + 1 = 5 Marks)***

Answer

(a) The model being applied by Eagle Manufacturing Ltd. is **Kurt Lewin's Three Phase Model of Change** comprising **Unfreezing, Changing and Refreezing.** It reflects strategic change undertaken to improve organizational efficiency, productivity and competitiveness.

Phases of Kurt Lewin's Change Model

(a) Unfreezing the Situation: Unfreezing means making employees aware of the need for change and preparing them to accept it by breaking old attitudes, rigid routines and existing work practices.

In the given case, employees initially resisted the new technologies and procedures. Therefore, management conducted awareness sessions, capacity building programmes and communication exercises to explain the need and long-term benefits of change.

(b) Changing to the New Situation: In this stage, new behaviour patterns, systems and procedures are introduced after employees recognize the need for change.

In the given case, new technologies and operating procedures were gradually implemented through phase wise integration with continuous support, guidance and feedback mechanisms for employees.

(c) **Refreezing:** Refreezing occurs when the new behaviour becomes a permanent way of organizational life and employees do not revert to old practices.

In the given case, revised policies, performance measures and reward systems were introduced to stabilize the new work methods and institutionalise the changed practices successfully.

Is it a One-Time Process?

No, it is not a one-time process. Change is a continuous and cyclical process due to dynamic business environment, technological changes and competition. Therefore, organizations continuously undergo the stages of unfreezing, changing and refreezing.

(b) Pearl India Ltd. is following the **Differentiation Strategy** propounded by Michael Porter. Differentiation strategy is aimed at a broad market and involves creation of products or services that are perceived by customers as unique. The uniqueness may be associated with product quality, features, brand image, technology or customer preferences. Because of differentiation, the business can charge a premium price and gain competitive advantage.

In the given case, Pearl India Ltd. offers high quality and unique food products matching customer tastes and preferences. It continuously enhances its brand image and charges premium prices for which buyers do not negotiate. The special features of its products help it gain a strong competitive position over rivals.

Disadvantages of Differentiation Strategy

1. In the long run, uniqueness may be difficult to sustain as competitors may imitate product features.
2. Charging very high prices for differentiated products may force customers to switch to alternative products.

3. Differentiation strategy fails if the basis of differentiation is not valued by customers.

(c) MM Company should adopt a **Stability Strategy**. A stability strategy is pursued when a firm continues in the same business and aims to maintain its market position through incremental improvements in efficiency and operations. In the given case, the company's product has reached the maturity stage of the product life cycle, and the company wants to modernise its plant and machinery to improve efficiency and productivity while preserving market share in a dynamic business environment.

Reasons for Adopting Stability Strategy

1. A product has reached the maturity stage of the product life cycle.
2. The staff feels comfortable with the status quo as it involves less changes and less risks.
3. It is opted when the environment in which an organisation is operating is relatively stable.
4. It is adopted where expansion may be perceived as threatening.
5. After rapid expansion, a firm may want to stabilise and consolidate itself.

Applicability in Case of Start-up Venture: Stability strategy is generally not suitable for start-ups because startups are in the early stages of ideation and development where speed, agility and expansion are important. Stability strategy is more meaningful for mature businesses operating at full capacity rather than emerging ventures.

Question 6

(a) "In a modern competitive landscape, the interaction of supply and demand determines the price at which quantity provided equals to quantity desired." Analyse the inherent characteristics of business products that must be managed to maintain profitability under these market dynamics. ***(5 Marks)***

(b) What is meant by corporate level strategies?

Identify and explain the basic features of corporate level strategies being represented by each of the following decisions:

(i) *The company decided to expand its profit-making units of packaged food division into the international market and closing down the loss-making units.*

(ii) *The company decided to sell-out its commercial real estate division entirely as it is incurring heavy losses due to intense competition.*

(iii) *The company has decided to maintain the current operations of the home appliances division which is maintaining steady sales and strong brand loyalty with no major investments.*

(iv) *The company decided to make high investments in a rapidly growing online learning platform division to take greater control over the market.* ***(1 + 4 = 5 Marks)***

Answer

(a) Business products possess certain inherent characteristics that businesses must manage effectively to maintain profitability in a competitive market where price is determined by the interaction of supply and demand.

Characteristics of Business Products

1. **Products are Tangible or Intangible:** A product may be tangible such as a car, mobile phone or table or intangible such as banking, insurance or telecom services. Businesses must manage both types efficiently to satisfy customer requirements.

2. **Product has a Price:** Every product has a price determined by market forces of supply and demand. The market price is the price at which quantity supplied equals quantity demanded. In the present competitive environment, businesses often cannot fix prices by simply adding profit margins over cost. Therefore, firms need to control and reduce costs to maintain profitability.

3. **Products have Features that Deliver Satisfaction:** Products possess features relating to design, quality, function and customer experience that provide value and satisfaction to consumers. Businesses continuously improve product features to optimise customer experience and differentiate products from competitors.

4. **Product is Pivotal for Business:** Product is the centre around which all strategic and operational activities revolve, including production, quality control, marketing, logistics and sales. Thus, product acts as the driving force behind business operations and profitability.

5. **Product has a Useful Life:** Every product has a useful life and product life cycle after which it may require replacement, reinvention or discontinuation. Businesses need to innovate and update products continuously to remain competitive and profitable in changing market conditions.

(b) Corporate level strategies are the strategies formulated at the top management level which define the overall direction and scope of the organization. These strategies deal with decisions relating to stability, expansion, retrenchment and combination of businesses.

(i) **Combination Strategy:** The company is simultaneously expanding its profitable packaged food business into international markets while closing down loss-making units. Thus, it is adopting a **Combination Strategy** involving both expansion and retrenchment strategies.

(ii) **Retrenchment Strategy:** The decision to sell out the commercial real estate division due to heavy losses represents **Retrenchment Strategy**. Under this strategy, the firm retrenches or drops loss making businesses through sell out or liquidation to improve overall performance.

(iii) **Stability Strategy:** The decision to continue current operations of the home appliances division with steady sales and strong brand loyalty represents **Stability Strategy**. Under this strategy, the firm continues with the same business and maintains the existing level of effort without major investments.

(iv) **Expansion/Growth Strategy:** The decision to make high investments in a rapidly growing online learning platform to gain greater market control represents **Expansion/Growth Strategy**. This strategy involves substantial investments and business growth to achieve greater market control and competitive advantage.

Question 7

(a) "Beyond the basic need to grow modern organizations are driven by a mix of market inadequacy resource needs and the collapse of international barriers." Analyse the various reasons why companies choose to globalise their operations. ***(5 Marks)***

(b) "The wider and stronger the channel the better position a business has to fight and win over competition." In the context of this statement, define the concept of channels. Why is channel analysis more important for a business strategy? Explain different type of channels. ***(1 + 1 + 3 = 5 Marks)***

Answer

(a) Globalisation refers to the process of expanding business operations beyond domestic boundaries into international markets. Companies choose to globalise their operations due to various strategic, economic and competitive reasons.

Reasons for Globalisation of Business

1. **Need for Growth:** The foremost reason for internationalisation is the need to grow. Organizations expand globally in search of new business opportunities, higher sales and greater earnings.
2. **Shrinking Time and Distance:** Rapid technological developments, faster communication, speedier transportation and increased financial flows have reduced geographical barriers and made global operations easier.
3. **Inadequacy of Domestic Markets:** Domestic markets are often not sufficient for long-term growth. Companies enter international markets where competition may be less intense and growth opportunities may be higher.
4. **Availability of Resources:** Businesses globalise to access reliable and cheaper sources of raw materials, skilled labour and talent pools available in foreign countries.
5. **Reduction in Transportation Costs:** Companies establish overseas manufacturing plants near target markets to reduce transportation costs, delivery time and logistics expenses.

6. **Expansion of Foreign Markets:** When foreign markets grow substantially, organizations establish overseas production and sales units to increase sales volume and improve cash flows.

7. **Growth of Service Sector and Regional Integration:** The growing importance of the service sector and regional economic integration among countries encourage firms to expand internationally.

8. **Collapse of International Trade Barriers:** Reduction in trade tariffs, customs barriers and government restrictions has increased the flow of international business and encouraged globalization.

9. **Formation of Strategic Alliances:** Globalization enables companies from different countries to form strategic alliances to face technological and economic challenges and leverage competitive advantages.

Thus, modern organizations globalise their operations to achieve growth, access resources, reduce costs, enhance competitiveness and exploit opportunities arising from technological and economic integration across nations.

(b) Channels refer to the distribution system through which an organisation distributes its products or provides its services to customers. Strong and wide channels help businesses reach customers effectively and gain competitive advantage.

Importance of Channel Analysis

Channel analysis is important when a business strategy aims to scale up and expand into new geographies and markets. Businesses need suitable channels to reach new customers effectively. Strong channels also help businesses fight competition and create barriers for new entrants into the industry.

Types of Channels

1. **Sales Channel:** Sales channel refers to intermediaries involved in selling the product to the end user. It focuses on who sells the product to customers. For example, fashion designers use agencies and retail stores to sell products to consumers.

2. **Product Channel:** Product channel refers to intermediaries who physically handle and distribute the product from producer to customer. For example, logistics companies and delivery services distribute products purchased through online platforms.

3. **Service Channel:** Service channel refers to entities providing support services such as installation, maintenance and customer assistance after purchase. For example, installation of appliances by authorised service providers after sales.

Thus, strong and efficient channels act as important strategic tools for market reach, customer satisfaction and competitive advantage.

Question 8

(a) "Strategic uncertainty refers to the unpredictability of future events and circumstances that can impact an organization's strategy and goals." In the light of this statement, discuss how an organization can deal with or manage such uncertainty. ***(5 Marks)***

(b) "Relying blindly on business strategy can go absolutely wrong when daily operation are impeded or when environmental estimates prove inaccurate." Discuss the overall objective of strategic management and evaluate the limitations attached to it that may prevent from overcoming a turbulent environment. ***(1 + 4 = 5 Marks)***

OR

Differentiate between Proactive and Reactive strategies. Explain in detail, why it is important for every organisation to use both these strategies in a dynamic and an uncertain business environment. ***(1 + 4 = 5 Marks)***

Answer

(a) Strategic uncertainty refers to the unpredictability of future events and circumstances that may affect an organization's strategy and goals. It may arise due to changes in market conditions, technology, competition, regulations and other external environmental factors.

An organization can deal with strategic uncertainty in the following ways:

1. **Flexibility:** Organizations should build flexibility into their strategies so that they can quickly adapt to environmental changes and respond effectively to uncertainties.

2. **Diversification:** Diversifying product portfolio, markets and customer base helps reduce dependence on a single business area and minimizes the impact of uncertainty.

3. **Monitoring and Scenario Planning:** Organizations should continuously monitor key indicators of change and undertake scenario planning to understand how different future situations may affect strategies and business operations.

4. **Building Resilience:** Firms should strengthen operational processes, improve financial flexibility and enhance risk management capabilities to withstand uncertain situations effectively.

5. **Collaboration and Partnerships:** Strategic alliances and collaborations with suppliers, customers and other organizations help in sharing resources, reducing risk and accessing new markets and technologies.

Thus, organizations can manage strategic uncertainty through flexibility, diversification, resilience, monitoring and collaboration to remain competitive and sustainable in a dynamic environment.

(b) The overall objective of strategic management is:

1. To create competitive advantage so that the company can outperform competitors.

2. To guide the company successfully through environmental changes and react in the right manner.

Limitations of Strategic Management

1. **Complex and Turbulent Environment:** Business environment is highly dynamic and uncertain. Organisational estimates about future conditions may go wrong, thereby affecting strategic plans adversely. Hence, strategy cannot always overcome a turbulent environment.

2. **Time Consuming Process:** Strategic management involves extensive planning, analysis and communication which may impede daily

operations and routine business activities. Excessive planning may reduce execution efficiency.

3. **Costly Process:** Strategic management requires expert planners, environmental analysis and implementation efforts, which increase organizational costs, especially for small and medium enterprises.

4. **Difficulty in Predicting Competitive Responses:** In a competitive environment, it is difficult to estimate competitors' strategic actions and responses accurately, as such decisions are generally confidential and uncertain.

Or

Difference between Proactive and Reactive Strategies

Basis	**Proactive Strategy**	**Reactive Strategy**
Meaning	Proactive strategy refers to planned and deliberate actions taken by management to improve market position and performance.	Reactive strategy refers to adaptive responses to unforeseen changes and unexpected developments in the business environment.
Nature	It is planned and intentional.	It is responsive and adaptive in nature.
Objective	To gain competitive advantage through advance planning.	To cope with changing circumstances and environmental uncertainties.

Importance of Using Both Strategies

Every organization needs both proactive and reactive strategies because the business environment is dynamic and uncertain.

1. **Helps in Achieving Planned Objectives:** Proactive strategies help organizations define long-term direction, improve market position and achieve organizational objectives through planned managerial actions.

2. **Helps in Coping with Uncertainty:** Business conditions may change unexpectedly due to competition, technology, regulations or customer preferences. Reactive strategies help firms respond effectively to such unforeseen developments.

3. **Provides Flexibility and Adaptability:** A combination of proactive and reactive strategies enables organizations to remain flexible and adapt to changing environmental conditions.

4. **Ensures Survival and Competitive Advantage:** Organizations using both strategies can exploit opportunities, tackle threats, handle crises and maintain competitiveness in turbulent business environments.

Thus, a company's actual strategy is always a blend of proactive planned actions and reactive adaptive responses to changing business circumstances.