FINAL EXAMINATION
GROUP IV
(SYLLABUS 2012)

SUGGESTED ANSWERS TO QUESTIONS
DECEMBER 2015

Paper-17 : STRATEGIC PERFORMANCE MANAGEMENT

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

The figures in the margin on the right side indicate full marks.
This Question paper has been divided into 3 parts viz., Section-A (60 marks), Section-B (20 marks) and Section-C (20 marks).

Please note:
- **From *Section-A*: Performance Management, you are to answer Question No. 1 which is *compulsory*, carrying 20 marks. Further answer any *two Questions* from the rest of the Questions in this section, each carrying 20 marks.**
- **From *Section-B*: IT & Econometric tool in Performance Management, your are to answer any *two Questions*, each carrying 10 marks.**
- **From *Section-C*: Enterprise Risk Management, you are to answer any *two Question*, each carrying 10 marks.**

SECTION A (60 Marks)
Performance Management

Answer Question No. 1, which is compulsory, carrying 20 marks.

Further answer any two Questions from the rest of the questions in this section, each carrying 20 marks.

1. Nestle is the world's leading nutrition, health and wellness company, employing around 3,30,000 people and having 461 factories in 83 countries around the world. Nestle works within the secondary sector of industry, creating and supplying products to customers. It converts raw materials into finished goods for consumers to enjoy. Raw materials used in many of Nestle's products are sourced from the primary sector-eg., Brands like KIT KAT, Aero, Smarties, etc., which contain cocoa. It works with cocoa farmers around the world in order to help them run profitable farms, whilst developing a sustainable supply of cocoa for Nestle products. Nestle looks at the importance of applying the principles of Corporate Social Responsibility (CSR) to its business activities.

Nestle, which works with its suppliers from a range of countries, many in poorer regions of the world, it is becoming increasingly important to take a wider view of its responsibilities. Nestle believes that companies can be successful in the long run only when they also create value for society, which is known in professional parlance as "Creating Shared Value" (CSV). Nestle does this by improving the quality of the product of consumers and by providing them with better rural development and better nutrition for good health.

Creating Shared Value (CSV) has become an integral part of the way in which Nestle does business. It is based on compliance with international laws and codes of conduct and the company's business principles with a focus on environmental sustainability. It aims to create new and greater value for society and shareholders in areas where the company can have the biggest impact on areas like nutrition, water and rural development.

These are core to its business activities and are vital for its value chain. The Nestle Cocoa Plan aims to help cocoa farmers to run profitable farms, respect the environment, have a good quality of life and give their children a better education. However, it also aims to ensure a sustainable and high quality supply of cocoa for Nestle in the long run.

Some of the areas il focuses on to achieve this are:

- **Improved farmer training**
- **Buying from cooperatives and paying a premium**
- **Working with certifications programmes such as Fair trade. This creates value through the supply chain, particularly for farmers and their families along the way.**

The Cocoa Plan of Nestle has thus become a key way in which Nestle is tackling issues facing cocoa farmers as well as their families and communities.

Nestle focus on improving supply has delivered benefits in many areas. By developing higher quality seedlings, which produce typically 200% more cocoa, this enables cocoa farmers to grow more and sustain a higher income. Training farmers to understand better crop management techniques and pest management, as well as improving their awareness of child labour issues, helps to improve outputs and boosts farmers' incomes.

Nestle has set up a partnership with the World Cocoa Foundation to build and repair schools within the cocoa farming regions and support cocoa farmers and their families.

Required:
(a) What is Corporate Social Responsibility (CSR)?
(b) How Nestle is applying the Principles of CSR to a business activity?
(c) Would you agree that creating shared value has become an integral part of the way in which Nestle does its business?
(d) Comment on the Nestle's Cocoa Plan?
(e) Do you agree that Nestle's focus on improving supply has delivered benefits in many areas? **4+4+4+4+4=20**

Answer:

1. (a) Corporate Social Responsibility (CSR) is defined as a company's sense of responsibility towards the community and environment(both ecological and social) in which it operates. CSR is also called as Corporate Conscience, Corporate Citizenship or a Responsible Business. It is a form of corporate self-regulation integrated into a business model. CSR policy functions as a self-regulatory mechanism, whereby a business monitors and ensures its active compliance with the spirit of the law, ethical standards and national or international norms. CSR is a management concept whereby companies integrate social and environmental concerns in their business operations and interactions with their stake-holders. In recent years, increasing attention is being given to this concept of CSR. CSR is generally understood as being the way through which a company achieves a balance of economic, environmental and social imperatives, while at the same time addressing the expectations of shareholders and stakeholders.

In simple terms, CSR refers to a business practice that involves participating in initiatives that benefit the society. It thus involves the business taking a broad view of its activities, looking beyond profits for its shareholders and stakeholders.

(b) Nestle, which works with its suppliers from a range of countries, many in poorer regions of the world, it is becoming increasingly important to take a wider view of its responsibilities. Nestle believes that companies can be successful in the long run only when they also create value for society, which is known in professional parlance as "Creating Shared Value" (CSV). Nestle does this by improving the quality of the product of consumers and by providing them with better rural development and better nutrition for good health.

(c) Creating Shared Value (CSV) has become an integral part of the way in which Nestle does business. It is based on compliance with international laws and codes of conduct and the company's business principles with a focus on environmental sustainability. It aims to create new and greater value for society and shareholders in areas where the company can have the biggest impact on areas like nutrition, water and rural development. These are core to its business activities and are vital for its value chain.

(d) The Nestle Cocoa Plan aims to help cocoa farmers to run profitable farms, respect the environment, have a good quality of life and give their children a better education. However, it also aims to ensure a sustainable and high quality supply of cocoa for Nestle in the long run.

Some of the areas it focuses on to achieve this are:

- Improved farmer training
- Buying from cooperatives and paying a premium
- Working with certifications programmes such as Fair trade.

This creates value through the supply chain, particularly for farmers and their families along the way.

The Cocoa Plan of Nestle has thus become a key way in which Nestle is tackling issues facing cocoa farmers as well as their families and communities.

(e) Yes. Nestle by focusing its attention on improving supply has delivered benefits in many areas. By developing higher quality seedlings, which produce typically 200% more cocoa, this enables cocoa farmers to grow more and sustain a higher income. Training farmers to understand better crop management techniques and pest management, as well as improving their awareness of child labour issues, helps to improve outputs and boosts farmers' incomes. Nestle has set up a partnership with the World Cocoa Foundation to build and repair schools within the cocoa farming regions and support cocoa farmers and their families.

2. (a) What are the different Performance Appraisal Methods? **8**

(b) Write a brief note on each of these Performance Appraisal Methods. **12**

Answer:

2. (a) Performance Appraisal Methods:

The following are the different Performance Appraisal Methods:
(i) Confidential Report
(ii) Essay Evaluation
(iii) Critical Incident Technique
(iv) Checklists and Weighted Check-lists:
(v) Graphic Rating Scale
(vi) Behaviourly Anchored Rating Scales
(vii) Forced Choice Method
(viii) Group Appraisal and
(ix) Management by Objectives (MBO)
(x) Ranking Method
(xi) Paired Comparison Method
(xii) Forced Distribution Method
(xiii) Performance Test
(xiv) Field review Technique.

(b) (i) **Confidential Report**: This method is mostly used in government organrzations. It is a descriptive report prepared generally at the end of every year by the employees' immediate boss. The report highlights the strengths and weaknesses of the subordinate.

(ii) **Essay Evaluation**: Under this method, the rater is asked to express the strong as well as the weak points of employees' behaviour. This technique is normally used with a combination of the graphic rating scale. While preparing the essay on the employee, the rater considers: -Job knowledge and potential of the employee, Employee's understanding of the company's programs, policies etc.. This is a non-quantitative technique.

(iii) **Critical Incident Technique**: Under this method, the manager prepares lists of statements of very effective and ineffective behaviour of an employee. These critical incidents or events represent the outstanding or poor behaviour of employees on the job.

(iv) **Check-lists and Weighted Check-lists**: This is a simple type of individual evaluation method. A check-list represents a set of objectives or descriptive statements about the employee and his behaviour. If the appraiser believes strongly that the employee possesses a particular listed trait, he checks the item; otherwise, he leaves the item blank. A more recent variation of this method is the weighted check-list.

(v) **Graphic Rating Scale**: This method is perhaps the most commonly used method of Performance Appraisal. Under this method, a printed form is used. This is used to evaluate the performance of an employee. A variety of traits may be used in these types of rating devices. The most common being the quantity and quality of work.

(vi) **Behaviourly Anchored Rating Scales**: This method represents the latest innovation in Performance appraisal. It is a combination of the Rating Scale and Critical Incident techniques of employee performance evaluation. The Critical Incidents serve as anchor statements on a scale and the Rating form usually contains 6 to 8 specifically defined performance dimensions.

(vii) **Forced Choice Method:** This method was developed to eliminate bias and the preponderance of high ratings that might occur in some organizations. The primary purpose of this method is to correct the tendency of a rater to give consistently high or low ratings to all the employees. This method makes use of several sets of pair phrases, two of which may be positive and two negative and the rater is asked to indicate which of the four phrases is the most and least descriptive of a particular worker.

(viii) **Group Appraisal**: In this method, an employee is appraised by a group of appraisers.

This group consists of the immediate supervisors of the employee, other supervisors, who have a close contact with the employee's work, manager or head of the department and consultants. This group may use any one of the multiple techniques as discussed above.

(ix) **Management by Objectives (MBO):** MBO represents a modem method. It is a form of results-oriented appraisal. It is commonly used for supervisors but could be used for other employees as well. It requires that both the Appraiser and the Appraisee agree upon specific objectives in the form of measurable results.

(x) Ranking Method: This is a relatively easy method of performance evaluation. Under this method, the ranking of an employee in a work group is done against that of another employee. The relative position of each employee is tested in terms of his numerical rank. It may also be done by ranking a person on his job performance against another member of the competitive group.

It is relatively easier to rank the best and the worst employees, it is very difficult to rank the average employees.

(xi) Paired Comparison Method: Ranking becomes more reliable and easier under the paired comparison method. Each worker is compared with all other employees in the group; for every trait the worker is compared with all other employees. For Instance, when there are five employees to be compared, then A's performance is compared with that of B's and decision is arrived at as to whose is the better or worse.

Next, B is also compared with all others. When there are five employees, fifteen decisions are made (comparisons). The number of decisions to be made can be determined with the help of the formulae n (n-2).

For several individual traits, paired comparisons are made, tabulated and then rank is assigned to each worker. Though this method seems to be logical, it is not applicable when a group is large.

(xii) Forced Distribution Method: Under this system, the rater is asked to appraise the employee according to a predetermined distribution scale. The rater's bias is sought to be eliminated here because workers are not placed at a higher or lower end of the scale. Normally, the two criteria used here for rating are the job performance and promotability. The limitation of using this method in salary administration however is that it may result in low morale, low productivity and high absenteeism.

(xiii) Field Review Method: Where subjective performance measures are used, there is scope for rater's biases influencing the evaluation process. To avoid this, some employees use this method. In this method a trained, skilled representative of the HR department goes into the 'field' and assists line supervisors with their ratings of their respective subordinates. The HR specialist requests from the immediate supervisor specific information about the employees performance. Based on this information, the expert prepares a report which is sent to the supervisor for review, changes, approval and discussion with the employee who is being rated. This approach is costly and impractical for many organizations.

(xiv) Performance Tests: Employee performance testing, including a skills assessment and cognitive abilities test, helps human resource managers evaluate candidates and employees quickly and consistently.

It reduces the risk of a bad hire.

It builds consistency and efficiency into your employee performance processes.

And evaluate employee performance.

3. (a) A company earns a profit of ` 3,00,000 p.a. after meeting its interest liability of ` 1,20,000 on 12% Debentures. The tax rate is 50%. The numbers of equity shares of ` 10 each are 80,000 and retained earnings amount to ` 12,00,000.

The company proposes to take up an expansion scheme for which a sum of ` 4,00,000 is required. It is anticipated that after expansion, the company will be able to achieve the same return on investment as at present. The Funds required for an expansion can be raised either through debt at the rate of 12% or by issuing equity shares at par.

You are required to compute the Return on Investment (ROI). **8**

(b) A company XYZ has to replace one of its machines, which has become unserviceable. Two options are available:
(i) A more expensive machine (MEM) with 12 years of life;
(ii) A less expensive machine (LEM) with 6 years of life.

If machine LEM is chosen, it will be replaced at the end of 6 years by another LEM machine. The pattern of maintenance, running costs and prices are as under:

Particulars	MEM (`)	LEM (`)
Purchase Price	10,00,000	7,00,000
Scrap value at the end of life	1,50,000	1,50,000
Overhauling is due at the end of	8th Year	4th Year
Overhauling Costs	2,00,000	1,00,000
Annual repairs	1,00,000	1,40,000

CostofCapital-14%.
You are required to recommend with supporting calculations, which of the machines should be purchased? Given:

Particulars	Discounting factor
End of 4th Year	0.5921
End of 6th Year	0.4556
End of 8th Year	0.3506
End of 12th Year	0.2076
Years 1-6	3.8890
Years 1-12	5.660

12

Answer:

3. (a) (i) Capital Employed before the Expansion Plan (`):

Equity Shares (80,000 × ` 10)	8,00,000
Debentures (` 1,20,000/12) × 100	10,00,000
Retained Earnings	12,00,000
Total Capital Employed	30,00,000

ii. Earnings before the payment of Interest and lax (EB1T) (`):

Profit	3,00,000
Interest	1,20,000
EB1T	4,20,000

iii. Return on Investment (ROI)
ROI = (EBIT/Capital Employed) × 100 = (4,20,000/30,00,000) x 100 = 14% .

(b) More Expensive Machine (MEM)-I2 year life:

Particulars	Year	Cost (`)	Discount factor	Present Value (`)
Purchase price	0	10,00,000	1.000	10,00,000
Overhauling costs	8	2,00,000	0.3506	70,120
Annual Repairs	1-12	1,00,000	5.6600	5,66,000
Scrap Value	12	1,50,000	0.2076	(31,140)
Total NPV of outflows				16,04,980

Less Expensive Machine life (LEM) -6 years:

Particulars	Year	Cost (`)	Discount factor	Present Value (`)
Purchase Price	0	7,00,000	1.000	7,00,000
Overhauling costs	4	1,00,000	0.5921	59,210
Annual Repairs	1-6	1,40,000	3.8890	5,44,460
Scrap Value	6	1,50,000	0.4556	(68,340)
Total –NEV of outflows				12,35,330

Annualized Value:

Name of Machine	Calculations	Amount (`)
MEM	16,04,980/5.660	2,83,565
LEM	12,35,330/3.889	3,17,647

Conclusion: More Expensive Machine (MEM) is recommended

4. (a) M/s Bilimoria & Co. is currently working with a process, which after paying for materials, labour etc., brings a profit of ` 10,000. The following alternatives are made available to the company:

(i) The company can conduct research (R1) which is expected to cost ` 10,000 and having 90% probability of success, the company gets a gross income of ` 25,000.

(ii) The company can conduct research (R2) which is expected to cost ` 5,000 and having 60% probability of success, the company gets a gross income of ` 25,000.

(iii) The company can pay ` 6,000 as royalty of a new process, which will bring a gross income of ` 20,000.

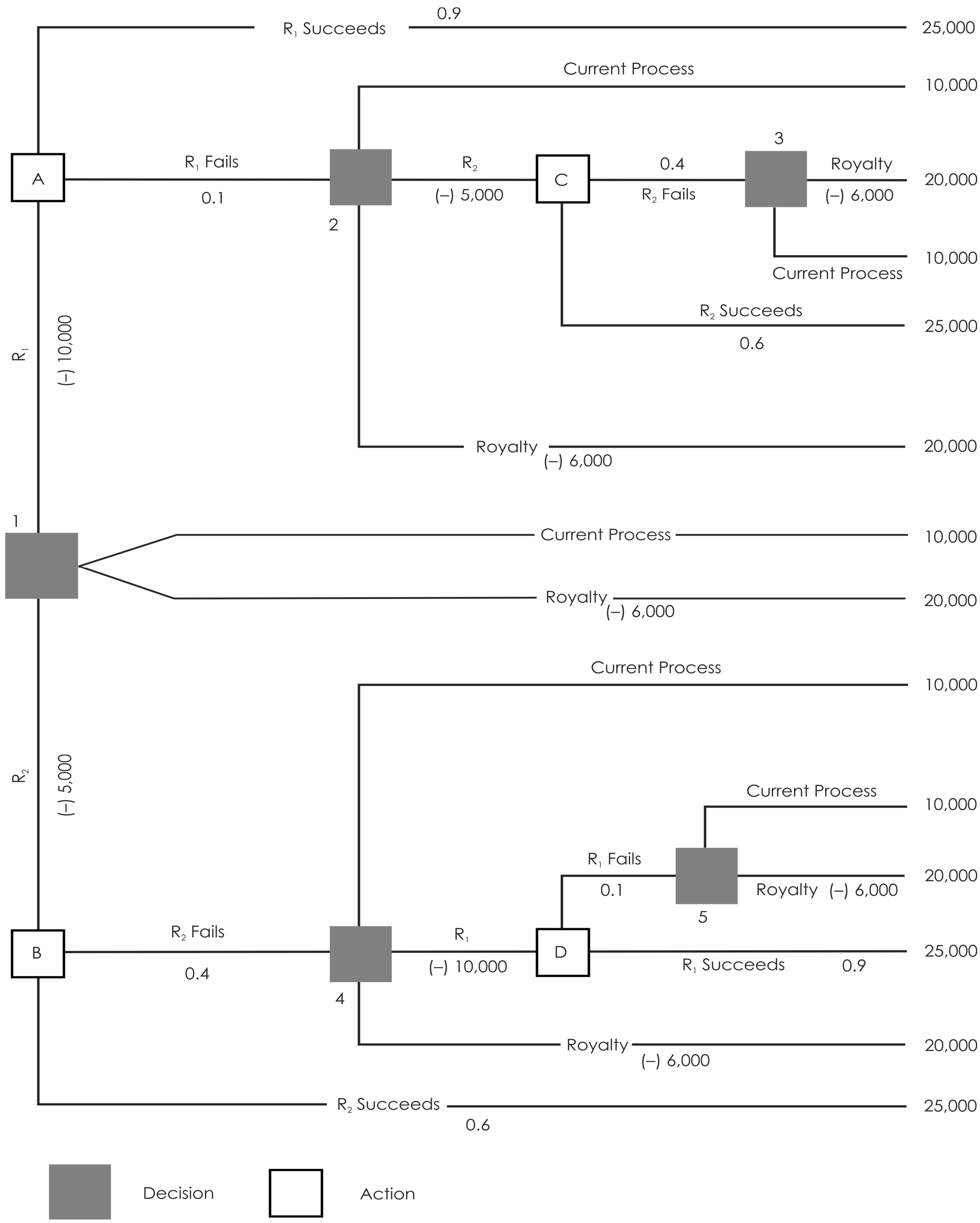
(iv) The company continues the current process.

Because of limited resources, it is assumed that only one of the two types of research can be carried out at a time. Which alternative should be accepted by the company? 20

Answer:

4.

DECISION TREE



Applying Rolling Back Technique

Branch-Current Process:
Net Return = ` 10,000.

Branch-Royalty:
Net Return = ` 20,000-`6,000 = ` 14,000

Branch-R1 First:

Value at 3: Royalty = Net Return=` 14,000
Current Process= ` 10,000.
Hence Net Value at 3 = ` 14,000.
Value at Point C: Expected Gross Profit = 25,000×0.6+14,000×0.4 = 15,000+5,600 = `20,600.
Hence Net Value at C = `20,600
Value at Point 2: Current Process = ` 10,000
Royalty = ` 14,000
R2 = ` 20,600 - `5,000 = ` 15,600.
Hence Net Value at 2 = ` 15,600
Value at Point A: `25,000 × 0.9 + 0.1 × 15,600 = ` 22,500 + ` 1,560 = `24,060.
Value at Branch R1= `24,060- ` 10,000 = ` 14,060.
Branch-R2 First:
Value at Point 5: Current Process = ` 10,000
Royalty=` 14,000
Hence net value at Point5=` 14,000.
Value at Point D: Expected Gross Profit = 25,000×0.9+14,000×0.1 = `22,500+`1,400 = `23,900.
Hence net value at Point D=`23,900.
Value at Point 4: Current Process=` 10,000
Royalty=` 14,000
R1= `23,900-` 10,000 = Rs 13,900.
Hence Net Value at 4 = ` 14,000.
Value at Point B : `25,000 × 0.6 + 0.4 × 14,000 = ` 15,000 + ` 5,600 = `20,600.
Hence net value at Point B=`20,600
Value of Branch R2 = `20,600-`5,000 = ` 15,600.

Conclusion: In view of the above, R2, followed by Royalty upon R1's failure is the best course of action.

SECTION B (20 Marks)

IT & Econometric tool in Performance Management

Answer* any two Questions, each *carrying 10 marks.

5. (a) Explain the technical and operational factors of E-Commerce? 5

(b) What do you mean by the term "Six Sigma"? 2
What are the conditions demanded by the "Six Sigma Doctrine"? 3

Answer:

5. (a) The Technical and operational factors of E-Commerce:

The following are the different technical and operational factors of E-Commerce:

(i) **Protocol (Standards) Making Process**: A well-established telecommunications and internet infrastructure provides many of the necessary building blocks for development of a successful and vibrant E-Commerce marketplace.
(ii) **Delivery Infrastructure**: Successful E-Commerce requires a reliable system to deliver goods to the business or private customer.

(iii) **Availability of Payment Mechanisms**: Secure forms of payment in E-Commerce transactions include credit cards, cheques, debit cards, wire-transfer and cash on delivery.
(iv) **General Business Laws:** The application of general business laws to the internet will serve to promote consumer protection by insuring the average consumer that the internet is not a place, where the consumer is a helpless victim.
(v) **Public Attitude to E-Commerce**: The public attitude towards using E-Commerce in daily life is a significant factor in the success of E-Commerce.
(vi) **Business Attitude to E-Commerce**: The willingness of companies to move away from the traditional ways of doing business and developing methods and models that include E- Commerce is essential.

(b) Meaning of the term "Six Sigma":

Six Sigma is a business management strategy, originally developed by Motorola in 1986. It simply means a measure of quality that strives for near perfection. It is a disciplined, data-driven approach and methodology for eliminating defects in any process-from manufacturing to transactional and from product to service.
Six Sigma seeks to improve the quality of process outputs by identifying and removing the causes of defects (errors) and minimizing variability in manufacturing and business processes. It uses a set of quality management methods, including statistical methods, and creates a special infrastructure of people within the organization. A six sigma process is one in which 99.99966% of the products manufactured are statistically expected to be free of defects (3.4 defects per million).

Six Sigma doctrine demands the following conditions:
- Continuous efforts to achieve stable and predictable process results (i.e., reduce process variation) are of vital importance to business success.
- Manufacturing and business processes have characteristics that can be measured, analyzed, controlled and improved.
- Achieving sustained quality improvement requires commitment from the entire organization, particularly from the top-management.

6. (a) After adopting Total Productive Maintenance, what are the benefits your organization is likely to gain? **5**

(b) Discuss what do you mean by the term "Data Availability"? **5**

Answer:

6. (a) Benefits anticipated due to the adoption of the concept of "Total Productive Maintenance" (TPM):

With the adoption of the concept of "Total Productive Maintenance" (TPM), any organization is likely to reap the following benefits:
- A set of new management goals will be developed by the management, using the skills and training provided during the implementation of the TPM.
- Team-bonding and better accountability.
- Improved quality and total cost competitiveness.
- Productivity and quality team training for problem-solving.
- Motivated people function better all the time. Measure impact of defects, sub-

optimal performance, and downtime using OEE (Overall Equipment Effectiveness)

(b) Data Availability:

The dictionary defines availability as that which is "present and ready for use; obtainable." You might therefore assume that Data Availability means having your data accessible and obtainable at all times. In the enterprise environment it is not quite that easy. There are quite a few factors to consider including:

- Available bandwidth between devices and network connections of mediums
- Mechanisms for high availability and their own security and accessibility
- Prioritization and type of data to be made available
- Recovery roles and responsibilities
- Type of file system and level of access
- Type of storage/retrieval device or media including both hardware and software
- Service Level Agreements between responsible and affected entities
- Processing overhead of affected mechanisms
- Disaster Recovery/Business Resumption Plan (BRP).

Data Availability is a term used by some computer storage manufacturers and storage service providers to describe products and services that ensure that data continues to be available at a required level of performance in situations ranging from normal through "disastrous". In general, Data Availability is achieved through redundancy involving where the data is stored and how it can be reached. Some vendors describe the need to have a data center and a storage-centric rather than a server-centric philosophy and environment.

Two increasingly popular approaches to providing data availability are the Storage Area Network (SAN) and Network-Attached Storage (NAS). Data availability can be measured in terms of how often the data is available and how much data can flow in terms of megabytes per second at a time.

7. "Business Intelligence" (BI) is the ways in which we store and use business information. It encompasses the technologies, applications and means for collecting, integrating, analyzing and presenting business data."

Discuss the above statement and state how you would choose the right business solution.

5+5=10

Answer:

7. **Business Intelligence (BI)** is the ways in which we store and use business information. It encompasses the technologies, applications, and means for collecting, integrating, analyzing, and presenting business data. Using data that has been stored in a data warehouse, software applications are able to use this data to report past business information as well as predict future business information, including trends, threats, opportunities and patterns.

Popular BI applications are very complex and experts in this field are in high demand. Some of the currently popular enterprise level systems, which can manage information about all of the business functions and systems, are sold and implemented by Oracle, SAP, IBM, and Hewlett Packard (HP). Companies often need in-house experts in these systems to assist with the implementation and the on-going use of these systems, which are quite complex!

When choosing a Business Intelligence solution, firms need to ask two key questions:

(i) What kind of data needs to be analyzed and where does it come from? Many packaged application and database vendors include some BI functionality in their core product, and if you plan to source all of your data from the same application or database, you may not need to buy additional products. However, this strategy may also limit the analytical range.

(ii) Who will be doing the analysis and how do they need to receive the results? Historically, report or analysis requests would be sent to the IT department, which would then code and generate the report.

Today, BI is on the front lines of business and the tools may well be used by executives or sales and marketing professionals. As a result, firms need to know the technical capabilities of the end-user upfront. To build a BI solution, enterprises will need to consider new investments and upgrades to current technology to build out the BI Technology stack. The technology stack is designed to highlight the different layers of technology that will be affected by an answer to BI project, all the way from the hardware hosting of data at the bottom of the stack to the portal product used to present information to users at the top.

SECTION C (20 Marks)

Enterprise Risk Management

Answer *any two* Questions, carrying 10 marks.

8. (a) Explain Economic Risk. Discuss the factors which reflect the economic climate of a country? 2+5=7
(b) How risk is reduced through Diversification? 3

Answer:

8. (a) Economic Risk: is concerned with the general economic climate within the country. Economic risk is the chance that macroeconomic conditions like exchange rates, government regulation, or political stability will affect an investment, usually one in a foreign country.

Some of the factors which reflect the economic climate of a country are:

- The level of affluence enjoyed by the country.
- The growth rate of income
- The nation's propensity to save/invest.
- The stability of prices (Inflation).
- Level of foreign debt outstanding
- Fluctuations of exchange rate and controls on foreign exchange. The characteristics of the labour force.

- The level of sophistication of the financial system.
- The major income earners (exports) and their sensitivity to overall global economic changes.
- The extent of dependence on major export items.
- The trends in balance of payments.
- The level of imports
- The level of reserve and credit standing

(b) **Risk Reduction through Diversification**:

The important principle to consider that in an efficient capital market, investors should not hold all their eggs in one basket; they should hold a well-diversified portfolio. In order to diversify risk for the creation of an efficient portfolio (one that allows the Firm to achieve the maximum return for a given level of risk or to minimize risk for a given level of return), the concept of correlation must be understood. Correlation is a statistical measure that indicates the relationship, if any, between series of numbers representing anything from cash flows to test data. If the two-series move together, they are positively correlated; if the series move in opposite directions, they are negatively correlated. The existence of perfectly correlated (especially negatively correlated) projects is quite rare. In order to diversify project risk and thereby reduce the firm's overall risk, the projects that are best combined or added to the existing portfolio of projects are those that have a negative (or low positive) correlation with existing projects.

9. (a) What are the various causes of Corporate Failure? **6**

(b) What are your recommendations that can help to reduce the risk of failures of organizations? **4**

Answer:

9. (a) Causes of Corporate Failure:

The following are some of the important causes for Corporate Failure:

1. **Technological Causes:**
Traditional methods of doing work have been turned upside down by the development of new technology. If within an industry, there is failure to exploit information technology and new production technology, the firms can face serious problems and ultimately fail.
2. **Working Capital Problems:**
Organizations also face liquidity problems when they are in financial distress. Poor liquidity becomes apparent through the changes in the working capital of the organization as they have insufficient funds to manage their daily expenses. Businesses, which rely only on one large customer or a few major customers, can face severe problems and this can be detrimental to the businesses. Losing such a customer can cause big problems and have negative impact on the cash flows of the businesses. Besides, if such a customer becomes bankrupt, the situation can even become worst, as the firms will not be able to recover these debts.
3. **Economic Distress**:
A turndown in an economy can lead to corporate failures across a number of businesses. The level of activity will be reduced, thus affecting negatively the performance of firms in several industries. This cannot be avoided by businesses.

4. **Mismanagement**:
Inadequate internal management control or lack of managerial skills and experience is the cause of the majority of company failures. Some managers may lack strategic capability that is to recognize strengths, weaknesses, opportunities and threats of a given business environment. These managers tend to take poor decisions, which may have bad consequences afterwards. Furthermore, managers of different department may not have the ability to work closely together. There are dispersed department objectives, each department will work for their own benefits not towards the goal of the company. This will bring failure in the company.
5. **Over-expansion and Diversification**:
Research has shown that dominant CEO is driven by the ultimate need to succeed for their own personal benefits. They neglect the objective set for the company and work for their self-interest. They want to achieve rapid growth of the company to increase their status and pay level. They may do so by acquisition and expansion. The situation of over expansion may arise to the point that little focus is given to the core business and this can be harmful as the business may become fragment and unfocused. In addition, the companies may not understand the new business field.
6. **Fraud by Management:**
Management fraud is another factor responsible for corporate collapse. Ambitious managers may be influenced by personal greed. They manipulate financial statements and accounting reports. Managers are only interested in their pay checks and would make large increase in executive pay despite the fact that the company is facing poor financial situation. Dishonest managers will attempt to tamper and falsify business records in order to fool shareholders about the true financial situation of the company. These fraudulent acts or misconduct could indicate a serious lack of control. These frauds can lead to serious consequences: loss of revenue, damage to credibility of the company, increased in operating expenses and decrease in operational efficiency.
7. **Poorly Structured board:**
Board of Directors is handpicked by CEO to be docile and they are encouraged by executive pay and generous benefits. These directors often lack the necessary competence and may not control business matters properly. These directors are often intimated by dominant CEO and do not have any say in decision making.
8. **Financial Distress:**
Firms that become financially distressed are found to be under- performing relative to the other companies in their industry. Corporate failure is a process rooted in the management defects, resulting in poor decisions, leading to financial deterioration and finally corporate collapse.

(b) **Preventing Corporate Failures**:

Some recommendations that can help to reduce the risk of failures of organizations are as listed below:

- **Appointment of non-executive Directors**: The non-executive directors will bring their special expertise and knowledge on strategies, innovative ideas and business planning of the organization. They will monitor the work of the executive management and will help to resolve situations where conflict of interest arises.
- **Audit committees**: Very often, there is occurrence of fraud in management and financial reporting. The presence of the Audit Committee will help to resolve this problem. Audit committees have the potential to reduce the occurrence of fraud by creating an environment, where there is both discipline and control.
- **Development of environment learning mechanism**: Some organizations fail because

they lose touch with their environment. Therefore, to counter this problem, there is a need to develop the environmental learning mechanism. Through it, new information can be brought on a continuous basis.

- **Focus on Research and Development**: Organizations can generate new knowledge by investing and focusing more on Research and Development. Thus, there will be more ideas on making the products much better than that of their competitors.

Thus the non-executive directors have a big responsibility. He has to implement the above recommendations and help to reduce corporate failure. Proper planning also is critical to the success of a business.

10. What are the different Strategic decisions that are available to combat Risk Management? Explain each of them in two or three sentences. 10

Answer:

10. (a) The following are some of the different strategic decisions that are available to a firm to combat the Risk Management:

- **Bisk Handling**: In ideal risk management, a prioritization process is followed whereby risks with the greatest loss and the greatest probability of occurring are handled first, and risks with lower probability loss are handled later.
- **Risk Reduction:** This strategy is attempted to decrease the quantum of losses arising out of a risky happening e.g., earthquake, storm, flood etc., Risk Reduction can be achieved through (a) Loss Prevention and (b) Loss Control.
- **Risk Avoidance**: This is a prevention strategy. This is also a proven strategy. This strategy results in complete elimination of exposure to loss due to a specific risk. This strategy can be approached in two ways:
  (i) Do not assume risk and
  (ii) Discontinuation of an activity in order to avoid risk
- **Risk Retention**: This strategy is adopted when risk cannot be avoided, reduced or transferred. It involves accepting the loss when it occurs by taking risky proposal or risky assignment where there are no other alternatives to avoid risk.
- **Risk Transfer**: It means causing another party to accept the risk, typically by contract. It involves a process of shifting risk responsibility on others. Insurance is one type of risk transfer, which is widely used in common parlance.
- **Risk Hedging**: It is a systematic process of reducing risk associated with an investment proposal or m some other assignments where risk is inevitable i.e., the risk is of such nature that it cannot be avoided altogether.
- **Risk Diversification**: It involves both systematic and unsystematic risk. This strategy is followed in reduction of risk of single portfolio by investing in shares, debentures, bonds, treasury bills etc. to reduce overall risk of the portfolio.
- **Risk Sharing**: Taking an insurance coverage for the exposure is a common method of sharing risk. By paying Insurance Premium, the company shares the risk with an insurance company. This insurance company can also share its risk with other insurance companies by doing re-insurance.
- **Risk Pooling**: It is the process of identification of separate risks and put them all together in a single blanket, so that the monitoring, integrating or diversifying risk can be implemented.