Intermediate Course: Group – II		(Mock Test Paper : 1)
DATE: 11.08.2024	MAXIMUM MARKS: 100	TIMING: 3¼ Hours

FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER – 6A : FINANCIAL MANAGEMENT

1. **The question paper comprises two parts. Part I and Part II.**
2. **Part I comprises Case Scenario based Multiple Choice Questions (MCQs)**
3. **Part II comprises questions which require descriptive type answers.**
4. **Working note should form part of the answer. Wherever necessary, suitable assumptions may be made by the candidates and disclosed by way of note. However, in answers to Questions in Part I, working notes are not required.**

PART I – CASE SCENARIO BASED MCQs (15 Marks)

Write the most appropriate answer to each of the following multiple choice questions by choosing one of the four options given. All questions are compulsory.

Ans. 1 to Ans. 5:
CASE SCENARIO

1. Ans. a
2. Ans. a
3. Ans. b
4. Ans. b
5. Ans. a **MCQ [5 MCQ of 2 Marks Each : Total 10 Marks]**

6. Ans. b } **{2 M Each}**
7. Ans. a }
8. Ans. c }**{1 M}**

PART II – DESCRIPTIVE QUESTIONS (35 Marks)

Question No. 1 is Compulsory.

Attempt any two questions out of the remaining three questions.

Answer 1:

(a) Workings:

(i) Financial Leverage $= \dfrac{EBIT}{EBIT - Interest}$ Or, $2 = \dfrac{EBIT}{EBIT - Rs.\,5{,}000}$

Or, EBIT = Rs. 10,000 **{1/2 M}**

(ii) Operating Leverage $= \dfrac{Contribution}{EBIT}$

Or, 3 $= \dfrac{Contribution}{Rs.10{,}000}$

Or, Contribution = Rs. 30,000 **{1/2 M}**

(iii) Sales $= \dfrac{Contribution}{P/V\ Ratio} = \dfrac{Rs.\,30{,}000}{25\%} = Rs.\,1{,}20{,}000$ **{1/2 M}**

(iv) Fixed Cost = Contribution - Fixed cost = EBIT
= Rs. 30,000 - Fixed cost = Rs. 10,000
Or, Fixed cost = Rs. 20,000 {1/2 M}

Income Statement for the year ended 31st March, 20X8

Particulars	Amount (Rs.)
Sales	1,20,000
Less: Variable Cost (75% of Rs. 1,20,000)	(90,000)
Contribution	30,000
Less: Fixed Cost (Contribution - EBIT)	(20,000)
Earning Before Interest and Tax (EBIT)	10,000
Less: Interest	(5,000)
Earning Before Tax (EBT)	5,000
Less: Income tax@ 30%	(1,500)
Earning After Tax (EAT or PAT)	3,500

{3 M}

Answer:

(b) We know that as per the realised yield approach, cost of equity is equal to the realised rate of return. Therefore, it is important to compute the internal rate of return by trial and error method. This realised rate of return is the discount rate which equates the present value of the dividends received in the past five years plus the present value of sale price of Rs. 11,280 to the purchase price of Rs. 10,000. The discount rate which equalises these two is 12 percent approximately. Let us look at the table given for a better understanding:

Year	Dividend (Rs.)	Sale Proceeds (Rs.)	Discount Factor @ 12%	Present Value (Rs.)
1	1000	-	0.893	893
2	1000	-	0.797	797
3	1000	-	0.712	712
4	1000	-	0.636	636
5	1000	-	0.567	567
6	Beginning	11,280	0.567	6395.76
				10,000.76

{3 M}

We find that the purchase price of Alpha Limited's share was Rs. 10,000 and the present value of the past five years of dividends plus the present value of the sale price at the discount rate of 12 per cent is Rs. 10,000.76. Therefore, the realised rate of return may be taken as 12 percent. This 12 percent is the cost of equity. {2 M}

Answer:

(c) Plan I= Raising Debt of Rs. 2.5 lakh + Equity of Rs. 22.5 lakh.
Plan II = Raising Debt of Rs. 10 lakh + Equity of Rs. 15 lakh.
Plan III = Raising Debt of Rs. 15 lakh + Equity of Rs. 10 lakh.

Calculation of Earnings per share (EPS):

Particulars	FINANCIAL PLANS		
	Plan I	Plan II	Plan III
	Rs.	Rs.	Rs.
Expected EBIT	5,00,000	5,00,000	5,00,000
Less: Interest [(a)]	(25,000)	(1,37,500)	(2,37,500)
Earnings before taxes	4,75,000	3,62,500	2,62,500
Less: Taxes @ 40%	(1,90,000)	(1,45,000)	(1,05,000)

Earnings after taxes (EAT)	2,85,000	2,17,500	1,57,500
Number of shares [b]	15,000	10,000	8,000
Earnings per share (EPS)	{1 M}{ 19	{1 M}{ 21.75	{1 M}{ 19.6875

Financing Plan II (i.e. Raising debt of Rs. 10 lakh and issue of equity share capital of Rs. 15 lakh) is the option which maximises the earnings per share. {1 M}

Working Notes:

(a) Calculation of interest on Debt.

Plan I	(Rs. 2,50,000 x 10%)		Rs. 25,000
Plan II	(Rs. 2,50,000 x 10%)	Rs. 25,000	
	(Rs. 7,50,000 x 15%)	Rs. 1,12,500	Rs. 1,37,500
Plan III	(Rs. 2,50,000 x 10%)	Rs. 25,000	
	(Rs. 7,50,000 x 15%)	Rs. 1,12,500	
	(Rs. 5,00,000 x 20%)	Rs. 1,00,000	Rs. 2,37,500

{1/2 M}

(b) Number of equity shares to be issued

Plan I : $\frac{\text{Rs. } 22{,}50{,}000}{\text{Rs. } 150 \text{ (Market price of share)}} = 15{,}000 \text{ shares}$

Plan II : $\frac{\text{Rs. } 15{,}00{,}000}{\text{Rs. } 150} = 10{,}000 \text{ shares}$

Plan III : $\frac{\text{Rs. } 10{,}00{,}000}{\text{Rs. } 125} = 8{,}000 \text{ shares}$

{1/2 M}

Answer 2:

Working Notes:

(1) **Calculation of Collection from Trade Receivables:**

Particulars	December	January	February	March
Sales (units)	1,800	1,875	1,950	2,100
Sales (@ Rs. 600 per unit) / Trade Receivables (Debtors) (Rs.)	10,80,000	11,25,000	11,70,000	12,60,000
Collection from Trade Receivables (Debtors) (Rs.)		10,80,000	11,25,000	11,70,000

{1 M}

(2) **Calculation of Payment to Trade Payables:**

Particulars	December	January	February	March
Output (units)	1,875	1,950	2,100	2,250
Raw Material (2 units per output) (units)	3,750	3,900	4,200	4,500
Raw Material (@ Rs. 150 per unit) / Trade Payables (Creditors) (Rs.)	5,62,500	5,85,000	6,30,000	6,75,000
Payment to Trade Payables (Creditors) (Rs.)		5,62,500	5,85,000	6,30,000

{1 M}

(3) **Calculation of Variable Overheads and Wages:**

Particulars	January	February	March
Output (units)	1,950	2,100	2,250
Payment in the same month @ Rs.100 per unit (Rs.)	1,95,000	2,10,000	2,25,000

{1 M}

(a) **Preparation of Cash Budget**

Particulars	January (Rs.)	February (Rs.)	March (Rs.)	
Opening Balance	35,000	3,57,500	6,87,500	
Receipts:				
Collection from Trade Receivables (Debtors)	10,80,000	11,25,000	11,70,000	
Receipt of Long-Term Loan			2,00,000	
Total (A)	11,15,000	14,82,500	20,57,500	
Payments:				
Trade Payables (Creditors) for Materials	5,62,500	5,85,000	6,30,000	
Variable Overheads and Wages	1,95,000	2,10,000	2,25,000	
Purchase of Machinery			3,00,000	
Total (B)	7,57,500	7,95,000	11,55,000	
Closing Balance (A – B) {1 M}	3,57,500	{1 M} 6,87,500	9,02,500	{1 M}

(b) **Calculation of Current Ratio**

Particulars	March (Rs.)	
Output Inventory (i.e. units produced in March) [(2,250 units x 2 units of raw material per unit of output x Rs. 150 per unit of raw material) + 2,250 units x Rs. 100 for variable overheads and wages] or, [6,75,000 + 2,25,000] from Working Notes 2 and 3	9,00,000	{1 M}
Trade Receivables (Debtors)	12,60,000	{1 M}
Cash Balance	9,02,500	{1/2 M}
Current Assets	30,62,500	
Trade Payables (Creditors)	6,75,000	{1/2 M}
Current Liabilities	6,75,000	
Current Ratio (Current Assets / Current Liabilities)	4.537 approx.	{1 M}

Answer 3:

(a) Statement showing the Evaluation of Two Machines

Machines	A	B
Purchase cost (Rs.) : (i)	1,50,000	1,00,000
Life of machines (years)	3	2
Running cost of machine per year (Rs.) : (ii)	40,000	60,000
Cumulative present value factor for 1-3 years @ 10%: (iii)	2,486	--
Cumulative present value factor for 1-2 years @ 10%: (iv)	--	1.735
Present value of running cost of machines (Rs.): (v)	99,440	1,04,100
	[(ii) x (iii)]	[(ii) x (iv)]
Cash outflow of machines (Rs.) (vi)=(i) = (v)	2,49,440	2,04,100
Equivalent present value of annual cash outflow {2 M}	1,00,338	{2 M} 1,17,637
	[(vi)+(iii)]	[(vi)+(iv)]

Decision: Company X should buy machine A since its equivalent cash outflow is less than machine B. {2 M}

Answer:

(b) (i) Walter's model is giveny by

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

Where
P = Market price per share.
E = Earnings per share = Rs. 5
D = Dividend per share = Rs. 3
R = Return earned on investment = 15%
K_e = Cost of equity capital = 12%

P = $\dfrac{3 + \dfrac{0.15}{0.12}(5-3)}{0.12} = Rs.\ 45.83$ }{2 M}

(ii) According to Walter's model when the return on investment is more than the cost of equity capital, the price per share increases as the dividend pay-out ratio decreases. Hence, the optimum dividend pay-out ratio in this case is nil. So, at a pay-out ratio of zero, the market value of the company's share will be: {1 M}

P = $\dfrac{0 + \dfrac{0.15}{0.12}(5-0)}{0.12} = Rs.\ 52.08$ }{1 M}

Answer 4:

(i) (a) **Floating Rate Bonds**: These are the bonds where the interest rate is not fixed and is allowed to float depending upon the market conditions. These are ideal instruments which can be resorted to by the issuers to hedge themselves against the volatility in the interest rates. They have become more popular as a money market instrument and have been successfully issued by financial institutions like IDBI, ICICI etc. {3 M}

(b) **Packing Credit**: Packing credit is an advance made available by banks to an exporter. Any exporter, having at hand a firm export order placed with him by his foreign buyer on an irrevocable letter of credit opened in his favour, can approach a bank for availing of packing credit. An advance so taken by an exporter is required to be liquidated within 180 days from the date of its commencement by negotiation of export bills or receipt of export proceeds in an approved manner. Thus Packing Credit is essentially a short-term advance. {3 M}

Answer:

(ii) On one hand when cost of 'fixed cost fund' is less than the return on investment financial leverage will help to increase return on equity and EPS. The firm will also benefit from the saving of tax on interest on debts etc. However, when cost of debt will be more than the return it will affect return of equity and EPS unfavourably and as a result firm can be under financial distress. This is why financial leverage is known as "double edged sword". {2 M}

Effect on EPS and ROE:

When, ROI > Interest – Favourable – Advantage
When, ROI < Interest – Unfavourable – Disadvantage
When, ROI = Interest – Neutral – Neither advantage nor disadvantage. {2 M}

PAPER – 6B : STRATEGIC MANAGEMENT

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

PART I – CASE SCENARIO BASED MCQs (15 Marks)

Ans. 1 to Ans. 5:
CASE SCENARIO

1. Ans. (b)
2. Ans. (d)
3. Ans. (a)
4. Ans. (c) **{2 M Each}**
5. Ans. (d)
6. Ans. (c)
7. Ans. (c)
8. Ans. (a) **}{1 M}**

PART II – DESCRIPTIVE QUESTIONS (35 Marks)
Question No. 1 is Compulsory.
Attempt any two questions out of the remaining three questions.

Answer 1:

(a) **{**An opportunity is a favourable condition in the organisation's environment which enables it to strengthen its position. On the other hand a threat is an unfavourable condition in the organisation's environment which causes a risk for, or damage to, the organisation's position. An opportunity is also a threat in case internal weaknesses do not allow organization to take their advantage in a manner rivals can.**}{1 M}**

The IPL (Cricket) tournament is highly profit and entertainment driven. A number of entities and process are involved in this IPL type tournament. IPL (Cricket) type of tournament would offer opportunities/threats to the following industries:

Opportunities: **{2 M for any Two Points}**

- Stadia.
- Sports Industry.
- Media Industry – Sports channels / television, advertisers.

Threats: **{2 M for any Two Points}**

- Entertainment industry like TV serials, cinema theatres, Entertainment theme parks as competitors will be fighting for the same viewers/target customers.
- Tourism and hotel Industry.
- Event Management.

Answer:

(b) The **{competitive rivalry{1 M}** will be a significant force in case of company of Rajiv Arya as all the rivals are similar in sizes and are manufacturing similar products. **{**It is difficult for any single manufacturer to dominate the market. Large number of patents will make it difficult for new entrants to break into the market. Further, as there are a large number of small suppliers the power that suppliers can exert will also be low.**}{1 M}**

{There is no information relating to **substitutes and bargaining power of customers** in the information given in scenario. However, a domestic vacuum

cleaner will directly compete with other options such as house maids. Availability of house maids at low cost can significantly disturb the sales of products.**}{1 M}**
{Further, as the products are similar customers can easily shift from one company to another. This will only enhance competitive rivalry.**}{1 M}**
{The competitive rivalry will be significant in Rajiv Arya's dealing industry as all rivals are similar in sizes and manufacture similar products, making it difficult for anyone manufacturer to dominates the market or gain market share. The large number of patents will make it hard for new entrants to break into the market, while the fact that Rajiv Arya buys from a large number of small suppliers suggests that supplier power is also low. Finally, there is no information relating to substitutes and bargaining power of customers in the information given in scenario.**}{1 M}**

Answer:

(c) **{**GWA of Japan and TRP group of India **opted for strategic alliance** as their growth strategy.**}{1 M}** A strategic alliance is a relationship between two or more businesses that enables each to achieve certain strategic objectives which neither would be able to achieve on its own. Strategic alliances are often formed in the global marketplace between businesses that are based in different regions of the world.
Advantages of Strategic Alliance
Strategic alliance usually is only formed if they provide an advantage to all the parties in the alliance. These advantages can be broadly categorised as follows:

1. **Organizational:** Strategic alliance helps to learn necessary skills and obtain certain capabilities from strategic partners. Strategic partners may also help to enhance productive capacity, provide a distribution system, or extend supply chain. Having a strategic partner who is well-known and respected also helps add legitimacy and creditability to a new venture.
2. **Economic:** There can be reduction in costs and risks by distributing them across the members of the alliance. Greater economies of scale can be obtained in an alliance, as production volume can increase, causing the cost per unit to decline. Finally, partners can take advantage of co-specialization, creating additional value, such as when a leading computer manufacturer bundles its desktop with a leading monitor manufacturer's monitor.
3. **Strategic:** Rivals can join together to cooperate instead of competing with each other. Vertical integration can be created where partners are part of supply chain. Strategic alliances may also be useful to create a competitive advantage by the pooling of resources and skills. This may also help with future business opportunities and the development of new products and technologies. Strategic alliances may also be used to get access to new technologies or to pursue joint research and development.
4. **Political:** Sometimes strategic alliances are formed with a local foreign business to gain entry into a foreign market either because of local prejudices or legal barriers to entry. Forming strategic alliances with politically influential partners may also help improve your own influence and position.

{1 M Each}

Answer 2:

(a) **The role of Chief Executive Officer pertains to Corporate level.**
The corporate level of management consists of the Chief Executive Officer (CEO) and other top-level executives. These individuals occupy the apex of decision making within the organization.
The role of Chief Executive Officer is to:

1. oversee the development of strategies for the whole organization;
2. defining the mission and goals of the organization;
3. determining what businesses, it should be in;

{1 M for any 5 Points}

4. allocating resources among the different businesses;
5. formulating, and implementing strategies that span individual businesses;
6. providing leadership for the organization;
7. ensuring that the corporate and business level strategies which company pursues are consistent with maximizing shareholders wealth; and
8. managing the divestment and acquisition process.

Answer:

(b) In most situations, strategy-execution process includes the following principal aspects:

- Developing budgets that steer ample resources into those activities critical to strategic success.
- Staffing the organization with the needed skills and expertise, consciously building and strengthening strategy-supportive competencies and competitive capabilities, and organizing the work effort.
- Ensuring that policies and operating procedures facilitate rather than impede effective execution.
- Using the best-known practices to perform core business activities and pushing for continuous improvement.
- Installing information and operating systems that enable company personnel to better carry out their strategic roles day in and day out.
- Motivating people to pursue the target objectives energetically.
- Creating a company culture and work climate conducive to successful strategy implementation and execution.
- Exerting the internal leadership needed to drive implementation forward and keep improving strategy execution. When the organization encounters stumbling blocks or weaknesses, management has to see that they are addressed and rectified quickly.

{1 M for any 5 Points}

Good strategy execution involves creating strong "fits" between strategy and organizational capabilities, between strategy and the reward structure, between strategy and internal operating systems, and between strategy and the organization's work climate and culture.

Answer 3:

(a) Soft Cloth Ltd. is facing internal as well as external challenges. The external environment is in economic recession and the organization is facing cash crunch. The company needs to work on retrenchment / turnaround strategy. The strategy is suitable in case of issues such as:

- Persistent negative cash flow.
- Uncompetitive products or services
- Declining market share
- Deterioration in physical facilities
- Overstaffing, high turnover of employees, and low morale
- Mismanagement

{2 M}

{The company may consider to substantially reduce the scope of its activity. This is done through an attempt to find out the problem areas and diagnose the causes of the problems. Next, steps are taken to solve the problems.**}{1 M}**

{These steps result in different kinds of retrenchment strategies. If the organization chooses to focus on ways and means to reverse the process of decline, it adopts at <u>turnaround</u> <u>strategy</u>. If it cuts off the loss-making units, divisions, or SBUs, curtails its product line, or reduces the functions performed, it adopts a <u>divestment strategy</u>. If none of these actions work, then it may choose to abandon the activities totally, resulting in a <u>liquidation strategy</u>.**}{2 M}**

Answer:

(b) A differentiation strategy may help to remain profitable even with: rivalry, new entrants, suppliers' power, substitute products, and buyers' power.

1. **Rivalry -** Brand loyalty acts as a safeguard against competitors. It means that customers will be less sensitive to price increases, as long as the firm can satisfy the needs of its customers.
2. **Buyers –** They do not negotiate for price as they get special features and also they have fewer options in the market.
3. **Suppliers –** Because differentiators charge a premium price, they can afford to absorb higher costs of supplies and customers are willing to pay extra too.
4. **Entrants –** Innovative features are an expensive offer. So, new entrants generally avoid these features because it is tough for them to provide the same product with special features at a comparable price.
5. **Substitutes –** Substitute products can't replace differentiated products which have high brand value and enjoy customer loyalty.

{1 M Each}

Answer 4:

(a) There are various types of strategic performance measures, including:

- Financial Measures: Financial measures, such as revenue growth, return on investment (ROI), and profit margins, provide an understanding of the organization's financial performance and its ability to generate profit.
- Customer Satisfaction Measures: Customer measures, such as customer satisfaction, customer retention, and customer loyalty, provide insight into the organization's ability to meet customer needs and provide high-quality products and services.
- Market Measures: Market measures, such as market share, customer acquisition, and customer referrals, provide information about the organization's competitiveness in the marketplace and its ability to attract and retain customers.
- Employee Measures: Employee measures, such as employee satisfaction, turnover rate, and employee engagement, provide insight into the organization's ability to attract and retain talented employees and create a positive work environment.
- Innovation Measures: Innovation measures, such as research and development (R&D) spending, patent applications, and new product launches, provide insight into the organization's ability to innovate and create new products and services that meet customer needs.
- Environmental Measures: Environmental measures, such as energy consumption, waste reduction, and carbon emissions, provide insight into the organization's impact on the environment and its efforts to operate in a sustainable manner.

{1 M for any 5 Points}

Answer:

(b) Strategic uncertainty refers to the unpredictability and unpredictability of future events and circumstances that can impact an organization's strategy and goals. It can be driven by factors such as changes in the market, technology, competition, regulation, and other external factors. Dealing with strategic uncertainty can be challenging and organizations need to have the flexibility, resilience, and agility to quickly respond to changes in the environment and minimize its impact. To be manageable, they need to be grouped into logical clusters or themes. It is then useful to assess the importance of each cluster in order to set priorities with respect to Information gathering and analysis.

- **Flexibility:** Organizations can build flexibility into their strategies to quickly adapt to changes in the environment.
- **Diversification:** Diversifying the organization's product portfolio, markets, and customer base can reduce the impact of strategic uncertainty.
- **Monitoring and Scenario Planning:** Organizations can regularly monitor key indicators of change and conduct scenario planning to understand how different future scenarios might impact their strategies.
- **Building Resilience:** Organizations can invest in building internal resilience, such as strengthening their operational processes, increasing their financial flexibility, and improving their risk management capabilities.
- **Collaboration and Partnerships:** Collaborating with other organizations, suppliers, customers, and partners can help organizations pool resources, share risk, and gain access to new markets and technologies.

{1 M for any 5 Points}

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