PAPER – 6: FINANCIAL MANAGEMENT AND STRATEGIC MANAGEMENT

6A: FINANCIAL MANAGEMENT

QUESTIONS

Case Scenarios

1. Mint Technologies, a startup in the IT infrastructure space, is planning to enter the computer networking market with a specialized offering—VPN connectivity solutions for enterprises with distributed office networks. The company recently won a significant tender from a major national bank to set up secure VPN connections across 100 branches. The leadership team is excited but cautious, as this move requires significant upfront investment and ongoing operational capability.

   To evaluate the financial viability of this project, you have been hired as a consultant.

   - They have forecasted their numbers for 5 years and they have assumed that they will grow at industry average (3%) afterwards.
   - Mint will invest all the money for CAPEX in the infrastructure and equipment. Mint is planning to issue 50Mn shares in lieu of the amount.
   - Mint will have to keep upgrading the infrastructure and equipment to cover different offices of various clients.
   - Mint expects an initial investment of around ₹ 150 Mn in network access as an initial setup cost for connecting different offices. Mint

needs to invest additional ₹10 Mn every year starting from beginning and is expected to grow 10% every year.

- The equipment investment varies with number of branches/ offices. This varies with time and currently it is ₹ 0.1 Mn per office.
- Initially, Mint has won a tender of 100 branches of a bank and expecting it to grow at 30% for next 5 years.
- Mint is expecting to have a maintenance cost of 10% for equipment and 15% for network.
- To handle all this, current manpower cost is ₹ 1 Mn
- Mint has entered into an agreement with local authority and has agreed to share 5% of the revenue with the same.
- Mint is expecting to generate revenue of ₹ 0.5 Mn per office and to remain competitive in the market, it is not going to increase with inflation.
- Capital expenditure and operating expenses will grow 10% every year.
- Tax slab in the country is 30% and depreciation of the equipment and network is assumed to be 10%. Discounting rate is 20%.
- Assume all the expenditure including initial setup cost from year 1.

Based on the above information, you are required to answer following 5 MCQs:

(i) What is the CFAT for year 1?

(a) -15,33,50,000

(b) 1,00,17,000

(c) 1,75,73,810

(d) 2,74,29,367

(ii) What is the CFAT for year 5?

(a) -15,33,50,000

(b) 1,00,17,000

(c) 4,02,25,268

(d) 2,74,29,367

(iii) Calculate the terminal value

(a) ₹ 24,37,17,801

(b) ₹ 9,79,74,556

(c) ₹ 6,38,54,064

(d) ₹ 21,32,20,955

(iv) What is the total present value of the mint technologies?

(a) ₹ 1,89,77,337

(b) ₹ 1,32,20,955

(c) ₹ 1,67,06,548

(d) ₹ 89,97,791

(v) Calculate the IRR for the company

(a) 22.60%

(b) 15.39%

(c) 20.25%

(d) 24.68%

Ratio Analysis and Leverages

2. A manufacturing company which is presently growing at a good rate has a Financial Leverage of 3. Its present borrowings are as follows:

12% Term Loan	₹ 60,00,000
Bank borrowings@10%	₹ 40,00,000
Public Deposits@8%	₹ 20,00,000

The Interest Coverage Ratio will be

(a) 1.0

(b) 1.5

(c) 2.0

(d) 2.5

Cost of Capital

3. Consider the below mentioned statements:

   1. A debt-equity ratio of 2:1 indicates that for every 1 unit of equity, the company can raise 2 units of debt.

   2. The cost of floating a debt is greater than the cost of floating an equity issue.

   State True or False:

   (a) 1-True, 2-True

   (b) 1-False, 2-True

   (c) 1-False, 2-False

   (d) 1-True, 2-False

Division B: Descriptive Questions

Financial Analysis & Planning – Ratio Analysis

4. Jamunapati Limited has furnished the following ratios and information relating to the year ended 31st March, 2024:

Sales	₹ 70,00,000
Return on net worth	25%
Rate of income tax	30%
Share capital to reserves	7:3
Current ratio	2
Net profit to sales	7%
Inventory turnover	10
Cost of goods sold	₹ 24,00,000
Interest on 15% debentures	₹ 1,05,000
Receivables	₹ 3,00,000
Payables	₹ 3,00,000

You are required to:

(a) CALCULATE the operating expenses for the year ended 31st March, 2024.

(b) PREPARE a Balance Sheet as on 31st March, 2024 in the following format:

Balance Sheet as on 31st March, 2024

Liabilities	₹	Assets	₹
Share Capital		Fixed Assets	
Reserve and Surplus		Current Assets	
15% Debentures		Stock	
Payables		Receivables	
		Cash	

Financing Decision - Cost of Capital

5. Lavanya Limited wishes to raise additional finance of ₹ 20 lakhs for meeting its investment plans. It has ₹ 4,20,000 in the form of retained earnings available for investment purposes. Further details are as following:

(1)	Debt / Equity mix	3:7
(2)	Cost of debt:	
	Upto ₹ 3,60,000	8% (before tax)
	Beyond ₹ 3,60,000	12% (before tax)
(3)	Earnings per share	₹ 5
(4)	Dividend pay out	40% of earnings
(5)	Retained Earnings	60%
(6)	Rate of Return on Retained Earnings	10%
(7)	Current market price per share	₹ 53
(8)	Tax rate	30%

You are required to:

(a) DETERMINE the pattern for raising the additional finance.

(b) DETERMINE the post-tax average cost of additional debt.

(c) DETERMINE the cost of retained earnings and cost of equity.

(d) COMPUTE the overall weighted average after tax cost of additional finance.

Financing Decision – Capital Structure

6. ABC Ltd. is planning to raise ₹50,00,000 for a major expansion project. The firm is evaluating three financing options:

(i) Equity Financing Only

Issuing new shares at ₹10 each (Issue price: ₹10, but flotation cost per share: ₹0.50).

Existing equity shares: 10,00,000.

Market price per share: ₹20.

(ii) Debt Financing Only

Borrow ₹50,00,000 at 12% interest.

Flotation cost on debt: 2% of the face value.

The lender imposes a debt covenant limiting the interest coverage ratio (EBIT/Interest) to a minimum of 2.5.

(iii) Mix of Equity and Debt Financing

Raise ₹25,00,000 through equity (floatation cost: ₹0.50/share at ₹ 10 issue price).

Raise ₹25,00,000 through debt at 12% interest (floatation cost: 2%).

Additional Information

(i) Project EBIT: ₹15,00,000 annually.

(ii) Corporate tax rate: 30%.

(iii) Existing shares: 10,00,000.

(iv) Risk-free rate: 6%, Market return: 14%, Equity beta: 1.2.

From the above information:

1. CALCULATE the net proceeds from each financing method (after floatation costs) and determine the number of new shares issued in Option (i) and Option (iii).

2. For debt options, CHECK if the interest coverage ratio complies with the covenant (minimum 2.5).

3. COMPUTE EPS under each option.

4. COMPUTE the WACC under each option, considering the impact of floatation costs on capital raised.

ADVISE which financing option is best from both an EPS and WACC perspective.

Financing Decision – Leverages

7. X Limited and Y Limited are two mid-sized companies operating in the same competitive industry. Both companies have recently undergone a financial performance review to assess their operational efficiency, cost structure, and overall financial risk. You, as a financial analyst, have been provided with selective financial indicators and are required to draw insights and comparisons based on leverage analysis and income statement reconstruction.

   The management of X Limited has disclosed that the company is currently operating with a Margin of Safety (M/S) ratio of 0.1667. In contrast, Y Limited has a Margin of Safety that is twice as high as that of X Limited.

   Both companies maintain a Financial Leverage of 3. Their variable cost ratios are 60% for X Limited and 50% for Y Limited.

   In terms of financing costs, X Limited incurs an annual interest expense of ₹30,000. Y Limited, however, incurs an interest cost that is 300% higher than X Limited. Both companies are subject to a corporate tax rate of 30%, which affects their net profitability after interest and taxes.

   You are required to PREPARE Income statement for both the companies and IDENTIFY the company which is better placed with reasons based on leverages.

Dividend Decision

8. In the month of April of the current Financial Year, shares of PQR Ltd. were sold for ₹ 1,570 per share. A long-term earnings growth rate of 8% is anticipated. PQR Ltd. paid dividend of ₹ 25 per share.

   (i) CALCULATE rate of return an investor can expect to earn assuming that dividends are expected to grow along with earnings at 8% per year in perpetuity.

   (ii) It is expected that PQR Ltd. will earn about 10% on retained earnings and shall retain 60% of earnings. In this case, STATE whether, there would be any change in growth rate and cost of Equity?

Management of Working Capital

9. A firm has a total sale of ₹ 200 lakhs of which 80% is on credit. It is offering credit terms of 2/40, net 120. Of the total, 50% of customers avail of discount and the balance pay in 120 days. Past experience indicates that bad debt losses are around 1.5% of credit sales. The firm spends about ₹ 2,40,000 per annum to administer its credit sales. These are avoidable as a factor is prepared to buy the firm's receivables. He will charge 2% commission. He will pay advance against receivables to the firm at an interest rate of 18% after withholding 10% as reserve.

   (i) DETERMINE the effective cost of factoring? Consider year as 360 days.

   (ii) If bank finance for working capital is available at 12% interest, ADVISE, should the firm avail of factoring service

Miscellaneous

10. (a) Contemplate the list of features given below and IDENTIFY each one of them with the most relevant sources of funds:

    (i) It is the most expensive source of funds.

    (ii) It entails a high degree of risk since they have to be repaid as per the terms of agreement.

(iii) It supports businesses in their routine activities.

(iv) Business enterprise has options to raise capital from International markets also.

(v) This source of finance sometimes is the last option for startups which doesn't qualify for bank funding

(b) Trade credit and bank overdraft are two commonly used short-term financing sources but each has distinct features. On the light of the statement SHOW the difference between trade credit and bank overdraft.

(c) ABC Ltd. is a manufacturing company experiencing rapid sales growth. To meet the increased demand, the company has started maintaining higher inventory levels and offering more generous credit terms to customers. However, its cash reserves are depleting, and it is facing difficulties in paying suppliers on time. As a financial analyst, apply your understanding of the scope of working capital management to ANALYZE the trade-offs the company is making between different components of working capital (inventory, receivables, advances, payables, and cash).

SUGGESTED ANSWERS/HINTS

Division A: Case Scenario

Q. No.		Hints
1.	**(i)**	**(a)** -15,33,50,000
	(ii)	**(c)** 4,02,25,268
	(iii)	**(a)** ₹ 24,37,17,801
	(iv)	**(c)** ₹ 1,67,06,548
	(v)	**(d)** 24.68%

Calculation of CFAT

Particulars	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Number of Offices (A)	100	130	169	219*	284*
Revenue Per office (B)	5,00,000	5,00,000	5,00,000	5,00,000	5,00,000
Total Revenue (C) (A x B)	5,00,00,000	6,50,00,000	8,45,00,000	10,95,00,000	14,20,00,000
Operating Cost					
Share of Local Authority	75,00,000	97,50,000	1,26,75,000	1,64,25,000	2,13,00,000
Manpower Cost	10,00,000	14,30,000	20,44,900	29,14,890	41,58,044
Maintenance Cost for Equipment	10,00,000	13,30,000	18,01,900	24,67,400	34,19,065
Maintenance Cost for Network	2,40,00,000	2,56,50,000	2,74,65,000	2,94,61,500	3,16,57,650
Total Operating Cost (D)	3,35,00,000	3,81,60,000	4,39,86,800	5,12,68,790	6,05,34,759
EBITDA (E) (C-D)	1,65,00,000	2,68,40,000	4,05,13,200	5,82,31,210	8,14,65,241
Less: Depreciation	1,70,00,000	1,84,30,000	2,01,11,900	2,21,08,400	2,45,24,165
EBIT (F)	-5,00,000	84,10,000	2,04,01,300	3,61,22,810	5,69,41,076
Less: Taxes	-1,50,000	25,23,000	61,20,390	1,08,36,843	1,70,82,323
PAT (G)	-3,50,000	58,87,000	1,42,80,910	2,52,85,967	3,98,58,753
Add: Depreciation	1,70,00,000	1,84,30,000	2,01,11,900	2,21,08,400	2,45,24,165
CFAT (H)	1,66,50,000	2,43,17,000	3,43,92,810	4,73,94,367	6,43,82,918
Less: Capex	17,00,00,000	1,43,00,000	1,68,19,000	1,99,65,000	2,41,57,650
Net CFAT (I)	-15,33,50,000	1,00,17,000	1,75,73,810	2,74,29,367	4,02,25,268

***Note:** Since offices cannot be represented in fractions, the number should be rounded down to the nearest whole number.

Working Note

Particulars	**Year 1**	**Year 2**	**Year 3**	**Year 4**	**Year 5**
Cost					
Manpower Cost (With Inflation)	10,00,000	11,00,000	12,10,000	13,31,000	14,64,100
Manpower Cost per office (With Inflation)	10,000	11,000	12,100	13,310	14,641
CAPEX					
Additional Branches	100	30	39	50	65
Network CAPEX w/o inflation	16,00,00,000	1,00,00,000	1,00,00,000	1,00,00,000	1,00,00,000
Network CAPEX With inflation	16,00,00,000	1,10,00,000	1,21,00,000	1,33,10,000	1,46,41,000
Additional Equipment CAPEX/Branch (with inflation)	1,00,000	1,10,000	1,21,000	1,33,100	1,46,410
CAPEX Schedule					
Network Capex	16,00,00,000	1,10,00,000	1,21,00,000	1,33,10,000	1,46,41,000
Cumulative Capex in Network	16,00,00,000	17,10,00,000	18,31,00,000	19,64,10,000	21,10,51,000
Additional Equipment CAPEX (in the Year)	1,00,00,000	33,00,000	47,19,000	66,55,000	95,16,650
Cumulative Additional Equipment CAPEX	1,00,00,000	1,33,00,000	1,80,19,000	2,46,74,000	3,41,90,650

Terminal Value (TV) using Gordon Growth Model (GGM)

$$\text{Terminal Value} = \frac{\text{Terminal Year Cash Flow x } (1+g)}{Ke - g}$$

$$= \frac{4{,}02{,}25{,}268\,(1+0.03)}{20\% - 3\%} = ₹\ 24{,}37{,}17{,}801$$

Calculation of Total PV

Year	CF	PVAF@20%	PV
1	-15,33,50,000	0.833	-12,77,86,555
2	1,00,17,000	0.694	69,51,798
3	1,75,73,810	0.579	1,01,75,236
4	2,74,29,367	0.482	1,32,20,955
5	4,02,25,268	0.402	1,61,70,558
5	24,37,17,801	0.402	9,79,74,556
Total PV			**1,67,06,548**

Calculation of IRR

Year	Cash Flows	PVAF@20%	PV	PVAF@25%	PV
1	-15,33,50,000	0.8333	-12,77,86,555	0.800	-12,26,80,000
2	1,00,17,000	0.694	69,51,798	0.640	64,10,880
3	1,75,73,810	0.579	1,01,75,236	0.512	89,97,791
4	2,74,29,367	0.482	1,32,20,955	0.410	1,12,46,040
5	4,02,25,268	0.402	1,61,70,558	0.328	1,31,93,888
5	24,37,17,801	0.402	9,79,74,556	0.262	6,38,54,064
			1,67,06,548		**-1,89,77,337**

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

H = Higher rate = 25%

L = Lower rate = 20%

$$IRR = 20 + \frac{1,67,06,548}{1,67,06,548 - (-1,89,77,337)}(25-20)$$

$= 20 + 4.68 = 24.68\%$

2. (b) Working Notes

Calculation of Interest

12% Term Loan	₹ 7,20,000
Bank borrowings@10%	₹ 4,00,000
Public Deposits@8%	₹ 1,60,000
Total Interest	₹ 12,80,000
Financial Leverage	= EBIT/EBIT – Interest
3	= EBIT/EBIT – 12,80,000
Or EBIT	= 19,20,000
So, Interest Coverage Ratio	= EBIT/Interest
	= 19,20,000/12,80,000
	= 1.5

3. (d) 1-True, 2-False

4. (a) Calculation of Operating Expenses for the year ended 31st March, 2024

	(₹)
Net Profit [@ 7% of Sales]	4,90,000
Add: Income Tax (@ 30% of PBT)	2,10,000
Profit Before Tax (PBT)	7,00,000
Add: Debenture Interest	1,05,000
Profit before interest and tax (PBIT)	8,05,000
Now, Sales (given)	70,00,000
Less: Cost of goods sold	24,00,000
Gross Profit	46,00,000

Less: PBIT	8,05,000
Operating Expenses	**37,95,000**

(b) **Balance Sheet as on 31st March, 2024**

Liabilities	₹	**Assets**	₹
Share Capital	13,72,000	Fixed Assets	23,60,000
Reserve and Surplus	5,88,000	Current Assets:	
15% Debentures	70,00,000	Stock	2,40,000
Payables	3,00,000	Receivables	3,00,000
		Cash	60,000
	29,60,000		**29,60,000**

Working Notes:

(i) Share Capital and Reserves and Surplus

The return on net worth is 25%. Therefore, the profit after tax of ₹ 4,90,000 should be equivalent to 25% of the net worth.

$$\text{Net worth} \times \frac{25}{100} = ₹\ 4{,}90{,}000$$

$$\therefore \text{ Net worth} = \frac{₹\ 4{,}90{,}000 \times 100}{25} = ₹\ 19{,}60{,}000$$

The ratio of share capital to reserves is 7:3

$$\text{Share Capital} = 19{,}60{,}000 \times \frac{7}{10} = ₹\ 13{,}72{,}000$$

$$\text{Reserves and Surplus} = 19{,}60{,}000 \times \frac{3}{10} = ₹\ 5{,}88{,}000$$

(ii) Debentures

Interest on Debentures @ 15% = ₹ 1,05,000

$$\therefore \text{ Debentures} = \frac{1{,}05{,}000 \times 100}{15} = ₹\ 7{,}00{,}000$$

(iii) Current Assets

Current Ratio = 2

Payables = ₹ 3,00,000

∴ Current Assets = 2 Current Liabilities

= 2 × 3,00,000

= ₹ 6,00,000

It is assumed that current liabilities include payables only.

(iv) Fixed Assets

	₹
Share capital	13,72,000
Reserves and Surplus	5,88,000
Debentures	7,00,000
Payables	3,00,000
Total Liabilities	29,60,000
Less: Current Assets	6,00,000
Fixed Assets	23,60,000

(v) Composition of Current Assets

Inventory Turnover = 10

$$\frac{\text{Cost of goods sold}}{\text{Closing stock}} = 10$$

$$\text{Closing stock} = \frac{₹\ 24,00,000}{10} = ₹\ 2,40,000$$

Composition	₹
Stock	2,40,000
Receivables	3,00,000
Cash (balancing figure)	60,000
Total Current Assets	6,00,000

5. (a) Pattern for raising the additional finance:

Equity	70% of ₹ 20,00,000	= ₹14,00,000
Debt	30% of ₹ 20,00,000	= ₹ 6,00,000

The capital structure after raising additional finance:

		(₹)
Shareholders' funds		
Equity Capital	(₹ 14,00,000 – ₹ 4,20,000)	9,80,000
Retained earnings		4,20,000
Debt (Interest at 8% p.a.)		3,60,000
(Interest at 12% p.a.)	(₹ 6,00,000 – ₹ 3,60,000)	2,40,000
Total Funds		20,00,000

(b) Determination of post-tax average cost of additional debt:

$K_d = I\ (1 - t)$

Where,

I = Interest Rate

t = Corporate tax-rate

On ₹ 3,60,000 =8% (1 – 0.3) =5.6% or 0.056

On ₹ 2,40,000 =12% (1 – 0.3) = 8.4% or 0.084

Average Cost of Debt

$$= \frac{(₹\ 3,60,000 \times 0.056) + (₹\ 2,40,000 \times 0.084)}{₹\ 6,00,000} \times 100 = 6.72\%$$

(c) Determination of cost of retained earnings and cost of equity by applying Dividend growth model:

$$K_e \text{ or } K_r = \frac{D_1}{P_0} + g = \frac{D_0(1+g)}{P_0} + g$$

Where,

D_0 = Dividend paid = 40% of EPS = 40% × ₹ 5 = ₹ 2

g = Growth rate = Retained Earnings x Rate of Return

= 0.6 x 0.10 = 0.06 or 6%

P_0 = Current market price per share = ₹ 53

$$K_e \text{ or } K_r = \frac{2\ (1+0.6)}{53} = \frac{2.12}{53} + 0.06 = 0.04 + 0.06 = 0.10 \text{ or } 10\%$$

(d) Computation of overall weighted average after tax cost of additional finance:

Particulars	**Amount (₹)**	**Weights**	**Cost of funds**	**Weighted Cost (%)**
Equity (including retained earnings)	14,00,000	0.70	10%	7
Debt	6,00,000	0.30	6.72%	2.016
WACC	20,00,000			**9.016**

6. (i) Calculation of Net Proceeds after Floatation Cost and Number of New Shares in Option (i) and (iii)

Equity Option

Net proceeds per share = ₹ 10 – ₹ 0.50 = ₹9.50

Number of shares issued = ₹ 50,00,000 / ₹ 9.50 = **5,26,316 shares**

Debt Option

Flotation cost = 2% of ₹ 50,00,000 = ₹1,00,000

Net proceeds = ₹ 50,00,000 – ₹1,00,000 = **₹49,00,000**

But project requires ₹ 50,00,000.

So gross borrowing = ₹50,00,000 / (1 – 0.02) = **₹51,02,041**

Interest = 12% × ₹51,02,041 = **₹6,12,245**

Mix Option (₹25 lakh Equity, ₹25 lakh Debt)

Equity

Net proceeds/share = ₹ 9.50

Shares issued = ₹ 25,00,000 / ₹ 9.50 = **2,63,158 shares**

Debt

Net debt proceeds = ₹ 25,00,000.

Gross borrowing = ₹25,00,000 / (1 – 0.02) = ₹25,51,020

Interest = 12% × ₹25,51,020 = **₹3,06,122**

(ii) Calculation of Interest Coverage Ratio (ICR)

ICR = EBIT / Interest

Debt Option:

EBIT = ₹ 15,00,000

Interest = ₹ 6,12,245

ICR = ₹ 15,00,000 / ₹ 6,12,245 ≈ **2.45 (Fails covenant)**

Mix of Equity and Debt Option

Interest = ₹ 3,06,122

ICR = ₹ 15,00,000 / ₹ 3,06,122 ≈ **4.90 (Passes covenant)**

(iii) Calculation of Earnings Per Share (EPS)

$$\text{EPS} = \frac{\text{(EBIT-Interest) (1-Tax)}}{\text{Total Shares}}$$

Equity Option

Interest = ₹ 0

Net Income = ₹ 15,00,000 × (1 – 0.30) = ₹ 10,50,000

Total Shares = 10,00,000 + 5,26,316 = **15,26,316**

EPS = ₹ 10,50,000 / 15,26,316 = **₹ 0.688**

Debt Option (Fails covenant)

Interest = ₹ 6,12,245

Net Income = (₹ 15,00,000 – ₹ 6,12,245) × (1 – 0.30)

= ₹ 6,21,428.5

Total Shares = 10,00,000

EPS = ₹ 6,21,428.5 / 10,00,000

= **₹ 0.621** (But violates ICR)

Mix Option

Interest = ₹ 3,06,122

Net Income = (₹ 15,00,000 – ₹ 3,06,122) × 0.70 = ₹ 8,35,714.6

Total Shares = 10,00,000 + 2,63,158 = **12,63,158**

EPS = ₹ 8,35,714.6 / 12,63,158 ≈ **₹ 0.662**

(iv) Calculation of WACC

Cost of Equity (Using CAPM)

Cost of Equity = Rf+β(Rm–Rf)

= 6%+1.2 × (14%–6%) = 6%+9.6%=15.6%

Now, WACC = (EV×Ke) + (DV×Kd×(1−t))

Equity Option

E = ₹ 50,00,000

D = ₹ 0

WACC = 15.6%

Debt Option

E = ₹ 0

D = ₹ 51,02,041

Kd = 12%

After-tax cost of debt = 12% × (1 – 0.30) = 8.4%

WACC = 8.4% (Lowest WACC but fails covenant)

Mix Option

E = ₹ 25,00,000, D = ₹ 25,51,020

Total Value = ₹ 50,51,020

Ke = 15.6%, Kd (after tax) = 8.4%

WACC = (Weight of Ke x Cost of Equity) + (Weight of Kd x Cost of Debt)

= (0.495 x 0.156) + (0.505 x 0.084)

= 0.0772 + 0.0424 = 0.1196 or 11.96%

Conclusion & Recommendation

Option	EPS	WACC	Covenant Compliant
Equity	₹ 0.688	15.6%	Not Applicable
Debt	₹ 0.621	8.4%	**No** (ICR < 2.5)
Mix	₹ 0.662	11.96%	Yes

Hence, the recommended option is Mixed Financing as it complies with the debt covenant, has higher EPS than Debt Option, and lower WACC than Equity Option.

7. Company X

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

So, 3 $= \dfrac{\text{EBIT}}{\text{EBIT} - ₹\ 30{,}000}$

Or, 3 (EBIT – 30,000) = EBIT

Or, 2 EBIT = 90,000

Or, EBIT = 45,000

(ii) Margin of safety = 0.1667

Operating Leverage = 1/Margin of safety

= 1/0.1667 = 6

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

Or, 6 $= \frac{\text{Contribution}}{₹\ 45,000}$

Or, Contribution = ₹ 2, 70,000

Sales $= \frac{\text{contribution}}{\text{P/V Ratio(1 – variable cost ratio)}}$

$$= \frac{₹\ 2,70,000}{40\%} = ₹\ 6,75,000$$

(iii) Fixed Cost = Contribution – EBIT

= ₹ 2,70,000 – 45,000

Or, Fixed cost = ₹ 2,25,000

Company Y

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

So, 3 $= \frac{\text{EBIT}}{\text{EBIT} - ₹\ 1,20,000}$

Or, 3 (EBIT – ₹ 1,20,000) = EBIT

Or, 3 EBIT – ₹ 3,60,000 = EBIT

Or, EBIT = ₹ 1,80,000

(ii) Margin of safety = 0.1667 x 2 = 0.3333

Operating Leverage = 1/Margin of safety

= 1/0.3333 = 3

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

Or, 3 $= \frac{\text{Contribution}}{₹\ 1,80,000}$

Or, Contribution = ₹ 5,40,000

Sales $= \dfrac{\text{Contribution}}{\text{P/V Ratio (1 - variable cost ratio)}}$

$= \dfrac{₹\ 5,40,000}{50\%} = ₹\ 10,80,000$

(iii) Fixed Cost = Contribution – EBIT

= ₹ 5,40,000 – ₹ 1,80,000

Or, Fixed cost = ₹ 3,60,000

(iv) Interest = ₹ 30,000+₹ 30,000x300% = ₹ 1,20,000

Income Statements of X Ltd and Y Ltd

	X Ltd (₹)	Y Ltd (₹)
Sales	6,75,000	10,80,000
Less: Variable cost	4,05,000	5,40,000
Contribution	2,70,000	5,40,000
Less: Fixed Cost	2,25,000	3,60,000
Earnings before interest and tax (EBIT)	45,000	1,80,000
Less: Interest	30,000	1,20,000
Earnings before tax (EBT)	15,000	60,000
Less: Tax @ 30%	4,500	18,000
Earnings after tax (EAT)	10,500	42,000

Comment based on Leverage

Comment based on leverage – Company Y is better than company X of the following reasons:

(i) Capacity of Company Y to meet interest liability is same that of companies X (from EBIT/Interest ratio)

$[X = \dfrac{₹\ 45,000}{₹\ 30,000} = 1.5,\ Y = \dfrac{₹\ 1,80,000}{₹\ 1,20,000} = 1.5]$

(ii) However, Company Y has lesser financial risk as the total risk (business and financial) of company Y is lower (combined leverage of Company X is 18 and Company Y is 9).

8. (i) According to Dividend Discount Model approach, the firm's expected or required return on equity is computed as follows:

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

$$K_e = \frac{25\ (1 + 0.08)}{1,570} + 0.08$$

$$= 0.0172 + 0.08 = 0.0972 \text{ or } 9.72\%$$

(ii) With rate of return on retained earnings (r) is 10% and retention ratio (b) is 60%, new growth rate will be as follows:

$g = br = 0.10 \times 0.60 = 0.06$

Accordingly, dividend will also get changed and to calculate this, first we shall calculate previous retention ratio (b_1) and then EPS assuming that rate of return on retained earnings (r) is same.

With previous Growth Rate of 8% and r =10%, the retention ratio comes out to be:

$0.08 = b_1 \times 0.10$

$b_1 = 0.80$. So, payout ratio = 0.20

With 0.20 payout ratio the EPS will be as follows:

$$\frac{₹\ 25}{0.20} = ₹\ 125$$

With new 0.40 (1 – 0.60) payout ratio, the new dividend will be

$D_1 = ₹\ 125 \times 0.40 = ₹\ 50$

Accordingly, new K_e will be

$$K_e = \frac{50}{1,570} + 0.06$$

or, $K_e = 9.18\%$

9.

Particulars	**(₹)**
Total Sales	₹ 200 lakhs
Credit Sales (80%)	₹ 160 lakhs
Receivables for 40 days	₹ 80 lakhs
Receivables for 120 days	₹ 80 lakhs
Average collection period [(40 x 0.5) + (120 $\times$0.5)]	80 days
Average level of Receivables (₹ 1,60,00,000 × 80/360)	₹ 35,55,556
Factoring Commission (₹ 35,55,556 × 2/100)	₹ 71,111
Factoring Reserve (₹ 35,55,556 × 10/100)	₹ 3,55,556
Amount available for advance {₹ 35,55,556 - (3,55,556 + 71,111)}	₹ 31,28,889
• Factor will deduct his interest @ 18%:	
• Interest = $\frac{₹\,31{,}28{,}889 \times 18 \times 80}{100 \times 360}$	₹ 1,25,156
• Advance to be paid (₹ 31,28,889 – ₹ 1,25,156)	₹ 30,03,733

(i) Statement Showing Evaluation of Factoring Proposal

		₹
A.	**Annual Cost of Factoring to the Firm:**	
	Factoring commission (₹ 71,111 × 360/80)	3,20,000
	Interest charges (₹ 1,25,156 × 360/80)	5,63,200
	Total	8,83,200
B.	**Firm's Savings on taking Factoring Service:**	₹
	Cost of credit administration saved	2,40,000
	Bad Debts (₹ 160,00,000 x 1.5/100) avoided	2,40,000
	Total	4,80,000
C.	Net Cost to the firm (A – B) (₹ 8,83,200 – ₹ 4,80,000)	4,03,200

$$\text{Effective cost of factoring} = \frac{₹\ 4{,}03{,}200}{₹\,30{,}03{,}733} \times 100 = 13.42^{*}\ \%$$

* If cost of factoring is calculated on the basis of total amount available for advance, then, it will be $= \frac{₹4,03,200}{₹31,28,889} \times 100 = 12.89\%$

(ii) If Bank finance for working capital is available at 12%, firm will not avail factoring service as 12% is less than 13.42% (or 12.89%)

10. (a) The most relevant sources of funds:

Feature	Sources of Fund
(i) It is the most expensive source of funds.	**Equity**
(ii) It entails a high degree of risk since they have to be repaid as per the terms of agreement.	**Debentures**
(iii) It supports businesses in their routine activities.	**Funding from Banks**
(iv) Business enterprise has options to raise capital from International markets also.	**International Funding**
(v) This source of finance sometimes is the last option for startups which doesn't qualify for bank funding	**Angel Financing**

(b) Trade credit and bank overdraft are two commonly used short-term financing sources but each has distinct features which are shown below:

S. No.	Trade credit	Bank overdraft
1.	Trade credit is the credit extended by suppliers, allowing the firm to delay payment for goods or services.	Under this facility, customers are allowed to withdraw in excess of credit balance standing in their Current Account.

2.	The usual duration of such credit is 15 to 90 days.	Though overdrafts are repayable on demand, they generally continue for long periods by annual renewals of the limits.
3.	Trade credit is a type of interest free loan, therefore failure to avail this facility has an interest cost.	Interest is charged on daily balances
4.	It generates automatically in the course of business and is common to almost all business operations.	Borrower need to apply to bank for Bank overdraft facility and are operated in the same way as cash credit and current accounts.
5.	It enhances automatically with the increase in the volume of business and fast payment.	A fixed limit is, therefore, granted to the borrower within which the borrower is allowed to overdraw his account.

(c) The trade-off between the components of working capital can be summarised as follows:

Component of Working Capital	**Advantages of higher side (Profitability)**	**Trade-off (between Profitability and Liquidity)**	**Advantages of lower side (Liquidity)**
Inventory	Fewer stock-outs increase the profitability.	Use techniques like EOQ, JIT etc. to carry optimum level of inventory.	Lower inventory requires less capital but endangered stock-out and loss of goodwill.
Receivables	Higher Credit period attract	Evaluate the credit policy;	Cash sales provide liquidity

	customers and increase revenue (but can result in more bad debts)	use the services of debt management (factoring) agencies.	but fails to boost sales and revenue (due to lower credit period)
Pre-payment of expenses	Reduces uncertainty and profitable in inflationary environment.	Cost-benefit analysis required	Improves or maintains liquidity.
Cash and Cash equivalents	Payables are honoured in time, improves the goodwill and helpful in getting future discounts.	Cash budgets and other cash management techniques can be used	Cash can be invested in some other investment avenues
Payables and Expenses	Capital can be used in some other investment avenues	Evaluate the credit policy and related cost.	Payables are honoured in time, improves the goodwill and helpful in getting future discounts.

6B: STRATEGIC MANAGEMENT

QUESTIONS

Multiple Choice Questions

1. In the serene city of Pune, *Royal Pens* stood as a distinguished company with a rich heritage spanning a century. Specializing in crafting luxurious writing instruments, Royal Pens had long been known for its elegance and precision—valued by collectors and enthusiasts across the nation.

   However, as the world progressed into the digital era, Royal Pens encountered a tsunami of challenges. Emerging substitutes quickly adapted to technological advancements, offering innovative writing solutions that appealed to a younger demographic. Despite its esteemed legacy, Royal Pens faced sluggish growth as it struggled to adapt to the evolving landscape of the writing instrument industry.

   In an effort to stand out, Royal Pens strategized on ambitious endeavors. They experimented with new materials, introduced limited-edition designs and even forayed into digital pen technology, including *a Bluetooth-enabled stylus for tablets*—a move intended to attract tech-savvy users. Least expected, these initiatives failed to resonate with modern consumers. Their attempts to innovate were perceived as outdated or disconnected from actual user needs and their once-unquestionable reputation began to downgrade.

   As Royal Pens struggled with reducing sales and increased competition, internal challenges started building up. Top executives including the CEO, CFO and the marketing head—accustomed to success—found themselves in a tough position to justify their acumen in the face of shifting market dynamics. Disagreements over strategic direction led to a wave of departures leaving a leadership vacuum at the top.

   Amidst the turmoil, one aspect of Royal Pens remained strong: its unique company culture. Despite the challenges, middle managers and employees remained deeply dedicated to the company's traditions and values. Compassionate leadership at the functional level ensured a sense of unity and resilience keeping the spirit of Royal Pens alive during uncertainty.

Yet the company's troubles were far from over. Royal Pens faced legal battles from a rival competitor alleging patent infringements. The ensuing legal proceedings drained resources and further depleted the company's finances worsening an already helpless situation.

Ultimately, Royal Pens faced a tough choice. With no clear path to recovery, the company made the painful decision to significantly scale down its operations. 70% of its business was discontinued and assets & equipment were sold off to generate much-needed funds. Though difficult, this decision allowed Royal Pens to redirect its resources toward niche opportunities preserving its legacy in a rapidly changing market.

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

(i) Royal Pens, a century-old brand began losing relevance as the market embraced modern digital writing tools. What external environmental factor caused the greatest disruption to Royal Pens' business model requiring a strategic shift that the company struggled to make?

(a) Political instability

(b) Rising inflation

(c) Legal regulations

(d) Technological advancement

(ii) After experiencing a decline in market share due to emerging competitors, Royal Pens responded by launching Bluetooth-enabled styluses and limited-edition pens. These actions were not pre-planned innovations but responses to market shifts. What type of strategic approach does this represent?

(a) Proactive strategy

(b) Reactive strategy

(c) Differentiation strategy

(d) Market penetration strategy

(iii) To regain market share, Royal Pens launched limited-edition designs and a stylus pen, targeting younger, tech-driven customers. This strategic choice most closely reflects which of the following business-level strategies?

(a) Cost leadership

(b) Market development

(c) Differentiation

(d) Retrenchment

(iv) Despite facing legal disputes and financial decline, Royal Pens' workforce remained resilient and united. Which aspect of the company played the most vital role in maintaining employee morale and commitment during turbulent times?

(a) Employee stock ownership

(b) Regular salary hikes

(c) Strong company culture

(d) Remote working options

(v) Royal Pens believed that its century-old reputation alone would continue to appeal to modern consumers. This assumption formed the basis of its strategies, which ultimately failed as market dynamics shifted. Which type of strategic control was lacking, leading to unchallenged reliance on outdated assumptions?

(a) Premise control

(b) Special alert control

(c) Implementation control

(d) Strategic surveillance

2. A beverage company's marketing team launches a campaign to boost social media engagement. The production unit enhances efficiency to cut costs and the HR department implements new training programs to

improve employee productivity. These departmental initiatives are aligned with the company's overall growth goals. What type of strategy does these efforts represent?

(a) Proactive strategy

(b) Reactive strategy

(c) Functional level strategy

(d) Corporate level strategy

3. A startup evaluates its strategic position by identifying its unique technology as a strength, high competition as a threat, an untapped market segment as an opportunity and operational inefficiencies as a weakness. It plans to use these insights to refine its business strategy. Which strategic tool is being used?

(a) Competitor benchmarking analysis

(b) SWOT analysis

(c) PESTEL analysis for market dynamics

(d) Internal capabilities evaluation

4. A health-conscious community group strongly advocates for more organic options in local eateries and shows great interest in influencing food choices. However, a small local café, whose loyal customer base prefers traditional food remains unaffected by the group's efforts. In terms of Mendelow's Matrix, how should this stakeholder group be classified?

(a) High Interest, High Power

(b) Low Interest, Low Power

(c) High Interest, Low Power

(d) Low Interest, High Power

5. A mobile phone company already has a strong customer base in its home country. To grow further, it focuses on increasing sales of its existing phones by offering promotional discounts, ramping up advertising and partnering with more local retailers for better

distribution. Which growth strategy does this represent according to Ansoff's Matrix?

(a) Market penetration strategy

(b) Product development strategy

(c) Market development strategy

(d) Diversification strategy

6. A well-established clothing brand is experiencing a decline in sales and market share due to the changing consumer preferences and rising competition. In response, the company restructures its operations, cuts cost, revamps its product line, enhances marketing efforts and focuses on boosting employee morale and operational efficiency. What type of strategy is the company implementing?

(a) Divestment strategy

(b) Market penetration strategy

(c) Cost leadership strategy

(d) Turnaround strategy

Descriptive Questions

Chapter 1-Introduction to Strategic Management

7. Vireon Foods started as a small dairy business but is still thriving after 25 years even as many competitors shut down or merged. Its leadership holds regular planning retreats, studies changing consumer habits and adapts its operations every few years. They recently invested in plant-based products before market demand spiked. What advantage is their strategic intelligence offering them? What are the other benefits of strategic management?

8. 'A company's mission statement is typically focused on its present business scope.' Explain the significance of a mission statement.

Chapter 2-Strategic Analysis: External Environment

9. Nuvanta Healthcare is planning to launch a nutrition supplement targeted at urban consumers in Tier-2 Indian cities. The product team analyzed local population data age groups, income levels, lifestyle patterns and health concerns before finalizing the formulation and pricing. They are also reviewing how changes in government policy and tech adoption may affect the rollout. What kind of external factor has Nuvanta considered for pricing the product? Briefly explain the major categories of such external influences that shape business strategy.

10. Value Chain Analysis consists of two activities: Primary activities and Support activities. As per Michael Porter both the activities are intertwined. Do you agree with the statement? Also delineate the main areas in which primary activities of any organization are grouped.

Chapter 3-Strategic Analysis: Internal Environment

11. Soltex Green Energy is rolling out a major wind project in a coastal town. A local business coalition with strong political ties and deep interest in the project has started influencing policy discussions. The company's strategy team is closely engaging with them while managing other stakeholders differently. What might be the reason Soltex is prioritizing engagement with this specific group? Identify and briefly explain the four types of stakeholder categories businesses typically deal with in such situations.

12. Write a short note on the Key Strategic Drivers of an organization.

Chapter 4-Strategic Choices

13. Zeon Beverages, known for its fruit juices, recently acquired a nationwide cold-storage logistics company to control the quality and speed of its product delivery. Earlier, it had set up its own fruit-processing unit to reduce dependence on third-party suppliers. The company believes this strategy strengthens its supply chain and market control. What type of strategic move is Zeon making through these acquisitions? How does this approach differ from horizontal and conglomerate diversification?

14. "There are certain conditions or indicators which point out that a turnaround is needed if the company has to survive". Discuss.

Chapter 5-Strategy Implementation and Evaluation

15. Merako Appliances recently automated its assembly line to produce kitchen gadgets faster and at lower cost, improving operational efficiency. However, customer feedback shows that the new products don't meet market needs, leading to declining sales. This has sparked an internal debate on balancing efficiency (doing things right) with effectiveness (doing the right things). How should Merako balance efficiency and effectiveness to achieve sustainable success? Also, describe the four possible situations a business can face when comparing levels of efficiency and effectiveness.

16. Describe the principal aspects of strategy-execution process which are included in most situations.

SUGGESTED ANSWERS

MCQ No.	Answer	
1.	**(i)**	**(d)**
	(ii)	**(b)**
	(iii)	**(c)**
	(iv)	**(c)**
	(v)	**(a)**
2.		**(c)**
3.		**(b)**
4.		**(c)**
5.		**(a)**
6.		**(d)**

7. Vireon Foods' continued success over 25 years despite the exit or merger of several competitors reflects the **importance and advantages of strategic management** particularly its contribution to the **longevity of a business**.

The strategic intelligence demonstrated by Vireon—through regular planning retreats, environmental scanning, understanding consumer behavior and timely investment in plant-based products—has provided it with a **competitive advantage** and the ability to **successfully navigate environmental changes**. This aligns with the dual objectives of strategic management:

- Creating competitive advantage by delivering something unique and valued by customers.
- Guiding the company through all changes in the environment by reacting appropriately.

Other benefits of strategic management evident from Vireon's case include:

- It enables the organization to be **proactive rather than reactive** helping it controls its future instead of merely responding to change.
- It provides a **clear strategic direction** allowing the organization to align its goals and actions with its vision.
- It serves as a **framework for sound decision-making** related to markets, products, investments and structure.
- It helps organizations **identify and leverage opportunities** while avoiding costly pitfalls.
- It contributes to **building core competencies** and **sustaining long-term growth and survival** as seen in Vireon's ability to adapt and remain relevant.

Thus, strategic management not only ensures superior performance but also enhances the **sustainability and adaptability** of a business in a dynamic environment.

8. A company's mission statement is typically focused on its present business scope, **who we are and what we do**. Mission statements broadly describe an organization's present capability, customer focus, activities, and business make up. Mission for an organization is significant for the following reasons:

- It ensures **unanimity of purpose** within the organization.
- It develops a basis, or standard, for **allocating organizational resources.**
- It provides a basis for **innovating the use of the organisation's resources.**
- It **establishes** a general tone or **organizational climate**, to suggest a business like operation.
- It serves as a **focal point** for those who can identify with the **organisation's purpose and direction**.
- It facilitates the **translation of objectives and goals into a work structure** involving the assignment of tasks to responsible elements within the organization.
- It specifies organizational purposes and the **translation of these purposes into goals** in such a way that cost, time, and performance parameters can be assessed and controlled.

9. Nuvanta Healthcare has considered the **Demographic Environment** as an external factor for pricing its nutrition supplement. The analysis of local population data such as **age groups, income levels, lifestyle patterns, and health concerns** reflects the company's effort to understand its target consumers and formulate a suitable pricing strategy.

External environmental factors significantly influence an organization's strategy and operations. These factors may be external to the firm or introduced by managers to adapt to change. The major categories of such external influences that shape business strategy include:

♦ **Demographic Environment** – It includes factors such as population size, age distribution, income levels, education, and occupation, which affect consumer preferences and demand.

- **Economic Environment** – Includes elements like purchasing power, inflation rates, and overall economic conditions that influence pricing and market potential.
- **Political-Legal Environment** – Consists of government policies, regulations, and legal aspects that can impact product rollout and compliance requirements.
- **Technological Environment** – Rapid technological changes affect production, product design, marketing, and distribution, influencing how companies deliver value.
- **Socio-Cultural Environment** – Involves lifestyle patterns, health consciousness, social values, and consumer attitudes that influence buying behavior.

10. **Yes, I agree with the statement** that Value Chain Analysis consists of two activities: Primary activities and Support activities. As per Michael Porter, both the activities are intertwined. It is a tool used to examine the activities that create value in an organization, helping to enhance efficiency and build competitive advantage. It breaks down a business's operations to identify areas for improvement in value creation.

The **primary activities** of an organization are categorized into five areas:

1. **Inbound logistics**: Activities related to receiving, storing, and distributing inputs (e.g., materials handling, stock control, and transport).
2. **Operations**: Transforming input into final products or services (e.g., machining, packaging, assembly).
3. **Outbound logistics**: Collecting, storing, and delivering products to customers (e.g., warehousing, transport).
4. **Marketing and sales**: Promoting and selling the product or service, including advertising and sales administration.
5. **Service**: Enhancing or maintaining product value (e.g., installation, repair, training).

11. Soltex Green Energy is prioritizing engagement with the **local business coalition** because they fall under the category of **Key Players** in **Mendelow's Stakeholder Matrix**. This group possesses **high power** (due to strong political ties and ability to influence policy) and **high interest** (due to deep involvement in the wind project). As per Mendelow's Matrix, such stakeholders must be **fully engaged**, informed regularly, and their advice and expectations carefully considered, as they can significantly impact the success of the project.

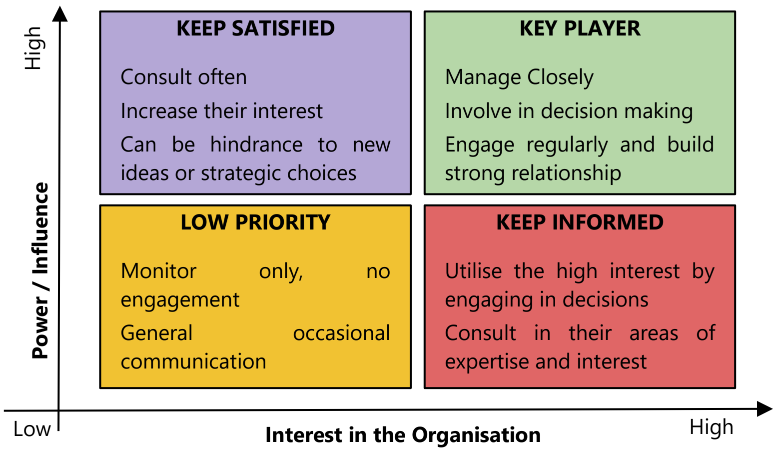
Mendelow's Matrix categorizes stakeholders into four types based on their **Power** (ability to influence the organization) and **Interest** (concern with the organization's success):

1. **Key Players (High Power, High Interest):** These stakeholders should be **closely managed and fully engaged**. They are critical to strategic decisions.

2. **Keep Satisfied (High Power, Low Interest):** These stakeholders should be kept **satisfied with regular information** but not over-communicated with.

3. **Keep Informed (Low Power, High Interest):** These stakeholders must be kept **adequately informed** to avoid misunderstandings and gain useful feedback.

4. **Low Priority (Low Power, Low Interest):** These stakeholders require **minimal effort**, only to be **monitored occasionally**.



Mendelow's Matrix thus helps organizations like Soltex to allocate their **time, resources, and communication efforts** strategically across different stakeholder groups, adjusting the engagement as the environment evolves.

12. Key Strategic Drivers of an Organization

Strategic drivers are essential elements that influence an organization's ability to differentiate itself from its competitors and achieve competitive advantage. These drivers assess the current performance of the business and provide insights into areas that need focus.

The key strategic drivers include:

1. **Industry and Markets:** Understanding the industry and markets is crucial for identifying the organization's relative position. Industries group similar companies based on their primary products, while markets are defined by the buyers and sellers of these products. Analyzing industry and market dynamics, often through tools like strategic group mapping, helps organizations evaluate competition and refine strategies.

2. **Customers:** Identifying and understanding customers is a critical driver. Customers are segmented based on their needs and spending capacity, which guides product development and marketing strategies. Differentiating between customers (buyers) and consumers (users) is vital to tailoring pricing, design, and usability strategies effectively.

3. **Products and Services:** Products and services are central to defining the business. Organizations must assess their offerings, classify products, and devise strategies for differentiation, branding, and pricing. Product innovation and marketing are key to maintaining competitiveness.

4. **Channels:** The channels through which products and services are delivered impact on accessibility and customer satisfaction. Strategies related to direct, digital, or relationship-based

marketing ensure the efficient distribution of offerings to target customers.

By aligning these drivers with organizational goals, businesses can achieve sustained growth and maintain a competitive edge.

13. Zeon Beverages is pursuing a strategy of **vertically integrated diversification**, a form of **concentric diversification**, where the company expands into businesses that are related to its existing operations along the value chain. By **setting up its own fruit-processing unit** (backward integration) and **acquiring a cold-storage logistics company** (forward integration), Zeon is strengthening its supply chain, improving quality control and enhancing speed of delivery.

This move falls under **concentric diversification**, where the new businesses are linked to existing ones through process, technology or marketing, providing synergistic benefits. This approach differs from:

1. **Horizontal Integrated Diversification** – where a firm expands by acquiring similar or complementary businesses operating at the same stage of production. For example, if Zeon had acquired another fruit juice brand, it would be horizontal diversification.

2. **Conglomerate Diversification** – which involves expansion into **unrelated businesses** with no connection in terms of product, market, or technology. For instance, if Zeon ventured into unrelated sectors like real estate or electronics, it would be conglomerate diversification.

Hence, Zeon's strategy is a **vertically integrated concentric diversification**, aimed at enhancing operational efficiency and gaining better control over its value chain.

14. In today's competitive and volatile business environment, no organization can assume sustained viability. A **turnaround strategy** is a focused effort aimed at restoring an organization's profitability and ensuring survival when both internal weaknesses and external threats endanger its existence.

Turnaround becomes necessary when a company faces a significant crisis that severely affects its operations and performance. It is typically adopted when survival is the immediate goal, before growth can be pursued.

There are several **indicators or conditions** that signal the need for a turnaround strategy:

- Persistent negative cash flows from operations
- Uncompetitive products or services
- Declining market share
- Deterioration in physical facilities
- Over-staffing, high employee turnover, and low morale
- Mismanagement

Early identification of these danger signals and immediate corrective action is essential for ensuring the company's survival and eventual recovery.

15. Merako Appliances has improved operational **efficiency** by automating its assembly line. However, declining sales due to products not meeting customer needs indicate a lack of **effectiveness**. This highlights the importance of balancing *doing things right* (efficiency) with *doing the right things* (effectiveness).

To achieve **sustainable success**, Merako must align its operations with customer preferences through sound **strategy formulation** (effectiveness), followed by efficient **strategy implementation**.

Four Possible Situations Based on Efficiency and Effectiveness:

1. **Efficient and Effective (Thrive):** Ideal scenario. The firm does the right things and does them well. Merako should aim for this by aligning products with customer needs while maintaining efficiency.

2. **Efficient but Ineffective (Die Slowly):** Merako's current state. Operations are streamlined, but customer needs are unmet, risking decline without strategic correction.

3. **Inefficient but Effective (Survive):** Right strategy but poor execution. The firm may survive but must improve efficiency to sustain.

4. **Inefficient and Ineffective (Die Quickly):** Neither aligned with customer needs nor operationally sound. Leads to rapid failure unless overhauled.

Strategic Formulation

Operational Management	**Effective**	**Ineffective**
Efficient	1 Thrive	2 Die Slowly
Inefficient	3 Survive	4 DieQuickly

Principal combinations of efficiency and effectiveness

Merako must integrate **customer feedback** into strategic planning and ensure both efficient execution and effective direction to gain long-term competitiveness.

16. Implementation **or execution** is an operations-oriented activity aimed at shaping the performance of core business activities in a strategy-supportive manner. In most situations, strategy-execution process includes the following principal aspects:

- **Developing budgets** that steer ample resources into those activities that are 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 culture and climate conducive** to successful strategy implementation and execution.
- **Exerting the internal leadership** needed to drive implementation forward and keep improving strategy execution.