Solved Scanner

Appendix

CMA Final Gr. IV (New Syllabus)

(Solution of December 2014)

Paper - 17: Strategic Performance Management

Chapter - 1: Conceptual Framework of Performance Management
2014 - Dec [2] (a), (b), (c), (d), (e)

(a) M.K. Paper Limited was hit the most due to recession in the following area: Sale or revenue of M.K. paper limited goes down as there were no fresh orders from the customers, because customers were focusing on correcting inventory positions due to high prices and reduced demand rather than giving fresh orders. Investors also sharply reacted to declining sales and revenues of the M.K. Paper Limited and stock price of M.K. paper limited fell from ₹ 57.20 on 1 January, 2012 to a low of ₹ 14.12 on 12 March, 2013. So we can say that recession affected the profitability of the M.K. Paper and thus it stock price.

(b) Company reacted properly to the recession impacts. For example, the company revised its corporate strategy and adopted the following measures which helped M.K. Paper Limited to emerge winner at the end.

(1) **Managing working capital flows:** The Company did not approach banks and investors; rather it intensified efforts to recover its debits from its clients. The efforts resulted in fast recovery of crores of rupees. Disputed debts were also settled expeditiously to raise more cash.

(2) **Cost Cutting:** No new appointments were made unless they were critically important. In addition, employees received lower increments for 2012-13; even Mr. Sondhi did not take any increment.

(3) **Improvement of employee productivity:** The Company took steps to improve productivity and reduce its wage bill. Inefficient employees were asked to leave.

Mr. Sondhi and his senior management team also re-evaluated the organizational structure to improve efficiency in the organization.

(c) M.K. Paper limited adopted some key functional strategies in the area of production, marketing and inventory management.

For Example:

Production Strategy: Instead of shutting down company's plants and cutting production, Mr. Sondhi decided to continue to operate the Company's two plants at Gujarat and Orissa at 100% capacity.

Marketing Strategy: To match sales with production, he planned to reach out to newer customers by widening Company's distribution network. He identified packaging boards to be marketed in rural areas where the meltdown had minimal effect. As the market conditions were still difficult, the company also decided to cut the prices by 2 to 3 per cent. Along-with the price cut, its marketing thrust in rural areas ensured that the sales were not impacted much.

Inventory strategy: Additionally, global slowdown sent the international prices of the pulp, the main raw material for the paper industry, crashing from ₹ 36,960 per ton in April, 2012 to ₹ 18,240 per ton in September, 2012. The company bought enough pulp to last for about 9 months as against its policy of buying, in the normal course, pulp for about 2-3 months. According to Mr. Sondhi, this decision also resulted in a huge saving.

(d) The following are some key responsibilities of a strategic leader managing human capital (perhaps the most critical of the strategic leader's skills). Effectively managing the company's operations. Sustaining high performance over time. Being willing to make candid and courageous decisions. Seeking feedback through face-to-face communications. Having decision-making responsibilities that cannot be delegated. Yes, Mr. Sondhi provided a true leadership to sail out the company from recession impacts. He derived the process with the help of his top management team to tackle the problems arisen due to recession. He took the candid and courageous decisions to take out the company from recession problems.

(e) Never give up and form an appropriate dynamic strategy are the biggest lessons one can learn from the experience of M.K Paper limited. Another important lesson is that organization always needs a true leader and capable top management team who are willing to take strong decisions for benefits of company and its shareholders. Finally, organizations need to form and implement the appropriate strategies at both corporate and functional levels. Also, there should be a good coordination among different functional components. For example, when Mr. Sondhi took to decision that production will be maintained at 100% capacity utilization, to match the production with sales the company took effective decision at marketing/sales levels.

Chapter - 3: Strategic Performance Evaluation & Management Tools

2014 - Dec [1]

(i) **Target costing** is defined 'as a cost management tool for reducing the overall cost of a product over its entire life cycle with the help of the production, engineering, R&D.'

The target cost is the estimated cost of a product that enables a company to remain and compete in the market in the long run. The idea of target costing, originally promoted in Japan, is about going upstream to achieve cost reduction. Target costing is not really a method of costing, but it is a technique used in cost management. The intent of target costing is to reduce cost, where reduction is aimed at the entire life cycle of any product.

Target costing can also help in achieving certain broader objectives, such as, identifying and delivering various customer requirements in a product through effective management of different processes.

There are **six key principles** in target costing:

1. Price – led costing (i.e. target price less desired mark-up = target costs);
2. Customer focus;
3. Focus on design of products and processes;
4. Cross- functional teams;
5. Life cycle cost reduction.

(ii) The problems faced by the company are:

(a) Lack of commitment by the line management.

(b) Typical command and control orientation.

(c) Actual Price of the product was higher than the projected price.
(d) Distinct deficiencies with the company's current cost management.
(e) Inadequate concern for the cost management and cost reduction.
(f) The company growth was sluggish.

(iii) The management of Moon glow Electronics apply many of the Japanese and financial accounting practices like TQM, JIT, Cost management and Target costing Programme to solve its problems.

Some remedial steps are:

- Plan price and cost reductions;
- Develop a formal "estimated cost system";
- Demand "estimated cost reviews" at each step;
- Continue to develop "team" approach to new product development;
- Measure and learn from experience;
- Develop "value engineering" skills and process throughout the organization;
- Use nontraditional targets and measures to manage cost management process improvements.

2014 - Dec [3] (a), (c)

(a) Steps of Business Process Re-engineering:

1. **Develop Business Vision and Process Objectives:** BPR is driven by a business vision which implies specific business objectives such as Cost Reduction, Time Reduction, Output Quality Improvement, Quality of Work life (QWL)/Learning/Empowerment.
2. **Identify Processes to be Redesigned:** Most firms use the *High-Impact* approach which focuses on the most important processes or those that conflict most with the business vision. Lesser number of firms use the Exhaustive approach that attempts to identify all the processes within an organization and then prioritize them in order of redesign urgency.
3. **Understand and Measure the Existing Processes:** Understanding and measuring the existing processes before redesigning them is especially important, because problems must be understood so that they are not repeated. On the other hand, accurate measurement can serve as a baseline for future improvements.

4. **Identify IT Levers:** In the broadest sense, all of IT's capabilities involve improving coordination and information access across organizational units, thereby allowing for more effective management of task interdependence. An awareness of IT capabilities can and should influence process design. Therefore, the role of IT in a process should be considered in the early stages of its redesign.
5. **Design and Build a Prototype of the New Process:** The actual design should not be viewed as the end of the BPR process. Rather, it should be viewed as a prototype, with successive iterations expected and managed. Key factors and tactics to consider in process design and prototype generation include using IT as a design tool, understanding generic design criteria and creating organizational prototypes.

(c)

	A	B	C
Selling price per package	400	480	600
Sales quantity in units	5,000	4000	2,500
Sales Revenue	20,00,000	19,20,000	15,00,000
Life Cycle Costs:			
R&D Cost	2,40,000	2,40,000	2,40,000
Design Cost of Product/Process	1,60,000	1,60,000	1,60,000
Production Cost:			
1,00,000+(25*5,000); 1,00,000+(4,000*25); 1,00,000+(2,500*25)	2,25,000	2,00,000	1,62,500
Marketing Cost:			
70,000+(5,000*24); 70,000+(4,000*24); 70,000+(2,500*24)	1,90,000	1,66,000	1,30,000
Distribution Cost:			
50,000+(5,000*16); 50,000+(4,000*16); 50,000+(2,500*16)	1,30,000	1,14,000	90,000

Customer Service:			
80,000+(5,000*30);			
80,000+(4,000*30);	2,30,000	2,00,000	1,55,000
80,000+(2,500*30)			
Total Life cycle cost	11,75,000	10,80,000	9,37,500
Life cycle operating Income	8,25,000	8,40,000	5,62,500

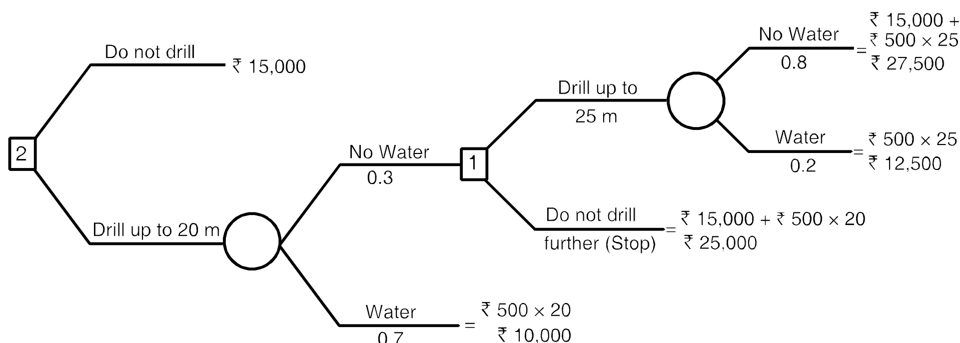
2014 - Dec [4] (b)

Particulars	A	B	C	D
Cost of sales visit	6,300	6,300	10,500	21,000
Purchase order	12,000	36,000	30,000	24,000
Product handling cost	18,000	24,000	30,000	21,000
Normal delivery	4,800	11,200	5,000	15,000
Rushed delivery cost	0	6,000	2,000	4,000
Total cost	41,100	83,500	77,500	85,000
Sales Revenue	1,20,000	2,40,000	1,00,000	1,40,000
Operating profit/Net Revenue	78,900	1,56,500	22,500	55,000

Conclusion: Product B earns maximum Revenue.

Chapter - 4: Strategic Reasoning & Decision Analysis

2014 - Dec [4] (a)



Decision Node	Options	Expected cost	Decision
1	Drill up to 25 metres	0.8×27,500+0.2×12,500 = ₹ 24,500	
	Do not Drill further (Stop)	₹ 25,000	Drill up to 25 metres
2	Do not drill	₹ 15,000	
	Drill up to 20 metres	0.3×24,5000+0.7×10,000 = ₹14,350	Drill up to 20 metres

From the analysis table, it may be observed that decision at node 2 implies that if it is decided to drill up to 20 metres and water is not found, then drilling up to 25 metres should be done. At node 1, the decision taken is to drill up to 20 metres as it involved lower expected cost. Thus, the optimal strategy is to drill up to 20 metres and if water is not struck then drill further to 25 metres.

Chapter - 5: Economic Efficiency of the Firm-Impact Analysis on Performance

2014 - Dec [3] (b)

Benefits of Branding:

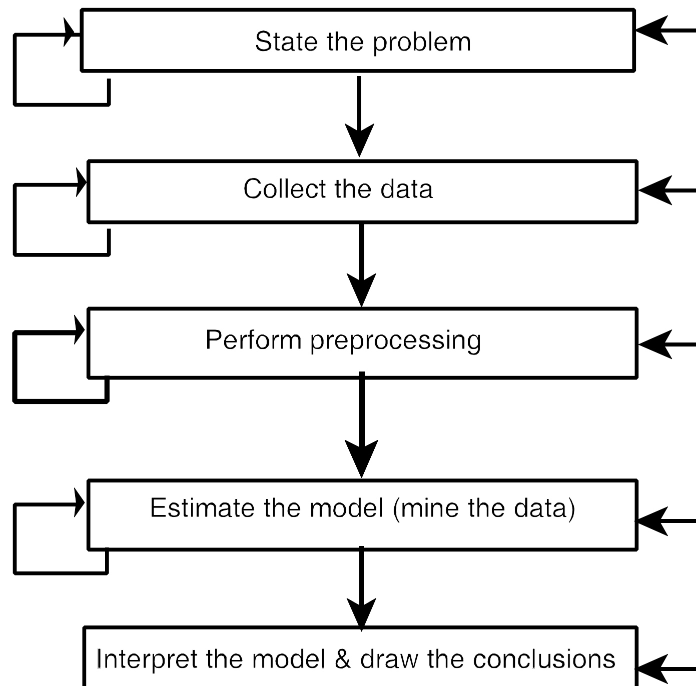
1. **Creates an Image or Personality:** A brand name can project an expectation of its performance and an emotion or feeling about it.
2. **May Help Segment Markets:** Virtually identical products could be sold in different distribution channels under different brand names and positioning.
3. **Makes Purchasing Easier:** After making a satisfactory brand decision for the first time, customers are likely to make repeat purchases without major reconsideration. Therefore, a good brand speeds up shopping.
4. **May Develop a Customer Franchise:** Achieving brand loyalty among your customers will protect you from competition and give you greater control over your marketing mix.

Chapter - 7: Application of IT & Econometric Tools in Performance Management

2014 - Dec [5] (a), (b)

(a) Data Mining is a process of discovering various models, summaries and derived values from a given collection of data.

The procedure adapted to data-mining problems involves the following steps:



(b) Quality: Quality can be defined through five principal approaches:

(1) Transcendent quality is an ideal, a condition of excellence.

(2) Product-based quality is based on a product attribute.

(3) User-based quality is fitness for use.

(4) Manufacturing-based quality is conformance to requirements.

(5) Value-based quality is the degree of excellence at an acceptable price.

Also, quality has two major components:

(i) **quality of conformance:** quality is defined by the absence of defects and

(ii) **quality of design:** quality is measured by the degree of customer satisfaction with a product's characteristics and features.

Promotions: One of the four P's (product, price, place and promotion) that constitute the set of tools used to direct the business offering to the customer. Promotion is the mechanism whereby information about the product offering is communicated to the customer and includes public relations, advertising, sales promotions and other tools to persuade customers to purchase the product offering.

Strategic Alliance: A relationship formed by two or more organizations that share (proprietary), participate in joint investments, and develop linked and common processes to increase the performance of both companies. Many organizations form strategic alliances to increase the performance of their common supply chain.

2014 - Dec [6] (a), (b)

(a) 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, checks, 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 toward 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 traditional ways of doing business and develop methods and models that include e-commerce is essential.

(b) Software tools, also known as programming tools, are necessary to keeping your technology running without a hitch. Software tools are programs that software developers create debug, maintain and support other systems. Software tools are usually relatively simple programs that can be combined together to perform more than one task.

Analyze performance

- Debug
- Check accuracy
- Build applications
- Check and adjust memory usage
- Linking and integrating
- Text editors

2014 - Dec [7] (a), (b)

(a) A spreadsheet is a program designed specifically for processing data in tabular form. These data may be numerical or textual, although most of the functions of a spreadsheet are for the former kind.

The following terms are commonly used to refer to parts of the spreadsheet:

1. **Mouse cursor:** The pointer in Excel takes the form of a cross.
2. **Active cell:** The current or selected cell.
3. **Cell reference:** The unique designator for a cell.
4. **Menu bar:** The horizontal area at the top of the Excel window containing the names of the various "drop-down" menus. In the example at right, the menu bar is shown with the Edit menu activated.
5. **Toolbar:** Two horizontal areas below the menu bar containing buttons, each with an icon representing the operations performed by the tool; these consist of the standard toolbar and the formatting toolbar. Moving the cursor onto the button causes an explanatory caption for it to be displayed briefly.
6. **Formula:** An expression entered into a cell that is designed to be evaluated by the spreadsheet software.
7. **Formula bar:** The horizontal area beneath the toolbar and to the right, where formulas are displayed when they are entered and whenever a cell containing a formula is selected.
8. **Sheet tabs:** The tab-like entities at the bottom of the workbook area, designated by "Sheet 1", "Sheet 2". Clicking on a tab causes the named sheet to be displayed.
9. **Vertical scroll bar:** The bar at the right-hand edge of the Excel window, used for scrolling up and down the sheet; similarly the horizontal scroll bar is used for right and left scrolling.

(b) 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!

Business Intelligence is becoming a critically important tool that can allow your company to better understand your customers and suppliers, or measure the efficiency of your own internal operations. If you are new to BI, try reading our Business Intelligence Overview first. Now, it's time to start planning a new BI project. You will need to design the right BI solution for the kind of analysis you plan to do and evaluate your existing IT infrastructure to ensure that it can support this kind of solution.

Choosing the Right BI Solution: BI tools offer functionality ranging from simple reports to drill-down analytical solutions targeted at specific industries and operational environments. When choosing a Business Intelligence solution, firms need to ask two key questions:

1. 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.
2. 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.

Chapter - 8: ERM, Performance Evaluation & Corporate Failure

2014 - Dec [8] (a), (b)

(a) 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.

Benefits of Diversification: The gains in risk reduction from portfolio diversification depend inversely upon the extent to which the returns on securities in a portfolio are positively correlated. Ideally the securities should display negative correlation. This implies that if a pair of securities has a negative correlation of returns, then in circumstances where one of the securities is performing badly the other is likely to be doing well and vice versa in reverse circumstances. Therefore the 'average' return on holding the two securities is likely to be much 'safer' than investing in one of them alone.

(b) Risk Retention denotes acceptance of the loss or benefit arising out of a risk when it takes place. In short, it is also termed as self insurance. This strategy is viable when the risks are small enough to be transferred at a cost that may be higher than the loss arising out of the risk itself. On the other hand, the risk can be so big that it cannot be transferred or insured. Such risks will have to be phased out when the eventuality occurs. War is an example as also are 'Acts of God' such as earthquakes and floods.

Certain guidelines relating to risk retention should be followed:

1. Determine the risk retention level through proper estimation of risk using sales projections, cash flows, contracts, liquidated damages and guarantees.
2. Though there is no precise formula for estimation of risks to be retained, statistical averages of such losses over a period of time give an indication to estimate such losses. For instance, bad debts occurring over a period of time are taken into consideration as an estimate to create a reserve for doubtful debts.

3. It is also necessary to ascertain the capacity for funding a loss arising out of retained risk that is the measure for transferring the risk beyond that level.

2014 - Dec [9] (a), (b)

(a) **Value at Risk (VaR)** is one of the popular methods of measuring financial risks. There are different types of VaR -long-term VaR, marginal VaR, factor VaR and shock VaR. VaR is also defined as the threshold value such that the probability of a portfolio making a market to a market loss over a specific time horizon exceeds this value. For example, if a portfolio stock has a one day 3 per cent VaR of ₹ 10 million, there is 0.03 probability that the portfolio may face a reduction in value by more than ₹ 10 million over a specific time period. This is on assuming that normal market operations and there is no trading. A loss which exceeds VaR threshold is known as 'VaR break'. VaR has applications in financial risk management, risk measurement, control and reporting. It can also be used in calculating regulatory capital.

(b) **Step 1: Risk Identification and Assessment:** This step involves event identification and data collection process. The institution has to put in place a system of capturing information either through key risk drivers (KRIs) or through a rating system. Once risks are identified, combine like risks according to the following key areas impacted by the risks - people, mission, physical assets financial assets and customer/stakeholder trust.

Step 2: Risk Quantification and Measurement: The next step is to Quantify and Measure risks-this means Rate risks according to probability and impact. Various standard tools are used by financial institutions to measure risk and understand their impact in terms of capital or its importance to the organization through a scoring technique.

Step 3: Risk Analysis, Monitor and Reporting: The next step is risk analysis, monitoring and reporting. This will help one to get the big picture and decided on the approach to risk management.

Step 4: Capital Allocation: Risk Analysis, Monitoring & Reporting sends information to the top management of the organization to take strategic decisions. Capital allocation plays key role in management decision making.

Step 5: Risk Management and Mitigation: After the above step, the last step is to make strategic decisions to manage the risk in order to mitigate the risk.

2014 - Dec [10] (a), (b)

(a) Causes of 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.
   This situation was seen in the case of Mittal Steel Company taking over Arcelor Steel Company. Arcelor Steel Company was using its old technology to make steel while Mittal Steel Company was using the new technology and as a result, Mittal Steel Company was able to sell steel at lower price than Arcelor Steel Company due to its low cost of production. Arcelor Steel Company was approaching corporate failure and luckily, Mittal Steel Company merged with Arcelor Steel Company and became Arcelor Mittal Steel Company, thus preventing Arcelor from failure.
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 cannot be avoided by businesses.
   The recent economic crisis in the USA led to many cases of corporate failures. One of them is the insurance AIG insurance company. It is facing serious problems and it might close its door in the near future.
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.

5. **Over-expansion and Diversification:** 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. Enron and WorldCom can be an example for this situation where the managers did not understand how growing overcapacity would influence its investment and therefore did not comprehend the risks associated with it.
6. **Fraud by Management:** 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. Example Enron and WorldCom where poorly structured board was a contributor towards their failure.
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. Financial distresses include the following reasons also low and declining profitability, investment Appraisal, Research and Development and technical insolvency amongst others.

   Another cause that will lead the company to fail is the investment appraisal. Many organizations run into difficulties as they fail to appraise investment projects carefully. The long-term nature of many projects means that outcomes are difficult to forecast and probabilities are usually subjective. "Big project gone wrong" is a common cause of decline. For example, the acquisition of a loser company, this has happen in the case for the failure of Parmalat Co. Ltd. of Italy, which made the acquisition of several losses making company where inappropriate evaluation of the acquired company, its strengths and weaknesses.

(b) Steps taken for preventing the corporate failure:

1. **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. Overall, the non-executive directors will act as a Cross Check.
2. **Audit committees:** Very often, there is occurrence of fraud in management and financial reporting. The presence of the audit committees 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.
3. **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 continuous basis. This is mainly done by carrying customer-feedback surveys. In this way, the organization can realign itself with the new needs and challenges.
4. **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 how to make the products much better than that of their competitors.

   It can be deducted that a director has a big responsibility that he has to assume there commendations mentioned above can help directors to reduce corporate failure, provided that the directors abide. Proper planning is also critical to the success of a business.

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