



ANNEXURE 2

SUGGESTED QUESTIONS AND ANSWERS

Study Note 1

STRATEGY FORMULATION

Question 1: Identify various steps for strategy formulation.

Answer:

The formal strategic management process has the following steps:

- Develop Corporate Vision
- Develop Corporate Mission
- Develop Corporate Goals / Strategic Objectives
- Commission SWOT Analysis – External Analysis of Opportunities and Threats and Internal Analysis of Strength and Weaknesses
- Develop there from Functional Level Strategy, Business Level Strategy, Global Strategy and Corporate Level Strategy.
- Initiate Planning Process – Corporate Planning, Long Range Planning, Business Policy Planning.

Question 2: Identify various steps for strategy implementation

Answer:

- Lay Down Principles For Corporate Performance, Governance and Ethics
- Operationalising Strategy
- Execute the Strategy using various tools
- Introduce Controls
- Detect Variance, Measure Variance, Match against Control & Initiate Feed Back for Revision if Necessary

Question 3: Identify the various steps for developing mission statements synthesizing various concepts evolved over a time horizon.

Answer:

In short a perfect Mission statement should include:

- Definition of the business in which the company would like to grow
- It sets apart the company from its competitors
- It is inclusive in that all the stake holders are covered
- The behavioral characteristics of the organization flowing out of values and beliefs
- The purpose for which the organization exists
- Clarify the same and
- The mission statement should be inspiring.



Question 4: Why do competing objectives arise and how are they resolved?

Answer:

Existence of a corporate body in an environment bounded by social, political, economic and technological developments is bound to have competing objectives arising out of the following:

- Balancing between profit maximization and social responsibilities
- Incongruence between goals of different stake holders
- Mismatch of Internal Goals.

These problems are usually resolved by adopting the following techniques:

Ranking: Managements can rank the various priorities and try to achieve a balance through setting particular levels of achievement, e.g., a target level for ROCE, as against a target for pollution control expenditure to meet their social responsibilities to the society.

Weightage: The above ranking can be made more meaningful by according different weights to the priorities, and the weighted score can be compared.

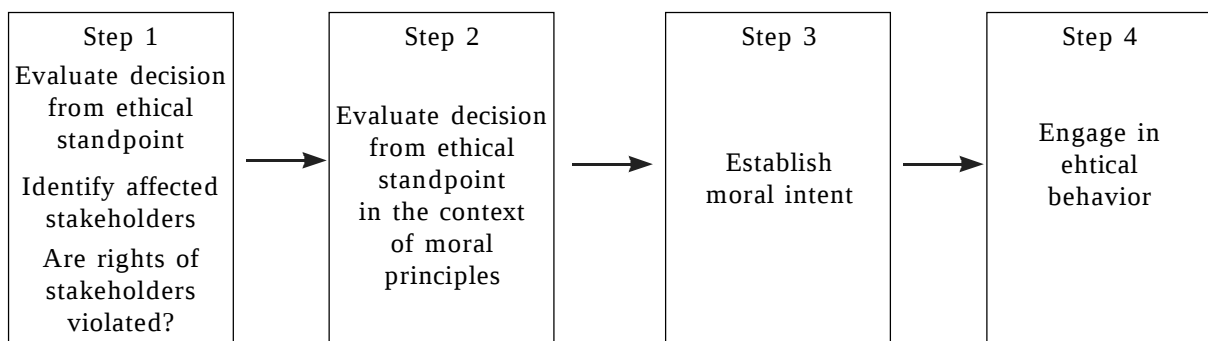
Composite Measures: Effective tools like balancing score card can be used to gauge the impact of performance both physically and financially.

Question 5: Develop an approach for ethical decision making.

Answer:

Formulation of goals should also take into account following responsibilities arising out of: ethical, discretionary, legal and economic areas. The ethical approach dictates what the company should do while the discretionary approach leaves enough elbow room. The legal responsibility lays down what the company has to do. While the economic obligations determine “the must do objectives”.

A Model of Ethical Decision Making



Question 6: How environmental consciousness is incorporated into a SWOT analysis?

Answer:

Business should be conducted in a way that preserves natural environment. For a good business it is fundamental to respond to the following factors:



1. Consumer Demand for environmentally safe products has become a necessity
2. There is a growing resistance against pollution of the environment from the society
3. This resistance is directed into environmental advocacy troops all over the world
4. Statutory regulations for preserving environment and pollution control are preserving environment and pollution controls are becoming more stringent
5. Funds providers are also particular about the environment liabilities of the company seeking loans
6. Stake holders hesitate to do business with environmentally weak firms
7. Litigations due to violations against statutory environmental requirements are on the increase. So many corporate bodies are becoming environmentally proactive which would mean that they integrate the factors and the limitations of the environment in their strategies for improving efficiency and effectiveness.

Question 7: What are the major outcomes of SWOT analysis?

Answer:

The three major outcomes from such an analysis are:

- Matching the company strengths to take advantage of the opportunities in the market place E.g. Converting fast food stands to full time restaurants
- Converting threat or weakness into an advantage.
- Eliminate the weaknesses that expose the company to external threats.

Question 8: What are the three phases of internal analysis?

Answer:

The internal analysis is carried out in three phases.

First Phase: Understanding the process by which the company creates value for the customer while earning a profit for the company. For this purpose the company needs to know the role of resources, capabilities and distinctive competencies in this process.

Second Phase: Comprehension of the importance of superior efficiency innovation, quality and responsiveness to customers for creating value for the customer and earning good profits for the company.

Third Phase: Analysis of the sources of the company's competitive advantage to identify the drivers for the profitability of the company as also the opposition for holistic improvement.

Distinctive competencies are company specific strengths to differentiate its products and / or achieve significantly lower cost than its competitors, thus gaining a competitive advantage. These competencies can be manufacturing technique, inventory control systems, optimizing cycle time, evolving innovative marketing techniques or establishing a well oiled net work



of distribution. The distinctive competencies evolve out of two main sources, viz., resources and capabilities.

Question 9: Define forward integration with an example.

Answer:

Forward Integration: Enhancing ownership and control over downstream products and distribution of the same.

Example: Sugar Industry, Alcohol and portable spirit along with various distribution outlets

Question 10: Define market development with an example.

Answer:

Market Development: Positioning present products or services into new geographic area.

Example: Introducing existing brands of potable liquor in other countries.

Question 11: Define the four level strategies.

Answer:

The alternative strategies can be grouped under FOUR heads as follows:

- Functional Level Strategy
- Business Level Strategy
- Global Level Strategy and
- Corporate Level Strategy

Functional Level Strategy

Functional Level Strategy aims at harnessing the internal strengths and eliminating the weakness. These strategies are focused on the effectiveness of a Company's operation to

- Achieve superior efficiency
- Quality
- Innovation and
- Customer responsiveness

Business Level Strategy

Functional level strategies are instrumental in lowering costs and lend stability to a cost structure of a product or service as required by a business strategy or in other words the results of functional level strategies are inputs to a Business level strategy.

Business level strategies can be different according as how a company endeavors to create value for customers. The main focus of business level strategy is to develop a firm specific business model to enable a company to achieve competitive advantage over its rivals. This strategy entails identification of

- Customer's needs



- Customer Groups and
- Distinctive competencies which are needed for satisfying the customers.

Global Level Strategy

The strategies required to operate in different countries across the globe called for a new type of strategy on the global environment. Thus the global strategies depended on two major issues, viz.

- Decision making in regard to geographical markets, timing of such an entry and their scale of such an entry and
- The ways and means a company should utilize to enable such a foreign investment.

Corporate Level Strategy

Corporate Level Strategy engages itself in the identification of businesses which a company should endeavor. The value creation activities are to be performed in those businesses and suitable methods for expansion or contraction of different businesses. Four major strategies normally pursued are

- Horizontal integration
- Vertical integration
- Strategic outsourcing and
- Diversification.

Question 12: Write short notes on

Learning curve

De-bottlenecking

Innovative projects

Answer:

Learning curve

Learning effects are savings in costs that derive from learning by doing for e.g., a laborer learns through repetition as to how best he could perform a task. Effects of learning can be plotted on a curve known as Learning Curve. Studies have been instituted to understand the aspects of learning effects and to improve training, education of labor, under Indian ethos this approach is known as “SAMAVAYA” which is holistic to include the 5Ws and 1H, viz., WHAT, WHO, WHEN, WHERE, WHY and HOW. Studies have been conducted in manufacturing and services areas. It was noted that learning effects proved very beneficial whenever processes had complex steps like assembly processes, chemical processes, etc. In the area of services studies conducted in the health care industry proved that mortality rate came down significantly with the Learning Curve.

De-bottlenecking

Increase output through synergy as well as effective utilization of capacity without any



increased fixed cost. This process reduces cost of the production significantly. Application of Theory of Constraints is a pointer in this direction to remove the bottle neck and effectively increase flow of materials through all processes thus increasing output. Superior efficiency could be achieved by improving productivity as well as through application of value engineering in providing alternative raw materials. This should not compromise quality.

Innovative projects

Innovative project should be structured properly to include the following steps:

Project selection should be made after a brain storming session of a group represents a cross section of a company as also include experts in a field drawn from external sources.

The project so identified should be able to produce or innovate a product / service in a foreseeable future, i.e., 2 to 3 years, as the life cycle of a product / service is reducing very rapidly and technological obsolescence sets in very easily.

Cross functional integration is extremely important in that the product identified is driven by customer needs; articulated or unarticulated, manufacturability of the new product is assured on a commercial scale. Development costs are held under check through quality function deployment and different milestones leading to commercialization are fully understood by all the members of the cross functional team.

Question 13: Write short notes on

Experience curve

International strategy

Multi domestic strategy

Global strategy

Transnational strategy

Answer:

Experience curve

Utilizing the local pool of employees through the learning effects and through economies of scale, the employees develop greater comprehension of the processes and are in a position to improve and innovate on these processes due to the experience they have gained over the years of repetitive operations. The advantages of experience curve have been reaped through empowerment by many big multi nationals. The conversion cost especially in the chemical industry and oil refining industry in India is nearly $1/10^{\text{th}}$ of the cost prevailing in the developed countries. Many pharmaceutical multi nationals had chosen India for contract, production or formulation for catering to the markets in India and the Far East. This strategy has reduced their cost of production as also the logistic cost.

International Strategy is based on transfer of distinctive competencies to foreign markets. Advantages include transfer of distinctive competencies. Disadvantages include inadequate local response, unrealized location economics, unavailable advantage due to experience-curve.



Multi Domestic Strategy depends on the ability to offer customized products catering to local market's requirements. Advantages include customization of product to suit local market. Disadvantages include unrealized location economics, unrealized advantage due to experience curve, inability to transfer distinctive competencies.

Global Strategy is based on the ability to exploit both the economies of scale and experience curve effects while guarding their own technology through wholly owned subsidiaries. Advantages include advantage of Experience Curve, advantage of location economics. Disadvantages include inadequate Local Response.

Transnational Strategy combines all the above three strategies to harvest the best of benefits. But this strategy is difficult to implement as complicated organizational structure to integrate both local and international talents will be required. Advantages include advantage of experience curve, advantage of location economics, advantage of customization, benefits of global knowledge. Disadvantages include problems in implementation because of organizational structure and culture.

Question 14: Write short notes on strategic outsourcing

Answer:

It is rather recent in that companies have been separating into certain non-core activities within a business and allowing them to be performed by an Independent Firm, the purpose being reduction in cost production, e.g., sponsoring of back office operations to a third party. Strategic outsourcing has assumed gargantuan proportions during the last decade. Then a race for cost reduction has become furious due to global competition. This outsourcing activity has been in relation to non core activity are a high technology activity which is not the core competence of the company. The benefits of outsourcing are reduction of cost and secondly differentiation product. Reduction of cost is achieved by outsourcing activities to a third party which has been specializing in a particular activity and able to offer services at a lower cost. It is also possible that a particular activity which is highly skilled or uses a costly technological activity, a company may outsource the specialized operation to a outside agency to avoid capital investment and maintain a special cadre of employees. In the same manner differentiation of a final product of a company is also adopted by adding some new features to the product through outsourcing. The risks of outsourcing are possibilities of holder not being able to meet the deadlines due to third parties mistakes and loss of confidentiality of information.

Question 15: Bargaining power with the suppliers as well as buyers comes under strain during inflation in the economy. Discuss.

Answer:

As per the economic dictum, inflation is a result of "too much money chasing too few goods". Lot of money in circulation with not much supply of goods will lead to high prices. For increased capacities through either organic or inorganic strategies will take advantage of this situation. However, inflation grips the raw material prices also and as such the operating margins come under strain. Building inventories or following a strategy of make to stock offers better advantage.



If the inflation trend gets intense and a spiral develops a new problem of lower purchasing power of the customer results and suddenly demands starts falling because the customer cannot afford the high price. The immediate future companies that have high capacities may phase recessionary trends that would increase their cost of production through lower capacity utilization. At this point of time, if the recessionary conditions were too prolong corporate restructuring and turnaround strategies will have to be thought of.

As far as the marketing strategies are concerned inflation will have to be understood fully as to the causes for the trend. The causes can be imported, unexploited resources, too much money in circulation, sudden change in supply position due to statutory regulations, etc.

Due to increase in prices of crude oil in FY 2006-07, FY 2007-08, which is largely, imported in India the refined products like petrol, diesel, and kerosene have become costlier. This is purely due to imported inflation and proper adjustment of the end product prices will have to be made to maintain the margins. However, in India due to “inclusive” policy followed by the government, products like Kerosene and LPG are subsidized, but still not to the extent of neutralizing the increase in the cost of production. This has put the oil industry in a difficult situation and the strategies followed by the oil companies are in developing efficient purchasing to keep the cost of crude at manageable proportions.

Fiscal policy of the government and the Reserve Bank of India in containing inflation also have its own share of impact on the strategies of any company. Increase in the interest rates leads to lower availability and utilization of funds and the monies in circulation are also controlled through increase of cash reserve ratio. This affects the purchasing power of the customer and the prices of product tend to fall to attract the customer. The strategy to be followed by a company under these conditions will be cost leadership, as there will be better maneuverability in fixing prices.

“Growth under inflation is always a catch 22 situation” as inflation is a double edged sword. It can help you as well as injure you.

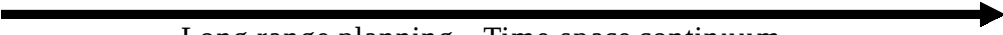
Question 16: “Planning is doing things today to make us better tomorrow because the future belongs to those who make the hard decisions today is the motto of Eaton Corporation.” Comment

Answer:

Taken the above adages corporate planning can be broken up into four phases:

- Strategic direction
- Externally oriented planning
- Forecast based planning
- Financial planning to impute values to physical targets

Identifying Strategic direction based on Vision, Mission, Objectives / Goals of a company	Externally oriented planning provides information regarding situation analysis, lead indicators, business cycles, macro level indices movement for economy	Forecast based planning – based on a time horizon five, ten or fifteen years select forecast model on the basis of data available if any, data pattern, forecast horizon, preparation time and the sophistication required	Financial planning – impute values to the physical targets/ milestones to be achieved at different points of time in the future. Use of annual budgets of the specific type required eg, zero based, performance budgeting, sunrise or sunset/ operating budgets
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 Long range planning – Time-space continuum



Study Note - 2

STRATEGY IMPLEMENTATION

Question 17: SEBI has introduced corporate governance in a comprehensive manner to protect shareholders interests as well as provide teeth in monitoring companies' performance through independent directors. Discuss.

Answer:

An outline provided by the CII was given concrete shape in the Birla Committee report of SEBI. SEBI implemented the recommendations of the Birla Committee and the Narayana Murthy committee worked on further refining the rules of SEBI. These recommendations were implemented through the enactment of Clause 49 of the Listing Agreements.

The committees which were created for the purpose were

1. Audit committee
2. Shareholders grievance committee
3. Remuneration committee
4. Share transfer committee

Audit committee

Audit committee has been empowered to discuss the performance of the company both from the point of view of interest of share holders and efficiency. This committee also discussed in detail quarterly performances taking care for proper disclosures and transparency. The annual report included a report on corporate governance, corporate social responsibility and management discussions on future plans.

Shareholders grievance committee

The interests of the share holders regarding dividend payments change of addresses, any grievances against the company were discussed and disposed of every quarter and the status is indicated in the quarterly report.

Remuneration committee

Remuneration of whole time and managing directors was recommended after application of mind as well as the relevant sections of companies act for approval in the general meetings of the share holders.

Share transfer committee

With dematerialization, transfers of shares have become more transparent. However, the committee looks into the aspects of insider trading and any possibilities of malpractices.

Question 18: “The continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large” Discuss.

Answer:

CSR can be classified under four heads namely:



- Community involvement
- Socially responsible production processes
- Socially responsible employee relations
- Socially responsible to stakeholders

CSR in relation to community can be stated as follows:

- Respect the principle of preventive action.
- Support a precautionary approach to environmental challenges.
- Rectify environmental damage as a priority at source.
- Respect the principle that the polluter bears the environmental costs.
- Promote greater environmental responsibility.
- Encourage the development and diffusion of environmentally friendly technologies.
- Contribute to the preservation of biodiversity.
- Contribute to equal access to health facilities.
- Contribute to access to basic food, housing, sanitation and sufficient safe drinking water.
- Contribute to education and access to information with respect to essential health problems in the community.

CSR in relation to production processes can be stated as follows:

- Reduce energy use
- Limit or alter material use
- Reduce water use
- Limit emissions
- Reduce waste

CSR in relation to employees would involve the following:

- Respect and ensure the freedom of association and right to collective bargaining
- Do not engage or support the use of forced Labour
- Contribute to the abolition of child Labour
- Do not discriminate with respect to employment and occupation
- Ensure security of employment
- Ensure a living wage.
- Ensure occupational health and safety.
- Respect maximum number of working hours.
- Provide training.
- Guarantee handling of complaints.
- Provide timely information on reorganizations and the right to collective discharge and redundancy schemes.
- Do not use the threat to transfer the operations of the company to other countries as a means for
- Influencing the negotiations with trade unions or employees.



- Do not use double standards.
- Employ and train local staff as much as possible.
- Enable worker representatives to negotiate and confer with decision makers.
- Promote respect for other socio-economic rights, like the right to work, social security, and maternity leave, to take part in cultural life.

CSR with respect to remaining stakeholders, consumers and the vendors' specific attention as follows:

1. Consumers
 - a. Ensure access to essential goods and services.
 - b. Ensure the right to safety, with respect to:
 - i. physical safety
 - ii. safety and quality of consumer goods and services
 - iii. food, water and pharmaceuticals
 - c. Ensure the right to information.
 - d. Ensure the right to choice in the market place.
 - e. Ensure the right to be heard.
 - f. Ensure the right to obtain redress.
 - g. Respect the right to consumer education.
 - h. Promote sustainable consumption.
 - i. Respect the right to privacy.
2. Vendors
 - a. Ensure the vendor understands corporate values in regard to social responsibilities programme
 - b. Provide raw materials and components of specifications to promote quality of finished product
 - c. Follow ethical practices in supply of materials to avoid adulteration, pilferage and other malpractices
 - d. Follow trade practices and respect law of the land in regard to payment of duties, taxes, etc.
 - e. Treat vendor as a partner and not as an outsider

Question 19: Benchmarking exercise is based on “best practices” and not on “best performances” Discuss.

Answer:

Benchmarking exercise is based on “best practices” and not on “best performances”. For “practices” connote continuity in use while performances may be flash in the pan and not continuous. Best practice is a continuous process of learning, feedback, reflection and analysis of what works (or does not work) and why? In tracking the practices of other companies, **benchmarking** of the process of measuring the company against the products, practices, and



services of some of its most efficient global competitors is the ideal way. For example, when Xerox was in the comeback trail in the last lap of 20th century, it decided to institute a policy of benchmarking as a means of identifying ways to improve the efficiency of its operations. Xerox benchmarked L.L.Bean for distribution procedures, Deere & Company for central computer operations, Procter & Gamble for marketing and Florida Power & Light for total quality management processes. By the early 1990s, Xerox was benchmarking more than 200 functions against comparable areas in other companies. This process helped Xerox dramatically to improve the efficiency of its operations.

Types of benchmarking are given below:

- i. **Strategic benchmarking:** This aims at enhancing a company's holistic performance by analyzing the long-term approaches and strategies adopted by the "best practice companies" for their success in any sector across the globe.
- ii. **Competitive benchmarking:** This is confined to the area relating to the performance characteristics of the companies key products and services. So competitive benchmarking will involve the best practices of the companies in the same sector.
- iii. **Process benchmarking:** This is attempted to improve specific key activities and operations culminating into processes with the help of best practice organizations that are engaged in similar activities and services.
- iv. **Functional benchmarking:** Optimization of functional processes or activities through benchmarking can be done by comparing with different business sectors but engaged in similar functions or processes.
- v. **Internal benchmarking:** This involves benchmarking against the companies own divisions or branches or strategic business units situated at different locations. The purpose is to develop a database which gives access to information and a cross fertilization of the managerial acumen with in the company.

Question 20: Balanced scorecard identifies exactly where the company is heading and what the company is trying to achieve. Discuss.

Answer:

Approach to a balanced scorecard has following steps:

- a. How do we look to shareholders? Or to succeed financially how should we appear to our shareholders? – Financial perspective
 - i. Identify goals / strategic objectives
 - ii. Develop measures
 - iii. Set targets
 - iv. Develop key performance indicators
 - v. Take initiatives
- b. What must we excel at? Or to satisfy our shareholders and customers what business processes must we excel at? – Internal business
 - i. Identify goals / strategic objectives



- ii. Develop measures
- iii. Set targets
- iv. Develop Key performance Indicators
- v. Take initiatives
- c. Can we continue to improve and create value? Or to achieve our vision how will we sustain our ability to change and improve? – Innovation and learning perspective
 - i. Identify goals / strategic objectives
 - ii. Develop measures
 - iii. Set targets
 - iv. Develop Key performance Indicators
 - v. Take Initiatives
- d. How do customers see us? Or to achieve our vision how should we appear to our customers? – Customer perspective
 - i. Identify goals / strategic objectives
 - ii. Develop measures
 - iii. Set targets
 - iv. Develop Key performance Indicators
 - v. Take Initiatives

Question 21: Attempts have been made to integrate corporate social responsibility into balanced scorecard. How far it has been successful?

Answer:

Balanced Scorecard Perspective	Market Forces (Objectives)	How success or failure is measured using the triple bottom the (A common framework for sustainability reporting)	Target: The level of performance or rate of improvement required.
Financial	“Green” consumers	Energy consumption footprint (annualized lifetime energy requirements) of major products	Annual reduction in energy footprint for new products
Financial	Energy crunch	Direct energy use segmented by source	100% renewable energy
Financial	Financial	Increase / decrease in retained earnings at end of period	Percentage



Balanced Scorecard Perspective	Market Forces (Objectives)	How success or failure is measured using the triple bottom the (A common framework for sustainability reporting)	Target: The level of performance or rate of improvement required.
Internal	Pollution and health	Standard injury, lost day and absentee rates and number of work-related fatalities (included subcontractors)	0 lost-time & fatalities, or long-term illnesses
Internal	Climate change	Total greenhouse gas emissions	Annualised reduction
Internal	Governments and regulators	Incidents and fines for non-compliance with all laws and regulations	0 incidents or fines
People and Knowledge	Civil society / NGOs	Policies guidelines and procedures to address needs of Indigenous people	Number of Indigenous employees
People and Knowledge	Activist shareholders	Business units currently operating or planning operations in or around protected or sensitive areas	Number of employees trained in environmental management practices
Customer	Erosion of trust / transparency	Policy to exclude all child labor	No child labor
Customer	Globalization backlash	Supplier performance related to environmental commitments	Use of 100% organic cotton or coffee

Question 22: Trace the evolution of Strategic business unit (SBU) concept.

Answer:

While the financial structure of an organization evolved **cost centers** gave way to **profit centers** to provide motivation to divisional managers. At this juncture ROCE was considered as the best measure of a profit centre. However, the divisional heads chose to improve this ratio more by denominator management, which is by reducing the denominator rather than augmenting the numerator. This lead to an occupational hazardous situation where the Net Fixed Assets were being phased out but the repair cost to maintain the fixed assets were on the increase without replacing the fixed assets. Technological obsolescence was looming large in the horizon and many companies collapsed due to their fixed assets becoming anachronistic and inefficient. So the profit center had to be upgraded into a **strategic business unit** to take care of the business holistically to include strategy both in respect of business functions and technology with a futuristic tilt.



Question 23: EVA should always be positive. Why? How can it be improved?

Answer:

Any return on investment should be higher than the cost of capital after all external outflows are taken into consideration, e.g., taxes, interest and dividend.

There fore the formula for EVA has been $EVA = NOPAT - c * x (CAPITAL)$.

To improve EVA and this can be done in four ways:

- Improving Operating Performance (Functional Level Strategy)
- Improving profitability of investment (Business Level Strategy)
- Divestment of unproductive capital (Global Corporate Level Strategy)
- Reducing the cost of capital (Corporate Level Strategy)

Question 24

CAPITAL: 10,000

NOPAT: 2000

C*: 15 PERCENT

r: 20PERCENT

$EVA = CAPITAL X(r-c^*) = 10,000(0.20-0.15) = 500$

Illustrate and quantify the impact of the four strategies on improving EVA using above data.

Answer:

Strategy 1: Improvement in operating performance

- NOPAT increase from 2000 to 2250, due to greater operating efficiencies. This rises to 22.5 percent. As a result EVA raises to 750
- $EVA = CAPITAL X (r - c^*) = 10,000(0.225 - 0.15) = 750$

Strategy 2: Profitable Investment

- A new project requiring 10,000 is expected to earn a return of 18 percent thereby adding 1800 to NOPAT .This project will increase EVA, even though the consolidated return will decline to 19 percent (the average of 20 percent and 18 percent)
- $EVA = CAPITAL x (r - c^*) = 20,000(0.19 - 0.15) = 800$
- Note that maximizing EVA is more important, not maximizing return on capital .Hence the project should be accepted

Strategy 3: Withdrawal of unproductive Capital

- 1000 of working capital can be liquidated with only a marginal decline of NOPAT. NOPAT will fall by just 50. Withdrawing this working capital would increase the rate of return to 21.67 percent ($2000 - 50 / (10000 - 1000)$) and EVA to 600
- $EVA = 9000 x (0.2167 - 0.15) = 600$

Strategy 4: Reduction in the cost of capital

- The capital structure of the firm is altered and its change lowers the cost of capital to 13%, without affecting anything else. As a result EVA rises from 500 -700
 $EVA = Capital x (x - c^*) = 10,000 (0.20 - 0.13) = 700$



Study Note 3

ALTERNATIVE STRATEGIES REVISITED

Question 25: Not all joint ventures lead down the garden path. They end up many a time on the way side due to various reasons. Enumerate.

Answer:

Not all joint ventures lead down the garden path. They end up many a time on the way side due to:

- The research and development for a new technology never materialized
- Preparation and planning for a joint venture might have been inadequate
- Conflicts in regard to the basic objectives of the joint venture cropping up after the formation
- Sense of secrecy and reluctance share expertise with the partner ends in a fiasco
- Difficulties faced in sharing managerial control between the partners made into a dead lock

Question 26: “Growth through concentric diversification into a related industry may be a very appropriate corporate strategy” Comment.

Answer:

While this statement may look relevant on the face of it, this can be applied only when a firm has a strong competitive position but industry attractiveness is low. For example, Murugappa group’s E.I.D. Parry India Ltd., for example, has diversified both internally and externally out of the unpredictable sugar business into a series of related businesses run by the parent company.

The related diversification internally took the form of diversifying sugar division into alcohol and confectionary to add profitability to the unpredictable sugar business. Again the fertilizer activity of EID parry group in the form of production of fertilizer mixtures, ammonium phosphate sulphate and super phosphate was integrated externally with Coromandal fertilizers of which E.I.D. Parry India is a major share holder.

Question 27: “Complementary mergers may result in each firm filling in the “missing pieces” of their firm with pieces from other firm” Comment.

Answer:

A merger of a firm with strong R & D unit would help to improve new product development while with a firm with a strong distribution network, may benefit better distribution. For example, Dr.Reddy’s went for acquisitions of R&D units to strengthen their exploration for new molecules to shorten the product development time horizon. Coca Cola when entered into India, took over the distribution systems of Parle and this saved them both efforts and time to develop distribution network.



Question 28: “The condition wherein the whole is greater than the sum of its parts; in a synergistic merger, the post merger value exceeds the sum of the separate companies’ pre merger values” Prove.

Answer:

Under ‘synergy’, the combined value of a firm is much greater than the value of individual firms. The phenomenon of synergy arises due to economies of scale of operation. Besides, the combined mega features such as enhanced managerial capabilities, creativity, innovativeness, R & D and market coverage capacity. Due to the complementary nature of resources and skills a widened horizon of opportunities are also responsible for synergy on a merger situation. For example, Madura bank had very big network compared to ICICI. Bank of Madura had one of the lowest costs of deposit and capital adequacy ratio was very high. ICICI had latest technology to be implemented and subsidiaries overseas but had no significant network in India. So, ICICI and Madura bank came together and there has been a dramatic improvement post merger due to synergy.

Question 29: “Takeover usually takes the form of ‘hostile’ or ‘forced’ or ‘unwilling’ acquisition and acquisition happens at the instance and the willingness of the company management and the shareholders” Do you agree?

Answer:

Yes, it is for this reason that acquisition is generally referred to as ‘friendly takeover’. An example of acquisition is Aditya Birla group, a leading conglomerate in India with substantial interest in textiles and cement, apart from other things, took over from L & T its cement business on a friendly takeover. Similar such transaction was that ORBI Tech by Polaris Software. On the other hand, the acquisition of Raasi Cement by India Cements earlier was a hostile takeover by the India Cements Group. Further, the term takeover is often used to denote the hostile nature of acquisition, where there is an element of resistance and opposition to the takeover bid.

Question 30: What are the strategies adopted to combat hostile takeover?

Answer:

A target company which faces the threat of a hostile takeover, would adopt the following strategies:

Poison pill tactics

This strategy aims at initiating action against the predator by destroying the attractiveness of the firm. The following are few methods:

The acquiring company may issue substantial amount of convertible debentures to its existing shareholders which would make it difficult for the potential acquirer as there is a danger of considerable increase in the voting power of the company.

- The target firm either sells or mortgages or leases or otherwise disposes off some of its precious assets.



- The target firm can defend itself from the onslaught of the potential bidder by disposing of its liquidity by acquiring some asset or other firm.
- The target grants its employees stock options that immediately vest if the company is taken over. This is intended to give employees an incentive to continue working for the target company at least until a merger is completed instead of looking for a new job as soon as takeover discussions begin. However, with the release of the “golden handcuffs”, many discontented employees may quit immediately after they’ve cashed in their stock options. The poison pill may create an exodus of talented employees. In many high-tech businesses, attrition of talented human resources often means an empty shell is left behind for the new owner.
- The target company issues rights to existing shareholders to acquire a large number of new securities, usually common stock or preferred stock. These new rights usually allow holders (other than an acquirer) to convert the right into a large number of common shares if anyone acquires more than a set amount of the target’s stock (typically 10-20%). This immediately dilutes the percentage of the target owned by the acquirer, and makes it more expensive to acquire control of the target.

Green mail tactics

The target firm can purchase its own stocks at a premium to avert a takeover bid. The incentive is offered by management of the target company to the potential bidder for not pursuing the takeover bid.

White Knight tactics

The target company’s management may seek out a friendlier potential acquiring company who could offer a higher offer price which would eventually drive away the original bidder. The purpose of ‘white knight strategy’ is to seek to find a bidder. The objective is to make the takeover exercise as much unviable and unprofitable as possible for the original bidder. Such a strategy will help get the target firm a better deal. There are cases where a white knight has later been aggressive with the target company and consummated the deal at better terms.

Golden Parachutes tactics

Adopted by the target company by offering hefty compensations to its managers if they manage to get ousted due to takeover; this is pursued to reduce their resistance to takeover. This was also mentioned among one of the strategies of poison pill. This is mainly initiated because soft target firms who are managed by professional managers may fear shifting of loyalty by professional managers and to avoid any such attempts set up golden parachutes so that predators may not have incentive to deal with the agents for consummating the deal.

Divestiture tactics: Whereby target the company arranges to divest or spin off some of its businesses in the form of an independent, subsidiary company thus reducing the attractiveness of the existing business to the predator. This clearly changes the valuation of the company and many a times the multiples of valuation for multi divisional businesses would encourage such moves by target companies.



Crown Jewel tactics: Whereby the target company arranges to sell its crown jewel namely highly profitable part of the business or ones which market values better in order to dissuade the predator. However, such strategic initiative requires clear understanding of predators target businesses and valuation guidelines to be effective.

Legal tactics: A target firm can forestall the possible takeover bid through legal mode. It takes the form of 'legal strategy' for guarding against hostile takeovers. In this case, it is possible for the target firm to move a court of law for obtaining injunction against the offer. For this purpose, relevant provisions exist in the Securities Contracts (Regulations) Act, 1956 and the Companies Act, 1956. This strategy is resorted to either to block or delay the tender offer in circumstances where the shares are lodged for the transfer by the bidder. SEBI has come with clear guidelines to discourage hostile takeovers in India.

Question 31: Due diligence is applied more to confirm the initial offer rather than to withdraw. Is it true?

Answer:

Due Diligence is the most important aspect in doing a merger and takeover deal. During the process of takeover, the predator and the target extend a lot of information on an informal mode and predator's deal progress is based on a number of assumptions and data inputs are primarily from public source and competitive intelligence. The process of due diligence gives the predator the authority to validate the "Homework" of the Deal. Hence the management gives a lot of importance for this activity during the transaction.

While doing the due diligence the focus would be to assert whether the deal is worth the bill. When someone triggers such a thought, the following aspects would prop up:

1. Confirmation of the strategy and feasibility of the target's business
2. Verifying operations and assets and liabilities are as represented
3. Develop and evaluate opportunities to best fit the target with the buyer
4. Cultural fit
5. Understanding the seller's financial and legal structure

The buyer must go with the spirit of confirming the value of the deal agreed to at the earlier stage and if corrections required, one must ascertain the same. Then the buyer must probably see how value generating activities could be driven on the post deal stage. If the buyer goes with the intention of finding gaps, probably the whole process may destabilize. There may not be perfect information sharing or mapping at Letter of intent stage.



Study Note 4

INDIAN SCENARIO – ECONOMIC SURVEY

Question 32: “Agricultural sector is poised for a second green revolution during the eleventh five year plan period” Comment.

Answer:

Agriculture sector has remained a problem area and there has been a deceleration in its growth. To arrest this trend and reverse the deceleration number of policy inputs has been made. A National Rain fed Area Authority (NRAA) has been created in November 2006 to support up gradation and management of dry land and rain fed agriculture. The authority would coordinate all schemes relating to watershed development and other aspects of land use. The accelerated irrigation benefit programme is also being revamped to repair, renovate and restore water bodies in various states. For improved productivity in the agricultural sector an action plan has been formulated product specific. Like the green revolution of 1960's another revolution is on the threshold. The 11th plan will give special emphasis to agriculture to reorient and rejuvenate this sector to meet the needs of the farmers. The credit flow to the agricultural sector has exceeded the target for the third consecutive year. However, doubts are being expressed about the efficacy of the delivery systems and the improvement of this system is the urgent need. The National Agricultural Insurance Scheme (NAIS) and the National Rural Employment Guarantee Scheme (NREGS) are two important schemes, which have been implemented recently. These have been extended to more number of villages, so that the under employment in agriculture sector is mitigated and business risk in agricultural farming due to natural calamities are also taken care of.

Dr. M.S. Swaminathan committee has identified insurance as a panacea for the above liabilities and the possible steps can be:

- Recognizing agriculture as an “open roof” industry and bringing in concepts of industrial liability insurances
- Pre-harvest hedging
- Cross dimensional liability coverage for inability
- Linking of life assurances of farming community with their property and casualty insurances

Question 33: Growth of infrastructure has lagged behind and may assume serious proportions during the eleventh five year plan. How does the government of India plan to meet this challenge?

Answer:

The growth of infrastructure has lagged behind and may assume serious proportions. So, the government has been actively pursuing public private partnership (PPP) to bridge the deficit



in the infrastructure. Under the overall guidance of the committee of infrastructure headed by the Prime Minister, the PPP programme formulation and implementation are being closely monitored by the relevant ministry / departments. An appraisal mechanism has been laid down and PPP appraisal committee has been given a mandate and guidelines for drawing up time frame for according approvals to proposals in a speedy manner. PPP projects normally involve long term contracts between the government and private parties detailing the rights and obligations of both the contracting parties. Government has decided to develop standardized frameworks based on due diligence and agreements will follow international practices. They will also create a framework with a right matrix of risk allocation, obligations and returns. Planning commission has also issued model concession agreement (MCA) for ports, state highways and operation maintenance agreements for highways. To promote PPP programme all state governments and central ministries are setting up PPP cell with a senior level office as a nodal officer. Technical assistance has been obtained from Asian Development Bank (ADB) including hiring of consultants and training of personnel.



Study Note 5

FORECASTING, MODEL BUILDING AND MODELS

Question 34: What are the types of forecasting? Identify the models.

Answer:

Forecasting models are of four types:

1. Qualitative models
 - a. Delphi model – Collects and analyzes panel of experts opinions
 - b. Historic data – Develop analogies to the past through judgment
 - c. Nominal group technique – Participative group process with forced voting
2. Naive (time series) quantitative models
 - a. Simple average – Averages past data to project the future based on that average
 - b. Exponential smoothing – Weights differently earlier forecasts and the recent to project into the future
3. Causal quantitative model
 - a. Regression analysis – Defines functional relationships among variables as to whether it is linear or non-linear
 - b. Economic modeling – Offers an overall forecast for a variable like Gross National Product (GNP)
4. Combination of monetary and physical projections
 - a. Marketing projections – Monetary by region, product and product group
 - b. Economic projections – Monetary by region, industry and broad product category
 - c. Historical demand projections – In units, monetary by product and product group
 - d. Demand forecast – In units by product and product group for operations management and monetary for sales and financial planning. (This is a combination of a, b and c)

Question 35: What are the various decision analysis models? Explain influence diagrams.

Answer:

There are three types of decision analysis models:

- Analytical hierarchical process
- Decision trees
- Influence diagrams

Influence diagrams

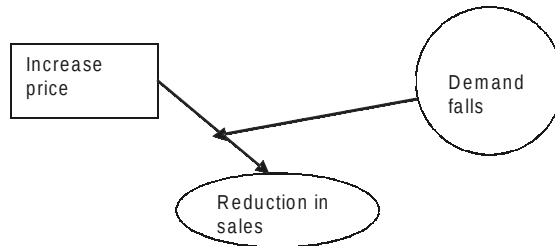
Another important decision analysis tools are known as an influence diagram. It offers a graphical presentation of decision situation expressing the exact nature of relationships between the variables. Bodily (1985) developed certain conventions for influence diagrams. They are:

1. A rectangle is a decision variable
2. A circle is an uncontrollable or intermediate variable



3. An oval is a result or outcome variable
These three types of variable are connected with arrows that indicate the direction of influence.
Arrows can be one way or two ways.

Influence diagram simplified



Question 36: What are the types of simulation models? What are the advantages and disadvantages of simulation models?

Answer:

There are several types of simulation as given below:

1. **Probabilistic simulation** where one or more independent variables is conceptualized as a probability distribution of values
2. **Discrete simulation** where it becomes important to know when an event exactly occurs
3. **Visual simulation** is a graphical representation of computerized results. Software for this method is one of the recent developments in computer - human interaction and problem solving

Decision support systems have been increasingly using simulation models for the following reasons:

1. Simulation theory is relatively easy to comprehend
2. Simulation can offer solutions to “what-if” type questions
3. Decision support system analysts work closely with managers who seek solution
4. The simulation model is built for one particular problem
5. Simulation models allow inclusion of real life complexities and no simplifications are necessary

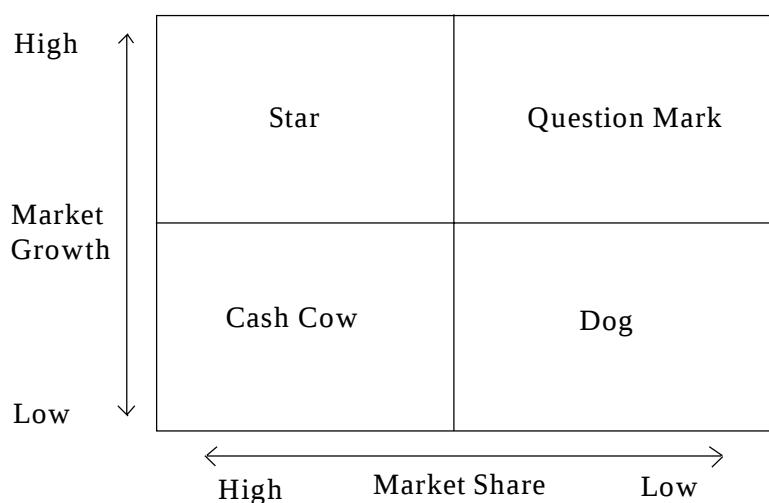
Disadvantages:

1. An optimal or the best solution is not always guaranteed
2. Building simulation model is a slow and costly process
3. Solutions and inferences from a specific simulation model cannot be transferred for other problems

Question 37: Compare and contrast BCG and GE matrices.

Answer:

The Boston Consulting Group (BCG) have developed a matrix, based on empirical research, which analyses products and businesses by market share and market growth. This growth / share matrix for the classification of products into cash cows, rising stars and questions marks is known as the Boston classification.



- Stars** are products with a high share of a high growth, market. In the short term, these require capital expenditure, possibly in excess of the cash they generate, in order to maintain their market position, but promise high returns in the future.
- In due course, however, stars will become **cash cows**, with a high share of a low-growth market. Cash cows need very little capital expenditure and generate high levels of cash income. The important strategic feature cash cows are that they are generating high cash returns, which can be used to finance the stars.
- A **question mark** (sometimes called **problem child**) is a product in a high growth market, but has a low market share. A decision needs to be taken about whether the product justifies considerable expenditure in the hope of increasing its market share, or whether it should be allowed to die quietly as it is squeezed out of the expanding market by rival products. Because, considerable expenditure would be needed to turn a question mark into a star by building up market share, question marks will usually be poor cash generators and show a negative cash flow.
- Dogs** are products with a low share of a low growth market. They may be ex-cash cows that have now fallen on hard times. Dogs should be allowed to die or should be killed off. Although they will show only a modest net cash flow or even a modest cash inflow, they are cash traps which tie up funds and provide a poor return on investment, and not enough to achieve the organization's target rate of return.



- e. There are also **infants** (i.e. products in an early stage of development) and **warhorse** (i.e. products that have been cash cows in the past, and still are making acceptable sales and profits even now) and **dodos** (low share, negative growth, and negative cash flow).

Directional Policy Matrix

		Business Strength		
		Weak	Average	Strong
Industry Attractiveness	Unattractive	Divest	Phased Withdrawal	Invest selectively to maximise cash generation
	Average			Invest for market share or withdrawal
	Attractive			Invest to retain market share as industry grows
				Priority products and services

General Electric of USA, assisted by McKinsey, developed a nine-cell strategic planning grid which attempted to correct some of the limitations of the BCG matrix approach. This grid is illustrated in the above figure as the Directional Policy Matrix. Each dimension is a composite measure of several component factors. Industry attractiveness is a function of a number of factors. The procedure involves assigning each of the factors a weight depending on its perceived importance, followed by assessing how each business compared on each factor using a 1 to 10 rating scale, and then computing a weighted composite rating. The choice of the factors and the weights assigned to the factors vary from business unit to business unit.

The same approach is used to measure Business Strength where aspects relevant to competitive position are considered. Each of the dimensions is classified into three categories: high (strong); medium; low (weak); thus, creating nine cells.



Study Note 6

MARKETING STRATEGIES

Question 38: Customer now articulates his own option to create a new product, as he has become “the boss”. How does this reflect change from product orientation to market orientation?

Answer:

Production orientation for a product to be put on to the market is based on the concept that customers prefer products, which are available freely and at low cost. But this orientation has given way with the customer driven strategy coming to the fore. So the market orientation stems out of the concept that the company should be more effective than the competitors in creating delivering and communicating superior customer value to the target markets. This change in the orientation has come about mainly due to the globalization of the market and liberalization of economies all over the world. This has resulted in multiple options being available to the customer and other things being equal the customer now articulates his own option to create a new product, as he has become “the boss”.

Question 39: Judy Strauss and Raymond Frost’s e-marketing model defines e-business as a continuous optimization of a firms business through digital technology. $EB = EC + BI + CRM + SCM + ERP$

Explain.

Answer:

$$EB = EC + BI + CRM + SCM + ERP$$

EB is electronic business, EC is electronic commerce, BI is business intelligence, CRM is customer relationship management, SCM is supply chain management and ERP is enterprise resource planning.

EC uses digital technologies to enable buying/ selling, BI uses digital technologies for collecting primary / secondary information, CRM is strategy to satisfy customers and build long lasting relationships on the basis of high interaction with customers. This high interaction has been enabled through webinars and web conferences. SCM relates to delivery of products efficiently and effectively both by the vendors to the manufacturers and manufacturers to the distributors/ customers. The high interaction with vendors and customers has been possible through EDI (electronic data interface), paper less transactions. ERP has helped optimization of business processes and lowering costs. Order entry and purchasing, invoicing and inventory control have been speeded up and also optimized through MRP, JIT, Kanban, etc using digital technologies.

Question 40: Define brand equity and identify its valuation methods.

Answer:

The endowed added value provided to all products and services is brought under the concept of brand equity. There fore brand equity is the added value share of every brand in comparison



with other brands. It can also be said that it depicts the differentiations in terms of value additions existing or proposed as perceived by customer. Brand equity can be equated with recognition of the brand through the number of customers, who are satisfied with the brand, customers who value the brand and see it as a friend and those customers who are devoted to the brand. Brand equity is essentially an asset and can be defined as the differential effect on a customer whose response to a product or service is through the knowledge of the brand. In essence brand equity makes a customer show a preference for one product over another when they are congruent.

Brand valuation is estimation of the total financial value of the brand. The estimate for valuation is based on the price premium the brand commands multiplied by the extra volume it is able to market over an average brand.

Brand valuation can be done in five ways:

1. Add up all costs of research and development and marketing expenditure of the brand over a specific time horizon. This method has certain limitations in that it is difficult to identify all expenses that relate to the brand and only quantifies the cost and not the value
2. Based on the present value of the price premium that a brand commands over the unbranded product. This is the first approach, which brings in the additional value earned by a brand. However,
 - a. It is difficult to identify a proper unbranded good for comparison
 - b. It does not recognize the stability attribute brought in to the earnings by the brand
 - c. The possibility of a brand being a barrier to the entry and this aspect of in terms of value is not included
3. If the brand were to be auctioned the value that may be fetched by such auction. Conceptually, this method is very sound but it may not be practicable for brand market is very narrow and accurate valuation is not possible
4. Computation of value based on intangible measures such as esteem, recognition and awareness. While the approach sounds interesting, translating these intangibles into commercial value is extremely difficult and the methods of quantification through use of statistics can be flawed
5. Discounting future potential earnings for brand valuation. This method virtually includes all the information from the earlier four methods and in addition has to develop a reliable forecast of future earnings and growth. Here it is difficult to gauge the life of the brand and the time horizon to be set apart from quantifying the earnings.



Study Note 7

APPLICATION OF MANAGEMENT ACCOUNTING IN STRATEGIC MANAGEMENT

Question 41: From a cost plus pricing model, a market driven model for pricing has lead to “target price”. How has it lead to target costing method for cost reduction?

Answer:

Until towards the last decade of the 20th century, product pricing was essentially a part of push strategy. Manufacturing to stock on the basis of an assured demand with adequate protection to tariff walls from the government, especially, Indian entrepreneurs produce goods at their own cost and provided their margin and fix their selling price on the “cost plus pricing” basis. However, this approach came in for a rude shock when the information technology revolution or the “third wave” as it is called engulfed the entire world. While on the one hand, developed countries found their market shrinking due to stagnation in their population, but had surplus capacity to produce world class goods, they had to look for new markets. The third wave came in as a boon and the entire world shrunk. Logistics no longer was a problem and the delay in reaching the customer was totally removed. Liberalized economies meant breaking down tariff walls and the markets became open. Now the customer has many options for buying a product as numerous producers were queuing up with quality products. Pricing of product was no longer the prerogative of the manufacturer, but of the customer. Pricing thus became market driven and a product of pull strategy.

From the point of view of the management accountant the market driven price is the target price at which the manufacturer has to market his products and source his earnings. At the same time the management accountant has also understood that if a business has to be carried on, it has to earn a return on capital employed (ROCE) at a higher level than the average cost of capital. Having quantified this return per unit of sale this element is deducted from the target price to yield the target cost. This area is the battle ground where the higher existing costs needed to be brought down to a level of the target cost for which a financial strategy has to be developed.

This financial strategy would involve cost reduction at all levels and thus would involve analysis of marketing costs and profitability on the one hand, product development policy and strategy on the other hand. Towards this, the main thrust of cost reduction is a three pronged exercise:

- Value engineering during design and development
- Kaizen costing during production
- Activity based management and costing during all stages of product life

Question 42: What are the phases of a value engineering job plan?

Answer:

There are seven phases, corresponding in part to the chain saw’s course of development. The specific phases of the job plan are:



1. General phase
2. Information phase
3. Function Phase
4. Creation Phase
5. Evaluation Phase
6. Investigation Phase
7. Recommendation Phase

- **General Phase:** This phase gives an overview of the entire job plan. Job Plan is broken up into: (A) A description of the process and the techniques of each stage of production or a cost centre. (B) Identification of any bottle necks by products and waste products which are to be overcome and the structure of human resources and any stresses and strains are recognizable affecting good human relations and inspired team work.
- **Information Phase:** Information relating to bottle necks, by products and waste products, raw materials, conversion costs will have to be obtained in an exhaustive manner. The specifications and requirements and the current costs incurred in these areas will have to be quantified accurately.
- **Function Phase :** Two techniques of this phase are a major part of Functional Approach:
 - Define the Function - Every function must be defined in two words, one verb and one noun
 - Evaluate Function Relationships -This is accomplished by taking the functions as defined in the above technique and the information and data secured in the information phase and establishing a relationship between them.
- **Creation Phase:** Creativity or Brain Storming. Two techniques simply point up the vital areas:
 - Establish Positive Thinking – Mind comprises 2 parts – Judicial & Creative. Necessary to turnoff the judicial part during the Creative Phase
 - Develop creative ideas – Cultivate uninhibited thinking and developing a multitude of ideas and approaches for accomplishing the defined functions. Large Quantity of Ideas desired
- **Evaluation Phase:** Techniques of this phase must be undertaken with care and diligence. Judicial part of the mind is brought into active use.
 - Refine and Combine Ideas.
 - Establish Cost on All Ideas.
 - Develop Functional Alternatives.
 - Evaluate by Comparison.

The combined creative ideas that have been refined to basically workable solutions and have the greatest potential return on further invested time are subjected to the techniques of the Investigation Phase.



- **Investigation Phase:** This technique provides selected ideas into workable and salable solutions providing lower cost methods of performing the required and desired functions through the application of additional, vast resources of knowledge.
 - Use Company and Industrial Standards.
 - Consult Vendors and Specialists
 - Use Specialty Products, Process and Procedures

These are to be evaluated and used when they provide a lower total cost than standard products, processes, and procedures would.

- **Recommendation Phase:** This phase and its techniques are the culmination and wrap-up of all previous efforts exerted throughout the Job Plan:
 - Present Facts
 - Present costs
 - Motivate Positive Action

The Presentation of these facts and costs and the motivation of positive action are accomplished in one of three ways – verbal form, written form or in combination of both.

Final combined form is recognized as best and contains sufficient data for the decision makers to determine the course of action to be taken. Changing things is central to Leadership, and changing them ahead of anyone else is Creativeness.

Question 43: Nine Price-Quality strategies offer a relationship between price and quality under different perceptions. Discuss.

Answer:

The price fixation for the first time takes place when:

- A company develops or acquires a new product
- Introducing existing product into a new geographic area or a new distribution channel
- A service company bids for a new contract work

For fixation of price the decision of the company regarding positioning of the product becomes important according as the nature of the product. Product quality has a bearing on the price.

Nine price-quality strategies

	Quality High	Quality Medium	Quality Low
High price	• Premium	• Mega value	• Ultra value
Medium price	• Overcharging	• Average value	• Fair value
Low price	• Rip off	• Deceptive	• Economy



Essentially, the strategies High-High (a), Medium-Medium (e) and Low-Low (i) can exist in a market at the same time as there is logic in pricing. The strategies (b), (c) and (f) are a consumer high surplus. The strategies (d), (g) and (h) lead to over pricing to take advantage of a temporary shortage market.

Question 44: The world class approach to cost management would require understanding the total production management, total quality management and align the total cost management on the lines of the other two strategies. How is it accomplished?

Answer:

The world class approach to cost management would require understanding the total production management, total quality management and align the total cost management on the lines of the other two strategies. This will ensure that all the aspects of the corporate strategies are translated in terms of values and control in the total cost management strategy. The following table shows the relationship among the three strategies:

Process	Product /service definition	Product / service development	Material sourcing and inbound logistics	Production or servicing	Support functions (HR/IT and Finance)	Marketing	Sales and outbound logistics	Service
TQM strategy	Quality function deployment and value engineering		Statistical and managerial tools for TQM accident and loss prevention			Customer relationship management, complaints and redressal	Adherence to schedules	Ensure service quality
Total Production management (IPM)	Ensure manufacturability, identification of required plant and machinery, proper vendors		Reduce cost of quality, improve plant availability through preventive and productive maintenance, waste reduction			Respond to marketing inputs relating to customers and develop pull technology	Work in coordination with the marketing function in regard to logistics as well as after sales service	
Total cost management (TCM)	Reduce design related defects and associated costs	Reduce time to market	Eliminate costs related to defective inputs	Eliminate costs related to rejects and rework	Ensure internal customer satisfaction	Ensure external customer satisfaction	Optimize logistics expenditure	Reduce service cost



Question 45: How has the classification of costs changed from the traditional method in strategic total cost management?

Answer:

Classification of costs has always been into variable, semi-variable, fixed categories. When cost as a strategy is to be implemented it presupposes that there is a time horizon which is longer than a few accounting periods. In such a time span even the so called fixed costs tend to vary e.g., rent, taxes, salaries, etc. So, the total cost management strategy has evolved a new classification namely, **bed rock fixed costs** e.g., depreciation, patent, amortization; **managed costs** rent, taxes, salaries and wages, maintenance, travel, advertising, etc. and **truly variable costs** include materials, royalties, freight, overtime costs, etc. This classification helps arriving at break even points which are more credible and take into consideration the changes in the costs over a period. A single break even is not possible and not acceptable in the total cost management. Another very important feature of total cost management is that almost all costs are manageable through cost strategy as even period costs tend to vary over time. For instance, rents which are considered period costs as fixed under normal parlance are treated as managed costs in total cost management strategy. This is particularly so, because the quantum of rent variation can be managed through leasing, rent or own strategies, tax planning, etc.



Study Note 8

RISK MEASUREMENT AND MANAGEMENT

Question 46: What are the types of risks?**Answer:**

Mark Dorfman has defined “risk management as the logical development and execution of a plan to deal with potential losses”. The risk can include both upside and downside. Potential risk management often refers to reducing downside potential and enhances the returns on topside.

Risks are of many types as follows:

1. **Physical Risk** like natural calamities: fire, tsunami, floods, earthquake, etc.
2. **Business Risk** which is inherent to a business due to its nature and susceptibility to environment, e.g., change of fashion, business cycles, conflicts like war, insurgency, cross border terrorism, technological obsolescence, etc.
3. **Financial Risk** arising out of the nature of financial transactions and conduct of business and investment.

Question 47: How do you measure physical risk?**Answer:**

Physical risks are measured by the application of technological tools. Earthquakes are measured in the Richter scale. Floods are measured through level monitoring and marking danger levels. Risk of fire is often monitored through measurement of flash point, fire point, ignition temperatures and propulsion temperatures. Spontaneous ignition temperatures are yet another measurement to identify fire risk, e.g., coal dumps, oil installations, explosive godowns, etc.

Physical risk arising out of Social, Political, Economic and Legal Environments are often identified through the performance of lead indicators. In the Social arena lead indicators can be pestilence, expediciencies, social upheavals, etc., measurement of these social risk are done on the basis of the impact on the Society, i.e., increase in crimes, violence and accidents, etc.

Political risk is often identified with the change in Government policy capitalistic, democratic or totalitarian and can be measured by the impact of such government policy on the economic activity, e.g., Government Industrial Policy and Labor Policy.

Economic risk may arise out of commercial transactions, foreign exchange currency variation, capital market fluctuations, trade cycles, etc. The lead indicators risks are like variation in GDF, IIP, Balance of Payments, Stock Market Indices, etc.

Legal Risk arises out of the implication of various statutes affecting business, Anti Trust Bills, Factory Acts, Industrial Disputes Act, and Foreign Exchange Management Act (FEMA).

Question 48: Explain the concept of risk pooling and diversification.**Answer:**

Whether it is the individual, an insurance company or insurer or a corporate, which necessarily has to insure all its risks, the proper way to look at the exigencies is to pool the risk. The



concept of pooling risk is the process of identification of separate risks and put them all together in a single basket, so that the monitoring, combining, integrating or diversifying risk can be implemented.

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 system 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 that 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 risks for commercial run. All these risks put together is pooling and is 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 risk

This involves identifying 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 with in 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 correlation “Beta”, which is a measure of market risk, lends itself for manipulation through portfolio management.



Study Note 9

RISK INSURANCE

Question 49: What are the characteristics of insurance contract?

Answer:

Following are the unique characteristics which are distinct from other forms of contract.

1. **Aleatory contract (Dependent on chance):** The values exchanged by the contracting parties in an insurance contract are unequal as they are dependent on chance or in other words in an insurance contract result depends entirely as risk. If the loss arises, compensation is paid by the Insurer on the occurrence of peril. If it doesn't occur insurer does not pay any compensation while the premium gets paid to the insurer
2. **Conditional Contract:** Insurance contracts lay down conditions like providing proof of insurable interest, immediate communication of loss, proof of loss, and payment of premium by the insured
3. **Contract of Adhesion:** Legally obligatory on the part of the insurer to explain the terms of contract fully to all the parties. This is particularly important as under contract of adhesion, any ambiguity in the wording of the agreement will be interpreted against the insurer as he had laid down the terms
4. **Unilateral Contract:** Insurer is the only party to the contract who makes promises that can be legally enforced.

Generally, Non life insurance contracts are usually annual contracts and have to be renewed each year. Each time the policy is renewed a new contract is issued by the Insurer.

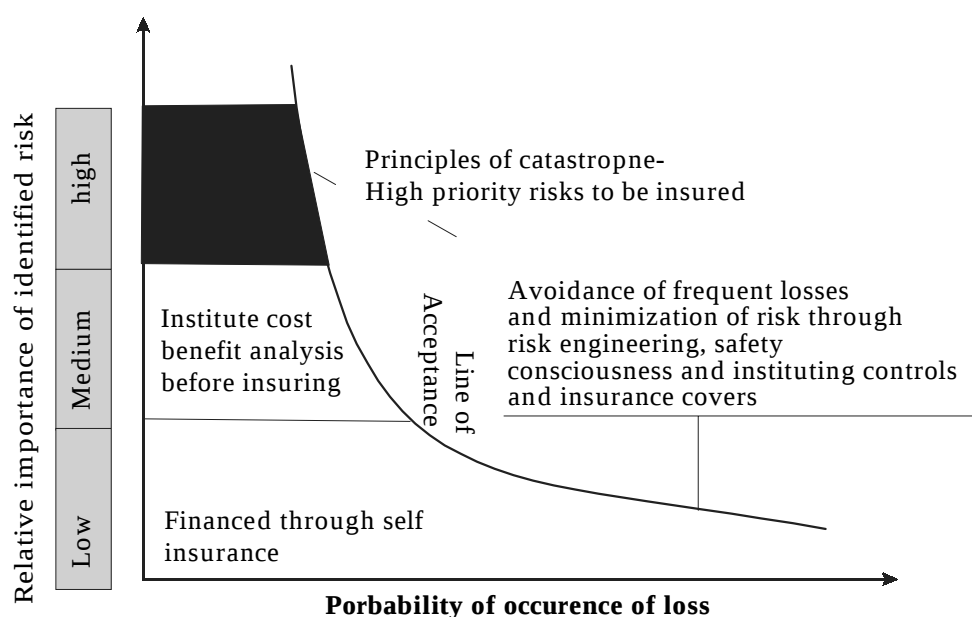
Question 50: What are the characteristics of insurance exposures? Discuss the relationship between relative importance of identified risk and probability of occurrence of loss.

Answer:

The characteristics for an exposure to be covered by Insurance are as follows:

5. **Pure Risk:** These are classified into *personal risk, property risk, liability risk and loss of income risk*.
 - a. *Personal Risk* – Can happen due to premature death, old age, sickness or disability and unemployment.
 - b. *Property Risk* – Can be classified as loss of property, loss of use of property, additional expenses arising out of loss of property.
 - c. *Liability Risk* – Can arise as injury to people or damage to property or negligence or carelessness.
 - d. *Loss of Income Risk* – Consequential loss of income arising out of personal or property losses.

6. **Similar Exposures:** Prediction of losses through application of statistical computations with the help of theory of probability require a sizeable population of similar exposures. This is particularly important in that estimation of probabilities for the happening of an event needs an adequate large sample, as accuracy increases with bigger sample.
7. **Accidental Losses:** Insurance contracts allow payments only for a accidental losses which beyond the insured's control. Losses taking place unintentionally alone are covered by Insurance. Suppression of information of a known risk will not entitle for compensation.
8. **Definite Loss:** A definite loss has three facets. It should be recognizable and should be susceptible to verification. The loss should be measurable. This is particularly important in that premium are computed mainly on the estimated quantification of losses.
9. **Large Loss:** As there is always a consideration in the form of a premium for receiving a compensation for a loss, care should be taken that the premium to loss ratio is sufficiently favorable. Insurance tariffs normally form a very small percentage sometime even less than a per cent.
10. **Catastrophic Losses:** Catastrophic losses from natural disasters have two main characteristics :
 - a. They are limited to geographic area where the impact has taken place.
 - b. Prediction of the event is very difficult. For example storms and floods or earthquakes etc. can create catastrophic losses as such an Insurer will have to take special precautions of calculating the premiums. Even then the loss may be so huge that the consumers normally resort to sharing the risks through reinsurance as also ensures dispersion of risks over a larger geographical area. To estimate the frequency and severity of the catastrophic losses probability analysis is resorted to:





Question 51: How is insurance premium is computer for a particular product and what is the role of management accountant in this exercise?

Answer:

The process of determining or fixing the rates of premium for a particular product is known as pricing. Traditionally, premiums have been calculated based on tariffs set by the Insurance Regulatory Authority. The rates are derived based on various factors like past loss ratio, location of the asset, type of asset, as well as exposure to the risks. Rate is the pricing factor upon which the premium is based. For example, car insurance policies are priced based on factors such as make and model of the car, the age of the driver, purpose for which the car is used, location where the vehicle is kept, etc.

Premium is calculated using the formula

$$\text{Premium} = \text{Annual Rate} * \text{SI}$$

The annual rate is usually given per thousand SI.

Where SI is Sum insured.

Traditionally, for motor insurance, the parameters that are used to price a policy have been model of the car, age of the driver, location of the car and purpose for which the car is driven, etc.

The industry will eventually move from price rating to risk rating. The pricing for each individual will be based on their track record. For example, for 'own damage' in a car insurance policy, the pricing parameters will be the model of the car, driver's age and engine capacity.

This is of particular importance to a management accountant as it is in the nature of pricing a product. The insurance premium can be broken up into four parts:

- Cost of payment for losses
- Cost of operation and maintenance of insurance pool
- Reserve for contingencies
- Return on Investment.

In the life insurance, calculation of insurance premium is very complicated exercise as the variables involve are many, e.g., factors aggravating mortality rates, like smoking, drinking, drugs and other habits, age of the insured, occupational hazard, etc. This computation is normally through actuarial computations involving mortality rates. Premium rate is often referred as rate per unit of exposure. If the total face value of life insurance is hundred thousand (Rs.100, 000) and the Unit of exposure is Rs.1000 the premium will be Rs.500/-. As already indicated the gross insurance premium is made up of a pure premium cover to expected loss and a loading to cover the cost of doing the business.



Question 52: Define liability exposures. Write a short note on:

Contractual liability

Agro and Bio liabilities

Answer:

Liability exposures can be defined as those losses, which are caused due to the failure to accomplish legally imposed obligations rather than enjoy the rights. The limit of liability of the Insurers under a policy is the sum insured.

1. Contractual liability is caused when promises are made to deliver particular goods or services at a price already determined and at certain time. The liabilities can be two fold:

- a. Post completion contractual liability: A liability arises when an agreement is made by a contractor for a performance of an agreed service, e.g., building contractor
- b. Professional services liability: A professional applies his special knowledge and skill in practice like a lawyer. Therefore a client or a patient can sue a professional for negligence or wrong doings

2. Agro and Bio liabilities: The basic liability issues arise as follows:

- a. Farmers credit liability
- b. Consequential losses liability
- c. Genetically modified crop seed liabilities
- d. Consulting expenses and royalty liabilities
- e. Casualty liabilities on farmers assets
- f. Latent deficiencies liabilities (public and professional liabilities)
- g. Inflation liabilities (dynamic risks in risk management) affecting the farming community

Dr. M.S. Swaminathan committee has identified insurance as a panacea for the above liabilities and the possible steps can be:

- Recognizing agriculture as an “open roof” industry and bringing in concepts of industrial liability insurances
- Pre-harvest hedging
- Cross dimensional liability coverage for inability
- Linking of life assurances of farming community with their property and casualty insurances

Question 53: Define management accountant’s role in insurance risk management.

Answer:

The management accountant wears two hats, a management accountant in an insurance company and a management accountant in an insured company. Both of them have the



responsibility for managing the risk from their own company's angle. A management accountant in an insurance company has to fully comprehend the computation of premium rates for different insurance products as also fully define the character of losses to be covered as a cross functional process along with the Actuarial professionals. Value imputation of the risks to be covered by the insurer's company has two aspects:

1. Quantifying the total risk to be covered for calculating a premium as a definite fraction of the risk value covered by the policy
2. If the quantification of risk is so high and the corresponding premium is likely to be also high enough for an insured to back out, then develop a framework where the insurer's company can re-insure itself for the policy risk with another insurance company. This will help in reducing the premium for the insured

A management accountant in an insured's company has his task cut out very clearly in two directions. At the time of covering the risk he has to work very closely with the cross functional team to identify the direct values of the risks involved and the indirect consequential values of the risks involved. For example, firstly, the replacement cost of a plant being insured is a direct cost and has to be quantified by proper methodology and secondly, the consequent loss of profits due to the stoppage of plant due to breakdown of the plant being replaced. In a service company it may be a cessation of a service being offered due to a peril such as fire or earthquake, etc and the consequential loss of profits there of.

Management accountants where ever they are need to be conversant with the use of mathematical models quantifying risk, financial cannons like Time value of money, dynamic programming, cost slopes and crashing, etc.



Study Note - 10

CORPORATE RISK MANAGEMENT

Question 54: Describe asset liability model and its utility for managing liquidity risk and exchange rate risk.

Answer:

Asset liability management is a technique to compute matching of assets and liabilities by which a prudent management of an investment portfolio can be properly taken care of. Asset liability management is defined as “maximizing the risk adjusted returns to shareholders over the long run”. It is also defined as management of total balance sheet in terms of size and quality (composition of assets and liabilities).

Liquidity risk management through asset liability management

It is difficult to measure liquidity risk as it entails expecting likely inflow of deposits, loan dispersals, changes in competitive environment, etc. The most commonly used techniques for measurement of liquidity risks is the gap analysis. The assets and liabilities are arranged according to their maturity pattern in time brackets. The gap is the difference between the maturing assets to the maturing liabilities. A positive gap indicates that maturities of assets are higher than those of liabilities. A negative gap indicates that some rearrangement of funds will have to be done during that time bracket. It can be from sale of assets or issue of new liabilities or rolling over existing liabilities.

Exchange rate risk management through asset liability management

At a particular exchange rate assets and liabilities of a financial institution match exactly. As the exchange rate fluctuates this balance gets disturbed. A simple solution to correct this risk is to match assets and liabilities of the same currency. Many financial institutions do not have foreign exchange exposure as all their assets and liabilities are in rupee currency. The risk of foreign exchange borrowings of these institutions are passed on to the lenders through dollar denominator loans. The uncovered loans are hedged at the time of contracting them through forward covers for the entire amount.

Question 55: What are solvency related measures for risk management?

Answer:

Solvency-related measures (these measures concentrate on the adverse “tail” of the probability distribution – and are relevant for determining economic capital requirements)

Probability of ruin – the percentile of the probability distribution corresponding to the point at which the capital is exhausted.

Shortfall risk – the probability that a random variable falls below some specified threshold level. (Probability of ruin is a special case of shortfall risk in which the threshold level is the point at which capital is exhausted.)

Value at risk (VAR) – the maximum loss an organization can suffer, under normal market conditions, over a given period of time at a given probability level. VaR is a common measure



of risk in the banking sector, where it typically calculated daily and used to monitor trading activity.

Expected policy holder deficit (EPD) or economic cost of ruin (ECOR) – an enhancement to the probability of ruin concept (and thus shortfall risk and VaR) in which the severity of ruin is also reflected. Technically, it is the expected value of the shortfall.

Tail Value at Risk (Tail VaR) or Tail Conditional Expectation (TCE) – an ECOR-like measure in the sense that both the probability and the cost of “tail events” are considered.

Tail events – unlikely but extreme events, usually from a skewed distribution. Rare outcomes, usually representing large monetary losses.

Question 56: What are performance related measures for risk management?

Answer:

Performance-related measures (these measures concentrate on the mid-region of the probability distribution –see “risk profile” above – i.e., the region near the mean, and are relevant for determination of the volatility around expected results):

- Return on equity (ROE) – net income divided by net worth
- Operating earnings – net income from continuing operations, excluding realized investment gains
- Earnings before interest, dividends, taxes, depreciation and amortization (EBITDA) – a form of cash flow measure, useful for evaluating the operating performance of companies with high levels of debt (when the debt service costs may overwhelm other measures such as net income).
- Cash flow return on investments (CFROI) – EBITDA divided by tangible assets.
- Weighted average cost of capital (WACC) – the sum of the required market returns of each component of corporate capitalization, weighted by that component’s share of the total capitalization.
- Economic value added (EVA) – a corporate performance measure that stresses the ability to achieve returns above the firm’s cost of capital. It is often stated as net operated profits after tax less the product of required capital times the firm’s weighted average cost of capital.

Question 57: What are the strategies adopted for Corporate risk management?

Answer:

In risk management, the following four strategies are generally adopted:

- **Risk Avoidance** is a strategy by which the organization does not engage in the activity which involves any risk.
- **Risk Reduction** is another strategy where the organization takes two steps. One is preventing the occurrence of risk and the second one is controlling the number of occurrences. One of the possible ways of reducing the risk is going for large number.



- **Risk Retention** is the most popular method of dealing with risk. Risk retention may be conscious or unconscious. Conscious risk retention takes place when the risk is perceived and not transferred or reduced. When a risk is not recognized, it is unconsciously retained.
- **Risk Transfer** is another method of managing risk. Risk can be transferred to a person willing to take it. Hedging or insurance are best examples for risk transfer
- **Risk Sharing** is process by which the potential risk is shared among many, so that the loss is not borne by a single person.

Question 58: Define Enterprise risk management. Write a short notes on:

Corporate risk governance

Portfolio management

Answer:

“Enterprise risk management is the discipline by which an organization in any industry assesses controls, exploits finances and monitors risks from all sources for the purpose of increasing the organization’s short and long term value to its stakeholders”.

Corporate risk governance

Responsibility of a corporate body encompasses

1. Identifying the organization’s appetite for risk in the areas of capital leverage, credit rating, etc
2. The capability of the organization to manage risk and support it’s business strategy
3. Establishing the structural relationship between the roles and responsibilities for risk management
4. Pooling of risk and develop such integrated risk measures encompassing the various spheres of activity like finance, marketing, human resources and operations
5. Establishing proper tools for risk assessment, measurement and analysis
6. Developing a proper culture and awareness in the organization through leadership
7. Educating the various layers of organization about risks absorption and management through case studies

Corporate governance has become a buzzword in Indian corporate world and SEBI has laid down guidelines in this regard. Every annual report contains a section on corporate governance along with management’s discussion on performance and future outlook.

Portfolio management

Pooling of risks should not just happen, but must be aggregated properly so that appropriate diversification of risk can be attempted. This will lead to optimal portfolio where natural hedges can be fully implemented so that risk and return are well balanced.

Portfolio theory essentially guides an investor to reach an optimal portfolio position. This theory has originally postulated by Harry M. Markowitz assumes that the utility of the investor is a function of mean return and variance of return [or standard deviation (Square root of variance)].



The expected return on a portfolio is simply the weighted arithmetic average of the expected returns on the assets constituting the portfolio. The riskiness of the portfolio is measured by the standard deviation of the portfolio rate of return which is a function of

The proportions invested in the components

The riskiness of the components

The correlation of returns on component securities

The principle of portfolio theory can be likened to pooling of risks and diversifying them.

Question 59: Enterprise risks involved in solvency transactions as well as ageing debts have to be taken care of on a day to day basis in the business. What are the tools (instruments) used for this purpose and application there of?

Major tools for managing enterprise risk are as below:

Instrument	Purpose	Remarks
Guarantee	Guarantees can be financial guarantees or performance guarantees. - Financial guarantees protects against the financial loss on failure to meet financial obligations - Performance guarantees are protection against non-performance of contractual obligations	Financial institutions provide guarantees as a risk cover against a collateral by the buyer for a consideration
Letter of credit or documentary credit	Guarantee against non payment of purchase consideration by the buyer in the nature of off-balance sheet financing	Financial institutions issue this instrument for a consideration. It can be revocable or irrevocable. Can also be revolving
Underwriting	Underwriting is a protection mechanism available in the capital market to cover the risk of non-subscription to a public issue	Financial institutions offer this risk cover for a consideration after due evaluation of risk
Collateralized debt obligations	Taken against short term and long term loans for working capital as well as fixed assets	Financial institutions offer this risk cover for a consideration after due evaluation of risk and cover themselves completely either through hypothecation or pledge or equitable markets
Asset Securitization	Companies offering financial services of hire purchasing, leasing, etc try to raise finance through this method	This is a special purpose vehicle (SPV) to manage default risk. Financial institutions as well as public subscribe to this method for a consideration in the form of interest and securitization is available from the assets that are being traded
Factoring	Companies resort to this instrument both as a risk cover and insure cash flow	Specific financial institutions called factoring companies offer this service for a commission with recourse or without the recourse



Question 60: How is project risk management done in practice?**Answer:**

In reality, the risk assessment is done through considering the various components of the financial estimates and developing certain judgmental approaches:

- Estimation of revenues: Revenues projected for a project need to be justified on the basis of real data available and then the projections are made conservatively. This avoids optimistic projections of income
- Cost estimates: Always include a margin of safety to take care of impact of inflation over the time horizon for which the projections are being made. Here again the margin of safety is computed on the basis of trend analysis of inflation over the recent past and the lead indicators that are available from fundamental analysis
- Acceptable return on investment: This is the prime measure and as such it should be arrived at on the basis of certain consensus. It will depend on the payback period to be assumed, the industry experience and the company's norm for return on any new project on the basis of the current experience
- Overall certainty index: The critical risks of the project are identified and the certainty index of each of these risks is quantified. Then the overall certainty index is developed as an average of the critical indices already computed. For instance, raw material availability, power availability, intensity of competition is a few of the risks, which are quantified in terms of certainty indices. The cumulative average is the overall certainty index
- Judgmental perceptions: Three different estimates of return on the investment are developed – pessimistic, most likely and optimistic on the basis of the stage at which the particular industry is in its life cycle. On the basis of the three estimates and comparing them with the earlier methods available on certainty equivalent coefficient, a judgmental decision can be taken

Question 61: How do you shape institutions for project risk management and what are the strategies to be adopted?**Answer:**

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 investments, 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.

Question 62: How do you hedge and diversify project risk management and what are the strategies to be adopted?**Answer:**

Hedging and diversification of project risk management use the following tools: portfolios, insurance and hedging. Project risk could be reduced through building a diversified portfolio



to balance risks and cash flows, hedging against currency fluctuations or commodity exposures, applying financial derivatives. Risk can be transferred by insuring risks as well as diversifying investments in different countries to reduce political risk.

Question 63: How do you embrace project risk management and what are the strategies to be adopted?

Answer:

Project risk can be embraced through comprehension of residual risk. This risk could be retained by developing a proper information system regarding the residual risks, commercial aspects and developing a clear sense in bearing various risks, then understanding of particular risk domains to develop ability to bear commercial risks. This risk could be transferred through Develop information system regarding financial institutions, capital markets and special vehicle applications identification local industrialists who are ready to partner for sharing risks through a portfolio of investment, identification of international partners for sharing investments through a portfolio of investment, identification of financial institutions locally like commercial banks, identification of international financial institutions.