Mock Test Paper - Series II: April, 2025

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INTERMEDIATE: GROUP – II

PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A : FINANCIAL MANAGEMENT

Suggested Answers/ Hints

PART I – Case Scenario based MCQs.

1. (a) ₹ 6,24,500

Calculation of Incremental Benefit Statement (Current Policy v/s Policy A)

	Current Policy (₹)	**Policy 'A' (₹)**
Credit Sales (365 lakhs X 0.9)	3,28,50,000	3,28,50,000
(-) Cost Of Sales @ 0.8	2,62,80,000	2,62,80,000
Operating Profit	65,70,000	65,70,000
(-) Bad Debts Exp (Wn-1)	98,550	98,550
(-) Collection Exp	5,00,000	3,50,000 (30% Reduction)
(-) Cash Discount Exp (Wn-2)	-	4,38,000
(-) Opportunity Cost of Carrying Debtors (Wn – 3)	13,14,000	4,01,500
Net Benefit	**46,57,450**	**52,81,950**

Incremental Benefit in Policy 'A' = ₹ 6,24,500

WN – 1: Calculation of Bad debts expense

Of the total credit sales, 15% are sold to the customers who are not financially sound and 2% of such sales is bad debts.

Bad debts = ₹ 3,28,50,000 x 0.15 x 0.02 = ₹ 98,550 (same under Policy A as well)

WN – 2: Calculation of Cash Discount under Policy A

Credit Sales made to 2/3 of the customer's avail Cash discount @ rate of 2% as they would be paying their dues within maximum of 15 days.

Cash Discount = ₹ 3,28,50,000 x 2/3 x 2% = ₹ 4,38,000

WN – 3: Calculation of Opportunity Cost of Carrying Debtors assuming Debtors are valued at Cost of Sales

Current Policy -

a) Average Debtors = Cost of Sales x Avg Collection Period / 360

= (₹ 3,28,50,000 x 80%) x 120 / 360

= ₹ 87,60,000

b) Apply Rate of Return on above debtors calculated

= ₹ 87,60,000 X 0.15 = ₹ 13,14,000

Policy 'A'

Total Cost of Sales = ₹ 2,62,80,000

2/3 Customers

Cost of Sales = ₹ 1,75,20,000

Avg Collection Period = 15 days

Debtors = 1,75,20,000 x 15/360

= ₹ 7,30,000

Opportunity Cost = ₹ 7,30,000 x 0.15 = ₹ 1,09,500

1/3 Customers

Cost of Sales = ₹ 87,60,000

Avg Collection Period = 80 days

Debtors = 87,60,000 x 80/360 = ₹ 19,46,667

Opportunity Cost = ₹ 19,46,667 x 0.15 = ₹ 2,92,000

Total Opportunity Cost = ₹ 1,09,500 + ₹ 2,92,000 = ₹ 4,01,500

2. (a) ₹ 27,294

Calculation of Incremental Benefit Statement (Current Policy v/s Policy B)

	Current Policy (₹)	Policy 'B' (₹)
Credit Sales (365 lakhs X 0.9)	3,28,50,000	3,61,35,000 (10% Increase)
(-) Cost Of Sales @ 0.8	2,62,80,000	2,89,08,000
Operating Profit	65,70,000	72,27,000
(-) Bad Debts Exp (Wn-1)	98,550	1,35,506
(-) Collection Exp	5,00,000	6,00,000
(-) Opportunity Cost of Carrying Debtors (Wn – 3)	13,14,000	18,06,750
Net Benefit	**46,57,450**	**46,84,744**

Incremental Benefit in Policy 'B' = ₹ 27,294

WN – 1: Calculation of Bad debts expense under Policy 'B'

Of the total credit sales, 15% are sold to the customers who are not financially sound (As proportion of those customer to remain same) and 2.5% of such sales is bad debts.

Bad debts = ₹ 3,61,35,000 x 0.15 x 0.025 = ₹ 1,35,506.25

WN – 3: Calculation of Opportunity Cost of Carrying Debtors assuming Debtors are valued at Cost of Sales under Policy 'B'.

Average Debtors = Cost of Sales x Avg Collection Period / 360

= ₹ 2,89,08,000 x 150 / 360

= ₹ 1,20,45,000

Therefore, Opportunity Cost of Carrying Debtors = ₹ 1,20,45,000 x 0.15 = ₹ 18,06,750

3. (b) Proposal 2, 3 & 1

Evaluating Proposal, I - Selling washing machine at discount

Selling price (with 5% discount) = ₹ 15,675

Therefore, Selling Price (Without Discount) = ₹ 15,675 / 0.95 = ₹ 16,500 per unit.

To increase the demand, a minimum of 10% discount is necessary and the marketing team has proposed a 12% discount to get a competitive advantage.

Thus, the New Selling Price = ₹ 16,500 – 12% = ₹ 14,520 per unit.

Total Sales @ new Selling Price = 1,000 Units x 4 Quarters x ₹ 14,520

= ₹ 5,80,80,000

Evaluating Proposal II - Exchange-sales scheme

Total Sales (Units)	= 4,650
Selling Price per unit	= ₹ 16,500
(-) Exchange off set price	= ₹ 3,500
Net Proceeds	= ₹ 13,000
Total Sales	= 4,650 x ₹ 13,000
	= ₹ 6,04,50,000

Evaluating Proposal III - All-round reduction in Inventory levels

Selling Price = ₹ 3,000 advance + ₹ 9,500 on delivery = ₹ 12,500

Total Sales = 400 x 12 x ₹ 12,500

= ₹ 6,00,00,000

Rankings: Rank 1 – Proposal 2

Rank 2 – Proposal 3

Rank 3 – Proposal 1

NOTE: In absence of other info, we would be considering the benefits in the form sales and decide on the proposal to be selected

4 (c) ₹ 98,550 and ₹ 1,35,506

5. (d) The best combination of Inventory proposal and Credit policies comes to Proposal 2 & Credit Policy 'A'.

6. (b) 2,50,000 shares

Ex-dividend price is ₹ 80 (100 – 20).

The total amount of dividend received is ₹ 40,00,000 (2,00,000 shares x ₹ 20 per share) which is re-invested at the rate of ₹ 80 per share.

Thus, additional shares purchased would be ₹ 40,00,000/₹ 80 = 50,000 shares

So, Mr. A would now hold 2,50,000 shares i.e. (2,00,000 + 50,000)

7. (c) ₹ 20,000

Combined Leverage = Operating Leverage x Financial Leverage

15 = 5 x Financial Leverage

Financial Leverage = 3

Now, Financial Leverage = $\frac{\text{EBIT}}{\text{EBIT - Interest}}$

Or 3 = $\frac{30,000}{30,000 - \text{Interest}}$

90,000 – 3 Interest = 30,000

3 Interest = 60,000

So, Interest = ₹ 20,000

8. (a) 5%

Ke = Rf + β (Rm – Rf)

15 = Rf + 2(10 – Rf)

15 = Rf + 20 - 2Rf

Rf = 5

PART II – Descriptive Questions

1. (a) Calculation of Present Value of cash flows

Year	PV factor @ 10%	Project A		Project B	
		Cash flows (₹)	Discounted Cash flows (₹)	Cash flows (₹)	Discounted Cash flows (₹)
0	1.00	(2,00,000)	(2,00,000)	(2,00,000)	(2,00,000)
1	0.91	35,000	31,850	2,18,000	1,98,380
2	0.83	80,000	66,400	10,000	8,300
3	0.75	55,000(90,000-35,000)	41,250	10,000	7,500
4	0.68	75,000	51,000	4,000	2,720
5	0.62	20,000	12,400	3,000	1,860
Net Present Value			2,900		18,760

(i) Discounted Payback period for the projects:

Project-A: The cumulative discounted cash inflows upto year 4 is ₹1,90,500 and remaining amount required to equate the cash outflow is ₹ 9,500 i.e. (₹ 2,00,000 – ₹ 1,90,500) which will be recovered from year-5 cash inflow. Hence, Payback period will be calculated as below:

$$4 \text{ years} + \frac{₹\,9,500}{₹\,12,400} = 4.766 \text{ years Or 4 years 9.19 months Or 4 years 9 months and 6 days.}$$

Project-B: The cash inflow in year-1 is ₹1,98,380 and remaining amount required to equate the cash outflow is ₹ 1,620 i.e. (₹ 2,00,000 – ₹ 1,98,380) which will be recovered from year-2 cash inflow. Hence, Payback period will be calculated as below:

$$1 \text{ year} + \frac{₹1,620}{₹\ 8,300} = 1.195 \text{ years Or 1 Year 2.34 months Or 1 Year 2 months and 10 days.}$$

(ii) Desirability factor of the projects

$$\text{Desirability Factor (Profitability Index)} = \frac{\text{Discounted value of Cash Inflows}}{\text{Discounted value of Cash Outflows}}$$

$$\textbf{Project A} = \frac{₹\,2,02,900}{₹\,2,00,000} = 1.01$$

$$\textbf{Project B} = \frac{₹\,2,18,760}{₹\,2,00,000} = 1.09$$

(iii) Net Present Value (NPV) of the projects:

Please refer the above table.

Project A- ₹ 2,900

Project B- ₹ 18,760

(b) (A) Approximation Method:

(i) Calculation of Cost of Bonds - 75% Opting for the conversion

Value of equity shares at the end of 5th year will be calculated using the concept of time value of money.

$FV = PV (1 + r)^n$

= 30 $(1 + 0.05)^5$

= 38.29

Consideration Value (Agreed Price) = 38.29 + 5% premium

= ₹ 40.20 for each equity share

Each bond holder will receive 4 equity shares for each bond converted.

∴ ₹ that each bond holder will receive on conversion would be,

₹ 40.20 x 4 = ₹ 160.80

So, RV = ₹ 160.80, NP = ₹ 100, Int = ₹ 10, n = 5 years

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

$$\therefore Kd = \frac{10(1-0.25)+\frac{(160.8-100)}{5}}{\frac{(160.8+100)}{2}}$$

∴ Kd = 15.08%

(ii) Calculation of Cost of Bonds - Not Opting for the conversion

RV = 100 + 25% (Premium) = 125

Add: Redemption cost = (125 x 2%) = 2.5

Gross RV = 127.50

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

$$\therefore Kd = \frac{10(1-0.25)+\frac{(127.5-100)}{5}}{\frac{(127.5+100)}{2}}$$

∴ Kd = 11.43%

(B) Yield To Maturity (YTM) Method:

(i) Calculation of Cost of Bonds - 75% Opting for the conversion

Year	Cash Flows (₹)	DF @ 10%	Present Value (₹)	DF @ 18%	Present Value (₹)
0	(100)	1.000	(100)	1.000	(100)
1	7.5	0.909	6.818	0.847	6.353
2	7.5	0.826	6.195	0.718	5.385
3	7.5	0.751	5.633	0.609	4.568
4	7.5	0.683	5.123	0.515	3.863
5	7.5 + 160.80	0.621	104.514	0.437	73.547
	NPV		28.283		- 6.284

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

H = Higher rate = 18%

L = Lower rate = 10%

$\therefore$ IRR $= 10 + \frac{28.283}{28.283 - (-6.284)}(18 - 10)$

Kd = 16.54%

(ii) Calculation of Cost of Bonds - Not Opting for the conversion

Year	Cash Flows (₹)	DF @ 10%	Present Value (₹)	DF @ 15%	Present Value (₹)
0	(100)	1.000	(100)	1.000	(100)
1	7.5	0.909	6.818	0.87	6.525
2	7.5	0.826	6.195	0.756	5.67
3	7.5	0.751	5.633	0.658	4.935
4	7.5	0.683	5.123	0.572	4.29
5	7.5 + 127.50	0.621	83.835	0.497	67.095
	NPV		7.604		-11.485

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

H = Higher rate = 15%

L = Lower rate = 10%

$\therefore$ IRR $= 10 + \frac{7.604}{7.604 - (-11.485)}(15 - 10)$

Kd = 12%

(c) (i) Operating leverages:

Particulars	**Situation-I (₹)**	**Situation-II (₹)**
Sales (3,000 units @ ₹ 30/- per unit)	90,000	90,000
Less: Variable Cost (VC) @ ₹ 15 per unit	(45,000)	(45,000)
Contribution (C)	45,000	45,000
Less: Fixed Cost (FC)	15,000	20,000
EBIT	30,000	25,000
Operating Leverage $\left(\frac{C}{EBIT}\right)$	$\frac{45,000}{30,000}$	$\frac{45,000}{25,000}$
	= 1.5	= 1.8

(ii) Financial Leverages:

	A (₹)	**B (₹)**
Situation I:		
EBIT	30,000	30,000
Less: Interest on debt	(2,000)	(1,000)
EBT	28,000	29,000
Financial Leverage $\left(\frac{EBIT}{EBT}\right)$	$\frac{30,000}{28,000}$	$\frac{30,000}{29,000}$
	= 1.07	= 1.03
Situation-II:		
EBIT	25,000	25,000
Less: Interest on debt	(2,000)	(1,000)

EBT	23,000	24,000
Financial Leverage $\left(\frac{EBIT}{EBT}\right)$	$\frac{25,000}{23,000}$	$\frac{25,000}{24,000}$
	= 1.09	= 1.04

(iii) Combined Leverages:

	A (₹)	B (₹)
(a) Situation I	1.5 × 1.07 = 1.61	1.5 × 1.03 = 1.55
(b) Situation II	1.8 × 1.09 = 1.96	1.8 × 1.04 = 1.87

2. (a) (i) The EPS of the firm is ₹ 10 (i.e., ₹ 2,00,000/ 20,000) and r = 2,00,000/ (20,000 shares × ₹100) = 10%. The P/E Ratio is given at 12.5 and the cost of capital, K_e, may be taken at the inverse of P/E ratio. Therefore, K_e is 8 (i.e., 1/12.5). The firm is distributing total dividends of ₹ 1,50,000 among 20,000 shares, giving a dividend per share of ₹ 7.50. the value of the share as per Walter's model may be found as follows:

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

The firm has a dividend payout of 75% (i.e., ₹ 1,50,000) out of total earnings of ₹ 2,00,000. Since, the rate of return of the firm, r, is 10% and it is more than the K_e of 8%, therefore, by distributing 75% of earnings, the firm is not following an optimal dividend policy. The optimal dividend policy for the firm would be to pay zero dividend and in such a situation, the market price would be-

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

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

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

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

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

So, the market price will come down to ₹ 76.

(b) (i) Amount of debt to be employed by firm as per traditional approach

Calculation of Equity, W_d and W_e

Total Capital (₹)	Debt (₹)	W_d	Equity value (₹)	W_e
(a)	(b)	(b)/(a)	(c) = (a) - (b)	(c)/(a)
50,00,000	0	-	50,00,000	1.0
50,00,000	5,00,000	0.1	45,00,000	0.9
50,00,000	10,00,000	0.2	40,00,000	0.8
50,00,000	15,00,000	0.3	35,00,000	0.7
50,00,000	20,00,000	0.4	30,00,000	0.6
50,00,000	25,00,000	0.5	25,00,000	0.5
50,00,000	30,00,000	0.6	20,00,000	0.4

Statement of Weighted Average Cost of Capital (WACC)

K_e	W_e	K_d	W_d	$K_e W_e$	$K_d W_d$	K_o
(1)	(2)	(3)	(4)	(5) = (1) x (2)	(6) = (3) x (4)	(7) = (5) + (6)
0.100	1.0	-	-	0.100	-	0.100
0.105	0.9	0.060	0.1	0.095	0.006	0.101
0.110	0.8	0.060	0.2	0.088	0.012	0.100
0.113	0.7	0.062	0.3	0.079	0.019	0.098
0.124	0.6	0.070	0.4	0.074	0.028	0.102
0.135	0.5	0.075	0.5	0.068	0.038	0.106
0.160	0.4	0.080	0.6	0.064	0.048	0.112

So, amount of Debt to be employed = ₹ 15,00,000 as WACC is minimum at this level of debt i.e. 9.8%.

(ii) As per MM approach, cost of the capital (K_o) remains constant and cost of equity increases linearly with debt.

$$\text{Value of a firm} = \frac{\text{Net Operating Income (NOI)}}{K_0}$$

$$₹\ 50,00,000 = \frac{₹\ 5,00,000}{K_o}$$

$$K_o = \frac{₹\ 5,00,000}{₹\ 50,00,000} = 10\%$$

Statement of Equity Capitalization rate (k_e) under MM approach

Debt (₹)	Equity (₹)	Debt/Equity	K_o	K_d	$K_o - K_d$	$K_e = K_o + (K_o - K_d)\frac{\text{Debt}}{\text{Equity}}$
(1)	(2)	(3) = (1)/(2)	(4)	(5)	(6) = (4) -(5)	(7) = (4) + (6) x (3)
0	50,00,000	0	0.10	-	0.100	0.100
5,00,000	45,00,000	0.11	0.10	0.060	0.040	0.104
10,00,000	40,00,000	0.25	0.10	0.060	0.040	0.110
15,00,000	35,00,000	0.43	0.10	0.062	0.038	0.116
20,00,000	30,00,000	0.67	0.10	0.070	0.030	0.120
25,00,000	25,00,000	1.00	0.10	0.075	0.025	0.125
30,00,000	20,00,000	1.50	0.10	0.080	0.020	0.130

3. (a) WN-1: Calculation of Total Current Assets using Current Ratio

$$\text{Current Ratio} = \frac{CA}{CL}$$

$$3.5 = \frac{CA}{2,80,000}$$

$$\therefore CA = ₹\ 9,80,000$$

WN-2: Calculation of Inventory using Liquid Ratio

$$\text{Liquid Ratio} = \frac{\text{CA- Inventory}}{CL}$$

$$2 = \frac{₹\ 9,80,000 - \text{Inventory}}{₹\ 2,80,000}$$

$$\therefore \text{Inventory} = ₹\ 4,20,000$$

WN-3: Calculation of Cash & Bank balance using Cash Asset Ratio

Cash asset ratio is nothing but just the cash ratio of the company

$$\text{Cash ratio} = \frac{\text{Cash \& Cash Equivalents + Marketable securities}}{\text{CL}}$$

$$0.36 = \frac{\text{Cash \& Cash Equivalents + 0}}{₹\ 2{,}80{,}000}$$

∴ Cash & Cash Equivalents = ₹ 1,00,800

WN-4: Calculation of Sales using Inventory turnover ratio

$$\text{Inventory turnover ratio} = \frac{\text{COGS}}{₹\ \text{Avg Inventory}}$$

$$\text{Avg Inventory} = \frac{\text{Opening + Closing}}{2}$$

Now, let the opening inventory be 'x' and as mentioned closing inventory would be 20% more than the opening inventory i.e. 1.2x

$$\therefore \text{Opening inventory} = \frac{₹\ 4{,}20{,}000 \times x}{(1.2x)}$$

∴ Opening inventory = ₹ 3,50,000

$$\therefore \text{Avg Inventory} = \frac{₹\ 4{,}20{,}000 + ₹\ 3{,}50{,}000}{2}$$

∴ Avg Inventory = ₹ 3,85,000

Now, using inventory turnover ratio

$$6 = \frac{\text{COGS}}{₹\ 3{,}85{,}000}$$

∴ COGS = ₹ 23,10,000

Sales = COGS + GP

x = ₹ 23,10,000 + 0.20x

∴ Sales = ₹ 28,87,500

WN-5: Calculation of Receivables using Receivables collection period

Receivables Collection Period $= \frac{\text{Receivables}}{\text{Credit Sales}} \times 360$

30 $= \frac{\text{Receivables}}{₹\ 28,87,500} \times 360$

∴ Receivables = ₹ 2,40,625

WN-6: Calculation of Short-term Advances

Current Assets = Inventory + Receivables + Cash & Cash equivalents + Short term advances

₹ 9,80,000 = ₹ 4,20,000 + ₹ 2,40,625 + ₹ 1,00,800 + x

∴ Short term advances = ₹ 2,18,575

WN-7: Calculation of Non-current Assets (Fixed asset) using non-current assets turnover ratio

Non-current asset turnover ratio = Sales / Non-current assets

0.80 $= \frac{₹\ 28,87,500}{x}$

∴ Non-current asset (Fixed assets) = ₹ 36,09,375

WN-8: Calculation of Net profit available for Equity shareholders using Equity dividend coverage ratio

Equity dividend coverage ratio $= \frac{\text{Net Profit for Equity shareholders}}{\text{Equity Dividend}}$

2.10 $= \frac{x}{₹\ 2,50,000}$

∴ Net Profit for Equity shareholders = ₹ 5,25,000

WN-9: Calculation of No of equity shares and amount of equity share capital

EPS $= \frac{\text{Net Profit for Equity shareholders}}{\text{No of equity shares}}$

3 $= \frac{₹\ 5,25,000}{x}$

∴ No of equity shares = ₹ 1,75,000

∴ Amount of Equity Share capital = 1,75,000 x ₹ 10 = ₹ 17,50,000

WN-10: Calculation of Reserves using Proprietary ratio

Proprietary Ratio $= \frac{\text{Proprietor's funds}}{\text{Total Assets}}$

Total assets = Non-current assets + Current Assets

= ₹ 36,09,375 + ₹ 9,80,000

= ₹ 45,89,375

0.72 $= \frac{\text{Proprietor's funds}}{₹\ 45,89,375}$

∴ Proprietor's funds = ₹ 33,04,350

∴ Reserves = ₹ 33,04,350 (-) ₹ 17,50,000

∴ Reserves = ₹ 15,54,350

Balance Sheet as of 31/03/2025

Liabilities	**Amount (₹)**	**Assets**	**Amount (₹)**
Equity Share Capital (Face Value ₹ 10) **(WN-9)**	17,50,000	Fixed Assets **(WN-7)**	36,09,375
Reserves **(WN-10)**	15,54,350	Receivables **(WN-5)**	2,40,625
Long term Debentures **(Bal. figure)**	10,05,025	Inventory **(WN-2)**	4,20,000
Current Liabilities	2,80,000	Cash & Bank balance **(WN-3)**	1,00,800
		Short term advances **(WN-6)**	2,18,575
TOTAL	**45,89,375**	**TOTAL**	**45,89,375**

(b) **Internal Rate of Return:** It is that rate at which discounted cash inflows are equal to the discounted cash outflows. In other words, it is the rate which discounts the cash flows to zero. It can be stated in the form of a ratio as follows:

$$\frac{\text{Cash inflows}}{\text{Cash Outflows}} = 1$$

This rate is to be found by trial and error method. This rate is used in the evaluation of investment proposals. In this method, the discount rate is not known but the cash outflows and cash inflows are known.

In evaluating investment proposals, internal rate of return is compared with a required rate of return, known as cut-off rate. If it is more than cut-off rate the project is treated as acceptable; otherwise project is rejected.

4. (a) (i) **Sales and Lease Back:** Under this type of lease, the owner of an asset sells the asset to a party (the buyer), who in turn leases back the same asset to the owner in consideration of a lease rentals. Under this arrangement, the asset is not physically exchanged but it all happen in records only. The main advantage of this method is that the lessee can satisfy himself completely regarding the quality of an asset and after possession of the asset convert the sale into a lease agreement.

Under this transaction, the seller assumes the role of lessee (as the same asset which he has sold came back to him in the form of lease) and the buyer assumes the role of a lessor (as asset purchased by him was leased back to the seller). So, the seller gets the agreed selling price and the buyer gets the lease rentals.

(ii) **Leveraged Lease:** Under this lease, a third party is involved besides lessor and the lessee. The lessor borrows a part of the purchase cost (say 80%) of the asset from the third party i.e., lender and asset so purchased is held as security against the loan. The lender is paid off from the lease rentals directly by the lessee and the surplus after meeting the claims of the lender goes to the lessor. The lessor is entitled to claim depreciation allowance.

(iii) **Sales-Aid Lease:** Under this lease contract, the lessor enters into a tie up with a manufacturer for marketing the latter's product through his own leasing operations, it is called a sales-aid lease. In consideration of the aid in sales, the manufacturer may grant either credit or a commission to the lessor. Thus, the lessor earns from both sources i.e. from lessee as well as the manufacturer.

(iv) **Close-Ended and Open-Ended Leases:** In the close-ended lease, the assets get transferred to the lessor at the end of lease, the risk of obsolescence, residual value etc., remain with the lessor being the legal owner of the asset. In the open-ended lease, the lessee has the option of purchasing the asset at the end of the lease period.

(b) Features of Debentures or Bonds:

(i) Face Value: Debentures or bonds are denominated with some value, this denominated value is called face value of the debenture. Interest is calculated on the face value of the debenture. E.g. if a company issue 9% non- convertible debentures of ₹100 each, this means the face value is ₹ 100 and the interest @ 9% will be calculated on this face value.

(ii) Interest (Coupon) Rate: Each debenture bears a fixed interest (coupon) rate (except Zero coupon bond and Deep discount bond). Interest (coupon) rate is applied to face value of debenture to calculate interest, which is payable to the holders of debentures periodically (annually, semi-annually, etc.).

(iii) Maturity period: Debentures or Bonds has a fixed maturity period for redemption. However, in case of irredeemable debentures maturity period is not defined and it is taken as infinite.

(iv) Redemption Value: Redeemable debentures or bonds are redeemed on its specified maturity date. Based on the debt covenants, the redemption value is determined. Redemption value may vary from the face value of the debenture.

(v) Benefit of tax shield: The payment of interest to the debenture holders are allowed as expenses for the purpose of corporate tax determination. Hence, interest paid to the debenture holders save the tax liability of the company. Saving in the tax liability is also known as tax shield.

(c) Conflict in Profit versus Wealth Maximization Principle of the Firm: Profit maximisation is a short-term objective and cannot be the sole objective of a company. It is at best a limited objective. If profit is given undue importance, a number of problems can arise like the term profit is vague, profit maximisation has to be attempted with a realisation of risks involved, it does not take into account the time pattern of returns and as an objective it is too narrow.

Whereas, on the other hand, wealth maximisation, as an objective, means that the company is using its resources in a good manner. If the share value is to stay high, the company has to reduce its costs and use the resources properly. If the company follows the goal of wealth maximisation, it means that the company will promote only those policies that will lead to an efficient allocation of resources.

OR

(c) It is a situation where a firm has more capital than it needs or in other words assets are worth less than its issued share capital, and earnings are insufficient to pay dividend and interest. This situation mainly arises when the existing capital is not effectively utilized on account of fall in earning capacity of the company while company has raised funds more than its requirements. The chief sign of over-capitalisation is the fall in payment of dividend and interest leading to fall in value of the shares of the company.

PAPER 6B: STRATEGIC MANAGEMENT

ANSWERS

PART I

1. (A)	**(i)**	**(c)**	**(ii)**	**(c)**	**(iii)**	**(c)**	**(iv)**	**(c)**	**(v)**	**(b)**	
(B)	**(i)**	**(b)**	**(ii)**	**(a)**	**(iii)**	**(b)**					

PART II PART II – Descriptive Questions

1. (a) The **Key Success Factors (KSFs)** for ABC Tech include:

- **Product Innovation:** Superior battery life, camera quality, and seamless software integration are crucial attributes influencing customer choice.
- **Cost Efficiency:** Optimizing the supply chain ensures competitive pricing and higher profit margins.
- **Customer Experience:** High-quality customer service builds brand loyalty and differentiation.

To gain a sustainable competitive advantage, ABC Tech should:

1. **Focus on continuous R&D** to introduce advanced features that set its products apart.
2. **Streamline its supply chain** to maintain cost leadership while ensuring product quality.
3. **Enhance customer engagement** through superior after-sales service and ecosystem integration.

By excelling in these KSFs, ABC Tech can establish a distinct market position and outperform competitors in the long run.

(b) Michael Porter's Generic Strategies framework includes **Cost Leadership, Differentiation, and Focus Strategies**. Based on the caselet:

1. **EcoTrend – Differentiation Focus Strategy**
    - Targets a niche market (**environmentally conscious consumers**) with **premium, eco-friendly products**.
    - Gains a competitive advantage through **product uniqueness and sustainability**.

2. **BudgetBazaar – Cost Leadership Strategy**
    - Focuses on **offering the lowest prices** by optimizing costs and streamlining operations.
    - Gains a competitive advantage through **operational efficiency and economies of scale**.
3. **VogueVista – Differentiation Strategy**
    - Differentiates itself with **exclusive, fashion-forward designs** that appeal to style-conscious customers.
    - Gains a competitive advantage through **unique product offerings and strong brand image**.

Each company applies a distinct **generic strategy** to establish a strong position in the market.

(c) To ensure a successful digital transformation, *Nexora Innovations* should adopt the following change management strategies:

1. **Begin at the Top:** Leadership must demonstrate commitment, clearly communicate the benefits of the change, and promotes a culture that embraces transformation.
2. **Ensure the Change is Necessary and Desired:** The company should explain the long-term benefits of the cloud-based system and address employees' concerns about job security.
3. **Reduce Disruption:**
    - Communicate the transition **early** and set expectations.
    - Provide **proper training and resources** to help employees adapt.
    - Empower **change agents** (team leaders, project managers) to guide employees through the process.
4. **Encourage Communication:** Establish **open feedback channels** where employees can voice concerns and seek assistance. Regular updates will keep everyone aligned with the transformation goals.
5. **Recognize Change as a Continuous Process:** Instead of a one-time project, digital transformation should be seen as **an ongoing adaptation** where employees are encouraged to develop a mindset of continuous learning and improvement.

By implementing these strategies, *Nexora Innovations* can overcome resistance, enhance adoption, and maximize the benefits of its digital transformation initiative.

2. **(a)** Currently, **NovaTech Pvt. Ltd.** operates in the **educational technology industry**, offering digital learning solutions. However, its management has decided to expand into an entirely different sector by launching **GlowNova, a luxury skincare brand.** Since there is no connection between their existing EdTech business and the new skincare venture in terms of **customer groups, customer needs, or technologies used,** NovaTech Pvt. Ltd. has opted for **conglomerate diversification.**

In **conglomerate diversification**, a company expands into a completely unrelated industry where its new products or services have no direct link to its existing business. There is no overlap in technology, market, or product functions. This type of diversification helps companies **spread risk, enter new markets, and explore new revenue streams.**

NovaTech Pvt. Ltd.'s decision to launch a skincare brand while operating in the EdTech sector demonstrates a strategic move toward unrelated diversification, allowing the company to tap into an entirely different consumer market.

(b) Business **Environment** refers to the external factors, influences, and conditions that impact a business's decisions, strategies, and operations. In Aarav's case, the business environment includes the evolving consumer preferences, government policies, and market dynamics in Pune, which will play a crucial role in shaping his organic food brand's strategy.

Benefits of Interaction with the Business Environment

- **Determine Opportunities and Threats:** Aarav can assess market demand for organic products, emerging health trends, and regulatory frameworks. This will help him identify potential opportunities for expansion and anticipate challenges such as competition and supply chain disruptions.
- **Give Direction for Growth:** By understanding consumer behavior and industry trends, Aarav can align his business with the growing demand for organic and sustainable food options. This insight will help him expand strategically and introduce innovative product offerings.
- **Continuous Learning:** Regular engagement with the business environment will encourage Aarav and his team to stay updated with **nutrition trends, technological advancements in food processing, and changing consumer preferences.** This knowledge will help them remain competitive and adapt to industry shifts effectively.
- **Image Building:** Responding to environmental and social expectations, such as **sustainable sourcing, eco-friendly packaging, and ethical farming practices**, will enhance the brand's reputation. A socially

responsible business is more likely to attract loyal customers and gain market trust.

- **Meeting Competition:** Aarav can analyze competitors' strategies and differentiate his brand through **unique selling propositions (USPs), better distribution networks, or customer engagement initiatives.** Understanding the competitive landscape will enable him to position his business effectively and stay ahead in the market.

By actively interacting with the business environment, Aarav can leverage opportunities, mitigate risks, and build a sustainable, customer-centric organic food brand in Pune.

3. (a) According to C.K. Prahalad and Gary Hamel, major core competencies are identified in three areas - competitor differentiation, customer value, and application to other markets.

- **Competitor differentiation:** The company can consider having a core competence if the competence is unique and it is difficult for competitors to imitate. This can provide a company an edge compared to competitors. It allows the company to provide better products or services to market with no fear that competitors can copy it.
- **Customer value:** When purchasing a product or service it has to deliver a fundamental benefit for the end customer in order to be a core competence. It will include all the skills needed to provide fundamental benefits. The service or the product has to have real impact on the customer as the reason to choose to purchase them. If customer has chosen the company without this impact, then competence is not a core competence.
- **Application of competencies to other markets:** Core competence must be applicable to the whole organization; it cannot be only one particular skill or specified area of expertise. Therefore, although some special capability would be essential or crucial for the success of business activity, it will not be considered as core competence, if it is not fundamental from the whole organization's point of view. Thus, a core competence is a unique set of skills and expertise, which will be used throughout the organisation to open up potential markets to be exploited.

(b) The statement *"Innovation leads to unnecessary expenses that do not give as many returns"* is often debated, but evidence strongly suggests that innovation is crucial for long-term business growth and success. I **disagree** with the statement for several reasons:

Innovation offers the following for a business to grow long term:

- **Helps to solve complex problems:** A business strives to find opportunities in existing problems of society, and it does so through planned innovation in areas of expertise. This guided innovation helps solve complex problems by developing customer centric sustainable solutions.
- **Increases productivity:** Innovation leads to simplification and in most cases automation of existing tasks. Companies are willing to spend millions on increasing their productivity. Innovation, by automating repetitive tasks and simplifying the long chain of processes, adds to productivity of teams and thereby the organization as a whole.
- **Gives competitive advantage:** Being ahead of competition is a need and businesses spend majority of their strategic time building solutions to achieve this advantage. The faster a business innovates, the farther it goes from its competitor's reach. Innovative products need less marketing as they aim to provide added satisfaction to consumers, thus creating a competitive advantage. Innovation not only helps retain its existing customers but helps acquire new ones with ease too.

4. (a) Although inextricably linked, strategy implementation is fundamentally different from strategy formulation. Summarized are the key distinctions between strategy formulation and strategy implementation:

Strategy Formulation Vs. Strategy Implementation

Strategy Formulation	Strategy Implementation
Strategy Formulation includes planning and decision-making involved in developing organization's strategic goals and plans.	Strategy Implementation involves all those means related to executing strategic plans.
In short, Strategy Formulation is **placing the forces before the action**.	In short, Strategy Implementation is **managing forces during the action**.
An **entrepreneurial activity** based on strategic decision-making.	An **administrative task** based on strategic and operational decisions.
Emphasizes on **effectiveness**.	Emphasizes on **efficiency**.
Primarily an **intellectual and rational process**.	Primarily an **operational process**.
Requires co-ordination among few individuals at the top level.	Requires co-ordination among many individuals at the middle and lower levels.

Requires a great deal of **initiative, logical skills, conceptual intuitive and analytical skills.**	Requires specific **motivational and leadership traits**.
Strategic Formulation precedes Strategy Implementation.	Strategy Implementation follows Strategy Formulation.

(b) A strategic vision serves as a roadmap for a company's future, detailing the specifics of technology, customer focus, geographic and product markets, and the capabilities the organization aims to develop. It answers the critical question, "Where are we going?" and provides a compelling rationale for the chosen direction, ensuring it aligns with the company's long-term objectives.

A strategic vision outlines the organization's aspirations, offering a broad, panoramic view of where it aims to be. It provides clear direction, charts a strategic path for future endeavors, and helps in shaping the organizational identity.

Essentials of a strategic vision

- The entrepreneurial challenge in developing a strategic vision is **to think creatively about how to prepare a company for the future.**
- Forming a strategic vision is **an exercise in intelligent entrepreneurship**.
- A well-articulated strategic vision **creates enthusiasm among the members of the organization.**

The best-worded vision statement **clearly illuminates the direction** in which the organization is headed.

OR

The vision describes a future identity while the Mission serves as an on-going and time-independent guide.

The vision statement can galvanize the people to achieve defined objectives, even if they are stretch objectives, provided the vision is specific, measurable, achievable, and relevant and time bound. A mission statement provides a path to realize the vision in line with its values. These statements have a direct bearing on the bottom line and success of the organization.

A mission statement defines the purpose or broader goal for being in existence or in the business and can remain the same for decades if crafted well while a vision statement is more specific in terms of both the future state and the time frame. Vision describes what will be achieved if the organization is successful.