PAPER – 20A : STRATEGIC PERFORMANCE MANAGEMENT AND BUSINESS VALUATION

SUGGESTED ANSWERS

SECTION – A

1.

(i)	(B)
(ii)	(B)
(iii)	(B)
(iv)	(D)
(v)	(A)
(vi)	(B)
(vii)	(A/B/C/D) Any
(viii)	(B)
(ix)	(D)
(x)	(C)
(xi)	(B)
(xii)	(C)
(xiii)	(C)
(xiv)	(A)
(xv)	(B)

SECTION – B

2. (a)

Fundamental aspects of CRM and its impact on organization:

CRM system, comprises following three fundamental aspects to facilitate building relationship with profitable customers –

Operative CRM takes care of individual transactions and is used by operational team. Interactions by customers are kept in the data base and are used later by the service, sales, and marketing team for operational decisions.

Analytical CRM analyses the data created on the operational side of the CRM effort for evaluation and prediction of customer behaviour.

Collaborative CRM ensures that information about customer must flow seamlessly throughout the supply chain, majorly distribution channel; in form of collaborative effort by all associated department of an organization to increase the quality of services provided to customers. Increase in utility at customer end will result in increased loyalty. Collaborative CRM comprises interactive technology like email, digital media to simplify the communications between customers and staff which would help in building relationships.

A CRM initiative generally has some of the following impacts on an organization:

1. Increased expectations from senior management to increase revenues reduce costs, increase market share and increase business flexibility may put tremendous pressure on the organization and may potentially compromise the internal control structure.
2. Increased complexity of managing multiple channels, technologies, customer relationships and customer definitions.
3. Vital and confidential customer information may be transmitted and shared across new networks, systems and platforms
4. Significant changes to the organization, attitudes and beliefs, placing heavy reliance on the organization's employees for the successful adoption of the solution.

   These factors introduce many risks to the organization, for instance, the potential disruption of vital operations, violations to customer privacy and confidentiality, ineffective, inconsistent or inefficient processes, lack of internal business controls, poor customer service, incorrectly targeted sales and marketing efforts, non-acceptance of new systems and processes and security breaches. Effective risk management helps in minimizing CRM risks and softens the impact.

2. (b)

Objectives of MIS

- To provide the managers at all levels with timely and accurate information for control of business activities
- To highlight the critical factors in the operation of the business for appropriate decision making
- To develop a systematic and regular process of communication within the organization on performance in different functional areas
- To use the tools and techniques available under the system for programmed decision making
- To provide best services to customers
- To gain competitive advantage
- To provide information support for business planning for future.

MIS Reports—Few examples of MIS reports

Summary reports, Trend reports, Predictive report, Exception report, on demand report, financial reports, inventory report sales reports, budget reports, production report, Cash flow reports, cost reports etc.

3. (a)

Profit of the discriminating monopolist = ₹7625 by Considering Cost Function as c = 3000 + 50 Q

3. (b)

The components of ERM

The components of ERM do not occur serially where one component affects only the next. Rather it is a multi-directional, iterative process in which component effects and influences other. The COSO Framework advocates eight interrelated components of an ERM which are:

(i) **Internal Environment** – this is the basis around which risk is viewed and addressed by an entity. The risk management philosophy which is based on the risk appetite, integrity and ethical values of the entity, and the environment in which they operate are aspects which design the internal environment.

(ii) **Objective Setting –** Objectives must be set before management can identify potential events affecting their achievement. Effectively implemented ERM ensures that management has in place a process to set objectives and that the chosen objectives support and align with the entity's mission and are consistent with its risk appetite.

(iii) **Event Identification –**Events that affect accomplishment of an entity's objectives are identified either as risks or opportunities. Opportunities, referred to as upside aspect of risk, are to be adjusted against the management's strategy or objective-setting processes.

(iv) **Risk Assessment –** Risks are analyzed, considering likelihood of occurrence and magnitude of impact. This is the basis which is the determining factor of risk management.

(v) **Risk Response –** Management must select risk responses which are either avoiding, accepting, reducing, or sharing risk. For this purpose, the organization must develop set of actions to align risks with the entity's risk tolerances.

(vi) **Control Activities –** Policies and procedures are established and implemented to help ensure risk responses are effectively carried out.

(vii) **Information and Communication –** Relevant information is identified, captured, and communicated in a structured form and within a timeframe that enable people to carry out their responsibilities. An important aspect of this component is effective communication which transpires in a broader sense, flowing down, across, and up the entity.

(viii) **Monitoring –** The entirety of ERM is monitored and modifications made as necessary. Monitoring is accomplished through ongoing management activities.

4. (a)

(i) Extended DuPont provides the drivers of ROE in terms of margins, assets utilization and leverage thereby provides important information in understanding business model of a company.

Extended DuPont Analysis decomposes ROE into three components as given below: -

ROE = (PAT/Sales) × (Sales/Assets) × (Assets/Equity)

The above equation shows that ROE is driven by profit Margin (PAT/Sales), Assets Utilization or Assets Turnover (Sales/Assets) and how much of the assets are financed by equity and debt, i.e. a measure of leverage (Assets/Equity)

Using the above decomposition, we obtain various decomposed components of ROE over a period of four years which are given below:

Year ended 31st March	**2020**	**2021**	**2022**	**2023**
ROE	18.287%	14.532%	14.883%	16.974%
PAT / Sales	18.930%	14.958%	15.778%	17.875%
Sales to Assets	0.937	0.884	0.914	0.833
Assets to Equity (Net worth)	1.031	1.099	1.032	1.140

(ii) The company saw a sharp decline in ROE in year 2021-22 which was primarily due to reduction in Profit Margins (from 18.930% to 14.958%) as well as reduction in the assets utilization, which may hint that the company (or perhaps the industry) might be having a tough time in pushing sales; situation improved in 2022-23 and 2023-24 and the main driver was Profit Margin. The big increase in ROE 2023-24 came primarily from Profit Margin and Leverage; had the company increased its assets utilization ROE would have increased further; seeing this, it is clear that the biggest challenge before Metcalf Ltd. is to increase Asset utilization.

4. (b)

Z-score = 2.35978 Or 2.36078

5. (a)

(i) Present value of the stock of Achal Ltd.= Rs.30

(ii) Using the constant growth model, the value will be = Rs.21.52

This value is less than the stock price of Rs. 30 as calculated above or Rs.35 as given in the question which indicates that stock of Achal Ltd is overvalued.

5. (b)

Value of CHATAPP = ₹ 202.224 Crore.

6. (a)

(i) Value of the building = ₹ 14131060.53

(ii) Value of the building = ₹ 60930000

6. (b)

Particulars	**Company-A**	**Company-B**	**Company-C**
P/E	7.35	8.84	9.89
EV / EBIT	7.19	7.30	7.42

The management's belief that the markets doesn't understand the reason for lower P/E of Company A is incorrect. The EV/EBITDA multiple of Company A is in line with the peers. The reason for the difference is that Company A has much more debt relative to equity than the other companies. Possibly, if Company A has the same level of D/E Ratio, the P/E would be higher and in line with peers. Except for very high growth companies, a company with higher debt relative to peers has a lower P/E Ratio because more debt translates to higher risk for shareholders and a higher cost of equity. Therefore, each rupee of earnings (and cash flow to shareholders) is worth less to an investor.

Since Price-to-earnings ratio mixes capital structure and non-operating items with expectations of operating performance, a comparison of P/Es is less reliable guide to companies' relative value than a comparison of enterprise value (EV) to EBIT.

7. (a)

(i) EPS of both the companies :

EPS of Radha Limited = INR 3.33

EPS of Krishna Limited = INR 5.00

(ii) Exchange Ratio

Exchange ratio based on EPS = 1.5

7. (b)

(i)	A Ltd.'s Market Price =	₹18.75
	B Ltd.'s Market Price =	₹ 6.25
(ii)	A Ltd.'s Market cap =	₹75 Lakhs
	B Ltd.'s market cap =	₹12.5 Lakhs
(iii)	Market price of A Ltd.'s =	₹14.0625
(iv)	Yes. The market value decreases. i.e., =	₹56.25 Lakhs.

8. (a)

(i) Swap ratio is for every one share of Y Ltd. to issue 2.5 shares of X Ltd. Hence total no. of shares to be issued = 18.75 lakh shares.

Promoters holding = 17.25 lakh shares

So, parameters holding percentage = 60%.

Total no. of shares = 28.75 lakhs

(ii) EPS = ₹6.956

(iii) Expected market price = ₹ 69.56

Market capitalization = ₹1999.85 lakh

(iv) Free float of market capitalization = ₹799.94 lakh

8. (b)

Asking price of XY Ltd.	INR 62,00,000
Annual sales of XY Ltd.	INR 82,00,000
Asking P/S ratio of XY Ltd. =	0.76

P/S ratio of XY Ltd. 0.76 is much higher than industry average 0.55, it is far below than the maximum P/S ratio of 2.35. The ratio of XY Ltd. is lying between 8th and 9th highest of the top ten players of the industry. In other words, XY Ltd. would need to be among the 22%* ($8.5/38 \times 100$) most desirable florist business to justify the asking price of ₹ 62,00,000 with annual gross sales of ₹ 82,00,000. If the sales are likely to hold in the coming years, the price may be $(0.85 + 0.72)/2 \times$ ₹ 82 Lakhs = ₹ 64.37 Lakhs.
Provided the buyer believes that XY Ltd. is a superior retail florist (among the top quartile), and the future sales are not likely to fall, the asking price of ₹ 62 lakhs appears to be reasonable. However, the buyer should make sure that the florist's accounts reflect a true and fair view of the business before he arrives at a final decision.