FINAL EXAMINATION

GROUP III

(SYLLABUS 2008)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 2013

Paper-13 : MANAGEMENT ACCOUNTING–STRATEGIC MANAGEMENT

Time Allowed : 3 Hours **Full Marks :** 100

SECTION I (60 MARKS)

(STRATEGIC MANAGEMENT)

Answer Question No. 1, and other two more from the rest in this section.

(Please answer all parts of the question at one place.)

1. **(a) In each of the cases/statements given below, one of four alternatives is correct. Indicate the correct answer: 1x10=10**

(i) The role of leadership can be best evaluated by looking at
(A) Vision
(B) Strategy
(C) Succession Planning
(D) All of the above

(ii) Successful differentiation strategy allows the company to
(A) Gain buyer to its brand
(B) Charge to high a price premium
(C) Depend only on intrinsic product attributes
(D) Segment a market into distinct group of buyers

(iii) '3C' model in business management (value based) consists of
(A) Customers, costs and competition
(B) Customers, context and channels
(C) Cost, capital and capability
(D) Competitors, channels and context

(iv) BSNL's plan behind introduction of 'Internet Plan 99', ISDN virtual private Network etc. would be an example
(A) Utilisation of newer technology
(B) Portfolio generation
(C) Diversification of business
(D) Product development

(v) The corporate governance framework should ensure
- **(A) Rights of stakeholders are established by law**
- **(B) Equitable treatment to all stakeholders**
- **(C) Timely and accurate disclosure of all material matters finance and ownership of the company**
- **(D) All of the above and social responsibility**

(vi) The difference between strategic alliances and joint ventures can best be explained by
- **(A) All strategic alliances are joint ventures**
- **(B) All joint ventures are strategic alliances**
- **(C) All strategic alliances are temporary phenomena**
- **(D) All joint ventures involve equity participation**

(vii)'Swift Desire' model of Maruti Ltd. provides interesting example to fit in the BCG matrix as
- **(A) Star**
- **(B) Question Mark**
- **(C) Cash Cow**
- **(D) Dog**

(viii) IBM found, after analyzing computer processing time that 80% of processing time was concerned with executing 20% of software operating code. As a result, its programmers rewrote the code to make the most frequently used parts of it is as streamlined as possible. This is possible. Because of
- **(A) GE Matrix**
- **(B) Pareto Analysis**
- **(C) Value Engineering**
- **(D) Benchmarking**

(ix) You engage a call taxi by dial-a taxi facility. This is an example of
- **(A) One Level marketing channel**
- **(B) Zero Level marketing channel**
- **(C) No marketing channel**
- **(D) Two Level marketing channel**

(x)The sale of tea through one-cup tea bag is an example of the following distinctive capability:
- **(A) Distribution**
- **(B) Innovation**
- **(C) Sales and marketing**
- **(D) New services**

(b) State whether the following statements, based on the quoted terms, are 'TRUE or FALSE', justifying your answer. If any statement is false, you are required to give the correct terms. No credit will be given for any answer without justification: 1x5=5

(i) 'Maturity' stage of PLC is characterized by decreasing rate of increase in sales volume.

(ii) At 'EOQ', the carrying cost per unit is equal to the ordering cost per unit.

(iii) 'Spider- Web' is a joint venture strategy where a firm begins a relationship which is not that strong and then develops several joint ventures which can lead to a merger.

(iv) 'Forecasts' are projections derived from a mathematical process and quantify factors for the future period.

(v) 'Goals are stated in broad, general terms, timeless and deal with matters of image, style and self- perception.

(c) Define the following terms (in not more than two sentences): 1x5=5

(i) Grand strategy
(ii) Market Information System
(iii) Technological Environment
(iv) Marketing Strategy Planning
(v) Marginal Pricing

Answer 1.

(a) (i) D – All of the above

(ii) A – Gain buyer loyalty to its brand

(iii) A – Customers, cost and competition

(iv) D – Product development

(v) D – All of the above and social responsibility

(vi) B – All joint ventures are strategic responsibility

(vii) A – Star

(viii) B – Pareto Analysis

(ix) B – Zero Level marketing channel

(x) B – Innovation

(b) (i) True

(ii) True

(iii) False: "Successive Integration Strategy".

(iv) False: "Forecast are predictions and include judgments, while projection are trend patterns obtained by extrapolation".

(v) False: "Objectives"

(c) (i) The comprehensive, general plan of major actions or a statement of means indicating how the objectives are to be achieved or a master strategy intended to guide the acquisition and allocation of resources over an extended period of time.

(ii) It is an information system used in gathering, analyzing and disseminating information about price and other information relevant to product.

(iii) The developed technology adopted by industries determines the type and quality of goods and services to be produced.

(iv) Marketing Strategy Planning means finding attractive opportunities and developing profitable marketing strategies.

(v) Marginal pricing refers to fixing a price which is above the marginal cost of the product but below its total cost which includes the fixed overheads.

2. (a) What are the factors that form the basis of analysis in each of the following models?

(i) BCG Matrix (ii) GE Matrix (iii) Hofer Matrix and (iv) ADL Matrix

(b) Critics of Nike often complain that it's shoes cost almost nothing to make, yet cost the consumer so much. Identify the strategic marketing planning steps which provide value that add to Nike's offering and result in the high price of Nike's shoes.

(c) What do you understand by 'compound Annualized Growth Rate (CAGR)'?

(d) What is meant by 'Backward Integration'? (1+4+3+3)+(1x5)+2+2

Answer 2.

(a) Factors that from the basis of analysis in the various models:

(i) BCG Matrix analyses product and businesses by
Market Share and Market Growth

(ii) **GE Matrix:** Industry attractiveness Vs Business Strength or Competitive position.
Industry Attractiveness: availability of inputs, overall market size, annual market growth rate, profitability, competitive intensity, technological requirements, capacity utilization.
Business Strength or Competitive Position: Market share growth rate, brand image, after sale service, pricing, distribution capacity, product quality, technology.

(iii) Hofer Matrix: Competitive position and Stage of product/Market evaluation State of Product – development growth, shake out, maturity and saturation, decline or death.

(iv) **ADL Matrix**: Competitive position Vs Stages in industry maturity.
Competitive position: dominant, strong, farourable, tenable, weak.

Stages in industry maturity: embryonic, growth, mature and ageing.

(b) The strategic marketing planning steps which provide value that add to Nike's offering and result in the high price of Nike's shoes are:
(i) Conduct a situation analysis
(ii) Determine marketing objectives
(iii) Selecting target market and measuring demand
(iv) Designing strategic marketing mix, and
(v) Prepare annual marketing plan

(c) The CAGR is a year-over-year growth rate of an investment over a specific period of time. The CAGR is calculated by taking the nth root of the total percentage growth rate where n is the number of years in the period being considered.

(d) Backward integration means in-house production of critical inputs for the main business.

3. A mobile phone company which was already in the business of laptops and portable computing devices to capture a wide range of customers. It took the following steps:

(i) It adopted a technology where mobile phones could be simply used as phones or connected to the laptop using a hardware device or use wireless connection to the internet. Printing could also be done directly from the mobile through a printing device. The technology allowed transfer of selected contents of SIM/ mobile phone memory into memory cards which were also sold by the company as accessories in small quantities of 5 cards per packet.

(ii) It introduced a wide range of products – from the basic key punch to a touch pad and even voice recognition system. It also introduced landline models which were bigger devices and could be used in a fixed location by multiple users (as in households or offices) using the same mobile numbers, by using a wireless connector between the portable model and landline model.

(iii) It entered into tie-up arrangements with financial institutions having numerous service outlets in metros, similar towns and rural areas and provided a scheme where buyers could play in easy installments, while making an interest- fetching fixed deposit with the respective outlets. This scheme would psychologically aid the buyers while safe guarding the seller against potential bad – debts in case the product becomes obsolete.

(a) Classify the above measures into the marketing mix strategy as defined Mc Carthy.

(b) What are the market segments that the company is trying to reach out to?

(c) It is criticized that while (iii) above provides access to a large number of customers, the scheme entails customers' outlay of the cost of the phone as fixed deposit as well as the first installment. Could you suggest other schemes to aid customers in buying higher

models even if they do not have enough cash, while keeping in mind the possibility of obsolescence, bad – debts and recovery costs?

(d) What are the parameters in which you could effectively use the analysis for the information given in (i) to (iii) above? 4+6+5+5

Answer 3.

(a) Mc Carthy's Marketing Mix Strategy:

Product: Innovative – using laptop connection, wireless connection to internet, printing from mobile, memory cards-accessories, land line interchange, voice recognition.

Place: Wide reach through urban and rural outlets.

Price: attractive price for affordability and credit price

Promotion:

(b) The market segments that the company is trying to reach are:

(i) Based on users – various age groups use the different models (from school children to the elderly.)

(ii) Based on geographical access to funding: highly placed officials use all the accessories and facilities, while even the lower economic range would use the lower end model.

(iii) Based on affordability and use of facilities: highly placed officials use all the accessories and facilities, while even the lower economic range would use the lower end model.

(iv) Based on attraction to non-existing segments which are only using landlines: these users will gradually convert to this new facility.

(v) Based on ancillary product's usage: users of printers, laptops, landlines, internet etc.

(vi) Based on financial tie-ups: persons may be induced to make the FDs for availing credit. This may be psychological boost while spending on consumable goods.

(c) (i) There could be a tie-up arrangement with the existing credit card/debit card banker for easy building and collection, so that the credit worthiness is monitored by the existing set up.

(ii) for the salaried class, a direct collection from the employer may be availed, so that default is lesser.

(iii) The number of installments or period of credit could be made lesser to take care of the obsolescence.

(iv) Instead of fresh FD, a takeover of the deposit may be considered without having to pass the penalty of foreclosure to the customer.

(v) Readily marketable value of other idle assets like gold could be taken as a safety mechanism in lieu of FD.

(d) Pareto analysis could be used in the given scenario in the following ways:

Concentrate on:

80% of the profit making product models and induce customers to buy.

80% of the non-defaulting customers try to retain them and repeat buying by offering more schemes.

80% of the market segment and bring better models/after sale service etc.

80% of the sales value generating products and strengthen tie-ups with the allied products like laptops etc.

80% of the geographical location buying the products and offer more value addition to those segments.

4. Write short notes (any four) on the following: **5x4**

(a) Lean Accounting

(b) Social Audit

(c) Strategic Business Unit (SBU)

(d) Logistic strategies

(e) Porter's generic strategies

Answer 4.

(a) Lean accounting: It refers to the application of lean principles in day to day accounting process by eliminating 3Ms (muda-waste, muri-variation, and mura-stain on resources) by looking at it from eyes of the costomer/user/beneficiary group. Lean accounting highlights the importance of the lean performance measurements and reporting in the general accounting for lean application process. There are basically three aspects to measure lean performance as given under:

(i) Development of strategy which supports, company level measurement,

(ii) Continuous improvement through value stream level measurements, and

(iii) Process and cell design measurements driving the 'mudiari' Process.

(b) Social audit is mechanism that empowers the people to audit any scheme, programme, policy or law since it is the people who happen to be the ultimate beneficiaries of these elements. The following are the benefits of an effective social audit:

(i) Comparing the performance with reference to policies and objectives of the organization;

(ii) Assessing comparative effectiveness of scheme, programme, policy etc.;

(iii) Good reputation of the society;

(iv) Encouragement of social concern;

(v) Encourages democracy in the local community through participative approach;

(vi) Develops human resources and social capital;

(vii) Promotes collective decision-making and sharing responsibilities.

(c) A multi-business enterprise groups related business units from the strategic planning stand point. Each such grouped business unit will have its own mission, objectives, competition and strategy and is evaluated for its profit performance. Such a business is called a Strategic Business Unit (SBU).

SBU purposes grouping. There is no need for any grouping in a single product single business entity. There is no effective use.

(d) Logistic refers to the flow of supplies or raw materials and other ingredients of products into and through an organization as also the disposal of wastes and craps so as to ensure production process continuing as per schedule. The process of management involved in known as supply chain management. The objective of logistic strategy is to ensure that materials and ingredients of the right quality and quantity are available at the right place and the right time. Management of logistic strategy thus includes maintaining regular contact with suppliers, intermediaries to the channel of distribution, and the transport operators concerned – with roadways, railways and sea transport, if necessary.

(e) Porter's Generic Strategies: This strategy has become an important influence on the development of organizations' strategies. Porter argues that there are three fundamental ways in which the firms can achieve sustainable competitive advantage. They are:

(i) A cost leadership strategy,

(ii) A differentiation strategy, and

(iii) A focus strategy.

SECTION II (40 Marks)

(Risk Managements)

Answer Question No. 5 and other two more from the rest in this section.

(Please answer all parts of the question at one place.)

5. **(a) In each of the cases/ statements given below, one of four alternatives is correct the correct answer:** **1x5**

(i) Portfolio Managements reduces

(A) Systematic risk

(B) Unsystematic risk

(C) Inflation risk

(D) Interest rate risk

(ii) Subrogation means

(A) Utmost good faith
(B) The active efficient case that sets in motion a chain of events which brings about a result
(C) The transfer of all rights and remedies available to the insured after indemnity has been effected
(D) Mitigation of loss

(iii) Unsystematic risk related to
(A) Market risk
(B) Beta
(C) Inherent risk
(D) Inflation risk

(iv) Instruments that hedge against risk do not include
(A) Letter of credit
(B) Underwriting
(C) Factoring
(D) Rights issues
(E) Guarantee

(v) Value migration suggests the needs to monitor on continuous basis to detect and measure the changes happening in value flows
(A) Between the industries
(B) Between the companies
(C) Between the divisions of a company
(D) Both (A) and (B) above
(E) All of the above

(b) State whether the following statements, based on the quoted terms, are 'TRUE or FALSE', with justifying for your answer. If any statement is false, you are required to give the correct terms. No credit will be given for any answer without justification:1x5

(i) 'Loss Control' is a method of risk financing for managing pure risk.
(ii) There is no distinction between risk and uncertainty in the business filed.
(iii) 'Knock- for-Knock' agreement in a motor insurance provides that in the event of damage caused by collision, each owner will bear his own loss irrespective of legal liability.
(iv) The current market price of an option is ₹105, strike price is ₹100, the call option premium is ₹9. The 'intrinsic value' is ₹109.
(v) In future trading the exchange rate at which the currencies are agreed to be exchanged under the contract is called' call and put option'.

Or,

An exporter who expects to receive foreign exchange after 6 months enters into a 'call option' which entitles him to sell the foreign currency at maturity at a predetermined price(strike price).

Answer 5.

(a) (i) A – Systematic risk
(ii) C – The transfer of all the rights and remedies available to the insured after indemnity has been effected.
(iii) C – Inherent risk
(iv) D – Rights Issues
(v) E – All of the above

(b) (i) False: "Loss Control aims at controlling the occurrences of losses, while risk financing aims to fund the risk that may arise".
(ii) False: "Former implies that chances of each outcome occurring is known and latter implies that odds can only be guessed".
(iii) False: "It is an agreement between the insurers writing motor insurance. The respective insurers and not the owners bear the loss".
(iv) False: "The Intrinsic value is Rs. 5".
(v) False: "it is called Strike Price".
Or False: "Put Option".

6. (a) What are the basic parts of an Insurance contract?

(b) How do you shape institutions for project risk management and what are the strategies to be adopted?

(c) A businessman wants to decide whether to stock commodity A or commodity B. He can stock either but not both. If he stocks A, if it is a success, he feels that he can make ₹200 but if it is failure, he will loose ₹500. If he chooses A, there is an 80% chance of making ₹200. If he stocks B and if it is success, he feels that he can make ₹400 but if it is a failure, he would loose ₹300. If he chooses B, there is 60% chance of making ₹400 but if it is a failure, he would loose ₹300. If he chooses B, there is 60% chance of making ₹400.
The question is: which commodity A or B should the businessman stock? 6+(1+2)+6

Answer 6.

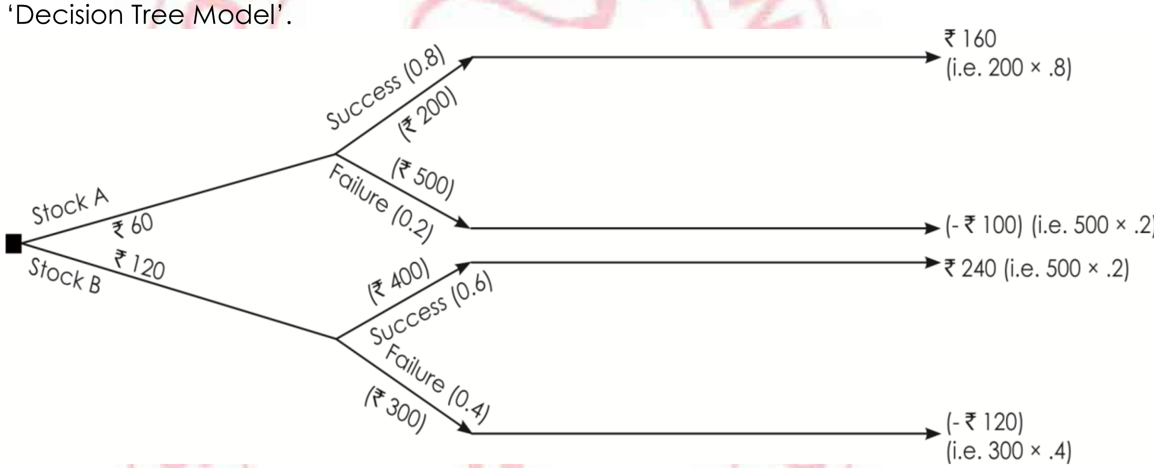
(a) The basic parts of an insurance contract – are as follows:

(i) Declaration – are the statements that provide information about the property or activity to be insured.
(ii) Definitions – clear the meaning of key words or phrases.

(iii) Insuring agreement – summarizes the major promises of the insurer.
(iv) Exclusions – three major types of excluded perils, excluded losses, and excluded property.
(v) Conditions – rules specific to a geographic location.
(vi) Miscellaneous provisions – situation or purpose specific.

(b) Institutions can be shaped by anchoring projects, ensuring repayment of investments, providing social utility.
This risk could be avoided by stabilization of long term future to enable investment, enhance the legitimacy of the project by developing practices like inviting the representatives of both the institutions and the public. Develop a strong framework for structuring decision making.

(c) Adopting the "**Rolling Back"** technique, the problem may be solved through simple 'Decision Tree Model'.



At stock A, the expected pay-off would be : Rs. (200 x 0.8) – (500 x 0.2) = Rs. 60
At stock B, the expected pay-off would be : Rs. (400 x 0.6) – (300 x 0.4) = Rs. 120
Therefore, as the expected pay-off at stock B (Rs. 120) is better than the expected pay-off of stock A (Rs. 60), we should stock commodity B, if we can have a stock of only one commodity.

7. (a) Developing a firm beyond its present market space it to a combination of risks. What are these risks?

(b) What is meant by; insurance policy reserve'? Mention the various of policy reserves.

(c) "The concept of pooling risk is the process of identification of separate risks and put them together in a single basket, so that the monitoring, combining, integrating or diversifying risk can be implemented." – Elucidate the statement with suitable examples.

4+(1+5)+5

Answer 7.

(a) Developing a firm beyond its present market space exposes it to a combination of four sorts of risks. These risks are:

(i) market risk

(ii) Product risk

(iii) Operational and managerial risk

(iv) Financial risk

(b) The Insurance Policy Reserve can be defined as the difference between the present value of future benefits and the present value of future net premiums.

The various types of insurance policy reserves are:

Basis of Classification	Name of the reserve
Time of experience:	
Past	Retrospective
Future	Prospective
Time of valuation:	Terminal, Initial and Mean
Financial view point:	
	Unearned Premium,
	Equity in Unearned Premium,
	Loss reserve: Claim reserved based on Judgment, Average Value and Tabular method, Incurred but not Reported Reserve.
Special case for LIC:	Policy reserve or legal reserve.

(c) Monitoring becomes easier when the specific agency put in charge knows that all the risks have been identified and they are being monitored according to the systematic drawn up to quantify the total risk through pooling and with a control figure i.e., plan the way to monitor, actually monitor, and then check whether there are variations from the monitoring exercise and then act to correct the deviation. This correction act can be combining risks or integrating risks or diversifying risks.

For example, whenever a project is put up insurance (Marine insurance) is taken for shipping the various plant and machinery from the manufacturers to the port near the project site. The logistics from the port to the project site is taken care of by the carrier and he insures (transit insurance) the risk for the segment. The material is received at site and stored until erection (storage insurance). During erection of different plant and machinery, mechanical, electrical etc. risk is covered (erection insurance). The erected plant and machinery is then tested and trial runs are taken for guarantee purposes on continuous run as per the contract. The risk during this period is covered as risk for commercial run. All these risks put together is polling and in each separate policy has a risk value and premium and conditions attached there to by the insurer and insured has to carry out those obligations. This is the process of monitoring.

To reduce risk after pooling it can be combining through a comprehensive policy from the plant and machinery Freight on Board (FOB) to the completion of final commercial guarantee run. Integrating risks will be to take care of all the foreign shipments together, inland transit risks together so that these risks which are similar are taken together.

Diversification of risks involves indentifying that fraction, which is systematic and the remaining unsystematic. Systematic risk is that inherent and peculiar to the type of business or the organization and can be reduced or diversified by acting within the organization, which is through functional level strategy. The unsystematic risk, which is the market risk is external to an organization and is also termed as market risk. The identification of characteristics of market risk through statistical correction "Beta", which is a measure of market risk, leads itself for manipulation through portfolio management.

8. Write short notes (any three) on the following: 5x3

(a) Project risk

(b) 'Cause proxima' principle of insurance

(c) Pure risk and Speculative risk

(d) Exclusions in an insurance contract

Answer 8.

(a) The project-specific risk for an individual investment project occurs because the cash-flows from the project might be higher or lower than expected, for reasons that are specific to the project.

Type of project risk: this risk can be classified under three heads:-

(i) Standalone Risk: This is a quantification of risk of a project when it is viewed in isolation.

(ii) Corporate Risk: When the project is taken as a part of the corporate entity, its contribution towards the risk of the company.

(iii) Systematic Risk: This represents the market risk of the project.

The project risk can be measured statistically by applying the following methods:-

(i) Range, (ii) Mean absolute deviation, (iii) Standard Deviation, (iv) Co-efficient of Variance (COV) and (v) Semi-Variance.

Out of the above, Standard Deviation can be easily determined. It is widely used to measure the risk as it contains all data relating to its probability distribution. While project risk analysis is attempted, 'what-if' analysis is becomes very important to determine the inter-dependencies of the variables.

Towards this, sensitively analysis is a tool, and can be done by the following steps:

(a) Identify the relationship between basic factors like quantity sold/produced, unit selling price, project life etc. and the Net Present Value (NPV).

(b) Compute the range of variation and acceptable value of each of the basic underlying factors, and

(c) Interpret the effect on NPV of variations in the basic variables.

(b) Causa Proxima is defined as "the active efficient case that sets in motion a chain of events which brings about a result, without the intervention if any force started and working actively from a new and independent source". Proximate cause means the most closely and directly connected of the perils insured against with loss. Thus the insurer is liable for loss, if the risk must be insured against is the proximate or the last cause of loss occurred. If there is one cause of loss identified, it is not required to go further into the cause of causes. If there is a series of causes of damage or loss is identified in such the nearest peril is the one insured against the principle of because proxima is applied. And also the insurer is bound to be responsible only if the closest cause comes within the meaning of the risk insured. Thus the closest peril is the one insured against risk, the loss of the subject matter would be compensated.

(c) Pure risk exists when there is uncertainty as to whether loss will occur. No possibility of gain is presented by pure risk – only the potential for loss. Examples of pure risk include the uncertainty of damage to property by fire or flood or the prospect of premature death caused by accident or illness.

In contrast to the pure risk, speculative risk exists when there is uncertainty about an event that could produce either a profit or loss. Business ventures and investment decisions are examples of situations involving speculative risk. Gains as well as losses may occur, changing the nature of the uncertainty that is present.

(d) Exclusion constitutes important elements in a contract of insurance. There are three major types of exclusions, e.g. as follows:

(i) **Excluded Perils**: the contract may exclude certain perils or causes of loss.

(ii) **Excluded losses**: certain types of losses may be excluded.

(iii) **Excluded property**: the contract may exclude or place limitations on the coverage of certain property.