PAPER – 6: FINANCIAL MANAGEMENT AND STRATEGIC MANAGEMENT

PART – I Multiple Choice Questions

Case Scenario - I

XYZ Ltd. wants to establish a shoe manufacturing unit. To setup this unit, it needs a loan. XYZ Ltd, approaches a commercial bank for working capital loan.

Bank has asked the company to present the proposal for such loan. To prepare such proposal, the company has appointed you and provided some information about the plan.

It wants to maintain margin of safety of 10% for contingencies. The company want to keep cash balance of ₹ 90,000.

The product will be sold at gross profit margin of 25% on COGS. Depreciation will be part of cost of production.

Stock of raw material will be held at 1.5 months of its consumption, while finished goods inventory will be maintained at one month's requirement. Finished goods will be valued at manufacturing cost.

The company will sell shoes in domestic as well as in foreign market. Total estimated annual sales will be ₹ 30,00,000. 20% of the sales are foreign sales and there will be a delay of 1/2 month to realise the sales proceed from foreign debtors. All domestic sales will be on credit and allowed a credit period of 2 months.

Raw material consumed will be 25% of estimated sales and the company will get credit period of 2 months of consumption from its supplier of raw material. Wage expenses will be 20% of sales and will be paid in 1/2 month's lag.

Outstanding cash manufacturing overhead expenses at the end of the year will be ₹ 60,000; it will be paid in one month arrear. Estimated total administrative cost (to be paid after one month) will be ₹ 1,80,000. Expected annual sales promotion expenses are ₹ 90,000, which will be paid quarterly in advance. The company want to submit the proposal to bank on cash cost basis.

You are required to answer the following question 1 to 5:

1. *What will be the total manufacturing cost and total cost of sales on cash cost basis?*

   (A) ₹ 20,70,000, ₹ 23,40,000

   (B) ₹ 24,00,000, ₹ 30,00,000

   (C) ₹ 22,50,000, ₹ 23,40,000

   (D) ₹ 16,80,000, ₹ 24,00,000 ***(2 Marks)***

2. *What will be the total estimated finished goods inventory and total debtors on cash cost basis?*

   (A) ₹ 2,00,000, ₹ 4,25,000

   (B) ₹ 1,72,500, ₹ 3,40,000

   (C) ₹ 1,72,500, ₹ 3,31,500

   (D) ₹ 1,87,500, ₹ 3,31,500 ***(2 Marks)***

3. *What will be the total estimated current assets on cash cost basis?*

   (A) ₹ 8,31,250

   (B) ₹ 7,18,750

   (C) ₹ 7,25,250

   (D) ₹ 7,10,250 ***(2 Marks)***

4. *What will be the total estimated current liabilities?*

   (A) ₹ 2,52,500

   (B) ₹ 1,90,000

   (C) ₹ 2,17,500

   (D) ₹ 2,25,000 ***(2 Marks)***

5. *What will be the estimated working capital to be submitted by you in the proposal?*

   (A) ₹ 5,33,775

   (B) ₹ 4,36,725

   (C) ₹ 5,50,275

(D) ₹ 4,50,225 **(2 Marks)**

6. *A company has net worth of ₹ 5,00,000. Its debt to equity ratio is 2. Interest on debt is 10%. The company earns an operating profit of ₹ 4,00,000. Tax rate is 30%.*

   What will be the financial leverage of the company?

   (A) 1.11

   (B) 1.33

   (C) 1.43

   (D) 1.90 **(2 Marks)**

7. *T Ltd. is looking for a capital project in order to replace its existing old machine. It got two proposals to consider; details of which are given below:*

	Proposal X	Proposal Y
Initial investment	₹ 6,50,000	₹ 7,80,000
Estimated useful life	5 Years	3 Years
Annal cash inflows	₹ 1,90,000	₹ 3,50,000
Cost of capital	10%	10%

Year	1	2	3	4	5
$PVIF_{0.10,\ t}$	0909	0.826	0.751	0.683	0.621
$PVIFA_{0.10,\ t}$	0.909	1.736	2.487	3.170	3.791

   What will be Equivalent Annual NPV for Proposal X and Proposal Y?

   (A) ₹ 70,290.00, ₹ 90,450.00

   (B) ₹ 18,541.28, ₹ 36,369.12

   (C) ₹ 1,90,000.00, ₹ 3,50,000.00

   (D) ₹ 77,326.73, ₹ 99,504.95 **(2 Marks)**

8. *Q Ltd. is planning to pay dividend of ₹ 2 per share in next year. Growth rate of company is 8% p.a. Current market price per share is ₹ 51. Flotation cost is ₹ 1 per share.*

What will be cost of equity?

(A) 12.23%

(B) 11.92%

(C) 12.00%

(D) 12.32% ***(1 Mark)***

Case Scenario - II

A team of professionals having expertise in the areas of Artificial Intelligence (Al), Block Chain (BC), Cloud Computing (CC) and Data Mining (DM) formed a company in the name and style of M/s. ABCD Ltd. (the company).

The aim of the company is to position itself as the best service provider in its area of operations with best user experience to its customer. Concentrating on its resources and capabilities, the company wants to target 8% year-on-year growth in revenue and 9% year-on-year growth in net profit in its business plan.

In order to identify right approach to select and implement the strategy, the company has decided to conduct in depth strategic analysis on strategic groups, objectives, performance and cost structure of companies having similar operations in the market.

In the month of March 2025, the Board of Directors of the company thought it proper to be in the business of manufacturing Robots and providing services relating thereto. The company knows that there is no linkage between existing and proposed business with specific reference to product or market or technology.

As per proposed arrangement, majority of the components of Robots will be imported from M/s. Faisla Inc. (FI), an established player in this area. The Robots will be assembled in India specifically for use at homes and in restaurants.

The company will endeavor to provide the above product while using cutting-edge technology with customized features and best of the services. The core intent will be to elevate the same to unprecedented level. In this context, the company would like to offer additional facilities like: better customer interface, online repair service and services on site to its customer.

In addition, company is of a considered view that meticulous analysis of its stakeholders will facilitate to build and maintain strong relationship with each group. As an accepted practice, greatest efforts are in place to satisfy Mr. X, the

Chief Executive Officer of the company by taking his advice and keeping him informed with all related information and developments on a regular basis.

Based on above case scenario, choose the correct option for MCQ number 9 to 13:

9. *In order to position itself as the best service provider, stating year-on-year growth, indicates which one of the components of the strategic intent?*

   (A) Goals

   (B) Objectives

   (C) Mission

   (D) Vision ***(2 Marks)***

10. *Analysis of strategic groups and cost structure can be termed as, which type of strategic analysis?*

    (A) Competitor analysis

    (B) Determinants analysis

    (C) Environmental analysis

    (D) Market analysis ***(2 Marks)***

11. *Entering into business of manufacturing of Robots can best be described as:*

    (A) Backward vertical integration

    (B) Co-generic diversification

    (C) Conglomerate diversification

    (D) Divestment ***(2 Marks)***

12. *Elevating customer service to unprecedented level by providing better customer interface, online repair service and service on site is known as:*

    (A) Augmented marketing

    (B) Enlightened marketing

    (C) Social marketing

    (D) Synchro marketing ***(2 Marks)***

13. *While preparing a Power Interest matrix of stakeholders, the position of Mr. X will be categorized in which one of the following quadrants?*

    (A) Key player

    (B) Keep satisfied

    (C) Keep informed

    (D) Low priority ***(2 Marks)***

14. *In response to a scheme of subsidy by the state government, a company started manufacturing E-Vehicles. Some of the customers were not at ease with battery life and time consumed in recharging the battery. Some of the customers were apprehensive about frequent incidents of battery catching fire. All these resulted in half-hearted response from the customers in evolving EV market.*

    Here, the customers' response is indicating towards which one of the limitations of strategic management?

    (A) Environment is highly complex and turbulent.

    (B) Strategic management is a time-consuming process.

    (C) Strategic management is a costly process.

    (D) It is difficult to estimate the competitive response to the firm's strategy.

    (2 Marks)

15. *M/s. A is providing mobile phones and Wi-Fi services in the country. M/s. B and M/s. C are other similar service providers already in operation. In competitive landscape, M/s. B and M/s. C decided to merge with each other. Such merger was an unexpected development in the industry. M/s. A decided to cope-up with such eventuality by intense review of its strategy and to form a core group to handle the situation.*

    The situation where intense review of strategy is needed due to merger between M/s. B and M/s. C, indicates towards which type of strategic control for M/s. A?

    (A) Premise control

    (B) Implementation control

    (C) Strategic surveillance

(D) *Special alert control* ***(2 Marks)***

16. *M/s. SPG is a multi-product multi-business enterprise. It has four prominent divisions. Each division functions as an independent product center with its own set of activities managed by respective division head, which is responsible for its own performance and profitability. This organizational structure is known as:*

    (A) *Divisional structure*

    (B) *Multi divisional structure*

    (C) *Strategic Business Unit*

    (D) *Network structure* ***(1 Mark)***

Answer Key

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

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) The following information is available for S Ltd. for the year ended 31st March, 2025:

Raw Material consumed	*20% of COGS*
Raw Material Inventory turnover ratio	*4.00*
Finished Goods Inventory holding period	*0.75 month*
Gross profit (based on COGS)	*12.50%*
Debtor collection period (all sales are credit sales)	*3 months*
Proprietary ratio	*0.3125*
Fixed Assets turnover ratio (based on sales)	*3.00*
Fixed Assets to Total Assets	*40%*

You are required to prepare a Balance Sheet as on 31st March, 2025 in the following format:

Liabilities	₹	***Assets***	₹
Shareholders' Fund (assume no Preference Shares)		*Fixed Assets*	*12,00,000*
Long-term Debt	*15,00,000*	*Stock of Raw Material*	
Current Liabilities		*Stock of Finished Goods*	
		Debtors	
		Cash	
Total		*Total*	

(5 Marks)

(b) *Y Ltd. produces energy drinks in different flavours. Due to high demand of its product, the rate of return on its earnings is 25%. Currently, the company retains 60% of its earnings and distributes the rest. The current P/E ratio is 8 and earnings per share is ₹ 10.*

According to Gordon's Model:

(i) *What will be retention ratio if the company wants to maintain its P/E ratio to 12 in current year, given that the expected rate of return for an investor is 20%?* **(2 Marks)**

(ii) *What will be the expected price per share after one year if Y Ltd. achieves above-mentioned targeted P/E ratio?* **(1 Mark)**

(iii) *Will there be any change in retention ratio if the company wants to maintain its P/E ratio to 10 in current year, given that the expected rate of return for an investor is 17.50%?* **(2 Marks)**

(c) *Following information relates to A Ltd. for the year ended 31st March, 2025:*

Profit volume ratio	24%
Operating leverage	2.00
Financial leverage	1.50
Interest Expenses	₹ 12,000
Tax rate	30%
Number of Equity Shares	1,000

You are required to:

(i) *Prepare Income Statement for the year ended 31st March, 2025.*

(ii) *Calculate EPS.*

(iii) *Calculate percentage change in earnings per share, if sales increase by 5%.* **(2 + 1 + 2 = 5 Marks)**

Answer

(a) Workings:

(i) Calculation of Sales, Cost of Goods Sold and Gross Profit

$$\text{Fixed Assets Turnover} = \frac{\text{Sales}}{\text{Fixed Assets}}$$

3 $= \dfrac{\text{Sales}}{12{,}00{,}000}$

So, Sales = 12,00,000 x 3 = ₹ 36,00,000

And Cost of Goods Sold $= 36{,}00{,}000 \times \dfrac{100}{(100 + 12.5)}$ = ₹ 32,00,000

Therefore, Gross Profit = 32,00,000 x 12.5% = ₹ 4,00,000

(ii) Calculation of Stock of Raw Materials

Raw Material Consumed = COGS x 20%

= 32,00,000 x 20%

= ₹ 6,40,000

So, stock of raw material $= \dfrac{6{,}40{,}000}{4}$ = ₹ 1,60,000

(iii) Calculation of Debtors

Debtor Collection Period $= \dfrac{12}{\text{Receivable Turnover Ratio}}$ = 3 months

Or Debtors $= 36{,}00{,}000 \text{ X } \dfrac{3}{12}$

= ₹ 9,00,000

(iv) Calculation of Total Assets

Total Asset $= \dfrac{\text{Fixed Assets}}{40\%}$

$= 12{,}00{,}000 \times \dfrac{100}{40}$ = ₹ 30,00,000

So Total Liabilities including shareholder's fund = ₹ 30,00,000

(v) Calculation of Stock of Finished Goods

Stock of Finished Goods $= 32{,}00{,}000 \times \dfrac{0.75}{12}$ = ₹ 2,00,000

(vi) Calculation of Current Assets and Fixed Assets

Current Assets = Total Assets – Fixed Assets

= 30,00,000 – 12,00,000 = ₹ 18,00,000

And Cash Balance = Current Assets – (Raw Material + Finished Goods + Debtors)

= 18,00,000 – (1,60,000 + 2,00,000 + 9,00,000)

= ₹ 5,40,000

(vii) Calculation of Shareholder's Fund

$$\text{Proprietary Ratio} = \frac{\text{Shareholders Fund}}{\text{Total Assets}}$$

$$0.3125 = \frac{\text{Shareholders Fund}}{30,00,000}$$

Shareholders Fund = ₹ 9,37,500

Balance Sheet as on 31st March 2025

Liabilities	(₹)	Assets	(₹)
Shareholders' Fund	9,37,500	Fixed Assets	12,00,000
Long-term Debt	15,00,000	Stock of Raw Material	1,60,000
Current Liabilities (Balancing Figure)	5,62,500	Stock of Finished Goods	2,00,000
		Debtors	9,00,000
		Cash	5,40,000
	30,00,000		**30,00,000**

(b) The question can be solved with the help of Justified P/E Ratio linked to Gordon Growth Model.

(i) Calculation of Retention Ratio

$$P/E = \frac{1-b}{K_e - br}$$

$$12 = \frac{1-b}{0.20-0.25b}$$

Or 2.4 – 3b = 1-b

Or 2.4 – 1 = 3b – b

Or 2b = 1.4

Or b = 0.70 or 70%

So, Retention Ratio is 70%, if the company wants to maintain its P/E ratio to 12 in the current year.

(ii) Calculation of Expected Price Per Share

$$P/E = \frac{\text{Market Price Share}}{\text{Earning Per Share}}$$

P/E Ratio is 12 and EPS is ₹ 10

So, Market Price Share = P/E Ratio x Earning Per Share

= 12 x 10 = ₹ 120

Retention Ratio is 70%, when P/E ratio is 12, Return on Earnings is 25%

So, New growth rate = 0.70 X 0.25 = 0.175 = 17.5%

Expected price after one year = ₹ 120 X (1+17.5%) = ₹ 141

Therefore, the expected price per share after one year is ₹ 141 if Y Ltd. achieves the targeted P/E ratio of 12.

(iii) Calculation of change in Retention Ratio

$$P/E = \frac{1-b}{K_e - br}$$

$$10 = \frac{1-b}{0.175 - 0.25b}$$

1.75 – 2.5b = 1-b

1.75 – 1 = 2.5b – b

1.5 b = 0.75

$$b = \frac{0.75}{1.5} = 0.5 \text{ or } 50\%$$

So, Retention Ratio is 50%, if the company wants to maintain its P/E ratio to 10 in the current year.

(c) Workings:

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

So, $1.5 = \dfrac{\text{EBIT}}{\text{EBIT} - 12{,}000}$

Or, 1.5 (EBIT – 12,000) = EBIT

Or, 0.5 EBIT = 18,000

Or, EBIT = ₹ 36,000

(b) Operating Leverage $= \dfrac{\text{Contribution}}{\text{EBIT}}$ Or, $2 = \dfrac{\text{Contribution}}{₹\ 36{,}000}$

Or, Contribution = ₹ 72,000

Sales $= \dfrac{\text{Contribution}}{\text{P/V Ratio}}$

$= \dfrac{₹\ 72{,}000}{0.24} = ₹\ 3{,}00{,}000$

(c) Fixed Cost = Contribution – EBIT

= 72,000 – 36,000

Or, Fixed cost = ₹ 36,000

(i) Income Statements for the year ended 31st March 2025

Particulars	**A Ltd. (₹)**
Sales	3,00,000
Less: Variable cost (76%)	2,28,000
Contribution	72,000
Less: Fixed Cost	36,000
Earnings before interest and tax (EBIT)	36,000
Less: Interest	12,000
Earnings before tax (EBT)	24,000
Less: Tax @ 30%	7,200
Earnings after tax (EAT)	16,800

(ii) Calculation of EPS

$$\text{EPS} = \frac{\text{Profit after tax}}{\text{No. of Equity Shares}} = \frac{16,800}{1,000} = ₹16.8$$

(iii) Calculation of % change in EPS if Sales increase by 5%

Degree of Combined Leverage (DCL) = Operating Leverage x Financial Leverage

= 2 x 1.5 = 3

Alternatively, solution can be presented in following way:

$$\text{DCL} = \frac{\text{Contribution}}{\text{EBT}} = \frac{72,000}{24,000} = 3$$

$$\text{So, } \frac{\%\text{ change in EPS}}{\%\text{ change in Sales}} = 3$$

Or % change in EPS = DCL x % change in Sales

= 3 x 0.05 = 0.15 or 15%

Question 2

(a) *Capital structure of B Ltd. for the year ended 31st March, 2025 are as follows:*

Particulars	***Amount (₹)***
Equity share capital @₹10 each	*14,00,000*
10% Preference share capital @₹1,000 each	*10,00,000*
Debenture @ ₹100 each	*9,60,000*
Bank Loan	*6,40,000*

- *Risk-free rate of return is 14%, Market rate of return is 19% and beta of company is 1.20.*
- *10% Preference shares are redeemable at ₹ 1,065.40 after 3 years.*
- *Interest on bank loan is 1.30 times of interest on debentures.*
- *Debentures are redeemable at par after 5 years. Floatation cost is ₹ 4 per debenture.*
- *Tax rate is 30%.*
- *Cost of capital is 14%.*

You are required to calculate the following:

(i) Cost of Equity.

(ii) Cost of preference share using YTM method.

(iii) Post-tax cost of debenture using approximation method.

(iv) Interest rate of bank loan.

PV factors @ 10% and 14%

Year	***1***	***2***	***3***	***4***
$PVIF_{0.10,\,t}$	*0.909*	*0.826*	*0.751*	*0.683*
$PVIF_{0.14,\,t}$	*0.877*	*0.769*	*0.675*	*0.592*

(1 + 2 + 3 + 2 = 8 Marks)

(b) Following details are related to H Ltd.:

EPS	*₹ 3.00*
Return on investment	*20%*
Cost of equity	*15%*

As per Walter's Model, what would be the maximum and minimum price of share? ***(2 Marks)***

Answer

(a) (i) Calculation of Cost of Equity

Ke = Rf + β (Rm – Rf) = 14% + 1.2 (19% - 14%) = 20%

(ii) Calculation of Cost of Preference Shares:

Current Market Price P0

= Preference Dividend (PD) X PVAF (r,14) + Redeemable Value (RV) X PVIF (r,14)

Or 1000 = 100 x PVAF (r,14) + 1065.4 x (r,14)

Calculation of NPV at discount rate of 10% and 14%

Year	Cash Flows (₹)	PVF @ 10%	PV (₹)	PVF @ 14%	PV (₹)
0	(1000)	1	(1000)	1	(1000)
1-3	100	2.487	248.70	2.322	232.20
3	1065.4	0.751	800.12	0.675	719.14
			+48.82		**-48.66**

$$IRR = 10\% + \frac{48.82}{48.82-(-48.66)} \times (14\% - 10\%)$$

$$= 10\% + \frac{48.82}{97.48} \times 4\%$$

$$= 10\% + 2\% = 12\%$$

(iii) Calculation of Post-tax Cost of Convertible Debentures:

Working Note:

Calculation of Interest rate on Bank term Loan & Debentures

Let the rate of interest on debentures be 'X'

Therefore, Rate of Interest on bank loan = 1.3X x (0.7) = 0.91X

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

$$= \frac{100X(1-0.3)+\frac{(100-96)}{5}}{\frac{(100+96)}{2}}$$

$$= \frac{70X+0.8}{98}$$

Sources of capital	Amount of capital	Weights (W)	Cost (K)	W x K
Equity share capital	14,00,000	0.35	0.20	0.07
Preference share capital	10,00,000	0.25	0.12	0.03

Debentures	9,60,000	0.24	$\frac{70X+0.8}{98}$	$\frac{16.8X+0.192}{98}$
Bank Loan	6,40,000	0.16	0.91X	0.16 x 0.91X
	40,00,000	1.00		0.14

$$0.14 = 0.07 + 0.03 + \frac{16.8X+0.192}{98} + 0.16x(0.91X)$$

$$0.04 \times 98 = 16.8\ X + 0.192 + 14.2688\ X$$

$$3.728 = 31.0688X$$

$$X = 0.1199 \text{ or } 12\ \%$$

So, interest on debentures = 12 %

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

$$= \frac{12(1-0.3)+\frac{(100-96)}{5}}{\frac{(100+96)}{2}}$$

$$= \frac{8.4+0.8}{98} = 9.387\% \text{ or } 9.39\%$$

(iv) Interest Rate of bank loan

= 12 x 1.3 = 15.60%

(b) In this question, since r>Ke, as per the Walter's Model, the price will be maximum when the company retains all the earnings. Detailed calculations are as follows:

(i) Maximum Price when company retains all the earnings i.e. D = 0

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

$$= \frac{0+\frac{0.20}{0.15}(3-0)}{0.15} = \frac{(1.333)x\ 3}{0.15} = \frac{4}{0.15}$$

= ₹ 26.67

(ii) Minimum Price is when company distributes all its earnings

$$Po = \frac{3+\frac{0.20}{0.15}(3-3)}{0.15} = \frac{3+0}{0.15} = \frac{3}{0.15} = ₹\ 20$$

Question 3

(a) *Following data are given for a capital project:*

Annual interim cash inflows for first two years	*₹ 1,00,000*
Annual interim cash inflows for next two years	*₹ 80,000*
Useful life	*4 Years*
Salvage value at end of the project	*₹ 50,000*
Internal rate of return	*12%*
Cost of capital	*10%*

You are required to calculate the following:

(i) *Initial investment*

(ii) *Net present value*

(iii) *Profitability Index*

(iv) *Discounted payback period*

(v) *MIRR*

Year	*1*	*2*	*3*	*4*
$PVIF_{0.09,\ t}$	0.917	0.842	0.772	0.708
$PVIF_{0.10,\ t}$	0.909	0.826	0.751	0.683
$PVIF_{0.11,\ t}$	0.901	0.812	0.731	0.659
$PVIF_{0.12,\ t}$	0.893	0.797	0.712	0.636
$PVIF_{0.10,\ t}$	1.100	1.210	1.331	1.464
$PVIF_{0.12,\ t}$	1.120	1.254	1.405	1.574

(1 + 1 + 1 + 1 + 2 = 6 Marks)

(b) *Z Ltd. is an unlevered company. It wants to repurchase its equity shares of ₹ 300 lakhs by issue of 12% debentures of same amount. Current market value of Z Ltd. is ₹ 1,400 lakhs. Its cost of capital is 18%. The company will* *maintain same level of EBIT in future years. Dividend pay-out ratio is 100%. Company pays tax at a rate of 30%.*

As per Modigliani and Miller approach, due to such change in capital structure, what will be impact on the following?

(i) Market Value of Z Ltd.

(ii) Overall cost of capital

(iii) Cost of equity ***(4 Marks)***

Answer

(a) (i) Initial Investment

Using IRR = 12%, the NPV is zero. So, the initial investment is equal to the present value of inflows at 12%.

Year	Cash Inflows (₹)	PVF@12%	Present Value (₹)
1	1,00,000	0.893	89,300
2	1,00,000	0.797	79,700
3	80,000	0.712	56,960
4	80,000	0.636	50,880
4	50,000 (salvage)	0.636	31,800
		Total	**3,08,640**

Total Present Value = ₹ 3,08,640. So, Initial Investment = ₹ 3,08,640.

(ii) Net Present Value (NPV)

Year	Cash Flows (₹)	PVF@10%	Present Value (₹)
0	(3,08,640)	1	(3,08,640)
1	1,00,000	0.909	90,900
2	1,00,000	0.826	82,600
3	80,000	0.751	60,080
4	80,000	0.683	54,640
4	50,000 (salvage)	0.683	34,150
	Sum of PV of Cash Inflows		3,22,370
NPV	(3,22,370-3,08,640)		**13,730**

(iii) Profitability Index (PI)

$$PI = \frac{\text{Sum of PV of Cash Inflows}}{\text{Initial Cash Outflow}} = \frac{₹\ 3,22,370}{₹\ 3,08,640} = 1.0445$$

(iv) Discounted Payback Period:

Year	Cash Flows (₹)	PVF@10%	PV (₹)	Cumulative PV (₹)
1	1,00,000	0.909	90,900	90,900
2	1,00,000	0.826	82,600	1,73,500
3	80,000	0.751	60,080	2,33,580
4	1,30,000 (including salvage)	0.683	88,790	3,22,370

So, discounted payback = 3 years + $\frac{₹\ 3,08,640 - ₹\ 2,33,580}{₹\ 88,790}$ = 3.845 years OR 3.85 years OR 3 years 10 months 4 days approx.

(v) Modified Internal Rate of Return (MIRR)

Terminal value of cash inflows compounded to year 4 using 10%:

Year	Cash Inflows (₹)	@ 10% reinvestment rate factor	Present Value (₹)
1	1,00,000	1.331	1,33,100
2	1,00,000	1.210	1,21,000
3	80,000	1.100	88,000
4	80,000	1.000	80,000
4	50,000 (salvage)	1.000	50,000
		Total	**4,72,100**

Total Terminal Value = ₹ 4,72,100

Now, 3,08,640/4,72,100 = 0.6537 or 0.654

If we see 0.654 in year of present value discount table, the rate which is coming is around 11.20%. So, MIRR is around 11.20%.

Alternatively, solution can be presented in following way for MIRR:

Total Return = 4,72,100/3,08,640 = 1.5296

$(1+r)^4$ = 1.5296

MIRR = $(1.5296)^{(1/4)} - 1$ = 11.20% (Approx)

(b) Market Value of Equity = $\dfrac{\text{Net income (NI) for equity holders}}{K_e}$

₹ 1,400 lakhs = $\dfrac{\text{Net income (NI) for equity holders}}{0.18}$

Net Income to equity holders/EAT = ₹ 252 lakhs

Therefore, EBIT = $\dfrac{\text{EAT}}{(1\text{-t})}$ = $\dfrac{252 \text{ lakhs}}{(1 - 0.3)}$ = ₹ 360 lakhs

Income Statement

	All Equity (₹ In lakhs)	**Equity & Debt (₹ In lakhs)**
EBIT (as calculated above)	360	360
Interest on ₹ 300 lakhs @ 12%	-	36
EBT	360	324
Tax @ 30%	108	97.2
Income available to equity holders	252	226.8

(i) Market value of Z Ltd

Market value of levered firm = Value of unlevered firm + Tax Advantage

= ₹ 1,400 lakhs + (₹ 300 lakhs x 0.3)

= ₹ 1,490 lakhs

Change in market value of the company = 1,490 lakhs – 1,400 lakhs

= ₹ 90 lakhs

The impact is that the market value of the company has increased by ₹ 90 lakhs due to replacement of equity with debt.

(ii) Overall Cost of Capital

Market Value of Equity = Market value of levered firm - Equity repurchased

= ₹ 1,490 lakhs – ₹ 300 lakhs = ₹ 1,190 lakhs

Cost of Equity (K_e) $= \frac{\text{Net Income to equity holders}}{\text{Market value of equity}} \times 100$

$= \frac{₹\ 226.8\text{ lakhs}}{₹\ 1190\text{ lakhs}} \times 100 = 19.06\%$ (approx.)

Cost of debt (K_d) = I (1 - t) = 12 (1 - 0.3) = 8.4%

Components	Amount (₹ In lakhs)	Cost of Capital %	Weight	WACC (K_o) %
Equity	1,190	19.06	0.80(approx.)	15.25
Debt	300	8.4	0.20(approx.)	1.68
	1490		1	16.93

(**Note:** If we take the weight of Equity as 0.7986 and weight of Debt as 0.2013 then WACC will be 16.91%).

Impact on Market value and Overall cost of capital of Z Ltd.

Particulars	Before restructure	After restructure	Impact
Market value of company	₹ 1,400 lakhs	₹ 1,490 Lakhs	Increase due to import of debt
Cost of equity	18%	19.06%	Increase
Overall cost of capital	18%	16.93%	Decrease

So, the impact is that the Overall Cost of Capital or K_o has fallen by 1.07% (18% - 16.93%) due to the benefit of tax relief on debt interest payment.

(iii) Cost of Equity

The impact is that cost of equity has risen by 1.06% (19.06% - 18%) due to the presence of financial risk i.e. introduction of debt in capital structure.

Note: Cost of Capital and Cost of equity can also be calculated with the help of following formulas,

Cost of Capital (K_o) = K_{eu} [1 – (t x L)]

Where,

K_{eu} = Cost of equity in an unlevered company

t = Tax rate

$$L = \frac{\text{Debt}}{\text{Debt + Equity}}$$

$$\text{So, } K_o = 0.18\left[1-\left(0.3 \times \frac{₹\ 300 \text{ lakhs}}{₹\ 1490 \text{ lakhs}}\right)\right] = 0.1691 \text{ or } 16.91\% \text{ (approx.)}$$

$$\text{Cost of Equity } (K_e) = K_{eu} + (K_{eu} - K_d)\frac{\text{Debt (1-t)}}{\text{Equity}}$$

Where,

K_{eu} = Cost of equity in an unlevered company

K_d = Cost of debt

t = Tax rate

$$\text{So, } K_e = 0.18 + \left((0.18-0.12) \times \frac{₹\ 300 \text{ lakhs (1-0.3)}}{₹\ 1190 \text{ lakhs}}\right)$$

$$= 0.1906 \text{ or } 19.06\%$$

Question 4

(a) What is agency cost and what are its types? How can a company minimize agency cost and align the interest of manager and shareholder? ***(4 Marks)***

(b) What are key features of bridge financing? ***(4 Marks)***

(c) What is hierarchy of financing under 'Pecking Order' theory, and why does it exist? ***(2 Marks)***

OR

(c) *"The total risk of any business is the combination of degree of operating and financial risk". In the light of the above statement, you are required to consider the first two columns of the given table and give your comments in the 3rd column.* ***(2 Marks)***

Your comments should depict the total risk profile by using the most appropriate amongst the following three words only:

Lower, Higher and Moderate

Also select the best combination of DOL and DFL from the given table.

DOL	*DFL*	*Comments*
Low	*High*	
High	*Low*	
High	*High*	

Answer

(a) Meaning of Agency Cost: Agency Problem is the chances that managers may place personal goals ahead of the goal of owners. Agency Problem leads to Agency Cost. Agency cost is the additional cost borne by the shareholders to monitor the manager and control their behaviour so as to maximize shareholders wealth.

Types of Agency Cost: Generally, Agency Costs are of four types (i) monitoring (ii) bonding (iii) opportunity (iv) structuring.

Following efforts have been made to address the issues of minimizing agency cost and align the interest of manager and shareholders:

- Managerial compensation is linked to the profit of the company to some extent and also with the long-term objectives of the company.
- Employee is also designed to address the issue with the underlying assumption that maximisation of the stock price is the objective of the investors.
- Effecting monitoring can be done.

(b) Key features of Bridge Financing

(i) Bridge finance refers to loans taken by a company normally from commercial banks for a short period because of pending disbursement of loans sanctioned by financial institutions.

(ii) The bridge loans are repaid/ adjusted out of the term loans as and when disbursed by the concerned institutions.

(iii) Bridge loans are normally secured by hypothecating movable assets, personal guarantees and demand promissory notes.

(iv) Generally, the rate of interest on bridge finance is higher as compared with that on term loans.

(c) Hierarchy of financing Pecking order:

Pecking order theory suggests that managers may use various sources for raising of fund in the following order:

1. Managers first choice is to use internal finance.
2. In absence of internal finance, they can use secured debt, unsecured debt, hybrid debt etc.
3. Managers may issue new equity shares as a last option.

The hierarchy of financing Pecking order exist to Minimize the cost of capital, financial control and avoiding negative market signals.

OR

Combination of DOL and DFL

DOL	DFL	Comments
Low	High	Moderate total risk. Best combination. Higher financial risk is balanced by lower total business risk.
High	Low	Moderate total risk. Not a good combination. Lower EBIT due to higher DOL and lower advantage of trading on equity due to low DFL.
High	High	Higher total risk. Very risky combination.

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) *SemiCon Pvt. Ltd. (SPL) is engaged in manufacturing of semiconductors from the year 2024. Company wants to start a strategic path to be followed in future so as to build best quality semiconductor and display design with innovative ecosystem to enable India's emergence as a global hub for electronics manufacturing in a more structured manner. Placing core values as its priority, it would like to clearly articulate its aspirations to the stakeholders with a guiding beacon to keep inspiring its workforce.*

Identify and explain one of the components of strategic intent which will help indicate towards above stated intentions. Why such component is important for a successful organization? Also state the essentials of such component. ***(1 + 1 + 1 + 2 = 5 Marks)***

(b) *In addition to new market opportunities and change in customer preferences, as a known fact, technology is also changing very fast. In view of the same, 'Twaran', having a small and mid-sized business wants to use latest digital technologies for improved procedures and products. The primary aim of the firm is to have a competitive edge in the evolving business landscape by digital transformation. The entity would like to deal with regular changes firmly, along with transforming its management techniques.*

Identify the strategy required for digital transformation. Also state the most preferred practices to be followed by the entity. ***(1 + 4 = 5 Marks)***

(c) *MaAi is a prominent group of companies. Currently it has businesses named Alpha, Bravo, Charlie and Delta. In year 2020, the company had acquired a business dealing in product 'Nota'. In evaluating the contribution to its portfolio, it was observed that product 'Nota', is not contributing as it was expected rather causing a financial duress. After identifying apparent problem area, in the year 2023, an emphasis was placed on change in management and improvement in internal efficiency. However, on further evaluation in the year 2024, it was observed that even* *after due emphasis, positive outcome is not there and in-turn the company decided to get rid-of the business related to product 'Nota'.*

Identify the retrenchment strategies followed by the company for product 'Nota' (i) in the year 2023 (ii) in the year 2024. Also state various reasons to adopt the strategy by any organization, as followed in the year 2024 for product 'Nota'. ***(1 + 1 + 3 = 5 Marks)***

Answer

(a) The component of strategic intent that best indicates the company's future aspirations is the Vision.

A Vision implies the blue print of the company's future position that outlines what an organization aspires to become in the long term. It reflects management's aspirations and serves as a guiding beacon for strategic decision-making by shaping the product-market-customer-technology focus of the business.

A strategic vision is important because -

- it provides a clear sense of direction, helping the organization focus its resources and efforts toward defined long-term goals.
- it serves as a source of alignment and inspiration for stakeholders—including employees, customers and investors—by communicating the overarching purpose and aspirations of the business.
- it shapes the organization's identity and culture, encouraging unity and collective motivation to achieve shared objectives.

Essentials of a Strategic Vision:

- It involves creative foresight to prepare the company for future challenges and opportunities.
- It is an exercise in intelligent entrepreneurship not merely operational planning.
- It creates enthusiasm and emotional engagement among organizational members.
- It is clearly worded to illuminate the organization's strategic direction.

(b) To enable successful digital transformation, the appropriate strategy for 'Twaran' is a Change Management Strategy. It is essential to effectively manage the organizational, procedural and cultural changes brought about by the adoption of new digital technologies.

Following are the five best practices for managing change in small and medium-sized businesses are:

1. **Begin at the top:** Change should be initiated and driven by a unified, focused leadership. A committed top management can create and promote a culture that inspires the organization to embrace change.

2. **Ensure that the change is both necessary and desired:** Before initiating digital transformation, decision-makers must understand its necessity and long-term impact. Without a proper strategy, introducing too much change too quickly can be counterproductive.

3. **Reduce disruption:** It is essential to minimize employee disruption during transformation. This can be done by:

   - Communicating changes early.
   - Equipping employees with tools and training.
   - Empowering change agents like project managers.
   - Involving IT teams proactively.
   - Creating an environment conducive to change.

4. **Encourage communication:** Promote open and continuous two-way communication. This ensures that employees feel heard and involved and that concerns are addressed timely. Effective communication also promotes innovation and collaboration across departments.

5. **Recognize that change is the norm, not the exception:** Businesses must treat change as a continuous process, not a one-time project. Being change-ready helps the organization to adapt, sustain performance and stay aligned with evolving customer expectations.

(c) In 2023, MaAi adopted a Turnaround Strategy. This is evident from their emphasis on change in management and improvement in internal efficiency which are key features of a turnaround strategy.

In 2024, MaAi decided to get rid of the business related to product 'Nota', which clearly indicates a Divestment Strategy. Divestment is adopted when "A turnaround has been attempted but has proved to be unsuccessful." This exactly matches the situation – despite a turnaround attempt in 2023, the business continued to underperform, leading to divestment in 2024.

Reasons for adopting a Divestment Strategy in 2024:

- **Mismatch with core business:** The business acquired in 2020 dealing in 'Nota' may have proved to be a mismatch and could not be integrated well within the MaAi group structure.
- **Persistent negative cash flows:** Continued financial duress indicates persistent negative cash flows, which create a burden on the entire group.
- **Failure of turnaround efforts:** Despite changes in management and efforts for internal efficiency, no positive outcome was achieved, fulfilling the condition where turnaround attempts prove unsuccessful.
- **Better alternative for investment:** The company may have better options for redeploying resources, prompting the divestment of this underperforming business.
- **Inability to cope with competition or technological upgrade:** If 'Nota' required significant technological upgrades or faced intense competition and MaAi was unable or unwilling to invest further, divestment would be a prudent strategic exit.

Question 6

(a) *Explain the importance of values, as one of the components of strategic intent for a company. What are the common examples of values? How values are different from intent?* ***(3 + 1 + 1 = 5 Marks)***

(b) *In order to get better performance and sustainable competitive advantages, a company has to focus on the characteristics of its resources and capabilities. In view of this, explain the major characteristics of resources and capabilities.* ***(5 Marks)***

Answer

(a) Values are fundamental principles or standards that guide the behaviour and decision-making of individuals and organizations. They are at the core of strategic intent and help define a company's culture and ethical posture.

A company's values set the tone for how people think and behave, especially in situations involving dilemmas. They create a sense of shared purpose, enabling all stakeholders to align and focus on the long-term success of the company.

Values have both internal and external implications:

- **Internally**, they influence employee behaviour, build trust, boost morale and help in creating a consistent workplace culture.
- **Externally**, they impact how customers, investors and society at large perceive the company. A majority of consumers prefer companies whose values reflect their own belief systems.

Some common organizational values include Integrity, Trust, Accountability, Humility, Innovation and Diversity.

Values and Intent are two distinct concepts:

- Intent refers to the purpose of doing business – the long-term direction the company aims to pursue.
- Values are the principles and ethical standards that guide how decisions are made and how the business is conducted.

While they go hand-in-hand, values often drive intent. Therefore, values are broader and more foundational than intent.

(b) To achieve better performance and sustainable competitive advantage, a company must focus on the four major characteristics of its resources and capabilities which determine the sustainability of its competitive advantage:

(i) **Durability:** Durability refers to how long the firm's resources and capabilities remain effective before they deteriorate or become obsolete.

For example, in industries with rapid product innovation, such as technology, patents may quickly become outdated. In contrast, strong brand names often possess a high degree of durability, contributing to sustained competitive advantage.

(ii) Transferability: Transferability determines how easily a competitor can acquire or replicate the resources and capabilities. If key resources and capabilities can be easily transferred between firms (such as through hiring key personnel or acquiring technology), the competitive advantage is less sustainable. The more difficult it is for rivals to gain access to similar resources, the more sustainable the advantage.

(iii) Imitability: This refers to how easily competitors can imitate or develop the same resources and capabilities. If imitation requires complex processes, organizational routines or is dependent on a firm's unique corporate culture, it becomes difficult to replicate. For instance, in financial services, where innovations are not legally protected, imitation is easier, reducing sustainability.

(iv) Appropriability: Appropriability refers to the ability of the firm's owners to appropriate the returns on its resource base. Even where resources and capabilities are capable of offering sustainable advantage, there is an issue as to who receives the returns on these resources.

Question 7

(a) What do you mean by value chain analysis? Delineate the support activities in value chain analysis, as stated by Michael Porter. ***(1 + 4 = 5 Marks)***

(b) Explain differentiation strategy as one of the generic strategies by Michael Porter. What are the major bases of differentiation? Also outline the strategies which can help achieve the differentiation strategy.

(1 + 2 + 2 = 5 Marks)

Answer

(a) Value chain analysis is a strategic tool used to examine each business activity to determine how it adds value, helping firms improve efficiency, identify cost-saving opportunities and gain competitive advantage through better coordination and performance of internal processes.

Support Activities in Value Chain Analysis (Michael Porter)

Michael Porter identified four main categories of support activities that support the primary activities and help the organization achieve competitive advantage:

1. **Procurement:** Refers to the processes involved in acquiring the various resource inputs needed for the primary activities. It focuses on how resources are sourced rather than the resources themselves. Procurement occurs across many parts of the organization.

2. **Technology Development:** Every value activity has an associated technology or know-how. This includes R&D, product design, process development and improvements in resources such as raw materials. Technology development enhances the efficiency and effectiveness of value activities.

3. **Human Resource Management:** This area spans across all primary activities and involves recruiting, managing, training, developing and rewarding employees. Effective HR management is vital for ensuring that the organization has the right people to perform its activities successfully.

4. **Infrastructure:** Infrastructure consists of the systems and routines that support the entire organization, including planning, finance, quality control, information management and organizational culture. It sustains and coordinates primary and support activities and is crucial for overall organizational performance.

(b) Differentiation strategy focuses on offering unique products or services to a broad market, allowing firms to stand out from competitors and charge premium prices. Uniqueness can stem from design, features, technology or service.

Major Bases of Differentiation include:

- **Product:** Innovative or new products that cater to customer needs can give a competitive edge. Though expensive in terms of R&D and marketing, they attract customers.

- **Pricing:** Pricing can be used as a differentiator—either through low prices or premium pricing backed by product superiority.
- **Organisation:** Organisational advantages like brand strength, location or customer loyalty can be used for differentiation.

Strategies to Achieve Differentiation: To achieve differentiation, a firm may adopt the following strategies:

1. Offer utility to customers and match products with their tastes and preferences.
2. Elevate product performance.
3. Provide high-quality products/services to ensure buyer satisfaction.
4. Engage in rapid product innovation to meet changing demands.
5. Enhance brand image and brand value.
6. Fix product prices considering product uniqueness and customers' buying capacity.

Question 8

(a) *What do you mean by Key Success Factors (KSF)? Structure the questions, answer to which can help identify KSFs of a company. Also state, as to how the understanding can help ascertain sustainable competitive advantages.*

(1 + 2 + 2 = 5 Marks)

(b) *Explain in brief the expansion strategy as one of the corporate strategy. Also state the characteristics of expansion strategy.* ***(1 + 4 = 5 Marks)***

OR

"A manager as a strategic leader has to play many leadership roles", while explaining the statement in brief, delineate the leadership roles which a manager has to play in pushing for a good strategy execution.

(1 + 4 = 5 Marks)

Answer

(a) Key Success Factors (KSFs) are those factors that most significantly impact an industry member's ability to succeed in the marketplace. These include strategic elements, product attributes, resources, competencies, capabilities and outcomes that determine whether a firm achieves profitability and competitive success. In other words, KSFs are the prerequisites for success in an industry.

Questions to Identify KSFs: To identify the KSFs of a company, managers should seek answers to the following structured questions:

- On what basis do customers choose between the competing brands of sellers?
- What resources and competitive capabilities are necessary to be successful?
- What does it take to achieve a sustainable competitive advantage?

A company that accurately understands the industry's KSFs can tailor its strategy to focus on excelling in these critical areas. By being distinctively better than competitors on one or more key success factors, the company can gain a sustainable competitive advantage. Misjudging the importance of KSFs, on the other hand, can lead to a misdirected strategy and competitive failure. Thus, aligning the company's efforts with the industry's KSFs increases the likelihood of long-term success and stronger market position.

(b) An Expansion Strategy (also called Growth Strategy) is a corporate-level strategy where a business redefines its scope by enlarging its operations and significantly increasing its investment. This strategy symbolizes dynamism, vigour, promise and success. It involves major initiatives such as entering new markets, adopting new technologies, launching new products and making fresh investments. Expansion strategy often involves pursuing ambitious growth, which can be risky yet rewarding.

Characteristics of Expansion Strategy

1. **Redefinition of Business Scope:** The strategy involves a fundamental reshaping of the corporation's business operations by exploring new areas, markets and technologies.
2. **High Risk – High Reward Nature:** Unlike stability strategy, expansion is characterized by high risks but also potentially high rewards. It is suited for firms willing to take bold steps for growth.

3. **Facilitates Business Growth:** It is a key strategy for firms aiming at substantial business growth, helping them to meet large-scale ambitions.

4. **Drives Renewal through Investment:** Expansion enables the **renewal of the firm** through fresh investments in new businesses, products and markets.

5. **Versatile Strategy with Multiple Growth Routes:** The strategy is flexible and versatile, allowing firms to design growth through various permutations in products, markets and functions. It encompasses two major routes:

   - **Intensification** – Growth in existing business areas.
   - **Diversification** – Growth through entry into new business areas.

Or

Strategic leadership refers to the manager's ability to anticipate, envision, maintain flexibility and empower others to create strategic change as necessitated by external conditions. A manager as a strategic leader is responsible for setting the firm's direction, formulating and implementing strategies and ensuring that the organization moves towards achieving its strategic goals. To achieve this, the manager must play multiple leadership roles such as visionary, strategist, administrator, culture builder and motivator.

Managers have five leadership roles to play in pushing for good strategy execution:

1. **Staying on top of the execution process:** Monitoring progress, resolving emerging issues and understanding obstacles in the way of effective execution.

2. **Promoting a culture of *esprit de corps*:** Nurturing unity, teamwork and high morale to mobilize and energize employees for effective strategy implementation.

3. **Keeping the organization responsive and innovative:** Ensuring the firm remains adaptive to changes, alert to new opportunities and ahead of rivals in developing competencies.

4. **Exercising ethical leadership:** Insisting that the company behaves ethically and acts as a model corporate citizen.

5. **Pushing corrective actions:** Taking necessary corrective measures to overcome execution problems and improve overall strategic performance.

These roles help managers drive strategy execution effectively while maintaining integrity, adaptability and performance.