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INTERMEDIATE: GROUP – II

PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A : FINANCIAL MANAGEMENT

Suggested Answers/ Hints

DIVISION A

(i) (b) ₹ (53,365)

Warehouse Baton (5-year life)

Straight-Line Depreciation

$$\text{Depreciation} = \frac{40,00,000 - 4,00,000}{5} = ₹\ 7,20,000$$

After-Tax Cash Flows

Year (1)	Savings (2)	Maintenance (3)	Depreciation (4)	Taxable Income (5)	After-tax Profit (6)	Cash Inflow (7) (6+4)	Present Value@10% (8)
1	12,00,000	0	7,20,000	4,80,000	3,36,000	10,56,000	9,59,904
2	14,00,000	0	7,20,000	6,80,000	4,76,000	11,96,000	9,88,374
3	10,00,000	5,00,000	7,20,000	- 2,20,000	- 1,54,000	5,66,000	4,25,236
4	10,00,000	0	7,20,000	2,80,000	1,96,000	9,16,000	6,25,628
5	13,00,000	0	7,20,000	5,80,000	4,06,000	11,26,000	6,99,133
5	4,00,000						2,48,360
						Total	**₹ 39,46,635**

Net Present Value (NPV)

NPV = −40,00,000 + 39,46,635 = ₹ (53,365)

(ii) (b) ₹ (14077)

Equivalent Annual Cost (EAC)

$$\frac{\text{NPV}}{\text{PVIFA}(10,5)} = \frac{(53,365)}{3.791} = ₹\ (14077)$$

(iii) (a) ₹ (41,667)

Warehouse Katon (8-year life)

Straight-Line Depreciation

$$\text{Depreciation} = \frac{60,00,000 - 6,50,000}{8} = ₹\ 6,68,750 \text{ per year}$$

After-Tax Cash Flows

Year (1)	Savings (2)	Maintenance (3)	Depreciation (4)	Taxable Income (5)	After-tax Profit (6)	Cash Inflow (7) (6+4)	Present Value@10% (8)
1	10,00,000	0	6,68,750	3,31,250	2,31,875	9,00,625	8,18,668
2	10,00,000	0	6,68,750	3,31,250	2,31,875	9,00,625	7,44,277
3	15,00,000	0	6,68,750	8,31,250	5,81,875	12,50,625	9,39,595
4	15,00,000	2,00,000	6,68,750	6,31,250	4,41,875	11,10,625	7,58,557
5	15,00,000	0	6,68,750	8,31,250	5,81,875	12,50,625	7,76,513
6	15,00,000	0	6,68,750	8,31,250	5,81,875	12,50,625	7,05,853
7	12,00,000	3,00,000	6,68,750	2,31,250	1,61,875	8,30,625	4,26,194
8	12,00,000		6,68,750	5,31,250	3,71,875	10,40,625	4,85,452
8	6,50,000						3,03,225
	Total						₹ 59,58,334

Net Present Value (NPV)

NPV=− 60,00,000 + 59,58,334

= ₹ (41,667)

(iv) (a) ₹ (7,810)

Equivalent Annual Cost (EAC)

$$\frac{\text{NPV}}{\text{PVIFA}(10,8)} = \frac{(41,667)}{5.335} = ₹\ (7,810)$$

(v) (b) Conclusion and Recommendation:

Warehouse	NPV (₹)	EAC (₹)
Baton	(53,365)	(14,071)
Katon	(41,667)	(7810)

From the above, it can be concluded that warehouse Katon should be chosen as it has the lower Equivalent Annual Cost, despite having higher upfront costs.

(vi) (b) 100%

Let original equity = ₹ 100

Then, original debt = ₹ 200 (since D/E = 2:1)

Let new equity raised = ₹x

So, revised equity = ₹ 100 + ₹x

Debt remains ₹ 200 (as only equity is raised)

New D/E = 1:1

So, $\frac{200}{100 + x} = 1$

Or 100 + x = 200

Or x = 200 – 100 = 100

Percentage increase in equity

$= \frac{100}{100} \times 100 = 100\%$

(vii) (d) ₹ 1,26,06,000

Average level of Receivables	₹ 6,00,00,000 x 90/360 = ₹1,50,00,000
Factoring Commission	₹ 1,50,00,000 x 2% = ₹ 3,00,000
Factoring Reserve	₹ 1,50,00,000 x 10% = ₹ 15,00,000
Amount available in advance	₹ 1,50,00,000 – (₹ 3,00,000 + ₹ 15,00,000) = ₹ 1,32,00,000
Factor will deduct interest @ 18%	
So, Interest	₹ 1,32,00,000 x 18/100 x 90/360 = 5,94,000
Hence, advance to be paid	₹ 1,32,00,000 - 5,94,000 = ₹ 1,26,06,000

(viii) (d) 10.25%

As per the Dividend Discount Model (DDM):

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

Where:

D0 = ₹ 10 (just paid dividend)

g = 5%

So, D1 = D0 × (1+g) = 10 × 1.05 = ₹ 10.50

P0 = ₹ 200

Now,

$$Ke = \frac{10.50}{200} + g$$

= 0.0525 + 0.05 = 0.1025 or 10.25%

Division B: Descriptive Question

1. (a) (i) Market Price Per Share using Walter's Model

Walter's Model Formula:

$$P = \frac{\left[D + \left(r / Ke\right) \times \left(E - D\right)\right]}{Ke}$$

Option A: 100% payout (D = ₹ 5)

$$P = \frac{[5 + \left(15\% / 12\%\right) \times \left(5 - 5\right)]}{0.12} = ₹\ 41.67$$

Option B: 50% payout (D = ₹ 2.5)

$$P = \frac{[2.5 + \left(15\% / 12\%\right) \times \left(5 - 2.5\right)]}{0.12} = ₹\ 72.92$$

Option C: 0% payout (D = ₹ 0)

$$P = \frac{[0 + \left(15\% / 12\%\right) \times 5]}{0.12} = ₹\ 104.17$$

Since the company earns more on retained earnings (r > Ke), lower payout leads to higher market price per share.

(ii) Feasibility of Funding ₹ 12,00,000 Investment Internally

Investment Requirement = ₹ 12,00,000

EAT = ₹ 10,00,000

Retained earnings depend on payout ratio.

The present situation can be summarized in the following table:

Option	Retained Earnings (₹)	Shortfall (₹)	Feasibility
100% payout	0	12,00,000	Feasible
50% payout	5,00,000	7,00,000	Feasible
0% payout	10,00,000	2,00,000	Feasible

(iii) Revised Debt-Equity Ratio (if 50% payout is chosen)

Existing Equity = ₹ 50,00,000

Existing Debt = 0.5 × ₹ 50,00,000 = ₹ 25,00,000

New Equity (post-retention): ₹ 55,00,000

New Debt (after ₹ 7,00,000 borrowing): ₹ 32,00,000

Revised debt-equity Ratio = ₹ 32,00,000 / ₹55,00,000 = 0.582

It is well within the 1:1 cap.

(iv) Recommendation

0% payout is the best option as it has the highest market price which increases shareholders wealth.

(b) Workings Notes:

(i) Computation of Current Assets & Current Liabilities & Total Assets

Net Working Capital = Current Assets – Current Liabilities = 2.5 – 1 = 1.5

$$\text{Thus, Current Assets} = \frac{\text{Net Working Capital} \times 2.5}{1.5}$$

$$= \frac{15,00,000 \times 2.5}{1.5} = ₹\ 25,00,000$$

Current Liabilities (CL) = ₹ 25,00,000 – ₹ 15,00,000 = ₹ 10,00,000

Total Assets = Current Assets + Fixed Assets

= ₹ 25,00,000 + ₹ 30,00,000 = ₹ 55,00,000

(ii) Computation of Sales & Cost of Goods Sold

Sales = Total Assets Turnover × Total Assets

= 2 x (55,00,000)

= ₹ 1,10,00,000

Cost of Goods Sold = (100% – 25%) of Sales = 75% of Sales

= 75% × ₹ 1,10,00,000 = ₹ 82,50,000

(iii) Computation of Stock & Quick Assets

$$\text{Average Stock} = \frac{\text{Cost of Good Sold}}{\text{Stock Turnover Ratio}} = \frac{82,50,000}{5}$$

= ₹ 16,50,000

Closing Stock = (Average Stock × 2) – Opening Stock

= (₹ 16,50,000 × 2) – ₹ 16,00,000 = ₹ 17,00,000

Quick Assets = Current Assets – Closing Stock

= ₹ 25,00,000 – ₹ 17,00,000 = ₹ 8,00,000

(iv) Computation of Proprietary Fund

$$\text{Debt-Equity Ratio} = \frac{\text{Debt}}{\text{Equity}} = \frac{1}{2}$$

Or Equity = 2 Debt

Total Assets = Equity + Preference capital + Debt + CL

₹ 55,00,000 = 2 Debt + ₹ 6,00,000 + Debt + ₹ 10,00,000

3 Debt = 55,00,000 – 6,00,000 - 10,00,000

= 39,00,000

Debt = 13,00,000

Equity = ₹ 13,00,000 × 2 = ₹ 26,00,000

So, Proprietary Fund = Equity + Preference Capital = ₹ 26,00,000 + ₹ 6,00,000 = ₹ 32,00,000

(v) **Computation of Profit after tax (PAT)** = Total Assets × Return on Total Assets

= ₹ 55,00,000 × 15% = ₹ 8,25,000

Calculation of Ratios:

(a) **Quick Ratio**

$$\text{Quick Ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities}} = \frac{8,00,000}{10,00,000} = 0.8$$

(b) **Fixed Assets Turnover Ratio**

$$\text{Fixed Assets Turnover Ratio} = \frac{\text{Sales}}{\text{Fixed Assets}} = \frac{1,10,00,000}{30,00,000}$$

$$= 3.67$$

(c) **Proprietary Ratio**

$$\text{Proprietary Ratio} = \frac{\text{Proprietary fund}}{\text{Total Assets}} = \frac{32,00,000}{55,00,000} = 0.58$$

(d) **Earnings per Equity Share (EPS)**

$$\text{Earnings per Equity Share} = \frac{\text{PAT - Preference Share Dividend}}{\text{Number of Equity Shares}}$$

$$= \frac{8,25,000 - 60,000\ (10\% \text{ of } 6,00,000)}{1,80,000} = ₹\ 4.25 \text{ per share}$$

(c) **Working Notes:**

1. **Raw Material Storage Period (R)**

$$\frac{\text{Average Stock of Raw Material}}{\text{Annual Consuption of Raw Material}} \times 365$$

$$\frac{\frac{585 + 845}{2}}{4,940} \times 365 = 52.83 \text{ or } 53 \text{ days}$$

Annual Consumption of Raw Material = Opening Stock + Purchases - Closing Stock

= ₹ 585 + ₹ 5,200 – ₹ 845 = ₹ 4,940 lakh

2. **Work – in - Progress (WIP) Conversion Period (W)**

$$= \frac{\text{Average Stock of WIP}}{\text{Annual Cost of Production}} \times 365$$

$$= \frac{\frac{455 + 663}{2}}{5,850} \times 365 = 34.87 \text{ or } 35 \text{ days}$$

3. **Finished Stock Storage Period (F)**

$$= \frac{\text{Average Stock of Finished Goods}}{\text{Cost of Goods Sold}} \times 365$$

$$= \frac{\frac{780 + 910}{2}}{6,825} \times 365 = 45.19 \text{ or } 45 \text{ days.}$$

4. **Receivables (Debtors) Collection Period (D)**

$$= \frac{\text{Average Receivables}}{\text{Annual Credit Sales}} \times 365$$

$$= \frac{\frac{1,456 + 1,755}{2}}{7,605} \times 365 = 77.06 \text{ or } 77 \text{ days}$$

5. **Payables (Creditors) Payment Period (C)**

$$= \frac{\text{Average Payables for Materials}}{\text{Annual Credit Purchases}} \times 365$$

$$= \frac{\frac{884 + 923}{2}}{5,200} \times 365 = 63.42 \text{ or } 63 \text{ days}$$

(i) Net Operating Cycle Period

= R + W + F + D - C

= 53 + 35 + 45 + 77 – 63 = 147 days

(ii) Number of Operating Cycles in the Year

$$= \frac{365}{\text{Operating Cycle Period}} = \frac{365}{147} = 2.48 \text{ times}$$

(iii) Amount of Working Capital Required

$$= \frac{\text{Annual Operating Cost}}{\text{Number of Operating Cycles}} = \frac{4,225}{2.48} = ₹\ 1,703.63 \text{ lakh}$$

Add: 10% Contingency Reserve = ₹ 170.363 lakh

Total Working Capital Requirement (including contingency) = ₹ 1,874 lakh

2. (a) Working Notes:

Contribution = DOL × EBIT = 2.5 × 20,00,000 = ₹ 50,00,000

$$\text{Sales} = \frac{\text{Contribution}}{\text{Contribution Margin Ratio}} = \frac{50,00,000}{0.40} = ₹\ 1,25,00,000$$

Calculation of Current Assets and Current Liabilities

Let Current Liabilities be X

Then, 2X - X = 20,00,000

So, Current Liabilities = ₹ 20,00,000

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Current Assets = 2 Current Liabilities

So, Current Assets = ₹ 20,00,000 x 2 = ₹ 40,00,000

Calculation of Fixed Assets

Sales = ₹ 1,25,00,000

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

So, Fixed Assets = ₹ 1,25,00,000/3 = ₹ 41,66,667

(1) Income Statement for the Financial Year ended 2025

Particulars	Amount (₹)
Sales	1,25,00,000

Less: Variable Costs @ 60%	75,00,000
Contribution	50,00,000
Less: Fixed Costs (b.f.)	30,00,000
EBIT	20,00,000
Less: Interest	5,00,000
EBT	15,00,000
Less: Tax (30%)	4,50,000
EAT	10,50,000
EPS (10,50,000/1,00,000)	₹ 10.50

Balance Sheet as at Year 2025

Liabilities	**₹**	**Assets**	**₹**
Equity Capital	10,00,000	Fixed Assets	41,66,667
Retained Earnings	10,00,000	Current Assets	40,00,000
12% Debentures	41,66,667		
Current Liabilities	20,00,000		
	81,66,667		**81,66,667**

(2) Calculation of EPS in each option under expansion plan

Post-Expansion Financials (2026)

Sales = 1,25,00,000 + 50,00,000

= ₹ 1,75,00,000

Variable Cost (55%) = 1,75,00,000 x 55% = ₹ 96,25,000

Contribution = ₹ 78,75,000

Fixed Costs = ₹ 30,00,000 + ₹ 10,00,000

= ₹ 40,00,000

EBIT = ₹ 38,75,000

Particulars	**Equity Option**	**Debt Option**
EBIT	38,75,000	38,75,000
Interest (old)	5,00,000	5,00,000
Interest (new)	-	3,00,000
EBT	33,75,000	30,75,000

Tax@30%	10,12,500	9,22,500
EAT	23,62,500	21,52,500
No. of Shares	3,50,000	1,00,000
EPS	6.75	21.525

(3) Calculation of Operating Leverage, Financial Leverage and Combined Leverage for each option under expansion plan

	2025	Equity Option (2026)	Debt Option (2026)
EPS	₹ 10.50	₹ 6.75	₹ 21.525
Operating Leverage = $\frac{\text{Contribution}}{\text{EBIT}}$	2.5	= $\frac{78,75,000}{38,75,000}$ = 2.03	= $\frac{78,75,000}{38,75,000}$ = 2.03
Financial Leverage = $\frac{\text{EBIT}}{\text{EBT}}$	1.333	= $\frac{38,75,000}{33,75,000}$ = 1.15	= $\frac{38,75,000}{30,75,000}$ = 1.26
Combined Leverage = OL x FL	3.333	= 2.03 x 1.15 = 2.33	= 2.03 x 1.26 = 2.56

(4) Recommendation of the best financing option

Debt financing results in a higher EPS of ₹ 21.525 and offer better returns to shareholders. Though financial risk increases slightly, the leverage ratios remain within manageable limits. Therefore, if the company is confident in its ability to generate stable cash flow, debt financing is the better option.

(b) The venture capital financing refers to financing of new high risky venture promoted by qualified entrepreneurs who lack experience and funds to give shape to their ideas. In broad sense, under venture capital financing, venture capitalist make investment to purchase equity or debt securities from inexperienced entrepreneurs who undertake highly risky ventures with potential to succeed in future.

Some of the characteristics of Venture Capital financing are:

(i) It is basically an equity finance in new companies.

(ii) It can be viewed as a long-term investment in growth-oriented small/medium firms.

(iii) Apart from providing funds, the investor also provides support in the form of sales strategy, business networking and management expertise, enabling the growth of the entrepreneur.

3. (a) (i) Calculation of Cost of Convertible Debentures:

Given that,

$R_f = 8\%$

$R_m - R_f = 16\%$

$\beta = 1.20$

$D_0 = 13.38$

Dividend 5 years ago = ₹ 10

Flotation Cost = 6%

Using CAPM,

$K_e = R_f + \beta (R_m - R_f)$

$= 8\% + 1.20 (16\%)$

$= 27.20\%$

Calculation of growth rate in dividend

$13.38 = 10 (1+g)^5$

$1.338 = (1+g)^5$

$g = 6\%$

Price of share after 6 years = $\frac{D_7}{k_e - g} = \frac{13.38 (1.06)^7}{0.272 - 0.06}$

$P_6 = \frac{13.38 \times 1.504}{0.212} = 94.92$

Redemption Value of Debenture (RV) = 94.92 × 2 = 189.84 (RV)

NP = 94

n = 6

$$K_d = \frac{Int(1-t) + \left(\frac{RV - NP}{n}\right)}{\frac{(RV - NP)}{2}} \times 100$$

$$= \frac{15(1-0.4) + \left(\frac{189.84 - 94}{6}\right)}{\frac{(189.84 + 94)}{2}} \times 100$$

$$= \frac{9 + 15.97}{141.92} x 100$$

K_d = 17.59%

(ii) Calculation of Cost of Preference Shares:

Net Proceeds = 100 (1.1) - 5% of 100 (1.1)

= 110 – 5.50

= 104.50

Redemption Value = 100

Year	Cash Flows (₹)	PVF @ 3%	PV (₹)	PVF @ 5%	PV (₹)
0	104.50	1	104.50	1	104.50
1-10	-5	8.530	-42.65	7.722	-38.61
10	-100	0.744	-74.40	0.614	-61.40
			-12.55		**4.49**

$$K_p = 3\% + \frac{5\% - 3\%}{[(-12.55) - 4.49]} x - 12.55$$

$$= 3\% + \frac{2\%}{17.04} x 12.55$$

K_p = 4.4730%

(b) (i) Assuming no tax as per MM Approach

Calculation of Value of Firms 'A Ltd.' and 'B Ltd' according to MM Hypothesis

Market Value of 'B Ltd' [Unlevered(u)]

Total Value of Unlevered Firm (Vu) = [NOI/ke] = 19,00,000/0.19 = ₹ 1,00,00,000

Ke of Unlevered Firm (given) = 0.19

Ko of Unlevered Firm (Same as above = Ke as there is no debt) = 0.19

Market Value of 'A Ltd' [Levered Firm (I)]

Total Value of Levered Firm (VL) = Vu + (Debt× Nil)

= ₹ 1,00,00,000 + (57,00,000 × nil)

= ₹1,00,00,000

Computation of Equity Capitalization Rate and

Weighted Average Cost of Capital (WACC)

	Particulars	A Ltd.	B Ltd.
A.	Net Operating Income (NOI)	₹ 19,00,000	₹ 19,00,000
B.	Less: Interest on Debt (I)	₹ 6,84,000	-
C.	Earnings of Equity Shareholders (NI)	₹ 12,16,000	₹ 19,00,000
D	Overall Capitalization Rate (ko)	0.19	0.19
E	Total Value of Firm (V = NOI/ko)	₹ 1,00,00,00	₹ 1,00,00,000
F	Less: Market Value of Debt (D)	₹ 57,00,000	-
G	Market Value of Equity (S)	₹ 43,00,000	₹ 1,00,00,000
H	Equity Capitalization Rate [ke = NI /S]	0.2828	0.19
I	Weighted Average Cost of Capital [WACC (ko)]*ko = (ke×S/V) + (kd×D/V)	0.19	0.19

*Computation of WACC A Ltd.

Component of Capital	Amount	Weight	Cost of Capital	WACC
Equity	₹ 43,00,000	0.43	0.2828	0.1216
Debt	₹ 57,00,000	0.57	0.12*	0.0684
Total	₹ 1,00,00,000			0.19

*Kd = 12% (since there is no tax)

WACC = 19%

(ii) Assuming 40% taxes as per MM Approach

Calculation of Value of Firms 'A Ltd.' and 'B Ltd' according to MM Hypothesis

Market Value of 'B Ltd' [Unlevered(u)]

Total Value of unlevered Firm (Vu) = [NOI (1 - t)/ke]

= 19,00,000 (1 – 0.40)] / 0.19 = ₹ 60,00,000

Ke of unlevered Firm (given) = 0.19

Ko of unlevered Firm (Same as above = Ke as there is no debt) = 0.19

Market Value of 'A Ltd' [Levered Firm (I)]

Total Value of Levered Firm (VL) = Vu + (Debt× Tax)

= ₹ 60,00,000 + (₹ 57,00,000 × 0.4) = ₹ 82,80,000

Computation of Weighted Average Cost of Capital (WACC) of 'B Ltd.'

= 19% (i.e. Ke = Ko)

Computation of Equity Capitalization Rate and

Weighted Average Cost of Capital (WACC) of A Ltd

Particulars	A Ltd. (₹)
Net Operating Income (NOI)	19,00,000
Less: Interest on Debt (I)	6,84,000
Earnings Before Tax (EBT)	12,16,000
Less: Tax @ 40%	4,86,400
Earnings for equity shareholders (NI)	7,29,600
Total Value of Firm (V) as calculated above	82,80,000
Less: Market Value of Debt	57,00,000
Market Value of Equity (S)	25,80,000
Equity Capitalization Rate [ke = NI/S]	0.2828
Weighted Average Cost of Capital (ko)* ko = (ke×S/V) + (kd×D/V)	13.77%

*Computation of WACC A Ltd.

Component of Capital	₹	Weight	Cost of Capital	WACC
Equity	25,80,000	0.312	0.2828	0.0882
Debt	57,00,000	0.688	0.072*	0.0495
Total	**82,80,000**			**0.1377**

*Kd = 12% (1- 0.4) = 12% × 0.6 = 7.2%

WACC = 13.77%

4. **(a)** While accumulating more inventories may increase the current ratio (Current Assets / Current Liabilities), it does not necessarily improve working capital efficiency. The reasons are as follows:

1. **Inefficient Use of Funds**: Increasing inventory ties up cash in unsold goods, which may lead to higher holding costs (storage, insurance, obsolescence).
2. **False Sense of Liquidity**: Inventory is a less liquid current asset compared to cash or receivables. A high current ratio driven by inventory does not ensure actual liquidity.
3. **Decline in Inventory Turnover**: More inventories may reduce the inventory turnover ratio, indicating poor inventory management.
4. **Risk of Obsolescence**: Excess stock might become obsolete, especially in fast-moving industries (e.g., technology, fashion), resulting in losses.
5. **Working Capital Efficiency Metrics**: Efficient working capital management focuses on optimizing the cash conversion cycle (CCC) not just boosting ratios. Stockpiling inventory may increase CCC, reducing efficiency.

Hence, it may be concluded that increasing inventory inflates the current ratio but harms working capital efficiency by locking funds in slow-moving assets. True efficiency comes from balancing liquidity with turnover, not simply increasing asset size.

(b) There are various factors like price of the product/ service, demand, price of inputs e.g. raw material, labour etc., which is to be managed by an organisation on a continuous basis. Proportion of debt also need to be managed by an organisation very delicately. Higher debt requires higher interest and if the cash inflow is not sufficient then it will put lot of pressure to the organisation. Both short term and long-term creditors will put stress to the firm. If all the above factors are not well

managed by the firm, it can create situation known as distress, so financial distress is a position where Cash inflows of a firm are inadequate to meet all its current obligations.

Now if distress continues for a long period of time, firm may have to sell its asset, even many times at a lower price. Further when revenue is inadequate to revive the situation, firm will not be able to meet its obligations and become insolvent. So, insolvency basically means inability of a firm to repay various debts and is a result of continuous financial distress.

(c) Preference shares are a hybrid financial instrument. They offer a fixed dividend (like debt), but the capital raised is considered part of the equity of the company. Holders of preference shares:

(i) Do not have voting rights in most cases (unlike equity shareholders).

(ii) Rank above equity shareholders in case of company liquidation, but below debt holders like debenture holders.

(iii) Are repaid after creditors but before equity holders, making them less risky than equity but riskier than debt.

OR

(c) Trade credit is a facility offered by suppliers that allows the buyer to purchase goods and services now and pay later, typically within 30 to 90 days. While it may appear essential for operations and cash flow, it is actually a form of short-term financing. It is:

(i) A part of working capital management.

(ii) Used to fund day-to-day operational needs.

(iii) Thus, not suitable or classified as a long-term source of finance.

PAPER 6B: STRATEGIC MANAGEMENT

ANSWERS

PART I

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

PART II – Descriptive Questions

1. (a) Values can be derived by analysing the vision and mission statements of an organisation, as they reflect the core beliefs that guide behaviour and decision-making. Based on the given scenario, the values of ABC Corporation can be inferred by aligning its strategic vision and mission with the concept of organizational values. ABC Corporation's emphasis on being at the forefront of technological advancements highlights **innovation** as a core value. Its commitment to developing **user-friendly** products reflects a strong **customer-centric approach** and user focus. The focus on **sustainability** demonstrates the company's concern for environmental responsibility and long-term societal impact. Additionally, its aim to **contribute positively to society** shows a commitment to **social responsibility** and **ethical conduct**. The fact that ABC is a **global technology company** also implies that values like **integrity** and **accountability** are essential to maintain stakeholder trust and global compliance. These values are central to how the company functions internally and how it presents itself externally to consumers and stakeholders. These values help shape employee behaviour, build consumer trust and provide a strong foundation for long-term success. Thus, the key values of ABC Corporation are **innovation, customer-centricity, sustainability, social responsibility, integrity and accountability** which collectively reflect the shared purpose and guiding principles of the organisation.

(b) To improve ZymaTech's competitive advantage, Mr. Anoj Dass would apply the five steps of understanding the competitive landscape as follows:

1. **Identify the competitors:** ZymaTech has already identified its three major competitors—HomeEdge, AutoNest and IntelliSpace. Data on their market share confirms they are significant players in the smart home industry.
2. **Understand the competitors:** Through market reports, online reviews, and competitor websites, Mr. Anoj Dass would assess each competitor's

product portfolio, pricing, market presence and customer feedback. This helps understand what they offer and how they position themselves.

3. **Determine the strengths of the competitors:** HomeEdge has strong brand loyalty—this makes it a premium and trusted choice. AutoNest's strength lies in affordability and an extensive distribution network. IntelliSpace leads in premium AI-driven innovations but faces service issues.

4. **Determine the weaknesses of the competitors:** IntelliSpace's weak post-sales service is a gap ZymaTech can exploit. AutoNest's lower product quality (not mentioned but inferred from low price) and HomeEdge's premium pricing could be other opportunities.

5. **Put all of the information together:** ZymaTech should improve its customer service, enhance brand visibility through digital campaigns and offer mid-range AI-integrated products to position itself between AutoNest's affordability and IntelliSpace's premium features. It should target the segment looking for quality and innovation at a reasonable price—thereby exploiting competitor gaps and strengthening its own capabilities.

(c) The corporate strategy adopted by ZephyrFit Pvt. Ltd. is a **Divestment Strategy**, which involves the sale or liquidation of a portion of business, or a major division, profit centre or strategic business unit (SBU). In this case, the company observed that certain regional wellness content, such as Kerala Ayurveda and Punjabi workouts, involved high costs and received low user engagement, making them financially unviable. As part of its restructuring plan, ZephyrFit decided to sell the rights to this content and halt further development in those areas.

A divestment strategy may be adopted when a business faces **persistent negative cash flows**, **severity of competition**, or when there is a **better alternative for investment**. These conditions are clearly evident in the case, as the company shifted focus to more popular and cost-effective wellness content. The characteristics of divestment strategy also highlight that such a move should be seen as an integral part of corporate strategy and not with stigma, especially when the goal is to restore overall business viability. Thus, the decision by ZephyrFit aligns with the principles and rationale of a divestment strategy.

2. (a) Each organization has to build its competitive advantage over the competitors in the business warfare in order to win. This can be done only by following the process of strategic management. Strategic Management is very important for the

survival and growth of business organizations in dynamic business environments. Other major benefits of strategic management are as follows:

- Strategic management helps organizations to be more proactive rather than reactive in dealing with its future. It facilitates to work within vagaries of environment and remains adaptable with the turbulence or uncertain future. Therefore, they are able to control their own destiny in a better way.
- It provides better guidance to entire organization on the crucial point – what it is trying to do. Also provides frameworks for all major business decisions of an enterprise such as on businesses, products, markets, organizational structures, etc.
- It facilitates to prepare the organization to face the future and act as pathfinder to various business opportunities. Organizations are able to identify the available opportunities and identify ways and means as how to reach them.
- It serves as a corporate defence mechanism against mistakes and pitfalls. It helps organizations to avoid costly mistakes in product market choices or investments.
- Over a period of time strategic management helps organization to evolve certain core competencies and competitive advantages that assist in the fight for survival and growth.

(b) Internationalization has become a pivotal trend for businesses aiming to enhance profitability and access cheaper resources. **It allows companies to explore new markets, achieve economies of scale, and prolong product lifecycles.** However, the process of internationalization is complex due to additional variables and linkages that differ from domestic operations.

To navigate this complexity, businesses should adopt a structured approach to international strategic planning. The steps involved include:

1. **Evaluate Global Opportunities and Threats:** Businesses must assess potential global markets, identify opportunities and threats while aligning them with their internal capabilities.
2. **Describe the Scope of Operations:** Clearly defining the extent of the firm's international commercial activities is crucial for focused strategy development.

3. **Create Global Business Objectives:** Establishing clear objectives helps guide the organization's international efforts and aligns with its overall mission.

4. **Develop Distinct Corporate Strategies:** Formulating specific strategies tailored for global operations ensures that the organization can effectively compete in diverse markets.

These steps facilitate the identification of market opportunities and the formulation of effective global strategies, enabling businesses to thrive in the international arena despite the inherent challenges and costs associated with such expansion.

3. (a) 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 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.

(b)

Strategic planning	Operational planning
Strategic planning shapes the organisation and its resources.	Operational planning deals with current deployment of resources.
Strategic planning assesses the impact of environmental variables.	Operational planning develops tactics rather than strategy.
Strategic planning takes a holistic view of the organisation.	Operational planning projects current operations into the future.
Strategic planning develops overall objectives and strategies.	Operational planning makes modifications to the business functions but not fundamental changes.
Strategic planning is concerned with the long-term success of the organisation.	Operational planning is concerned with the short-term success of the organisation.
Strategic planning is a senior management responsibility.	Operational planning is the responsibility of functional managers.

4. **(a)** Ansoff's Product Market Growth Matrix, developed by Igor Ansoff, is a strategic tool that helps businesses identify growth opportunities by analyzing the interplay between products and markets.

It offers four distinct strategies based on whether the products and markets are existing or new. These strategies are:

1. **Market Penetration**: Focuses on selling existing products in existing markets. This involves increasing market share by enhancing sales through advertising, promotions, competitive pricing, or encouraging higher usage among current customers.
2. **Market Development**: Entails selling existing products in new markets. This could involve exploring new geographical regions, utilizing alternative distribution channels, or creating new market segments.
3. **Product Development**: Involves introducing new or modified products into existing markets. This strategy often requires innovation and developing products that meet current market needs.

4. **Diversification**: Refers to marketing new products in new markets. It is a high-risk strategy as the business ventures into unfamiliar products and markets.

As market dynamics evolve, companies may transition between these strategies to adapt and sustain growth. The matrix provides a structured framework for businesses to align their growth strategies with their capabilities and market conditions.

(b) Any organisation may find the work of digital transformation challenging and overwhelming. To ensure that a digital transition is effective, change management is essential. Here are some pointers for navigating change during the digital transformation:

1. **Specify the digital transformation's aims and objectives:** What is the intended outcome? What are the precise objectives that must be accomplished? It will be easier to make sure that everyone is on the same page and pursuing the same aims if everyone has a clear grasp of their goals.
2. **Always, always, always communicate:** It might be challenging for people to accept change and adjust to it. Ensure that you routinely and honestly discuss the objectives of digital transformation and how they will affect stakeholders, including employees, clients, and other parties.
3. **Be ready for resistance:** Even when a change is for the better, it can be challenging for people to embrace it. Have a strategy in place for dealing with any resistance that may arise.
4. **Implement changes gradually:** Changes should ideally be implemented gradually rather than all at once. In order to avoid overwhelming individuals with too much change at once, this will give people time to become used to the new way of doing things.
5. **Offer assistance and training:** Workers will need guidance with the new procedures, software applications, etc.

In conclusion, effective completion of the massive project known as digital transformation depends on meticulous planning and change management. Digital transformation efforts are more likely to fail without change management. Organizations can successfully integrate a new digital system by planning for and managing the changes that must take place. Any project involving digital transformation must include it.

OR

Aarav Textiles Pvt. Ltd. is transitioning into a **network structure**, a modern and flexible organisational design. This structure is particularly suitable in times of uncertainty and disruption, such as during a global pandemic. Its essential features include:

1. It is sometimes called a "non-structure" as it eliminates many in-house functions and extensively **outsources** them.
2. Organisations adopting this model are often referred to as **"virtual organisations"**, comprising a set of project teams or external collaborations connected through non-hierarchical, web-like structures.
3. This structure is highly effective in **unstable environments** where rapid innovation and quick responses are needed.
4. Instead of maintaining a large permanent workforce, the company may **contract individuals or agencies** for specific projects or time periods.
5. **Long-term contracts** with suppliers, manufacturers, and logistics partners replace traditional in-house operations.

Disadvantages

Aarav Textiles may face in the future under this structure include:

1. Managing a **wide array of potential partners** can become complex and may result in quality or consistency issues.
2. Ensuring **effective coordination** among diverse, independent business units spread globally is a significant managerial challenge.
3. Employees may feel **less connected** to the organisation, leading to reduced motivation or reluctance to engage in learning and development initiatives.