

DATE: ___/___/___

DAY: ___/___/___

PART-II

QUESTION 7 - RATE OF RETURN

PART A

Information Given

loan \$10,000

Duration 3 years

Future Value \$16,000

Interest ?

Requirement:-

i) Find interest rate Annually

ii) Find interest rate semi-annually

i) Interest rate annually

Formula

$$PV = \frac{FV}{\left(1 + \frac{i}{m}\right)^{m \times n}}$$

PV = Present Value

FV = Future Value

i = Interest rate

M = Number of compounding per year

n = Number of years

$$i) \quad PV = \frac{FV}{(1+i)^{mn}}$$

$$10,000 = \frac{16000}{(1+i)^{1 \times 3}}$$

$$10,000 = \frac{16000}{(1+i)^3}$$

$$(1+i)^3 = \frac{16000}{10,000}$$

$$1+i = \sqrt[3]{\frac{16000}{10000}}$$

$$i = \sqrt[3]{\frac{16000}{10000}} - 1$$

$$i = 0.1696$$

$$i = 16.9\%$$

$$\text{Round off} = 17\%$$

Implicit Rate of Interest on annuity
is 17%.

ii) Computation of rate of interest on
Semi-annually

$$PV = \frac{FV}{(1+i)^{mn}}$$

DATE: ___/___/___

DAY: ___/___/___

$$10,000 = \frac{16,000}{\left(1 + \frac{i}{2}\right)^{3 \times 2}}$$

$$10,000 = \frac{16,000}{\left(1 + \frac{i}{2}\right)^6}$$

$$\left(1 + \frac{i}{2}\right)^6 = \frac{16,000}{10,000}$$

$$1 + \frac{i}{2} = \sqrt[6]{\frac{16,000}{10,000}}$$

$$\frac{i}{2} = \sqrt[6]{\frac{16,000}{10,000}} - 1$$

$$i = 2 \times \left(\sqrt[6]{\frac{16,000}{10,000}} - 1 \right)$$

$$i = 2 \times 0.0814$$

$$i = 0.1629$$

Round off answer is

16.3% interest

Implicit Rate of Interest

on semi-annually is

16.3%

Part 7B

Pecking Order Theory

1. Basic Idea of Pecking Order Theory

Pecking Order Theory says that firms do not choose capital structure

DATE: ___/___/___

DAY: ___/___/___

by targeting an ideal ~~debt~~ debt-equity ratio. Rather firms follow a financing order that is called Pecking order theory. Following is the financing order:-

1. Internal funds; (Retained earnings, Reserve)
2. Debt; (Bank loans, Bonds, Debenture)
3. New Equity; (Issuing new shares)

Thus, corporation prefers internal financing to External financing. The main reason is that there is asymmetry information. Which states that managers know more about the true health and performance of the business than outside investors and lenders.

2. Why Internal funds are Preferred

A. No Information Problem Inside the Firm

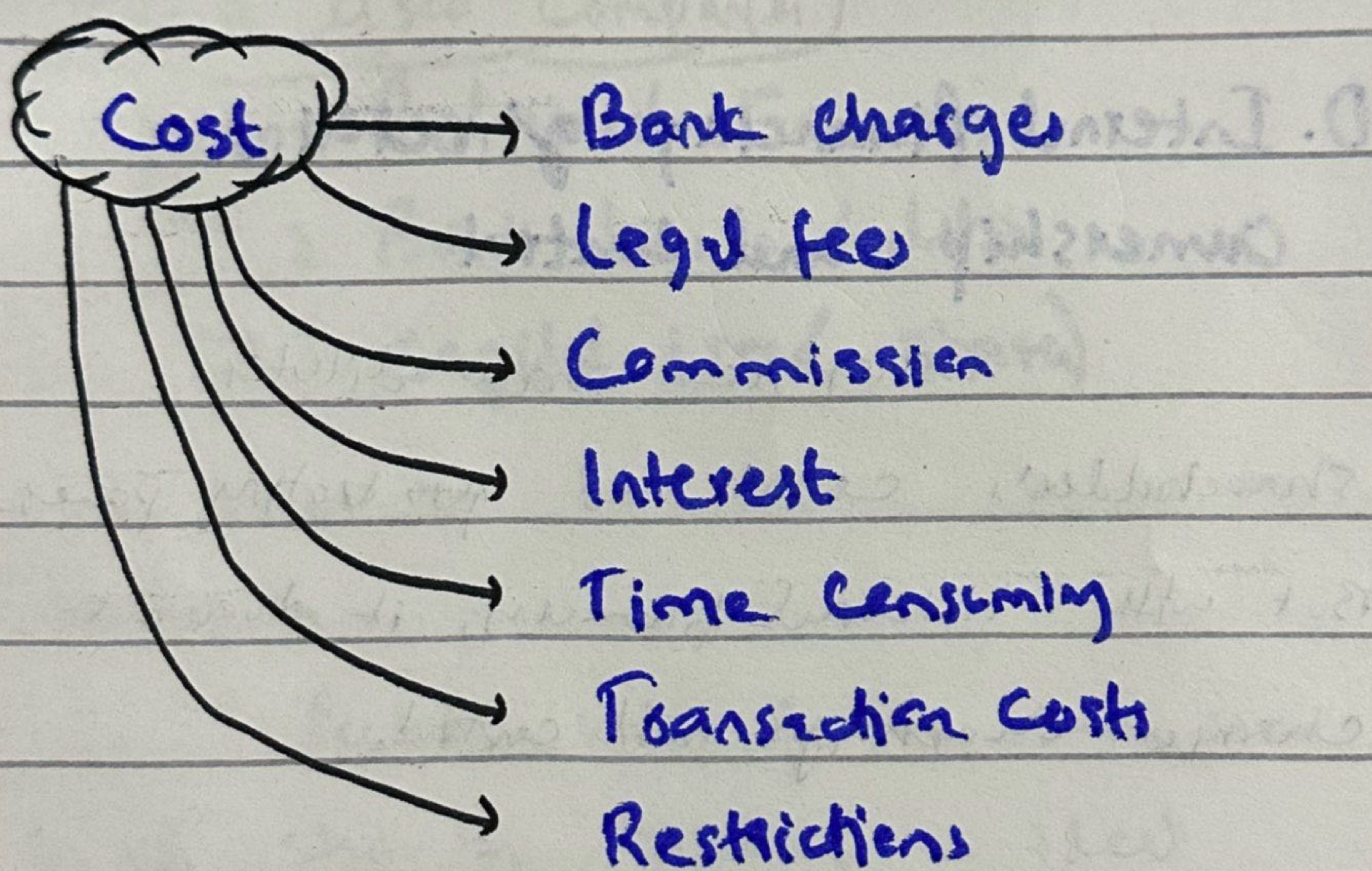
When managers use retained earnings and general reserve, managers do not have to convince anyone whether the project is financially viable or not.

Real-life Example:- Khaadi Clothing

brand opened restaurant called "Kanteen" with their own retained earnings and reserves rather than external financing.

B. External financing is costly

To raise funds from external sources, firms bear costs like mentioned below:



Real-life Example:- Idear by Gul Ahmed

wanted to purchase Ethnic brand for Western Attire. For that Idear uses internal financing. Instead of External Financing. Else, Idear had to bear S&P fees, advertising fees, transaction fees,

C. External Financing gives Market Reaction and Signalling Problems

When a company issues new shares, in the market, investors perceive that company is selling shares because they know the company is overvalued. Share price often falls after equity issue thus negative signal.

D. Internal Financing retains ownership and control

Issuing new share dilutes shareholders' control and voting power. But with internal financing, it does not change ownership and control.

E. Internal Financing gives financial flexibility and risk

When the firm uses internal funds, it keeps its borrowing capacity safe for the future. While external debt increases fixed payments of interest that leads to financial risk.

3. How the Pecking Order use in real life

Small-sized Companies

- 1. limited Profit and Retained Earnings
- 2. Small software house

Mature listed Companies

- 1. Retained Earnings
- 2. Bank loan and debt
- 3. Capital issued (share)

4. Conclusion

Pecking order theory says firm do not start by choosing an ideal mix of debt and equity. Rather, due to information asymmetry, issue cost, control problems and signalling impact, Thus, corporation uses retained earning first, followed by borrowing and then new shares issues as a last resort.

— XXX —

QUESTION 8A - USES OF RATIO

1. Introduction

There are countless benefits of ratio analysis for different stakeholders of the company.

2. Ratio Analysis User 1: Management

Management of the company is the internal stakeholder of the company. They use to identify profitability, liquidity and solvency ~~ratio~~ of problems of the company. It helps manager to identify weak areas and also helps to identify how well resources are being used. Management's focus ratios are as below

↳ Inventory Turnover

↳ Return on Equity

↳ Current Ratio

3. Ratio Analysis User 2: Shareholders

Shareholders look at the profitability of the share company and market-based ratios. That helps to decide whether to buy, sell or hold the company's shares. Shareholders mostly used ratios like:

- ↳ Earnings Per Share

- ↳ Gearing Ratio

- ↳ Dividend Yield

- ↳ Profit Earnings Ratio

4. Ratio Analysis User 3: Lenders

Lenders use ratios to check the liquidity and solvency concerns in the company. Lenders say company's ability to pay interest and principal amount. Then decide, the loan term, amount and interest.

- ↳ Current Ratio

- ↳ Acid Test Ratio

↳ Quick Ratio

↳ Interest - Coverage Ratio

↳ Debt - to - Equity Ratio

5 Ratio Analysis User 4: Suppliers or Accounts payable

Suppliers of Accounts payable

Focus on the short term liquidity position of the company. This also tells the working capital management by the company. Suppliers evaluate whether to sell on credit or not.

6. Ratio Analysis User 5: Government

Government ~~and~~ and state

Institutions use ratios to assess the tax capacity, of financial health, and industry ~~instability~~ ^{instability} of

7. Conclusion

Other than these stakeholders, employees and remaining stakeholders also use ratios for company's performance.

QUESTION 8B - Ratios Calculations

A) Long Term Debt to Equity

$$LT D-E = \frac{\text{Debt}}{\text{Equity}}$$

$$0.5 = \frac{\text{Debt}}{100,000 + 100,000}$$

$$0.5 = \frac{\text{Debt}}{200,000}$$

$$\text{Debt} = 0.5 \times 200,000$$

$$\text{Debt} = \$100,000$$

B) Total Asset Turnover

$$TAI = \frac{\text{Sales}}{\text{Assets}}$$

$$2.5 = \frac{\text{Sales}}{(\text{Assets}) \text{ or } (\text{Equity} + \text{Liability})}$$

$$2.5 = \frac{\text{Sales}}{400,000}$$

$$\text{Sales} = \$1,000,000$$

c) Average Collection Period

$$ACP = \frac{\text{Acc. Receivables} \times 360}{\text{Credit Sales}}$$

$$18 = \frac{A/R \times 360}{1000,000}$$

$$A/R = \frac{18 \times 1000,000}{360}$$

$$A/R = \$ 50,000$$

d) Inventory Turnover

$$IT = \frac{\text{Sales}}{\text{Inventory}}$$

$$9 = \frac{1000,000}{\text{Inventory}}$$

$$\text{Inventory} = \frac{1000,000}{9}$$

$$\text{Inventory Turnover} = 111111$$

e) Gross Profit Margin

$$GP = \frac{GP}{\text{Sales}}$$

$$\frac{10}{100} = \frac{CIP}{5000}$$

$$\frac{CIP}{100} = \frac{CIP}{1000,000}$$

$$CIP = \frac{10 \times 1000,000}{100}$$

$$CIP = \$100,000$$

F/ Acid Test Ratio

$$ATR = \frac{Cash + A/R}{CL}$$

$$1 = \frac{Cash + 70,000}{100,000}$$

$$100,000 = Cash + 70,000$$

$$Cash = 100,000 - 70,000$$

$$Cash = \$30,000$$

Balance sheet

Cash (working F)

70,000

Account Receivable (working C)

50,000

Inventory (working D)

~~50,000~~ 11111

Plant and Equipment bal. fig	188,881
Total Asset	<u>400,000</u>

Liabilities and Shareholders equity	
Notes and Notes Payables	100,000
Long Term Debt (W.A.)	100,000
Common stock	100,000
Retained Earnings	<u>100,000</u>
Total Liabilities and Equity	<u>400,000</u>

— xxx —

QUESTION 6 - STRATEGIC FIT

1A. Introduction

Strategic fit means supply chain decisions support the company's promise to customers. By providing goods and services at low cost and with efficiency.

2B Understanding Strategic fit

Strategic fit includes the competitive strategy of how the company wants to win in the market. ~~Whereas~~ whereas, supply chain strategy means how the company buys, makes, stores and delivers products. Supply chain decisions support the company's promise to customers. If company competes on low cost, supply chain must be efficient. If it competes on speed & variety or customization, supply chain must be very responsive.

Examples:- Walmart:- "Every day low prices"

Zar:- "Latest fashion, very fast to market"

3. Step 1: Understanding customer needs

The company must know what its target customers really care about:

Do they want: → low Price?

→ fast Delivery?

→ High / premium quality?

Example:- Amazon Price care about
fast and reliable delivery

4. Step 2: Understanding the nature of your products

Company must see how predictable or unpredictable the demand is:

Stable Product

- cooking oil
- Pens
- Salt
- Soap



Need an efficient,
low-cost supply chain

Trendy Products

- Gadgets
- Seasonal items
- clothes



Need a responsive,
flexible supply chain

5. Step 3: Deciding the right position on the "efficiency-responsiveness" spectrum

No supply chain can be 100% efficient and 100% responsive. Therefore company needs to decide the right balance, based on its strategy.

Efficient Supply Chain → Cost leadership

Responsive Supply chain → speed and variety

6. Step 4: Align key supply chain drivers with the competitive strategy

✓ Facilities (Factories and warehouse)

✓ Inventory

✓ Transportation

✓ Information

✓ Sourcing

✓ Pricing

7. Step 5: Ensure all functions in the firm support the same strategy

* **Marketing**:- Ensuring 24 hour delivery

* **Production**:- enhancing production size

* **Finance**:- arranging finance

* **Human Resource**:- Training to employees.

8. Step 6: Coordinate and share information along the supply chain

Step 7: Segmenting products and design more than one supply chain

Companies have more than one type of product. When companies have basic predictable items, for that there should be efficient chain. Whereas, for seasonal items, there should be responsive chain.

In order to achieve strategic fit, companies need to segment their product and design different supply chain policies for each segment.

Step 8: Build flexibility and manage risk

Strategic fit also means being ready for shocks; supply risk, that includes strikes, floods - Demand risk that includes recession, COVID. A company can rely on multiple suppliers to counter this issue.

Step 9: Continuously measure performance and adjustments

Strategic fit is not one-time, market and technology change, so must the supply chain. Companies should regularly monitor following:

- ✓ Delivery lead time
- ✓ Order fill rate
- ✓ Inventory Turnover
- ✓ Cost per unit

Conclusion

To cap it all, to achieve strategic fit, a company must understand its customers and products. Choose the right balance between efficiency and responsiveness. Align all supply chain drivers with competitive strategy. Moreover, it also need to ensure all departments and external partners support the same goal. Lastly, continuously monitor, coordinate and adjust its inventory.