(GI-8, GI-9, GI-10, GI-11, VI-2(A) & AI-2(A), DI-1+2 & Drive)
DATE: 28.03.2024 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 Division A, working notes are not required.**

PART I – CASE SCENARIO BASED MCQs (15 Marks)

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

1. I. Ans. a
 II. Ans. b
 III. Ans. c
 IV. Ans. d **{2 M Each}**
 V. Ans. c
2. Ans. a
3. Ans. d
4. Ans. b **}{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) The net profit is calculated as follows:

	Rs.
Sales Revenue	22,50,000
Less: Direct Costs	15,00,000
Gross Profits	7,50,000
Less: Operating Expense	2,40,000
Earnings before Interest and tax(EBIT)	5,10,000
Less: Interest on debt [9% × 7,50,000 (i.e. 30 % of25,00,000)]	67,500
Earnings before Tax)(EBT)	4,42,500
Less: Taxes (@ 40%)	1,77,000
Profit after Tax (PAT)	2,65,500

{1 M}

(i) Net Profit Margin (After Tax)

Net Profit Margin $= \frac{PAT}{Sales} \times 100 = \frac{Rs.\ 2,65,500}{Rs.\ 22,50,000} = 11.8\%$ **}{1 M}**

(ii) Return on Assets (ROA)(After tax)

$$ROA = \frac{EBIT\ (1\text{-}t)}{Total\ Assets}$$

$$= \frac{₹\ 5,10,000\ (1-0.4)}{₹\ 25,00,000} = \frac{₹\ 3,06,000}{₹\ 25,00,000}$$

$= 0.1224 = 12.24\ \%$ }{1 M}

(iii) Asset Turnover

$$Asset\ Turnover = \frac{Sales}{Assets} = \frac{₹\ 22,50,000}{₹\ 25,00,000} = 0.9$$ }{1 M}

Asset Turnover = 0.9

(iv) Return on Equity (ROE)

$$ROE = \frac{PAT}{Equity} = \frac{₹\ 2,65,500}{₹\ 17,50,000} = 15.17\%$$ }{1 M}

ROE = 15.17%

Answer:

(b) Ascertainment of probable price of shares of Prakash Limited

Particulars	Plan-I	Plan-II
	If Rs. 4,00,000 is raised as debt(Rs.)	**If Rs. 4,00,000 is raised by issuing equity shares (Rs.)**
Earning Before Interest and Tax (EBIT) {20% of new capital i.e. 20% of (Rs.14,00,000 + Rs. 4,00,000)} (Refer working note 1)	3,60,000	3,60,000
Less: Interest on old debentures (10% of Rs. 4,00,000)	(40,000)	(40,000)
Less: Interest on new debt (12% of Rs. 4,00,000)	(48,000)	--
Earnings Before Tax (EBT)	2,72,000	3,20,000
Less: Tax@50%	(1,36,000)	(1,60,000)
Earnings for equity shareholders (EAT)	1,36,000	1,60,000
No. of Equity Shares (refer working note 2)	30,000	40,000
Earnings per share (EPS)	Rs. 4.53	Rs. 4.00
Price/Earnings (P/E) Ratio (refer working note 3)	8	10
Probable Price Per Share (PE Ratio x EPS)	Rs. 36.24	Rs. 40

}{$1^{1/2}$ M} }{$1^{1/2}$ M}

Working Notes:

1. Calculation of existing Return of Capital Employed (ROCE):

	(₹)
Equity Share capital (30,000 shares × ₹10)	3,00,000
10% Debentures $\left(₹40,000 \times \frac{100}{10}\right)$	4,00,000
Reserves and Surplus	7,00,000
Total Capital Employed	14,00,000
Earnings before interest and tax (EBIT) (given)	2,80,000
ROCE $= \frac{₹2,80,000}{₹14,00,000} \times 100$	20% }{1 M}

2. **Number of Equity Shares to be issued in Plan-II:**

$$= \frac{₹4,00,000}{₹40} = 10,000 \text{ shares}$$ }{1/2 M}

Thus, after the issue total number of shares = 30,000+ 10,000 = 40,000 shares

3. **Debt/Equity Ratio if ₹ 4,00,000 is raised as debt:**

$$= \frac{₹8,00,000}{₹18,00,000} \times 100 = 44.44\%$$ }{1/2 M}

As the debt equity ratio is more than 40% the P/E ratio will be brought down to 8 in Plan-I

Answer:

(c) **Income Statements of Company A and Company B**

	Company A (Rs.)	Company B (Rs.)
Sales	91,000	1,05,000
Less: Variable cost	56,000	63,000
Contribution	35,000	42,000
Less: Fixed Cost	20,000	31,500
Earnings before interest and tax (EBIT)	15,000	10,500
Less: Interest	12,000	9,000
Earnings before tax (EBT)	3,000	1,500
Less: Tax @ 40%	1,200	600
Earnings after tax (EAT)	1,800	900
	}{1 M}	}{1 M}

Working Notes:

Company A

(i) Financial Leverage $= \frac{EBIT}{EBT \text{ i.e. } EBIT - Interest}$

So, 5 $= \frac{EBIT}{EBT - 12,000}$

Or, 5 (EBIT – 12,000) = EBIT

Or, 4 EBIT = 60,000

Or, EBIT = Rs. 15,000 }{1 M}

(ii) Contribution = EBIT + Fixed Cost
= Rs. 15,000 + Rs. 20,000 = Rs. 35,000

(iii) Sales= Contribution + Variable cost
= Rs. 35,000 + Rs. 56,000
= Rs. 91,000 **{1/2 M}**

Company B

(i) Contribution = 40% of Sales (as Variable Cost is 60% of Sales)
= 40% of 1,05,000 = Rs. 42,000

(ii) Operating Leverage = $\frac{\text{Contribution}}{\text{EBIT}}$ Or, $4 = \frac{₹\ 42{,}000}{\text{EBIT}}$

EBIT = $\frac{₹\ 42{,}000}{4}$ = ₹10,500 **}{1 M}**

(iii) Fixed Cost = Contribution – EBIT = 42,000 – 10,500 = ₹ 31,500 **}{1/2 M}**

Answer 2:

(i) Computation of the weighted average cost of capital (using market value weights)

Source of finance (a)	Market Value of capital (Rs.)	Weight (b)	After tax Cost of capital (%) (c)	WACC (%) (d) = (b) × (c)
Equity share (Working note 1) [Rs. 110 × 10,000 shares]	11,00,000	0.5238	15.09	7.9041
10% Preference share	4,00,000	0.1905	10.00	1.9050
12% Debentures	6,00,000	0.2857	6.00	1.7142
	21,00,000	1.0000		11.5233

{3 M}

(ii) Computation of Revised Weighted Average Cost of Capital (using market value weights)

Source of finance (a)	Market Value of capital (Rs.)	Weight (b)	After tax Cost of capital (%) (c)	WACC (%) (d) = (b) × (c)
Equity shares (Working note 2) [Rs. 105 × 10,000 shares]	10,50,000	0.3443	17.43	6.0011
10% Preference shares	4,00,000	0.1311	10.00	1.3110
12% Debentures	6,00,000	0.1967	6.00	1.1802
14% Loan	10,00,000	0.3279	7.00	2.2953
	30,50,000	1.0000		10.7876

{3 M}

Working Notes:

(1) Cost of equity shares (K_e)

$$K_e = \frac{Dividend\ \ per\ \ share\ \ (D_1)}{Market\ \ price\ \ per\ \ share\ \ (P_0)} + Growthrate\ \ (g)$$

$$= \frac{Rs.\ 10}{Rs.\ 110} + 0.06 = 0.1509\ \ or\ 15.09\%$$ **}{2 M}**

(2) Revised cost of equity shares (K_e)

Revised K_e $= \frac{Rs.\ 12}{Rs.\ 105} + 0.06 = 0.1742\ \ or\ 17.43\%$ **}{2 M}**

Answer 3:

(a) Advise to the Hospital Management

Determination of Cash inflows

Sales Revenue	40,000
Less: Operating Cost	7,500
	32,500
Less: Depreciation (80,000 – 6,000)/8	9,250
Net Income	23,250
Tax @ 30%	6,975
Earnings after Tax (EAT)	16,275
Add: Depreciation	9,250
Cash inflow after tax per annum	25,525
Less: Loss of Commission Income	12,000
Net Cash inflow after tax per annum	13,525
In 8th Year :	
New Cash inflow after tax	13,525
Add: Salvage Value of Machine	6,000
Net Cash inflow in year 8	19,525

{1 M}

{1/2 M}

Year	CFAT	PV Factor @ 10%	Present Value of Cash inflows
1 to 7	13,525	4.867	65,826.18
8	19,525	0.467	9,118.18
			74,944.36
Less: Cash Outflows			80,000.00
	NPV		(5,055.64)

{2 M}

$$\text{Profitability Index} = \frac{\text{Sum of discounted cash inflows}}{\text{Present value of cash outflows}} = \frac{74{,}944.36}{80{,}000} = 0.937$$ {1 M}

Advise: Since the net present value is negative and profitability index is also less than 1, therefore, the hospital should not purchase the X-Ray machine. {1/2 M}

Answer:

(b) (i) The EPS of the firm is Rs. 10 (i.e., Rs. 4,00,000/ 40,000) and r = 4,00,000/ (40,000 shares × Rs.100) = 10%. The P/E Ratio is given at 12.5 and the cost of capital, Ke, may be taken at the inverse of P/E ratio. Therefore, Ke is 8 (i.e., 1/12.5). The firm is distributing total dividends of Rs. 3,00,000 among 40,000 shares, giving a dividend per share of Rs. 7.50. the value of the share as per Walter's model may be found as follows:

$$P = \frac{D + \frac{r}{K_e}(E - D)}{K_e} = \frac{7.5 + \frac{0.1}{0.08}(10 - 7.5)}{0.08} = ₹\ 132.81$$ {1 M}

The firm has a dividend payout of 75% (i.e., Rs. 3,00,000) out of total earnings of Rs. 4,00,000. Since, the rate of return of the firm, r, is 10% and it is more than the Ke of 8%, therefore, by distributing 75% of earnings, the firm is not following an opti mal dividend policy. The optimal dividend policy for the firm would be to pay zero dividend and in such a situation, the market price would be- {1 M}

$$= \frac{0 + \frac{0.1}{0.08}(10-0)}{0.08} = ₹\ 156.25$$ }{1 M}

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

(ii) The P/E ratio at which the dividend policy will have no effect on the value of the share is such at which the Ke would be equal to the rate of return, r, of the firm. The Ke would be 10% (= r) at the P/E ratio of 10. Therefore, at the P/E ratio of 10, the dividend policy would have no effect on the value of the share. {1 M}

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

$$P = \frac{D + \frac{r}{K_e}(E-D)}{K_e} = \frac{7.5 + \frac{0.1}{0.125}(10-7.5)}{0.125} = ₹\ 76$$ }{1 M}

Answer 4:

(a) Bridge finance refers, normally, to loans taken by the business, usually from commercial banks for a short period, pending disbursement of term loans by financial institutions, normally it takes time for the financial institution to finalise procedures of creation of security, tie-up participation with other institutions etc. even though a positive appraisal of the project has been made. However, once the loans are approved in principle, firms in order not to lose further time in starting their projects arrange for bridge finance. Such temporary loan is normally repaid out of the proceeds of the principal term loans. It is secured by hypothecation of moveable assets, personal guarantees and demand promissory notes. Generally rate of interest on bridge finance is higher as compared with that on term loans. **{3 M}**

Answer:

(b) Virtual Banking and its Advantages

Virtual banking refers to the provision of banking and related services through the use of information technology without direct recourse to the bank by the customer. **{2 M}**

The advantages of virtual banking services are as follows:

- ➢ Lower cost of handling a transaction.
- ➢ The increased speed of response to customer requirements.
- ➢ The lower cost of operating branch network along with reduced staff costs leads to cost efficiency.
- ➢ Virtual banking allows the possibility of improved and a range of services being made available to the customer rapidly, accurately and at his convenience.

{1/2 M for Each Point}

Answer:

(c) Concentration Banking: In concentration banking the companyestablishes a number of strategic collection centres in different regions instead of a single collection centre at the head office. This system reduces the period between the time a customer mails in his remittances and the time when they become spendable funds with the company. Payments received by the different collection centers are deposited with their respective local banks which in turn transfer all surplus funds to the concentration bank of head office. **{3 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)

Answer 1:

1.	A.	(i)	Ans. (a)	{2 M Each}
		(ii)	Ans. (b)	
		(iii)	Ans. (d)	
		(iv)	Ans. (c)	
		(v)	Ans. (b)	
	B.	(i)	Ans. (c)	
		(ii)	Ans. (c)	
		(iii)	Ans. (b)	{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) (i) 'ALBELA' foods is proactive in its approach. On the other hand, 'JustBE' foods is reactive in its approach. **{1 M}**

(ii)
- Proactive strategy is planned strategy. While continuing with the previously initiated business approaches that are working well, the newly launched managerial initiatives aim to strengthen the company's overall position and performance. These are outcomes of management's analysis and strategic thinking about the company's situation and its conclusions about the positioning of the company in the marketplace. If done well, it helps the company to effectively compete for buyer patronage. **{$1^{1/2}$ M}**
- Reactive strategy is an adaptive reaction to changing circumstances. It is not always possible for a company to fully anticipate or plan for changes in the market. There is also a need to adapt strategy as new learnings emerge about which pieces of strategy are working well and which aren't. By itself also, the management may hit upon new ideas for improving the current strategy. **{$1^{1/2}$ M}**

(iii) In reference to the given case, proactive strategy seems to be better because ALBELA foods had been able to utilise available opportunities, reduce adverse impact, enhance the demand for product and is also able to avail the first mover advantage. **{1 M}**

Answer:

(b) Manoj has started a telecom business. Accounts, Administration, Marketing (customer creation, after sales service, vendor coordination) are the functional areas that are desired in the organisational structure. Further there is inherent need to have a department for the management of telecom services/ operations. **{1 M}**

A widely used structure in business organisations is functional type because of its simplicity and low cost. A functional structure groups tasks and activities by business function, such as production/operations, marketing, finance/accounting, research **{2 M}** and development, and management information systems. Besides being simple and inexpensive, a functional structure also promotes specialization of labour, encourages efficiency, minimizes the need for an elaborate control system, and allows rapid decision making.

The functional structure consists of a chief executive officer or a managing director and supported by corporate staff with functional line managers in dominant functions such as production, financial accounting, marketing, R&D, engineering, and human resources. The functional structure enables the company to overcome the growth-related constraints of the simple structure, enabling or facilitating communication and coordination. **{2 M}**

Answer:

(c) Woodworld is having a product portfolio that is evidently in the decline stage. The product is being replaced with the latest designs with better quality of the product. Strategically, the company should minimize their dependence on the existing products and identify other avenues for the survival and growth. As a CEO of Woodworld Ltd., following can be the strategic options available with the CEO: **{1 M}**

- Invest in new product development and switchover to the latest designs. Woodworld Ltd. also need time to invest in hiring interior designers.
- They can acquire or takeover a competitor, provided they have or are able to generate enough financial resources.
- They may also consider unrelated growth and identify other areas for expansion. This will enable Woodworld Ltd. to spread their risks.
- In longer run, they should divest the existing products. However, they may continue with the existing products in a limited manner for such time there is demand for the product.

{1 M Each}

Answer 2:

(a) Formulation of strategies and their implementation have become essential for all organizations for their survival and growth in the present turbulent business environment.

The major benefits of strategic management are:

♦ The strategic management gives a direction to the company to move ahead. It helps define the goals and mission. It helps management to define realistic objectives and goals which are in line with the vision of the company.

♦ Strategic management helps organisations to be proactive instead of reactive in shaping its future. Organisations are able to analyse and take actions instead of being mere spectators. Thereby they are able to control their own destiny in a better manner. It helps them in working within vagaries of environment and shaping it, instead of getting carried away by its turbulence or uncertainties.

♦ Strategic management provides frameworks for all major decisions of an enterprise such as decisions on businesses, products, markets, manufacturing facilities, investments and organisational structure. It provides better guidance to entire organisation on the crucial point - what it is trying to achieve.

♦ Strategic management seeks to prepare the organisation to face the future and act as pathfinder to various business opportunities. Organisations are able to identify the available opportunities and identify ways and means to reach them.

♦ Strategic management serves as a corporate defence mechanism against mistakes and pitfalls. It helps organisations to avoid costly mistakes in product market choices or investments.

{1 M Each for Any 5 Points}

- ♦ Strategic management helps to enhance the longevity of the business. With the state of competition and dynamic environment it may be challenging for organisations to survive in the long run. It helps the organization to take a clear stand in the related industry and makes sure that it is not just surviving on luck. Actions over expectations is what strategic management ensures.
- ♦ Strategic management helps the organisation to develop certain core competencies and competitive advantages that would facilitate assist in its fight for survival and growth.

Answer:

(b) Shyam Samosa Corner faces competition from paper disposal and falls under **Threat of Substitutes}{1 M}** force categories in Porter's Five Forces Model for Competitive Analysis. Paper disposals are substitutes of recyclable plastic disposal as they perform the same function as plastic disposal. **{**Substitute products are a latent source of competition in an industry. In many cases, they become a major constituent of competition.Substitute products offering a price advantage and/or performance improvement to the consumer can drastically alter the competitive character of an industry. **}{4 M}**

Answer 3:

(a) A tool to identify the market positions of rival companies by grouping them into like positions is strategic group mapping. A strategic group consists of those rival firms which have similar competitive approaches and positions in the market.
The procedure for constructing a strategic group map and deciding which firms belong in which strategic group are as follows: **{1 M}**

1. Identify the competitive characteristics that differentiate firms in the industry typical variables that are price/quality range (high, medium, low); geographic coverage (local, regional, national, global); degree of vertical integration (none, partial, full); product-line breadth (wide, narrow); use of distribution channels (one, some, all); and degree of service offered (no-frills, limited, full).
2. Plot the firms on a two-variable map using pairs of these differentiating characteristics.
3. Assign firms that fall in about the same strategy space to the same strategic group.
4. Draw circles around each strategic group making the circles proportional to the size of the group's respective share of total industry sales revenues.

{1 M Each}

Answer:

(b) Cost leadership strategy emphasizes producing standardized products at a very low per-unit cost for consumers who are price-sensitive. It frequently results from productivity increases and aggressive pursuit of cost reduction throughout the development, production, marketing, and distribution processes. It allows a firm to earn higher profits than its competitors. **{1 M}**

The circumstances in which an organization can gain competitive advantages from cost leadership strategy are:

- when the market is composed of many price-sensitive buyers.
- when there are few ways to achieve product differentiation.
- when buyers do not care much about differences from brand to brand.
- when there are a large number of buyers with significant bargaining power.

{3M}

The basic idea is to underprice competitors and thereby gain market share driving some of the competitors out of the market.
Some risks of pursuing cost leadership are:

- that competitors may imitate the strategy, therefore driving overall industry profits down
- that technological breakthroughs in the industry may make the strategy ineffective; or that buyer interests may swing to other differentiating features besides price.

{1 M}

Answer 4:

(a) Quite often suppliers, too, exercise considerable bargaining power over companies. The more specialised the offering from the supplier, greater is his clout. And, if the suppliers are also limited in number, they stand a still better chance to exhibit their bargaining power. The bargaining power of suppliers determines the cost of raw materials and other inputs of the industry and, therefore, industry attractiveness and profitability. **{2 M}**

Suppliers can influence the profitability of an industry in a number of ways. Suppliers can command bargaining power over a firm when:

(i) Their products are crucial to the buyer and substitutes are not available.
(ii) They can erect high switching costs.
(iii) They are more concentrated than their buyers.

{1 M Each}

Answer:

(b) Kamlesh is a follower of transactional leadership style that focuses on designing systems and controlling the organization's activities. Such a leader believes in using authority of its office to exchange rewards, such as pay and status. They prefer a more formalized approach to motivation, setting clear goals with explicit rewards or penalties for achievement or non-achievement. Transactional leaders try to build on the existing culture and enhance current practices. The style is better suited in persuading people to work efficiently and run operations smoothly. **{$2^{1/2}$ M}**

On the other hand, Pawan is follower of transformational leadership style. The style uses charisma and enthusiasm to inspire people to exert them for the good of the organization. Transformational leaders offer excitement, vision, intellectual stimulation and personal satisfaction. They inspire involvement in a mission, giving followers a 'dream' or 'vision' of a higher calling so as to elicit more dramatic changes in organizational performance. Such a leadership motivates followers to do more than originally affected to do by stretching their abilities and increasing their self-confidence, and also promote innovation throughout the organization. **{$2^{1/2}$ M}**

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