SUGGESTED ANSWERS JANUARY 2026

PAPER 6: FM & SM - INTERMEDIATE COURSE

PAPER – 6: FINANCIAL MANAGEMENT AND STRATEGIC MANAGEMENT

Part I – Multiple Choice Questions

Case Scenario - I

AB Infra Projects Limited operates in the construction and infrastructure sector, executing large-scale public and private projects. The company has shown consistent profitability and strong project execution capabilities, which is supported by a balanced mix of equity and long-term debt financing. With several new infrastructure projects under consideration, the management now wants to review the cost of capital to ensure that the company's financing decisions are efficient and aligned with the company's strategic growth objectives. The finance department is evaluating the cost of equity, cost of preference shares and cost of debentures to determine the company's overall Weighted Average Cost of Capital (WACC) and maintain financial stability. The capital structure of AB Infra Projects Limited is as follows:

Particulars	***Amount (₹)***
Equity Shares (face value 10 per share)	*60,00,000*
12% Preference Share Capital	*20,00,000*
10% Convertible Debentures	*40,00,000*
Total Capital of the Company	*1,20,00,000*

The following are some of the additional information provided by the company relating to the above-mentioned capital structure:

(i) The risk-free rate of return (R_f) is 6%, equity beta (β) is 1.25 and equity risk premium (Rp) is 8%.

(ii) The face value of 12% preference shares is ₹ 100 each. These shares are irredeemable, having a flotation cost of 4%. The current market price of preference share is ₹ 100 per share.

(iii) 10% convertible debentures of ₹ 100 each are issued with a maturity period of 5 Years. At maturity, the debenture holders will have an option to convert the debenture into equity shares of the company in the ratio of 1: 4 (4 shares for each debenture). The current market price of the equity share is ₹ 120 each and company expects share prices to grow at an average rate of 5% per annum in the future. The current market price per debenture is ₹ 150.

(iv) The rate of corporate income tax is 30%.

Based on the above information, you are required to answer the following questions 1 to 5:

1. *What is the cost of equity share capital using Capital Asset Pricing Model (CAPM) Approach and cost of irredeemable preference share capital?*

   (A) 14.5% and 13%

   (B) 15% and 11.5%

   (C) 16% and 12.5%

   (D) 17.5% and 12%

2. *What is the Redemption Value (RV) of debenture?*

   (A) ₹ 612.62

   (B) ₹ 650.60

   (C) ₹ 480.00

   (D) ₹ 515.50

3. *What is the cost of the convertible debentures using approximation method?*

   (A) 29.33%

   (B) 30.74%

   (C) 32.50%

   (D) 28.25%

4. *What is the weighted average cost of capital using market value weights?*

   (A) 16.05%

(B) *18.55%*

(C) *19.20%*

(D) *17.02%*

5. *If the capital structure remains unchanged, determine the market price per equity share (MPS) when the net profit available to equity shareholders (after tax) is ₹ 48,00,000 and the company's P/E ratio is 21.*

   (A) *₹ 168*

   (B) *₹ 175*

   (C) *₹ 150*

   (D) *₹ 180*

6. *Mr. X, a senior executive of BPC Electronics Limited has holding of 42,000 shares of the company. The shares are currently trading in the stock exchange at ₹ 480 per share. Mr. X has a policy of reinvesting the amount of any dividends received back into the shares of the company. BPC Electronics Limited has declared and paid a dividend of ₹ 30 per share.*

   What is the total number of shares that Mr. X would hold after he reinvests the dividend received in shares of BPC Electronics Limited?

   (A) *45,500 shares*

   (B) *44,800 shares*

   (C) *45,000 shares*

   (D) *44,625 shares*

7. *A firm maintains a separate account for cash disbursement. The administrative and transaction cost of transferring cash to the disbursement account is ₹ 25 per transfer. Marketable securities yield 10% per annum. The firm has determined its optimum cash balance at ₹ 30,000, according to the William J. Baumol Model.*

   What will be the Total Annual Cash Disbursements of the firm?

   (A) *₹ 18,00,000*

(B) ₹ 45,00,000

(C) ₹ 36,00,000

(D) ₹ 27,00,000

8. *ZED Ltd. is expecting to pay a dividend of ₹ 50 per share in the next financial year 2025-26. The company's speed of adjustment is 25%, the target pay-out ratio is 40%, and the earnings per share (EPS) for the year amount to ₹ 200.*

   What was the dividend paid for the financial year 2024-25 using Lintner's Model?

   (A) ₹ 30 per share

   (B) ₹ 40 per share

   (C) ₹ 60 per share

   (D) ₹ 50 per share

Case Scenario - II

Kalpanjali Dairy, a mid-sized cooperative based in Uttar Pradesh, has established a reputation over the past 20 years for producing traditional but high-quality dairy products sourced from small-scale farmers. Its operations are rooted in cooperative ethics, aiming for both profitability and farmer welfare.

Now, Kalpanjali is facing multiple cross-challenges rising competition, shifting health narratives, concern for climate change, and ethical debates around animal welfare. With a vision to become a national brand by 2035, Kalpanjali must rethink its plan of action.

The founders of Kalpanjali Dairy intended to create a values-driven brand that not only delivered quality but also empowered dairy farmers. It intends to become one of the top 10 dairy brands in India by 2035, with a strong presence in organic and health-based dairy offerings and proving good services, which is in a heavy demand and has to draw a vision plan accordingly.

A Value Chain Analysis revealed strength in material handling, stock control and better transportation system, but a gap in R&D and digital marketing.

After extensive stakeholder discussion, Kalpanjali considered three strategic options:

1. *Defensive Strategy Double down on traditional dairy and educate consumers on the nutritional value of milk and the ethical treatment of animals.*
2. *Diversification Strategy - Launch a vegan product line (e.g., almond/oat-based milk, vegan yogurt) under a sub-brand to appeal to changing preferences.*
3. *Collaborative Strategy - Partner with NGOs and health influencers to improve public image and trust.*

On detailed internal analysis of various strategic drivers, leadership opted for a hybrid strategy:

- *Continue improving and promoting high-quality dairy products with transparent animal welfare practices.*
- *Simultaneously launch a vegan line to cater to health-conscious and ethically driven consumers under a new sub-brand Kalpanjali Plant Wise.*
- *Investing in an R&D facility to develop almond milk, oat milk, and vegan ghee.*
- *Partnering with food tech startups and nutritionists.*
- *Training farmers to improve animal healthcare and promote "cruelty-free dairy" certification.*
- *A strong communication campaign: "Empowered by your choice, grounded in respect" - highlighting that Kalpanjali supports both dairy and plant-based lifestyles.*
- *Rebranding efforts to clearly differentiate the dairy and vegan lines while maintaining core brand identity.*

Based on the above case scenario, choose the correct answer to Question No. 9 to 13.

9. *Kalpanjali Dairy's action plan to become a top 10 dairy brand by 2035, with a strong presence in organic and health-based dairy offerings, is an example of:*

   (A) Strategic control

   (B) Strategic intent

   (C) Operational efficiency

   (D) Tactical planning

10. *Within the context of Kalpanjali Dairy's analysis, which of the following would be best classified as strength?*

    (A) Operations

    (B) Service

    (C) Inbound logistics

    (D) Sales

11. *Kalpanjali Dairy has decided to launch a new product line featuring vegan yogurt and organic milk in response to shifting consumer preferences.*

    This initiative represents which type of strategic option?

    (A) Market Penetration

    (B) Concentric Diversification

    (C) Conglomerate Diversification

    (D) Innovation

12. *There is external pressure on the company's traditional dairy business. Which type of strategic challenge is the company facing?*

    (A) Supply chain inefficiency

    (B) Industry deregulation

    (C) Socio-cultural shift impacting demand

    (D Technological disruption

13. *What strategic driver did company adopt for a long term strategy?*

    (A) Product

    (B) Industry

    (C) Pricing

    (D) Channel

14. *Herbal Care Pvt. Ltd., a reputed Ayurveda brand, had strong domestic sales but struggled to expand internationally due to unclear long-term direction. After reviewing its declining exports, the company introduced a strategic plan focused on global positioning, R&D investment, and sustainable packaging. The process unified departmental efforts, improved brand consistency, and attracted foreign partners. Within a short span, Herbal Care's exports rose significantly. This case highlights which key importance of strategic management?*

    (A) It enhances daily operational control.

    (B) It provides clear direction and long-term organizational focus to move ahead.

    (C) It focuses mainly on employee enhancement and growth.

    (D) It ensures faster product manufacturing.

15. *Urban Stay Realty decided to expand into Tier-2 cities after strategic planning. The firm allocated budgets, assigned projects to motivated teams, collaborated with local banks for financing, set up monitoring systems for construction and marketing activities, and develop conducive culture. Within two years, the company launched new housing projects successfully and captured market share in new regions. Which stage of strategic management does this case describe?*

    (A) Environmental Scanning

    (B) Strategy Formulation

    (C) Strategy Implementation

(D) *Evaluation and Control*

16. *A café is overcrowded on weekends but nearly empty on weekdays. To even out demand, it launches a "Workday Loyalty Card" with discounts for weekday visits. This strategy illustrates:*

    (A) *Demarketing*

    (B) *Augmented Marketing*

    (C) *Social Marketing*

    (D) *Synchro-marketing*

Answer Key

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

Part II – Descriptive Questions

SECTION A: FINANCIAL MANAGEMENT

*Question No. **1** is compulsory.*

*Attempt any **two** questions out of the remaining **three** questions.*

In case, any candidate answers extra question(s)/ sub-question(s) over and above the required number, then only the requisite number of questions first answered in the answer book shall be valued and subsequent extra question(s) answered shall be ignored.

Working notes should form part of the answer.

Question 1

(a) From the books of AIL Limited following information is taken for the year 2024-25:

Gross profit margin (25% of Sales)	*₹ 30,00,000*
Inventory holding period	*28 Days*
Opening Inventory	*₹ 8,00,000*
Current Ratio	*1.20*
Quick Ratio	*0.80*
Selling & Distribution Expenses	*₹ 12,00,000*
Depreciation and other Non-cash Expenses	*₹ 4,80,000*

Assume 360 days in a year.

You are required to calculate:

(i) Inventory as on 31.03.2025

(ii) Working Capital

(iii) Basic Defense Interval ***(5 Marks)***

(b) X Ltd. has average debtors of ₹ 90,00,000. The company's average collection period is 60 days. At present, it incurs credit administration expenses of ₹ 4,00,000 per year and bad-debt losses amounting to 1% of credit sales.

A factoring company has proposed to purchase these receivables by charging a commission of 2% on credit sales. The factor will provide an advance of 85% of receivables, after keeping 15% as reserve, and will charge interest at 15% per annum for the collection period. Assume 360 days in a year.

Required:

(i) Calculate the effective cost of factoring.

(ii) As a financial consultant, advise whether X Ltd. should accept the factoring proposal. ***(5 Marks)***

(c) PQR Ltd. is a leading company operating in the coal sector, engaged in the extraction, processing, and distribution of coal for industrial and energy purposes.

The following information is provided by the management of PQR Ltd.

Particulars	
Issued Share Capital	*₹ 24,00,000*
Dividend Paid	*10 per Share*
Growth Rate	*20% p.a. in perpetuity*
Cost of Equity (K_e)	*25%*

You are required to calculate:

(i) Using Gordon Model:

(a) The current market price of the share.

(b) Number of issued shares, if market price per share (MPS) is equal to face value per share.

(ii) Using Modigliani and Miller (MM) Hypothesis:

(a) The market price of the share at the end of year if dividend is paid. Use the current market price calculated in Gordon model as P_o.

(b) What will be the amount of earnings required for the company so that the MM hypothesis holds true, if the company has made new investments of ₹ 5,00,000 during the period and issued 1,000 new equity shares? ***(5 Marks)***

Answer

(a) (i) Sales $= \frac{30,00,000}{0.25}$ = ₹ 1,20,00,000

Gross Profit = ₹ 30,00,000

Cost of goods sold (COGS) = Sales - Gross Profit = ₹ 90,00,000

Average Inventory $= \frac{\text{Cost of goods sold (COGS)}}{\text{Inventory Turnover}}$

$= \frac{₹\ 90,00,000 \times 28}{360}$ = 7,00,000

$\frac{\text{Opening Inventory} + \text{Closing Inventory}}{2}$ = 7,00,000

8,00,000+Closing Inventory = 7,00,000 x 2

Closing Inventory = ₹ 6,00,000

(ii) Current Ratio $= \frac{\text{Current Assets (CA)}}{\text{Current Liabilities (CL)}}$

Or, $\frac{CA}{CL} = \frac{1.2}{1}$

$\therefore$ CA = 1.2 CL ......(1)

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

$= \frac{\text{Current Assets} - 6,00,000}{\text{Current Liabilities}}$

Or, 0.8CL = CA - 6,00,000

CA = 0.8CL + 600000 ......(2)

Equating 1 and 2

1.2 CL = 0.8CL + 6,00,000

CL = ₹ 15,00,000

CA = 1.2 CL = ₹ 18,00,000

Working Capital = CA – CL = 18,00,000 – 15,00,000 = ₹ 3,00,000

(iii) Basic Defense Interval Ratio = $\frac{\left(\begin{array}{c}\text{Cash and Bank balances} + \\ \text{Marketable Securities}\end{array}\right)}{\text{Operating Expenses (Cash)} \div \text{No. of days}}$

Cash Operating Expenses = COGS + Selling and Dist. Exp – Depreciation and Non-cash expenditures

= 90,00,000 + 12,00,000 - 4,80,000

= ₹ 97,20,000

Quick Assets = 18,00,000 – 6,00,000 = ₹ 12,00,000

Basic Defense Interval Ratio = $\frac{12,00,000}{97,20,000 \div 360} = \frac{12,00,000}{27,000}$ = 44.44 days

(b) (i) Working notes:

Credit Sales = $\frac{90,00,000 \times 360}{60}$ = ₹ 5,40,00,000

	Particulars	₹
A.	**Annual Savings (Benefit) on taking Factoring Service**	
	Cost of credit administration saved	₹ 4,00,000
	Bad debts avoided	₹ 5,40,000
	Total	₹ 9,40,000
B.	**Annual Cost of Factoring to the Firm:**	
	Factoring Commission [2% x 5,40,00,000]	₹10,80,000
	Interest Charged by Factor on advance (90,00,000 – 1,80,000 – 13,50,000) x 15%	₹ 11,20,500
	Total	₹ 22,00,500
C.	**Net Cost of Factoring to the Firm:**	**₹ 12,60,500**

Advance to be paid

$$= (90,00,000 - 1,80,000 - 13,50,000) - \left(\frac{₹\ 74,70,000 \times 0.15 \times 60}{360 \times 100}\right)$$

= ₹ 72,83,250

Rate of Effective Cost of Factoring to the Firm $= \frac{12,60,500}{72,83,250} \times 100$

$= 17.307\%$

Rate of Effective Cost of Factoring to the Firm can also be also calculated for advance without taking Interest into consideration:

Rate of Effective Cost of Factoring to the Firm

$$= \frac{12,60,500}{74,70,000\,(90,00,000 - 1,80,000 - 13,50,000)} \times 100 = 16.874\%$$

(ii) Advice: Since the cost to the firm exceeds the saving to the firm on account of factoring, therefore, the proposal should not be acceptable.

(c) (i) (a) $P_0 = \frac{E_1(1-b)}{K_e - br} = \frac{D_1}{K_e - g}$

$D_0 = 10$

$Ke = 25\%$

$g = 20\%$

$$P_0 = \frac{10(1+0.20)}{0.25-0.20} = 240$$

(b) Number of Shares $= \frac{24,00,000}{240} = 10,000$ shares

(ii) (a) As per MM Hypothesis,

$$P_o = \frac{P_1 + D_1}{1 + K_e}$$

$$240 = \frac{P_1 + 12}{1 + 0.25}$$

$$P_1 = 288$$

(b) Calculation of Amount of earning required

$$V_f \text{ or } nP_0 = \frac{(n + \Delta n)P_1 - I + E}{(1 + K_e)}$$

Where,

V_f = Value of firm in the beginning of the period

n = Number of shares in the beginning of the period

Δn = Number of shares issued to raise the funds required

I = Amount required for investment

E = Total earnings during the period

$$24,00,000 = \frac{[(10,000 + 1,000) \times ₹\,288] - ₹\,5,00,000 + E}{(1 + 0.25)}$$

30,00,000 = 26,68,000 + E

Amount of earnings required (E) = ₹ 3,32,000

Question 2

(a) RK Limited provided following data for the year ended on 31-03-2025:

Sales	*₹ 50,00,000*
EPS	*₹ 2.50*
Tax Rate	*₹ 40%*
Fixed cost excluding interest	*₹ 10,80,000*
The Capital structure is as under:	
Equity Share capital of ₹ 10/- each	*₹ 18,00,000*
10% Preference share of ₹ 100/- each	*₹ 9,00,000*
12% Debentures	*₹ 75,00,000*

You are required to:

(i) Calculate Earnings before Interest and Tax (EBIT).

(ii) Calculate Combined Leverage.

(iii) Advise, the level of sales where Earning before Tax (EBT) will be zero.

(5 Marks)

(b) Algo Steel Ltd. is a well-established company in the steel manufacturing sector, successfully operating for the past 20 years. The existing capital structure comprises of 80% equity and 20% debt. Company's Cost of Equity (K) is 13.5%, reflecting the return expected by shareholders. Its debt component comprises of a bank loan carrying an interest rate of 8% per annum. The company is subject to taxation and taxes are to be considered in project evaluation. After preliminary evaluation, the Board of Directors has shortlisted a project with the following details:

Particulars	
Initial Investment	*₹ 24,00,000*
Estimated Salvage Value	*10% of Initial Investment*
Expected Life of the Project	*4 years*
Tax Savings on Depreciation	*₹ 1,35,000 p.a.*
Method of Depreciation	*Straight Line Method (SLM)*

Particulars	***Year 1***	***Year 2***	***Year 3***	***Year 4***
Expected Cash Flows before depreciation & tax (in ₹)	*12,00,000*	*20,00,000*	*18,00,000*	*16,00,000*
PV Factor @ 10.00%	*0.909*	*0.826*	*0.751*	*0.683*
PV Factor @ 12.00%	*0.893*	*0.797*	*0.712*	*0.636*

Required:

(i) Calculate Average Rate of Return (ARR) based on Average Investment.

(ii) Calculate Net Present Value (NPV) by using Weighted Average Cost of Capital (WACC). ***(5 Marks)***

Answer

(a) (i) Calculation of Earnings before Interest and Tax (EBIT)

Particulars	**Amount (₹)**
Sales Revenue	50,00,000
Less: Variable Cost (Balancing figure)	21,20,000

Contribution	**28,80,000**
Less: Fixed Cost (excluding interest)	10,80,000
Earnings Before Interest & Tax (EBIT)	**18,00,000**
Less: Interest on Debentures (12% of ₹ 75,00,000)	9,00,000
Earnings Before Tax (EBT)	**9,00,000**
Less: Tax @ 40%	3,60,000
Profit After Tax (PAT)	**5,40,000**
Less: Preference Dividend (10% of ₹ 9,00,000)	90,000
Profit available to Equity Shareholders (1,80,000 × 2.50)	**4,50,000**

(ii) Combined Leverage = $\frac{\text{Contribution}}{\text{EBT - Pref. Dividend (Pre - tax)}}$

$$= \frac{₹\ 28,80,000}{₹\ 9,00,000 - 1,50,000} = 3.84$$

(iii) EBT zero means 100% reduction in EBT. Since combined leverage is 3.84, sales have to be dropped by 100/3.84 = 26.042%. Hence new sales will be ₹ 50,00,000 × (100 – 26.042) = ₹ 36,97,900.

Therefore, at ₹ 36,97,900. level of sales, the Earnings before Tax of the company will be equal to zero.

Combined Leverage and Sales can also be calculated without deducting preference dividend in following way:

(ii) Combined Leverage = $\frac{\text{Contribution}}{\text{EBT}} = \frac{₹\ 28,80,000}{₹\ 9,00,000} = 3.2$

(iii) EBT zero means 100% reduction in EBT. Since combined leverage is 3.2, sales have to be dropped by 100/3.2 = 31.25%. Hence new sales will be ₹ 50,00,000 × (100 – 31.25) = ₹ 34,37,500.

Therefore, at ₹ 34,37,500. level of sales, the Earnings before Tax of the company will be equal to zero.

(b) Annual Depreciation $= \dfrac{21,60,000\ (24,00,000 - 2,40,000)}{4}$

= ₹ 5,40,000

Tax Saving on Depreciation = Depreciation × Tax Rate

1,35,000 = 5,40,000 x Tax Rate

Tax Rate = 25%

(i) Average Rate of Return (ARR)

Statement of Profit after Tax

Particulars	**Year 1 (₹)**	**Year 2 (₹)**	**Year 3 (₹)**	**Year 4 (₹)**
Cash flow before dep. & tax	12,00,000	20,00,000	18,00,000	16,00,000
Less: Depreciation	5,40,000	5,40,000	5,40,000	5,40,000
Profit before tax	**6,60,000**	**14,60,000**	**12,60,000**	**10,60,000**
Less: Tax @ 25%	1,65,000	3,65,000	3,15,000	2,65,000
Profit after tax (PAT)	**4,95,000**	**10,95,000**	**9,45,000**	**7,95,000**

Average Rate of Return (ARR) $= \dfrac{\text{Average annual net income (PAT)}}{\text{Average Investment}}$

Total PAT = 4,95,000 + 10,95,000 + 9,45,000 + 7,95,000

= ₹ 33,30,000

Average PAT $= \dfrac{33,30,000}{4}$ = ₹ 8,32,500

Average Investment = (₹ 24,00,000 + ₹ 2,40,000)/2 = ₹ 13,20,000

Or, Average Investment = ½ (Initial Investment – Salvage Value) + Salvage Value

= ½ (₹ 24,00,000 - ₹ 2,40,000) + ₹ 2,40,000
= ₹ 13,20,000

ARR $= \dfrac{8,32,500}{13,20,000} \times 100$ = 63.068% or 63.07%

(ii) Calculation of WACC

WACC = (0.80 x 13.5%) + {0.20 x 6% (8% x 0.75)}

=10.8% + 1.2%

= 12%

Statement of Cash Flows after Tax

Particulars	**Year 1 (₹)**	**Year 2 (₹)**	**Year 3 (₹)**	**Year 4 (₹)**	**Year 4 (₹)**
Profit after tax (PAT)	4,95,000	10,95,000	9,45,000	7,95,000	
Add: Depreciation	5,40,000	5,40,000	5,40,000	5,40,000	
Cash Flow after Tax (CFAT)	10,35,000	16,35,000	14,85,000	13,35,000	2,40,000 (Salvage Value
PV Factor @12%	0.893	0.797	0.712	0.636	0.636
PV	**9,24,255**	**13,03,095**	**10,57,320**	**8,49,060**	**1,52,640**

Total PV of Inflows = ₹ 42,86,370

NPV = PV of Inflows – Initial Investment

= 42,86,370 – 24,00,000

= ₹18,86,370

Question 3

(a) The Balance Sheet extract of ST Ltd. as on March 31 (current year) is as follows:

Liabilities	***Amount (₹ in lakh)***	***Assets***	***Amount (₹ in lakh)***
Share capital	*260*	*Fixed Assets*	*600*
Reserves	*168*	*Inventories*	*360*
Long-term loans	*420*	*Receivables*	*270*
Short-term loans	*220*	*Cash & bank*	*78*
Payables	*144*		
Provisions	*96*		
	1,308		*1,308*

Sales for the current year amounted to ₹ 900 lakh. For the next financial year ending March 31 (next year), sales are expected to increase by 20%.

The net profit margin (after tax) is expected to be 5% of sales, and the dividend payout ratio is anticipated to be 50%.

Total assets including cash & bank and current liabilities (payables and provisions) vary directly with sales.

You are required to:

(i) Estimate the amount of external funds required (EFR) for the next financial year.

(ii) Determine the sources and composition of funds to meet the requirement, given the following parameters:

(1) The current ratio must be maintained at 1.40.

(2) The ratio of fixed assets to long-term loans should be 1.50.

(3) The remaining fund is raised by issue of Equity shares.

(4) The additional funds are to be raised in the following order of preference:

(i) Short-term bank borrowings

(ii) Long-term loans

(iii) Equity ***(8 Marks)***

(b) *Explain in what ways financial leverage operates as a "double edged sword".*

(2 Marks)

Answer

(a) (i) External Funds Requirement (EFR)

Particulars	**₹ in lakhs**
Expected sales (₹ 900 + 20% of ₹ 900)	1,080.00
Net profit margin @ 5%	54.00
Dividend payout ratio @ 50%	27.00
Balance to be ploughed back (A)	**27.00**

Additional assets required [(₹1,308 – (144+96)*] × 20% (B)	213.60
Balance to be met from external sources (B – A)	**186.60**

*As total assets and current liabilities (payables & provisions) increase proportionately with sales.

Calculation of External Funds Requirement (EFR) can be presented in the following way-

Particulars	**₹ in lakhs**
A. Projected Level of Assets (1308 x 1.20)	1,569.60
B. Projected Level of Payables & Provisions (144+96) x 1.20	288.00
C. Retained Earnings (900 x 1.20 x 0.05 x 0.50	27.00
D. Existing (Share Cap. + Reserves + LTL + STL) (260+168+420+220)	1068.00
External Funds Requirement (EFR): A - (B+C+D)	186.60

(ii) Amount to be raised from different sources subject to given conditions:

(1) Amount to be raised from Short-Term Bank Borrowings

Particulars	**₹ in lakhs**
A. New Current Assets (708 lakhs + 20% of 708 lakhs)	849.60
B. New current liabilities as per given condition	606.86
C. *Less:* Existing current liabilities (240 lakhs + 20% of 240 lakhs+220 lakhs)	508
D. Additional funds to be raised from Short-term bank borrowings (B-C)	98.86

To maintain Current Ratio = 1.40

Required Current Liabilities $= \frac{849.60}{1.40} = 606.86$ lakhs

(2) Amount to be raised from Long-Term Loans

Particulars	**₹ in lakhs**
Existing fixed assets	600.00
Increase @ 20%	120.00
New fixed assets	**720.00**

To maintain fixed assets to long-term loans = 1.50:

Long-term loans required = $\frac{720}{1.5}$ = 480.00 lakhs

Particulars	**₹ in lakhs**
Required long-term loans	480.00
Less: Existing long-term loans	420.00
Amount to be raised from long-term funds	**60.00**

(3) Amount to be raised from Equity Shares

Particulars	**₹ in lakhs**
External funds required	186.60
Less: From short-term funds	98.86
Less: From long-term funds	60.00
Balance to be raised by issue of Equity Shares	**27.74**

(b) When the cost of 'fixed cost fund' is less than the return on investment, financial leverage will help to increase return on equity and EPS. The firm will also benefit from the saving of tax on interest on debts etc. However, when cost of debt will be more than the return it will affect return of equity and EPS unfavourably and as a result firm can be under financial distress. Therefore, financial leverage is also known as "double edged sword".

Question 4

(a) Discuss briefly the key features of seed capital assistance as a source of finance. ***(4 Marks)***

(b) Why the Virtual banking service is popular among the customers?

Discuss the advantages of Virtual Banking. ***(4 Marks)***

(c) *Define financial distress. Briefly explain the consequences of a prolonged financial distress.* ***(2 Marks)***

OR

(c) *BEE Ltd. has a current ratio of 2:1, showing enough short-term liquidity in the company. You are required to comment whether the current ratio will improve, decline, or remain unchanged.* ***(2 Marks)***

Sr. No	***Transaction***	***Impact***
(i)	*A debtor owing ₹ 60,000 becomes insolvent and only 75% is recovered in cash in full and final settlement.*	
(ii)	*Issued equity shares for ₹ 2,00,000, proceeds kept in current account with bank.*	
(iii)	*₹ 25,000 collected from customers in cash.*	
(iv)	*Goods costing 8,000 sold for ₹ 12,500 on credit.*	

Answer

(a) Seed Capital Assistance: The Seed Capital Assistance scheme is designed by IDBI for professionally or technically qualified entrepreneurs and/or persons possessing relevant experience, skills and entrepreneurial traits but lack adequate financial resources. All the projects eligible for financial assistance from IDBI, directly or indirectly through refinance are eligible under the scheme.

The Seed Capital Assistance is interest free but carries a service charge of one per cent per annum for the first five years and at increasing rate thereafter. However, IDBI will have the option to charge interest at such rate as may be determined by IDBI on the loan if the financial position and profitability of the company so permits during the currency of the loan. The repayment schedule is fixed depending upon the repaying capacity of the unit with an initial moratorium up-to five years.

(b) The popularity which virtual banking services have won among customers is due to the speed, convenience and round the clock access they offer.

The advantages of virtual banking services are as follows:

(i) Lower cost of handling a transaction.

(ii) The increased speed of response to customer requirements.

(iii) The lower cost of operating branch network along with reduced staff costs leads to cost efficiency.

(iv) Virtual banking allows the possibility of improved and a range of services being made available to the customer rapidly, accurately and at his convenience.

(c) Financial distress is a position where Cash inflows of a firm are inadequate to meet all its current obligations.

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.

OR

(c)

Sr. No.	Transaction	Impact on Current Ratio
(i)	A debtor owing ₹ 60,000 becomes insolvent and only 75% is recovered in cash	**Declines**
(ii)	Issued equity shares for ₹ 2,00,000, proceeds kept in current account with bank	**Improves**
(iii)	₹ 25,000 collected from customers in cash	**No change**
(iv)	Goods costing ₹ 8,000 sold for ₹ 12,500 on credit	**Improves**

SECTION – B: STRATEGIC MANAGEMENT

Part II – Descriptive Questions

*Question paper comprises of **4** questions, Answer Question No. **5** which is compulsory and any **2** out of the remaining **3** questions.*

Question 5

(a) *Full Health Limited is a beverage company engaged in the production and distribution of energy drink. It plans to launch a new line of beverages targeted at health-conscious consumers. The Indian energy drink market, however, is already saturated with strong competitors, including several well-established national and international brands that command a significant market share. Considering the dominant position of these rival firms in the segment, which analytical tool would you recommend the manager to use to assess the market environment? Additionally, explain the procedure for implementing this tool effectively.* ***(5 Marks)***

(b) *Next Tech Solutions, an IT services firm, is suffering from declining client retention, rising operational costs, and outdated service offerings. Employee morale is low, and the firm's reputation for innovation has faded. Due to uncompetitive product and services, continuous losses, negative cash flow from business have alarmed investors. The board chooses not to wind up the operations but to rejuvenate the organization through effective leadership. They appointed Mr. Moksha a young and visionary executive to initiate strategic changes. What corporate strategy should Moksha adopt, and what measures should he take to implement this strategy effectively and ensure long-term sustainability?* ***(5 Marks)***

(c) *Mr. Rohit Khanna runs a chain of organic grocery stores under the brand name "Green Basket" in northern India. Over the past two years, he has faced intense competition from large retail chains and online delivery platforms offering organic products at discounted prices. Despite loyal customers, his profit margins are shrinking. On his consultant's advice, Rohit decided to undertake a comprehensive study to understand the competitors, their vision, mission, and financial status to gain competitive advantage. Identify the business analysis done by Mr. Rohit and discuss steps to carry out the same.* ***(5 Marks)***

Answer

(a) **Strategic Group Mapping** is the most appropriate analytical tool in the given case. Since the Indian energy drink market is **saturated and dominated by strong national and international competitors**, this tool helps in analysing **competition within the industry** by grouping firms that follow **similar strategies**. It enables the manager of *Full Health Limited* to understand the **relative competitive positions** of rival firms and identify **strategic gaps or opportunities**.

The procedure for constructing a **Strategic Group Mapping** and deciding which firms belong to which strategic group is as follows:

1. **Identify the competitive characteristics** that differentiate firms in the industry. Typical variables include price/quality range (high, medium, low), geographic coverage (local, regional, national, global), degree of vertical integration (none, partial, full), product-line breadth (wide, narrow), distribution channels used (one, some, all), and degree of service offered (no-frills, limited, full).
2. **Plot firms on a two-variable map** using selected pairs of these differentiating characteristics.
3. **Assign firms falling in the same strategy space** to the same strategic group.
4. **Draw circles around each strategic group**, making the circles proportional to the group's respective share of total industry sales revenue.

Thus, **Strategic Group Mapping** helps the manager assess **intra-industry competitive dynamics** and take informed decisions before launching a new beverage line in a **highly competitive market**.

(b) In the given case, **Next Tech Solutions** is facing continuous losses, declining client retention, outdated service offerings, low employee morale and negative cash flows. However, since the Board has decided **not to wind up the business** and has appointed a young and visionary leader, the most appropriate corporate strategy is **Turnaround Strategy**.

A **Turnaround Strategy** is adopted when an organisation is **sick but viable**, and management believes that through **corrective actions and effective leadership**, the firm can regain **profitability, competitiveness and long-term sustainability**.

Stages in the Action Plan for Turnaround Strategy

1. **Stage One – Assessment of Current Problems:** The first step is to diagnose the root causes of decline such as uncompetitive products, poor cash flow, rising costs and internal inefficiencies, and assess the extent of damage.

2. **Stage Two – Situation Analysis and Strategic Planning:** The firm should evaluate its chances of survival and develop a strategic plan focusing on improving competitiveness, employee morale and operational efficiency.

3. **Stage Three – Implementing an Emergency Action Plan:** Immediate steps are taken to stabilise the business, including cost cutting, improving cash flows, raising funds and addressing short-term operational issues.

4. **Stage Four – Restructuring the Business:** This stage involves restructuring core operations and finances, improving efficiency and repositioning the firm for recovery and growth.

5. **Stage Five – Returning to Normal:** The organisation gradually moves towards profitability by introducing new services, improving customer relationships, strengthening innovation and building long-term sustainability.

Thus, by adopting a **Turnaround Strategy** and systematically implementing these stages, Mr. Moksha can rejuvenate Next Tech Solutions and restore stakeholder confidence.

(c) In the given case, Mr. Rohit Khanna has undertaken **Competitor Analysis/Competitive Landscape analysis.** Competitor analysis is a part of **external environment analysis**, wherein a firm systematically studies its competitors to understand their **objectives, strategies, strengths, weaknesses and capabilities** in order to gain competitive advantage.

Steps to Understand the Competitive Landscape

1. **Identify the Competitors:** The first step is to identify existing and potential competitors in the industry and collect data regarding their respective market shares.
2. **Understand the Competitors:** After identification, information about competitors' products and services, pricing, distribution and strategies is gathered through sources such as market research reports, internet, newspapers, social media and industry publications.
3. **Determine Competitors' Strengths:** Analyse what competitors do well, such as superior products, strong branding, effective marketing or efficient operations and why customers prefer them.
4. **Determine Competitors' Weaknesses:** Weaknesses are identified through consumer reports, reviews and feedback available in various media, highlighting areas where competitors underperform.
5. **Put all of the information together:** All information is consolidated to identify gaps in competitors' offerings and areas where the firm can improve or differentiate to build competitive advantage.

Thus, through **Competitor Analysis**, Mr. Rohit can better understand the competitive dynamics of the organic grocery market and formulate suitable strategies to **protect profit margins and sustain the competitive position** of *Green Basket*.

Question 6

(a) What is Corporate culture? Where does it come from? ***(5 Marks)***

(b) In a business strategy, consider a firm pursuing cost leadership to become the lowest-cost producer in its industry. For this approach to be effective, what key conditions must be present? However, cost leadership is not without its pitfalls - discuss the potential disadvantages that could undermine its effectiveness. ***(5 Marks)***

Answer

(a) Corporate culture refers to a company's **values, beliefs, business principles, traditions, ways of operating and internal work**

environment. Every organisation has a **unique culture** shaped by its philosophy, history, values, rituals, work climate and ingrained ways of doing things. Corporate culture exerts a **powerful influence on the behaviour of managers and employees** and guides how decisions are made and work is carried out.

Where Does Corporate Culture Come From?

Corporate culture is shaped and manifested through the following sources:

1. **Values and Business Principles of Management:** The values, ethical standards and business principles that management **preaches and practices** strongly influence organisational culture.
2. **Organisational History and Traditions:** Past experiences, successes, failures, traditions, stories and legends repeated within the organisation help embed cultural values.
3. **Leadership Behaviour and Supervisory Practices:** The leadership style, attitudes and behaviour of managers shape employee conduct and work practices.
4. **Stakeholder Relationships:** Dealings with employees, unions, shareholders, vendors and the community influence beliefs and behavioural norms.
5. **Formal and Informal Systems:** Policies, procedures, reward systems, communication patterns, peer pressure and organisational politics together define and reinforce culture.

Thus, **corporate culture emerges over time** from multiple sociological forces operating at different levels of the organisation and acts as a **guiding force for employee behaviour, strategy execution and organisational performance**.

(b) **Cost Leadership Strategy** aims at becoming the **lowest-cost producer in an industry** while offering products or services of **acceptable quality**. It enables the firm to charge lower prices than competitors and still earn satisfactory profits.

Striving to be a low-cost producer in an industry can especially be effective,

- when the market is composed of many price-sensitive buyers and
- when there are few ways to achieve product differentiation.

Disadvantages of Cost Leadership Strategy

1. Cost advantage may not last long as competitors may imitate cost reduction techniques.
2. Cost leadership can succeed only if the firm can achieve higher sales volume.
3. Cost leaders tend to keep their costs low by minimizing cost of advertising, market research, and research and development, but this approach can prove to be expensive in the long run.
4. Technological advancement areas a great threat to cost leaders.

Thus, while **Cost Leadership Strategy** can provide a strong competitive advantage, its success depends on favourable conditions and continuous vigilance to avoid risks that may undermine its effectiveness.

Question 7

(a) An organization should select the right strategic performance measures that are aligned with its goals and objectives and provide relevant and actionable information. Explain all the factors and importance of these factors that needs to be considered. ***(5 Marks)***

(b) Innovation is widely regarded as a catalyst for business growth, enabling firms to upgrade existing products and processes, enhance customer satisfaction, and improve profitability. In light of this statement explain what an innovation offers to the organisation and any risk involved in doing so. ***(5 Marks)***

Answer

(a) Strategic performance measures should be **carefully selected** so that they are aligned with organisational goals and provide **relevant, reliable and actionable information**. In selecting the right measures, organizations should consider the following factors:

- **Relevance:** The measure should be relevant to the organization's goals and objectives and provide information that is actionable and meaningful.
- **Data Availability:** The measure should be based on data that is readily available and can be collected and analyzed in a timely manner.
- **Data Quality:** The measure should be based on high-quality data that is accurate and reliable.
- **Data Timeliness:** The measure should be based on data that is current and up to date, enabling organizations to make informed decisions in a timely manner.

These **factors are important** because they provide a way for organizations to **assess the success of their strategies, identify areas for improvement, and make informed decisions about how to allocate resources and adjust their strategies to achieve their desired outcomes**. Effective strategic performance measures should be relevant, meaningful, and easy to understand and should be regularly reviewed and updated to ensure their continued alignment with the organization's goals and objectives.

(b) **Innovation** refers to the creation and implementation of **new or significantly improved products, services, processes or business models**. Innovation acts as a key driver of **growth, competitiveness and long-term sustainability**.

Innovation refers to the upgradation of existing products, services or processes, which leads to **higher market share, revenues, profitability and customer satisfaction**. For long-term business growth, innovation plays a crucial strategic role.

What Innovation Offers to an Organisation

1. **Helps Solve Complex Problems:** Innovation enables businesses to identify opportunities in societal and business problems and develop **customer-centric and sustainable solutions**. Though initial costs may be high, innovation ensures long-term economic and environmental sustainability.

2. **Increases Productivity:** Innovation simplifies and automates tasks, reduces manual effort and improves efficiency. Automation and digital tools enhance productivity at both process and organisational levels, creating a ripple effect across industries.

3. **Gives Competitive Advantage:** Faster innovation helps firms move ahead of competitors. Innovative products offer greater customer satisfaction, require less marketing effort, help retain existing customers and attract new ones.

Risks Involved in Innovation

1. **High Cost and Financial Risk:** Innovation involves significant investment and returns may not be immediate or assured.

2. **Uncertain Returns:** Some innovations may not deliver expected benefits, making them appear as unnecessary expenses in the short run.

3. **Technological Uncertainty:** Rapid technological changes may make existing innovations obsolete.

4. **Implementation Risk:** Poor execution or lack of organisational capability can lead to failure of innovative initiatives.

Thus, while **innovation is a powerful driver of growth, productivity and competitive advantage**, it also involves risks that must be carefully managed to achieve **long-term sustainability and success**.

Question 8

(a) *Porter's five forces model hold that the state of competition in an industry is a composite of active competitive pressure in the market. Identify the areas of market in which competitive pressure operates.* ***(5 Marks)***

(b) *Objectives with a strategic focus is aimed at achieving outcomes that enhance an organization's overall business position and competitive strength. In view of the above statement, enumerate the characteristics of ideal objectives that are meaningful and effectively serve their intended purpose.* ***(5 Marks)***

OR

(b) *Write short note on concept of strategy.*

Answer

(a) **Porter's Five Forces Model** holds that the state of competition in an industry is a composite of competitive pressures operating in five areas of the overall market:

- Competitive pressures associated with the market manoeuvring and jockeying for buyer patronage that goes on among rival sellers in the industry.
- Competitive pressures associated with the threat of new entrants into the market.
- Competitive pressures coming from the attempts of companies in other industries to win buyers over to their own substitute products.
- Competitive pressures stemming from supplier bargaining power and supplier-seller collaboration.
- Competitive pressures stemming from buyer bargaining power and seller-buyer Collaboration.

(b) Objectives with strategic focus relate to outcomes that strengthen an organisation's overall business position and competitive vitality. Objectives, to be meaningful to serve the intended role, must possess the following characteristics:

- Objectives should define the organisation's relationship with its environment.
- They should be facilitative towards achievement of mission and purpose.
- They should provide the basis for strategic decision-making.
- They should provide standards for performance appraisal.
- They should be concrete and specific.
- They should be related to a time frame.
- They should be measurable and controllable.
- They should be challenging.
- Different objectives should correlate with each other.

♦ Objectives should be set within the constraints of organisational resources and external environment.

Or

In the context of business, **strategy** refers to the ways in which an organisation **responds to dynamic and often hostile external forces** while pursuing its **vision, mission and long-term objectives**. The idea of strategy is incorporated to **reduce uncertainty and complexity** arising from environmental changes.

Strategy seeks to **relate the goals of the organisation to the means of achieving them**. It is the **game plan of management** to take market position, conduct operations, attract and satisfy customers, compete successfully and achieve organisational objectives.

Strategy may be defined as a **long-range blueprint of an organisation's desired image, direction and destination**—what it wants to be, what it wants to do, how it wants to do things and where it wants to go. It provides an **integrated and unified framework** for mobilising resources, directing human effort and handling opportunities and threats.

Strategy is **flexible and pragmatic in nature**, enabling the organisation to adapt to environmental changes and unforeseen situations. It integrates organisational goals, policies and actions into a **cohesive whole**, ensuring long-term survival, growth and competitive advantage.

A strategy may be formulated at the **corporate level, divisional level** and **functional level.** The corporate wide strategies are operationalized by divisional and functional strategies. A company's strategy is typically a blend of **proactive actions** on the part of managers to improve the company's market position and financial performance, and **reactive actions** to unanticipated developments and fresh market conditions in the dynamic business environment.