PAPER – 6:
FINANCIAL MANAGEMENT AND STRATEGIC MANAGEMENT

6A: FINANCIAL MANAGEMENT

QUESTIONS

Division A: Case Scenarios

Integrated Case Scenario

1. Samvar Ltd, a leading **FMCG** company having its current presence in more than 150 Tier I and Tier II cities in India. The stores are operating in the brand name of **GoMART** competing with Reliance fresh, Walmart, BigBazaar and other chains. Owing to the increase in demand from Tier III cities and rural areas, it is planning for massive expansion and is contemplating to open up additional 50 stores which will have variety of FMCG products.

   The CFO and his team estimate that the funds needed for massive expansion would be ₹ 200 lakhs per store. Such funds would be utilized for buying out a space and setting up a store, buying the other required fixed assets, etc. Central government will provide a revenue subsidy of 15% on Gross profit if the overall cost of capital doesn't exceed 10%

   Apart from above, CFO and his team require an estimate on the additional capital needed based for the smooth running of fixed assets and its daily operations. Based on their market research, they have collected the other information for each store which is as follows-

Average Sales would be ₹ 120 lakhs p.a. with a GP margin of 18%. Customers pay through different digital modes and channels including POS systems (Debit and credit cards) which generally takes approx. 9 days for the funds to get credited in the bank account. 15% of the customers use debit and credit cards to make the payment. Installing a POS system comes with a fee of 2% of total sales through POS.

Being a FMCG outlet, inventories of multiple products need to be kept. Different products have different storage period. However primarily, products are classified into three broad categories, Durable, Semi Durable & Perishable. Perishable products comprise 60% of sales, whereas semi-durable is 25% and balance is for durable products. Inventory storage period for perishable, semi-durable & durable products are 10 days, 30 days & 60 days respectively. Suppliers of these products provide a credit period of average 30 days.

Each store will employ around 20 personnel of a different hierarchy and monthly average salaries to staff for each store is estimated at ₹ 4 lakhs per month. Company will pay employees' dues on the 1st of next month.

Samvar Ltd plans to keep optimum cash balance in hand as suggested by Baumol's model. Excess cash balance if any, will be invested in the marketable securities which will generate a return of 12% p.a. The total disbursement for the year is estimated at ₹ 1.50 lakhs per month with the transaction cost of ₹ 20 per transfer to the disbursement account.

The optimum capital structure with debt equity of 2:1 has been proven ideal for raising the finance and company wishes to follow the same pattern for the additional funds required for each store. Trade credit can also be utilized for financing the expansion needs.

The cost of raising debt and equity for each store is as per the slabs as under:

Project Cost *	**Cost of Debt**	**Minimum rate expected by equity share holders**
Upto 80 lakhs	10%	12.5%
Above 80 lakhs but upto 150 Lakhs	11.5%	13.5%

Above 150 lakhs & Upto 250 lakhs	12%	14%
Above 250 lakhs	13.5%	15%

*It means that upto 80 lakhs of project cost company can raise debt at 10% and equity at 12.5% and so on.

Tax rate applicable to the corporate is 25%

Based on the above details, calculate the following for each store:

i. The optimum Cash balance is

(A) ₹ 7,071

(B) ₹ 26,500

(C) ₹ 7,150

(D) ₹ 24,495

ii. The Gross and Net Working Capital for the next year would be

(A) ₹ 6.7730 L, (5.9396 L)

(B) ₹ 6.7730 L, 12.7125 L

(C) ₹ 200 L, (5.9396L)

(D) ₹ (5.9396 L), 6.7730 L

iii. The amount of total funds needed to setup a store is

(A) ₹ 194.0605 L

(B) ₹ 200 L

(C) ₹ 6.7730 L

(D) ₹ 206.7730 L

iv. The overall cost of capital for raising additional funds for setting up of each store is

(A) 10.01%

(B) 10.65%

(C) 9.90%

(D) 8.91%

v. The amount of revenue subsidy granted by the central govt is

(A) ₹ 3 L

(B) ₹ 3.24 L

(C) Nil

(D) ₹ 2.25 L

Dividend Decision

2. The cost of capital of a firm is 12% & its expected earning per share at the end of the year is ₹ 20. its existing payout ratio is 25%. the company is planning to increase its payout ratio to 50% what will be the effect of this change on the market price of equity share (MPS) of the company as per Gordon model, if the reinvestment rate of the company is 15%?

(A) It will increase by ₹ 444.45

(B) It will decrease by ₹ 444.45

(C) It will increase by ₹ 222.22

(D) It will decrease by ₹ 222.22

Financing Decision - Cost of Capital

3. Abhi Ltd is an all equity financed company. It is considering replacing ₹ 275 lakhs equity shares with 15% debentures of the same amount. Current Market value of the company is 1750 lakhs with cost of capital at 20%. Future EBITs are going to be constant and entire earnings are going to be distributed. Corporate Tax Rate can be assumed to be 30%. What will be the new cost of equity of the firm?

(A) 19.11%

(B) 17.53%

(C) 10.50%

(D) 20.62%

Division B: Descriptive Questions

Financial Analysis & Planning – Ratio Analysis

4. Vardhaman Limited gives you the following information related for the year ending 31st March, 2024:

Particulars	Amount (₹)
Current Ratio	3:1
Loan funds to Owned Funds Ratio	1:3
Gross Profit Ratio	25%
Stock Turnover Ratio	10
Net Working Capital	₹ 5,00,000
Return on Total Assets (pre-tax)	15%
MPS	₹ 20
Total Assets Turnover Ratio	2.5
Opening stock	₹ 6,50,500
Fixed Assets	₹ 15,00,000
75,000 equity shares of	₹ 10 each
25,000, 12% Pref. Shares of	₹ 10 each
Depreciation	₹ 50,000
Interest on Debt	9%
Future Instalments	₹ 2,00,000

Tax rate applicable to the company is 25%

You are required to CALCULATE:

(i) Quick Ratio

(ii) Fixed Assets Turnover Ratio

(iii) Debt Service Coverage

(iv) Earnings per Share

(v) Price Earnings Ratio

Financing Decision - Cost of Capital

5. The Capital Structure of Samyaktva Limited is as follows:

	Amount (in ₹)
12% Debentures	3,50,000
14% Pref. Shares	4,50,000
Equity shares (Face value of ₹ 10 each)	8,50,000
	16,50,000

Additional Information:

1. ₹ 100 per debentures redeemable at premium of 6% with floatation cost of 5% & 5 years of maturity. The current market price of the debenture is ₹ 115
2. ₹ 100 per preference shares redeemable at a premium of 10%, issued at discount of 2% with a floatation cost of 5% on the issue price. The current market price per preference share is ₹ 108. It has maturity of 10 years
3. An equity share has a floatation cost of ₹ 5 with a market price per share currently quoted at ₹ 30. Samyaktva Limited paid a last dividend of ₹ 4 and the company is expected to give an annual growth rate of 9% on the dividends. The company has a practice of paying all the earnings in the form of dividends.
4. Corporate Taxation rate is at 25%

CALCULATE WACC using market value weights

Financing Decision - Capital Structure

6. Ritu Limited in the expansion stage and it provides you the following information:

	(₹)
Profit (EBIT)	5,00,000
Less: Interest on Debenture @ 10%	(1,00,000)
EBT	4,00,000
Less Income Tax @ 30%	(1,20,000)
	2,80,000
No. of Equity Shares (₹ 10 each)	50,000

Earnings per share (EPS)	5.6
Price /EPS (PE) Ratio	10

The company has reserves and surplus of ₹ 10,00,000 and required ₹ 5,00,000 further for modernisation. Return on Capital Employed (ROCE) is constant. Debt (Debt/ Equity) Ratio lesser than 2 will raise the P/E Ratio to 12. Interest rate on additional debts is 12%. You are required to ASCERTAIN the probable price of the share.

(i) If the additional capital are raised as debt; and

(ii) If the amount is raised by issuing equity shares at ruling market price.

Financing Decision – Leverages

7. From the following financial data of Company X and Company Y:

(i) PREPARE their Income Statements.

(ii) CALCULATE Margin of Safety for both the Companies

(iii) CALCULATE Percentage change in EPS for both the companies, if percentage change in sales is 25%

(in ₹)

	Company X	Company Y
Variable Cost	72,000	65% of Sales
Fixed Cost	35,000	-
Interest Expenses	12,000	6,000
Financial Leverage	4:1	-
Operating Leverage	-	5:1
Income Tax Rate	30%	30%
Sales	-	1,45,000

Dividend Decisions

8. The following information is supplied to you:

Particulars	Amount (₹)
Total Earnings	4,50,000
No of Equity Shares (of ₹ 100 each)	25,000 shares
Retention ratio	40%
MPS	198

Applying Walter's Model:

(i) ANALYSE whether the company is following an optimal dividend policy.

(ii) COMPUTE P/E ratio at which the dividend policy will have no effect on the value of the share. Also calculate the MPS at such P/E ratio

(iii) Will your decision change if the P/E ratio is 4.5? ANALYSE.

Investment Decisions – Capital Budgeting

9. A company is considering the proposal to take up a new project which requires investment of ₹ 850 lakhs in plant & machinery and ₹ 150 lakhs in working capital. The project is expected to yield the following Cash flows before tax and depreciation over the next five years:

Year	Amount (₹ in Lakhs)
1	290
2	320
3	360
4	390
5	270

The desired rate of return from the project is 14% and assets must be depreciated at 20% on a written down value basis. The scrap value at the end of the five-year period may be taken as ₹ 140 lakhs. The income tax

applicable to the company is 20%. This is the only asset in the entire block. Capital gains tax is at 15% (for capital loss as well)

You are required to CALCULATE the net present value of the project and advise the management to take appropriate decisions. Also calculate the Internal Rate of Return and Desirability factor of the Project.

Note: Present values of Re. 1 at different rates of interest are as follows:

Year	14%	16%	20%
1	0.88	0.86	0.83
2	0.77	0.74	0.69
3	0.67	0.64	0.58
4	0.59	0.55	0.48
5	0.52	0.48	0.40

Management of Working Capital

10. Nirmoh Limited wants to avail short-term loan from the bank. However, bank grants short term loan by keeping the collateral in the form of accounts receivable. A bank is analyzing the receivables of Nirmoh Limited to identify acceptable collateral for a short-term loan.

The current policy of the company is 3/10 net 40. Bank will lend only to the extent of 90% of acceptable receivables at an interest rate of 12% only if both the conditions mentioned below are fulfilled. Bank will keep a reserve of 5% for cash discount & returns

(a) Customers are not currently overdue for more than 5 days to the net period

(b) Average aging (payment period) of the customer should not exceed 15 days past the net period.

If any of the above conditions are not fulfilled, the bank will lend 65% of the receivables subject to a reserve of 15% and the interest rate will be charged at 15% on such accounts. The corporate tax rate applicable is 25%.

On the scrutiny of all the receivables, following are the acceptable receivables considered for lending-

Accounts	Amount (₹)	Outstanding in Days since invoiced	Average Aging (payment period) in Days
DR 01	50,000	37	40
DR 02	25,000	25	48
DR 03	1,20,000	47	49
DR 04	72,000	10	56
DR 05	45,000	30	30
DR 06	1,75,000	39	50
DR 07	19,000	55	25
DR 08	54,000	44	54
DR 09	1,05,000	15	25
DR 10	37,000	22	75

You are required to CALCULATE:

(a) Total amount lend by the bank

(b) Effective Interest cost (%) to the company

11. (a) LIST the emerging issues (any four) affecting the future role of CFO.

(b) EXPLAIN any four Methods for Computation of Cost of Equity Capital.

(c) Do the profitability index and the NPV criterion of evaluating investment proposals lead to the same acceptance-rejection and ranking decisions? In what SITUATIONS will they give conflicting results?

SUGGESTED ANSWERS/HINTS

1. i. (D) ₹ 24,495

As per William J Baumol,

optimum cash balance = $\sqrt{\frac{2AT}{O}}$

A = Annual Cash disbursement

T = Cost per transfer

O = Opportunity cost

= $\sqrt{\frac{2 \times 18,00,000 \times 20}{0.12}}$ **= ₹ 24,495/-**

ii. (A) ₹6.7730 L, (5.9396 L)

Gross working capital is sum of total current assets and net working capital is Gross working capital less current liabilities.

Estimation of Working Capital Statement

		Amount (₹)	**Amount (₹)**
A)	**CURRENT ASSETS / GROSS W.C**		
	1. FG Inventory **WN - 1**	6,15,000	
	2. Trade receivables **WN - 2**	37,800	
	3. Cash/ bank balance **(Calculated in Solution 1)**	24,495	**6,77,295**
B)	**CURRENT LIABILTIES**		
	1. Trade payables **WN - 3**	8,71,250	
	2. Outstanding salaries **WN - 4**	4,00,000	**12,71,250**
NET WORKING CAPITAL (A) - (B)			**(5,93,955)**

WN – 1 Calculation of FG Inventory

FG Inventory = COGS x $\frac{\text{FG STORAGE PERIOD (DAYS)}}{360}$

COGS = 120 Lakhs x 82% = 98.40 Lakhs

Perishable = 98.40 x 60% x 10 /360 = 1.64 Lakhs

Semi Durable = 98.40 X 25% X 30 /360 = 2.05 Lakhs

Durable = 98.40 X 15% X 60 /360 = 2.46 Lakhs

Total = **₹ 6.15 lakhs**

WN – 2 Calculation of Trade Receivables

Since, company is into FMCG industry, sales are always on cash basis as no credit is given to any of the custome₹ However, as mentioned in the case study, company will get the credit in the bank account only after 9 days for those customers that pay through POS (debit and credit cards). It means companies funds' get blocked for 9 days.

Company's trade receivable would only comprise of 15% of total sales as rest are through cash basis

Trade Receivables = Cost of Sales x Days Blocked / 360

= 15.12 L x 9 / 360

= **0.378 Lakhs**

Cost of Sales = COGS + POS Transaction fees

= (98.40 L x 0.15) + (120 L x 0.15 x 2%)

= 15.12 Lakhs

WN – 3 Calculation of Trade Payables

$$\text{Trade Payables} = \text{Purchases} \times \frac{\text{Average Credit period in days}}{360}$$

= 104.55 x 30 /360

= **8.7125 Lakhs**

Purchases = COGS (+) Closing Stock (-) Opening Stock

Since, company is planning to open up new store, its opening stock would be NIL but there would be definitely a closing FG stock which is calculated in WN -1

Therefore, Purchases = 98.40 L + 6.15 L - 0 = **104.55 Lakhs**

WN – 4 Calculation of Outstanding salaries

Salaries are paid on 1st of next month, thereby meaning it has been outstanding for a period of 30 days assuming salaries accruing evenly throughout.

Outstanding salaries = 48,00,000 x 30 / 360

= **4,00,000**

iii. (A) ₹ 194.0605 L

Total Capital needed = Total capital needs (Fixed assets) + Working Capital needs

= 200 L + (5,93,955)

= ₹ 194.0605 L

iv. (C) 9.90%

Samvar Ltd would require financing of ₹ 194.0605 lakhs from debt and equity and not ₹ 200 lakhs as trade credit is also considered to be a source of finance as mentioned in the case study.

Furthermore, the overall cost of raising this additional fund for each store of ₹ 194.0605 needs to be calculated slab wise

Project Cost	Weights (W)	Cost (K)	W X K	Total cost (₹)
Upto 80 Lakhs	Debt = 0.67 Equity = 0.33	Kd = 10 (1 - 0.25) = 7.5 Ke = 12.5	Ko = 9.167%	= 80L x 9.167% **= 7.334 Lakhs**
Above 80 L upto 150 L	Debt = 0.67 Equity = 0.33	Kd = 11.5(1-0.25) = 8.625 Ke = 13.5	Ko = 10.25%	= 70L x 10.25% **= 7.175 Lakhs**
Above 150 L upto 250 L	Debt = 0.67 Equity = 0.33	K = 12 (1-0.25) = 9 Ke = 14	Ko = 10.667%	=44.0605L x 10.667% **= 4.7Lakhs**

Total Funds = 194.0605 L

Total Cost (₹) = 7.334 L + 7.175 L + 4.700 L = 19.209 L

Ko = Total Cost (₹) / Total Funds

= 19.209 / 194.0605

= 9.90%

v. (B) ₹ 3.24 L

Since the Overall Cost of Capital is below 10%, Samvar Ltd is eligible for revenue subsidy

Revenue Subsidy = GP x 15%

= 21.6 L x 15%

= **₹ 3.24 Lakhs**

2. (B) It will decrease by ₹ 444.45

Current D1 = 20 x 25% = 5

Current g = 0.75 x 0.15 = 11.25%

Current MPS = 5/(0.12 - 0.1125) = 666.67

Proposed D1 = 20 x 50% = 10

proposed g = 0.5 x 0.15 = 0.075,

Proposed MPS = 10/(0.12 - 0.075) = 222.22

Change in MPS = 666.67 - 222.22 = **₹444.45**

3. (D) 20.62%

Current PAT	= 1750 x 20%	= 350
Current PBT	= Future EBIT	= 350/0.7 = 500
Future PBT	= 500 - 275x15%	= 458.75
Future PAT	= 458.75 x 70%	= 321.125
Value (L)	= Value (UL) + Debt x t	= 1750+275 x 30% = 1832.5
Value of Equity	= 1832.5-275	= 1557.5
Ke	= 321.125/1557.5	**= 20.62%**

4. WN 1: Calculation of Current Assets & Current Liabilities

Current Ratio = CA / CL = 3:1

Therefore, CA	=	3CL
Net Working Capital	=	CA - CL = 5,00,000
	=	3CL (-) CL = 5,00,000
Therefore, CL	=	2,50,000,
CA	=	7,50,000

WN 2: Calculation of Average Stock Value & Closing Stock

Total Assets	=	Fixed Assets + Current Assets
	=	15 L + 7.5 L = **22.50 lakhs**
Total Assets Turnover Ratio	=	Sales / Total Assets = 2.5 (given)
Therefore Sales	=	22.5 lakhs X 2.5
Sales	=	**56,25,000**
GP Margin	=	25%, therefore COGS = 75% of Sales
COGS	=	56.25 x 75% = **42,18,750**
Stock Turnover Ratio	=	COGS / Average Stock = 10 (given)
Average Stock	=	42,18,750 / 10 = **4,21,875**
Average Stock	=	Op. Stock + Cl. Stock / 2
4,21,875	=	6,50,500 + Cl. Stock / 2
Cl Stock	=	1,93,250

WN 3: Calculation of Cash Profit before Interest & Tax

Return on Total Assets (pre-tax)	= (EBIT / Total Assets)
0.15	= EBIT / 22.50 lakhs
Therefore, EBIT	= **3,37,500**
Cash Profit before Int & Tax	= EBIT + Depreciation
	= 337500 + 50000
Cash Profit before Int & Tax	= **3,87,500**

WN 4 : Calculation of Loan Funds (Debt) & Owned Funds (Equity)

Debt to Equity = 1 : 3, which means 3 times Debt = Equity (Owned Funds)

As per the Accounting equation,

Equity + Debt + Current Liab.	**=**	**Fixed Assets + Current Assets**
3 Debt + Debt + 2,50,000	=	15,00,000 + 7,50,000
4 Debt	=	20,00,000
Therefor Debt (Loan Funds)	=	**5,00,000**
Equity (Owned Funds)	=	**15,00,000**

WN 5: Calculation of Earnings Available to Eq. Share holders

Particulars	Amount (₹)
EBIT	3,37,500
(-) Int (5 lakhs x 9%)	(45,000)
EBT	2,92,500
(-) Tax @ 0.25	(73,125)
EAT	2,19,375
(-) Pref Div. (250000 x 12%)	(30,000)
Earnings For Eq. Sh Holders	1,89,375

1. Quick Ratio = {CA - CI Stock}/CL

   = 7,50,000 – 1,93,250 / 2,50,000

   Quick Ratio = 2.23 : 1

2. Fixed Assets Turnover Ratio = Sales / Total Fixed Assets

   = 56,25,000 / 15,00,000

   Fixed Assets Turnover Ratio = 3.75 times

3. Debt Service Coverage Ratio = Cash profit before Int & Tax / Int + Instalments

   = 3,87,500 / (45,000+2,00,000)

   Debt Service Coverage Ratio = 1.58 times.

4. **EPS = Earnings for Eq. Shareholders / No of Eq. Shareholders**

= 1,89,375/75,000

EPS = ₹ 2.53

5. Price to Earnings Ratio = MPS / EPS

= 20 / 2.53

Price to Earnings Ratio = 7.91 times

5. WN 1: Calculation of Cost of Debt

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

RV = 100 + 6% = 106

n = term = 5 years

t = tax = 0.25

NP = Issue Price – Floatation cost

= 115 – 5% (Issue price will be at Market price and no Face Value)

= 109.25

$$Kd = \frac{12(1-0.25)+\frac{(106-109.25)}{5}}{\frac{(106+109.25)}{2}}$$

Therefore **Kd = 7.76%**

WN 2: Calculation of Cost of Preference Shares

$$Kp = \frac{PD+\frac{(RV-NP)}{n}}{\frac{(RV+NP)}{2}}$$

RV = 100 + 10% = 110

n = term = 10 years

NP = Issue Price – Floatation cost

Issue Price = (108 – 2%) = 105.84

Net Proceeds = 105.84 (-) 5% = 100.55

$$\text{Kp} = \frac{14+\frac{(110-100.55)}{10}}{\frac{(110+100.55)}{2}}$$

Therefore **Kp = 14.19%**

WN 3: Calculation of Cost of Equity

Since growth rate is given, Ke is to be calculated by using Gordon's formula

As per Gordon,

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

Where, D1 = Expected dividend at the end of Year 1

Po = Current Market Price (–) Floatation cost

G = growth rate in dividends

$$\text{Ke} = \frac{4+9\% \times 4}{30-5} + 0.09$$

Ke = 26.44%

Calculation of WACC using Market Value Weights

Sources	Amount of Capital (₹)	Weights (W)	Cost (K)	W X K
Debentures	4,02,500 (3,500 x 115)	0.1171	7.76 (WN 1)	0.9087
Preference shares	4,86,000 (4,500 x 108)	0.1413	14.19 (WN 2)	2.00
Equity shares	25,50,000 (85,000 x 30)	0.7416	26.44 (WN 3)	19.6079
	34,38,500			Ko = 22.52%

6. Ascertainment of probable price of shares of Akash limited

Particulars	Plan-I	Plan-II
	If ₹ 5,00,000 is raised as debt (₹)	**If ₹ 5,00,000 is raised by issuing equity shares (₹)**
Earnings Before Interest and Tax (EBIT) {20% of new capital i.e. 20% of (₹ 25,00,000 + ₹ 5,00,000)} (Refer working note1)	6,00,000	6,00,000
Less: Interest on old debentures (10% of ₹ 10,00,000)	(1,00,000)	(1,00,000)
Less: Interest on new debt (12% of ₹ 5,00,000)	(60,000)	--
Earnings Before Tax (EBT)	4,40,000	5,00,000
Less: Tax @ 30%	(1,32,000)	(1,50,000)
Earnings for equity shareholders (EAT)	3,08,000	3,50,000
No. of Equity Shares (refer working note 2)	50,000	58,929
Earnings per Share (EPS)	₹ 6.16	₹ 5.94
Price/ Earnings (P/E) Ratio (refer working note 3)	12	10
Probable Price Per Share (PE Ratio × EPS)	₹ 73.92	₹ 59.40

Working Notes:

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

	(₹)
Equity Share capital (50,000 shares × ₹ 10)	5,00,000

10% Debentures $\left(₹1,00,000 \times \frac{100}{10}\right)$	10,00,000
Reserves and Surplus	10,00,000
Total Capital Employed	25,00,000
Earnings before interest and tax (EBIT) (given)	5,00,000
ROCE $= \frac{₹\,5,000,000}{₹\,25,00,000} \times 100$	20%

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

$$= \frac{₹5,00,000}{₹56} = 8,929 \text{shares}$$

Thus, after the issue total number of shares = 50,000+ 8,929 = 58,929 shares

3. Debt/Equity Ratio if ₹ 5,00,000 is raised as debt:

$$= \frac{₹15,00,000}{₹15,00,000} = 1$$

As the debt equity ratio is less than 2 the P/E ratio will be increase to 12 in Plan-I

7. (i) Income Statement

Particulars	Co. X (₹)	Co. Y (₹)
Sales	1,23,000 **(WN 2)**	1,45,000
(-) Variable Cost	(72,000)	(94,250) (65% on sales)
Contribution	51,000 **(WN 2)**	50,750
(-) Fixed Cost	(35,000)	(40,600)
EBIT	16,000 **(WN 1)**	10,150 **(WN 3)**
(-) Interest	(12,000)	(6,000)

EBT	4,000	4,150
(-) Tax @ 30%	(1,200)	(1,245)
EAT	**2,800**	**2,905**

WN 1: Calculation of EBIT for Co. X using Financial Leverage

$$FL = \frac{EBIT}{EBT} \text{ or } \frac{EBIT}{EBIT - Interest}$$

$$4 = \frac{EBIT}{EBIT - 12,000}$$

EBIT = ₹ 16,000

EBT = ₹ 16,000 – ₹ 12,000 = ₹ 4,000

WN 2: Calculation of Contribution and Sales using reverse mechanism

Contribution = EBIT + Fixed Cost

= ₹ 16,000 + ₹ 35,000

Contribution = ₹ 51,000

Sales = Contribution + Variable Cost

Sales = ₹1,23,000

WN 3: Calculation of EBIT for Co. Y using Operating leverage

OL = Contribution / EBIT

$$5 = \frac{50,750}{EBIT}$$

EBIT = ₹ 10,150

(ii) Margin of Safety (MOS) is inversely proportionate to the Operating Leverage as higher the safety margin lower would be the business risk

$$MOS = \frac{1}{OL}$$

Operating Leverage (Co. X) $= \frac{51,000}{16,000}$

Operating Leverage (Co. X) = 3.1875 : 1

Therefore, MOS for Co. X = 1 / 3.1875

MOS for Co. X = 31.37%

Operating Leverage (Co. Y) = 5 : 1

Therefore, MOS for Co. X $= \frac{1}{5}$

MOS for Co. Y = 20%

(iii) Combined leverage measures the percentage change in EPS due to percentage change in sales

Combined Leverage $= \frac{\text{Contribution}}{\text{EBT}}$

Combined Leverage (Co. X) $= \frac{51,000}{4,000}$

$= 12.75$

Combined Leverage $= \frac{\text{\% change in EPS}}{\text{\% change in sales}}$

12.75 $= \frac{\text{\% change in EPS}}{25\%}$

% change in EPS (Co. X) = 318.75%

Combined Leverage (Co. Y) $= \frac{50,750}{4,150}$

$= 12.23$

12.23 $= \frac{\text{\% change in EPS}}{25\%}$

% change in EPS (Co. Y) = 305.75%

8. (i) As per Walter,

If ROI > Ke, firm should retain everything and distribute nothing to maximize the share price. On the contrary, if ROI < Ke, firm should distribute everything and retain nothing to maximize the wealth of the equity owners.

ROI = Total Earnings / Equity Share capital

= 4,50,000 / 25,00,000

ROI = 18%

Ke = $\frac{1}{PE}$

P.E Ratio = MPS / EPS = 198 /18 = 11

Therefor Ke = 1/11 = 9.091%

Since ROI > Ke, optimal dividend policy of the firm should be to retain everything and distribute nothing. However, the firm has retained 40% and distributed 60%, hence it is not having an optimal dividend policy as per Walter's model.

(ii) When ROI = Ke, dividend policy of the company will have no effect on the value of the share as per Walter's model

Therefore, in that case, Ke should be equal to 18%

P.E Ratio = $\frac{1}{Ke} = \frac{1}{0.18}$

P.E Ratio = 5.56 times

MPS at the above P.E Ratio = 18 x 5.56 = ₹ 100.08

(iii) If P.E Ratio is 4.5,

Ke = $\frac{1}{4.5}$ = 22.22%

Since, ROI < Ke, optimal dividend policy of the firm should be to distribute everything and retain nothing, as the value of share would be maximum at that point thereby maximizing the wealth of the shareholder

9. (A) Calculation of NPV

WN 1 : Calculation of Present Value of Cash Outflow (PV CO)

(i) Initial Investment = ₹ 850 lakhs

(ii) Working capital outlay = ₹ 150 lakhs

Therefore, total PV CO = ₹ 1000 lakhs

WN 2 : Calculation of Present Value of Cash Inflows (PV CI)

Cash flows before tax are given i.e. nothing but NPBDT

Amount (₹ in lakhs)

Year	1	2	3	4	5
NPBDT	290.00	320.00	360.00	390.00	270.00
(-) Dep	170.00	136.00	108.80	87.04	69.63
NPBT	120.00	184.00	251.20	302.96	200.37
(-) Tax	24.00	36.80	50.24	60.59	40.07
NPAT	96.00	147.20	200.96	242.37	160.29
(+) Dep	170.00	136.00	108.80	87.04	69.63
CFAT	266.00	283.20	309.76	329.41	229.93
(+) Working Capital Release					150.00
(+) Scrap					140.00
PV Factor @ 14%	0.88	0.77	0.67	0.59	0.52
PV CI	**234.08**	**218.06**	**207.54**	**194.35**	**270.36**

(i) Total PV CI = ₹ 1124.40 Lakhs

WN 3 : Calculation of Present Value of tax savings on short term Capital loss

	₹ in Lakhs
WDV at end of 5th year	278.53
(-) Sale value	140.00

Loss on sale	138.53
Tax savings on above @ 15%	20.78

PV of tax savings on short term capital loss (STCL) = Tax saving x PV factor (14%, 5th year)

= 20.78 x 0.52

= ₹ 10.81 lakhs

NPV = PV CI + PV of tax savings on STCL - PV CO

= 1124.40 + 10.81 - 1000

NPV = ₹ 135.20 lakhs

Advise: Since the NPV of the project is positive, project should be accepted

(B) Calculation of IRR

IRR is that discounting rate where NPV = 0 (point where PV of all CI = PV Co)

We know that @ 14%, NPV is ₹ 135.20, so by trial-and-error method we need to calculate that rate where NPV equals 0.

When Discounting rate is 16%

	1	2	3	4	5
CFAT	266.00	283.20	309.76	329.41	229.93
(+) Working Capital Release					150.00
(+) Scrap					140.00
PV Factor @ 14%	0.86	0.74	0.64	0.55	0.48
PV CI	**228.76**	**209.57**	**198.25**	**181.17**	**249.56**

PV CI = 1067.31

(+) PV of tax savings on STCL = 9.97 {20.78 x 0.48}

(-) PV CO = (1000)

NPV **= ₹ 77.29**

Since NPV is positive at 16% as well, we need to go for Trial II at 20%

When Discounting rate is 20%

	1	2	3	4	5
CFAT	266.00	283.20	309.76	329.41	229.93
(+) Working Capital Release					150.00
(+) Scrap					140.00
PV Factor @ 14%	0.83	0.69	0.58	0.48	0.4
PV CI	220.78	195.41	179.66	158.12	207.97

PV CI = 961.94

(+) PV of tax savings on STCL = 8.31 {20.78 x 0.40}

(-) PV CO = (1000)

NPV **= ₹ (29.75)**

Since NPV is negative at 20%, IRR lies somewhere between 16% and 20%

$$\textbf{IRR} = LR + \frac{\text{NPV at LR}}{\text{NPV at LR - NPV at HR}} \times (HR - LR)$$

LR = Lower Rate (16% here) HR = Higher Rate (20% here)

$$IRR = 16 + \frac{77.29}{77.29 - (-29.75)} \times (20 - 16)$$

IRR = 18.89%

(C) Calculation of Desirability Factory (Profitability Index)

PI = TOTAL PV CI / PV CO

PI = 1135.21 / 1000

PI = 1.13521

10. (A) **Condition (a)** says that accounts shouldn't be overdue for more than 5 days to the net period. In other words, it means those accounts who are overdue by 45 days (40 days + 5 additional days), will not fulfill condition a) and thus will not be eligible for 90% lending.

Therefore, from the above, we can see that **Accounts DR 03 & DR 07** are overdue for more than 45 days and hence will not be eligible for 90% lending.

Condition (b) says that average receivables ageing (payment period) should not exceed 15 days to the net period i.e. it should not exceed 55 days (40 days + 15 days = 55 days). Therefore, from the above, we can see that **Accounts DR 04 & DR 10** has an ageing of more than 55 days. Hence, they would also not be eligible for 90% lending.

Amount of Bank Lending:

Accounts	Bank Lending at 90%	Bank Lending at 65%
DR 01	50,000	-
DR 02	25,000	-
DR 03	-	1,20,000
DR 04	-	72,000
DR 05	45,000	-
DR 06	1,75,000	-
DR 07	-	19,000
DR 08	54,000	-
DR 09	1,05,000	-
DR 10	-	37,000
Total	**4,54,000**	**2,48,000**
(-) Reserve	22,700 {4,54,000 x 5%}	37,200 {2,48,000 x 15%}
Net	**4,31,300**	**2,10,800**
Loan	**3,88,170**	**1,37,020**

Total short-term loan granted by the bank = ₹ 5,25,190

(B) Calculation of the Effective Interest Cost

Interest at 12% (On 90% lending) = 3,88,170 x 0.12 = 46,580.4

Interest at 15% (On 65% lending) = 1,37,020 x 0.15 = 20,553

Total Interest = ₹ 67,133.4

Effective Interest Cost (%) = Interest (1-t) / Total Short-term Loan

= 67,133.4 (1-0.25) / 5,25,190

Effective Interest Cost (%) = 9.59%

11. (a) Emerging Issues/Priorities Affecting the Future Role of Chief Financial Officer (CFO)

(i) **Regulation**: Regulation requirements are increasing and CFOs have an increasingly personal stake in regulatory adherence.

(ii) **Globalisation:** The challenges of globalisation are creating a need for finance leaders to develop a finance function that works effectively on the global stage and that embraces diversity.

(iii) **Technology:** Technology is evolving very quickly, providing the potential for CFOs to reconfigure finance processes and drive business insight through 'big data' and analytics.

(iv) **Risk:** The nature of the risks that organisations face are changing, requiring more effective risk management approaches and increasingly CFOs have a role to play in ensuring an appropriate corporate ethos.

(v) **Transformation:** There will be more pressure on CFOs to transform their finance functions to drive a better service to the business at zero cost impact.

(vi) **Stakeholder Management:** Stakeholder management and relationships will become important as increasingly CFOs become the face of the corporate brand.

(vii) **Strategy:** There will be a greater role to play in strategy

validation and execution, because the environment is more complex and quick changing, calling on the analytical skills CFOs can bring.

(viii) Reporting: Reporting requirements will broaden and continue to be burdensome for CFOs.

(ix) Talent and Capability: A brighter spotlight will shine on talent, capability and behaviours in the top finance role.

(b) Cost of equity capital is the rate of return which equates the present value of expected dividends with the market share price.

Methods for Computation of Cost of Equity Capital

- **Dividend Price Approach (:** Here, cost of equity capital is computed by dividing the expected dividend by market price per share.

$$K_e = \frac{D_1}{P_o}$$

- **Earning/ Price Approach:** The advocates of this approach co-relate the earnings of the company with the market price of its share.

$$K_e = \frac{E}{P}$$

- **Realized Yield Approach:** According to this approach, the average rate of return realized in the past few years is historically regarded as 'expected return' in the future. The yield of equity for the year is:

$$Y_t = \frac{D_t + P_t}{P_{t-1}}$$

- **Capital Asset Pricing Model Approach (CAPM):** CAPM model describes the risk-return trade-off for securities. It describes the linear relationship between risk and return for securities.

$K_e = R_f + ß\ (R_m - R_f)$

(c) In the most of the situations the Net Present Value Method (NPV) and Profitability Index (PI) yield same accept or reject decision. In general items, under PI method a project is acceptable if profitability index value is greater than 1 and rejected if it less than 1. Under NPV method a project is acceptable if Net present value of a project is positive and rejected if it is negative. Clearly a project offering a profitability index greater than 1 must also offer a net present value which is positive. But a conflict may arise between two methods if a choice between mutually exclusive projects has to be made. Consider the following example:

	Project A	**Project B**
PV of Cash inflows	3,00,000	1,60,000
Initial cash outflows	1,00,000	40,000
Net present value	2,00,000	1,20,000
P.I	$\frac{3,00,000}{1,00,000} = 3$	$\frac{1,60,000}{40,000} = 4$

According to NPV method, project A would be preferred, whereas according to profitability index method project B would be preferred.

This is because Net present value gives ranking on the basis of absolute value of rupees, whereas, profitability index gives ranking on the basis of ratio. Although PI method is based on NPV, it is a better evaluation technique than NPV in a situation of capital rationing.

6B: STRATEGIC MANAGEMENT

QUESTIONS

Multiple Choice Questions

1. In the ever-growing consumer electronics industry, Horizon Technologies found itself at a crossroads in 2018. The company, founded a decade earlier, had established itself as a key player in the global market for smartphones and other electronics. However, the pressure to stay relevant, meet customer demands, and fend off competitors was mounting. This is the story of how Horizon Technologies navigated its challenges, leveraging key business strategies and analyses to achieve remarkable success.

   Horizon Technologies recognized the need to divide its operations to find areas for improvement. They conducted a comprehensive value chain analysis, identifying both primary and support activities. By streamlining processes and eliminating redundancies, the company reduced production costs and enhanced product quality. This allowed them to offer more competitive prices, thus gaining a strategic edge in the market.

   The company's CEO, Mr. Jonathan Mercer, was known for his authoritative management style. His challenge was to transform his leadership approach to one that encouraged creativity and teamwork within the SBUs. Mr. Mercer invested in leadership development programs for middle and senior managers to enhance their interpersonal and communication skills. The transition wasn't easy, but it fostered a more collaborative and dynamic work environment.

   They did not stop there, Horizon Technologies adopted a Strategic Business Unit (SBU) structure, dividing the company into smaller, more manageable units. Each SBU was tasked with focusing on specific product lines. This decentralization empowered individual units to make

strategic decisions autonomously, leading to quicker market response and a deeper understanding of customer needs. It was the catalyst for innovation and improved customer satisfaction.

Post organizational changes, Horizon Technologies strategized to embrace a cost leadership strategy, positioning itself as the go-to brand for affordable yet high-quality electronics. By optimizing production processes and supply chain management, the company achieved cost efficiencies that competitors struggled to match. This not only attracted cost-conscious consumers but also enabled the company to maintain healthy profit margins.

As Horizon Technologies expanded into new international markets, the management recognized the importance of adapting to the local environment. Conducting a thorough PESTLE analysis (Political, Economic, Social, Technological, Legal, and Environmental) proved pivotal for navigating complex market dynamics. This analysis highlighted specific challenges, especially in understanding socio-cultural trends and regulatory differences across regions. By leveraging these insights, Horizon Technologies was able to overcome these obstacles, customizing its products, marketing strategies, and operations to align more effectively with local preferences and regulations, ultimately contributing to their success.

Through these strategic moves, Horizon Technologies experienced a remarkable transformation. Within two years, their market share had significantly grown in local markets, whereas the cost leadership strategy resonated strongly. Their annual revenue skyrocketed by 35%, and the company saw a 20% increase in its stock price. The business case for Horizon Technologies serves as an inspiration for companies navigating competitive and dynamic industries.

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

(i) In Horizon Technologies' journey towards globalization, PESTLE analysis played a pivotal role in navigating diverse international markets. Which aspect of PESTLE analysis proved to be the most challenging for Horizon Technologies?

(a) Socio-cultural factors, as they struggled to keep up with changing trends and cultural preferences.

(b) Legal factors, given the complex regulatory landscape in foreign markets.

(c) Environmental factors, with the need to adhere to varying sustainability standards.

(d) Technological factors, due to rapid changes in local technology preferences.

(ii) Horizon Technologies implemented a Strategic Business Unit (SBU) structure to improve its responsiveness and innovation. How did the SBU structure differ from the company's previous organizational model, and what benefits did this new structure bring?

(a) The SBU structure replaced a functional structure and empowered units to make strategic decisions. It led to quicker market response and enhanced customer satisfaction.

(b) The SBU structure replaced a matrix structure, improving vertical communication and reducing operational silos.

(c) The SBU structure maintained the existing functional structure but focused solely on cost-cutting measures.

(d) The SBU structure introduced a more centralized approach, ensuring consistent decision-making across units.

(iii) Horizon Technologies faced internal challenges, including leadership struggles with an authoritative CEO. How did Mr. Jonathan Mercer transform his leadership style to foster a more collaborative work environment, and what were the key outcomes of this transformation?

(a) Mr. Mercer increased his authoritative approach to drive quicker decision-making and efficiency.

(b) He introduced a strict top-down hierarchy to enhance discipline and order within the organization.

(c) Mr. Mercer invested in leadership development programs, enhancing interpersonal and communication skills, which resulted in a more collaborative and dynamic work environment.

(d) He delegated most of his responsibilities to middle managers, reducing his involvement in the company's daily operations.

(iv) While implementing a cost leadership strategy, Horizon Technologies went beyond just streamlining their production processes. What other factors did they consider achieving cost efficiencies, and how did this contribute to their success?

(a) They solely focused on reducing labor costs, resulting in job cuts and employee dissatisfaction.

(b) Horizon Technologies invested heavily in extravagant marketing campaigns to attract a premium customer base.

(c) They optimized supply chain management and invested in research and development, leading to enhanced product quality and reduced production costs.

(d) The company acquired competitors to eliminate competition and establish a monopoly in the market.

(v) The primary factor contributing to Horizon Technologies' remarkable transformation was their commitment to systematic analysis. What role did value chain analysis play in this transformation, and how did it drive their success in both local and global markets?

(a) Value chain analysis revealed opportunities for diversification, enabling them to cater to various market segments.

(b) It allowed the company to identify and eliminate inefficiencies in their operations, resulting in cost reductions and improved product quality.

(c) Value chain analysis highlighted the need for excessive vertical integration, helping them control the entire supply chain.

(d) Horizon Technologies used value chain analysis primarily for financial forecasting and budgeting.

2. In a recent strategy meeting, the leadership team of TechNova, a growing software development firm, emphasized the importance of defining the core purpose of the organization. They aimed to outline the primary reason for the company's existence and to guide their decision-making processes during challenging times. They noted that this central guiding declaration would help align the team's efforts and communicate to stakeholders what the company stands for. What term best describes the central guiding declaration that communicates the purpose and values of TechNova?

(a) Vision

(b) Mission

(c) Objectives

(d) Goals

3. A company's flagship product has experienced a plateau in sales despite heavy promotions and marketing. What phase of the Product Life Cycle are they likely in, and what is the best strategic option to consider?

(a) Introduction; increase prices

(b) Growth; diversify product range

(c) Maturity; seek product differentiation

(d) Decline; invest in new technology

4. A multinational corporation is planning a merger with a local firm in a developing country. The local firm's community has high stakes in maintaining local employment and environmental standards but possesses low power in formal negotiations. How should the corporation categorize this stakeholder?

(a) High power, low interest

(b) Low power, high interest

(c) High power, high interest

(d) Low power, low interest

5. EcoGreen, a company specializing in sustainable home products, has decided to enter the energy sector by developing and marketing solar panels and home energy storage solutions. This new direction involves creating a completely new product line that extends beyond their traditional home goods, thereby entering an industry with their current brand. What strategy is EcoGreen using to enter the energy sector?

(a) Market penetration

(b) Product development

(c) Market development

(d) Diversification

6. Alpha Corp is undergoing a shift to foster a culture that encourages innovative thinking and team collaboration. To achieve this, the company is focusing on how leaders interact with their teams and set examples for behavior, aiming to align leadership practices with desired cultural outcomes. Which aspect of AlphaCorp is being adjusted to foster a culture of innovation and collaboration?

(a) Structure

(b) Systems

(c) Skills

(d) Style

Descriptive Questions

Chapter 1-Introduction to Strategic Management

7. XYZ Enterprises operates in various sectors, including renewable energy solutions, organic skincare products, eco-friendly packaging, and smart home technologies. The organization is currently in the process of recruiting a Chief Executive Officer. In this scenario, imagine yourself as an HR consultant for XYZ Enterprises. Identify the strategic level that encompasses this role within XYZ Enterprises. Provide an overview of the key duties and responsibilities falling under the Chief Executive Officer's scope.

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. Mr. Arun Kumar has built a successful business in the handmade ceramic products industry in Gujarat. His company, CeramiCrafts, is renowned for crafting distinctive, high-quality ceramic home décor items that have gained a strong foothold in the market. However, recent market shifts and rising competition have impacted sales. Seeking professional guidance, Mr. Kumar consults a strategic advisor who recommends an in-depth analysis of the competitive landscape. To comprehend the competitive landscape, what steps should Mr. Kumar follow?

10. According to Michael Porter, what are the five competitive forces that exist within an industry?

Chapter 3-Strategic Analysis: Internal Environment

11. ABC Corporation, a leading manufacturer of consumer electronics, is considering launching a new line of smart home devices. As a strategic manager, conduct a SWOT analysis for ABC Corporation to assess the feasibility and potential success of this new venture. Consider both internal and external factors that could impact on the success of the new product line.

12. What are channels? Why is channel analysis important? Explain the different types of channels?

Chapter 4-Strategic Choices

13. InnovaTech, a technology company with a range of business units, is assessing its investment opportunities. To allocate resources effectively, InnovaTech uses a matrix that evaluates each business unit based on two key factors: **industry attractiveness** and **business unit strength**. For example, the AI solutions division, positioned in a highly attractive industry with a strong competitive edge, receives a "go ahead" for further investment. In contrast, its legacy software division, operating in a less attractive industry with a weaker position, receives a "be careful" rating, suggesting limited investment. Identify and explain which analytical tool InnovaTech is using for this evaluation.

14. What do you understand by Strategic Alliance? Discuss its advantages.

Chapter 5-Strategy Implementation and Evaluation

15. EcoTec, a company specializing in sustainable technology solutions, is facing challenges due to shifts in environmental regulations and market preferences. To manage these uncertainties, they regularly review and update their business assumptions and strategic plans based on changing regulatory environments and consumer trends. This proactive approach helps them stay aligned with evolving market conditions and maintain a competitive edge. Explain which approach is EcoTech to adapt to changes in regulations and market conditions?

16. **GloWare Ltd.**, an apparel manufacturer, has been in the market for over a decade. Until 2023, it operated on the founding principles of its CEO, focusing on a limited regional market. With new growth opportunities arising, GloWare is now interested in developing new competencies in areas such as digital marketing, product innovation, sustainable materials, and financial management. Recognizing that changing one area may impact others, the company wants a comprehensive understanding of the interconnected elements that contribute to its operational effectiveness.

    As a strategist, you are tasked with creating a questionnaire to analyze both the "hard" and "soft" elements of the organization. This assessment will enable GloWare to understand the factors that influence its effectiveness and to strategically align its structure, skills, and culture with its growth ambitions.

SUGGESTED ANSWERS/HINTS

MCQ No.	Answer	
1.	(i)	(a)
	(ii)	(a)
	(iii)	(c)
	(iv)	(c)
	(v)	(b)

2.		**(b)**
3.		**(c)**
4.		**(b)**
5.		**(d)**
6.		**(d)**

7. The Chief Executive Officer (CEO) position within XYZ Enterprises operates at the **Corporate Level.** This executive level is key in leading the overall direction, performance, and success of the entire organization. The CEO assumes a central role in shaping the company's strategic vision, overseeing diverse business sectors, and ensuring alignment with organizational goals.

Key Duties and Responsibilities of the CEO:

The CEO's role encompasses various strategic responsibilities at the Corporate Level, involving:

1. **oversee the development** of strategies for the whole organization;
2. **defining the mission and goals** of the organization;
3. **determining what businesses**, it should be in;
4. **allocating resources** among the different businesses;
5. **formulating, and implementing** strategies that span individual businesses;
6. **providing leadership** for the organization;
7. ensuring that the corporate and business level strategies which company pursues are consistent with **maximizing shareholders wealth**; and
8. managing the **divestment and acquisition** process.

Given the diverse nature of XYZ Enterprises, including renewable energy solutions, organic skincare products, eco-friendly packaging, and smart home technologies, the CEO's responsibilities are tailored to navigate the unique challenges and opportunities presented by each sector. In conclusion, the CEO at the Corporate Level plays a critical role in guiding

XYZ Enterprises strategically, ensuring cohesive leadership, and driving sustainable success across its diverse business domains.

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. Understanding the competitive landscape is crucial for Mr. Arun Kumar to navigate the handmade ceramic products industry in Gujarat successfully. This involves identifying both direct and indirect competitors while gaining insights into their vision, mission, core values, niche markets, and strengths and weaknesses. Here are the structured steps Mr. Kumar should follow to comprehend the competitive landscape and bolster his strategic position:

(i) **Identify the competitor:** The first step to understanding the competitive landscape is to identify the competitors in the

handmade ceramic products industry. Mr. Kumar should gather actual data on the market share and positioning of competitors within the industry.

(ii) **Understand the competitors:** Once the competitors have been identified, Mr. Kumar can use market research reports, the internet, newspapers, social media, industry reports, and various other sources to understand the products and services offered by competitors. This will help him comprehend how they position themselves in different markets and their unique selling propositions.

(iii) **Determine the strengths of the competitors:** Mr. Kumar should assess what the competitors excel at. Do they offer superior product quality? Are they using marketing strategies that reach a wider customer base? Why do consumers choose them over others? Understanding these strengths will help Mr. Kumar identify areas where his company, CeramiCrafts, can enhance its offerings.

(iv) **Determine the weaknesses of the competitors:** Weaknesses of competitors can be identified by reviewing customer feedback, consumer reports, and reviews. Consumers often share their experiences, especially when products or services are either exceptional or subpar. By examining these weaknesses, Mr. Kumar can find opportunities to position CeramiCrafts as a better alternative.

(v) **Put all of the information together:** At this stage, Mr. Kumar should consolidate all the information gathered about competitors. This will help him identify gaps in the market that his company can fill, as well as areas where CeramiCrafts needs to improve. By understanding the competition thoroughly, he can devise strategies that strengthen his market position.

By following these steps, Mr. Kumar can gain a comprehensive understanding of the competitive landscape, enabling him to make informed strategic decisions for CeramiCrafts. This tailored approach ensures that the insights gained are directly applicable to the handmade ceramic products industry in Gujarat.

10. Michael Porter's Five Forces model is a widely utilized tool for systematically analyzing the competitive forces within an industry. The model identifies five competitive forces that shape the overall competitive landscape:

- **Threat of New Entrants:** New entrants bring added capacity and product variety, intensifying competition and impacting prices. The size of new entrants magnifies their competitive influence, placing constraints on prices and affecting existing players' profitability.
- **Bargaining power of Buyers:** The ability of buyers to form groups or cartels influences their bargaining power. This force, particularly in industrial products, impacts pricing and often leads to demand for better services, influencing costs and investments for producers.
- **Bargaining power of Suppliers:** Suppliers with specialized offerings exert significant bargaining power, especially when limited in number. Supplier bargaining power determines raw material costs, affecting industry attractiveness and profitability.
- **Rivalry among Current Players:** Existing players engage in competition, influencing strategic decisions across various levels. This rivalry is evident in pricing, advertising, cost pressures, and product strategies, impacting the overall competitive landscape.
- **Threats from Substitutes:** Substitute products can alter an industry's competitive dynamics, offering price advantages or performance improvements. Substitutes limit prices and profits, and industries with substantial R&D investments are particularly susceptible to threats from substitute products.

These forces collectively determine industry's attractiveness and profitability by influencing factors such as costs and investments required for industry participation. The strength of these forces varies across industries, ultimately shaping the potential for earning attractive profits.

11. SWOT Analysis for ABC Corporation's New Smart Home Devices Venture:

Strengths	**Weaknesses**
• Strong brand reputation in consumer electronics.	• Limited experience in the smart home devices market.
• Established distribution network.	• May require additional investments in research and development.
• Access to technological expertise for product development.	• Potential challenges in integrating a new product line with existing offerings.
• Financial resources to support product launch and marketing.	• Lack of established customer base for smart home devices.
Opportunities	**Threats**
• Growing market for smart home devices due to increasing consumer interest in home automation.	• Intense competition from established players in the smart home devices market.
• The possibility of partnering with existing smart home platform providers.	• Rapid technological advancements lead to short product life cycles.
• Potential to leverage brand loyalty from existing customers.	• Potential for cybersecurity threats in connected devices.
• Ability to differentiate through innovative features and design.	• Economic factors impacting consumer spending on discretionary items.

The SWOT analysis highlights that while ABC Corporation has several strengths that can support the launch of a new smart home devices line, there are also significant weaknesses and threats to consider. To maximize the chances of success, ABC Corporation should focus on leveraging its brand reputation and distribution network while carefully addressing the weaknesses and threats identified. Additionally, being informed about technological developments and consumer trends will be essential for maintaining competitiveness in the dynamic smart home devices market.

12. Channels represent the **distribution system** through which organizations distribute their products or provide services to customers. They play a pivotal role in reaching target markets, maximizing sales, and establishing competitive advantages.

Channel analysis is important when the business strategy is to scale up and expand beyond the current geographies and markets. When a business plans to grow to newer markets, they need to develop or leverage existing channels to get to new customers. Thus, analysis of channels that suit one's products and customers is of utmost importance.

There are typically three channels that should be considered: sales channel, product channel and service channel.

- **The sales channel** - These are the intermediaries involved in selling the product through each channel and ultimately to the end user. The key question is: Who needs to sell to whom for your product to be sold to your end user? **For example**, many fashion designers use agencies to sell their products to retail organizations, so that consumers can access them.
- **The product channel** - The product channel focuses on the series of intermediaries who physically handle the product on its path from its producer to the end user. This is true of Australia Post, who delivers and distributes many online purchases between the seller and purchaser when using eBay and other online stores.

- **The service channel** - The service channel refers to the entities that provide necessary services to support the product, as it moves through the sales channel and after purchase by the end user. The service channel is an important consideration for products that are complex in terms of installation or customer assistance. **For example**, a Bosch dishwasher may be sold in a Bosch showroom, and then once sold it is installed by a Bosch contracted plumber.

13. InnovaTech is using the **GE Matrix**, a strategic tool designed to assess the resource allocation needs of different business units based on two factors: **industry attractiveness** and **business unit strength**. This matrix is a nine-cell grid that helps companies prioritize investments by categorizing units into "grow," "hold," or "harvest" zones, depending on their positions within the matrix.

For InnovaTech, the **AI solutions division**, which operates in a highly attractive industry with a strong competitive position, falls into the "grow" category, meriting further investment. Meanwhile, the **legacy software division** operates in a less attractive industry with weaker positioning, likely placing it in the "harvest" or "hold" category, where investments are minimized.

The GE Matrix enables companies like InnovaTech to systematically evaluate each business unit's potential, optimize resource allocation, and focus on divisions that align with long-term growth and profitability goals.

14. A strategic alliance is a relationship between two or more businesses that enables each to achieve certain strategic objectives which neither would be able to achieve on its own. The strategic partners maintain their status as independent and separate entities, share the benefits and control over the partnership, and continue to make contributions to the alliance until it is terminated. The advantages of strategic alliance can be broadly categorised as follows:

(a) **Organizational:** Strategic alliance helps to learn necessary skills and obtain certain capabilities from strategic partners. Strategic

partners may also help to enhance productive capacity, provide a distribution system, or extend supply chain.

(b) **Economic:** There can be reduction in costs and risks by distributing them across the members of the alliance. Greater economies of scale can be obtained in an alliance, as production volume can increase, causing the cost per unit to decline. The partners can also take advantage of co-specialization, creating additional value.

(c) **Strategic:** Rivals can join together to cooperate instead of competing. Strategic alliances may also be useful to create a competitive advantage by the pooling of resources and skills. This may also help with future business opportunities and the development of new products and technologies. Strategic alliances may also be used to get access to new technologies or to pursue joint research and development.

(d) **Political:** Sometimes strategic alliances are formed with a local foreign business to gain entry into a foreign market either because of local prejudices or legal barriers to entry.

15. EcoTech is using **Premise Control** to adapt to changes in regulations and market conditions. Premise Control is a strategic management approach focused on continuously monitoring and reviewing the underlying assumptions that form the basis of an organization's strategy. By regularly assessing these assumptions—such as environmental regulations and consumer preferences, EcoTech ensures that its strategic plans remain relevant and responsive to external changes. This proactive process helps the company make timely adjustments to its strategies, allowing it to stay competitive and aligned with the evolving market environment.

16. In addressing the strategic needs of **GloWare Ltd.**, the **McKinsey 7-S Model** serves as a valuable tool. This model examines how various "hard" and "soft" elements within the organization interact, with the understanding that modifying one aspect can create a ripple effect on other elements, helping to maintain a balanced and effective organizational structure. By analyzing these elements, **GloWare** can gain

insights into its organizational design and make strategic adjustments to improve performance.

The McKinsey 7-S Model categorizes elements into **hard** and **soft** components:

Hard Elements (directly managed by the company):

1. **Strategy**: The organization's direction and competitive approach, designed to leverage core competencies and achieve industry leadership.
2. **Structure**: The chosen organizational setup, shaped by resource availability and the degree of centralization or decentralization desired by management.
3. **Systems**: The daily operations, processes, and teams that execute objectives in an efficient and effective manner.

Soft Elements (influenced by organizational culture and more challenging to define):

1. **Shared Values**: Core beliefs that shape the culture and ethical code within the organization.
2. **Style**: Leadership style and its impact on decision-making, employee motivation, and goal delivery.
3. **Staff**: The talent pool and workforce capabilities.
4. **Skills**: The key competencies of employees that contribute to organizational success.

While the McKinsey 7-S Model provides a structured approach to analyzing organizational effectiveness, it has certain limitations:

1. **Limited Focus on External Environment**: The model focuses only on internal elements, potentially overlooking external factors impacting the organization.
2. **Undefined Organizational Effectiveness**: It does not clearly explain how to measure or achieve organizational effectiveness.

3. **Static Nature**: The model is considered more static and may lack flexibility in dynamic decision-making situations.

4. **Potential Gaps in Strategy Execution**: It may not fully capture gaps between strategy development and execution.

By applying the McKinsey 7-S Model, **GloWare Ltd.** can gain a comprehensive understanding of the interconnected elements within its organization and how they impact overall performance. Insights gathered from a questionnaire based on this model can inform strategic decisions, allowing **GloWare** to enhance growth, operational efficiency, and competitiveness in a changing market.