Mock Test Paper - Series I: November, 2024
Date of Paper: 23rd November, 2024
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INTERMEDIATE: GROUP – II
PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT
PAPER 6A : FINANCIAL MANAGEMENT
Suggested Answers/ Hints
PART I – Case Scenario based MCQs

1. (c) ₹ 0.72

Computation of EPS under financial plan I: Equity Financing

	(₹)
EBIT	37,50,000.00
Interest	-
EBT	37,50,000.00
Less: Taxes 40%	(15,00,000.00)
PAT	22,50,000.00
No. of equity shares	31,25,000.00
EPS	0.72

2. (b) ₹ 0.90

Computation of EPS under financial plan II: Debt – Equity Mix

	(₹)
EBIT	37,50,000.00
Less: Interest	(14,06,250.00)
EBT	23,43,750.00
Less: Taxes 40%	(9,37,500.00)
PAT	14,06,250.00
No. of equity shares	15,62,500.00
EPS	0.90

3. (a) ₹ 0.44

Computation of EPS under financial plan III: Preference Shares – Equity Mix

	(₹)
EBIT	37,50,000.00
Less: Interest	-

EBT	37,50,000.00
Less: Taxes (40%)	(15,00,000.00)
PAT	22,50,000.00
Less: Pref. dividend	(15,62,500.00)
PAT for equity shareholders	6,87,500.00
No. of Equity shares	15,62,500.00
EPS	0.44

4. (a) ₹ 28,12,500

EBIT – EPS Indifference Point- Plan I and Plan II:

$$\frac{(\text{EBIT})\times(1\text{-}T_C)}{N_1}=\frac{(\text{EBIT}-\text{Interest})\times(1-T_C)}{N_2}$$

$$\frac{\text{EBIT}(1-0.40)}{31,25,000}=\frac{(\text{EBIT}-14,06,250)\times(1-0.40)}{15,62,500}$$

0.6EBIT = 1.2 EBIT – 16,87,500

= ₹ 28,12,500

5. (d) ₹ 52,08,333.33

EBIT – EPS Indifference Point: Plan I and Plan III

$$\frac{\text{EBIT}(1-T_c)}{N_1}=\frac{\text{EBIT}(1-T_c)-\text{Pref. Div.}}{N_2}$$

$$\frac{\text{EBIT}(1-0.4)}{31,25,000}=\frac{\text{EBIT}(1-0.4)-15,62,500}{15,62,500}$$

0.6EBIT = 1.2EBIT – 31,25,000

EBIT = ₹ 52,08,333.33

6. (b) 30%

The formula for Degree of Combined Leverage (DCL) is:

DCL=DOL×DFL

DCL=2×3=6

The percentage change in EPS is:

% Δ EPS = DCL × % Δ Sales

% Δ EPS = 6 × 5% = 30%

7. (c) 3.79

Initial Investment = Annual Cost Savings × PVAF

Annual cost savings = ₹ 1,80,000

PVAF (10%, 5 years) = 3.79

Initial Investment = 1,80,000 × 3.79 = 6,82,200

Payback Period = Initial Investment/ Annual Cost Savings

= 6,82,200/1,80,000

= 3.79 years

8. (c) **Remains unchanged because value depends on earnings and investment policy.**

(Explanation: M&M's theory suggests that dividend policy has no impact on shareholder wealth in a perfect market.)

PART II – Descriptive Questions

1. (a) **Statement showing Computation of Combined leverage**

	₹
Sales	2,00,000
Less: Variable costs (50%)	1,00,000
Contribution	1,00,000
Less: Fixed operating costs	40,000
EBIT	60,000
Less: Interest	10,000
Taxable Income (PBT)	50,000

Combined leverage $= \frac{C}{PBT} = \frac{1,00,000}{50,000} = 2$

The combined leverage of '2' indicates that with every increase of ₹ 1 in sales, the taxable income will increase by ₹ 2 (i.e. 1×2). This can be verified by the following computations when the sales increase by 10%

	₹
Sales	2,20,000
Less: variable costs (50%)	1,10,000
Contribution	1,10,000
Less: Fixed operating costs	40,000
EBIT	70,000
Less: Interest	10,000
Taxable Income (PBT)	60,000

It is clear from the above computation that on account of increase in sales by 10%, the profit before tax has increased by 20%.

(b) (i) Computation of Weighted Average Cost of Capital based on existing capital structure

Source of Capital	Existing Capital structure (₹)	Weights (a)	After tax cost of capital (%) (b)	WACC (%) (a) × (b)
Equity share capital (W.N.1)	10,00,000	0.250	10.000	2.500
12% Preference share capital	15,00,000	0.375	12.000	4.500
10% Debentures (W.N.2)	15,00,000	0.375	6.500	2.438
Total	40,00,000	1.000		9.438

Working Notes:

1. Cost of Equity Capital:

$$K_e = \frac{\text{Expected dividend}(D_1)}{\text{Current Market Price}(P_0)} + \text{Growth}(g)$$

$$= \frac{₹\,5}{₹\,100} + 0.05$$

$$= 10\%$$

2. Cost of 10% Debentures

$$K_d = \frac{\text{Interest}(1-t)}{\text{Net proceeds}}$$

$$= \frac{₹\,1,50,000\,(1-0.35)}{₹\,15,00,000}$$

$$= 0.065 \text{ or } 6.5\%$$

(ii) Computation of Weighted Average Cost of Capital based on new capital structure

Source of Capital	New Capital structure (₹)	Weights (a)	After tax cost of capital (%) (b)	WACC (%) (a) x (b)
Equity share capital (W.N.3)	10,00,000	0.222	12.777	2.836
12% Preference share capital	15,00,000	0.334	12.000	4.000
10% Debentures (W.N.2)	15,00,000	0.333	6.500	2.165

12% Debentures (W.N.4)	5,00,000	0.111	7.800	0.866
Total	45,00,000	1.000		9.867

Working Notes:

3. Cost of Equity Capital:

$$K_e = \frac{₹\,7}{₹\,90} + 0.05$$

$= 12.777\%$

4. Cost of 12% Debentures

$$K_d = \frac{₹\,60{,}000\,(1-0.35)}{₹\,5{,}00{,}000}$$

$= 0.078$ or 7.8%

(c) Fair Value of Company = Present Value all future cash flows discounted at the expected Rate of return of acquiring company.

WN 1 – Calculation of Cash flows **₹ in Lakhs**

YEAR	**1**	**2**	**3**	**4**	**5**	**6**
Contribution (40% on sales)	10	12	14.4	20.16	28.22	35.28
(-) Fixed Cost	-12	-12	-10	-10	-10	-10
NPBT (A)	-2	0	4.4	10.16	18.22	25.28
(-) Losses Set Off	0	0	-2(Setoff)	0	0	0
Taxable Income	0	0	2.4	10.16	18.22	25.28
(-) Tax @ 25% **(B)**	0	0	0.6	2.54	4.55	6.32
Cash Flow (A – B)	**-2**	**0**	**3.8**	**7.62**	**13.66**	**18.96**
PV OF CASH FLOWS @ 15%	-1.740	0	2.50	4.35	6.79	8.19

Total PV of cash flows (yr 1 to 6) = 20.08 lakhs

(+) PV of cash flow at terminal value (end of Year 6) = $\frac{18.96 + 10\%}{0.15 - 0.10}$

= 417.12 Lakhs

Therefore, PV of above = 417.12 X PV factor (15%, 6^{th} Year) = 180.20 lakhs

Total fair value of Aryayash limited = 20.08 + 180.20 = 200.28 Lakhs

Note – 1. Discounting rate should be the desired rate of acquiring company i.e. of Vyom Limited

2. Terminal value of cash flows means the cash flows at that point from where it would grow at constant rate. Here it assumed that from 7^{th} year, Cash flows/NPAT will grow at a constant rate and not sales

2. (a) Working Note:

1. Current Liabilities and Current Assets:

Let Current Liabilities be x

Given Current ratio = 2.5

Current Assets = 2.5x

Working Capital = 2.5x- x =1.5x

or x = 1,20,000/1.5 = 80,000

So Current Liabilities = 80,000

And Current Assets = 80,000 x 2.5 = 2,00,000

2. Closing Stock

Given, Quick Ratio = 1.3

$$\frac{\text{CurrentAssets - Closing Stock}}{\text{CurrentLiabilities - Bank Overdraft}} = 1.3$$

$$\frac{2{,}00{,}000 - \text{Closing Stock}}{80{,}000 - 15{,}000} = 1.3$$

or Closing Stock = 2,00,000-84,500 =1,15,500

Opening Stock = 1,15,000 x 100/110 =1,05,000

3. Debtors

Given Debtors Velocity = 40 days

$$\frac{\text{Debtors}}{\text{Sales}} \times 365 = 40$$

$$\text{Debtors} = \frac{7{,}30{,}000 \times 40}{365} = 80{,}000$$

4. Gross Profit = 7,30,000 x 10/100 = 73,000

5. Proprietary Fund:

Proprietary Ratio = 0.6

$$\frac{\text{Fixed Assets}}{\text{Proprietary Fund}} = 0.6$$

$$\frac{\text{Working Capital}}{\text{Proprietary Fund}} \quad 0.4$$

$$\text{Proprietary Fund} = \frac{1{,}20{,}000}{0.4} = 3{,}00{,}000$$

Fixed Assets = 3,00,000 x 0.6 = 1,80,000

Net Profit = 10% of Proprietary Fund = 30,000

M/s Anya Co Ltd.

Trading and Profit and loss Account for the year ended 31 March 2024

Particulars	Amount in ₹	Particulars	Amount in ₹
To Opening Stock	1,05,000	By Sales	7,30,000
To Purchase (Balancing Fig.)	6,67,500	By Closing Stock	1,15,500
To Gross Profit	73,000		
	8,45,500		**8,45,500**
To Operating Expenses (Balancing Figure)	43,000	By Gross Profit	73,000
To Net Profit	30,000		
	73,000		**73,000**

Balance Sheet as on 31 March 2024

Liabilities	Amount in ₹	Assets	Amount in ₹
Share Capital	2,50,000	Fixed Assets	1,80,000
Reserves & Surplus (Opening bal. + current profit)	50,000		
Current Liabilities		*Current Assets*	
Bank Overdraft	15,000	Stock	1,15,500
Other Current Liabilities	65,000	Debtors	80,000
		Other Current Assets	4,500
	3,80,000		**3,80,000**

(b) As per Dividend discount model, the price of share is calculated as follows:

$$P= \frac{D_1}{(1+K_e)^1}+\frac{D_2}{(1+K_e)^2}+\frac{D_3}{(1+K_e)^3}+\frac{D_4}{(1+K_e)^4}+\frac{D_5}{(K_e-g)}\times\frac{1}{(1+K_e)^4}$$

Where,

P = Price per share

K_e = Required rate of return on equity

g = Growth rate

Calculation PV of Dividends

Year	Dividend per share	PVF @ 15%	PV
1	4.4	0.870	3.828
2	4.84	0.756	3.660
3	5.324	0.658	3.503
4	5.856	0.572	3.350
Total			14.341

PV of Terminal Value = $\frac{₹5.856 \text{x} 1.05}{(0.15-0.05)^1} \times \frac{1}{(1+0.15)^4}$ = 61.488 x .572 = 35.171

Intrinsic value of share = PV of Dividends + PV of terminal value

= 14.341 + 35.171 = ₹ 49.512

3. 1. In-House Management of Receivables (With Dynamic Discounting)

Particulars:

1. **Cash Discount Cost:**
   - Revised discount rate: 2.5%
   - 60% of customers avail discount.
   - **Cost of Discount:** ₹ 90,00,000 × 60% × 2.5% = ₹ 1,35,000
2. **Bad Debts (Reduced to 0.8% due to dynamic discounting):**
   - ₹ 90,00,000 × 0.8% = ₹ 72,000
3. **Administration Cost:** ₹ 1,20,000
4. **Cost of Financing Receivables:**
   - **Working Note 1 (Average Collection Period):** (10 days × 60%) + (60 days × 40%) = 30 days
   - **Working Note 2 (Average Receivables):** ₹ 90,00,000 × (30/360) = ₹ 7,50,000
   - **Working Note 3 (Cost of Financing):**
     - Cost of Bank Funds: ₹ 7,50,000 × 1/2 × 15% = ₹ 56,250
     - Cost of Owned Funds: ₹ 7,50,000 × 1/2 × 14% = ₹ 52,500
     - **Total Cost of Financing Receivables:** ₹ 1,08,750

Total Cost with In-House Receivables Management and Dynamic Discounting:

Particulars	Amount (₹)
Cash Discount (₹ 90,00,000 × 60% × 2.5%)	1,35,000
Bad Debts (₹ 90,00,000 × 0.8%)	72,000
Admin Cost	1,20,000

Cost of Financing Receivables	1,08,750
Total Cost (In-House with Dynamic Discounting):	**4,35,750**

2. Factoring Firm's Offer:

Particulars:

1. **Factoring Commission:** ₹ 90,00,000 × 4% = ₹ 3,60,000
2. **Interest Charges on Receivables:** Factor Reserve: 12%, so financing on 88% of receivables. Interest for 25 days: (₹ 90,00,000-3,60,000) × 88% × 15% × (25/360) = ₹ 79,200
3. **Cost of Owned Funds (Receivables not factored):** ₹ 13,96,800 × 14% × (25/360) = ₹ 13580

Owned Funds: (₹ 90,00,000-3,60,000) × 12% + 3,60,000 = ₹ 13,96,800

Total Cost with Factoring Firm:

Particulars	Amount (₹)
Factoring Commission (₹ 90,00,000 × 4%)	3,60,000
Interest Charges on Receivables	79,200
Cost of Owned Funds	13,580
Total Cost with Factoring:	**4,52,780**

3. Impact of Extending Credit Period:

If Zomo Ltd. extends the credit period to 75 days:

- **Sales increase:** 10% of ₹ 120,00,000 = ₹ 12,00,000

  New total turnover = ₹ 120,00,000 + ₹ 12,00,000 = ₹ 1,32,00,000

  Credit Sales (75%) = ₹ 99,00,000
- **Increased Bad Debts (1.5%):** ₹ 99,00,000 × 1.5% = ₹ 1,48,500
- **Late Payment Penalty:** Customers delaying beyond 60 days (40%): ₹ 99,00,000 × 40% × 5% = ₹ 1,98,000

A. Cash Discount Cost:

- **Discount rate:** 2% (since there's no mention of dynamic discounting in this case)
- **Percentage of customers availing discount:** 60%
- **Calculation:** ₹ 99,00,000 × 60% × 2% = ₹ 1,18,800

B. Bad Debts (Increased to 1.5%):

- **Calculation:** ₹ 99,00,000 × 1.5% = ₹ 1,48,500

C. Administration Costs (Remains the same):

- The administration cost stays fixed at ₹ 1,20,000, as no change in admin structure is mentioned.

D. **Cost of Financing Receivables (Based on the new extended credit period):**

- **Working Note 1 (Average Collection Period):** Credit period has been extended to 75 days for customers who don't take the discount (40% of customers).
  - **Revised Average Collection Period:** (10 days × 60%) + (75 days × 40%) = 36 days
- **Working Note 2 (Average Receivables):** ₹ 99,00,000 × (36/360) = ₹ 9,90,000
- **Working Note 3 (Cost of Financing Receivables):**
  - **Cost of Bank Funds (15%):** ₹ 9,90,000× 1/2 × 15% = ₹ 74,250
  - **Cost of Owned Funds (14%):** ₹ 9,90,000 × 1/2 × 14% = ₹ 69,300
  - **Total Cost of Financing Receivables:** ₹ 74,250 + ₹ 69,300 = ₹ 1,43,550

Revised Bad Debts after Penalty:

- **Bad debts before penalty:** ₹ 1,48,500
- **Penalty earned:** ₹ 1,98,000
- **Net effect on bad debts:** ₹ 1,48,500 - ₹ 1,98,000 = (-₹ 49,500) (Zomo Ltd. would effectively earn ₹ 49,500 from penalties, reducing bad debt cost.)

4. **Total Cost Calculation:**

Now, summing up all the components:

Particulars	Amount (₹)
Cash Discount (₹ 99,00,000 × 60% × 2%)	1,18,800
Net Bad Debts after Penalty (–₹ 49,500)	-49,500
Administration Costs	1,20,000
Cost of Financing Receivables	1,43,550
Total Cost (In-House with Extended Credit Period)	**₹ 3,32,850**

5. **Final Decision:**

Option	Total Cost (₹)
In-House with Dynamic Discounting	4,35,750
Factoring Firm's Offer	4,52,780
In-House with Extended Credit Period	**3,32,850**

Recommendation: Zomo Ltd. should **extend the credit period** and continue in-house management. This option will not only reduce costs (due to lower bad debts offset by penalties) but also increase sales by 10%. Factoring is the least beneficial due to its high commission charges, and dynamic discounting offers only marginal savings compared to the credit extension option.

4. **(a)** The financing of current assets involves a trade off between risk and return. A firm can choose from short or long term sources of finance. Short term financing is less expensive than long term financing but at the same time, short term financing involves greater risk than long term financing.

Depending on the mix of short term and long term financing, the approach followed by a company may be referred as matching approach, conservative approach and aggressive approach.

In matching approach, long-term finance is used to finance fixed assets and permanent current assets and short term financing to finance temporary or variable current assets. Under the conservative plan, the firm finances its permanent assets and also a part of temporary current assets with long term financing and hence less risk of facing the problem of shortage of funds.

An aggressive policy is said to be followed by the firm when it uses more short term financing than warranted by the matching plan and finances a part of its permanent current assets with short term financing.

(b) Over-capitalization and its Causes and Consequences

It is a situation where a firm has more capital than it needs or in other words assets are worth less than its issued share capital, and earnings are insufficient to pay dividend and interest.

Causes of Over Capitalization

Over-capitalisation arises due to following reasons:

(i) Raising more money through issue of shares or debentures than company can employ profitably.

(ii) Borrowing huge amount at higher rate than rate at which company can earn.

(iii) Excessive payment for the acquisition of fictitious assets such as goodwill etc.

(iv) Improper provision for depreciation, replacement of assets and distribution of dividends at a higher rate.

(v) Wrong estimation of earnings and capitalization.

Consequences of Over-Capitalisation

Over-capitalisation results in the following consequences:

(i) Considerable reduction in the rate of dividend and interest payments.

(ii) Reduction in the market price of shares.

(iii) Resorting to “window dressing”.

(iv) Some companies may opt for reorganization. However, sometimes the matter gets worse and the company may go into liquidation.

(c) “The profit maximisation is not an operationally feasible criterion.” This statement is true because Profit maximisation can be a short-term objective for any organisation and cannot be its sole objective. Profit maximization fails to serve as an operational criterion for maximizing the owner's economic welfare. It fails to provide an operationally feasible measure for ranking alternative courses of action in terms of their economic efficiency. It suffers from the following limitations:

(i) Vague term: The definition of the term profit is ambiguous. Does it mean short term or long term profit? Does it refer to profit before or after tax? Total profit or profit per share?

(ii) Timing of Return: The profit maximization objective does not make distinction between returns received in different time periods. It gives no consideration to the time value of money, and values benefits received today and benefits received after a period as the same.

(iii) It ignores the risk factor.

(iv) The term maximization is also vague.

OR

(c) **Modified Internal Rate of Return (MIRR):** There are several limitations attached with the concept of the conventional Internal Rate of Return. The MIRR addresses some of these deficiencies. For example, it eliminates multiple IRR rates; it addresses the reinvestment rate issue and produces results, which are consistent with the Net Present Value method.

Under this method, all cash flows, apart from the initial investment, are brought to the terminal value using an appropriate discount rate (usually the cost of capital). This results in a single stream of cash inflow in the terminal year. The MIRR is obtained by assuming a single outflow in the zeroth year and the terminal cash inflow as mentioned above. The discount rate which equates the present value of the terminal cash inflow to the zeroth year outflow is called the MIRR.

PAPER 6B: STRATEGIC MANAGEMENT

ANSWERS

PART I

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

PART II

1. (a) According to Mendelow's Matrix, environmentally conscious consumers who influence industry standards fall into the **Key Players** quadrant. These stakeholders possess both high power and high interest, making them crucial to the success of *Chic Threads'* sustainability-focused initiatives. Their high interest stems from their alignment with the brand's ethical and eco-friendly values, while their high power arises from their ability to shape market trends, advocate for sustainable practices, and impact on the brand's reputation through their purchasing decisions and influence within the industry.

As Key Players, these consumers require active engagement. *Chic Threads* must focus on satisfying their expectations by providing regular updates on sustainability efforts, maintaining transparent communication, and incorporating their feedback to ensure continued support. The brand should actively involve these stakeholders in its decision-making processes by seeking their input on product design and sustainability measures. Additionally, building strong relationships through targeted marketing campaigns, collaborations, and awareness initiatives will further solidify their trust and advocacy. Effectively managing this stakeholder group is vital, as their support and satisfaction directly contribute to the success of the brand's eco-friendly clothing line.

(b) To target tech-savvy consumers for the new smartphone model, the tech company can develop a marketing strategy based on customer behavior. Consumer behaviour may be influenced by a number of things. These elements can be categorised into the following conceptual domains:

- **External Influences:** Utilize online platforms and tech forums to generate buzz around the new smartphone. Partner with tech influencers and bloggers to review the product and create awareness among tech-savvy consumers.
- **Internal Influences:** Appeal to the desire for innovation and advanced features among tech-savvy consumers. Highlight the unique selling points of the new smartphone, such as its cutting-edge technology, performance, and design.
- **Decision Making:** Recognize that tech-savvy consumers are early adopters who value functionality and performance. Provide detailed specifications and comparisons with other smartphones to help them make an informed decision.

- **Post-decision Processes:** Offer excellent customer service and support to address any technical issues or concerns. Encourage customers to provide feedback and reviews to build credibility and trust among tech-savvy consumers.

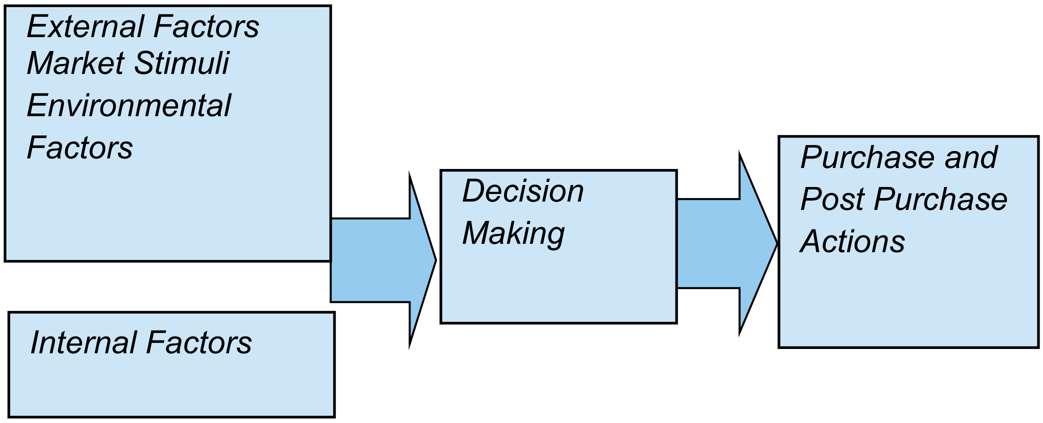

Figure: Process of consumer behaviour

By understanding the behavior of tech-savvy consumers and aligning the marketing strategy with their preferences, the tech company can effectively promote the new smartphone and attract this demographic.

(c) Strategic Performance Measures (SPM) are metrics organizations use to evaluate and track the effectiveness of their strategies in achieving their goals and objectives. SPM provides a framework for monitoring key areas critical to the organization's success, ensuring progress toward desired outcomes and enabling timely adjustments to improve performance. For *GreenEdge Solutions*, various types of SPM can be utilized:

- **Financial Measures:** Metrics like revenue growth, return on investment (ROI), and profit margins help evaluate the company's financial health and profitability.
- **Customer Satisfaction Measures:** Assessments of customer satisfaction, retention, and loyalty indicate how well the company meets customer needs.
- **Market Measures:** Market share, customer acquisition, and referral rates reflect competitiveness and market position.
- **Employee Measures:** Employee satisfaction, engagement, and turnover rate help track workplace culture and talent retention.
- **Innovation Measures:** R&D spending, patent filings, and new product launches gauge the company's innovation capabilities.
- **Environmental Measures:** Monitoring energy consumption, waste reduction, and carbon emissions ensures the company aligns with sustainability goals.

Using these measures, *GreenEdge Solutions* can systematically assess its strategy and make informed decisions to drive sustainable growth and success.

2. **(a)** *Connect Group* has to make strategic changes for its survival. The changes in the environmental forces often require businesses to make modifications in their existing strategies and bring out new strategies. Strategic change is a complex process that involves a corporate strategy focused on new markets, products, services and new ways of doing business. Unless companies embrace change, they are likely to freeze and unless companies prepare to deal with sudden, unpredictable, discontinuous, and radical change, they are likely to be extinct.

Three steps for initiating strategic change are:

(i) **Recognise the need for change** – The first step is to diagnose the which facets of the present corporate culture are strategy supportive and which are not.

(ii) **Create a shared vision to manage change** – Objectives of both individuals and organisation should coincide. There should be no conflict between them. This is possible only if the management and the organisation members follow a shared vision.

(iii) **Institutionalise the change** – This is an action stage which requires the implementation of the changed strategy. Creating and sustaining a different attitude towards change is essential to ensure that the firm does not slip back into old ways of doing things.

(b) The term '**strategic management'** refers to the managerial process of developing a strategic vision, setting objectives, crafting a strategy, implementing and evaluating the strategy, and initiating corrective adjustments were deemed appropriate.

The presence of strategic management cannot counter all hindrances and always achieve success as there are limitations attached to strategic management. These can be explained in the following lines:

♦ **The environment is highly complex and turbulent.** It is difficult to understand the complex environment and exactly pinpoint how it will shape up in future. The organisational estimate about its future shape may awfully go wrong and jeopardise all strategic plans. The environment affects as the organisationhas to deal with suppliers, customers, governments and other external factors.

♦ **Strategic management is a time-consuming process.** Organisations spend a lot of time preparing, communicating the strategies that may impede daily operations and negatively impact on routine business.

♦ **Strategic management is a costly process.** Strategic management adds a lot of expenses to an organization. Expert strategic planners need to be engaged, efforts are made for analysis of external and internal environments devise strategies and properly implement. These can be really costly for organisations with limited resources particularly when small and medium organisation create strategies to compete.

- **Competition is unpredictable.** In a competitive scenario, where all organisations are trying to move strategically, it is difficult to clearly estimate the competitive responses to the strategies.

3. **(a)** Yes, *Easy Access* and its rivals get advantage by this move. The new bureaucratic process is making it more complicated for organizations to start up and enter the *Easy Access* market, increasing barriers to entry and thereby reducing the threat of new entrants. New entrants can reduce an industry's profitability, because they add new production capacity, leading to increase in supply of the product, sometimes even at a lower price and can substantially erode existing firm's market share position. However, New entrants are always a powerful source of competition. The new capacity and product range they bring in throws up a new competitive pressure. The bigger the new entrant, the more severe the competitive effect. New entrants also place a limit on prices and affect the profitability of existing players, which is known as Price War.

(b) There are several basis of differentiation, major being: Product, Pricing and Organization.

Product: Innovative products that meet customer needs can be an area where a company has an advantage over competitors. However, the pursuit of a new product offering can be costly – research and development, as well as production and marketing costs can all add to the cost of production and distribution. The payoff, however, can be great as customers' flocks are among the first to have the new product.

Pricing: It fluctuates based on its supply and demand and may also be influenced by the customer's ideal value for a product. Companies that differentiate based on product price can either determine to offer the lowest price or can attempt to establish superiority through higher prices.

Organisation: Organisational differentiation is yet another form of differentiation. Maximizing the power of a brand or using the specific advantages that an organization possesses can be instrumental to a company's success. Location advantage, name recognition and customer loyalty can all provide additional ways for a company to differentiate itself from the competition.

4. **(a)** *Leatherite Ltd.* is currently manufacturing footwears for males and females and its top management has decided to expand its business by manufacturing leather bags for males and females. Both the products are similar in nature within the same industry. The strategic diversification that the top management of *Leatherite Ltd.* has opted for is concentric in nature. They were in business manufacturing leather footwear and now they will manufacture leather bags as well. They will be able to use existing infrastructure and distribution channels.

Concentric diversification amounts to related diversification.

In concentric diversification, the new business is linked to the existing businesses through process, technology or marketing. The new product is a spin-off from the existing facilities and products/processes. This means that in concentric diversification too, there are benefits of synergy with the current operations.

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

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

OR

Strategic planning	Operational planning
Strategic planning shapes the organisation and its resources.	Operational planning deals with current deployment of resources.
Strategic planning assesses the impact of environmental variables.	Operational planning develops tactics rather than strategy.
Strategic planning takes a holistic view of the organisation.	Operational planning projects current operations into the future.

Strategic planning develops overall objectives and strategies.	Operational planning makes modifications to the business functions but not fundamental changes.
Strategic planning is concerned with the long-term success of the organisation.	Operational planning is concerned with the short-term success of the organisation.
Strategic planning is a senior management responsibility.	Operational planning is the responsibility of functional managers.