



CA INTERMEDIATE • PAPER 6 • FINANCIAL MANAGEMENT AND
STRATEGIC MANAGEMENT

Scanner Notes 2.0

Topic by Topic • October 2026 Edition



2 Parts • 19 Chapters • 134 Topics • 581 Classified Questions

Based on the ICAI Study Material and the Scanner, Financial Management and Strategic Management 2026 October
Edition (V1)

How this book works

For each topic, first read the Study Material paragraphs named in the “Read first” line. Then work down the skill bands — each band names the skill the examiner has actually used on that topic, and lists the exact Scanner questions to practise at it.

The section that follows the Contents — **How to Use These Notes** — explains the question lines, ICAI’s Manner of Assessment, and what the skill mix should change about your preparation. Read it once before you begin.

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BEFORE YOU START

How to Use These Notes

Every question in the Scanner has been read and classified — **581 of them in this paper** — against the skill framework ICAI itself publishes. These notes are built around that classification rather than around the syllabus order. Ten minutes spent on this page will change how you use the rest of the book.

1. How a topic is laid out

Read it like this	
Read first	The exact Study Material paragraphs the topic rests on. Open the Study Material and read them before the notes — the notes assume you have.
Notes	What the topic actually turns on, written for the examination rather than for coverage. Short, and meant to be re-read the night before.
Skill bands	One band for each skill the examiner has actually used on that topic, each with a few lines of guidance and the exact Scanner questions to practise. Work down the bands in the order printed: they run from the least demanding skill to the most.
Concept base	A topic the examiner has not yet reached. It is not optional — it has simply not been asked, and it is examinable.

2. Reading a question line

CSQ 3.4 · PYQ 2025-Sep [1] (b) {C} · 5M · Pg 347 **LEVEL II Application** **Medium**

Part of the line	What it tells you
CSQ 3.4	The Scanner's own question number. CSQ is a case-scenario question, TQ a theory question.
PYQ 2025-Sep [1] (b)	Where it was asked — PYQ past examination, MTP mock test paper, RTP revision test paper — then the sitting, and its number in that paper.
{C}	A compulsory question in that paper.
5M	Marks, as printed in the Scanner. Blank where the source does not print them — RTPs do not.
Pg 347	The page of the Scanner where the question and its answer are printed.
LEVEL II Application	ICAI's skill level, and the sub-skill within it. Section 3 explains these.

Part of the line	What it tells you
Easy	How demanding the question is — judged on the marks it carries and the number of separate things it asks for.

3. The Manner of Assessment — what each skill asks of you

ICAI publishes a **Skill Assessment Specification Grid**. It states three skill levels, and in its **Manner of Assessment of Skills** column it describes each level as two distinct skills. Those six skills are the band headings that run through this book.

Skill	Rolls up to	What the examiner is asking you to do	Directive verbs to watch for
Remembering	Level I	Reproduce what you have learnt, as you learnt it.	Define · List · State · Name · Enumerate · Recognise
Understanding	Level I	Explain it, and place it in context — show you have grasped why the rule is what it is.	Describe · Explain · Distinguish · Identify · Illustrate · Outline
Application	Level II	Use the knowledge — take the stated provision to the stated facts and reach a conclusion.	Apply · Calculate · Determine · Prepare · Reconcile · Record · Perform · Use · Conduct · Demonstrate
Analysis	Level II	Examine the interrelationships between distinct areas to identify root causes and find evidence that supports a judgement.	Analyse · Discuss · Compare and Contrast · Examine · Develop · Monitor · Prioritise · Produce · Align · Communicate
Evaluation	Level III	Assess the problem and use judgement to reach a conclusion.	Advise · Evaluate · Recommend · Review · Select · Assess
Synthesis	Level III	Integrate data and information, separating the relevant facts from the irrelevant.	ICAI lists no verb for synthesis.

ICAI prints the verbs for **Application** and **Analysis** as two separate lists, so that division is the Institute's own. For Level I and for Level III it prints one combined list each — so the line between **Remembering and Understanding**, and between **Evaluation and Synthesis**, follows ICAI's description of the manner of assessment rather than a published list of verbs.

CA Intermediate is assessed at **Levels I and II only** — the Intermediate table carries no Level III column at all, and Evaluation & Synthesis begins at Final. That matters in this paper because both Sections lean on the Institute's Level III verbs: Section B asks you to "**advise on a suitable strategy**", "**evaluate the options**", "**recommend a structure**", and Section A closes a computation with "**advise whether the project should be accepted**". In neither case are you being asked to judge a rule against a standard. You are being asked to take a stated framework, or a stated formula, to stated facts and reach a conclusion, which is **Application**. Every such question in this book is therefore banded at Application, or at Analysis where the ask takes more than one option, division or limb separately. That reading is ours, not the Institute's, and it is recorded question by

question in the Question Register.

4. What the skill mix should change about your preparation

ICAI's Skill Assessment Specification Grid gives CA Intermediate **no Level III column at all** — Evaluation and Synthesis enter the scheme only at Final. It also gives this paper **two bands, not one: Financial Management 20–30% Level I and Strategic Management 30–55% Level I**. On the classified Scanner questions Section A's marks divide **16% Level I to 84% Level II**, and Section B's **58% to 42%**. Three things follow that are easy to miss.

- **Do not read "Analysis & Application" as an even split.** Inside Level II this paper puts about **73%** of the marks on Application and about **27%** on Analysis. Most of the work is taking a stated formula or a stated framework to a stated set of facts and reaching a conclusion — not writing about the formula or the framework.
- **The two Sections are opposite in shape, and you prepare them differently.** Section A carries almost no theory — **84%** of its marks are Level II, so preparation is practice, not reading. Section B is the reverse at **58%** Level I, so its marks are in naming the framework and its components before you apply anything. Revising both the same way costs marks in whichever one you neglect.
- **The paper's balance is not each chapter's balance.** Every chapter opens with its own **ICAI Skill Profile** panel, showing how that chapter's marks actually divide and what that means for preparing it. Some chapters are a third theory; others carry almost none. Read the panel before you start the chapter.

5. Two guides at the front of the book

	What it is for
Study Priority Guide	Every examined topic ranked by its share of the classified Scanner questions, and graded A, B or C on cumulative coverage. Category A carries the first 60% of all questions — secure those to full command first.
Importance grade	The A–D grade printed against each chapter in the Contents. This is ICAI's syllabus weightage signal, and it is separate from the question-frequency ranking. Where the two disagree, prepare the chapter to the higher of the two.

STUDY PRIORITY GUIDE

Topic Ranking — Exam Weightage

Read first: Every topic in this booklet that the examiner has actually asked is ranked below by its share of the 581 classified Scanner questions (2026 October Edition, V2), aggregated across all 19 Units — and graded A, B or C on cumulative coverage. **Category A (ranks 1–27)** covers the first 60% of all classified questions: with the passing standard at 50%, a student who prepares the A-topics to full command holds a clear margin above it. **Category B (ranks 28–40)** adds the next 15%, taking coverage to about 75% — work through these as time allows. **Category C (ranks 41–104)** is the remaining 25%: a long tail that is slower to mine for marks, much of which gets covered automatically while preparing A and B. The **Pg.** column cross-references the page on which that topic's study notes begin.

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
1	A	Financing Decisions - Leverages	Combined Leverage	4.3%	4.3%	82
2	A	Strategic Choices	Strategic Choices	4.0%	8.3%	182
3	A	Financial Analysis and Planning - Ratio Analysis	Topic 2F: Types of Ratio: Comprehensive-Financial Statement Reconstruction	3.4%	11.7%	50
4	A	Strategic Analysis: External Environment	Industry Environment Analysis	3.4%	15.1%	164
5	A	Investment Decisions	Topic 7A: Capital Budgeting Techniques: Discounting Techniques: Net Present Value Technique	2.9%	18.1%	91
6	A	Strategic Analysis: Internal Environment	Competitive Advantage Using Michael Porter's Generic Strategies	2.9%	21.0%	178
7	A	Strategic Choices	Strategic Exits	2.9%	23.9%	186
8	A	Introduction to Strategic Management	Strategic Intent (Vision, Mission, Goals, Objectives and Values)	2.8%	26.7%	152
9	A	Strategy Implementation and Evaluation	Topic 4A: Organisational Framework: Organisational Structure	2.6%	29.3%	199
10	A	Cost of Capital	Weighted Average Cost of Capital (WACC)	2.4%	31.7%	65
11	A	Management of Working Capital - Introduction to Working Capital Management	Operating or Working Capital Cycle	2.4%	34.1%	121
12	A	Financing Decisions - Leverages	Operating Leverage	2.2%	36.3%	80
13	A	Financing Decisions - Capital Structure	Capital Structure Theories	2.1%	38.4%	71

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
14	A	Strategy Implementation and Evaluation	Strategic Changes Through Digital Transformation	2.1%	40.4%	195
15	A	Introduction to Strategic Management	Strategic Levels in Organisation	1.9%	42.3%	155
16	A	Types of Financing	Long Term Sources of Finance	1.7%	44.1%	30
17	A	Financing Decisions - Capital Structure	EBIT-EPS-MPS Analysis	1.7%	45.8%	75
18	A	Strategic Analysis: External Environment	Competitive Strategy	1.7%	47.5%	168
19	A	Strategic Choices	Strategic Options	1.7%	49.2%	189
20	A	Scope and Objectives of Financial Management	Objectives of Financial Management	1.5%	50.8%	20
21	A	Financing Decisions - Capital Structure	Factors Determining Capital Structure	1.5%	52.3%	73
22	A	Dividend Decisions	Theories of Dividend: Walter's Model	1.5%	53.9%	108
23	A	Strategic Analysis: External Environment	Strategy and Business Environment	1.5%	55.4%	160
24	A	Types of Financing	Short Term Sources of Finance	1.4%	56.8%	37
25	A	Cost of Capital	Comprehensive Questions	1.4%	58.2%	67
26	A	Strategic Analysis: Internal Environment	Strategic Drivers	1.4%	59.6%	172
27	A	Strategy Implementation and Evaluation	Strategic Management Process	1.4%	60.9%	193
28	B	Strategy Implementation and Evaluation	Strategic Control	1.4%	62.3%	205
29	B	Types of Financing	Lease Financing	1.2%	63.5%	35
30	B	Financial Analysis and Planning - Ratio Analysis	Topic 2E: Types of Ratio: Comprehensive-Ratio Computation	1.2%	64.7%	49
31	B	Cost of Capital	Cost of Equity Share Capital KE	1.2%	65.9%	62
32	B	Management of Working Capital - Management of Receivables	Approaches to Evaluation of Credit Policies	1.2%	67.1%	135
33	B	Introduction to Strategic Management	Strategic Management -Importance and Limitations	1.2%	68.3%	151
34	B	Strategy Implementation and Evaluation	Strategic Performance Measures	1.2%	69.5%	208
35	B	Types of Financing	International Financing	1.0%	70.6%	40

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
36	B	Investment Decisions	Comprehensive Question	1.0%	71.6%	100
37	B	Dividend Decisions	Theories of Dividend : Modigliani and Miller (MM) Hypothesis	1.0%	72.6%	107
38	B	Dividend Decisions	Theories of Dividend : Comprehensive	1.0%	73.7%	112
39	B	Management of Working Capital - Management of Receivables	Financing Receivables	1.0%	74.7%	137
40	B	Strategy Implementation and Evaluation	Strategic Leadership	1.0%	75.7%	203
41	C	Financial Analysis and Planning - Ratio Analysis	Financial Analysis	0.9%	76.6%	55
42	C	Investment Decisions	Topic 7C: Capital Budgeting Techniques: Discounting Techniques: Internal Rate of Return Method (IRR)	0.9%	77.5%	95
43	C	Dividend Decisions	Theories of Dividend : Gordon's Model	0.9%	78.3%	110
44	C	Introduction to Strategic Management	Concept of Strategy	0.9%	79.2%	149
45	C	Strategic Analysis: Internal Environment	Understanding Key Stakeholders	0.9%	80.0%	171
46	C	Strategic Analysis: Internal Environment	Role of Resources and Capabilities: Building Core Competency	0.9%	80.9%	175
47	C	Strategic Analysis: Internal Environment	Combining Internal and External Analysis (SWOT Analysis)	0.9%	81.8%	177
48	C	Scope and Objectives of Financial Management	Role of Finance Executive	0.7%	82.4%	24
49	C	Cost of Capital	Cost of Long Term Debt KD	0.7%	83.1%	60
50	C	Financing Decisions - Capital Structure	Over-Capitalisation and Under-Capitalisation	0.7%	83.8%	77
51	C	Dividend Decisions	Practical Considerations in Dividend Policy	0.7%	84.5%	105
52	C	Dividend Decisions	Dividend Discount Model	0.7%	85.2%	111
53	C	Management of Working Capital - Introduction to Working Capital Management	Estimating Working Capital Needs	0.7%	85.9%	120
54	C	Strategic Analysis: External Environment	Understanding Product and Industry	0.7%	86.6%	162
55	C	Types of Financing	Debt Securitisation	0.5%	87.1%	33
56	C	Types of Financing	Other Sources of Finance	0.5%	87.6%	39
57	C	Investment Decisions	Capital Budgeting Techniques: Traditional or	0.5%	88.1%	90

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
Non- Discounting Techniques						
58	C	Management of Working Capital - Treasury and Cash Management	Methods of Cash Flow Budgeting	0.5%	88.6%	126
59	C	Strategy Implementation and Evaluation	Organisational Framework	0.5%	89.2%	198
60	C	Scope and Objectives of Financial Management	Meaning of Financial Management	0.3%	89.5%	16
61	C	Scope and Objectives of Financial Management	Finance Function/Finance Decisions	0.3%	89.8%	18
62	C	Scope and Objectives of Financial Management	Conflict of profit Versus Value Maximisation Principle	0.3%	90.2%	22
63	C	Scope and Objectives of Financial Management	Financial Distress and Insolvency	0.3%	90.5%	25
64	C	Scope and Objectives of Financial Management	Agency Problem and Agency Cost	0.3%	90.9%	27
65	C	Types of Financing	Venture Capital Financing	0.3%	91.2%	32
66	C	Types of Financing	Contemporary Sources of Funding	0.3%	91.6%	42
67	C	Cost of Capital	Determination of Cost of Capital	0.3%	91.9%	59
68	C	Cost of Capital	Marginal Cost of Capital	0.3%	92.3%	66
69	C	Financing Decisions - Capital Structure	Optimal Capital Structure	0.3%	92.6%	75
70	C	Dividend Decisions	Forms of Dividend	0.3%	92.9%	102
71	C	Management of Working Capital - Introduction to Working Capital Management	Significance of Working Capital	0.3%	93.3%	117
72	C	Management of Working Capital - Introduction to Working Capital Management	Management of Working Capital	0.3%	93.6%	118
73	C	Management of Working Capital - Treasury and Cash Management	Functions of Treasury Department	0.3%	94.0%	124
74	C	Management of Working Capital - Treasury and Cash Management	Cash Management Models	0.3%	94.3%	128
75	C	Management of Working Capital - Treasury and Cash Management	Recent Developments in Cash Management	0.3%	94.7%	129
76	C	Strategic Analysis: External Environment	Strategic Analysis	0.3%	95.0%	159
77	C	Strategy Implementation and Evaluation	Topic 4B: Organisational Framework: Organisational Culture	0.3%	95.4%	202

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
78	C	Scope and Objectives of Financial Management	Evolution of Financial Management	0.2%	95.5%	17
79	C	Scope and Objectives of Financial Management	Importance of Financial Management	0.2%	95.7%	19
80	C	Scope and Objectives of Financial Management	Relationship of Financial Management with Related Disciplines	0.2%	95.9%	26
81	C	Types of Financing	Financial Needs and Sources of Finance of A Business	0.2%	96.0%	29
82	C	Financial Analysis and Planning - Ratio Analysis	Ratio and Ratio Analysis	0.2%	96.2%	44
83	C	Financial Analysis and Planning - Ratio Analysis	Topic 2A: Types of Ratio: Liquidity Ratio	0.2%	96.4%	45
84	C	Financial Analysis and Planning - Ratio Analysis	Topic 2D: Types of Ratio: Profitability Ratios	0.2%	96.6%	48
85	C	Cost of Capital	Meaning of Cost of Capital	0.2%	96.7%	57
86	C	Cost of Capital	Significance of Cost of Capital	0.2%	96.9%	58
87	C	Financing Decisions - Capital Structure	Meaning of Capital Structure	0.2%	97.1%	70
88	C	Financing Decisions - Leverages	Financial Leverage	0.2%	97.2%	82
89	C	Investment Decisions	Basic Principles For Measuring Project Cash Flows	0.2%	97.4%	89
90	C	Investment Decisions	Topic 7D: Capital Budgeting Techniques: Discounting Techniques: Discounted Payback Period Method	0.2%	97.6%	96
91	C	Investment Decisions	Topic 7E: Capital Budgeting Techniques: Discounting Techniques: Modified Internal Rate of Return Method (MIRR)	0.2%	97.8%	97
92	C	Investment Decisions	Topic 7F: Capital Budgeting Techniques: Discounting Techniques: Comparison of NPV and IRR Methods	0.2%	97.9%	98
93	C	Investment Decisions	Special Cases	0.2%	98.1%	99
94	C	Dividend Decisions	Stock Splits	0.2%	98.3%	114
95	C	Dividend Decisions	Integrated Problems	0.2%	98.5%	115
96	C	Management of Working Capital - Introduction to Working Capital Management	Meaning and Concept of Working Capital	0.2%	98.6%	116
97	C	Management of Working Capital - Management of Receivables	Aspects of Management of Debtors	0.2%	98.8%	133

#	CAT.	CHAPTER	TOPIC	SHARE	CUM.	PG.
98	C	Management of Working Capital - Management of Receivables	Monitoring of Receivables	0.2%	99.0%	139
99	C	Management of Working Capital - Management of Payables (Creditors)	Cost and Benefits of Trade Credit	0.2%	99.1%	141
100	C	Management of Working Capital - Management of Payables (Creditors)	Computation of Cost of Payables	0.2%	99.3%	142
101	C	Management of Working Capital - Financing of Working Capital	Forms of Bank Credit	0.2%	99.5%	145
102	C	Introduction to Strategic Management	Meaning and Nature of Strategic Management	0.2%	99.7%	148
103	C	Introduction to Strategic Management	Business Ethics and Strategic Management	0.2%	99.8%	157
104	C	Strategic Analysis: External Environment	Market and Customer	0.2%	100.0%	167

Share % is a question-frequency signal drawn from the Scanner — what has actually been asked. The **Importance** grade (A–D) printed against each Chapter and Unit heading is ICAI's own weightage signal, taken from the Chapter Priority Table, Front Matter — ICAI marks over the 8 papers set under the 2023 scheme, including September 2026. The two measure different things, and where they diverge, prepare to the higher of the two standards. A further **30 topics** are declared in the Scanner's frequency tables but carry no question yet; they are badged **CONCEPT BASE** in the notes and are not ranked here.

P A R T

A

Financial Management

14 chapters

SECTION A · FINANCIAL MANAGEMENT · CHAPTER 1

Scope and Objectives of Financial Management

11 Topics · 26 Classified Questions · Importance: C

ICAI SKILL PROFILE ICAI band for Financial Management: Level I 20-30% · Level II 70-80% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge

57.5%

46 of 80 marks

Level II — Analysis & Application

42.5%

34 of 80 marks

Above this Section's Level I ceiling: 57% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for Financial Management. Reading carries more of the preparation here than it does elsewhere; do not prepare this chapter by working sums alone.

Topic 1: Meaning of Financial Management

L2P6-A-C1-T01

Read first Read ICAI Study Material Chapter 1, Scope and Objectives of Financial Management, on the meaning of financial management and the sources of corporate finance introduced with it.

NOTES

The Scanner prints this topic's questions on sources of corporate finance rather than on a textbook definition, so learn what it actually asks. **Angel financing is a form of equity financing** in which an angel investor - a wealthy individual - provides capital for start-up or expansion **in exchange for an ownership/equity in the company**. Angel investors have idle cash available and are looking for a higher rate of return than traditional investments give them.

Two sentences carry the marks in a two-mark angel financing answer. Angels **will invest around 25% to 60%** to help a company get started. And this source is sometimes **the last option for start-ups** which do not qualify for bank funding and are too small for venture capital financing. Give the definition, the percentage and the last-option sentence, and the answer is complete at two marks.

International funding travels with angel financing in the same question. With liberalisation and globalisation a business enterprise has options to raise capital from international markets, and the answers name **FDI and FII as the two major routes**, besides ADRs (American depository receipts) and GDRs (Global depository receipts). Close on the qualifying line the printed answer ends on: the mechanism of procurement of funds has to be modified in the light of the requirements of foreign investors.

The same angel financing paragraph is printed again in Chapter 2, where the matching question tags it as the source of last resort for start-ups. **Learn it once, in this form**, and it answers in both chapters; the wording the Scanner reuses is the wording the examiner recognises.

Understanding explain it, and place it in context · 1 question

- Define the instrument in one line, then add the two qualifying sentences the answers give - who the investor is, and why the start-up comes to him.
- A two-mark question wants the definition and the figure. Do not spend the time writing a page on venture funding.

TQ 1.1 · PYQ 2024-Sep [2] (b) · DESC · 2M · Pg 0

LEVEL I
Understanding**Easy****Analysis** break it down and take the parts separately · 1 question

- Two sources are named, so take them one at a time and give each its own short paragraph. An answer that blends them loses the second set of marks.

TQ 1.2 · RTP 2026-May [10] (a) · DESC · Pg 0

LEVEL II
Analysis**Medium****Topic 2: Evolution of Financial Management**

L2P6-A-C1-T02

Read first Read ICAI Study Material Chapter 1, Scope and Objectives of Financial Management, on the evolution of the subject.

NOTES

Financial management evolved gradually over the past 50 years, and the answers divide that evolution into **three phases**: the traditional phase, the transitional phase and the modern phase. Name all three, in that order, before you describe any of them; a two-mark question is marked mainly on the naming.

The traditional phase: financial management was considered necessary only during occasional events such as takeovers, mergers, expansion and liquidation. When financial decisions were taken in the organisation, **the needs of outsiders to the business** were the ones kept in mind.

The transitional phase: the day-to-day problems that finance managers faced were given importance, and the general problems of **funds analysis, planning and control** drew the attention. The shift in this phase is from the occasional event to the running of the business.

The modern phase is still going on. The scope of financial management has greatly increased; financial analysis is carried out for a company and that analysis helps in decision making. The phase has produced theories on **efficient markets and capital budgeting**, option pricing and valuation models, among several other fields in the subject.

Understanding explain it, and place it in context · 1 question

- Give one identifying line per phase: occasional events, day-to-day problems, developed theory. This is not a history essay and there are no marks in narrative.

TQ 2.1 · PYQ 2021-Dec [6] (c) · DESC · 2M · Pg 4

LEVEL I
Understanding

Easy

Topic 3: Finance Function/Finance Decisions

L2P6-A-C1-T03

Read first Read ICAI Study Material Chapter 1, Scope and Objectives of Financial Management, on the finance function and the finance decisions.

NOTES

The answers label the decisions and the labels are worth keeping: **Investment decisions (I)**, **Financing decisions (F)** and **Dividend decisions (D)**. The later answer adds a fourth, Working Capital Management (WCM) - generally short term decisions reduced to the management of current assets and current liabilities. Even where the question asks for two basic functions, the printed answer lists all four with their letters, so give the letters.

Investment decisions relate to the selection of assets in which funds will be invested by a firm. Long term funds go into a project for fixed assets (PPE) and also for current assets, and the investment is made **after careful assessment through capital budgeting**. A part of the long term funds is also kept for financing the working capital requirement, and asset management policies are laid down for the various items of current assets - the inventory policy being settled by the production manager and the finance manager together, in the light of production requirements, future price estimates of raw materials and the availability of funds.

Financing decisions relate to acquiring the optimum finance to meet financial objectives, and to seeing that fixed and working capital are effectively managed. The finance manager needs a good knowledge of the sources of funds and their respective costs, and must secure **a sound capital structure** - a proper balance between equity capital and debt. The answers press the distinction between profit and cash flow: **profit is of little avail** unless the organisation is adequately supported by cash to pay for assets and sustain working capital.

Risk sits inside the financing decision, and the answers develop it. **Excessive debt carries high risk** for an organisation's equity because of the priority rights of the lenders, and overseas trading leaves the organisation vulnerable to currency fluctuation. The protective procedure named is **hedging** - a strategy designed to minimise, reduce or cancel out the risks in another investment; the example given is the shopkeeper who covers the risk of fire by a fire insurance contract.

Dividend decisions relate to how much, and how frequently, cash is paid out of the profits of the organisation as income for its owners. The decision has **two elements** - the amount paid out and the amount retained to support growth, and the retention limb is itself a financing decision. Close

on the market consequence the answers close on: **the level and regular growth of dividends** is a significant factor in determining the value the stock market places on the shares.

Understanding explain it, and place it in context · 2 questions

- Give one line of definition for each decision first, then expand only the decision the question actually names.
- Where the question says 'two basic functions' but the answer prints four, give all four briefly. You are not penalised for the extra and the count is what is marked.

TQ 3.1 · PYQ 2019-Nov [6] (a) · DESC · 3M · Pg 5

LEVEL I
Understanding

Easy

TQ 3.2 · PYQ 2025-Sep [4] (c) · DESC · 2M · Pg 7

LEVEL I
Understanding

Easy

Topic 4: Importance of Financial Management

L2P6-A-C1-T04

Read first Read ICAI Study Material Chapter 1, Scope and Objectives of Financial Management, on the importance of good financial management.

NOTES

The printed answer demonstrates importance **by describing the tasks it involves**, and it lists six of them where the question asks for four. Give all six: the marks follow the count of correct items, and there is no penalty for the extra two.

The six tasks, in the printed order: taking care **not to over-invest in fixed assets**; ensuring a **sufficient level of short-term working capital**; setting sales revenue targets that will deliver growth; increasing gross profit by setting the correct pricing for products or services; controlling the level of general and administrative expenses by finding more cost efficient ways of running the day-to-day business operations; and **tax planning that will minimise the taxes** the business has to pay.

Notice what the list is made of. Three of the six are about growth - revenue targets, pricing, and not starving the business of working capital - and three are about control: fixed assets, overheads and tax. **Write them as one numbered list**, a clause each, exactly as printed. This is a list answer, and prose costs you time without gaining a mark.

Remembering reproduce what you have learnt · 1 question

- Give all six tasks even where the question asks for four. Marks follow the count of correct items you name.

TQ 4.1 · PYQ 2021-Jan [6] (a) · DESC · 4M · Pg 8

LEVEL I
Remembering

Medium

Topic 5: Scope of Financial Management

L2P6-A-C1-T05

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 1, Scope and Objectives of Financial Management, on the scope of financial management.

NOTES

The Scanner prints no question on this topic. It is a concept base: nothing here has been set on its own in any past paper, revision test or mock test in the period covered, and no printed answer in this chapter develops it. Read the Study Material once and spend the revision time on the topics that are examined.

The scope is in practice examined through the topics on either side of it. **The finance function decisions** - investment, financing, dividend and working capital management - are Topic 3, and **the relationship with the related disciplines**, accounting in particular, is Topic 10. A question that reaches for the scope of the subject is answered out of those two.

So do not manufacture a scope answer in the hall. **Answer with the decisions the Study Material names**, in the words the printed answers use, and you stay inside the marking scheme. Anything you add from general reading is unmarked.

Topic 6: Objectives of Financial Management

L2P6-A-C1-T06

Read first Read ICAI Study Material Chapter 1, Scope and Objectives of Financial Management, on the objectives of financial management - profit maximisation and wealth maximisation.

NOTES

Two objectives, always named together: profit maximisation and wealth maximisation. Financial management is basically concerned with the procurement and use of funds, and the answers open on that sentence before naming the two. Profit maximisation is defended on two grounds - **profit acts as a measure of efficiency**, and it serves as a protection against risk.

Wealth = present value of benefits less costs. That is the model the answers work from: the present value of the benefits minus the present value of the costs. Shareholders' wealth is the result of a cost benefit analysis adjusted for timing and risk, that is for the time value of money,

and the benefits must be measured **in terms of cash flow** and not accounting profit. To measure and maximise shareholders' wealth the finance manager follows three things, in this order: the cash flow approach rather than accounting profit, cost benefit analysis, and the application of time value of money.

Van Horne on value: the value of a firm is represented by **the market price of the company's common stock**. That price is the focal judgement of all market participants as to what the firm is worth; it takes into account present and prospective future earnings per share, the timing and risk of those earnings, the dividend policy and many other factors. The answers add the image worth quoting - **the market price serves as a performance index**, a report card of the firm's progress and of how well management is doing on behalf of the stockholders.

Four limitations of profit maximisation, and this is the most reused list in the chapter. The term profit is **vague** - short term or long term, before or after tax, total profit or profit per share. It makes no distinction between returns received in different periods, so it ignores **the time pattern of returns** and gives no weight to the time value of money. It ignores risk, although higher risk carries the possibility of higher profit, so on this criterion a manager would accept highly risky proposals. And it is too narrow, failing to take in social considerations and the obligations to workers, consumers and society, as well as ethical trade practices. The answers add that **the term maximisation is itself vague**.

Why wealth maximisation is superior, in the four reasons the answers give: it considers all future cash flows, dividends, earnings per share and the risk of a decision, where profit maximisation considers none of the returns to shareholders; a firm that maximises wealth may pay regular dividends, where a profit maximiser may refrain from paying; shareholders prefer an increase in wealth to an increasing flow of profits; and **the market price of a share** reflects the expected return, the long-term prospects, the differences in the timing of returns, risk and the distribution of returns. The sentence to close on: **profit maximisation is part of the wealth maximisation strategy**, not its rival.

Advantages of wealth maximisation, four of them and best learnt as a block: it emphasises long-term gains; it recognises risk and uncertainty; it recognises the timing of returns, that is the time value of money; and it considers shareholders' returns. The objective itself is stated as maximising **the market value of shareholders' wealth** - the market value of the shares.

The comparison is set on **four bases: objective, risk, time horizon and sustainability**. Profit maximisation seeks a large amount of profits, ignores risk or uncertainty, emphasises short term gains, and is not sustainable in the long term. Wealth maximisation seeks **the highest market value of shares**, recognises risk or uncertainty, emphasises long term gains, and is critical to the very existence of the business enterprise. **Answer this one in a table** with the basis in the first column. Where the printed answer reads 'recognises risk or certainty', read it as uncertainty.

Remembering reproduce what you have learnt · 1 question

- The four limitations of profit maximisation and the four advantages of wealth maximisation are fixed lists. Learn them as lists and give exactly the count the question asks for.

- Van Horne is the only name printed in this chapter's answers. Attribute the definition of value to him and quote the market-price sentence.

TQ 6.4 · PYQ 2021-Jul [6] (c) · DESC · 2M · Pg 11

LEVEL I
Remembering**Easy****Understanding** explain it, and place it in context · 6 questions

- Define the objective in one line - the highest market value of the shares - before you argue anything about it.
- Where the question asks why wealth maximisation is superior, answer with the reasons, not with a fresh definition of each objective.

TQ 6.2 · PYQ 2018-Nov [6] (c) · DESC · 2M · Pg 9

LEVEL I
Understanding**Easy**

TQ 6.7 · PYQ 2025-Sep [4] (Or) (c) · DESC · 2M · Pg 13

LEVEL I
Understanding**Easy**

TQ 6.8 · MTP 2025-Dec S2 [4] (c) · DESC · 2M · Pg 14

LEVEL I
Understanding**Easy**

TQ 6.9 · PYQ 2026-May [4] (c) · DESC · 2M · Pg 14

LEVEL I
Understanding**Easy**

TQ 6.3 · MTP 2019-Mar [6] (b) · DESC · 4M · Pg 10

LEVEL I
Understanding**Medium**

TQ 6.5 · PYQ 2023-Nov [6] (Or) (c) · DESC · 2M · Pg 12

LEVEL I
Understanding**Hard****Analysis** break it down and take the parts separately · 2 questions

- Where the question compares the two objectives, set a basis column and work basis by basis: objective, risk, time horizon, sustainability. Two loose paragraphs leave the comparison for the examiner to make, and he will not make it for you.

TQ 6.1 · RTP 2018-May [11] (i) · DESC · Pg 8

LEVEL II
Analysis**Medium**

TQ 6.6 · PYQ 2025-Jan [4] (b) · DESC · 4M · Pg 13

LEVEL II
Analysis**Medium**

Topic 7: Conflict of profit Versus Value Maximisation Principle

L2P6-A-C1-T07

Read first Read ICAI Study Material Chapter 1, Scope and Objectives of Financial Management, on the conflict between profit maximisation and value maximisation.

NOTES

The table is the answer here. Four columns - goal, objective, advantages, disadvantages - and two rows, profit maximisation and shareholders' wealth maximisation. Build the table first; prose on this topic spends the time the table would have saved you.

Profit maximisation - objective: **a large amount of profits**. Advantages, two: profits are easy to calculate, and the link between financial decisions and profits is easy to determine. Disadvantages, four: it emphasises **short term gains**, ignores risk or uncertainty, ignores the timing of returns, and requires immediate resources.

Wealth maximisation - objective: **the highest market value of shares**. Advantages, four: it emphasises long term gains, recognises risk or uncertainty, recognises the timing of returns, and considers shareholders' return. Disadvantages, two, and these are the ones candidates cannot recall: **no clear relationship between financial decisions and share price**, and it can lead to management anxiety and frustration.

The scenario question sets a project with high short-term accounting profit and aggressive cost cutting against one with lower immediate profit but better customer satisfaction, brand loyalty and long-term cash flows. **The printed answer runs in three moves:** profit maximisation and what it ignores; wealth maximisation, which is concerned with increasing the net present value of shareholders' wealth over the long run; then value creation - **sustainable returns exceeding the cost of capital**.

End with the recommendation, in a sentence. The answer chooses the long-term project because it enhances long-term cash flows and strengthens brand equity, and because it builds intangible assets such as customer loyalty and goodwill that lead to **long-term competitive advantage**. An answer that compares the three concepts and never names a project **loses the last mark**.

Understanding explain it, and place it in context · 1 question

- Give the objective of each goal in one line before you list advantages against it. The objective line is itself a marked item in the printed table.

TQ 7.1 · RTP 2024-Sep [12] (a) · DESC · Pg 15

LEVEL I
Understanding

Medium

Application use the rule - work the problem · 1 question

- The question hands you two projects and one principle. Say which project each objective would choose, then say why value maximisation prefers the other, and close with the choice.

TQ 7.2 · MTP 2025-Aug S2 [4] (a) · DESC · 4M · Pg 15

LEVEL II
Application

Hard

Topic 8: Role of Finance Executive

L2P6-A-C1-T08

Read first Read ICAI Study Material Chapter 1, Scope and Objectives of Financial Management, on the role of the finance executive and the Chief Financial Officer.

NOTES

Two different lists are printed under this topic, and the stem of the question tells you which one it wants. **emerging issues affecting the future role** of the CFO is one; **the role of the CFO in today's world** is the other. Read the stem for the words 'emerging' or 'future' before you start writing, because the wrong list scores nothing.

Nine emerging issues, in the printed order: regulation, globalisation, technology, risk, transformation, stakeholder management, strategy, reporting, and talent and capability. Each carries one supporting line - regulatory requirements are increasing and CFOs have **an increasingly personal stake** in adherence; technology lets CFOs reconfigure finance processes and drive business insight through 'big data'; transformation means pressure to improve the service to the business **at zero cost impact**; and stakeholder management matters because CFOs increasingly become the face of the corporate brand.

The role in today's world opens on a framing sentence worth reproducing: the CFO's role is **no longer confined to accounting**, financial reporting and risk management; it is about being a **strategic business partner of the CEO**. Then the list: budgeting, forecasting, managing mergers and acquisitions, profitability analysis by customer or product, pricing analysis, decisions about outsourcing, overseeing the IT function, overseeing the HR function, strategic planning, regulatory compliance and risk management.

A shorter form of the same topic is set as the finance executive's responsibilities, and this one is five items: **financial analysis and planning** - determining the proper amount of funds to employ in the firm, and so its size and its rate of growth; **investment decisions** - the efficient allocation of funds to specific assets; **financing and capital structure decisions** - raising funds on terms as favourable as possible, that is determining the composition of the liabilities; the management of financial resources such as working capital; and risk management, which is the protection of assets.

The questions here are almost all two and four marks, so a **compact numbered list serves better than prose**: estimating the requirement of funds and deciding the capital structure through which they are raised; investment decisions and the allocation of funds; the management of working capital and of cash flows; the dividend decision and profit allocation; and the evaluation of financial performance together with risk management.

Remembering reproduce what you have learnt · 2 questions

- Learn the nine emerging issues as single words. A question asking for any four is marked on whether the four you name are on the list.

TQ 8.2 · PYQ 2018-May [6] (c) · DESC · 2M · Pg 18

LEVEL I
Remembering

Easy

TQ 8.1 · PYQ 2016-Nov [5] (c) · DESC · 4M · Pg 16

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 1 question

- Open with the framing sentence - no longer confined to accounting, now a strategic partner of the CEO - and then list. That opening line is itself worth a mark.
- Match the length of the answer to the marks: a two-mark role question is a list, a four-mark one is a list with a line of explanation on each item.

TQ 8.4 · PYQ 2026-Sep [4] (c) · DESC · 2M · Pg 19

LEVEL I
Understanding

Easy

Analysis break it down and take the parts separately · 1 question

- Group the duties rather than listing them flat — raising funds, allocating them, controlling them, reporting on them. Grouped answers read as analysis and score better than a list of twelve.

TQ 8.3 · MTP 2024-Jul [4] (Or) (c) · DESC · 2M · Pg 18

LEVEL II
Analysis

Easy

Topic 9: Financial Distress and Insolvency

L2P6-A-C1-T09

Read first Read ICAI Study Material Chapter 1, Scope and Objectives of Financial Management, on financial distress and insolvency.

NOTES

Learn the definition in the printed words. Financial distress is a position where cash inflows of a firm are **inadequate to meet all its current obligations**. Every answer on this topic, whether a two-mark definition or a four-mark short note, starts from that sentence, so write it first and then build.

The short note builds up to the definition through the factors a firm has to manage continuously: **the price of the product or service**, demand, and the price of inputs such as raw material and labour. **The proportion of debt has to be managed very delicately** - higher debt requires higher interest, and if the cash inflow is not sufficient it puts the organisation under pressure, with both short term and long term creditors adding to the stress.

Prolonged distress has two consequences, and they run in sequence. The firm may have to sell its assets, **many times at a lower price** than they are worth. Then, when the revenue is inadequate to

revive the situation, it will not be able to meet its obligations and it becomes insolvent.

Insolvency is the **inability of a firm to repay its various debts**, and the answers describe it as the result of continuous financial distress. Keep the two terms apart in your answer: distress is a cash flow position, insolvency is that position left unmanaged for long enough. A question that asks you to define distress and explain the consequences of prolonged distress wants both terms, **in that order**.

Remembering reproduce what you have learnt · 1 question

- Distress and insolvency are two definitions, not one. An answer that gives only distress has half the marks available to it.

TQ 9.1 · MTP 2025-Jul S1 [4] (b) · SN · 4M · Pg 19

LEVEL I
Remembering

Medium

Application use the rule - work the problem · 1 question

- Define first, in one line, then set the consequences out as a sequence: what distress does to operations, then to creditors, then to the firm's survival.

TQ 9.2 · PYQ 2026-Jan [4] (c) · DESC · 2M · Pg 20

LEVEL II
Application

Easy

Topic 10: Relationship of Financial Management with Related Disciplines

L2P6-A-C1-T10

Read first Read ICAI Study Material Chapter 1, Scope and Objectives of Financial Management, on the relationship of financial management with related disciplines, particularly financial accounting.

NOTES

Only one question is printed here and it is a distinguish question: financial management against financial accounting, on **two bases - treatment of funds and decision-making**. Set those two out as headings and the answer writes itself. The answers concede that the two are closely related, then separate them on exactly those two points.

Treatment of funds. In accounting the measurement of funds is based on **the accrual principle**, and accrual based data do not fully reflect the financial condition of the organisation - a firm that is profitable in the accounting sense may still be unable to meet its current obligations through a shortage of liquidity, say from uncollectible receivables. In financial management the treatment is **based on cash flows**: revenue is recognised only when cash is actually received, and expense only on actual payment.

Decision-making is the second basis. The chief focus of an accountant is to collect the data and

present it, while the financial manager's primary responsibility relates to financial planning, controlling and decision-making. The answer closes on the line worth quoting back: **financial management begins where financial accounting ends.**

State the point of the cash flow treatment, because the answer states it: **cash flow based returns help the financial manager avoid insolvency** and achieve the desired financial goals. That sentence ties this topic to financial distress in Topic 9, and it is the reason the distinction is examined at all.

Analysis break it down and take the parts separately · 1 question

- A distinguish question is marked on paired points. On each basis, say what accounting does and what financial management does, in the same row or the same sentence, so the pairing is visible.

TQ 10.1 · MTP 2025-Nov S1 [4] (a) · DESC · 4M · Pg 20

LEVEL II
Analysis

Medium

Topic 11: Agency Problem and Agency Cost

L2P6-A-C1-T11

Read first Read ICAI Study Material Chapter 1, Scope and Objectives of Financial Management, on the agency problem and agency cost.

NOTES

The agency problem starts with a separation. In a sole proprietorship or a partnership the owners participate in management; in a corporate they are not active in management, so there is a separation between the owners or shareholders and the managers. In theory managers should act in the best interest of the shareholders; in reality they may try **to maximise their individual goals** such as salary and perks. That principal-agent relationship is the agency problem - the chance that managers place **personal goals ahead of the goal of the owners.**

Agency problem leads to agency cost. Agency cost is **the additional cost borne by the shareholders** to monitor the manager and control his behaviour so as to maximise shareholders' wealth. Define the problem first and the cost second, in that order; an answer that opens with the cost has to double back to explain where it came from.

Four types of agency cost, and the question asks for them by name: **monitoring**, the expense of overseeing managerial actions; **bonding**, the cost of managers committing to actions that align with shareholders' interests; **opportunity**, the cost arising when managers make decisions that do not maximise shareholder value; and **structuring**, the expense of designing the agreements that mitigate the agency problem.

Three efforts reduce agency cost. Link managerial compensation to the profit of the company to

some extent, and to the long term objectives of the company. Use an **employees' stock option plan (ESOP)**, whose underlying assumption is that maximisation of the stock price is the objective of the investors. And monitor effectively through corporate governance.

The question almost always comes in two halves - what agency cost is and what its types are, then how the company minimises it and aligns the interests of manager and shareholder. **Answer both halves.** Four marks split roughly evenly between the types and the remedies, so an answer that only defines agency cost is a half answer however well it is written.

Analysis break it down and take the parts separately · 2 questions

- Separate the cost from the remedy. Name the types of agency cost first, then take the alignment devices one by one and say which cost each one attacks.

TQ 11.1 · MTP 2018-Aug [6] (a) · DESC · 4M · Pg 21

LEVEL II
Analysis

Medium

TQ 11.2 · PYQ 2025-May [4] (a) · DESC · 4M · Pg 22

LEVEL II
Analysis

Medium

SECTION A · FINANCIAL MANAGEMENT · CHAPTER 2

Types of Financing

9 Topics · 42 Classified Questions · Importance: B

ICAI SKILL PROFILE ICAI band for Financial Management: Level I 20-30% · Level II 70-80% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge

66.2%

102 of 154 marks

Level II — Analysis & Application

33.8%

52 of 154 marks

Above this Section's Level I ceiling: 66% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for Financial Management. Reading carries more of the preparation here than it does elsewhere; do not prepare this chapter by working sums alone.

Topic 1: Financial Needs and Sources of Finance of A Business

L2P6-A-C2-T01

Read first Read ICAI Study Material Chapter 2, Types of Financing, on the financial needs of a business and the sources of finance that meet them.

NOTES

The question printed here is a matching question: five features are given and you **identify the most relevant source of funds** for each. **Answer in two columns** - the feature on the left, the source on the right - and do not explain the sources unless the question asks you to.

The five pairings as printed: the most expensive source of funds is **equity**; the source that entails a high degree of risk, since it has to be repaid as per the terms of the agreement, is **debentures**; the source that supports businesses in their routine activities is **funding from banks**; the option to raise capital from overseas markets is **international funding**; and the last option for start-ups which do not qualify for bank funding is **angel financing**.

Equity as the most expensive source is the pairing candidates reverse, because equity carries no fixed charge and so looks cheap. The pack gives the pairing without a reason attached to it, so learn it as printed and do not argue yourself out of it under time pressure in the hall.

Read the five features as a map of the chapter that follows. Two are long term sources, equity and debentures; one is bank funding, which is where the short term sources sit; one is **international financing**, Topic 8; and one is **angel financing**, which the Study Material carries as a contemporary source. Place the feature in the right topic and the source names itself.

Understanding explain it, and place it in context · 1 question

- This is a matching question. Give the feature, then the source, then one clause of justification for each pairing — the justification is what separates full marks from half.

TQ 1.1 · RTP 2025-Sep [10] (a) · DESC · Pg 26

LEVEL I
Understanding

Medium

Topic 2: Long Term Sources of Finance

L2P6-A-C2-T02

Read first Read ICAI Study Material Chapter 2, Types of Financing, on the long term sources of finance - equity, preference shares, debentures and bonds, and bridge finance.

NOTES

Bridge finance is the most examined item here. It is a **short-term loan taken from commercial banks** to disperse loans sanctioned by financial institutions: it bridges the time gap between the date of sanction of a term loan and its disbursement, a gap caused by procedural formalities which would otherwise result in cost overruns on the project. **The facility does not exceed 12 months.**

The features to give: it is a short term loan; it bridges the gap between sanction and final disbursement; **the rate of interest is usually high**, higher than on a term loan; and it is **repaid as and when the term loans are disbursed**. Security is generally the **hypothecation of movable assets**, personal guarantees and demand promissory notes. Bank of Baroda's scheme is named 'Bridge Loan', and bridge loans may also be extended against the expected proceeds of non-convertible debentures, external commercial borrowings, GDRs and foreign direct investment, provided the company has already made firm arrangements to raise them. The same question pairs bridge finance with clean packing credit - an advance made to an exporter only on production of a firm export order or a letter of credit, without any charge or control over raw material or finished goods, with a suitable margin and with ECGC cover obtained by the bank.

Features of debentures or bonds, five and in this order: face value, on which the interest is calculated; the **interest (coupon) rate**, fixed except for a zero coupon bond and a deep discount bond; maturity period, which is taken as infinite for irredeemable debentures; redemption value, which may vary from the face value and is settled by the debt covenants; and **the benefit of tax shield**, because interest paid to debenture holders is allowed as an expense in determining corporate tax and so saves tax.

The named bonds come one line each, because that is how they are asked. A **callable bond** carries a call option giving the issuer the right to redeem it before maturity **at a predetermined call price**, generally at a premium. A **puttable bond** gives the investor a put option, the right to sell the bond back to the company before maturity. A **masala bond** is the Indian name for a rupee denominated bond that Indian corporate borrowers sell to investors in overseas markets - issued outside India but denominated in rupees, and **NTPC raised ₹2,000 crore** by this route in 2016. A **drop lock bond** is a floating rate note that converts automatically into a fixed rate bond if the interest rate falls below a predetermined level, the new fixed rate staying till maturity.

Six types of preference shares, one salient feature each: cumulative, where the arrear dividend

will accumulate; non-cumulative, with no right to arrear dividend; redeemable, where redemption should be done; participating, which **can participate in the surplus** remaining after payment to the equity shareholders; non-participating, which cannot participate in that surplus after the fixed rate of dividend is paid; and convertible, which carries the **option of converting into equity shares**.

The scenario question describes an instrument with a fixed periodic return, no voting rights, and a rank above equity but below debentures on liquidation. The answer is **preference shares, a hybrid instrument**: a fixed dividend like debt, but the capital raised counts as part of the equity of the company. Say where they rank - repaid after the creditors but before the equity holders - and close on the verdict, **less risky than equity but riskier than debt**.

Debentures, two advantages and two disadvantages: **fixed interest cost**, so the cost is predictable whatever the profitability, and **no ownership dilution**, since debenture holders have no voting rights; against that a fixed payment obligation, because interest must be paid even in a loss year, and a repayment obligation at maturity which is a risk if the cash flows are insufficient. Where the question asks **under which circumstances** debentures are advantageous, organise by circumstance and not by generic merit: where earnings are stable and predictable; where the return on assets exceeds the cost of debt, so trading on equity lifts the shareholders' return; where there is unused debt capacity and assets to offer as security; where control is to be preserved; and where the deductibility of interest is valuable and debt costs less to raise than a share issue.

Remembering reproduce what you have learnt · 1 question

- The bond names - callable, puttable, masala, drop lock - are one-line definitions. Learn the line, not a paragraph, and give the option holder in each case.
- Bridge finance is asked as features and as key features. Either way it is a list: short term, bridges the sanction-to-disbursement gap, high interest, repaid on disbursement.

TQ 2.1 · PYQ 2016-Nov [7] (d) (i) · SN · 2M · Pg 27

LEVEL I
Remembering

Easy

Understanding explain it, and place it in context · 7 questions

- Where a four-mark question names four instruments, give one mark's worth to each and keep the four answers the same length.

TQ 2.2 · PYQ 2018-May [2] (b) · DESC · 2M · Pg 29

LEVEL I
Understanding

Easy

TQ 2.3 · PYQ 2021-Jan [6] (Or) (c) · DESC · 2M · Pg 29

LEVEL I
Understanding

Easy

TQ 2.8 · MTP 2025-Jul S1 [4] (c) · DESC · 2M · Pg 32

LEVEL I
Understanding

Easy

TQ 2.5 · RTP 2024-Sep [12] (b) · DESC · Pg 30

LEVEL I
Understanding

Medium

TQ 2.6 · MTP 2025-Apr S2 [4] (b) · DESC · 4M · Pg 31	LEVEL I Understanding	Medium
TQ 2.7 · PYQ 2025-May [4] (b) · DESC · 4M · Pg 32	LEVEL I Understanding	Medium
TQ 2.9 · PYQ 2025-Sep [4] (b) · DESC · 4M · Pg 33	LEVEL I Understanding	Medium

Analysis break it down and take the parts separately · 2 questions

- Answer in two columns of prose: the case for and the case against, matched item for item. Give the number asked for exactly; two advantages means two, developed, not five listed.

TQ 2.4 · PYQ 2024-Sep [4] (a) · DESC · 4M · Pg 30	LEVEL II Analysis	Medium
TQ 2.10 · PYQ 2026-Sep [4] (a) · DESC · 4M · Pg 33	LEVEL II Analysis	Medium

Topic 3: Venture Capital Financing

L2P6-A-C2-T03

Read first Read ICAI Study Material Chapter 2, Types of Financing, on venture capital financing and its methods.

NOTES

Venture capital financing is **finance for a new, high risk venture** promoted by qualified entrepreneurs who lack the experience and the funds to give shape to their ideas. The European Venture Capital Association describes it as **risk finance for entrepreneurial growth oriented companies**. It is an investment for the medium or long term seeking to maximise the return, under which the venture capitalist purchases debt or equity from inexperienced entrepreneurs undertaking highly risky ventures with the potential of success.

Three features, where the question asks for them: it is a long term investment in a growth oriented but small and new high risky venture; it is **in the form of equity finance**; and the investor also provides support in the form of **sales strategy and business networking**.

Four methods, always in this order: equity financing, income note, conditional loan and participating debenture. Name all four before you explain any of them - the marks follow the count of methods named, and the explanation only fills them out.

Equity financing is the usual form, because a venture capital undertaking needs funds for a longer period and cannot provide returns to investors in the initial stages. The limit matters and is asked: **the equity contribution does not exceed 49%** of the total equity capital of the undertaking, so control and ownership stay with the entrepreneur.

A conditional loan is repayable as a royalty after the venture is able to generate sales, and no

interest is paid on it. In India the financiers charge **royalty ranging between 2 and 15 per cent**, the actual rate depending on the gestation period, the cash flow pattern and the risk of the enterprise. Some financiers offer the enterprise a choice of paying a high rate of interest - **well above 20 per cent** - instead of royalty on sales, once it becomes commercially sound.

An income note is a hybrid combining the features of a conventional loan and a conditional loan: the entrepreneur pays both interest and royalty on sales, but at substantially low rates. The answers attach a figure to it - **IDBI's VCF funds 80 to 87.50% of project cost** for the commercial application of indigenous technology.

A participating debenture carries charges in three phases: no interest in the start-up phase; a low rate of interest up to a particular level of operation; and a high rate of interest once that level is reached. Give all three phases. The three-step structure is the whole of the answer, and a candidate who gives two of them has given two thirds of it.

Understanding explain it, and place it in context · 2 questions

- Define venture capital in one line and quote the European Venture Capital Association description. The attributed line is itself a mark.

TQ 3.1 · PYQ 2015-Nov [5] (d) · DESC · 4M · Pg 34

LEVEL I
Understanding

Medium

TQ 3.2 · RTP 2025-May [10] (b) · DESC · Pg 35

LEVEL I
Understanding

Medium

Topic 4: Debt Securitisation

L2P6-A-C2-T04

Read first Read ICAI Study Material Chapter 2, Types of Financing, on debt securitisation - its meaning, process and advantages.

NOTES

Open with the definition the answers open with. Debt securitisation is **a method of recycling of funds**, a process whereby loans and other receivables are underwritten and sold in the form of an asset. It transforms **the assets of a lending institution into a negotiable instrument** for the generation of funds, and it is especially beneficial to financial intermediaries because it supports their lending volumes. Assets generating steady cash flows are packaged together and securities issued against the pool - housing finance, auto loans and credit card receivables are the examples given.

Three functions, named in this order: the origination function, the pooling function and the securitisation function. That naming is the spine of every answer here, whether the question asks for the meaning, the process or the basics, so write the three names down before you explain any

of them.

Origination: a bank, financial institution, leasing company, hire purchase company, credit card company or housing finance company lends money to a borrower; the borrower's creditworthiness is evaluated and a contract is entered into, with a repayment schedule structured over the life of the loan. What origination creates is **the financial asset in the lender's books**.

Pooling: similar loans or receivables are clubbed together to create an underlying pool of assets, and **the pool is transferred in favour of an SPV** - a special purpose vehicle, which acts as a trustee for the investors. **Securitisation:** the SPV structures and issues its securities against that asset pool - **called pass through certificates** - carrying a coupon and an expected maturity, asset-based or mortgage-based, and generally sold to investors through merchant bankers. The investors named are pension funds, mutual funds and insurance funds.

The process is also printed as a five-step list: the loans are segregated into relatively homogeneous pools; the basis of the pool is **the type of credit, maturity pattern, interest rate and risk**; the asset pools are transferred to a trustee; the trustee issues securities which investors purchase; and the securities are sold **without recourse to the seller**. That last phrase carries the consequence, so state it - the investors bear the credit risk, and the issuer is obliged to pay them only if he receives the cash flows from the collateral.

The advantages are split by whom they accrue to, and the split is marked. **To the originator:** the asset is shifted off the balance sheet, giving **recourse to off balance sheet funding**; illiquid assets are converted into a liquid portfolio; balance sheet management improves, which helps satisfy **capital adequacy norms**; and the originator's credit rating is enhanced. **For the investors:** securitisation opens up new investment avenues, and though the investor bears the credit risk the securities are tied up to definite assets.

Remembering reproduce what you have learnt · 1 question

- Name the three functions in order before describing them. Origination, pooling, securitisation - the order is the process.

TQ 4.1 · PYQ 2016-Nov [5] (d) · DESC · 4M · Pg 36

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 2 questions

- Say what each function produces: origination produces the asset, pooling produces the SPV's portfolio, securitisation produces the pass through certificates.
- Where the question asks for advantages, head them 'to the originator' and 'for the investors'. The two headings are themselves worth marks.

TQ 4.2 · PYQ 2019-May [6] (b) · DESC · 4M · Pg 38

LEVEL I
Understanding

Medium

Topic 5: Lease Financing

L2P6-A-C2-T05

Read first Read ICAI Study Material Chapter 2, Types of Financing, on lease financing - the types of lease, the advantages and limitations of leasing, and the lease or buy evaluation.

NOTES

Types of lease first, because the theory questions here are all about types. **Sale and lease back**: the owner sells the asset to a buyer who leases the same asset straight back to him for a lease rental; the asset is not physically exchanged, it happens in the records only, so **the seller becomes the lessee and the buyer the lessor**. **Sales-aid lease**: the lessor ties up with a manufacturer to market the latter's product through his own leasing operations, and earns from both sides - a credit or a commission from the manufacturer, and rentals from the lessee. **Close-ended lease**: the asset gets transferred to the lessor at the end, and the risk of obsolescence and residual value stays with him as legal owner. **Open-ended lease**: the lessee has the option of purchasing the asset at the end of the lease period. The scenario on a sale and leaseback wants benefits and risks - immediate cash inflow, continued use of the asset without ownership, and off balance sheet financing that improves the capital structure ratios, against loss of ownership with a higher long term cost and lease obligations that add to fixed costs - and closes on the condition that the arrangement applies only if the lease terms are favourable and the company lacks better financing options.

Leveraged lease - three parties, and that is the point of it: the lessor, who is the equity participant; the lessee; and a lender, the loan participant. The lessor finances only a part of the money required and **arranges the major part, say 80%**, with a financier to whom the title deeds for the asset and the lease rentals are assigned. The lender is paid off from the lease rentals directly by the lessee and the surplus goes to the lessor, and **the lessor claims the depreciation allowance**. The name comes from the leverage: the lessor expands the volume of lease business on a limited amount of capital.

Advantages and limitations are asked separately, so keep them as two lists. Advantages: flexibility; the leasing company may **finance 100% of the cost** of the equipment; quick documentation, so it saves time; an operating lease **safeguards the lessee against obsolescence**; it does not affect the borrowing capacity of the lessee; the leased equipment is an 'off the balance sheet' asset and does not affect the lessee's debt position; sale and lease back meets an immediate financial crisis; it suits small equipment where debt financing is impracticable; and tax benefits may accrue depending on the lessee's tax status. Limitations: **rentals fall due soon after the acquisition**, with no moratorium period such as a term loan allows, so the arrangement does not suit a new project which would pay before it operates; the seller's warranties may not reach the lessee, because the lessor is the owner; the lessor's own bank borrowing carries a hypothecation charge, so a **default**

by the lessor may cause seizure of the asset and loss to the lessee; and the cost of interest is very high against a term loan.

The lease or buy working has a fixed format. Build the debt alternative first: the equal annual instalment is **the loan divided by the PVAF at the borrowing rate**, and then comes a debt repayment schedule with columns for the total payment, the interest, the principal and the principal outstanding - **the last year's principal is a balancing figure**. Then the outflow table, in the printed column order: debt payment, interest, depreciation, interest plus depreciation, the tax shield on that total, the net cash outflow, and its present value. Deduct the present value of the salvage value and add the present value of the annual licence fee net of tax, and the total is the present value of outflow under the buy option.

Discount at the after-tax rate of interest, not at the borrowing rate. The answers state the computation expressly: $10\% - (30\% \text{ of } 10\%) = 7\%$. The lease alternative is then one line - after tax lease rent is **the rental $\times (1 - \text{tax rate})$** , multiplied by the PVAF at that after-tax rate. The decision rule is a comparison of outflows: since the present value of outflow is lower under leasing, **the company should prefer leasing**. Write that sentence out. The figure without the decision sentence loses the last mark.

The alternate answer **values the lease against the buy as an NPV**. Find the incremental cash flow of lease over buy and discount it at the net of tax interest rate of the equivalent loan; **if the value is positive, lease, otherwise buy**. The traps the answers correct: under a lease **the depreciation tax shield belongs to the lessor**, because he is the legal owner for income tax, so for the lessee it is a negative cash flow; the interest tax shield is lost in the same way; and at the end the loss on sale - written down value less sale proceeds - carries its own tax saving in the final year.

The other practical form asks you to **structure the rental** rather than to choose. The working: compute **the present value of the tax saving on depreciation** under each depreciation method; deduct it from the investment to get the amount to be recovered from rentals; express the present value of the after-tax rentals as a multiple of $X - \text{rental} \times (1 - \text{tax rate}) \times \text{PVAF}$ where the rentals are equal, or the ratio pattern discounted year by year where they follow the client's utilisation; then **$X = \text{amount to be recovered} \div \text{that multiple}$** . Under the straight line method the depreciation is even; under units of production it follows the usage ratio, so the present value of the shield is lower and the rental required is correspondingly higher.

Understanding explain it, and place it in context • 4 questions

- A type-of-lease question wants the parties and what each of them does. Name the parties first: lessor, lessee, and the financier where there is one.

TQ 5.1 • PYQ 2016-May [7] (e) (i) • DESC • 2M • Pg 40

LEVEL I
Understanding

Easy

TQ 5.3 • PYQ 2019-May [6] (Or) (c) • DESC • 2M • Pg 41

LEVEL I
Understanding

Easy

TQ 5.4 · MTP 2025-Aug S2 [4] (Or) (c) · DESC · 2M · Pg 42

LEVEL I
Understanding

Easy

TQ 5.5 · MTP 2025-Dec S2 [4] (a) · DESC · 4M · Pg 43

LEVEL I
Understanding

Medium

Application use the rule - work the problem · 2 questions

- Set the debt alternative out as a table with the columns in the printed order, and put the discount rate at the top of your working with its computation shown, not just its value.
- State the decision sentence: the present value of outflow is lower under leasing, so the company should lease. The figure alone does not carry the last mark.
- Where the question asks for the rental, work backwards - investment less the present value of the depreciation tax shield, divided by the present value factor of one rupee of rental.

PQ 5.2 · RTP 2026-May [8] · Pg 48

LEVEL II
Application

Medium

PQ 5.1 · PYQ 2019-Nov [4] · 10M · Pg 44

LEVEL II
Application

Hard

Analysis break it down and take the parts separately · 1 question

- Where two alternatives are compared, total each to a single present value of outflow and set the two totals side by side before you comment on them.

TQ 5.2 · PYQ 2018-Nov [6] (b) · DESC · 4M · Pg 41

LEVEL II
Analysis

Medium

Topic 6: Short Term Sources of Finance

L2P6-A-C2-T06

Read first Read ICAI Study Material Chapter 2, Types of Financing, on the short term sources of finance, spontaneous sources and export finance.

NOTES

The plain list question wants six sources: **trade credit**; accrued expenses and deferred income; short term loans such as working capital loans from commercial banks; **fixed deposits for a period of one year or less**; advances received from customers; and various short-term provisions. Six items, one line each, and the marks follow the count.

Four of them are set for description, and each carries its own fact. **Trade credit** is credit granted by the suppliers of goods as an incident of sale, of **usual duration 15 to 90 days**, in the form of an 'open account' or bills payable; it generates automatically in the course of business and **enhances automatically with the volume of business**. **Commercial paper** is an unsecured money market instrument issued in the form of a promissory note, introduced by the Reserve Bank of India in

1989 to let highly rated corporate borrowers diversify their short-term borrowing; primary dealers and all India financial institutions may also issue it, and every issuer must be rated by **CRISIL, ICRA, CARE or FITCH**, or another agency the RBI specifies. **Treasury bills** are a class of Central Government securities issued by the Government of India with **maturities between 14 and 364 days**. Bank advances are the fourth.

Trade credit is not free. It has no explicit cost, but it carries **an implicit cost**: the supplier bears the opportunity cost of the funds invested in trade receivables and passes it to the buyer by raising the price or withholding the cash discount. Its advantages are easy availability, flexibility and informality, and **MSMEs are heavily dependent** on it for financing their working capital needs.

Spontaneous sources are **those which arise naturally in the course of business operations**, and three are named: trade credit, bills payable and accrued expenses. Trade credit **contributes about one-third of the total short-term requirements**, and where the buyer gets the credit without completing much formality it is called open account trade credit. Under bills payable the purchaser gives a written promise to pay the amount either on demand or at a fixed future date. Accrued expenses are services availed but not yet paid for - **a built-in and automatic source**, because wages, salaries, taxes and duties are paid at the end of the period.

Trade credit against bank overdraft is set as a distinguish question, on five bases. Trade credit is extended by suppliers, runs 15 to 90 days, is **interest free** so that failing to use it has an interest cost, arises automatically in the course of business, and grows with the volume of business. Under an overdraft the customer is allowed to **withdraw in excess of the credit balance** in his current account, **interest is charged on daily balances**, the facility must be applied for and is operated like a cash credit account, and a fixed limit is granted within which he may overdraw; though repayable on demand, overdrafts generally continue by annual renewal of the limit.

Post-shipment finance is finance given after the exporter has shipped the goods but before payment is received from the foreign buyer - recognise the scenario by those words, then give the forms. **Purchase or discounting of documentary export bills**, backed by documents of title such as the bill of lading, post parcel receipt or air consignment note. **ECGC guarantee**, where the exporter holds a shipments or contracts policy covering both political and commercial risks, and the corporation fixes a credit limit for each exporter to which its liability is restricted. **Advance against export bills sent for collection**, granted having regard to the creditworthiness of the party, the nature of the goods, the usance and the standing of the drawee. And **advance against duty drawback and cash subsidy**, which is clean in nature and so calls for precaution.

The short scenario questions test one classification. Of equity, debt, retained earnings and supplier credit, **the short-term source is trade credit** - payment falls due typically within 30 to 90 days, it is **part of working capital management**, and it funds day-to-day operational needs, so it is not a long term source. Name the source, then give the characteristics; naming it without the reasons is half an answer.

Remembering reproduce what you have learnt · 1 question

- The four forms of post-shipment finance and the six short term sources are counted lists. Reproduce the count the question asks for and no fewer.

TQ 6.1 · PYQ 2018-May [6] (a) · DESC · 4M · Pg 51

LEVEL I
Remembering**Medium****Understanding** explain it, and place it in context · 4 questions

- Attach the defining fact to each source - 15 to 90 days for trade credit, a promissory note and the 1989 RBI scheme for commercial paper, 14 to 364 days for treasury bills.

TQ 6.3 · PYQ 2019-Nov [6] (Or) (c) · DESC · 4M · Pg 52

LEVEL I
Understanding**Medium**

TQ 6.4 · PYQ 2021-Jul [6] (a) · DESC · 4M · Pg 54

LEVEL I
Understanding**Medium**

TQ 6.5 · PYQ 2023-Nov [6] (b) · DESC · 4M · Pg 55

LEVEL I
Understanding**Medium**

TQ 6.8 · PYQ 2026-May [4] (b) · DESC · 4M · Pg 57

LEVEL I
Understanding**Medium****Analysis** break it down and take the parts separately · 3 questions

- The trade credit against overdraft question is marked on paired points. Take one basis at a time and say what each does on that basis, in the same row.

TQ 6.2 · MTP 2018-Aug [6] (b) · DESC · 4M · Pg 51

LEVEL II
Analysis**Medium**

TQ 6.6 · MTP 2025-Jul S1 [4] (Or) (c) · DESC · 2M · Pg 56

LEVEL II
Analysis**Medium**

TQ 6.7 · RTP 2025-Sep [10] (b) · DESC · Pg 56

LEVEL II
Analysis**Medium****Topic 7: Other Sources of Finance**

L2P6-A-C2-T07

Read first Read ICAI Study Material Chapter 2, Types of Financing, on the other sources of finance - secured premium notes, seed capital assistance and junk bonds.

NOTES

Secured premium notes are issued along with a detachable warrant and are redeemable after a **notified period of say 4 to 7 years**. The conversion of the detachable warrant into equity shares has to be done within the time period notified by the company. That is the whole of the printed

answer, and a two-mark question wants exactly those two sentences - the warrant and the period.

Seed capital assistance is an IDBI scheme for professionally or technically qualified entrepreneurs, and for persons possessing relevant experience, skills and entrepreneurial traits, **who lack adequate financial resources**. All projects eligible for financial assistance from IDBI, directly or indirectly through refinance, are eligible under the scheme.

The terms are what the four-mark answer is marked on. The assistance is **interest free** but carries **a service charge of one per cent per annum** for the first five years, at an increasing rate thereafter. IDBI keeps the option to charge interest at a rate it determines if the financial position and profitability of the company permit it during the currency of the loan. The repayment schedule is fixed on the repaying capacity of the unit, with **an initial moratorium up to five years**.

Junk bonds are rated below investment grade by the credit rating agencies, which means the issuing company has a greater chance of not repaying and the bond is riskier for the investor. They are called **high yield bonds** because, to attract investors despite that risk, the issuer offers a **higher rate of interest** than safer bonds do. State the link expressly, because the question asks for it: the high interest compensates the investor for taking on the extra risk.

Understanding explain it, and place it in context · 1 question

- For junk bonds, give the rating position first and the name second. The reason for the name is the second half of the question and half of the marks.

TQ 7.3 · PYQ 2026-May [4] (Or) (c) · DESC · 2M · Pg 60

LEVEL I
Understanding

Easy

Analysis break it down and take the parts separately · 2 questions

- Name the instrument, then its features as a numbered list. These carry two to four marks, so four crisp features beat one long paragraph.

TQ 7.1 · PYQ 2023-May [6] (Or) (c) · DESC · 2M · Pg 59

LEVEL II
Analysis

Easy

TQ 7.2 · PYQ 2026-Jan [4] (a) · DESC · 4M · Pg 59

LEVEL II
Analysis

Medium

Topic 8: International Financing

L2P6-A-C2-T08

Read first Read ICAI Study Material Chapter 2, Types of Financing, on international financing - depository receipts, euro issues and the instruments of the international market.

NOTES

ADR against GDR is the distinguish question, and it is set on five bases: meaning, created by, issued in, listed in, and negotiation in. Use those five as row headings and the answer is complete without a word of padding.

GDRs are negotiable certificates denominated in US dollars that represent a non-US company's publicly traded local currency (INR) equity shares. They are created when the local currency shares are delivered to the depository's local custodian bank, against which the depository bank issues depository receipts in US dollars. They are issued in the **European capital market**, listed on a **non-US stock exchange**, and negotiable all over the world.

An ADR is created by depositing the securities of an Indian company with a custodian bank; in arrangement with that bank, a depository in the US issues the ADRs, and the holder may trade the ADR and generally enjoys the rights of an owner of the underlying Indian security. ADRs are issued in the **American domestic capital market**, listed on an American stock exchange, and negotiated in America.

The instruments are asked four at a time, so learn one line each. **Euro bonds** are long term loans raised by entities enjoying an excellent credit rating, **not denominated in the currency of the country** in which they are issued, and issued in bearer rather than registered form, so they carry neither the investor's name nor his country of origin. **Foreign bonds** are debt instruments denominated in a currency foreign to the borrower and sold in the country of that currency. **Fully hedged bonds** are foreign bonds devoid of currency fluctuation risk, which they eliminate **by selling the entire stream of principal and interest** in the forward market. A euro issue itself is an issue listed on a foreign stock exchange, made through depository receipts or foreign currency convertible bonds.

Floating rate notes provide foreign currency at a rate lower than foreign loans, are issued for a period **up to seven years**, and their interest rates are adjusted to reflect the prevailing exchange rate. **Euro commercial papers** are unsecured promissory notes with a maturity of **less than one year**, issued by a corporate body and usually designated in US dollars, the main investors being banks, insurance companies and fund managers. **Medium term notes** answer the cost of frequent separate issues: several lots of bonds are issued under one programme, each lot with different features such as a different coupon or currency, the timing of each chosen for the market opportunity, **with the documentation and approvals taken at one time**.

Yankee bonds are the scenario item - bonds issued by non-US banks and non-US corporations in the USA. The features, as a list: **denominated in dollars**; issued in the USA and **registered with the SEC**; **issued in tranches**; the time taken can be **up to 14 weeks**; and the interest rate is dollar LIBOR. Write it as the Study Material has it. Be aware, though, that USD LIBOR settings ceased in 2023 and dollar floating rate instruments now reference SOFR.

ESG bonds fall into two categories, project-based and target-based. **Green bonds** are the most popular, issued by financial, non-financial or public institutions, with the proceeds financing 'green projects' that have a positive environmental or climate impact, such as eco-friendly technologies. **Social bonds** finance projects with a social impact - human rights, equality, animal welfare.

Sustainability-linked bonds combine the two: the proceeds are **not designated for a specific project** but used for general corporate purposes aimed at achieving specified key performance indicators. Where a green bond alone is asked for two features, develop two: the proceeds are **earmarked exclusively** for projects with an environmental or climate benefit, with the issuer tracking and reporting their use; and the instrument otherwise behaves as an ordinary debt security, with a fixed coupon, a stated maturity and recourse to the issuer.

Remembering reproduce what you have learnt • 1 question

- Learn the one-line definition of each instrument. A four-mark question naming four instruments gives one mark each, and length beyond the line earns nothing.

TQ 8.3 • PYQ 2022-Nov [6] (a) • DESC • 4M • Pg 63

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context • 4 questions

- Say what problem the instrument solves - the medium term note solves the cost of frequent issues, the fully hedged bond removes currency risk. That sentence is what separates an explanation from a definition.

TQ 8.6 • PYQ 2026-Sep [4] • DESC • 2M • Pg 65

LEVEL I
Understanding

Easy

TQ 8.2 • PYQ 2018-Nov [6] (a) • DESC • 4M • Pg 61

LEVEL I
Understanding

Medium

TQ 8.4 • MTP 2024-Jul [4] (b) • DESC • 4M • Pg 63

LEVEL I
Understanding

Medium

TQ 8.5 • PYQ 2025-Jan [4] (a) • DESC • 4M • Pg 64

LEVEL I
Understanding

Medium

Analysis break it down and take the parts separately • 1 question

- For ADR against GDR, answer basis by basis in a table: meaning, created by, issued in, listed in, negotiation in. Five bases, five rows.

TQ 8.1 • PYQ 2017-May [7] (e) • DESC • 4M • Pg 60

LEVEL II
Analysis

Medium

Topic 9: Contemporary Sources of Funding

L2P6-A-C2-T09

Read first Read ICAI Study Material Chapter 2, Types of Financing, on the contemporary sources of funding - crowd funding and peer-to-peer lending.

NOTES

Crowd funding means **raising money from a group of people** for an individual or organisation, to fund a project, typically **via the internet** - social media and crowd funding websites. The funds come from family, friends, strangers and corporates, in exchange of **equity, called equity funding**; loans, called P2P lending; or nothing at all, which is a donation.

Two details the answers add and candidates drop. The route **helps a start-up substantiate demand** for its product before it enters into production. And **three parties are involved** - the fund raiser, the mediator and the fund investor; the platform acting as mediator may charge a processing fee or a transaction fee, as a fixed amount, a percentage, or a combination of both.

Peer-to-peer lending is a category of crowd funding in which lenders are matched with borrowers to provide unsecured loans through an online platform. The funds raised are paid back by the borrowers with interest, and the lending carries a risk of default, just as a bank bears in conventional lending. An investor visits a P2P platform and chooses amongst borrowers considering risk and return; the platforms named are **i2iFunding, Lendbox, Faircent and Rupee Circle**.

The relation is the verdict the question wants: crowd funding is the broader concept, and **P2P lending is a part of crowd funding**. An answer that describes both and never states how they stand to each other loses the mark the word 'difference' is asking for.

Understanding explain it, and place it in context · 1 question

- Define crowd funding in one line, then give the three forms with their names - equity funding, P2P lending, donation.

TQ 9.1 · PYQ 2024-May [4] (Or) (c) · DESC · 2M · Pg 65

LEVEL I
Understanding

Easy

Analysis break it down and take the parts separately · 1 question

- The difference question ends in a relation, not a table. Say in the last line that crowd funding is the wider concept and P2P lending sits inside it.

TQ 9.2 · MTP 2025-Aug S2 [4] (b) · DESC · 4M · Pg 66

LEVEL II
Analysis

Medium

SECTION A · FINANCIAL MANAGEMENT · CHAPTER 3

Financial Analysis and Planning - Ratio Analysis

11 Topics · 35 Classified Questions · Importance: A

ICAI SKILL PROFILE ICAI band for Financial Management: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge **0.0%** 0 of 192 marks

Level II — Analysis & Application **100.0%** 192 of 192 marks

Below this Section's Level I floor: none of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for Financial Management. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Ratio and Ratio Analysis

L2P6-A-C3-T01

Read first Read ICAI Study Material Chapter 3, Financial Analysis and Planning - Ratio Analysis, on what a ratio is and the classes of ratio a financial soundness report covers.

NOTES

The set-piece question gives the balance sheet as percentages and one absolute figure. **Build the total first:** equity share capital of `10,00,000 is 40% of the total, so total liabilities are `25,00,000, and every other line is a percentage of that figure - preference capital 10%, other shareholders' funds 15%, term loan 10%, current liabilities 25%. Fixed assets are 60% of total assets and current assets the balance of 40%. Nothing in the question can be computed until that column is complete.

The chain the answer then follows: receivables are one-fifth of current assets, so `2,00,000; **sales = receivables × 12 ÷ credit period in months**, giving `12,00,000 on a two-month period with no cash sales; EBIT at an operating margin of 15% is `1,80,000; interest is 15% of the `2,50,000 term loan, `37,500; EBT `1,42,500; tax at 50% leaves PAT `71,250; preference dividend is 12% of `2,50,000, `30,000; earnings for equity `41,250 on 1,00,000 shares, so **EPS is `0.41**.

Answer in the bank's own format or you lose the presentation marks. Reproduce the seven columns - Issue, Ratio, Numerator, Denominator, Ideal range, the company's own ratio, and **Favourable or Adverse** - and give **one row per issue** the bank raised, in the order it raised them.

The six soundness ratios, with the ideal the answer states and the verdict it reaches: **Current Ratio = Current Assets ÷ Current Liabilities**, ideal 2, here 1.6, adverse; **Quick Ratio = Quick Assets ÷ Current Liabilities**, ideal 1, here 0.32 because only the receivables are quick assets, adverse; DSCR, ideal 2, here 6.1, favourable; **Interest Coverage = EBIT ÷ Interest**, more than 1, here 4.8; Preference Dividend Coverage = PAT ÷ preference dividend, more than 1, here 2.375; Fixed Charges Coverage = (EBIT + depreciation) ÷ (interest + repayment of loan), more than 1, here 6.34.

Two workings inside that table are where the marks hide. Earnings available for debt service is **PAT + Interest + Depreciation + Instalments** = 71,250 + 37,500 + 3,75,000 + 50,000 = `5,33,750, the instalment being the `2,50,000 term loan over five instalments. Depreciation is grossed up from the closing figure, because fixed assets of `15,00,000 are stated **after providing 20% depreciation**:  $15,00,000 \times 20 \div 80 = `3,75,000$.

The four investor ratios asked at the end, each tied to what the question says it indicates: **Debt-Equity** = $\text{Debt} \div \text{Equity}$, $2,50,000 \div 16,25,000 = 0.15$, for the composition of capital structure; **EPS** `0.41 for the profit generated per share in existence; **Market value to Book value**, 12 lakhs $\div$ 13.75 lakhs = 0.87, for the market's response to the shareholders' investment; and **PE Ratio** = $\text{MPS} \div \text{EPS}$, $12 \div 0.41 = 29.27$ times, for the investors' expectation of earnings. Market price is face value `10 plus the 20% premium. These three carry **no ideal range - write 'not applicable'**.

Application use the rule - work the problem · 1 question

- Build the percentage balance sheet and the EBIT-to-PAT column before you write a single ratio. Every ratio asked is two lines of those two workings divided by each other.
- Answer inside the table the question prints, one row per issue, and fill the verdict column. A correct ratio with no favourable or adverse comment loses the last mark.

PQ 1.1 · RTP 2026-Jan [5] · Pg 71

LEVEL II
Application

Medium

Topic 2A: Types of Ratio: Liquidity Ratio

L2P6-A-C3-T02A

Read first Read ICAI Study Material Chapter 3, Financial Analysis and Planning - Ratio Analysis, on the liquidity ratios.

NOTES

The liquidity ratios as the chapter's answers write them: **Current Ratio** = $\text{Current Assets} \div \text{Current Liabilities}$, ideal 2:1; the Quick or Acid Test Ratio, quick assets over current liabilities, **ideal 1:1**, quick assets being current assets less inventory, and less prepaid expenses where the question separates them; the Cash Ratio, cash and cash equivalents plus marketable securities over current liabilities, which one answer calls the cash asset ratio and treats as the same thing; and Net Working Capital, current assets less current liabilities, which is a figure rather than a ratio.

The basic defence interval is **Quick Assets $\div$ average daily cash operating expenses**. The answer defines cash operating expenses as cost of goods sold plus selling and distribution expenses **less the non-cash expenses**, so $90,00,000 + 12,00,000 - 4,80,000 = `97,20,000$ , and quick assets of `12,00,000 over that expense run at 360 days give 44.44 days. Forgetting to strip out the non-cash

expenses is the standard slip.

The short question does not want figures at all. It states a current ratio of **2:1** and asks, for each transaction, whether the ratio will improve, decline or remain unchanged. Print the question's table back with an Impact column and **one word per row**, then a line of reason.

The four printed verdicts and why. A debtor owing ₹60,000 turning insolvent with only 75% recovered **declines** the ratio: the shortfall is a loss of current assets with no movement in current liabilities. Issuing equity shares for ₹2,00,000 with the proceeds in the bank **improves** it. Collecting ₹25,000 from customers in cash is **no change**, one current asset simply replacing another. Goods costing ₹8,000 sold for ₹12,500 on credit **improves** it, because the receivable exceeds the stock given up by the profit.

One rule decides all four rows, so do not recompute the ratio each time. **A transfer between two current items leaves the ratio unchanged**; an addition to current assets that does not touch current liabilities improves a ratio already above 1; and a loss written off current assets reduces it.

Analysis break it down and take the parts separately · 1 question

- Answer transaction-impact questions in the table given, one word per row, then one short reason. Two marks means four crisp rows, not four computations.
- Ask of every transaction whether current assets and current liabilities move, and by how much, before you decide the direction.

PQ 2A.1 · PYQ 2026-Jan [4] (Or) (c) · 2M · Pg 75

LEVEL II
Analysis

Hard

Topic 2B: Types of Ratio: Long Term Solvency Ratio/Leverage Ratio

L2P6-A-C3-T02B

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 3, Financial Analysis and Planning - Ratio Analysis, on the long term solvency and leverage ratios.

NOTES

No question is printed against this topic, but every ratio in it is **computed somewhere else in the chapter**. Learn the formulae here and most of the comprehensive and reconstruction questions are already half done.

The capital structure ratios as the answers write them: **Debt-Equity Ratio = Debt ÷ Equity**, 0.15 in the soundness report; debt to total assets, where one answer notes expressly that debt is taken as

long-term debt plus accounts payable; long-term debt to equity, applied to shareholders' funds where the question says equity; and the proprietary ratio, **proprietary fund ÷ total assets**, that fund being equity plus reserves plus preference capital.

Two of those are printed with a second definition, and the question tells you which to use. **Capital gearing is defined more than one way** - the answers take capital bearing a fixed rate of return over capital not bearing it - and the proprietary ratio is sometimes given in the question's own data as **fixed assets ÷ proprietary fund**. State the basis you are using in one line; a stated basis is allowed, an unstated one is not.

The coverage ratios all answer the same question, whether the firm can service its fixed charges: **Interest Coverage = EBIT ÷ Interest**; DSCR, **earnings available for debt service ÷ (interest + instalments)**, where earnings available is PAT + interest + depreciation + instalments in one answer and cash profit before interest and tax, that is EBIT + depreciation, in another; Preference Dividend Coverage = PAT ÷ preference dividend; and Fixed Charges Coverage = (EBIT + depreciation) ÷ (interest + repayment of loan). **More than 1 is favourable** for all of them, except DSCR where the ideal printed is 2.

Financial leverage = EBIT ÷ EBT in the printed answer, $170 \div 57 = 2.98$ for the year against 1.22 for the year before. The answer sets the two years side by side rather than commenting on one, because a rise here means a fixed interest charge weighing on a shrinking EBIT.

Topic 2C: Types of Ratio: Activity Ratios /Efficiency Ratios/ Performance Ratios/Turnover Ratios

L2P6-A-C3-T02C

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 3, Financial Analysis and Planning - Ratio Analysis, on the activity, efficiency, performance and turnover ratios.

NOTES

No question is printed against this topic, but the turnover ratios **drive almost every reconstruction question** in the chapter. They are the bridges that turn a ratio into a rupee figure, so a slip here loses every figure downstream of it.

Inventory Turnover = COGS ÷ Average Stock, where average stock is opening plus closing divided by two, so closing stock = (average × 2) - opening. Where the question gives no opening figure, the answers divide by closing stock directly and say so. The holding period is inventory over cost of goods sold times the days in the year, and dividing the days by the turnover reaches **the same number by another route**.

The trap the answers correct most often: the ratio may be **based on cost of goods sold or on sales**, and the question always says which in a bracket after the ratio's name. 'Based on sales' means $\text{Sales} \div \text{Inventory}$; 'based on cost of goods sold' means $\text{COGS} \div \text{stock}$. Using sales where cost was asked is described in the pack as **the single most common error** in this family.

The receivables and payables side: **Debtors Turnover = Credit Sales $\div$ Debtors**, and the collection period is debtors over credit sales times the days in the year. A velocity stated in months converts by **turnover = $12 \div \text{months}$** , so a three-month debtors velocity is a turnover of 4. Creditors turnover is printed as credit purchases over creditors in one answer and cost of goods sold over trade payables in another. Where bills receivable or bills payable are given, they **form part of debtors or creditors** and must be deducted to leave the sundry figure.

The asset ratios, both expressed in times: **Total Assets Turnover = Sales $\div$ Total Assets**, and the same sales figure over fixed assets for the fixed assets turnover. Use the days the question specifies - 360 in most of these answers, 365 where it says so - and where the answer works through an average collection period it computes **average sales per day** first and divides debtors by that.

Topic 2D: Types of Ratio: Profitability Ratios

L2P6-A-C3-T02D

Read first Read ICAI Study Material Chapter 3, Financial Analysis and Planning - Ratio Analysis, on the profitability ratios.

NOTES

The working is the same statement every time, and setting it out is worth more than the ratios themselves: **Sales - Direct cost = Gross profit, less operating expenses = EBIT, less interest = EBT, less tax = EAT**. Where the question gives only total assets and a debt percentage, draw the small balance sheet above it: equity is total assets less debt, and interest is the stated rate on the debt.

The chain in the printed answer runs backwards from the interest figure. Debt is 50% of total assets `10,00,000, so interest at 10% is `50,000; **direct cost is ten times the interest cost**, `5,00,000; and sales are the direct cost at a 50% margin **on the direct cost**, so  $\times 150\% =$  `7,50,000. Read a margin stated on cost as a mark-up on cost, never as a margin on sales.

The margins: **Net profit margin = EAT $\div$ Sales**, 9.33%, and the net operating profit margin, EBIT over sales, 20%. A second answer in the chapter also prints a margin **before tax, EBT $\div$ Sales**, and offers EBIT $(1 - t)$ over sales as an alternative after-tax form. Whichever you use, write the numerator above the line.

Return on Assets is printed four ways in this one answer and all four are shown as acceptable: 15% on EBIT $\div$ total assets, 12% on earnings after tax plus interest $\div$ total assets, 10.5% on EBIT $(1 - t) \div$ total assets and 7% on EAT $\div$ total assets. **EBIT $(1 - t) \div$ average total assets** is the form the

later answers in the chapter settle on. An unlabelled percentage cannot be marked, so name your numerator.

Return on owners' equity = $\text{EAT} \div \text{Equity}$, 14% here, and equity means **total assets less debt** rather than the paid-up capital. Where the question fixes debt as a percentage of assets, compute equity as the complement - 65% of `50,00,000 in one answer - before dividing.

Application use the rule - work the problem · 1 question

- Draw the profit and loss statement down to earnings after tax before computing a single margin. Every ratio asked is one of those lines over sales, assets or equity.
- Label the numerator of every return ratio. Return on assets has four accepted forms, and the label is what earns the mark when your percentage differs from the printed one.

PQ 2D.1 · PYQ 2022-Nov [1] (b) {C} · 5M · Pg 76

LEVEL II
Application

Hard

Topic 2E: Types of Ratio: Comprehensive-Ratio Computation

L2P6-A-C3-T02E

Read first Read ICAI Study Material Chapter 3, Financial Analysis and Planning - Ratio Analysis, on computing a stated list of ratios from given financial data.

NOTES

These questions name the ratios they want, usually four or five for five marks. **Compute them in the order asked**, and show the formula line before the substitution: the formula alone carries part of each mark, and the figure alone carries the rest only if it is labelled with its unit - per cent, times or days.

Capital employed is **share capital plus reserves, preference capital and long-term debt**, and two returns are computed on that base in the same answer: ROCE pre-tax, EBIT over capital employed, at 15.38%, and ROCE post-tax, profit after tax over capital employed, at 9.23%. A later answer computes it after tax only and says so in a bracket. EPS is profit after tax less preference dividend, over the number of equity shares, giving `2.2, and **PE = market price ÷ EPS** gives $14 \div 2.2 = 6.36$ times.

Where the question gives ratios instead of figures, the route is fixed. **Net working capital with the current ratio gives current assets**: at 2.5:1, $\text{CA} = \text{NWC} \times 2.5 \div 1.5 = `25,00,000$, and current liabilities are the difference. Then total assets = current + fixed, sales = total assets turnover × total assets, and $\text{COGS} = (100\% - \text{gross profit ratio})$ of sales. Average stock comes from the stock turnover, **closing stock = (average × 2) - opening**, and quick assets are current assets less closing stock.

To unwind a debt-equity ratio, the answers write the balance sheet as an equation - total assets = **equity + preference capital + debt + current liabilities** - then substitute equity = $2 \times \text{debt}$ for a 1:2 ratio and solve for the one unknown. Proprietary fund in that answer is equity plus preference capital, so the proprietary ratio follows in a line.

Grossing up for tax appears twice and is worth learning as a line: **tax = net profit $\times$ rate $\div$ (1 - rate)**, so `28,80,000} \times 40\% \div 60\% = \text{`19,20,000 , and profit before tax is the sum of the two. Add back debenture interest to reach profit before interest and tax. From the other direction, **debentures = interest $\div$ rate**, `3,36,000} \div 14\% = \text{`24,00,000 , and net worth is profit after tax over the return on net worth.

Where two years of statements are given, compute the asked year and **set the prior year beside it**: inventory turnover 7.91, financial leverage, EBIT over EBT, at 2.98 against 1.22, ROCE after tax 0.651%, ROE 1.77%, and an average collection period of 22 days worked on **365 days and average sales per day**. Use the days the question states, not the days you are used to.

Application use the rule - work the problem · 7 questions

- Write the formula, then substitute, then state the figure with its unit. A bare number with no unit and no formula gets very little.
- Number your working notes and refer to them from each ratio. These answers are marked on the workings as much as on the final figures.

PQ 2E.1 · PYQ 2019-Nov [1] (a) {C} · 5M · Pg 78	LEVEL II Application	Medium
PQ 2E.5 · PYQ 2026-Jan [1] (a) {C} · 5M · Pg 86	LEVEL II Application	Medium
PQ 2E.7 · MTP 2026-Apr S2 [1] (c) {C} · 5M · Pg 90	LEVEL II Application	Medium
PQ 2E.2 · PYQ 2020-Nov [1] (a) {C} · 5M · Pg 80	LEVEL II Application	Hard
PQ 2E.3 · MTP 2025-Jul S1 [1] (b) · 5M · Pg 81	LEVEL II Application	Hard
PQ 2E.4 · PYQ 2025-Sep [1] (b) {C} · 5M · Pg 84	LEVEL II Application	Hard
PQ 2E.6 · RTP 2026-May [4] · Pg 87	LEVEL II Application	Hard

Topic 2F: Types of Ratio: Comprehensive-Financial Statement Reconstruction

L2P6-A-C3-T02F

Read first Read ICAI Study Material Chapter 3, Financial Analysis and Planning - Ratio Analysis, on reconstructing a balance sheet or financial statement from given ratios.

NOTES

This is the most examined topic in the chapter - **34 questions declared** across past papers, RTPs and MTPs - and it is always the same exercise. You are given a list of ratios and one or two absolute figures and asked to fill in a printed format. **Reproduce that format exactly as printed** and put each figure on the line the question names for it.

Start where an absolute figure is given and work outwards; nothing here can be reached out of sequence. The usual entry points are gross profit with the gross profit ratio, so **Sales = Gross Profit ÷ GP ratio**; an equity share capital figure with a total-debt-to-equity ratio; a fixed assets figure with a fixed asset turnover; or a current liabilities figure with the current ratio.

The standard chain, in the order the answers run it: cost of goods sold is sales less gross profit; **total assets = sales ÷ total assets turnover**; current assets are the current ratio times current liabilities; stock is cost of goods sold over the inventory turnover; debtors are credit sales times the collection period over the days in the year; then **cash as the balancing figure** of current assets, and fixed assets as total assets less current assets. On the other side, **net worth = PAT ÷ return on net worth**, split between share capital and reserves in the stated ratio, and debentures are interest over the rate.

Two derivations recur and should be memorised. Stock from the current and liquid ratios: **the gap between the two ratios is the stock element**, so current assets = stock × current ratio ÷ (current ratio - liquid ratio), $3,75,000 \times 1.5 \div 0.5 = 11,25,000$. And the pair of simultaneous equations another answer uses: **CA = 1.2 CL** and **CA - stock = 0.8 CL**, equated to give current liabilities and then current assets.

State the assumptions the answers state. **All sales are treated as credit sales** unless a credit-to-total-sales ratio is given, in which case debtors run on credit sales only: $60 \text{ days} \times 0.8 \times 3,00,000 \div 360 = 40,000$. Where a long-term-debt-to-equity ratio is used, **equity means shareholders' funds**, although the answer notes the question can also be solved taking share capital alone. Where the printed answer carries such a note, print it too.

The traps corrected across these twenty answers: the turnover is **based on cost of goods sold, not on sales**, unless the question says otherwise; **closing stock is not average stock**, so where an opening figure or a 'closing exceeds opening by' clause is given, solve for closing before you use it; and current debt and long-term debt together make total debt, so split the total with the given fraction rather than treating the two as separate givens.

Finish by totalling both sides. **The two totals must agree**, and where the format leaves cash or fixed assets as the balancing figure that agreement is the only check you have. An answer that does not total is marked down on every line that depends on the error.

Application use the rule - work the problem · 20 questions

- Find the one absolute figure first and write out the chain of ratios that leads from it. Do not start at the top of the printed format and work down.

- Show every working note, numbered, and cross-reference each balance sheet line to the note that produced it. The marks sit in the workings.

PQ 2F.1 • PYQ 2018-May [1] (c) {C} • 5M • Pg 92	LEVEL II Application	Medium
PQ 2F.2 • PYQ 2018-Nov [1] (c) {C} • 5M • Pg 93	LEVEL II Application	Medium
PQ 2F.3 • PYQ 2019-May [1] (a) {C} • 5M • Pg 95	LEVEL II Application	Medium
PQ 2F.4 • PYQ 2021-Jan [1] (a) {C} • 5M • Pg 96	LEVEL II Application	Medium
PQ 2F.9 • PYQ 2023-Nov [1] (a) {C} • 5M • Pg 106	LEVEL II Application	Medium
PQ 2F.10 • RTP 2024-May [1] • Pg 108	LEVEL II Application	Medium
PQ 2F.11 • PYQ 2024-May [1] (a) {C} • 5M • Pg 110	LEVEL II Application	Medium
PQ 2F.12 • MTP 2024-Jul [1] (a) {C} • 5M • Pg 112	LEVEL II Application	Medium
PQ 2F.13 • PYQ 2024-Sep [1] (c) {C} • 5M • Pg 113	LEVEL II Application	Medium
PQ 2F.14 • RTP 2024-Sep [4] • Pg 115	LEVEL II Application	Medium
PQ 2F.15 • MTP 2024-Nov [2] (a) • 6M • Pg 118	LEVEL II Application	Medium
PQ 2F.16 • PYQ 2025-Jan [3] (b) • 4M • Pg 120	LEVEL II Application	Medium
PQ 2F.18 • PYQ 2025-May [1] (a) {C} • 5M • Pg 123	LEVEL II Application	Medium
PQ 2F.5 • PYQ 2021-Jul [3] • 10M • Pg 98	LEVEL II Application	Hard
PQ 2F.6 • PYQ 2021-Dec [2] • 10M • Pg 100	LEVEL II Application	Hard
PQ 2F.7 • PYQ 2022-May [1] (a) {C} • 5M • Pg 102	LEVEL II Application	Hard
PQ 2F.8 • PYQ 2023-May [2] • 10M • Pg 104	LEVEL II Application	Hard
PQ 2F.17 • RTP 2025-Jan [4] • Pg 121	LEVEL II Application	Hard
PQ 2F.19 • PYQ 2026-May [1] (c) {C} • 5M • Pg 125	LEVEL II Application	Hard
PQ 2F.20 • PYQ 2026-Sep [1] (b) {C} • 5M • Pg 127	LEVEL II Application	Hard

Topic 3: Users and Objectives of Financial Analysis

L2P6-A-C3-T03

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 3, Financial Analysis and Planning - Ratio Analysis, on the users of financial analysis and its objectives.

NOTES

No question is printed against this topic. What the chapter's questions do show is who asks for the analysis and why: **the bank, as lender**, calls for a Financial Soundness Report certified by the company's chartered accountant or auditor, as part of a periodic review and to meet its own internal and regulatory requirements, with the first instalment of a term loan about to fall due.

The lender's concerns are set out as issues, and each maps to exactly one ratio: whether the business **can pay its short-term debts**, whether it can **meet current debt immediately**, whether it can meet the commitment of debt services such as interest and instalments, whether it can meet its interest obligations, whether it can pay the preference dividend, and how many times cash flow before interest and tax covers all fixed financing charges. That group is the **liquidity and solvency interest of a lender**.

The equity investor asks different questions, and the same answer separates them out: the **composition of capital structure** between debt and equity, the profit generated for each share in existence, the market's response to the shareholders' investment, and the expectations of investors about the firm's earnings. Management sits between the two - it is the chief executive who asks the statutory auditor to draft the reply to the bank.

So the objective of the analysis is never the ratio itself but the answer to a named user's question. **Name the user, state the question, then give the ratio**, and where the user has no ideal range in view, report the figure and say so rather than pass a verdict.

Topic 4: Application of Ratio Analysis in Financial Decision Making

L2P6-A-C3-T04

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 3, Financial Analysis and Planning - Ratio Analysis, on applying ratio analysis in financial decision making.

NOTES

No question is printed against this topic, but the chapter's answers show **the decision format the examiner rewards**: a table with one row per issue and columns for the ratio, its numerator, its denominator, the ideal ratio or range, the company's own ratio, and a verdict of **favourable or adverse**. The verdict column is the point of the exercise.

A computed ratio decides nothing on its own. It has to be set against something - an ideal figure, the same company's ratio for the previous year, or the level a lender requires. In the printed report a current ratio of 1.6 against an ideal of 2, and a quick ratio of 0.32 against 1, are both **adverse**, while DSCR at 6.1 against 2 and the three other coverage ratios are all **favourable**. The same company can be weak on liquidity and strong on debt service, and the answer says both.

Where **no ideal exists** - debt-equity, EPS, market value to book value - the printed answer writes '**not applicable**' in the ideal column and still reports the figure. Do the same. Inventing a benchmark costs more than leaving the comparison open.

A second decision form is the effect of a proposed transaction, where you **judge the direction and not the new figure**: improves, declines or unchanged, with one line of reason. A movement between two current items leaves the ratio unchanged; an addition to current assets that does not touch current liabilities improves a ratio already above 1.

The third is comparison over time. Where two years are given the answer computes each ratio for both and sets them side by side - **financial leverage 2.98 against 1.22** - and the comment follows from the direction of the move rather than from the level alone.

Topic 5: Limitations of Financial Ratios

L2P6-A-C3-T05

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 3, Financial Analysis and Planning - Ratio Analysis, on the limitations of financial ratios.

NOTES

No question is printed against this topic, but the chapter's own answers **display the limitations** plainly, and citing them from the printed solutions is the safest way to write this. Four recur.

A ratio has more than one accepted definition. Return on assets is printed four ways in a single answer - on EBIT, on EBIT after tax, on earnings after tax, and on earnings after tax plus interest - and all are shown as acceptable. Return on capital employed is computed **pre-tax and post-tax** in the same answer. Capital gearing is **defined more than one way** and the examiner allows a stated basis. A ratio quoted without its definition tells the reader nothing.

The base changes the answer. Inventory turnover on cost of goods sold and inventory turnover on

sales give different figures from the same accounts, and so does a turnover taken on closing stock rather than average stock. One answer states in terms that stock turnover and fixed asset turnover may be **computed on sales or on cost of goods sold**. The days in the year vary too - 360 in most of these answers, 365 where the question says so.

Ratios rest on assumptions. The printed answers have to assume that all sales are credit sales, that all purchases are credit purchases, and that equity in a long-term-debt-to-equity ratio means shareholders' funds rather than share capital alone. Each assumption changes the figure, and each is written into the answer as a note precisely because it is not derivable from the data.

A ratio needs a benchmark to mean anything. Several ratios in the printed soundness report carry 'not applicable' in the ideal column, so no verdict can be passed on them at all: the figure is reported and left uninterpreted.

Topic 6: Financial Analysis

L2P6-A-C3-T06

Read first Read ICAI Study Material Chapter 3, Financial Analysis and Planning - Ratio Analysis, on preparing and analysing financial statements from given ratios.

NOTES

This topic takes reconstruction one step further: **prepare the statements, not just the ratios** - a trading and profit and loss account, a balance sheet, and in one question two balance sheets a year apart - in the format the question prints. The ratios are the raw material; the statement is the answer.

The two-year question works the earlier year first. **Working capital and the current ratio give current liabilities:** at 2.5:1, $CL = 6,00,000 \div 1.5 = ₹4,00,000$, current assets ₹10,00,000, and stock is current assets less liquid assets. Where the question defines the proprietary ratio as fixed assets over proprietary fund at 0.75, working capital is the remaining 0.25, so fixed assets = $6,00,000 \div 0.25 \times 0.75 = ₹18,00,000$. **Use the definition the question gives**, not the usual one.

For the later year the answer opens a **fixed assets account** and works it down: opening ₹18,00,000, less sale proceeds ₹90,000, less loss on sale ₹90,000 on a book value of ₹1,80,000, less depreciation at **the previous year's rate** of 5%, leaving ₹15,39,000. Profit carries forward, so the profit and loss balance is **the prior balance plus the current year's profit**, ₹2,70,000 + ₹3,45,600 = ₹6,15,600.

Two shortcuts the answers use repeatedly. Where no dividend is mentioned, **the increase in reserves is the year's net profit**, which unlocks sales through the net profit ratio - ₹10,00,000 ÷ 8% = ₹1,25,00,000. And depreciation charged on the opening written down value is grossed up from the closing figure: closing is 85 where opening is 100, so **depreciation = closing × 15 ÷ 85**.

Where the printed format gives a line for every item, **one line is always the balancing figure** - sundry creditors in one answer, long-term debentures in another, cash in a third, outstanding

expenses and provisions in a fourth. Compute everything you can, put the balancing figure in last, and **check that both sides total**.

Read the small print in the question data. Where prepaid expenses are shown **net inside current liabilities**, the answer adds them back before applying the current ratio, ₹45,00,000 + ₹7,50,000 = ₹52,50,000. Where the cash balance is given as a period of cost of goods sold, convert it - **1.5 months of COGS** is $\text{COGS} \div 12 \times 1.5$. And close with the assumptions: all sales credit, all purchases credit, and turnover ratios computable on sales or on cost.

Application use the rule - work the problem - 5 questions

- Complete the earlier year before you touch the later one. The later year's opening balances are the earlier year's closing figures, and nothing in the second column works without them.
- Open a ledger account for fixed assets whenever a disposal, a loss on sale or a depreciation rate appears. That account is the working the examiner marks.

PQ 6.1 · MTP 2024-Dec S2 [1] (a) · 5M · Pg 128	LEVEL II Application	Medium
PQ 6.3 · RTP 2025-May [4] · Pg 135	LEVEL II Application	Medium
PQ 6.4 · MTP 2025-Aug S2 [1] (b) · 5M · Pg 139	LEVEL II Application	Medium
PQ 6.5 · MTP 2025-Dec S2 [1] (a) · 5M · Pg 140	LEVEL II Application	Medium
PQ 6.2 · MTP 2025-Apr S2 [3] (a) · 8M · Pg 131	LEVEL II Application	Hard

SECTION A · FINANCIAL MANAGEMENT · CHAPTER 4

Cost of Capital

10 Topics · 39 Classified Questions · Importance: B

ICAI SKILL PROFILE ICAI band for Financial Management: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge

3.6%

8 of 225 marks

Level II — Analysis & Application

96.4%

217 of 225 marks

Below this Section's Level I floor: only 4% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for Financial Management. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Meaning of Cost of Capital

L2P6-A-C4-T01

Read first Read ICAI Study Material Chapter 4, Cost of Capital, on the meaning of cost of capital and why it matters to decision-making.

NOTES

Cost of capital is **the return expected by the providers of capital** - shareholders, lenders and debt-holders - as compensation for their contribution to the total capital. Open with that sentence, exactly there. The printed answer then adds that a correct cost of capital helps the management or an investor take an appropriate decision, and that line is the bridge into the list of uses the second half of the question asks for.

The uses the printed answer names, in this order, are **evaluation of investment options**, financing decision and designing of optimum credit policy. Name all three as headings before you explain any of them. The question asks for three reasons and the marks follow the count, so a fourth reason of your own adds nothing while a missing third costs a mark.

Evaluation of investment options: the estimated future cash flows from an available opportunity are converted into the present value of benefits by discounting them at the relevant cost of capital. The answer presses one point here - **every investment option may have a different cost of capital** - so you must use the rate relevant to the option in hand rather than one company-wide figure.

Financing decision: where the manager has to choose between two sources of finance, he compares their cost and takes the lower. The answer adds that besides cost he also considers **financial risk and control**. Write that clause. It is the half of the reason most students drop, and it is what distinguishes the financing head from the investment head.

Designing of optimum credit policy: while appraising the credit period to be allowed to customers,

the cost of allowing that credit is compared against the benefit or profit earned from the customer or segment, with cost of capital used to bring **both cost and benefit to present value**.

The trap: the question is framed round a company buying machinery, so students open with investment appraisal. Give **the definition first**, then the three headed reasons, each tied back to the company by name in half a sentence. A scenario-framed question still wants the textbook list; the scenario earns the framing, not a different answer.

Understanding explain it, and place it in context · 1 question

- Define cost of capital in one line as the return expected by the providers of capital, then move to the uses.
- Mention the company named in the question once under each head. That is all the scenario asks for.

TQ 1.1 · MTP 2025-Dec S2 [4] (b) · DESC · 4M · Pg 146

LEVEL I
Understanding

Medium

Topic 2: Significance of Cost of Capital

L2P6-A-C4-T02

Read first Read ICAI Study Material Chapter 4, Cost of Capital, on the significance of cost of capital.

NOTES

This is the same list as the meaning topic with a different middle item: the significance answer names evaluation of investment options, **performance appraisal** and designing of optimum credit policy. Learn both trios. Whichever wording the question uses, the shape of a four-mark answer is three named heads with two lines under each.

Under evaluation of investment options this answer carries one extra line that the meaning answer does not: **IRR is treated as cost of capital** when two options or projects are being evaluated. Everything else in the head is identical - future cash flows discounted to present value, and a different cost of capital possible for each option.

Performance appraisal: cost of capital is used to appraise the performance of a particular project or business, and the performance is compared against it. The answer gives the rate two names here, **cut-off rate or hurdle rate**. Write both; the examiner is looking for the label as much as the explanation.

Designing of optimum credit policy is worded the same in both answers - the cost of allowing a credit period set against the benefit or profit earned by providing credit - with cost of capital used to reach **the present value of cost and benefits received**.

The trap: this is a four-mark descriptive question and it is over in half a page. **Three heads, two lines each** is the whole answer. A long essay on what cost of capital is scores the opening sentence

and nothing more, because there is no head to hang the rest of the marks on.

Understanding explain it, and place it in context · 1 question

- Use the words cut-off rate and hurdle rate when you explain performance appraisal.
- Keep each head to two lines. The mark scheme has no room for more.

TQ 2.1 · PYQ 2019-Nov [6] (c) · DESC · 4M · Pg 147

LEVEL I
Understanding

Medium

Topic 3: Determination of Cost of Capital

L2P6-A-C4-T03

Read first Read ICAI Study Material Chapter 4, Cost of Capital, on determining the cost of each individual source of finance.

NOTES

A determination question hands you a capital structure and asks for the component costs one by one. Take them in the order the question numbers them. $K_e = R_f + \beta (R_m - R_f)$ wherever CAPM data is given; K_p and K_d by the approximation formula, or by YTM where the question names that method. Each component is a separate headed working, not a line inside a table.

The approximation formula the answers use throughout is $K_d = [I(1-t) + (RV-NP)/n] \div [(RV+NP)/2]$, where I is the interest payment, NP the net proceeds, RV the redemption value and n the remaining life of the instrument. For a preference share the same shape runs with PD in place of $I(1-t)$, because **preference dividend carries no tax shield**.

The YTM route is a small NPV table: year 0 the net proceeds or market price as an outflow, years 1 to n the interest, year n the redemption value, all discounted at two chosen rates. Then $IRR = L + [NPVL \div (NPVL - NPVH)] \times (H - L)$. The 2025-May answer runs the preference share at 10% and 14%, gets +48.82 and -48.66, and reads off 12%.

The harder variant reverses the arithmetic: the overall cost of capital is given and one interest rate is hidden. Let the debenture rate be x , express every component cost in terms of x , build the ordinary weight and cost table, and **set the total equal to the given cost of capital**. One equation, one unknown. The 2025-May answer reached $x = 12\%$, so K_d on debentures was 9.39% and the bank loan rate $1.3 \times 12 = 15.60\%$.

The RTP variant gives you WACC on book weights and on market weights and works backwards to the components. Write $0.5X + 0.5Y = 11$ and $0.75X + 0.25Y = 12.5$ and solve the pair: K_e is 14% and post-tax K_d is 8% . Two conversions matter there - 150 basis points means 1.5% , and equity at three times book value turns 50:50 book weights into 0.75 and 0.25.

With post-tax K_d known, the tax rate falls out of **post-tax K_d = pre-tax K_d (1 - T)**, and beta falls out

of the CAPM relation read backwards. Where two comparable securities are correctly priced on the same line, subtract one CAPM equation from the other: the risk-free rate cancels and the market risk premium is left, 6% in that answer, giving R_f of 8% and R_m of 14%.

The trap the answers correct: **flotation cost reduces NP, not RV**. Flotation of ₹4 on a ₹100 debenture makes NP ₹96 and leaves RV at ₹100. Netting it off redemption instead throws out the whole component and, in a reverse question, the interest rate you solve for as well.

Application use the rule - work the problem - 2 questions

- Answer the components in the numbered order the question sets, each under its own heading, even where a later part supplies a figure an earlier one needed.
- Write the formula, then substitute, then state the percentage. The method mark sits on the formula line, not on the answer.

PQ 3.2 · RTP 2026-May [5] · Pg 151

LEVEL II
Application

Medium

PQ 3.1 · PYQ 2025-May [2] (a) · 8M · Pg 149

LEVEL II
Application

Hard

Topic 4: Cost of Long Term Debt KD

L2P6-A-C4-T04

Read first Read ICAI Study Material Chapter 4, Cost of Capital, on the cost of long term debt, including redeemable and convertible debentures.

NOTES

Two methods, and the question always names the one it wants. Approximation: $K_d = [I(1-t) + (RV - NP)/n] \div [(RV + NP)/2]$. Present value, YTM or IRR method: discount the actual cash flows at two rates and interpolate with $IRR = L + [NPVL \div (NPVL - NPVH)] \times (H - L)$. The two give different figures, so never offer one when the other was asked for.

Interest enters net of tax as $I(1-t)$ in both methods - ₹10 at 25% tax is ₹7.5 in every row of the NPV table - while the redemption value is left untouched. Where the question gives a current market price for the debenture, **that price is the year 0 outflow**, not the face value; the 2026-May answer starts its column at ₹85 and the 2024-Sep answer at ₹80.

For a convertible debenture the redemption value is **the higher of cash redemption value and conversion value**, and the answers say which is higher in words before computing anything. Conversion value is shares per debenture times the share price grown to maturity, $P_n = P_0 (1 + g)^n$. In the 2020-Nov answer ₹121.67 beat the ₹100 cash option and became RV; in the 2026-May answer ₹112.25 beat redemption at ₹105.

Where only part of the holding converts, the answers compute **a separate Kd for each group** and stop there - they do not blend the two. In the 2025-Apr answer 75% converted at intrinsic value plus a 5% premium, giving RV of `160.80 and Kd of 15.08%; the other 25% redeemed at a 25% premium with 2% redemption cost added on top of the premium, a gross RV of `127.50 and Kd of 11.43%.

Where the growth rate is not given it is derived from the dividend history: $8.03 = 5(1+g)^7$ gives a factor of 1.606, which the printed FVIF table reads as $g = 7\%$. Use the table supplied with the question rather than logarithms - the tables are printed precisely so the factor can be matched by eye.

The reverse question gives Kd and asks for the issue price. Put NP as the unknown in the approximation formula and solve the linear equation; the 2025-Sep answer reached **NP = `90**. Then re-run the same formula unchanged with the revised RV for the second part, `110 against `90, to get 15.1%.

The trap: **n is the remaining life, not the original tenure**, and NP is net of flotation cost while RV is not. Read the issue date and the balance sheet date before you fill either in - a debenture issued for six years and examined one year on has five years to run.

Application use the rule - work the problem · 4 questions

- State which method the question named before you compute. Approximation and YTM give different figures and only the named one is marked.
- Lay the NPV table out as year, cash flow, factor at the low rate, PV, factor at the high rate, PV. The interpolation line then writes itself.

PQ 4.1 · PYQ 2020-Nov [1] (d) {C} · 5M · Pg 155	LEVEL II Application	Medium
PQ 4.2 · MTP 2025-Apr S2 [1] (b) · 5M · Pg 156	LEVEL II Application	Medium
PQ 4.3 · PYQ 2025-Sep [3] (b) · 3M · Pg 159	LEVEL II Application	Medium
PQ 4.4 · PYQ 2026-May [1] (b) {C} · 5M · Pg 160	LEVEL II Application	Medium

Topic 5: Cost of Preference Share Capital KP

L2P6-A-C4-T05

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 4, Cost of Capital, on the cost of preference share capital.

NOTES

No question is printed on this topic alone, but **Kp appears in almost every WACC question** in the chapter, so it is examined constantly at second hand. Two forms cover everything the answers do, and which one you use depends on a single word in the question: redeemable or irredeemable.

Irredeemable: $K_p = PD \div P_0$, the preference dividend over the price. The answers apply it to issue price or to current market price and, where the question gives both, present both as alternatives - `8 on an issue price of `45 gives 17.78%, the same `8 on a market price of `55 gives 14.55%, and the WACC is shown twice accordingly.

Redeemable, approximation method: $K_p = [PD + (RV - NP)/n] \div [(RV + NP)/2]$. RV is the redemption value including any premium, NP is the issue price net of discount and flotation cost, and n is the remaining life. The 2025-Jan answer takes `100 less 2% discount less 5% flotation to reach NP of `100.55 against RV of `110.

Redeemable, YTM method: $P_0 = PD \times PVAF(r, n) + RV \times PVIF(r, n)$, solved by taking NPV at two rates and interpolating, exactly as for a debenture. The 2022-May answer runs it at 3% and 5% on a ten-year preference share and lands on 4.60%.

The single trap across the whole chapter: **preference dividend gets no tax shield**. Kp never carries a (1-t). Every WACC table in the pack puts Kp in undisturbed while Kd goes in after tax, and an answer that grosses Kp down by the tax rate loses that component and the WACC line built on it.

Adjust the price before you divide. A cum-dividend quotation must have **the dividend stripped out first** - `18 cum-dividend less a `2 dividend gives a market price of `16 - and a discount on issue or a flotation cost comes off the issue price to reach NP. The number of preference shares for the weights then follows from book value divided by face value.

Topic 6: Cost of Equity Share Capital KE

L2P6-A-C4-T06

Read first Read ICAI Study Material Chapter 4, Cost of Capital, on the cost of equity share capital and the methods of computing it.

NOTES

Four methods, and a question can ask for any of them by name: **dividend price approach** ($K_e = D_1 \div P_0$), **earning/price approach** (K_e based on the expected rate of earnings over market price), **realized yield approach** (the average return realised over the past few years taken as the expected future return), and **CAPM**, $K_e = R_f + \beta (R_m - R_f)$. Name all four before explaining any; a question asking for four methods is marked on the count.

Dividend price approach in the answer's own words: cost of equity is computed by **dividing the**

expected dividend by the market price per share, and the ratio expresses the cost in relation to what yield the company should pay to attract investors. D_1 is the dividend per share in period 1, P_0 the market price per share today. The earnings price approach correlates the earnings of the company with the market price of its share and, the answer adds, **seeks to nullify the effect of changes in dividend policy**.

Where a growth rate is given the answers use $K_e = D_1/P_0 + g$ and call it the Dividend Discount Model or Gordon's model. Where only a dividend just paid is given, gross it up first as $D_1 = D_0 (1 + g)$; where a flotation cost per share is given, the denominator becomes $P_0 - F$. Reading a paid dividend as an expected one is the commonest slip in this topic.

The growth-rate-change question is a fixed chain of five steps. $g = b \times r$ gives the new growth rate; the old g run backwards through the same relation gives the old retention ratio and so the old payout; $EPS = D \div \text{payout ratio}$; the new payout applied to that EPS gives the new D_1 ; and $K_e = D_1/P_0 + g$. The 2025-Sep answer moved 9.72% to 9.18%, the 2025-Dec answer 9.80% to 9.68%.

The distinguish-between question on risk runs on three bases in this order. **Meaning:** systematic risk is the macro-economic or market-specific risk under which a company operates, unsystematic is company-specific and relates to the company's own performance. **Nature:** uncontrollable against controllable. Reduction or elimination: systematic risk **cannot be reduced by diversification and is non-diversifiable**, unsystematic risk can be, by diversifying the securities portfolio.

Where two correctly priced securities are given with their betas and expected returns, write the CAPM relation for each and treat them as simultaneous equations. **Subtracting one from the other eliminates R_f** and leaves the market risk premium, because the difference in expected returns is the difference in betas times the premium. Substitute back for R_f , then $R_m = R_f + \text{premium}$.

Answer the parts in the order asked even though the premium falls out first.

Application use the rule - work the problem · 3 questions

- Check whether the dividend given is just paid or expected. If just paid, multiply by one plus g before dividing by price.
- Deduct flotation cost from the price, not from the dividend.

TQ 6.3 · RTP 2025-Jan [11] (b) · DESC · Pg 162

LEVEL II
Application

Medium

PQ 6.1 · RTP 2025-Sep [8] · Pg 164

LEVEL II
Application

Medium

PQ 6.3 · PYQ 2026-Sep [2] (b) · 3M · Pg 166

LEVEL II
Application

Medium

Analysis break it down and take the parts separately · 4 questions

- Where retention and return on retained earnings change, recompute the dividend as well as the growth rate. Changing g alone is the common half-answer.

TQ 6.1 · MTP 2019-Mar [6] (c) · DESC · 2M · Pg 161	LEVEL II Analysis	Easy
TQ 6.4 · MTP 2026-Apr S2 [4] (c) · DESC · 2M · Pg 163	LEVEL II Analysis	Easy
PQ 6.2 · MTP 2025-Dec S2 [3] (b) · 3M · Pg 165	LEVEL II Analysis	Easy
TQ 6.2 · PYQ 2020-Nov [6] (c) · DB · 2M · Pg 162	LEVEL II Analysis	Medium

Topic 7: Cost of Retained Earning KR

L2P6-A-C4-T07

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 4, Cost of Capital, on the cost of retained earnings.

NOTES

No standalone question is printed, but retained earnings sit in the WACC table of most questions in this chapter, so the rule has to be automatic: **Kr = Ke**. The 2026-Apr answer states it flatly, the 2019-Nov answer repeats it, and the 2025-May answer supplies the reason - **in the absence of information on opportunity cost**.

Where the question gives a rate of personal income tax, and only then, the answers reduce it: **Kr = Ke (1 - tp)**. The 2024-May answer takes Ke of 18.32% and a personal tax rate of 20% to reach **14.656%**. Without a personal tax rate in the question, make no adjustment at all - the corporate tax rate has nothing to do with it.

In a book value WACC table retained earnings appear as **their own row at the same cost as equity**. The 2026-Apr answer weights equity at 0.3 and retained earnings at 0.2 and costs both at 21.8%. Keep them on separate rows; merging them loses the weighting mark even though the WACC total is unchanged.

On market value weights the treatment differs and the answers say so expressly: the market value of reserves and surplus is **already included in the market value of equity**. Where an answer still shows them on two rows, it splits the single equity market value in the book value proportion rather than putting a price on reserves.

In the marginal cost questions retained earnings set the ceiling on cheap finance: **retained earnings ÷ equity's proportion of total capital** is the amount that can be spent before new shares must be sold. Beyond that point Ke is recomputed on the new issue price, so the cost of retained earnings and the cost of fresh equity are no longer the same number.

Topic 8: Weighted Average Cost of Capital (WACC)

L2P6-A-C4-T08

Read first Read ICAI Study Material Chapter 4, Cost of Capital, on the weighted average cost of capital and book value against market value weights.

NOTES

The formula the answers write is **$WACC = W_d K_d(1-T) + W_p K_p + W_e K_e$** , and the working is always the same table: source, amount, weight, after-tax cost, product. **Weights total 1.00** and the product column totals the WACC. Build every component cost as a numbered working note above the table and never inside it; the working notes are marked separately from the table.

Book value weights take the capital structure as given. **Market value weights are price times number of units**, and the number of units comes from book value divided by face value - `6,00,000 of `100 debentures is 6,000 debentures carried at their market price. Read which basis the question names. Several questions ask for both, and the 2026-Apr answer shows 15.5% on book weights against 14.88% on market weights.

Adjust the quoted prices before you weight anything. A **cum-dividend price less the dividend** gives the preference market price, `18 less `2 makes `16. Debentures quoted at **120 per cent ex-interest** are `120. A flotation cost per share comes off the price in the K_e denominator, not off the market value used for the weights.

K_e reaches the table by whichever route the data allows, and the answers switch freely: **$D_1/P_0 + g$** where a dividend and a growth rate are given, **$R_f + \beta(R_m - R_f)$** where CAPM data is given, and **$K_e = 1 \div P/E \text{ ratio}$** where only a P/E multiple is printed - a P/E of 4 gives 25%, a P/E of 6.667 gives 15%. Where the question simply states K_e , use it as given and say so.

The expansion variant asks for WACC before and after the new borrowing. Recompute K_e on **the new dividend and the fallen share price** - the price falls because investors' required return has risen - add the new loan or debenture as its own row at its own cost, and re-weight on the enlarged total. The 2023-May answer moved from 18.40% to 16.76% on book weights.

The reverse variant gives the WACC and hides an interest rate. Set the debenture rate as x , express K_d on the debentures and on the bank loan in terms of x , fill the product column with x still in it, and **set the column total equal to the given WACC**. The 2024-Mar answer solved to $x = 8.20\%$ and then $1.4x = 11.48\%$ for the bank loan.

Where the question compares financing options, the answers run four steps in order: **net proceeds after flotation** and the resulting share count, **interest coverage ratio against the covenant**, EPS under each option, then WACC under each. The verdict is explicit - **mixed financing is recommended** because it complies with the covenant, gives a higher EPS than the debt option and a lower WACC than the equity option. Debt alone had the lowest WACC at 8.4% and still failed on an ICR of 2.45 against a minimum of 2.5.

Application use the rule - work the problem - 14 questions

- Compute every component cost as a numbered working note first, then fill one table. The notes carry marks of their own.
- Put the basis in your table heading - book value weights or market value weights. An answer on the wrong basis loses the weighting marks even when the costs are right.

PQ 8.2 • PYQ 2021-Dec [1] (b) {C} • 5M • Pg 170	LEVEL II Application	Medium
PQ 8.3 • PYQ 2022-Nov [1] (c) {C} • 5M • Pg 171	LEVEL II Application	Medium
PQ 8.7 • RTP 2024-Sep [5] • Pg 180	LEVEL II Application	Medium
PQ 8.8 • MTP 2024-Nov [1] (b) {C} • 5M • Pg 182	LEVEL II Application	Medium
PQ 8.9 • RTP 2025-Jan [5] • Pg 184	LEVEL II Application	Medium
PQ 8.10 • RTP 2025-May [5] • Pg 186	LEVEL II Application	Medium
PQ 8.11 • PYQ 2025-Sep [1] (a) {C} • 5M • Pg 190	LEVEL II Application	Medium
PQ 8.12 • RTP 2025-Sep [6] • Pg 191	LEVEL II Application	Medium
PQ 8.13 • MTP 2025-Nov S1 [1] (a) • 5M • Pg 195	LEVEL II Application	Medium
PQ 8.1 • PYQ 2021-Jan [4] • 10M • Pg 167	LEVEL II Application	Hard
PQ 8.4 • PYQ 2023-May [4] • 10M • Pg 173	LEVEL II Application	Hard
PQ 8.5 • MTP 2024-Mar [3] (a) • 8M • Pg 176	LEVEL II Application	Hard
PQ 8.6 • PYQ 2024-Sep [2] (a) • 8M • Pg 177	LEVEL II Application	Hard
PQ 8.14 • MTP 2026-Apr S2 [3] (a) • 7M • Pg 196	LEVEL II Application	Hard

Topic 9: Marginal Cost of Capital

L2P6-A-C4-T09

Read first Read ICAI Study Material Chapter 4, Cost of Capital, on the marginal cost of capital and the level of finance at which it changes.

NOTES

Marginal cost of capital is the weighted cost of the next rupee raised. Use the **specific costs of the new issues** with the existing capital structure weights, which the question always describes as optimum, and lay it out as the same proportion, specific cost and product table you use for WACC. The weights do not change; only the costs do.

The specific costs come off the new terms, not the old ones: $K_d = I(1-t) \div P_0$ on the current market price of the debenture, $K_p = PD \div \text{net price}$ at which the new preference shares can be sold, and $K_e = D_1/P_0 + g$ with equity treated as coming from retained earnings. The 2022-Nov answer gave 10.9375%, 13.1148% and 15%, and a marginal cost of 14.3%.

D1 in these questions is defined off EPS, not taken from elsewhere: **next year's DPS is 50% of the stated year's EPS**, so EPS of `2.50 gives D1 of `1.25 and EPS of `2.36 gives `1.18. Read which year's EPS the question points at; it is usually the year before the balance sheet date.

Where a uniform trend of EPS is printed over ten years, the growth rate comes from $(EPS_2 - EPS_1) \div EPS_1$. The 2025-Aug answer reads 10% straight off `1.00 rising to `1.10 and uses no other year. One adjacent pair is enough precisely because the trend is uniform.

The second half of the question is always the break point: **retained earnings $\div$ equity's proportion of total capital**. Retained earnings of `62,500 on an 80% equity proportion gives `78,125 that can be spent before new equity must be sold; `11,800 on the same proportion gives `14,750. Show the retained earnings figure as 50% of EPS times the number of shares first.

Past the break point, recompute K_e on the new issue price and rebuild the whole table. In the 2025-Aug answer `1.18  $\div$  `25 + 0.10 gave 14.72% against 16% from retained earnings, so **the marginal cost fell to 13.63%** - the issue price of `25 was above the market price of `19.67, which is why the cost went down rather than up.

Application use the rule - work the problem - 2 questions

- Show the three specific costs as separate numbered steps before the marginal cost table. Each carries its own mark.
- State the break point as an amount in rupees with the division shown, not just as the ratio.

PQ 9.2 · MTP 2025-Aug S2 [1] (c) · 5M · Pg 200

LEVEL II
Application

Medium

PQ 9.1 · PYQ 2022-Nov [5] (b) · 6M · Pg 198

LEVEL II
Application

Hard

Topic 10: Comprehensive Questions

L2P6-A-C4-T10

Read first Read ICAI Study Material Chapter 4, Cost of Capital, on comprehensive problems combining component costs, slab-rate debt and the cost of additional finance.

NOTES

The standard comprehensive question raises additional finance in a stated debt to equity ratio and asks four things in order: **the pattern of finance**, the post-tax average cost of the additional debt, the cost of equity and retained earnings, then **the overall weighted average cost of the additional finance**. Answer under those four headings in that order; the marks are split across them fairly evenly.

Set the pattern out as a short capital structure statement before you compute anything. Equity is the ratio share of the total, and **retained earnings come out of the equity share**, not on top of it - `3.75 crore of equity with `1 crore of retentions leaves `2.75 crore of fresh equity capital. Debt is then split across its slabs as separate lines, and the lines total the amount to be raised.

Slab-rate debt is averaged by amount, never by simple mean: **average $K_d = \sum (\text{slab } K_d \times \text{slab weight})$** , the slab weight being that slab's amount over total debt. The 2021-Jul answer weights 7%, 6.30% and 5.60% in the ratio 5:5:10 to reach 6.125%. The 2019-Nov answer does the same on two slabs to reach 8.1%.

Read whether each slab rate is before or after tax. The 2023-Nov question gives 8% and 10% before tax and **12% after tax**, and the answer applies $(1-t)$ to the first two only. That is the single most-corrected slip in this topic, and it moves the average cost of debt and therefore the final WACC.

For K_e the answers use the dividend growth model and state expressly which dividend they hold. The 2021-Jul answer notes **DPS is treated as D_0** and multiplies by $(1+g)$; the 2019-May answer takes D_1 as EPS times the payout ratio. Where a retention ratio is given instead, **$D_0 = (1 - \text{retention}) \times \text{EPS}$** and EPS is total earnings over the number of shares. Throughout, **$K_r = K_e$** .

The cut-off-rate variant costs each slab of the whole project, not just the debt in it. Build K_o for each slab from the debt and equity rates applying in that slab, then **cost each tranche at its own K_o** , then divide total cost by total capital. The 2024-Jul answer priced `15 lakh at 12.95% and `26 lakh at 13.79% that way.

That variant ends in a decision, and the sentence is the last mark. A project returning 13% after tax is acceptable only where its **overall cost of capital is 13% or less**, because at 13% it merely breaks even. So Project I at 12.95% is accepted and Project II at 13.79% is rejected, and interpolating between the two gives the largest project that still breaks even, **`15.65 lakh**.

Application use the rule - work the problem - 8 questions

- Write out the capital structure after raising the finance as a statement before computing any cost. Several marks sit in that statement alone.
- Label every rate as before tax or after tax as you lift it out of the question, and carry the label into your working.

PQ 10.7 • MTP 2024-Jul [1] (b) {C} • 5M • Pg 215	LEVEL II Application	Medium
PQ 10.2 • PYQ 2019-Nov [5] • 10M • Pg 204	LEVEL II Application	Hard
PQ 10.3 • PYQ 2021-Jul [2] • 10M • Pg 206	LEVEL II Application	Hard
PQ 10.4 • PYQ 2022-May [5] • 10M • Pg 208	LEVEL II Application	Hard
PQ 10.5 • PYQ 2023-Nov [4] • 10M • Pg 210	LEVEL II Application	Hard
PQ 10.6 • PYQ 2024-May [2] (a) • 6M • Pg 213	LEVEL II Application	Hard
PQ 10.8 • PYQ 2025-Jan [2] (a) • 7M • Pg 217	LEVEL II Application	Hard

SECTION A · FINANCIAL MANAGEMENT · CHAPTER 5

Financing Decisions - Capital Structure

6 Topics · 38 Classified Questions · Importance: B

ICAI SKILL PROFILE ICAI band for Financial Management: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge

6.9%

14 of 203 marks

Level II — Analysis & Application

93.1%

189 of 203 marks

Below this Section's Level I floor: only 7% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for Financial Management. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Meaning of Capital Structure

L2P6-A-C5-T01

Read first Read ICAI Study Material Chapter 5, Financing Decisions - Capital Structure, on the meaning of capital structure and the factors behind the choice of source and quantum of capital.

NOTES

Capital structure is the mix of long-term sources a firm funds itself with. The only question printed on the meaning asks for the **factors considered in deciding the source and quantum of capital**, and the printed answer names three, each with one line of reason. Nothing else is wanted.

The three, in the order the answer gives them. **Control** - the structure should be designed so that existing shareholders continue to hold the majority stake. **Risk** - it should be designed so that the financial risk of the company does not rise beyond the tolerable limit. **Cost** - the overall cost of capital should remain minimum.

This is a two-mark question, so the shape is three headings and a sentence each. **Marks follow the number of factors named**, not the length of the explanation. Do not drift into the theories of capital structure; that is a different topic and earns nothing here.

Remembering reproduce what you have learnt · 1 question

- Name Control, Risk and Cost before you explain any of them, then give the one-line reason the answer gives for each.

TQ 1.1 · PYQ 2022-Nov [6] (Or) (c) · DESC · 2M · Pg 222

LEVEL I
Remembering

Easy

Topic 2: Capital Structure Theories

L2P6-A-C5-T02

Read first Read ICAI Study Material Chapter 5, Financing Decisions - Capital Structure, on the capital structure theories - Net Income, Net Operating Income, Traditional, Modigliani-Miller with and without tax, and Pecking Order.

NOTES

Under the **Pecking Order theory** the structure decision follows the manager's preference for the source that reveals the least information. The hierarchy is fixed and the marks follow it: **Rule 1, use internal finance first**; Rule 2, issue debt next - secured, unsecured or hybrid; Rule 3, issue new equity shares last. It exists to minimise the cost of capital, keep financial control and avoid negative market signals. Firms issue debt when positive about future earnings and equity when doubtful.

The **Net Income approach** is three lines. Market value of equity = $(\text{EBIT} - \text{Interest}) \div K_e$; add the market value of debt to get the value of the firm; then $K_o = \text{EBIT} \div \text{Value of the firm}$. On EBIT ₹3,00,000, interest ₹1,00,000 and a capitalisation rate of 12.5% the answer reaches equity ₹16,00,000, firm ₹26,00,000 and an overall cost of 11.54%.

The **Traditional approach** question gives several levels of debt, each with its own K_d and K_e , and asks which to recommend. Build one column per option: EBIT, less interest, earnings available to equity holders, divided by the equity capitalisation rate to get the market value of equity, plus the given market value of debt, giving total market value; then overall cost = $\text{EBIT} \div \text{total market value}$. **Recommend the option whose overall cost of capital is minimum**, and write that sentence out.

MM without tax holds the two firms equal in value, so where the levered firm is worth more the investor arbitrages. Three steps, always in this order: value both firms (equity = earnings available to equity $\div K_e$, plus debt); sell the holding in the levered firm and **borrow the same percentage of the levered firm's debt**; buy shares in the unlevered firm with the whole amount and compare the new income, net of interest on the personal borrowing, with the old. **The incremental income is what the question asks for.**

MM with tax runs backwards from the given market value. First **Net income to equity = Market value $\times K_e$** , then $\text{EBIT} = \text{that net income} \div (1 - t)$. Only then write the two income columns, all-equity and equity-plus-debt, down to income available to equity holders. The value of the levered firm is the value of the unlevered firm plus the tax shield, $V_l = V_u + (t \times \text{Debt})$ - the tax rate times the amount of debt, never times the interest.

After the restructuring, **equity value = levered value less the equity repurchased**, and $K_e = \text{income available to equity} \div \text{that equity value}$. Cost of debt after tax is $I(1 - t)$. Set out the WACC table with amount, cost, weight and product. The examiner wants the impact in three sentences: market value up by the tax shield, **overall cost down**, cost of equity up because of the financial risk introduced. The formulae $K_o = K_{eu}[1 - (t \times L)]$ and $K_e = K_{eu} + (K_{eu} - K_d) \times \text{Debt}(1 - t) \div \text{Equity}$ reach

the same figures and the answers print both routes.

The trap the answers correct most often is the order of deduction: **interest comes out before tax**, so earnings available to equity in a levered firm are EBIT less interest, then taxed. Taxing first and deducting interest afterwards gives a tidy wrong figure. Under the net operating income approach, learn the reason the answer gives for the equal values - **equity capitalisation is a linear function of the debt-equity ratio**, so the decline in required equity return exactly offsets the loss of cheaper debt.

Understanding explain it, and place it in context • 1 question

- Name the theory before you use it. A pecking order answer is the three rules plus the reason the hierarchy exists; an NOI answer is the linear relation between the equity return and the debt-equity ratio.
- Where a question asks for the impact on value, cost of capital and cost of equity, answer in three separate labelled parts with the direction of change stated in each.

TQ 2.1 • PYQ 2025-May [4] (c) • DESC • 2M • Pg 223

LEVEL I
Understanding

Easy

Application use the rule - work the problem • 10 questions

- Work out EBIT from the given market value and K_e before anything else. Every later figure depends on it, and questions that look unsolvable are usually this step missing.
- State the formula, substitute, then state the impact in rupees or percentage points. A figure with no sentence on the impact loses the last mark.

PQ 2.1 • PYQ 2018-May [1] (a) {C} • 5M • Pg 224	LEVEL II Application	Medium
PQ 2.3 • MTP 2021-Oct [1] (a) {C} • 5M • Pg 227	LEVEL II Application	Medium
PQ 2.4 • PYQ 2022-Nov [5] (a) • 4M • Pg 228	LEVEL II Application	Medium
PQ 2.5 • PYQ 2023-May [1] (d) {C} • 5M • Pg 230	LEVEL II Application	Medium
PQ 2.6 • PYQ 2024-May [2] (b) • 4M • Pg 231	LEVEL II Application	Medium
PQ 2.7 • PYQ 2025-May [3] (b) • 4M • Pg 232	LEVEL II Application	Medium
PQ 2.8 • MTP 2024-Dec S2 [1] (b) • 5M • Pg 235	LEVEL II Application	Medium
PQ 2.9 • MTP 2025-Dec S2 [1] (b) • 5M • Pg 235	LEVEL II Application	Medium

PQ 2.10 · RTP 2026-Jan [7] · Pg 236

LEVEL II
Application

Medium

PQ 2.11 · PYQ 2026-Sep [2] (a) · 7M · Pg 238

LEVEL II
Application

Hard

Analysis break it down and take the parts separately · 1 question

- In an arbitrage question, value both firms first and say plainly which is overvalued before you move a single rupee of the investor's holding.
- Where two firms differ only in gearing, set the two columns side by side and explain the difference in the required equity return by reference to the debt used.

PQ 2.2 · PYQ 2021-Jan [3] · 10M · Pg 226

LEVEL II
Analysis

Hard

Topic 3: Factors Determining Capital Structure

L2P6-A-C5-T03

Read first Read ICAI Study Material Chapter 5, Financing Decisions - Capital Structure, on the factors determining capital structure and the choice between debt and equity for an expansion.

NOTES

The theory question asks what you would evaluate before raising funds by debt, equity or a mix. The printed answer names four: **cost of capital** - debt is cheaper for its tax shield, but excess debt raises financial risk; **control** - equity dilutes ownership, debt does not; current interest rates and market conditions; and **cash flow stability** - stable cash flows can safely carry debt. Close as the answer closes: stable earnings plus a wish to retain control favour a mix with a reasonable portion of debt.

Every practical question here is an expansion financed two ways, and the EBIT after expansion is usually not given. The answers say so expressly and assume that **existing return on capital employed is maintained**: compute ROCE as $\text{EBIT} \div \text{capital employed}$ on the existing figures, then apply it to the enlarged base, so that **proposed EBIT = new capital employed × ROCE**. State that assumption in a line of its own before you use it, because every printed answer states it.

Capital employed is equity share capital plus reserves and retained earnings plus debt, and where only the interest figure is given, the debt is **interest ÷ rate** - `1,20,000 at 12% is `10,00,000 of debentures. This line is the foundation of the whole question; get it wrong and every figure that follows is wrong.

Then one column per plan, in this order: EBIT, less existing interest, less new interest, EBT, less tax, PAT, less preference dividend, earnings for equity shareholders, ÷ number of shares, EPS. **New shares = funds raised ÷ market price**, added to the existing count. Where the rate is slab-wise, split the borrowing across the slabs and show each line of interest separately.

The twist these questions carry is a **debt-equity threshold that changes the P/E ratio**. Compute the ratio on the definition the question gives - some use $\text{Debt} \div \text{Shareholders' funds}$, others $\text{Debt} \div (\text{Debt} + \text{Equity})$ - state which side of the limit each plan falls, and apply the P/E ratio that follows. Then **$\text{MPS} = \text{EPS} \times \text{P/E ratio}$** .

Answer the question actually asked. Where the objective is market price, **the plan with the higher EPS can still lose**: in the K Textiles answer the loan option gives EPS `2.053 against `1.911 but a market price of `16.42 against `19.11 once the P/E ratio drops to 8. Where the question asks whether to expand at all, compare the post-expansion EPS with the **existing EPS** before recommending the source.

One question in this topic is of a different kind - **external funds requirement**. $\text{EFR} = \text{additional assets required less the earnings ploughed back}$, where additional assets are $(\text{total assets less payables and provisions}) \times \text{the growth in sales}$, both varying directly with sales. Then meet it in the stated order of preference: short-term borrowing to the extent the **current ratio of 1.40** permits, long-term loans to the extent the **fixed assets to long-term loans ratio of 1.50** permits, and equity for the balance.

Application use the rule - work the problem · 9 questions

- Show the working notes first - capital employed, ROCE, proposed EBIT, number of new shares, debt-equity ratio - then the comparative column. The notes carry as many marks as the table.
- Read whether the objective is EPS or market price per share, and state the recommendation in those terms. A correct table with no advice sentence loses the last mark.

PQ 3.5 · PYQ 2024-Sep [3] (b) · 5M · Pg 247	LEVEL II Application	Medium
PQ 3.6 · MTP 2025-Aug S2 [2] (b) · 5M · Pg 250	LEVEL II Application	Medium
PQ 3.7 · PYQ 2025-Sep [3] (a) · 7M · Pg 252	LEVEL II Application	Medium
TQ 3.1 · MTP 2025-Aug S2 [4] (c) · DESC · 2M · Pg 239	LEVEL II Application	Hard
PQ 3.1 · PYQ 2021-Dec [3] · 10M · Pg 239	LEVEL II Application	Hard
PQ 3.2 · PYQ 2022-May [4] · 10M · Pg 241	LEVEL II Application	Hard
PQ 3.3 · PYQ 2023-May [3] · 10M · Pg 243	LEVEL II Application	Hard
PQ 3.4 · PYQ 2023-Nov [2] · 10M · Pg 245	LEVEL II Application	Hard
PQ 3.8 · PYQ 2026-Jan [3] (a) · 8M · Pg 253	LEVEL II Application	Hard

Topic 4: Optimal Capital Structure

L2P6-A-C5-T04

Read first Read ICAI Study Material Chapter 5, Financing Decisions - Capital Structure, on optimal capital structure and the process for analysing it.

NOTES

Optimum capital structure is the combination of equity and debt at which the wealth of the firm is maximum. At that combination the **cost of capital is minimum** and the market price per share, that is the value of the firm, is at its maximum. Give both halves; a definition with no consequence for cost and value is half an answer, and the second half is where the second mark sits.

The process for analysing it has three named steps, and marks follow the count. **EBIT-EPS-MPS analysis:** start with the same EBIT for every structure, compute EPS, then either multiply by the P/E ratio or divide by the cost of equity to reach MPS, and choose the structure with the highest MPS. **Indifference point analysis:** the first test values one EBIT only, so check whether a change in EBIT would change the decision. **Financial break-even point analysis:** financial risk moves with the structure, and although the P/E ratio or K_e already reflects it, it may be computed and considered separately.

Begin from the objective. The answer opens with **the objective of financial management is to maximise wealth** and derives the test from it. Even in a two-mark answer, name all three steps; a description of EBIT-EPS analysis on its own does not cover the topic.

Remembering reproduce what you have learnt · 1 question

- Name the three steps - EBIT-EPS-MPS, indifference point, financial break-even - before describing any of them.

TQ 4.1 · MTP 2024-Mar [4] (c) · DESC · 2M · Pg 256

LEVEL I
Remembering

Easy

Analysis break it down and take the parts separately · 1 question

- Give the process as ordered steps, not as a description. The marks are in the sequence — estimate the mix, compute the cost at each level, and pick the minimum.

TQ 4.2 · MTP 2025-Aug S2 [3] (b) · DESC · 2M · Pg 256

LEVEL II
Analysis

Medium

Topic 5: EBIT-EPS-MPS Analysis

L2P6-A-C5-T05

Read first Read ICAI Study Material Chapter 5, Financing Decisions - Capital Structure, on EBIT-EPS-

MPS analysis, the financial break-even point and the indifference point.

NOTES

Financial break-even point is **the minimum level of EBIT** needed to satisfy all the fixed financial charges - interest and preference dividend - and it is the level at which **EPS equals zero**. Below it EPS is negative. Above it, more fixed-cost financing instruments can be taken into the structure; otherwise equity would be preferred. A plan carrying no interest has a financial break-even of zero.

Preference dividend is paid out of post-tax profit, so it must be grossed up in that figure: **Financial BEP = Interest + Preference dividend ÷ (1 - t)**. On 10% preference capital of ₹2,00,000 at a 50% tax rate the charge is ₹40,000, not ₹20,000, and that single step is what makes a preference plan look worse than a debt plan of the same size.

The indifference point is **the EBIT at which two plans give equal EPS**. Equate $(EBIT - I_1)(1 - T) ÷ E_1$ with $(EBIT - I_2)(1 - T) ÷ E_2$, where I is the fixed interest charge under each alternative, E the number of equity shares and T the tax rate. Write the formula out and define every term before you substitute; that is a mark on its own, and the algebra after it runs to two lines.

Where a range of EBIT figures is given, tabulate EPS for every plan at every EBIT and read the crossover off the table. State the conclusion in the form the answers use: **above ₹80,000 the debt-equity mix gives higher EPS**, below it equity financing does, and the preference-equity plan is not acceptable at any level because its EPS is lower throughout.

Two plans may have no indifference point at all - when the EBIT terms cancel on both sides, there is none - and the decision then rests on **dominance**. Plan Y dominates Plan Z because its financial break-even is ₹20,000 against ₹40,000 and its EPS ₹4 against ₹3. Say which dominates and give both reasons.

Several questions run the analysis backwards from ratios. **EPS = MPS ÷ P/E ratio** and **earnings yield = EPS ÷ MPS**; from EPS you reach earnings for equity, add back preference dividend, gross up for tax to EBT, add interest for EBIT, and the leverages carry you up to contribution and sales. **Pre-tax interest rate = post-tax rate ÷ (1 - t)**, and the debt is interest ÷ that rate.

Keep the two fixed charges apart. **Interest is deducted before tax, preference dividend after**. That distinction alone decides the financial break-even, the EPS and the sales figure a backwards question builds up to, and it is the slip corrected most often across these answers.

Application use the rule - work the problem · 8 questions

- Lay out the EBIT-to-EPS column for every plan in the same rows before you compute any leverage or indifference point.
- Show the indifference formula with its terms defined, then substitute, then state which plan is preferable above and below that EBIT.

PQ 5.1 · PYQ 2018-May [1] (d) {C} · 5M · Pg 258	LEVEL II Application	Medium
PQ 5.2 · PYQ 2018-Nov [1] (a) {C} · 5M · Pg 259	LEVEL II Application	Medium
PQ 5.6 · RTP 2025-Jan [6] · Pg 266	LEVEL II Application	Medium
PQ 5.7 · MTP 2025-Mar S1 [1] (b) · 5M · Pg 268	LEVEL II Application	Medium
PQ 5.9 · PYQ 2026-Sep [3] (b) · 4M · Pg 274	LEVEL II Application	Medium
PQ 5.3 · PYQ 2019-May [2] · 10M · Pg 261	LEVEL II Application	Hard
PQ 5.4 · PYQ 2020-Nov [3] · 10M · Pg 263	LEVEL II Application	Hard
PQ 5.5 · PYQ 2025-Sep [2] (a) · 7M · Pg 265	LEVEL II Application	Hard

Analysis break it down and take the parts separately · 2 questions

- Where three plans are given, compare them in pairs and say expressly whether any plan is dominated at every level of EBIT rather than only at the given one.

TQ 5.1 · MTP 2025-Nov S1 [4] (Or) (c) · DESC · 2M · Pg 257	LEVEL II Analysis	Medium
PQ 5.8 · RTP 2025-May [6] · Pg 270	LEVEL II Analysis	Hard

Topic 6: Over-Capitalisation and Under-Capitalisation

L2P6-A-C5-T06

Read first Read ICAI Study Material Chapter 5, Financing Decisions - Capital Structure, on over-capitalisation and under-capitalisation - meaning, causes, consequences and remedies.

NOTES

Over-capitalisation is excess capital: the firm has more capital than it requires, its assets are worth less than the issued share capital, and its earnings are insufficient to pay dividend and interest. It is the situation of a firm consistently unable to earn the prevailing rate of return on its capital employed. Two parameters identify it - **actual earning below the current rate**, and **real value below book value**. The chief sign is a fall in the payment of dividend and interest, and with it a fall in the value of the shares.

Causes, in the printed order: **under-estimation of the capitalisation rate**; over-issue of capital, the

promoters having over-estimated the requirement; high promotion and preliminary expenses; **liberal dividend policy** that starves the reserves; inadequate depreciation, so that the real value of assets falls below book value; and formation of the company in an inflationary period, the assets being bought dear and falling when depression sets in. The shorter four-mark version lists raising more than can be employed profitably, borrowing above the rate the company can earn, **excessive payment for fictitious assets such as goodwill**, improper depreciation and dividend policy, and wrong estimation of earnings.

Consequences, five of them, each with its reason: **poor creditworthiness**, so loans and credit come dearer; difficulty in obtaining further capital, because investors have lost confidence; **loss of goodwill** as the share price falls below face value; loss of market, because goods cannot be produced at competitive cost; and **liquidation** unless the whole capital structure is reorganised. The shorter version adds a cut in the rate of dividend and interest and resort to window dressing.

Remedies are asked as a question of their own and carry four steps: **thorough reorganisation** of the company; **buyback of shares**; reduction in the claims of debenture-holders and creditors; and reduction in the value of shares, which frees sufficient funds to replace assets.

These are all two to four mark descriptive questions, so the shape is fixed: one line of meaning, then a numbered list under the heading asked for. **Marks follow the number of items named**, not the length of each explanation. Where the question asks only for consequences, or only for remedies, do not spend the space on causes.

Understanding explain it, and place it in context · 3 questions

- Open with the one-line meaning in the answer's own words: more capital than needed, assets worth less than issued share capital, earnings insufficient to pay dividend and interest.
- Where the question sets a scenario - high capital base, low EPS - name the situation first, then run the list.

TQ 6.1 · PYQ 2022-Nov [6] (c) · DESC · 2M · Pg 275

LEVEL I
Understanding

Easy

TQ 6.4 · MTP 2025-Apr S2 [4] (Or) (c) · DESC · 2M · Pg 278

LEVEL I
Understanding

Easy

TQ 6.3 · MTP 2024-Nov [4] (b) · DESC · 4M · Pg 277

LEVEL I
Understanding

Medium

Application use the rule - work the problem · 1 question

- Remedies must be actionable. Say what the company does to each element — reduce the debt, write down the capital, improve earnings — rather than describing the condition again.

TQ 6.2 · PYQ 2024-Sep [4] · DESC · 2M · Pg 277

LEVEL II
Application

Easy

SECTION A · FINANCIAL MANAGEMENT · CHAPTER 6

Financing Decisions - Leverages

4 Topics · 39 Classified Questions · Importance: A

ICAI SKILL PROFILE ICAI band for Financial Management: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge

1.7%

4 of 229 marks

Level II — Analysis & Application

98.3%

225 of 229 marks

Below this Section's Level I floor: only 2% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for Financial Management. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Introduction

L2P6-A-C6-T01

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 6, Financing Decisions - Leverages, on the introduction to leverage and the three types of leverage.

NOTES

No question is printed on the introduction alone, but everything the chapter asks rests on one column. Set it out once and keep it: **Sales - Variable cost = Contribution**, Contribution - Fixed cost = EBIT, **EBIT - Interest = EBT**, then tax, then preference dividend, then earnings for equity shareholders. Every leverage asked in this chapter is a ratio of two lines in that column.

Leverage is the use of a fixed cost to magnify a change. **Operating leverage arises from fixed operating cost** and measures the effect of a change in sales on EBIT. **Financial leverage arises from fixed financial cost** - interest and preference dividend - and measures the effect of a change in EBIT on EPS. Combined leverage covers both and measures the effect of a change in sales on EPS, which is why it is the one most often asked for.

Each leverage names a risk, and the answers use the words consistently. **Operating risk attaches to the cost structure** and shows as variability in EBIT; were there no fixed cost there would be no operating risk. Financial risk is the additional risk placed on the shareholders by **debt and preference shares in the capital structure**. Companies that issue more debt carry higher financial risk than those financed mostly by equity, and combined leverage measures the total of the two.

The three formulae in the form the answers write them: **DOL = Contribution ÷ EBIT**; **DFL = EBIT ÷ EBT**; **DCL = Contribution ÷ EBT**, or **DOL × DFL**. Learn them as ratios of lines in the column above rather than as three separate definitions, because the questions give you two of them and ask for

the third.

Topic 2: Operating Leverage

L2P6-A-C6-T02

Read first Read ICAI Study Material Chapter 6, Financing Decisions - Leverages, on operating leverage, its computation and its link with margin of safety and the cost structure.

NOTES

DOL = Contribution ÷ EBIT, and equally **DOL = 1 ÷ Margin of safety**. The answers use whichever the given data reaches first: a margin of safety of 0.25 gives an operating leverage of 4 in one line, and 0.1667 gives 6. Read the same formula backwards where contribution is the unknown -

Contribution = EBIT × DOL - because most questions in this topic are worked backwards.

The standard question gives ratios and asks for the income statement. The route the answers take, in order: **pre-tax interest rate = post-tax rate ÷ (1 - t)**, and interest = loan × that rate; EBIT from financial leverage, solving $FL = EBIT ÷ (EBIT - \text{Interest})$; contribution from operating leverage; fixed cost = contribution - EBIT; **Sales = Contribution ÷ P/V ratio**; variable cost as the balancing figure. Then present the statement downwards in the usual order.

Two links the answers use without comment. **P/V ratio = Fixed cost ÷ BEP sales**, and **cash fixed cost = cash break-even sales × P/V ratio**, to which depreciation is added back to reach total fixed cost. If the variable cost ratio is 60%, the P/V ratio is 40%; the two always sum to one, and the answers move between them in a single step.

Financial leverage is a double-edged sword. Where the cost of fixed-cost funds is less than the return on investment it raises return on equity and EPS, and the firm also saves tax on the interest; where the cost of debt exceeds the return it drags both down and can put the firm in financial distress. State the three cases as the answers state them: **ROI above interest - favourable**; ROI below interest - unfavourable; ROI equal to interest - neutral, neither advantage nor disadvantage.

Where preference shares sit in the structure, financial leverage is **EBIT ÷ [EBT - Preference dividend ÷ (1 - t)]**, and in a tax-exempt company simply $EBIT ÷ (EBT - \text{preference dividend})$. The ShirtCo answer corrects a stated DFL of 2 to **3.33** on exactly this point, and the combined leverage with it from 12 to 20.

The trap this topic is built around: **operating leverage predicts EBIT only for a volume change**. A 10% rise in quantity does deliver the 60% rise in EBIT that a DOL of 6 promises. A 10% rise in selling price with quantity unchanged raises EBIT by 100%, because unit contribution rises from `300 to `350 while fixed cost stands. If demand is elastic at 1.2, the same price rise cuts quantity by 12% and EBIT rises only 16%. Operating leverage is a **function of fixed cost, margin and volume**.

Every leverage answer ends in a comment, and the comment is a mark. Operating leverage indicates **the choice of technology and fixed cost** in the cost structure, and it is level specific - once

the firm operates beyond its operating break-even, operating leverage is low. Say what the number means for risk, not merely what it is.

Understanding explain it, and place it in context · 1 question

- Explain the double-edged sword in the three cases the answer uses, and name the effect on both EPS and return on equity in each.
- When asked what operating leverage indicates, answer in terms of fixed cost in the cost structure and sensitivity of EBIT to sales, and say that it is level specific.

TQ 2.1 · PYQ 2026-Jan [3] (b) · DESC · 2M · Pg 282

LEVEL I
Understanding

Easy

Application use the rule - work the problem · 12 questions

- Start from whichever ratio gives a rupee figure - the post-tax interest rate or the margin of safety - and build the column upwards. Write each working note separately and number it.
- Where the question asks for a percentage change, use the leverage as the multiplier and then verify by recomputing the column; the verification is what the answers print and what carries the last mark.

PQ 2.2 · RTP 2024-May [4] · Pg 285	LEVEL II Application	Medium
PQ 2.3 · MTP 2025-Mar S1 [1] (c) · 5M · Pg 286	LEVEL II Application	Medium
PQ 2.4 · MTP 2025-Apr S2 [1] (c) · 5M · Pg 289	LEVEL II Application	Medium
PQ 2.5 · RTP 2025-May [7] · Pg 291	LEVEL II Application	Medium
PQ 2.8 · RTP 2025-Sep [7] · Pg 300	LEVEL II Application	Medium
PQ 2.9 · MTP 2025-Nov S1 [3] (b) · 4M · Pg 303	LEVEL II Application	Medium
PQ 2.11 · PYQ 2026-Jan [2] (a) · 5M · Pg 307	LEVEL II Application	Medium
PQ 2.1 · PYQ 2022-Nov [2] · 10M · Pg 283	LEVEL II Application	Hard
PQ 2.6 · MTP 2025-Jul S1 [2] (a) · 8M · Pg 294	LEVEL II Application	Hard
PQ 2.7 · MTP 2025-Aug S2 [2] (a) · 5M · Pg 297	LEVEL II Application	Hard
PQ 2.10 · MTP 2025-Dec S2 [3] (a) · 7M · Pg 304	LEVEL II Application	Hard
PQ 2.12 · RTP 2026-May [7] · Pg 309	LEVEL II	Hard

Topic 3: Financial Leverage

L2P6-A-C6-T03

Read first Read ICAI Study Material Chapter 6, Financing Decisions - Leverages, on financial leverage and the concept of trading on equity.

NOTES

Financial leverage is **the use of funds with fixed cost** - long-term debt and preference share capital - alongside equity share capital, and that use is what is known as **trading on equity**. A firm is said to be trading on equity when the quantity of fixed-cost funds is relatively high compared with the equity capital.

The two-mark answer has a second half that candidates drop: a firm is known to have **positive leverage** when its earnings are more than the cost of debt. Write the meaning of trading on equity, then that test. The term and the test together are what carries the two marks.

DFL = EBIT ÷ EBT, where EBT is EBIT less interest. In percentage form **DFL = % change in EPS ÷ % change in EBIT**, which is how questions that give only percentages are solved: a financial leverage of 1.9231 with EBIT moving 15% moves EPS by 28.85% in the same direction.

Whether the leverage is favourable is asked directly, and the test is a comparison, not a formula. **Compare ROCE with the rate of interest**: a return on capital employed of 9.375% against interest of 12% means the company **does not have favourable financial leverage**; a return above the rate of interest means it does. Give the two figures, then the verdict in one line.

Analysis break it down and take the parts separately · 1 question

- Explain the concept, then show the condition that makes it work: the return on capital employed must exceed the cost of debt. State that comparison expressly; it is the whole of trading on equity.

TQ 3.1 · PYQ 2023-May [6] (c) · DESC · 2M · Pg 312

LEVEL II
Analysis

Medium

Topic 4: Combined Leverage

L2P6-A-C6-T04

Read first Read ICAI Study Material Chapter 6, Financing Decisions - Leverages, on combined leverage, its relation with operating and financial leverage, and the total risk of the business.

NOTES

DCL = DOL × DFL, and equally **DCL = Contribution ÷ EBT**. Use whichever the given data reaches in fewer steps; both are accepted. Where two of the three are given the third is one division - a combined leverage of 2.16 over an operating leverage of 1.2 gives a financial leverage of 1.8, and that is the whole of part (i) in several questions.

Build the column before you compute anything: Sales, less variable cost, Contribution, less fixed cost, EBIT, less interest, EBT, less tax, PAT, less preference dividend, earnings for equity, ÷ shares, EPS. Where a balance sheet is given with a **total asset turnover ratio**, the first line is **Sales = Total assets × that ratio**. Once the column is right, each leverage is a single line.

DCL = % change in EPS ÷ % change in sales, and the relation is used in reverse as often as forwards. To find the sales at which EBT falls to zero, EBT must fall 100%, so sales must fall by **100 ÷ CL** per cent: a combined leverage of 3.84 needs a 26.042% fall, giving ₹36,97,900 on sales of ₹50,00,000. The alternative presentation, computed without deducting preference dividend, gives 3.2 and a different sales figure, and both are printed as acceptable.

The examiner returns to the risk combinations and the wording is fixed. Low DOL with high DFL is **moderate overall risk and the best combination**, because the higher financial risk is balanced by lower business risk. High DOL with low DFL is also moderate but **not an ideal combination**, since a high DOL means lower EBIT and reduced benefit from trading on equity. High DOL with high DFL is **higher overall risk** and very risky.

When output rises, both leverages fall, and the comment on that is required. In the Shiva Ltd answer a rise from 2,00,000 to 2,40,000 units takes operating leverage from 2 to 1.71 and financial leverage from 2 to 1.56, and the answer reads that as **a reduction in business risk and financial risk**. Where the question asks you to comment, give the direction of both leverages and then the effect on the firm's risk profile.

Reverse questions are the norm, so learn the algebra rather than the arithmetic. **FL = EBIT ÷ (EBIT - Interest)** solved for EBIT is usually the first step; contribution then follows from DOL, fixed cost is contribution less EBIT, and sales are contribution ÷ P/V ratio. Where fixed cost and OL are given, solve **OL × (Contribution - Fixed cost) = Contribution**. **MOS = 1 ÷ OL** converts either way.

Two slips recur. **Preference dividend is not interest**: it is deducted after tax to reach earnings for equity, and it enters the leverage only on the alternative basis some answers print alongside. And read a leverage as a **multiplier of percentage change, not of rupees** - a combined leverage of 2 means a 10% rise in sales lifts taxable income by 20%.

Understanding explain it, and place it in context · 1 question

- For the risk-combination question, use only the words the answer uses - lower, moderate, higher - and give the reason for each combination in one clause.
- Explain combined leverage as the study of fixed cost in the cost structure together with debt in the capital structure, and say that it measures sensitivity of EPS to sales.

TQ 4.1 · MTP 2026-Mar S1 [4] (c) · DESC · 2M · Pg 313

LEVEL I
Understanding**Hard****Application** use the rule - work the problem · 23 questions

- Write the income column first and label every line. Each leverage is then one division, and the examiner can see the figures you divided.
- For a percentage-change question, state the leverage, multiply, and then verify by recomputing the column at the new level of sales.

PQ 4.19 · PYQ 2025-May [4] (Or) (c) · 2M · Pg 345	LEVEL II Application	Easy
PQ 4.1 · PYQ 2018-May [1] (b) {C} · 5M · Pg 314	LEVEL II Application	Medium
PQ 4.10 · PYQ 2023-Nov [1] (b) {C} · 5M · Pg 330	LEVEL II Application	Medium
PQ 4.11 · PYQ 2024-May [1] (b) {C} · 5M · Pg 332	LEVEL II Application	Medium
PQ 4.12 · MTP 2024-Jul [1] (c) {C} · 5M · Pg 334	LEVEL II Application	Medium
PQ 4.13 · PYQ 2024-Sep [1] (a) {C} · 5M · Pg 334	LEVEL II Application	Medium
PQ 4.14 · RTP 2024-Sep [8] · Pg 336	LEVEL II Application	Medium
PQ 4.15 · MTP 2024-Nov [1] (a) {C} · 5M · Pg 338	LEVEL II Application	Medium
PQ 4.17 · RTP 2025-Jan [7] · Pg 341	LEVEL II Application	Medium
PQ 4.18 · PYQ 2025-May [1] (c) {C} · 5M · Pg 343	LEVEL II Application	Medium
PQ 4.21 · MTP 2026-Apr S2 [1] (b) {C} · 5M · Pg 347	LEVEL II Application	Medium
PQ 4.22 · PYQ 2026-May [1] (a) {C} · 5M · Pg 348	LEVEL II Application	Medium
PQ 4.2 · PYQ 2018-Nov [2] · 10M · Pg 315	LEVEL II Application	Hard
PQ 4.3 · PYQ 2019-May [4] · 10M · Pg 317	LEVEL II Application	Hard
PQ 4.4 · PYQ 2019-Nov [2] · 10M · Pg 318	LEVEL II Application	Hard
PQ 4.5 · PYQ 2020-Nov [5] · 10M · Pg 321	LEVEL II Application	Hard
PQ 4.6 · PYQ 2021-Jan [2] · 10M · Pg 322	LEVEL II Application	Hard

PQ 4.7 · PYQ 2021-Jul [5] · 10M · Pg 324	LEVEL II Application	Hard
PQ 4.8 · PYQ 2021-Dec [5] · 10M · Pg 326	LEVEL II Application	Hard
PQ 4.9 · PYQ 2022-May [2] · 10M · Pg 328	LEVEL II Application	Hard
PQ 4.16 · PYQ 2025-Jan [1] (b) {C} · 5M · Pg 339	LEVEL II Application	Hard
PQ 4.20 · MTP 2026-Mar S1 [2] (b) · 4M · Pg 346	LEVEL II Application	Hard
PQ 4.23 · PYQ 2026-Sep [1] (a) {C} · 5M · Pg 350	LEVEL II Application	Hard

Analysis break it down and take the parts separately · 1 question

- Where two companies are compared, prepare both income statements side by side and base the comment on the leverages and the interest coverage, not on the size of the profit.
- Where several situations and financial plans are combined, compute every pairing before naming the highest and the lowest combined leverage.

TQ 4.2 · MTP 2026-Apr S2 [4] (Or) (c) · DESC · 2M · Pg 313	LEVEL II Analysis	Hard
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SECTION A · FINANCIAL MANAGEMENT · CHAPTER 7

Investment Decisions

14 Topics · 36 Classified Questions · Importance: B

ICAI SKILL PROFILE ICAI band for Financial Management: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge **17.6%** 35 of 199 marks

Level II — Analysis & Application **82.4%** 164 of 199 marks

Below this Section's Level I floor: only 18% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for Financial Management. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Purpose of Capital Budgeting

L2P6-A-C7-T01

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 7, Investment Decisions, on the purpose of capital budgeting.

NOTES

No question is printed against this topic, but every practical answer in the chapter ends where this topic begins — with a decision. Capital budgeting exists to settle one question: **should this long-term outlay be made**. The last mark in almost every question here sits in the sentence that answers it, not in the figure above it.

One RTP tabulates the acceptable range of every technique in the chapter side by side, and it is worth learning as a block: **NPV > 0**, **MIRR > WACC**, simple payback and discounted payback each shorter than the asset's life, **ARR > WACC** and **PI > 1**. In that same answer the project cleared five of the six and failed only ARR, at 7.5% against a WACC of 9%, and the report still ran technique by technique rather than collapsing into one verdict.

The printed questions show what capital budgeting is actually used for: buying a new plant or launching a new product, replacing a machine that still works, choosing between two mutually exclusive ways of getting the same job done, deciding whether a cost-saving technology pays for itself, and even **valuing a company for a takeover** by discounting its future cash flows. Recognise which of these you are in before you pick a format.

Where funds are limited, the purpose narrows to ranking rather than accepting. The answers say that although PI is derived from NPV, it is a **better technique in capital rationing**, because NPV

ranks on absolute rupees while PI ranks on return per rupee committed.

Topic 2: Capital Budgeting Process

L2P6-A-C7-T02

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 7, Investment Decisions, on the capital budgeting process.

NOTES

No question is printed against this topic, but the process is visible in the order the printed answers are laid out, and copying that order is worth marks of its own. Working notes first, then the cash flow statement, then discounting, then the rule, then **the advice in words**.

Settling the discount rate is a step in its own right and is sometimes the first computation in the answer. One MTP derives it as **MCLR 12% plus a premium of 3% = 15%**; a PYQ computes it as a WACC of $(0.80 \times 13.5\%) + (0.20 \times 6\%) = 12\%$, the 6% being 8% interest net of 25% tax. Where the question gives a cut-off rate directly, say that you are using it.

Cash flow estimation is always pushed into working notes — depreciation schedules, output per year, incremental cost tables — so that the main statement has one clean line per year. Where the question gives data for two machines, the working note carries **existing, new and differential columns** and only the differential column goes forward.

The last step is never optional. Every practical answer in the chapter closes with a sentence of the form the examiner wants: the project should be accepted because the NPV is positive, or the existing machine should be replaced because the incremental NPV is positive.

Topic 3: Types of Capital Investment Decisions

L2P6-A-C7-T03

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 7, Investment Decisions, on the types of capital investment decisions.

NOTES

No question is printed against this topic, but the chapter's practical questions divide cleanly into

the types, and naming your type in the first line of the answer tells the examiner which format is coming. The four that appear are **new project or expansion, replacement, mutually exclusive alternatives** and cost reduction through new technology.

New project questions give you a fresh outlay, a life, a production and sales schedule and a residual value, and the whole answer is one absolute cash flow statement — the PD Ltd. product launch over eight years and the SRT Limited smelting plant over five are the models.

Replacement questions give you two machines and are always worked **incrementally**. The existing machine's sale proceeds reduce the outlay, the depreciation charge is the new machine's less the old one's, and the verdict is phrased as whether the existing machine should be replaced, not whether the new one is profitable.

Mutually exclusive questions give two ways of achieving the same thing — buying new vehicles or second-hand ones, servicing a part now or replacing it later, Machine M or Machine N — and require a separate complete evaluation of each, set side by side, before **the higher NPV is chosen**. Where the two lives differ, the choice moves to the equivalent annualised criterion.

Two less obvious types appear as well. Cost-reduction proposals compare the cost of doing nothing with the cost of the new arrangement, as in the video conferencing and the AI questions. And one MTP uses the same discounting machinery to compute **the fair value of a takeover target**, discounting its future cash flows at the acquiring company's desired rate of return.

Topic 4: Estimation of Project Cash Flows

L2P6-A-C7-T04

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 7, Investment Decisions, on the estimation of project cash flows.

NOTES

No question is printed against this topic, but it is the single most valuable one in the chapter, because the same column is built in every practical answer. The order is fixed: **Sales – Variable cost = Contribution**, less fixed cost excluding depreciation gives profit before depreciation and tax, less depreciation gives PBT, less tax gives PAT, and then **add depreciation back to reach CFAT**.

Depreciation is deducted only to compute the tax and is then added back, because it is not a cash flow. Several answers reach the same CFAT without it, listing contribution less cash fixed costs directly — the CK Ltd. answer prints both routes and both are accepted. Where tax is to be ignored, say so and stop at the cash line.

Working capital enters as an outflow when it is committed and comes back as an inflow when it is

released. The answers put it in at **year 0 unless the question times it otherwise** — one question injects ₹2,50,000 at the beginning of year one and ₹3,00,000 at the beginning of year three and releases ₹5,50,000 at the end of year four — and it is never depreciated and never taxed.

Terminal year flows are three separate lines and each must appear: the **salvage or scrap value**, the release of working capital, and the tax effect of selling the asset. Where the sale price exceeds the written down value there is a capital gain and tax on it reduces the inflow; where it falls short there is a capital loss and **the tax saving is an inflow**.

Four exclusions are stated expressly in the answers and each has been asked about. **Sunk costs are irrelevant** — the ₹2,00,000 project report fee and the ₹5,00,000 of R&D already spent are not cash flows of the project. **Allocated common costs are added back**, because they would be incurred anyway. Interest is added back to EBT because it is already inside the discount rate. Dividends are deemed irrelevant to cash flow analysis.

Where a cost is paid in advance, the answers separate the **charge against profit from the year of payment**. The AI question deducts the annual maintenance cost in computing taxable profit, adds it back in the cash flow, and then shows it again as an actual payment at the beginning of the year — which puts the first payment in year 0.

Topic 5: Basic Principles For Measuring Project Cash Flows

L2P6-A-C7-T05

Read first Read ICAI Study Material Chapter 7, Investment Decisions, on the basic principles for measuring project cash flows.

NOTES

The one question printed here asks for the exclusion of financing cost principle, and the answer is two numbered points, so write both. One: **interest on long-term debt is ignored** while computing profits and taxes. Two: **expected dividends are deemed irrelevant** in cash flow analysis. Two marks, two points — do not pad it.

The reason is applied, not just stated, in the practical answers. Where a question gives EBT after deducting interest, the answer **adds the interest back** before taxing, with the note that interest is excluded from the cash flows because it is already covered in the discounting rate. Counting it twice — once as a cost and once in the rate — is the error the principle exists to prevent.

Two companion exclusions travel with this principle in the same answers and are worth carrying in the same breath: costs already incurred, such as a project report fee or past R&D, are **sunk costs and irrelevant**; and an allocated share of common cost is added back because the company bears it whether or not the project runs.

In a two-mark descriptive question the marks follow the number of principles named, so state each

as a numbered line in the answer's own words before you explain anything.

Remembering reproduce what you have learnt · 1 question

- Name both limbs of the principle — interest ignored, dividends irrelevant. The mark is for the count, not the explanation.

TQ 5.1 · PYQ 2025-Jan [4] (Or) (c) · DESC · 2M · Pg 355

LEVEL I
Remembering

Easy

Topic 6: Capital Budgeting Techniques: Traditional or Non- Discounting Techniques

L2P6-A-C7-T06

Read first Read ICAI Study Material Chapter 7, Investment Decisions, on the traditional or non-discounting techniques — payback period, payback reciprocal and average rate of return.

NOTES

Payback reciprocal = Average annual cash inflow ÷ Initial investment. The Scanner's answer makes the point that it approximates the IRR only where the project life is at least twice the payback period and the annual inflows are equal. State both conditions: they are the marks in a two-mark question, not the formula alone.

Payback is computed on undiscounted cash flows and the answers set it out as a cumulative column. The fraction is the shortfall over the flow of the year in which recovery falls: in the ABC Ltd. answer, `5,00,000 less the `4,62,800 recovered by year four leaves `37,200, and payback is **4 years + 37,200 ÷ 1,60,700 = 4.23 years**. The rule the answers apply is that **payback shorter than the life** supports purchase.

The payback reciprocal is asked as a two-mark theory question and the answer is about relevance, not arithmetic. It is the reciprocal of the payback period, and it is argued to be **a close approximation of the IRR** provided the life of the project is at least twice the payback period and the annual cash inflows are equal. Say the two conditions; they carry the marks.

The limitations of the average rate of return are a printed four-point answer and are asked directly. It **ignores the time value of money**; it uses net income rather than cash flow; it depends on the organisation's choice of accounting procedures, so different depreciation methods give different book values; and taking only the book value of the invested assets ignores **commitments of working capital** and other outlays.

When ARR is computed, say which base you are using, because both appear. One answer takes **average NPAT ÷ initial investment** and notes expressly that it could equally be done on average investment; a PYQ takes average PAT over $\frac{1}{2}$ **(cost – salvage) + salvage**, which on `24,00,000 with 10% salvage gives an average investment of `13,20,000 and an ARR of 63.07%. The acceptance rule

used in the chapter is ARR above the WACC.

The video conferencing question shows how a cost-reduction proposal is set out without discounting: cost each option for a year on the same basis — travel ₹7,56,000, owned equipment ₹14,35,200 including depreciation, rented facilities ₹7,29,600 — then test the saving against the company's stated policy. The rented option was cheapest, but the saving of ₹26,400 fell short of the required 10% of existing travel cost, so **no change was suggested**. The trap is stopping at the cheapest option and never applying the policy threshold.

Understanding explain it, and place it in context · 1 question

- For payback reciprocal, give the two conditions — life at least twice the payback, and equal annual inflows — or the answer is incomplete.

TQ 6.1 · PYQ 2021-Jul [6] (Or) (c) · DESC · 2M · Pg 355

LEVEL I
Understanding

Easy

Application use the rule - work the problem · 1 question

- Write payback as whole years plus a fraction, and show the fraction as shortfall over that year's inflow.
- State the base you used for ARR in words. Initial investment and average investment give different percentages and both are accepted only if named.

PQ 6.1 · MTP 2025-Dec S2 [1] (c) · 5M · Pg 357

LEVEL II
Application

Medium

Analysis break it down and take the parts separately · 1 question

- Give the relevance and the conditions under which it holds. A two-mark answer needs the definition plus the assumption, not a worked example.

TQ 6.2 · PYQ 2024-May [4] (c) · DESC · 2M · Pg 356

LEVEL II
Analysis

Easy

Topic 7A: Capital Budgeting Techniques: Discounting Techniques: Net Present Value Technique

L2P6-A-C7-T07A

Read first Read ICAI Study Material Chapter 7, Investment Decisions, on the net present value technique.

NOTES

NPV is the **present value of cash inflows** less the **present value of cash outflows**, and the decision

rule is that a positive NPV means accept. This is the most heavily examined topic in the paper — the Scanner declares thirty-four questions against it — and the closing sentence is always of the form used in the answers: since the project has a positive NPV, it should be accepted.

The working runs in a fixed order and is best built as a table with one column per year. Cash flow after tax first, from the contribution column; then the discount factors the question supplies; then the present value line; then total PV of inflows; then the outflow; then NPV. Where the inflows are equal the answers use the annuity factor in a single line — **CFAT × PVIFA** — and only the irregular items get their own rows.

Replacement questions are worked on **net initial cash outflow**, and that figure has its own working note. Cost of the new machine, less the sale proceeds of the existing machine, plus installation and testing, plus additional working capital, less any government subsidy, and adjusted for the tax on the sale of the old machine. One PYQ prints `32,00,000 less `9,60,000 plus `52,800 of tax on the gain, giving `22,92,800, and prints the alternative without that tax alongside it.

In a replacement the depreciation charge is **incremental, not absolute**: the new machine's depreciation less the old machine's. Where the company has several machines in the same block, the answers add the written down value of the old machine into the block and deduct its sale value before computing the base — `10,00,000 plus `84,000 gives a depreciation base of `10,84,000. The incremental and total approaches both appear and both reach the same NPV; pick one and label it.

Where the question gives scenarios or probabilities, compute an NPV for each scenario and then **an expected NPV on the weighted cash flow**. The Door Ltd. answer works the three cases separately, then weights the annual flows to `1,05,000 and discounts once, and advises on the expected figure because it is positive at `86,010. Where the scenarios apply to different stretches of the life, the answer discounts each stretch with its own factors and adds.

Where two options are mutually exclusive, evaluate each in full and **choose the higher NPV**, saying so. The second-hand vehicle option at `16,60,441 beats the new vehicles at `16,41,425; the replace-the-part option at +`476 beats the service-the-part option at -`4,938. A small positive NPV is still an acceptance, but the answers comment when it is very low relative to the investment.

The traps this topic keeps correcting: **tax on the sale of the old machine** belongs in the initial outlay, whether it is a gain taxed or a loss relieved, and it is the most frequently dropped mark in the replacement family; working capital must be released at the end; sunk costs such as a project report fee or past R&D never enter; and interest, allocated common cost and dividends stay out of the cash flows.

Remembering reproduce what you have learnt · 1 question

- Where a long problem asks you to state an assumption or a convention as its first part, write it in one sentence and move on. Those marks are quick; the computation is where the time goes.

Application use the rule - work the problem · 15 questions

- Build the net initial cash outflow as a labelled working note first. Marks are given for that table separately from the NPV table.
- Use the annuity factor where the flows are equal and the per-year factors only for the irregular items. It halves the arithmetic and the error rate.
- Close with the decision sentence naming the sign of the NPV. The figure alone does not earn the last mark.

PQ 7A.2 · PYQ 2019-Nov [1] (b) {C} · 5M · Pg 360	LEVEL II Application	Medium
PQ 7A.5 · PYQ 2023-May [1] (c) {C} · 5M · Pg 370	LEVEL II Application	Medium
PQ 7A.8 · RTP 2024-May [5] · Pg 376	LEVEL II Application	Medium
PQ 7A.10 · MTP 2024-Nov [1] (c) {C} · 5M · Pg 382	LEVEL II Application	Medium
PQ 7A.11 · PYQ 2025-Sep [1] (c) {C} · 5M · Pg 383	LEVEL II Application	Medium
PQ 7A.12 · RTP 2025-Jan [9] · Pg 384	LEVEL II Application	Medium
PQ 7A.13 · RTP 2025-Jan [11] (c) · Pg 387	LEVEL II Application	Medium
PQ 7A.15 · MTP 2025-Mar S1 [3] (b) · 7M · Pg 392	LEVEL II Application	Medium
PQ 7A.16 · MTP 2026-Mar S1 [1] (c) {C} · 5M · Pg 398	LEVEL II Application	Medium
PQ 7A.16 · PYQ 2026-Sep [3] (a) · 6M · Pg 400	LEVEL II Application	Medium
PQ 7A.1 · PYQ 2018-Nov [3] · 10M · Pg 358	LEVEL II Application	Hard
PQ 7A.4 · PYQ 2021-Jul [4] · 10M · Pg 364	LEVEL II Application	Hard
PQ 7A.6 · PYQ 2023-May [5] · 10M · Pg 371	LEVEL II Application	Hard
PQ 7A.7 · MTP 2024-Mar [2] (a) · 8M · Pg 374	LEVEL II Application	Hard
PQ 7A.9 · MTP 2024-Jul [3] (a) · 8M · Pg 379	LEVEL II Application	Hard

Analysis break it down and take the parts separately · 1 question

- In a replacement, state at the top whether you are working incrementally or on the total approach, and stay in it. Mixing the two is where the figures go wrong.

- Where the question gives two options, complete each evaluation before you compare, then put the two NPVs side by side in one closing line.

PQ 7A.3 · PYQ 2020-Nov [1] (b) {C} · 5M · Pg 361

LEVEL II
Analysis

Medium

Topic 7B: Capital Budgeting Techniques: Discounting Techniques: Profitability Index/Desirability Factor/Present Value Index Method

L2P6-A-C7-T07B

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 7, Investment Decisions, on the profitability index or desirability factor.

NOTES

No question is printed against this topic alone, but it is computed in at least six of the chapter's practical answers and is worth as much as NPV. PI is the **discounted value of cash inflows** divided by the discounted value of cash outflows, and it also travels under the names desirability factor and present value index. The rule is that **PI above 1 means accept**, and a PI below 1 means reject.

It costs you nothing once the NPV table is built, because both lines are already there. Project A with PV inflows of ₹2,02,900 on an outflow of ₹2,00,000 gives 1.01; the SRT plant gives ₹1,03,94,884 over ₹22,50,000, which is 4.62; the ABC Ltd. machine gives 0.93 and is rejected on that ground as well as on its negative NPV.

Be deliberate about the denominator, because the answers are and they say so. Where part of the purchase price is paid later, the outflow is **the present value of all outflows**, not the sticker price — the AI question divides ₹45,12,409 by ₹22,38,418. Where a subsidy is netted off the outlay the PI is 1.224 and where the same subsidy is shown as a year-one inflow it is 1.195; both are printed as correct, so state which treatment you took.

PI and NPV give the same accept or reject answer, and the answers say why: a project with a PI above 1 must also have a positive NPV. The conflict is only about **ranking mutually exclusive projects**. The printed example has project A with an NPV of ₹2,00,000 and a PI of 3 against project B with ₹1,20,000 and a PI of 4 — NPV prefers A, PI prefers B.

The explanation the examiner wants in that answer is one sentence: NPV ranks on **the absolute value of rupees** while PI ranks on a ratio. Add the consequence — although PI is derived from NPV, it is the better technique **in a situation of capital rationing**, where the scarce thing is the rupee committed rather than the project.

Topic 7C: Capital Budgeting Techniques: Discounting Techniques: Internal Rate of Return Method (IRR)

L2P6-A-C7-T07C

Read first Read ICAI Study Material Chapter 7, Investment Decisions, on the internal rate of return method and the cut-off rate.

NOTES

IRR = $LR + \frac{NPV \text{ at } LR}{NPV \text{ at } LR - NPV \text{ at } HR} \times (HR - LR)$, with **LR** the lower trial rate and **HR** the higher. Take the NPV at the higher rate into the denominator **with its own sign** — the Scanner writes $77.29 - (-29.75)$, which is 107.04, not 47.54. Getting that sign wrong is the single commonest slip in the printed answers.

Two definitions are printed and either will do, so learn the shorter one and add the second line. IRR is the discount rate that **equates the PV of expected cash inflows** with the initial cash outflow; equivalently it is the rate at which discounted cash inflows equal discounted cash outflows, that is, **the rate which discounts cash flows to zero**. The answers add that it can be stated as the ratio cash inflows ÷ cash outflows = 1, and that it is **found by trial and error**.

The acceptance rule is asked on its own and must be written as a pair. **If $IRR \geq \text{cut-off rate or WACC}$, accept**; if IRR is below the cut-off rate or WACC, reject. Write both limbs even when the question seems to want only one.

Cut-off rate has its own short-note question. It is **the minimum rate management wishes to have** from any project, usually based on the cost of capital; management gains only if the project returns more than it; and it can therefore be used as the discount rate or the opportunity cost rate.

In a practical question IRR is reached by discounting at a lower rate and a higher rate until the NPV changes sign, then interpolating between them — the answers label them **LR for the lower rate and HR for the higher**. One RTP finds a positive NPV at 14% and at 16% and a negative one at 20%, and concludes the IRR lies between 16% and 20%, at 18.89%. Another moves from 10% to 20% and reaches 14.14%, then states the decision as IRR 14.14% against a cost of capital of 10% — accept.

The limitations are a printed four-point answer. The calculation is tedious and **there can be multiple IRRs** where cash outflows are interspersed between the inflows; the approach creates a peculiar situation when comparing projects with different inflow and outflow patterns; it assumes all future inflows are **reinvested at a rate equal to the IRR**, ignoring the firm's ability to reinvest at different rates; and between mutually exclusive projects with different outlays, a project with a larger commitment but a lower IRR may add more absolute NPV and more shareholder wealth.

Remembering reproduce what you have learnt · 4 questions

- Number the four limitations before you explain any of them. A four-mark question is marked on the count.

TQ 7C.3 · MTP 2024-Mar [2] (b) · DESC · 2M · Pg 402	LEVEL I Remembering	Easy
TQ 7C.4 · MTP 2025-Apr S2 [3] (b) · SN · 2M · Pg 402	LEVEL I Remembering	Easy
TQ 7C.1 · PYQ 2021-Jan [6] (c) · DESC · 4M · Pg 401	LEVEL I Remembering	Medium
TQ 7C.5 · RTP 2026-May [10](c) · DESC · Pg 403	LEVEL I Remembering	Medium

Understanding explain it, and place it in context · 1 question

- Define IRR in one line and then give the acceptance rule as two limbs, accept and reject. Both limbs are expected.

TQ 7C.2 · PYQ 2022-May [6] (a) · DESC · 4M · Pg 402	LEVEL I Understanding	Medium
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Topic 7D: Capital Budgeting Techniques: Discounting Techniques: Discounted Payback Period Method

L2P6-A-C7-T07D

Read first Read ICAI Study Material Chapter 7, Investment Decisions, on the discounted payback period method.

NOTES

The discounted payback period is the ordinary payback computed on **discounted cash flows instead of raw ones**. Build the year-by-year present value column first, cumulate it, find the year in which the cumulative figure passes the outflow, and express the remainder as a fraction of that year's discounted inflow.

The printed working is worth copying exactly. For project A the cumulative discounted inflow to year four is `1,90,500, leaving `9,500 of the `2,00,000 to be recovered from year five, so the answer is **4 years + 9,500 ÷ 12,400 = 4.766 years**, and it is then restated as 4 years 9 months and 6 days. Give the decimal and the months; the answers give both.

The trap in the printed question is an item held back from the given data: `35,000 of sales promotion in year three **has not been taken into account** in the pre-tax cash flows, so year three becomes `90,000 less `35,000 = `55,000 before it is discounted. Read the narrative under the table before you touch the discount factors.

The same question asks for discounted payback, desirability factor and NPV together, and all three come out of the one present value column, so build it once. The decision rule the chapter applies is **payback shorter than the asset's life** — seven years against a life of eight was accepted in the

appraisal table.

Application use the rule - work the problem · 1 question

- Discount first, cumulate second, interpolate third. Working the fraction on undiscounted flows is the standard slip.
- Adjust the year's cash flow for anything the question says was left out of the given figures before you discount it.

PQ 7D.1 · MTP 2025-Apr S2 [1] (a) · 5M · Pg 403

LEVEL II
Application

Medium

Topic 7E: Capital Budgeting Techniques: Discounting Techniques: Modified Internal Rate of Return Method (MIRR)

L2P6-A-C7-T07E

Read first Read ICAI Study Material Chapter 7, Investment Decisions, on the modified internal rate of return method.

NOTES

MIRR is defined against the weaknesses of IRR, so open the answer there. It **eliminates multiple IRR rates**, it addresses the reinvestment rate issue, and it produces results **consistent with the net present value method**. Those three claims are the marks in the two-mark definition question.

The mechanism, in the answer's own words: all cash flows apart from the initial investment are **brought to the terminal value** using an appropriate discount rate, usually the cost of capital. That gives a single stream of cash inflow in the terminal year. MIRR is then obtained by assuming a single outflow in the zeroth year and that terminal inflow, and is **the rate which equates the two**.

In computation the relation the answers use is **Initial investment $\times (1 + \text{MIRR})^n = \text{terminal value}$** , and it is worked both ways. Given a terminal value of `11,43,589 and an MIRR of 10.9% over one compounding, the initial investment is `5,00,000. Given an outflow of `3,08,640 and a terminal value of `4,72,100 over four years, the ratio $3,08,640 \div 4,72,100 = 0.654$ is read against the fourth-year present value factors to give about 11.20%.

The same answer prints the direct route as an alternative, and it is quicker: total return = $4,72,100 \div 3,08,640 = 1.5296$, so **MIRR = $1.5296^{(1/4)} - 1 = 11.20\%$** . Compound each year's inflow forward with the FVIF factors the question supplies before you do any of this — the year-one inflow is compounded for the full remaining life, and the terminal year's inflow and salvage are taken at face value. The decision rule applied in the chapter is MIRR above the WACC.

Remembering reproduce what you have learnt · 1 question

- Give the three advantages over IRR — no multiple rates, the reinvestment assumption fixed, consistency with NPV — and then the mechanism in one sentence.

TQ 7E.1 · MTP 2024-Nov [4] (Or) (c) · DESC · 2M · Pg 406

LEVEL I
Remembering

Easy

Topic 7F: Capital Budgeting Techniques: Discounting Techniques: Comparison of NPV and IRR Methods

L2P6-A-C7-T07F

Read first Read ICAI Study Material Chapter 7, Investment Decisions, on the comparison of the NPV and IRR methods.

NOTES

The printed question here is an appraisal report, and the answer's final table is the thing to learn: technique, acceptable range, outcome, recommendation. **NPV > 0**; MIRR greater than the WACC; simple payback and discounted payback each shorter than the life; **ARR > WACC**; **PI > 1**. The project accepted on five of the six and was rejected only on ARR, at 7.5% against 9%.

That answer is also a reverse-engineering drill, and the chain is worth memorising because it is how the examiner hides the data. From the terminal value and MIRR you get the **initial investment of `5,00,000**; from the investment and the simple payback of 5 years you get a CFAT of `1,00,000; from the investment and a discounted payback of 7 years you get **PVAF for 7 years = 5, so WACC = 9%**; then $NPV = `1,00,000 \times 5.535 - `5,00,000 = `53,500$ over the eight-year life, and $PI = 5,53,500 \div 5,00,000 = 1.107$.

ARR in that answer is computed on PAT: CFAT less depreciation gives `37,500, and  $`37,500 \div `5,00,000 = 7.5\%$. It is the only technique that rejects the project, which is exactly the point of running six techniques — a single measure can be made to say anything, and the recommendation must acknowledge the one that dissents.

The substantive difference between NPV and IRR is stated in the IRR limitations: where mutually exclusive projects have **considerably different cash outlays**, a project with a larger fund commitment but a lower IRR contributes more in absolute NPV and increases shareholders' wealth more, so a decision based only on IRR may not be correct. IRR also assumes reinvestment at the IRR itself, which NPV does not.

The parallel conflict with PI runs the same way — NPV ranks on absolute rupees, PI on a ratio — so if a question asks you to reconcile conflicting rankings, the answer in every case is **prefer NPV for wealth, ratios for rationing**, stated with the figures in front of you.

Analysis break it down and take the parts separately · 1 question

- Where several techniques are asked for together, present them as one table of technique, acceptable range and outcome. The table is the answer, not a decoration.
- Where the techniques disagree, say which one dissents and why, rather than averaging them into a single verdict.

PQ 7F.1 · RTP 2026-Jan [9] · Pg 406

LEVEL II
Analysis

Medium

Topic 8: Special Cases

L2P6-A-C7-T08

Read first Read ICAI Study Material Chapter 7, Investment Decisions, on the special cases, in particular the equivalent annualised criterion.

NOTES

The equivalent annualised criterion is printed as a three-step answer and is examined as such.

One: **compute the NPV** using the WACC or the given discounting rate. Two: compute the present value annuity factor of that same rate **for the period of each project**. Three: divide the NPV by the PVAF and compare the values. Three steps, three marks.

It exists because NPV alone cannot compare projects of unequal life, and the chapter prints the case that proves it. Machine M has an NPV of `5,33,027.25 over five years and Machine N `5,56,035 over seven, so on NPV alone N wins. On the equivalent annualised figures — $5,33,027.25 \div 3.889 = `1,37,060$  against  $5,56,035 \div 5.032 = `1,10,500$ — **Machine M is selected**.

That reversal is the whole point and the examiner sets it deliberately. Where two options serve the same purpose but run for different numbers of years, **do not stop at the higher NPV**; divide each by the annuity factor for its own life before you recommend.

Use the PVIFA for the project's own life, not a common horizon, and take it from the table the question prints. Where the question also asks for NPV and PI, report all three and let the equivalent annualised figure carry the final recommendation, because that is what it was asked for.

Understanding explain it, and place it in context · 1 question

- Set the steps out in the order the answers run them and say what the criterion is used for — comparing assets of unequal lives. An answer that gives the steps without that purpose loses a mark.

TQ 8.1 · PYQ 2019-Nov [6] (b) · DESC · 3M · Pg 410

LEVEL I
Understanding

Easy

Topic 9: Comprehensive Question

L2P6-A-C7-T09

Read first Read ICAI Study Material Chapter 7, Investment Decisions, on comprehensive questions combining several appraisal techniques on one set of data.

NOTES

Every question here is one data set assessed by three or four techniques, so the economy is in the working note. Build **one annual cash inflow figure** — revenue less depreciation less operating cost, taxed, with depreciation added back — and then payback, NPV, PI, discounted payback and MIRR all read out of it. The ABC Ltd. answer reaches `1,15,700 once and uses it for all three parts.

Report each technique's own verdict; do not force them into agreement. In that same answer payback of **4.23 years is less than the five-year life** and supports purchase, while the NPV is **negative at `33,465** and the PI is 0.93, and the answer says on each of the latter two that the company should not purchase the machine. Marks are given per technique.

Some questions run the chain backwards and the step is always the same: **at the IRR the NPV is zero**, so the initial investment equals the present value of the inflows discounted at the IRR. Discounting `1,00,000, `1,00,000, `80,000, `80,000 and a `50,000 salvage at 12% gives `3,08,640, and every later part — NPV at 10%, PI of 1.0445, discounted payback of 3.845 years, MIRR of 11.20% — hangs off that figure.

A missing rate can be recovered the same way. Where the question gives the tax saving on depreciation, $\text{`1,35,000} \div \text{`5,40,000} = 25\%$ gives you the tax rate; where it gives the capital structure, $\text{WACC} = (0.80 \times 13.5\%) + (0.20 \times 6\%) = 12\%$, the 6% being the 8% interest net of tax. Do these first and put them in a working note.

Average investment appears in the ARR part of these questions and has a printed formula: $\frac{1}{2}(\text{initial investment} - \text{salvage}) + \text{salvage}$, which on `24,00,000 and a 10% salvage is `13,20,000. Average PAT over that base gives the ARR, and the answers show the arithmetic both as $(\text{cost} + \text{salvage}) \div 2$ and in the half-plus-salvage form.

The presentational traps in this family: state whether working capital is assumed invested at the start of the year or at the end, because the answers price both and the NPV differs; keep salvage value out of the depreciable base when the question says depreciation is on cost less residual value; and where a subsidy or a delayed instalment is involved, **show your treatment before you use it**, since the alternative treatment is also marked correct.

Application use the rule - work the problem · 5 questions

- Compute the annual cash inflow once in a working note and label it. Every part of the question then refers back to that line.
- Where the question supplies a result instead of an input — an IRR, a tax saving, a payback — work backwards from the definition first and show that step.

PQ 9.5 • PYQ 2026-Jan [2] (b) • 5M • Pg 421	LEVEL II Application	Medium
PQ 9.6 • PYQ 2026-May [2] (a) • 7M • Pg 423	LEVEL II Application	Medium
PQ 9.2 • PYQ 2024-May [3] (a) • 7M • Pg 412	LEVEL II Application	Hard
PQ 9.3 • PYQ 2025-Jan [3] (a) • 6M • Pg 416	LEVEL II Application	Hard
PQ 9.4 • PYQ 2025-May [3] (a) • 6M • Pg 418	LEVEL II Application	Hard

Analysis break it down and take the parts separately • 1 question

- Give a verdict under each technique separately. Two techniques rejecting and one accepting is a complete answer, not a contradiction to be resolved.

PQ 9.1 • PYQ 2023-Nov [3] • 10M • Pg 410	LEVEL II Analysis	Hard
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SECTION A • FINANCIAL MANAGEMENT • CHAPTER 8

Dividend Decisions

14 Topics • 38 Classified Questions • Importance: A

ICAI SKILL PROFILE ICAI band for Financial Management: Level I 20-30% • Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge **13.2%** 22 of 167 marks

Level II — Analysis & Application **86.8%** 145 of 167 marks

Below this Section's Level I floor: only 13% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for Financial Management. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Meaning of Dividend

L2P6-A-C8-T01

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 8, Dividend Decisions, on the meaning of dividend and the payout-retention split.

NOTES

No question is printed on this heading, but every numerical topic that follows rests on one idea: a dividend is the part of earnings **paid out to shareholders**, and what is not paid out is retained. Retention ratio b and payout ratio $(1 - b)$ are two readings of the same figure, and the questions routinely give you one and ask for the other.

The forms the answers recognise are **cash dividend, share repurchase and stock dividend** (bonus shares). Cash dividend is the most common; the pack defines cash widely - cash, cheque, warrant, demand draft, pay order or Electronic Clearing Service - and then closes the definition with **but not in kind**.

The models work in per-share terms, never in totals. Where the question gives total earnings, compute **EPS first, then $DPS = EPS \times \text{payout ratio}$** . Where preference capital exists, earnings for equity shareholders are struck only after preference dividend, and that subtraction is a mark on its own.

Topic 2: Forms of Dividend

L2P6-A-C8-T02

Read first Read ICAI Study Material Chapter 8, Dividend Decisions, on the forms of dividend, bonus

shares and the SEBI conditions.

NOTES

The SEBI conditions for a bonus issue are a **four-item list, and marks follow the count**. One, bonus shares are issued not in lieu of cash dividends. Two, the issue must be authorised by the Articles of Association and is not to be declared unless all partly paid-up shares have been converted into fully paid-up shares. Three, the company should not have defaulted on repayment of loan, interest and any statutory dues. Four, bonus shares are to be issued only from **share premium and free reserves**.

The fourth condition has a tail the answer prints expressly and the examiner looks for: bonus shares are **not to be issued from capital reserve** arising on revaluation of fixed assets. Write the exclusion, not just the permission.

A stock dividend is a distribution of shares in lieu of cash dividend; where the company issues new shares to existing shareholders **without any consideration** it is a bonus issue. The advantage to the company is that it suits a **cash crunch** and suits the case where lenders have imposed restrictions on paying a cash dividend.

The advantage to the investor is liquidity. A bonus issue breaks higher priced shares into lower priced shares, which gives the shareholder **a choice to sell some** of the lower priced shares and realise cash. Where the question says "to the company as well as to the investor", it is two marks and two halves - answer both or lose one.

Remembering reproduce what you have learnt · 1 question

- Number the SEBI conditions one to four and keep them in the order printed. A four-mark question is four conditions, one mark each.

TQ 2.2 · MTP 2024-Dec S2 [4] (Or) (c) · DESC · 2M · Pg 431

LEVEL I
Remembering

Easy

Understanding explain it, and place it in context · 1 question

- For a two-mark advantage question, give one advantage to each party in one line each. Do not spend the answer on what a bonus issue is.

TQ 2.1 · PYQ 2023-May [6] (a) · DESC · 4M · Pg 431

LEVEL I
Understanding

Medium

Topic 3: Significance of Dividend Policy

L2P6-A-C8-T03

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 8, Dividend Decisions, on the significance of dividend policy.

NOTES

Nothing is printed under this heading, so read it as the question that topics 7 to 9 argue over: does the payout ratio change the share price? **Walter and Gordon say it does; MM say it does not.** Decide which camp a question sits in before you reach for a formula.

The significance reduces to one comparison, not a computation. **When r is greater than K_e , retain everything;** when r is less than K_e , distribute everything; when r equals K_e , the payout makes no difference to the price. Every "is this policy optimal" question in the chapter is answered by that line plus the firm's actual payout.

The answers phrase the verdict in a settled way. A firm paying 40% while r exceeds K_e is **not following an optimum dividend policy**; a computed price below the market price means **the current dividend policy is not optimal**; a computed price equal to the market price means the current retention and dividend policy appears acceptable. Copy the sentence, do not paraphrase it.

Topic 4: Relationship between Retained Earning and Growth

L2P6-A-C8-T04

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 8, Dividend Decisions, on the relationship between retained earnings and growth.

NOTES

The whole relationship is one line: **$g = b \times r$** , growth equals the retention ratio times the return on investment. It is the only route by which retention enters a valuation, and it is asked for as a working note in almost every Gordon question.

The pack's own instances, so you can see the substitution is mechanical: $0.75 \times 22\% = 16.5\%$; $0.65 \times 15\% = 9.75\%$; retention of 60% and 40% against r of 25% give **15% and 10%**; and an averaged retention of 46% against an expected return of 21% gives 9.66%. Compute g as a separate labelled step before you touch the price formula.

Retention and payout are complements: **$b + \text{payout ratio} = 1$** . Where the question gives dividend per share and EPS, $b = 1 - D/E$, and where it gives a payout percentage, b is the remainder. Getting

these the wrong way round inverts the growth rate and loses the whole answer.

Because r drives g , the return on investment reaches the price through growth even when it does not appear in the formula you have written. The pack settles this expressly: the claim that **only cost of equity matters** under Gordon's model is not valid, since return on investment is used in computing the growth rate.

Topic 5: Determinants of Dividend Decisions

L2P6-A-C8-T05

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 8, Dividend Decisions, on the determinants of dividend decisions.

NOTES

No question is printed here and the pack gives no list of determinants, so do not manufacture one. What the answers do supply, in passing, are the constraints that actually bite in the numerical questions: **the investment the firm must fund**, whether fresh equity can be raised, and the ceiling the firm accepts on its debt-equity ratio.

The Walter limitation answer names what the formula leaves out, and by implication what a real dividend decision turns on: **taxation**, various legal and contractual obligations, and **management policy and attitude** towards dividend policy. That is the nearest the pack comes to a determinants list, and it is defensible because it is printed.

A payout question that also states an investment requirement is testing the funding constraint, not the model. Set the working out in the order the answers use - **retained earnings, then shortfall, then financing** - and only then recommend a payout.

Topic 6: Practical Considerations in Dividend Policy

L2P6-A-C8-T06

Read first Read ICAI Study Material Chapter 8, Dividend Decisions, on practical considerations in dividend policy, Lintner's model and the Graham and Dodd approach.

NOTES

Graham and Dodd: $P = M \times [D + E/3]$, where M is the multiplier, D the dividend per share and E the earnings per share. On EPS `60, payout 60% and multiplier 5 the Scanner computes $5 \times (36 +$

20) = `280 — note that **E/3 is one third of EPS**, not of the dividend.

Lintner's model has **two parameters** and a two-mark question wants exactly those two, named and nothing beyond them. The first is **the target payout ratio**. The second is the spread at which current dividends adjust to that target, and the answer states it in those words. Name both and stop; there is no third item to pad the answer with.

The Lintner computation is $D_1 = D_0 + [(EPS \times \text{target payout}) - D_0] \times \text{adjustment factor}$. The pack's case: $6.34 + [(12 \times 60\%) - 6.34] \times 45\% = 6.34 + [7.2 - 6.34] \times 45\% = 6.34 + 0.387 = `6.727$. Work the square bracket first; the adjustment factor multiplies the gap, never the whole dividend.

Graham and Dodd is asked as a two-mark substitution. With a multiplier of 5, EPS of `60 and a payout of 60%, the printed working is  $5 \times (36 + 20) = `280$, where 36 is the dividend per share and 20 is one third of EPS. Show the multiplier and the bracket - the arithmetic is one line.

Walter's limitations are **two points, each with two halves**. First, the formula does not consider all the factors affecting dividend policy and share prices, and determination of the market capitalisation rate is difficult. Second, it ignores taxation, various legal and contractual obligations, and management policy and attitude towards dividend policy.

The hard variant gives you two market prices and asks for r and K_e . Set $x = K_e$ and $y = r/K_e$, write Walter's equation once per situation as $D + y(E - D) = Px$, and solve the pair. The pack's case yields $x = 20\%$ and $y = 1.25$, so K_e is 20% and r is $1.25 \times 20\% = 25\%$.

Once r and K_e are out, the limiting values follow in two lines. At 100% retention the Walter price is $10 \times 1.25 / 0.2 = `62.50$ ; at 100% payout it is  $10 / 0.2 = `50$. Under Gordon the same data give `92 and `66, and **because r exceeds K_e the firm should retain 100%**, so a 40% dividend is not the optimum policy.

Remembering reproduce what you have learnt · 1 question

- For Lintner's parameters and Walter's limitations, write the numbered points and nothing else. These are two-mark questions and prose costs you time, not marks.

TQ 6.2 · MTP 2025-Nov S1 [4] (c) · DESC · 2M · Pg 432

LEVEL I
Remembering

Easy

Application use the rule - work the problem · 2 questions

- In Lintner, compute the target dividend ($EPS \times \text{target payout}$) as a visible step, then the gap, then apply the adjustment factor.
- Where two situations are given, tabulate DP ratio, retention ratio, DPS, retention per share and MPS as rows before forming equations.

PQ 6.1 · PYQ 2023-Nov [1] (c) (i) {C} · 2M · Pg 432

LEVEL II
Application

Easy

PQ 6.2 · RTP 2026-Jan [10] · Pg 433

LEVEL II
Application

Medium

Analysis break it down and take the parts separately · 1 question

- After solving for r and K_e , say in one sentence which is larger and what that implies for the payout. The comparison is the marked conclusion, not the algebra.

TQ 6.1 · MTP 2024-Jul [3] (b) · DESC · 2M · Pg 432

LEVEL II
Analysis

Easy

Topic 7: Theories of Dividend : Modigliani and Miller (MM) Hypothesis

L2P6-A-C8-T07

Read first Read ICAI Study Material Chapter 8, Dividend Decisions, on the Modigliani and Miller hypothesis of dividend irrelevance.

NOTES

The assumptions are a **five-item named list**: Perfect Capital Market, No Taxes, Fixed Investment Policy, No Flotation or Transaction Costs, and No Risk or Uncertainty. Name each, then give the one-line gloss - a perfect market means all investors behave rationally and have equal access to complete information; fixed investment policy means investment decisions do not change with the dividend decision and all investment is equity financed.

The share-price relation is $P_0 = (D_1 + P_1) / (1 + K_e)$, rearranged in every numerical as $P_1 = P_0(1 + K_e) - D_1$. With P_0 of ₹120, K_e of 9.6% and a contemplated dividend of ₹6.4: $P_1 = 120 \times 1.096 - 6.4 = ₹125.12$ when declared, and ₹131.52 when not declared. The whole difference between the two columns is the dividend.

The valuation formula is $nP_0 = [(n + D_n)P_1 - I + E] / (1 + K_e)$, where n is the number of shares at the start, D_n the shares issued to raise the funds needed, I the investment, E the total earnings for the period and K_e the capitalisation rate. Write the term key out; the answers do, and it carries method marks even where the arithmetic slips.

The funds working is the same three lines in both columns. **Earnings less dividend paid = funds available**; investment less funds available = balance to be raised; **number of new shares = balance / P_1** . Lay the two columns - dividend declared and not declared - side by side, because the examiner is looking for the contrast, not two separate answers.

The capital-structure form of MM appears here too. Without tax, $V_u = NOI / K_e$ and $V_L = V_u + (Debt \times nil)$, so the two firms are worth the same; with tax, $V_u = NOI(1 - t) / K_e$ and $V_L = V_u + (Debt \times t)$. Then $K_e = NI / S$ and $k_o = (K_e \times S/V) + (K_d \times D/V)$, with K_d after tax at $12\%(1 - 0.4) = 7.2\%$.

The verdict sentence is the mark. Value of the firm **remains the same irrespective of the dividend paid**, and where the two columns differ slightly the answers attribute it to rounding. The one

exception the pack prints: where the question itself hands you a different P1 for each payout, the computed P0 does move, and the answer then concludes that the change in payout has indeed impacted valuation.

Understanding explain it, and place it in context · 1 question

- Close every MM answer with the irrelevance sentence. A page of correct arithmetic without it loses the last mark.

TQ 7.1 · PYQ 2026-May [4] (a) · DESC · 4M · Pg 435

LEVEL I
Understanding

Medium

Application use the rule - work the problem · 5 questions

- Compute P1 first, then the funds required, then the new shares. Doing the shares before P1 leaves you dividing by a figure you have not found.
- Set the dividend and no-dividend cases as two columns of one table, not as two answers.

PQ 7.3 · PYQ 2021-Jul [1] (b) {C} · 5M · Pg 441

LEVEL II
Application

Medium

PQ 7.4 · MTP 2025-Aug S2 [1] (a) · 5M · Pg 442

LEVEL II
Application

Medium

PQ 7.5 · MTP 2025-Nov S1 [1] (c) · 5M · Pg 444

LEVEL II
Application

Medium

PQ 7.1 · PYQ 2018-Nov [5] · 10M · Pg 436

LEVEL II
Application

Hard

PQ 7.2 · MTP 2020-May [2] · 10M · Pg 439

LEVEL II
Application

Hard

Topic 8: Theories of Dividend: Walter's Model

L2P6-A-C8-T08

Read first Read ICAI Study Material Chapter 8, Dividend Decisions, on Walter's model.

NOTES

The formula as the answers write it is $P = [D + (r/K_e)(E - D)] / K_e$, where P is market price per share, E earnings per share, D dividend per share, K_e the cost of equity or rate of capitalisation, and r the internal rate of return or return on investment. Write the term key, substitute, then compute - the pack's answers do all three every time.

The assumptions are a **six-item list**: all investment proposals are financed through retained earnings only; r and K_e are constant; perfect capital markets, with rational investors and freely

available information; no taxes and no tax discrimination between dividend income and capital gain; no flotation or transaction cost; and **the firm has perpetual life**.

Before the formula, build the EPS. Where there is preference capital, **net profit less preference dividend** gives earnings for equity shareholders, divided by the number of equity shares - 50 lakh less 26 lakh over 6 lakh shares gives `4. Where the question starts at profit before tax, take tax off first: 40 lakh less 30% is 28 lakh, over 4 lakh shares, `7.

Ke is often hidden in the P/E ratio. **$Ke = 1 / (P/E \text{ ratio})$** , and $P/E = MPS / EPS$. A P/E of 10 means Ke of 10%; an MPS of `198 against an EPS of `18 gives a P/E of 11 and so a Ke of 9.091%. Deriving Ke this way is a separate mark, so show it.

The decision rule: **when r exceeds Ke the optimum payout is nil**, because the price rises as the payout falls, and when r is below Ke the firm should distribute everything. With EPS `3,  $r$  20% and Ke 15%, the maximum price at zero dividend is **`26.67** and the minimum at full distribution is **`20**. Say which case you are in before you compute either.

The reverse question sets the price and asks for the payout. **Let D be the unknown**, put the target price on the left, and solve. At a price of `40 on EPS `4 the answer reaches $D = `1$  and a payout of 25%; at `48 on EPS `7 it reaches  $D = `6$ and 85.714%. The algebra is one line once the formula is written with D loose.

The recurring trap is the ratio you are given. **Retention ratio is not payout ratio** - a retention of 40% means a dividend of 60% of EPS - and r/Ke must go in as a decimal multiple, $0.15/0.12 = 1.25$, not as a percentage.

Understanding explain it, and place it in context • 1 question

- Assumptions are a list, and marks follow the count. Name each in a short clause, and do not expand any of them unless the question asks you to.

TQ 8.1 • PYQ 2022-May [6] (b) • DESC • 4M • Pg 446

LEVEL I
Understanding

Medium

Application use the rule - work the problem • 7 questions

- Compute EPS and DPS as numbered workings above the formula. Most lost marks in this topic are in the earnings figure, not in Walter.
- State the formula with its term key before substituting. Where a question gives P and asks for D, write the same formula with D left as the unknown.

PQ 8.4 • PYQ 2023-Nov [1] (c) (ii) {C} • 3M • Pg 450

LEVEL II
Application

Easy

PQ 8.7 • PYQ 2025-May [2] (b) • 2M • Pg 454

LEVEL II
Application

Easy

PQ 8.2 · PYQ 2020-Nov [1] (c) {C} · 5M · Pg 448	LEVEL II Application	Medium
PQ 8.3 · PYQ 2021-Jul [1] (d) {C} · 5M · Pg 449	LEVEL II Application	Medium
PQ 8.5 · PYQ 2025-Jan [1] (c) {C} · 5M · Pg 451	LEVEL II Application	Medium
PQ 8.1 · PYQ 2019-Nov [1] (c) {C} · 5M · Pg 446	LEVEL II Application	Hard
PQ 8.8 · MTP 2025-Jul S1 [1] (a) · 5M · Pg 454	LEVEL II Application	Hard

Analysis break it down and take the parts separately · 1 question

- Compare r with K_e in one sentence and let that sentence drive the optimum payout you quote.

PQ 8.6 · RTP 2025-Jan [8] · Pg 452	LEVEL II Analysis	Medium
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Topic 9: Theories of Dividend : Gordon's Model

L2P6-A-C8-T09

Read first Read ICAI Study Material Chapter 8, Dividend Decisions, on Gordon's model and the dividend growth approach.

NOTES

Gordon is printed in two equivalent forms: $P_0 = E(1 - b) / (K_e - br)$ and $P_0 = D_1 / (K_e - g)$ with $g = br$. Both appear in the answers for the same data, so say which form you are using. The denominator is the whole risk in this topic - K_e and g must both be decimals and K_e must exceed g .

The assumptions are a **four-item list**: no external financing, all investment being financed through retained earnings; constant rate of return r and cost of capital k ; **perpetual life of the firm**; and a stable dividend payout ratio.

Where the question gives a dividend already paid, grow it. Share capital of ₹2,400 crores of ₹5 each with a 1,000% dividend gives **DPS of ₹50**, so $D_1 = 50 \times 1.14 = 57$ and $P_0 = 57 / (0.18 - 0.14) = ₹1,425$. Drop the growth rate to 10% and the same working gives ₹687.5 - one input changes, the format does not.

The P/E variant is the same equation divided through by EPS: $P/E = (1 - b) / (K_e - br)$. Set the target P/E on the left and solve for b . A P/E of 12 with K_e 20% and r 25% gives $b = 0.70$; a P/E of 10 with K_e 17.5% gives $b = 0.50$. The expected price a year on is then **MPS $\times (1 + g)$** at the new growth rate.

The model also runs backwards from a given price. With P_0 of ₹159.09, EPS ₹10, K_e 8% and r 12%, the answer solves $159.09(0.08 - 0.12b) = 10(1 - b)$ to **$b = 0.30$** , so the payout is 0.70 and the dividend per share is ₹7. Clear the fraction first, then collect the b terms.

Two decision sentences carry marks. When r exceeds K_e the **optimum payout ratio is zero** - the price per share rises as the payout falls. When r equals K_e **there is no optimum ratio**, because the payout does not affect the price at all. The second is the one candidates leave out.

Remembering reproduce what you have learnt • 1 question

- Four assumptions, four lines, in the order printed. A four-mark question is asking you to count.

TQ 9.1 • PYQ 2024-Sep [4] (b) • DESC • 4M • Pg 456

LEVEL I
Remembering

Medium

Application use the rule - work the problem • 4 questions

- Compute g as its own step, then check K_e is greater than g before dividing. A negative denominator means you have mixed up b and the payout.
- Where the answer can be written either as $D1/(K_e - g)$ or as $E(1-b)/(K_e - br)$, name the form you use; the pack accepts both.

PQ 9.2 • PYQ 2023-Nov [5] (b) • 5M • Pg 458

LEVEL II
Application

Medium

PQ 9.3 • PYQ 2025-May [1] (b) {C} • 5M • Pg 459

LEVEL II
Application

Medium

PQ 9.4 • PYQ 2025-Sep [2] (b) • 3M • Pg 461

LEVEL II
Application

Medium

PQ 9.1 • PYQ 2023-May [1] (a) {C} • 5M • Pg 457

LEVEL II
Application

Hard

Topic 10: Dividend Discount Model

L2P6-A-C8-T10

Read first Read ICAI Study Material Chapter 8, Dividend Decisions, on the dividend discount model and multi-stage growth.

NOTES

The multi-stage question has one shape. Grow the dividend year by year at the first rate, discount each year at the given factor, and then take a terminal value at the stabilised growth rate and discount it at the final year's factor. **Intrinsic value = PV of dividends + PV of terminal value.**

The pack's clearest working: D0 of `4 growing at 10% gives 4.4, 4.84, 5.324 and 5.856 across four years, which at PVF 15% come to `14.341; the terminal value of 61.488 discounted at 0.572 gives 35.171; the intrinsic value is `49.512. Tabulate year, dividend, PVF and PV - the table is where the method marks sit.

The verdict sentence is mandatory and it is comparative. An intrinsic value of ₹1,408.29 against a market price of ₹2,185 is reported as **over-priced by ₹776.71**. Give the direction and the difference, not just the two figures.

Getting D0 right is where the short version of this question is won. Retained earnings per share of ₹3.60 at a 40% retention means **EPS is ₹9**, so the dividend per share is $9 \times 60\% = ₹5.40$. Read what the per-share figure you have been given actually is before you grow it.

The descriptive question attached to this head asks for the common forms of dividend: **cash dividend**, the most common, paid by cash, cheque, warrant, demand draft, pay order or ECS but not in kind; **share repurchase**, where the company buys back its own shares using corporate cash; and **stock dividend or bonus shares**, a distribution of shares in lieu of cash dividend.

Understanding explain it, and place it in context · 1 question

- Name the form, define it in one line, then give one example or consequence. Two marks means three sentences, not a page.

TQ 10.1 · MTP 2025-Dec S2 [4] · DESC · 2M · Pg 462

LEVEL I
Understanding

Easy

Application use the rule - work the problem · 3 questions

- Lay the discounting out as a table of year, dividend, PVF and PV, then add the terminal value as a separate line. A running paragraph of arithmetic loses the working marks.
- Use the year-n discount factor for the terminal value, not the year-(n+1) factor.

PQ 10.2 · PYQ 2024-May [3] (b) · 3M · Pg 463

LEVEL II
Application

Easy

PQ 10.1 · PYQ 2021-Dec [1] (c) {C} · 5M · Pg 462

LEVEL II
Application

Medium

PQ 10.3 · MTP 2024-Nov [2] (b) · 4M · Pg 464

LEVEL II
Application

Medium

Topic 11: Theories of Dividend : Comprehensive

L2P6-A-C8-T11

Read first Read ICAI Study Material Chapter 8, Dividend Decisions, on applying Walter's and Gordon's models to the same data.

NOTES

The comprehensive question hands you one set of data and asks for both prices. Write Walter as $P = [D + (r/K_e)(E - D)] / K_e$ and Gordon as $P_0 = E(1 - b) / (K_e - br)$, answer them in the order the

question numbers them, and do not let the two share a working. The same data routinely give very different prices - `71.875 and `100 on one question, `1,200 and `2,250 on another - and that divergence is not an error.

The earnings working is common to both and is marked separately. Net profit `30,00,000 less preference dividend of 12% on `1,00,00,000 leaves `18,00,000, over 6,00,000 shares, so **EPS is `3**; a retention of 75% then makes DPS `0.75. Where only a return on equity and a book value are given, **EPS = ROE x BVPS**, so  $0.15 \times 125 = `18.75$.

Gordon can be written with D1 or with D0 and the pack prints both for the same question - `58.27 using the grown dividend and `50 using the unexpanded form. **Name the version you are using** in a line above the substitution; the alternative is shown as acceptable, an unlabelled mixture is not.

Where Walter is applied to data built for Gordon, the answers state the bridging assumption expressly: **D is assumed constant through infinity**, so no growth is added to the dividend inside Walter. Write that assumption down rather than quietly using a different dividend in each model.

The combined MM and Gordon question runs in one chain. Gordon gives $P_0 = 12 / (0.25 - 0.20) = `240$ ; the number of shares is issued capital over price,  $`24,00,000 / 240 = 10,000$; MM then gives P_1 from $P_0 = (D_1 + P_1) / (1 + K_e)$, so $P_1 = `288$ ; and the earnings needed follow from  $nP_0 = [(n + D_n)P_1 - I + E] / (1 + K_e)$ , giving **E = `3,32,000**. Each step feeds the next, so a slip in P_0 costs the whole chain.

Walter also runs backwards here. To hold the price at `60 on EPS `6 with r 25% and K_e 15%, solve for D as the unknown: D comes to `1.50, so the **retention ratio is $4.5/6 = 75\%$** . Under Gordon the accompanying answer is the standard sentence - when r exceeds K_e the optimum payout ratio is zero.

Application use the rule - work the problem · 6 questions

- Do the EPS and DPS working once, box it, and feed both models from it. Recomputing earnings inside each model is where the two answers drift apart.
- Answer the models in the order the question lists them and head each with its formula.

PQ 11.1 · PYQ 2019-May [1] (d) {C} · 5M · Pg 465	LEVEL II Application	Medium
PQ 11.2 · PYQ 2021-Jan [1] (b) {C} · 5M · Pg 466	LEVEL II Application	Medium
PQ 11.3 · MTP 2024-Jul [2] (b) · 4M · Pg 468	LEVEL II Application	Medium
PQ 11.4 · MTP 2024-Dec S2 [2] (b) · DESC · 4M · Pg 470	LEVEL II Application	Medium
PQ 11.6 · PYQ 2026-May [3] (a) · 4M · Pg 473	LEVEL II Application	Medium
PQ 11.5 · PYQ 2026-Jan [1] (c) {C} · 5M · Pg 471	LEVEL II	Hard

Topic 12: Stock Splits

L2P6-A-C8-T12

Read first Read ICAI Study Material Chapter 8, Dividend Decisions, on stock splits.

NOTES

A four-mark question here is **two advantages and two limitations**, evenly split, one mark each. The structure of the answer is two headed lists - do not write a paragraph and hope the examiner finds four points in it.

The advantages as printed: a split makes the share **affordable to small investors**; and the larger number of shares may increase the number of shareholders, so the potential of investment may increase.

The limitations as printed: additional expenditure has to be incurred on the process of the split itself; and a **low share price may attract speculators** or short-term investors, who are generally not preferred by a company.

Analysis break it down and take the parts separately · 1 question

- Balance the answer: give as many limitations as advantages, and give exactly the number asked for. Split the two under their own sub-headings so the examiner can find both.

TQ 12.1 · PYQ 2025-Sep [4] (a) · DESC · 4M · Pg 474

LEVEL II
Analysis

Medium

Topic 13: Share Buyback

L2P6-A-C8-T13

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 8, Dividend Decisions, on share buyback.

NOTES

No question is printed on this heading and the pack carries only one line of definition, so keep the answer to what is supported: a share repurchase is a transaction in which a company **buys back its own shares using corporate cash**, and the pack adds that a lot of corporates do this now.

Its place in the syllabus is as a **form of dividend**. Where a question asks you to explain the common forms of dividend, buyback is the second of the three - cash dividend, share repurchase, stock

dividend - and leaving it out costs a mark on a three-item list.

Do not import buyback pricing, tax treatment or the statutory limits into an answer from memory. **Nothing on those is printed in this Scanner**, and the marks available here are for naming and defining, not for computation.

Topic 14: Integrated Problems

L2P6-A-C8-T14

Read first Read ICAI Study Material Chapter 8, Dividend Decisions, on integrated problems combining Gordon's and Walter's models with CAPM.

NOTES

The integrated problem is Gordon with the three inputs buried in the narrative. **Compute g, D1 and Ke as three separate labelled workings**, each with its own heading, before you write the price line. The answer is structured exactly that way and the headings themselves carry marks.

For g: the retention ratio is the **average of the five years given**, $(40 + 65 + 50 + 45 + 30) / 5 = 46\%$, and the expected return is the probability-weighted sum, 20×0.3 plus 15×0.6 plus $12 \times 0.5 = 21\%$, so $g = 0.46 \times 21\% = 9.66\%$. The printed probabilities sum to more than one and the answer uses them exactly as given - reproduce its method, do not normalise them.

For D1: the dividend is quarterly, so **annualise first** - $\text{'3 per quarter} \times 4 = \text{'12}$ - and then grow it, $12 \text{ plus } 9.66\% = \text{'13.16}$. A per-quarter figure fed straight into an annual model quarters the answer.

For Ke: use CAPM, **Ke = Rf + (Rm - Rf) x beta** = $4.5 + (12.5 - 4.5) \times 1.3 = 14.9\%$. Then $P_0 = 13.16 / (0.149 - 0.0966) = \text{'251.15}$.

The same data are then put through Walter, and the answer flags the difference: **where D is constant, no growth is added**. EPS is recovered as dividend over one minus the retention ratio, $12 / (1 - 0.46) = \text{'22.22}$, and Walter's price comes to '177.21 . Two models, two prices, both reported.

Application use the rule - work the problem · 1 question

- Write the three inputs as lettered workings (A) g, (B) D1, (C) Ke before the price. An integrated question is marked on the workings, because the final division is one line.
- Annualise and gross up every figure - quarterly dividends, averaged ratios, probability-weighted returns - before it enters a formula.

TQ 14.1 · RTP 2025-May [8] · Pg 475

LEVEL II
Application

Medium

SECTION A · FINANCIAL MANAGEMENT · CHAPTER 9.1

Management of Working Capital - Introduction to Working Capital Management

6 Topics · 23 Classified Questions · Importance: C

ICAI SKILL PROFILE ICAI band for Financial Management: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge

2.9%

4 of 140 marks

Level II — Analysis & Application

97.1%

136 of 140 marks

Below this Section's Level I floor: only 3% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for Financial Management. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Meaning and Concept of Working Capital

L2P6-A-C9.1-T01

Read first Read ICAI Study Material Chapter 9 Unit I, Introduction to Working Capital Management, on the meaning and concept of working capital.

NOTES

Permanent working capital is the base working capital: the **minimum level of investment in current assets** carried by the entity at all times to carry on its day-to-day activities. The answer adds the qualifier that earns the second mark - it generally stays invested in the business unless operations are **scaled up or down permanently**, which itself raises or lowers the permanent requirement.

Temporary working capital is the part required in addition to the permanent portion. The answer names its aliases - variable or fluctuating working capital - and ties it to a cause: it finances the short-term requirements that arise from **fluctuation in sales volume**.

A four-mark "describe" question of this kind is two paragraphs, one per type, each running definition then behaviour then cause. The quoted statement says both are necessary to facilitate production and sales through the operating cycle, so **close by linking both to the operating cycle** rather than leaving two definitions sitting side by side.

Understanding explain it, and place it in context · 1 question

- Define each type in its own paragraph, using the phrases the answer uses - base or minimum level for permanent, variable or fluctuating for temporary.
- Answer the proposition the question quotes. If it says both are necessary, say why each is, in one closing line.

TQ 1.1 · PYQ 2023-May [6] (b) · DESC · 4M · Pg 482

LEVEL I
Understanding

Medium

Topic 2: Significance of Working Capital

L2P6-A-C9.1-T02

Read first Read ICAI Study Material Chapter 9 Unit I, Introduction to Working Capital Management, on the significance and scope of working capital management.

NOTES

The scope question is answered through a **trade-off table with five components**, in this order: inventory, receivables, prepayment of expenses, cash and cash equivalents, and payables and expenses. Each row carries three cells - the advantage of the **higher side, which is profitability**, the advantage of the lower side, which is liquidity, and the technique that balances the two.

The rows as printed. Inventory: fewer stock-outs increase profitability, against lower inventory requiring less capital but risking stock-out and loss of goodwill, balanced by **EOQ and JIT**.

Receivables: a higher credit period attracts customers and increases revenue but brings more bad debts, against cash sales giving liquidity but failing to boost revenue, balanced by evaluating the credit policy and using **factoring**. Prepayment of expenses: reduces uncertainty and is profitable in an inflationary environment, against improved liquidity, balanced by **cost-benefit analysis**.

The last two rows. Cash and cash equivalents: holding cash means payables are honoured in time, which improves goodwill and helps in getting future discounts, against cash being investable elsewhere, balanced by **cash budgets** and cash management techniques. Payables and expenses: delaying payment frees capital for other investment avenues, against honouring payables in time for goodwill and future discounts, balanced by evaluating the credit policy and its related cost.

Applied to a scenario, the answer does not lecture. It takes each component the narrative has moved - higher inventory, longer credit, depleting cash, delayed supplier payments - and says **which side of the trade-off the company has chosen** and what that costs it. Name the component, name the side, name the consequence.

The numerical under this head is a supplier discount decision. Gross up the alternative return first: a monthly **1.5% net of 10% TDS** is $1.5/0.90 \times 12 = 20\% \text{ per annum}$. Against that, the implied annual cost of forgoing a 2% discount over the extra 45 days works out at **17.54%**. Because the gross return exceeds the implied cost, **the company should not accept the supplier's offer**.

The same conclusion is then proved on a `10,000 invoice, and the table is worth copying. Refuse the discount: pay `10,000, less the return from investing `9,800 between day 15 and day 60 at 20%, which is `245, so the **net cost is `9,755**. Accept the discount: pay **`9,800**. Refusing is cheaper, because the return on cash retained beats the saving on the discount.

Analysis break it down and take the parts separately · 2 questions

- Work component by component through the scenario the question gives, and state the trade-off each one represents before you comment on the whole.

TQ 2.1 · RTP 2025-Sep [10] (c) · DESC · Pg 483

LEVEL II
Analysis

Medium

PQ 2.1 · MTP 2025-Dec S2 [2] · 10M · Pg 484

LEVEL II
Analysis

Hard

Topic 3: Determinants of Working Capital

L2P6-A-C9.1-T03

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 9 Unit I, Introduction to Working Capital Management, on the determinants of working capital.

NOTES

No question is printed under this heading, so there is no printed list to reproduce and none should be invented. What the Scanner does show is which determinants the paper actually uses, because they arrive as the data of every estimation question: **holding periods for raw materials, work-in-progress and finished goods**, the credit allowed to debtors and taken from suppliers, the lag in payment of wages and overheads, the minimum cash balance, and the level of activity.

Each of those is a determinant because moving it moves the requirement in a predictable direction. A longer stock or debtor period **raises current assets and so raises the requirement**; a longer creditor period raises current liabilities and so reduces it. That is the whole logic behind the operating cycle formula in topic 6.

Where a question asks you to discuss determinants rather than compute, take them from the facts the question itself supplies - the growth in sales, the credit terms offered, the nature of the production process - and say in each case **whether the requirement rises or falls**. An answer that lists determinants without directions of movement reads as recall, not analysis.

Topic 4: Management of Working Capital

L2P6-A-C9.1-T04

Read first Read ICAI Study Material Chapter 9 Unit I, Introduction to Working Capital Management, on managing working capital, liquidity ratios and factoring.

NOTES

On the claim that piling up inventory improves working capital efficiency, the answer is **no**, supported by a **five-point list** in this order: inefficient use of funds, because cash is tied in unsold goods with higher holding costs; **false sense of liquidity**, inventory being less liquid than cash or receivables; decline in inventory turnover; risk of obsolescence, especially in fast-moving industries; and the efficiency metric itself, which is the **cash conversion cycle**, not the ratio.

The closing sentence is the mark for judgement: increasing inventory **inflates the current ratio but harms working capital efficiency** by locking funds in slow-moving assets, and true efficiency comes from balancing liquidity with turnover, not from increasing asset size. Write the current ratio as current assets over current liabilities once, then argue.

The factoring evaluation runs in a fixed order and each line is a mark. Credit sales, then the **average collection period as a weighted average** of the two payment patterns, then average receivables = credit sales x collection period / 360, then **factoring commission**, then the **factoring reserve**, then the amount available for advance = receivables less reserve less commission, then the factor's interest for the collection period, then the advance actually paid.

The costs computed so far are for one collection period, so **annualise them by multiplying by 360/collection period** before comparing anything. Commission of `71,111 and interest of `1,25,156 over 80 days become `3,20,000 and `5,63,200, a total annual cost of `8,83,200.

Against that set the savings the firm makes by factoring: **cost of credit administration saved** and bad debts avoided, `2,40,000 each here, `4,80,000 in total. **Net cost = annual cost less savings** = `4,03,200. Both halves must appear as headed blocks A and B - a net figure with no savings block does not show the method.

The effective cost is **net cost divided by the advance actually paid**, $\text{`4,03,200} / \text{`30,03,733} = \mathbf{13.42\%}$, and the answer records the alternative of dividing by the amount available for advance, which gives 12.89%. State which base you have used. The decision is then a straight comparison: bank finance at 12% is cheaper than 13.42%, so the firm **should not avail the factoring service**.

Application use the rule - work the problem · 1 question

- Build the receivables figure before anything else - commission, reserve and interest are all percentages of it.
- Annualise commission and interest before comparing with the bank rate. Comparing a per-period cost with an annual rate is the standard slip.

PQ 4.1 · RTP 2025-Sep [9] · Pg 488

LEVEL II
Application

Medium

Analysis break it down and take the parts separately · 1 question

- This is a claim to be tested, not a topic to describe. Say what the ratio does, then what accumulating inventory does to liquidity and cost, then give a verdict sentence on the claim.

TQ 4.1 · MTP 2025-Jul S1 [4] (a) · DESC · 4M · Pg 487

LEVEL II
Analysis

Hard

Topic 5: Estimating Working Capital Needs

L2P6-A-C9.1-T05

Read first Read ICAI Study Material Chapter 9 Unit I, Introduction to Working Capital Management, on estimating working capital needs and evaluating credit policy.

NOTES

The statement has a fixed shape and reproducing it is worth more than speed. **A. Current Assets** - raw material stock, work-in-progress, finished goods, debtors, cash and bank, prepaid expenses, advance tax - totalling to **gross working capital**. **B. Current Liabilities** - creditors for materials, outstanding wages, outstanding overheads. Then **net working capital = A - B**, and the safety margin below it.

Where the question says cash cost basis, **strip out every non-cash item** and value the assets at cost, not at selling price. Depreciation comes out of manufacturing overheads; a **revenue subsidy also comes out**, because it reduces a revenue expense rather than the cost of the machine. Debtors are then carried at the **cash cost of sales**, never at sales value.

The stock lines follow the holding periods given. Raw material at one month of consumption; finished goods at one month of the cash cost of goods sold; work-in-progress at the stated stage - **material at 90% or 100% and conversion at 50%** where the question is silent. Where you have assumed a completion stage, **write the assumption as a note**; the printed answers do, and the notes are marked.

Current liabilities are where the timing words matter and the timings are the marks. Wages **paid at the beginning of the next month** means one month outstanding; expenses paid one month in arrear means one month outstanding, and where only the outstanding amount is given it is what lets you gross up to the annual figure; anything **paid in advance is a prepayment on the assets side**, not a liability.

One sequencing trap recurs. Where cash is to be held at a percentage of current liabilities, cash cannot be computed until the liabilities block is complete, and the liabilities include the outstanding wages and expenses. **Compute liabilities first, then cash, then total**. Adding cash before the liabilities are final is the error the answers warn against.

The safety margin goes on at the end, on the net working capital, and **say that you have applied it** - 15% on `9,62,124 gives `1,44,319 and a net requirement of `11,06,443. In an export question the same statement absorbs the specials: imported material is **purchase price plus customs duty less duty drawback**; a letter of credit cuts the export debtor period from three months to **one month**; and the advice compares the cash cost of export sales with the export sales value before adding

the non-monetary factors.

The credit policy question is a separate format, worked as a percentage return. Take the increased credit sales, then the **contribution at (1 - variable cost ratio)**, less the bad debt loss, less the cost of the cash discount, giving after-tax profit at (1 - tax rate); then the decrease in receivable investment; then **expected return = profit / change in investment**; then **net gain = opportunity cost less expected return**. A net gain of 5.2% is reported as a reason to change the policy, and the recommendation sentence is the last mark.

Application use the rule - work the problem - 4 questions

- Head the statement A. Current Assets and B. Current Liabilities and total each block before subtracting. An unheaded column of figures loses the presentation marks.
- Write every assumption you make - completion stage, cash cost basis, treatment of other overheads - as a numbered note under the statement.

PQ 5.4 · PYQ 2026-Sep [1] (c) {C} · 5M · Pg 499

LEVEL II
Application

Medium

PQ 5.1 · RTP 2025-May [9] · Pg 490

LEVEL II
Application

Hard

PQ 5.2 · MTP 2025-Aug S2 [3] (a) · 8M · Pg 494

LEVEL II
Application

Hard

PQ 5.3 · MTP 2025-Nov S1 [2] (a) · 8M · Pg 496

LEVEL II
Application

Hard

Topic 6: Operating or Working Capital Cycle

L2P6-A-C9.1-T06

Read first Read ICAI Study Material Chapter 9 Unit I, Introduction to Working Capital Management, on the operating or working capital cycle.

NOTES

The formula is **Operating Cycle = R + W + F + D - C**, where R is the raw material storage period, W the work-in-progress conversion or holding period, F the finished goods storage period, D the debtors collection period and C the creditors payment period. Write the term key out - the answers do, and it is a mark before any arithmetic.

Each period is the average stock over the matching annual flow, times 365 or 360, and pairing them wrongly is the commonest error. R goes over **annual consumption**, which is opening stock plus purchases less closing stock, not over purchases. W goes over the **annual cost of production**. F goes over the **cost of goods sold**. D goes over **annual credit sales** and C over **annual credit purchases**. Round each to whole days before you add them.

Then two lines close the question. **Number of operating cycles = $365 / \text{operating cycle period}$** , and the working capital required is the annual operating cost divided by that number of cycles. Worked through: $53 + 35 + 45 + 77 - 63 = 147$ days, so $365/147 = 2.48$ times, and $\text{₹}4,225 \text{ lakh} / 2.48 = \text{₹}1,703.63 \text{ lakh}$; a 10% contingency reserve of $\text{₹}170.36 \text{ lakh}$ is added after that division, not before, giving $\text{₹}1,874 \text{ lakh}$.

Two variations are printed. Where credit sales are discontinued in favour of pre-payment, **drop D from the cycle** - $45 + 20 + 25 - 60$ falls from 60 days to 30 - and the requirement halves; report the reduction, not just the new figure. Where the contingency is stated as a percentage **of the requirement including the provision**, the multiplier is $1/9$, not 10%, so $\text{₹}4,49,792 \times 1/9 = \text{₹}49,977$.

The cash cycle questions are the same idea in cash terms. The cash cycle is inventory days plus receivable days less payable days; **cash turnover = $360 / \text{cash cycle}$** ; and the minimum operating cash is the total annual cash outlay divided by that turnover, the outlay being sales less net profit. So $60 + 90 - 30 = 120$ days, turnover 3, outlay $\text{₹}180 \text{ lakhs}$, minimum cash $\text{₹}60 \text{ lakhs}$. Where a discount is offered to shorten collection, recompute the cycle, then the new minimum cash, then set the opportunity cost saving (the rate times the reduction, after tax) against the cost of the discount (the discount times the proportion availing times sales, after tax) - here $\text{₹}1.26 \text{ lakhs}$ against $\text{₹}1.68 \text{ lakhs}$, so **the scheme should not be adopted**.

The estimation questions under this head are cash cost problems and carry two traps of their own. Where only part of sales is on credit, **debtors are computed on the credit portion only** - if cash sales are 75% less than credit sales, credit sales are 80% of the total. And finished goods and debtors are valued at **cost excluding depreciation**, with creditors computed on purchases, which are consumption plus closing raw material stock, not on consumption alone.

Two set-piece theory items sit here. The working capital policy question tabulates conservative, moderate and aggressive and asks for **net working capital, rate of return and current ratio** under each, the pattern being that the aggressive policy shows the **highest return and the lowest current ratio**. And factoring against forfaiting is a six-row distinction: meaning; recourse, where factoring may be with or without recourse but forfaiting is **always non-recourse**; amount, **80% to 90% up front against 100%**; type of receivables, domestic or international against international only; cost, borne by the seller against borne by the overseas buyer; and the secondary market, which factoring lacks and forfaiting has.

Application use the rule - work the problem · 13 questions

- Compute annual consumption from opening stock plus purchases less closing stock before you touch the raw material period.
- Match each average stock to its own denominator - production cost for work-in-progress, cost of goods sold for finished goods, credit sales for debtors.

PQ 6.7 • RTP 2024-May [7] • Pg 513	LEVEL II Application	Medium
PQ 6.8 • PYQ 2024-Sep [1] (b) {C} • 5M • Pg 517	LEVEL II Application	Medium
PQ 6.9 • RTP 2024-Sep [10] • Pg 518	LEVEL II Application	Medium
PQ 6.10 • PYQ 2025-Jan [2] (b) • 3M • Pg 520	LEVEL II Application	Medium
PQ 6.11 • MTP 2025-Jul S1 [1] (c) • 5M • Pg 522	LEVEL II Application	Medium
PQ 6.12 • RTP 2026-May [9] • Pg 524	LEVEL II Application	Medium
PQ 6.13 • PYQ 2026-May [3] (b) • 6M • Pg 527	LEVEL II Application	Medium
PQ 6.1 • PYQ 2018-May [5] • 10M • Pg 501	LEVEL II Application	Hard
PQ 6.2 • RTP 2018-Nov [7] • Pg 504	LEVEL II Application	Hard
PQ 6.3 • PYQ 2019-May [5] • 10M • Pg 506	LEVEL II Application	Hard
PQ 6.4 • PYQ 2020-Nov [2] • 10M • Pg 508	LEVEL II Application	Hard
PQ 6.5 • PYQ 2021-Jan [1] (d) {C} • 5M • Pg 510	LEVEL II Application	Hard

Analysis break it down and take the parts separately • 1 question

- Where the question changes one term, such as removing the debtor period, recompute the cycle and report the change in requirement, not just the new requirement.

TQ 6.1 • MTP 2024-Dec S2 [4] (a) • DESC • 4M • Pg 500	LEVEL II Analysis	Medium
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SECTION A · FINANCIAL MANAGEMENT · CHAPTER 9.2

Management of Working Capital - Treasury and Cash Management

7 Topics · 9 Classified Questions · Importance: D

ICAI SKILL PROFILE ICAI band for Financial Management: Level I 20-30% · Level II 70-80% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge **34.1%** 15 of 44 marks

Level II — Analysis & Application **65.9%** 29 of 44 marks

Above this Section's Level I ceiling: 34% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for Financial Management. Reading carries more of the preparation here than it does elsewhere; do not prepare this chapter by working sums alone. Read the split with care: the chapter carries only 9 classified questions, so a single question moves it several points.

Topic 1: Meaning of Treasury Management

L2P6-A-C9.2-T01

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 9, Unit II - Treasury and Cash Management, on what treasury management means and where the treasury sits inside the finance function.

NOTES

The Scanner declares **no PYQ, RTP or MTP** against this head and prints no question on it. Read it once as the frame for the next topic; everything the examiner has actually asked about treasury comes back as the functions list.

The scope the printed answers support is a single sentence: the treasury is responsible for the firm's cash, funding, currency, corporate finance and banking relationships. The 2026 RTP question adds the direction of travel - the department has moved **from cash handling to hedging forex risk** and to the composition of capital structure.

If a question ever opens "explain treasury management", give that one-line scope sentence and move straight into the five heads of topic 2. **The marks sit on the heads**, not on the definition.

Topic 2: Functions of Treasury Department

L2P6-A-C9.2-T02

Read first Read ICAI Study Material Chapter 9, Unit II - Treasury and Cash Management, on the

fundamental tasks of the treasury department.

NOTES

The answer is a **five-head list** and the marks follow the number of heads named. The 2016 answer runs Cash Management, Funding Management, Currency Management, Corporate Finance, Banking; the 2026 RTP answer runs Cash Management, Currency Management, Fund Management, Banking, Corporate Finance. **Either order is accepted** - name all five first, then give two or three sub-points under each.

Cash Management: forecasting future cash requirements through **cash budgets**; efficient collection of receivables and payment of liabilities through **float management**; monitoring the funds position at divisions and branches and moving idle balances to where they are needed; and parking surplus funds in marketable securities to optimise return. The RTP version adds that investment policy weighs future need for liquid funds against the level of risk company policy accepts.

Funding or Fund Management: planning **short, medium and long-term** cash needs; participating in decisions on capital structure and dividend payout; obtaining the funds from sources such as bank loans and public issues; and timing temporary investment of surplus by mapping the gap between inflow and outflow.

Currency Management: managing the **foreign currency risk exposure**. In a group the first step is to **set off intra-group indebtedness**; then match receipts and payments in the same currency, which saves transaction costs and shelters the firm from adverse movements; then manage the net exposure in line with company policy, using **forward contracts** to buy or sell currency forward. It also decides the currency used to invoice export sales.

Corporate Finance and Banking, the two heads students drop. Corporate finance is advice on **buy-back, mergers, acquisitions and divestments** and the funding of them, plus investor relations and capital-market intelligence on market trend and the timing of a public issue. Banking is the cordial relationship with bankers and financial institutions and the **negotiation of rates with lenders**; the treasury is the initial point of contact.

The trap is the quoted-statement wording. The RTP sets the question "in the light of this statement" about treasury evolving beyond cash handling. You still answer with **the same five heads** - the quotation only tells you to open with one sentence tying the heads to that evolution.

Understanding explain it, and place it in context · 2 questions

- Give two or three sub-points under each head; one line per head is not a four-mark answer.
- Where the question quotes a statement, open with one sentence tying the heads to it, then list.

TQ 2.2 · RTP 2026-May [10](b) · DESC · Pg 532

LEVEL I
Understanding

Medium

Topic 3: Management of Cash

L2P6-A-C9.2-T03

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 9, Unit II - Treasury and Cash Management, on the management of cash itself.

NOTES

No questions are printed under this head and the Scanner declares no frequency against it. Treat it as reading, not as a question you prepare a model answer for.

Everything the examiner has actually set in this unit reaches you through the neighbouring heads: **cash budgeting in topic 4** and the Baumol model in topic 5. That is where the revision hour belongs.

Read the Study Material section once so the vocabulary the printed answers use - surplus or idle funds, marketable securities, a minimum cash balance - is familiar before you start the numerical topics. Nothing beyond that is supported by what the Scanner prints here.

Topic 4: Methods of Cash Flow Budgeting

L2P6-A-C9.2-T04

Read first Read ICAI Study Material Chapter 9, Unit II - Treasury and Cash Management, on the methods of cash flow budgeting and the preparation of a cash budget.

NOTES

Every printed answer uses one format. Opening balance, then receipts, then **Total (A)**; then payments, then **Total (B)**; then **Closing balance = (A) - (B)**, carried down as next month's opening. Note that the opening balance sits **inside Total (A)**, not above it - that is how all three answers set it out. Rule the three month columns first and fill downwards.

The marks are in the **working notes, not the budget**. Build one small table per flow before you touch the budget: sales receipts split by collection lag, payment for materials or for cost of goods sold by its credit lag, and the cash costs paid in the month they arise. The 2019 answer prints three such notes - Sales Receipts, Payment for raw material, Variable cost and Wages - and the budget is then simply copied down from them.

Getting the lag right is the whole question. In the 2019 paper production runs **one month before**

sale, so January's output is February's sales units; raw material is two units at ₹150 per unit of output bought on one month's credit, so January pays for December's purchase; variable overheads and wages of ₹100 per unit are paid **in the month of production**, not of sale.

In the 2021 paper credit sales are **four times cash sales**, which makes the split 20% cash and 80% credit; of the credit sales 15% pay in the month, 25% the next and 58% the next after that, and **the residual 2% is written off** and never appears in the budget. Purchases are made the month before sale and paid the month after purchase, so the two lags cancel and **payment to creditors = 90% of that month's sales**.

The 2025 answer adds a **minimum balance of ₹1 lakh**. Strike the closing balance before adjustment first, then borrow up to the minimum where it falls short and invest the excess where the balance exceeds ₹2 lakh; the adjusted figure is what carries forward. The question says to **ignore the interest** on both the borrowing and the investment, so do not compute any.

Where a part (b) asks for the **forecast current ratio**, take every figure from the budget you have just built. Closing inventory is the last month's production valued at material plus variable cost and wages, receivables are the last month's sales still uncollected, cash is the closing balance, and current liabilities are the last month's purchases still unpaid. The 2019 answer reaches **4.537 approx.**

The recurring slip is entering a flow in the month it is earned rather than the month it is **received or paid**. Non-cash items never enter a cash budget at all; a capital receipt or payment enters in full in its own month - **₹2,00,000 loan in and ₹3,00,000 machine out**, both in March, in the 2019 answer.

Application use the rule - work the problem · 3 questions

- Write the working notes above the budget and label them. The examiner gives the marks for the lag, and a figure that appears only inside the budget cannot be traced.
- Carry the closing balance down as the next month's opening before you compute anything else in that column.
- Show the minimum-balance adjustment as its own two lines, borrowing and investment, rather than silently adjusting the closing figure.

PQ 4.2 · PYQ 2021-Dec [1] (d) {C} · 5M · Pg 535

LEVEL II
Application

Medium

PQ 4.3 · PYQ 2025-Jan [1] (a) {C} · 5M · Pg 536

LEVEL II
Application

Medium

PQ 4.1 · PYQ 2019-Nov [3] · 10M · Pg 533

LEVEL II
Application

Hard

Topic 5: Cash Management Models

L2P6-A-C9.2-T05

Read first Read ICAI Study Material Chapter 9, Unit II - Treasury and Cash Management, on the cash management models, the Baumol model in particular.

NOTES

Baumol's optimum cash balance = $\sqrt{(2AT / I)}$, where A is the total cash needed for the period, T the transaction cost of one conversion and I the interest rate on marketable securities. The Scanner's working then runs average balance = optimum $\div$ 2, number of conversions = annual outflow $\div$ optimum, and interval = 360 $\div$ conversions. On A = ₹36,00,000, T = ₹60 and I = 12% that gives ₹60,000, ₹30,000, 60 conversions and 6 days — use those as your check figures.

The question names the model - **Baumol** - and hands you three inputs. Pull them out before anything else: A, the annual cash outflow; T, the transaction cost of converting investments into cash; and I, the opportunity cost of holding cash. In the 2022 answer a quarterly outflow of ₹9,00,000 is **annualised to ₹36,00,000**, T is ₹60 and I is 12% p.a.

Annualise first. The outflow is given per quarter and the return per annum, and **the two must be on the same basis** before they meet. The same applies to the day count: the question says to **consider 360 days** in the year, so use 360 and say that you have.

The answer runs in **four numbered steps**, in this order: optimum cash balance, average cash balance, number of conversions each year, time interval between two conversions. Set the four headings down first; each is a single line of arithmetic.

On these figures the optimum transaction size is **₹60,000**, and the rest follows from it mechanically. **Average balance is half the optimum**, ₹30,000. **Conversions = annual outflow $\div$ optimum**, 36,00,000 $\div$ 60,000 = 60 a year. The interval is 360 $\div$ 60 = **6 days**. Use ₹60,000 as your check figure - if your substitution does not reproduce it, the error is in the units of I or in a failure to annualise A.

The trap is answering a question that was not asked. The 2022 paper wants the **average balance, the number of conversions and the interval** - the optimum balance is only the route to them. Compute it, then answer the three numbered parts, each labelled. A working that stops at ₹60,000 has answered none of them.

Understanding explain it, and place it in context · 1 question

TQ 5.1 · PYQ 2026-Sep [4] (b) · DESC · 4M · Pg 538

LEVEL I
Understanding

Medium

Application use the rule - work the problem · 1 question

- Annualise the cash outflow and state the day count before you substitute. Most lost marks here are unit errors, not formula errors.

- Label the four steps, then answer only the parts the question lists, in the order it lists them.

PQ 5.1 · PYQ 2022-Nov [1] {C} · 5M · Pg 539

LEVEL II
Application

Medium

Topic 6: Recent Developments in Cash Management

L2P6-A-C9.2-T06

Read first Read ICAI Study Material Chapter 9, Unit II - Treasury and Cash Management, on recent developments in cash management, virtual banking in particular.

NOTES

Both printed questions are on **virtual banking** and both want the same four-point list: lower cost of handling a transaction; increased speed of response to customer requirements; cost efficiency from a **smaller branch network and lower staff costs**; and a wider range of services delivered rapidly, accurately and at the customer's convenience.

Watch the mark weight, because it decides the length. **Two marks asks for any two** advantages, a line each - that is all the 2025 answer gives. **Four marks asks for all four**, and the 2026 question puts a first part in front of them: why the service is popular with customers.

The popularity answer is a named three. Customers have taken to virtual banking for the **speed, convenience and round-the-clock access** it offers. Open the four-mark answer with that sentence, then give the advantages as a list.

The trap is turning this into an essay on technology in banking. What the Scanner prints is a **sentence and a list** - extra material earns nothing and costs you time you need in a two-mark part.

Remembering reproduce what you have learnt · 1 question

- Learn the four advantages as four short phrases. In a two-mark part, give two of them and stop.

TQ 6.1 · PYQ 2025-Jan [4] (c) · DESC · 2M · Pg 540

LEVEL I
Remembering

Easy

Analysis break it down and take the parts separately · 1 question

- Two things are asked — why it is popular and what its advantages are. Answer them separately; the popularity is about the customer, the advantages are about the bank and the firm.

TQ 6.2 · PYQ 2026-Jan [4] (b) · DESC · 4M · Pg 541

LEVEL II
Analysis

Medium

Topic 7: Management of Marketable Securities

L2P6-A-C9.2-T07

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 9, Unit II - Treasury and Cash Management, on the management of marketable securities.

NOTES

The Scanner declares **two past-paper appearances** for this head but **prints no question** under it, so there is no model answer to work from. Read the Study Material section for yourself and do not expect the Scanner to rehearse it.

Where marketable securities do appear in a printed answer, they appear as the other end of the cash balance. Treasury parks **surplus or idle funds** in marketable securities to optimise return, which is the cash management head of topic 2; and the firm meets its cash demands by **periodically selling marketable securities**, which is the Baumol question in topic 5.

Carry that second link into the exam. In the Baumol question the return on the portfolio - 12% p.a. - is **the opportunity cost** **I** in the model. If a question gives you a yield on securities and asks for a cash balance, **that yield is the cost of holding cash**.

SECTION A · FINANCIAL MANAGEMENT · CHAPTER 9.3

Management of Working Capital - Management of Inventory

1 Topics · 0 Classified Questions · Importance: D

ICAI SKILL PROFILE ICAI band for Financial Management: Level I 20-30% · Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge

0.0%

0 of 1 marks

Level II — Analysis & Application

100.0%

0 of 1 marks

Below this Section's Level I floor: none of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for Financial Management. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading. Read the split with care: the chapter carries only 0 classified questions, so a single question moves it several points.

Topic 1: Management of Inventory

L2P6-A-C9.3-T01

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 9, Unit III - Management of Inventory, and alongside it Chapter 2, Material Cost, of Paper 4 Cost and Management Accounting, which is where the Scanner sends you for this topic.

NOTES

The Scanner prints **no questions and no frequency table** for this unit. In their place it prints a cross-reference: inventory management is covered in **Chapter 2, Material Cost, of Paper 4**, Cost and Management Accounting. That is the whole of what the Scanner says here, and these notes go no further than it.

So the topic has **carried no marks** in any sitting the Scanner covers - no past paper, no RTP, no MTP. It is still **on the syllabus and still examinable**. A nil frequency is a record of what has been asked, not a promise about the next paper.

Prepare it where the Scanner says it lives. Work the **Paper 4, Chapter 2 material** - the content, the formulae and the question forms are the same, and anything set here would be set on that base. Do not build a separate Paper 6 answer bank for inventory out of nothing.

Read this unit of the Study Material once so the vocabulary is not new to you in the hall, then give the time to the units of this chapter that **do carry printed questions** - receivables, cash, payables and the financing of working capital.

SECTION A • FINANCIAL MANAGEMENT • CHAPTER 9.4

Management of Working Capital - Management of Receivables

8 Topics • 15 Classified Questions • Importance: C

ICAI SKILL PROFILE ICAI band for Financial Management: Level I 20-30% • Level II 70-80% — this chapter reads **problems first**

Level I — Comprehension & Knowledge **13.4%** 11 of 82 marks

Level II — Analysis & Application **86.6%** 71 of 82 marks

Below this Section's Level I floor: only 13% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for Financial Management. There is little theory to fall back on — nearly every mark here is earned by working the problem, so preparation is practice, not reading.

Topic 1: Meaning and Objective

L2P6-A-C9.4-T01

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 9, Management of Working Capital - Management of Receivables, on the meaning and objective of receivables management.

NOTES

Receivables arise the moment goods go out on credit, and the chapter's answers treat their management as one thing: **a trade-off**. On one side are the profits on the additional sales that arise because credit was extended. On the other is **the cost of carrying those debtors and bad debt losses**. Every evaluation in this chapter is that one sentence turned into a column of figures.

So the objective is not to hold debtors down. It is to **maximise net benefit**, and the printed workings show you the four costs that eat into it: the opportunity cost of funds locked in receivables, bad debts, cash discount allowed, and collection or administration expenditure. A policy that kills bad debts by refusing credit kills the contribution with it, which is why the answers always price both sides in the same statement.

No question in this chapter asks for the meaning on its own. It surfaces as **the opening line of a credit-policy answer** and as the reason sentence at the end, so learn it as one or two lines you can write from memory before the figures start.

Topic 2: Aspects of Management of Debtors

L2P6-A-C9.4-T02

Read first Read ICAI Study Material Chapter 9, Management of Working Capital - Management of Receivables, on the aspects of management of debtors.

NOTES

The answer names **three aspects** and numbers them: Credit Policy, Credit Analysis, and Control of Receivables, in that order. Marks follow the count, so name all three at the head of the answer and explain them afterwards. An answer that only reaches the third aspect halfway down a paragraph reads to the examiner as two.

Credit Policy. A balanced credit policy has to be determined for receivables to be managed effectively. The decision on **credit standards, credit terms and collection efforts** is included in it, and it settles credit period, cash discount and other relevant matters. The answer gives the reason expressly: it involves **a trade-off between the profits on additional sales** that credit brings and the cost of carrying those debtors and the bad debt losses.

Credit Analysis. This requires the finance manager to determine **how risky it is to advance credit** to a particular party. In practice it is due diligence, or a reputation check on the customer, with respect to credit worthiness.

Control of Receivables. This requires the finance manager to **follow up debtors** and decide a suitable credit collection policy. The answer adds that it involves both the laying down of credit policies and the execution of such policies, and that second half is what the word control is doing there — say execution, not only the framing of policy.

Trap: do not fold credit analysis into credit policy. They are separately numbered and separately marked, and a five-mark answer that offers two headings cannot reach the third mark.

Understanding explain it, and place it in context · 1 question

- For five marks give each aspect two or three lines: what the finance manager decides under it, and why. Bare headings do not carry the marks.
- Use the trade-off sentence under Credit Policy. It is the line the printed answer gives and it reads as the reason the whole topic exists.

TQ 2.1 · MTP 2026-Mar S1 [3] (ii) · DESC · 5M · Pg 550

LEVEL I
Understanding

Medium

Topic 3: Factors Determining Credit Policy

L2P6-A-C9.4-T03

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 9, Management of Working Capital - Management of Receivables, on the factors determining credit policy.

NOTES

The Scanner declares this topic three times but prints no answer for it, so learn it from what the evaluation questions actually turn. **Every printed question moves the same handful of factors** and asks what the movement does to net benefit.

The factors the questions move are the credit period (**15 days raised to 45 days** in one, 30 days to 45 or 60 in another), the cash discount terms (**1/10 net 50 changed to 2/10 net 35**), the percentage of default or bad debts, the collection expenditure, and the required rate of return on the funds locked up. Expect two or three of them to move at once.

Behind all of them sits the firm's own cost structure, because it fixes how much of each extra rupee of sales survives. The answers derive it as **variable cost as a percentage of sales** — 70% of cost of sales in one question, $120/150 = 80\%$ in another, and 78% backed out of creditors in a third.

Treat this as vocabulary for the numerical answers rather than as an essay. **If asked to list, list the levers the questions move**, and say for each which way it pushes profit and which way it pushes cost.

Topic 4: Factors Under the Control of the Finance Manager

L2P6-A-C9.4-T04

CONCEPT BASE — no exam question asked yet • essential for full preparation

Read first Read ICAI Study Material Chapter 9, Management of Working Capital - Management of Receivables, on the credit-policy factors under the control of the finance manager.

NOTES

No answer is printed for this topic either. Take it from the Topic 2 answer, which is the pack's own statement of what the manager controls: the decision on **credit standards, credit terms and collection efforts**, and within credit terms the credit period, the cash discount and the other relevant matters that answer refers to without listing.

Control of receivables is listed there as the manager's own task as well — **follow up debtors and decide a suitable credit collection policy** — and the answer stresses that it covers both laying the policy down and executing it.

The numerical questions confirm the same list by handing you exactly those levers to change: collection period, discount rate and the proportion of customers availing it, collection or

administration expenditure, and whether to hand the function to a factor. **What he does not control** is the required rate of return, the tax rate, or the level of demand; the question supplies those as data.

So in an answer, separate the two lists plainly. **Controllable: terms, standards, collection effort;** given by the question: cost of capital, tax rate, and the percentages of customers who take a discount or default. The examiner is testing whether you know which side of that line each item falls on.

Topic 5: Approaches to Evaluation of Credit Policies

L2P6-A-C9.4-T05

Read first Read ICAI Study Material Chapter 9, Management of Working Capital - Management of Receivables, on the approaches to evaluation of credit policies.

NOTES

The standard working is a **Statement Showing Evaluation of Credit Policies**, one column per policy with the present policy first. Block A builds expected profit: (a) credit sales, (b) less variable cost, (c) contribution, (d) less bad debts, (e) contribution after bad debts. Block B is the **opportunity cost of investment in receivables**. Block C is **net benefit, A minus B**. Then one sentence of recommendation. Where the question says **Total Approach**, line (b) becomes total cost other than bad debts, variable plus fixed, and line (e) is expected profit rather than contribution.

Opportunity cost = total cost × period/360 × required rate. So ₹24,00,000 × 15/360 × 15% = ₹15,000 on the present policy against ₹28,80,000 × 45/360 × 15% = ₹54,000 on the proposed. Note what the rate is applied to: the cost of the receivables, **never the sales value**. Even where fixed cost is excluded from the profit block because it does not change, the answers still take cost of sales, variable plus fixed, as the base for this line.

Where the question gives creditors extra credit for the additional variable cost, net it off before charging the rate: **average debtors less average creditors, then × 20%**. Debtors are cost of sales × credit period/360; creditors are variable cost × 15/360. Missing the deduction overstates the opportunity cost in every proposed column and can flip the ranking.

When the question is about cutting the expenditure on receivables rather than expanding sales, the answers flip to a **cost of credit** statement: cost of investment in debtors, plus bad debt losses, plus collection expenditure, totalled per policy. Sales are the same in every column, so the decision rule flips with it — **choose the policy with the lowest cost of credit**. Cost of investment there is sales × cost-of-sales % × collection period/12 × 20%, the percentage coming from total cost per unit ÷ selling price, **120/150 = 80%**.

Where a tax rate and a cash discount appear, the column runs sales, less variable cost, contribution, less bad debts, less cash discount, **PBT, less tax, PAT**, less opportunity cost of

investment, net benefit. **Cash discount = sales × % availing × discount rate:** $12,00,000 \times 50\% \times 1\% = ₹6,000$ against $15,00,000 \times 80\% \times 2\% = ₹24,000$. The opportunity cost is struck after tax, so unless the rate is already described as post-tax the answers multiply by $(1 - t)$: $9,36,000 \times 30/360 \times 70\% \times 15\% = ₹8,190$. One question makes you derive sales and the variable cost percentage first, from debtors $\times 360/\text{collection period}$ and creditors $\times 360/60$.

A different question gives a debtors ageing table and asks for the **effective cost of the collection process**. Add bad debts, cash discount and administration cost, deduct the interest income charged on the overdue buckets, and divide by the operating cost of sales, total debtors $\times 0.75$: $(51,734 + 9,941 + 50,000 - 8,259) \div 15,91,350 = 6.50\%$. The answer records expressly that with no opportunity rate of return given, **opportunity cost is not calculated** — say so rather than assuming a rate.

Finish with the sentence, not the figure. The answers write that the proposed policy should be **adopted since the net benefit is higher**, and they name the policy: Proposed Policy A, Policy X, Policy I. With three columns the winner is not automatically the longest credit period — in one answer the **45-day policy beats the 60-day one**, because the opportunity cost climbs faster than the profit.

Application use the rule - work the problem • 5 questions

- Draw the statement before you compute anything: one column per policy, present policy first, the same row labels down the side. Every number you need is then a single line entry.
- Show the opportunity cost working separately as a working note with the base, the period fraction and the rate visible. That working carries method marks even where the arithmetic slips.
- State the formula you are using, substitute, then write the recommendation sentence naming the policy. A figure without that sentence loses the last mark.

PQ 5.2 • PYQ 2021-Jul [1] (a) {C} • 5M • Pg 552	LEVEL II Application	Medium
PQ 5.3 • PYQ 2023-May [1] (b) {C} • 5M • Pg 553	LEVEL II Application	Medium
PQ 5.5 • RTP 2024-Sep [11] • Pg 556	LEVEL II Application	Medium
PQ 5.6 • MTP 2024-Jul [2] (a) • 6M • Pg 557	LEVEL II Application	Medium
PQ 5.7 • MTP 2026-Mar S1 [3] (i) • 5M • Pg 559	LEVEL II Application	Medium

Analysis break it down and take the parts separately • 2 questions

- Where three policies are compared, complete each column fully before you rank. Do not rank on bad debts or sales alone - the ranking is on net benefit.

- Read the question for whether fixed cost changes and whether creditors give extra credit. Those two readings decide the base of the opportunity cost line.

PQ 5.4 · PYQ 2024-Sep [3] (a) · 5M · Pg 554

LEVEL II
Analysis

Medium

PQ 5.1 · PYQ 2018-Nov [4] · 10M · Pg 551

LEVEL II
Analysis

Hard

Topic 6: Financing Receivables

L2P6-A-C9.4-T06

Read first Read ICAI Study Material Chapter 9, Management of Working Capital - Management of Receivables, on the financing of receivables through factoring and forfaiting.

NOTES

Forfaiting. **Forfait is a French term meaning relinquish a right.** It is an arrangement of bill discounting in which a bank or financial institution **buys the trade bills or trade receivables from an exporter**, who gives up his right to receive payment from the importer. The finance is immediate and **without recourse**, so the risk and rewards in the receivable pass to the institution. The overseas buyer can open a letter of credit in favour of the exporter and import on deferred payment terms.

The five features the answer lists, in its order: it **motivates exporters to explore new geographies** because payment is assured; the importer can import on **deferred payment terms**; the exporter enjoys **reduced transaction costs** and less of the complexity of international trade; the exporter can compete in the international market and keep his working capital working to scale up operations; and importers themselves take forfaiting from international institutions to **finance imports at competitive rates**. Four marks, five features — name them all.

Factoring in its simple form is a **savings against costs** statement. Savings: administration cost saved, but only the **avoidable** part (one question gives 2/5 of `18,60,000); bad debts saved at the stated percentage of credit sales; and interest saved because the factor pays earlier, credit sales $\times$ variable cost % $\times$ days saved/365 $\times$ borrowing rate. Cost: the commission, 2% of credit sales. Net benefit positive, enter the agreement.

Where the question asks for the effective cost of factoring, build the advance first. **Average receivables = credit sales $\times$ period $\div$ 360**; deduct the service charge and the reserve; deduct the factor's interest for the guaranteed payment period; what is left is the net amount of advance available. Then **effective cost = net annual cost $\div$ net advance $\times$ 100** — `4,85,187.5  $\div$  `64,66,078 = 7.504% in one answer, `12,60,500  $\div$  `72,83,250 = 17.307% in another.

Two decision sentences, and they are not the same test. Against a cost of capital: **accept if effective cost is below cost of capital**. Against savings: **reject where cost exceeds saving**. Say which comparison you are making. Where an answer treats a redundancy payment as possibly

irrelevant, or takes the collection period as 45 rather than 70 days, it recomputes and prints both rates, so state the base you used and the alternative will not be marked wrong.

A longer question compares in-house management, dynamic discounting and factoring, and ranks them on total cost: **lowest total cost wins**. In-house cost is cash discount plus bad debts plus administration cost plus the cost of financing receivables. The collection period there is **weighted: $(10 \times 60\%) + (60 \times 40\%) = 30$ days**, and financing splits 1:1 between bank funds at 15% and owned funds at 14%. Under factoring, interest runs on **88% of receivables net of commission** for 25 days, and the 12% reserve still carries the owned-funds rate.

Receivables pledged as collateral is a screening question before it is a costing one. Test every account against **both conditions**: outstanding not more than 5 days past the net period ($40 + 5 = 45$ days) and average ageing not more than 15 days past it ($40 + 15 = 55$ days). Accounts passing both get 90% lending with a 5% reserve at 12%; the rest get 65% with a 15% reserve at 15%.

Deduct the reserve first, then apply the lending percentage. Finally, effective interest cost = $\text{interest} \times (1 - t) \div \text{total loan} = 9.59\%$.

Understanding explain it, and place it in context • 1 question

- Features are marks. Name each in a clause of its own, in the order the printed answer gives them, then stop.

TQ 6.1 • PYQ 2021-Jul [6] (b) • DESC • 4M • Pg 561

LEVEL I
Understanding

Medium

Application use the rule - work the problem • 4 questions

- Split the factoring answer into a savings block and a cost block with a total under each, then one net line. Marks sit on the split, not on the total alone.
- When effective cost is asked, show the advance computation as a separate working note - receivables, less charge, less reserve, less interest - before you divide.
- For the collateral question, show the two cut-off days you derived and list which accounts fail which condition before any money is computed.

PQ 6.1 • PYQ 2021-Dec [1] (a) {C} • 5M • Pg 562

LEVEL II
Application

Medium

PQ 6.2 • PYQ 2024-May [1] (c) {C} • 5M • Pg 563

LEVEL II
Application

Medium

PQ 6.4 • RTP 2025-Jan [10] • Pg 569

LEVEL II
Application

Medium

PQ 6.5 • PYQ 2026-Jan [1] (b) {C} • 5M • Pg 571

LEVEL II
Application

Medium

Analysis break it down and take the parts separately · 1 question

- Where the question sets two or three financing routes against each other, cost each one out in the same format and put them in one comparison table before you recommend.

PQ 6.3 · MTP 2024-Nov [3] · 10M · Pg 565

LEVEL II
Analysis

Hard

Topic 7: Innovation in Receivable Management

L2P6-A-C9.4-T07

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 9, Management of Working Capital - Management of Receivables, on innovations in receivable management.

NOTES

No question is printed under this heading and the pack gives no list, so stand on the ground the chapter does cover. One long printed answer prices two innovations by name: **dynamic discounting** and **late payment penalties**.

Dynamic discounting, as that answer treats it, raises the discount rate to pull payment forward — **2% raised to 2.5%** on the 60% of customers who take it — and the benefit shows up as bad debts falling from 1% to 0.8%. Price it exactly as you price any credit policy: the extra discount cost against **the bad debts and financing cost saved**.

Late payment penalties run the other way: **5% of receivables outstanding beyond 60 days**, charged to the 40% of customers who delay. In that answer the penalty of `1,98,000 exceeded bad debts of `1,48,500, so the line became **a net credit of `49,500** in the cost statement. Netting the penalty against bad debts, rather than showing it as separate income, is what the answer does.

Factoring and forfaiting are handled under Topic 6, and an ageing-based collection policy under Topic 8. If a question here asks you to discuss an innovation, **describe the mechanism, then price it** — nothing in this chapter is rewarded for stopping before the figures.

Topic 8: Monitoring of Receivables

L2P6-A-C9.4-T08

Read first Read ICAI Study Material Chapter 9, Management of Working Capital - Management of Receivables, on monitoring of receivables and the ageing schedule.

NOTES

The ageing schedule is the important means of getting an insight into the collection pattern of debtors. Receivables are classified **according to their age from the date of invoicing**, and the answer's own brackets are 0–30 days, 31–60, 61–90, 91–120 and more. Learn the brackets as printed; the marks are for the classification, not for a general remark about old debts.

What it is for. The schedule **helps the firm in its collection efforts** and enables management to keep close control over **the quality of individual accounts**, because it is built customer by customer rather than as a single total. Say both things, the collection effort and the control over quality, because they are two separate points in the answer.

The comparisons the answer names are where the two marks sit. The schedule can be compared with **the earlier month's figures**, with the corresponding month of the earlier year, and **with other firms**. A definition that names no comparison is half an answer, so list all three even if you add nothing to them.

It is not only theory. The evaluation question on the effective cost of a collection policy hands you an ageing table in exactly these buckets, customer by customer, and asks you to price each band separately — **bad debt and interest rates differ by age band**. Read those columns as the schedule you have just defined.

Understanding explain it, and place it in context · 1 question

- Define the schedule in one line, then say what management does with it - collection effort and control over the quality of individual accounts.
- Where a numerical question shows an ageing table, say in one line that it is the ageing schedule before you compute on it.

TQ 8.1 · MTP 2026-Apr S2 [2] (b) · DESC · 2M · Pg 572

LEVEL I
Understanding

Easy

SECTION A · FINANCIAL MANAGEMENT · CHAPTER 9.5

Management of Working Capital - Management of Payables (Creditors)

2 Topics · 2 Classified Questions · Importance: D

ICAI SKILL PROFILE ICAI band for Financial Management: Level I 20-30% · Level II 70-80% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge

57.1%

4 of 7 marks

Level II — Analysis & Application

42.9%

3 of 7 marks

Above this Section's Level I ceiling: 57% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for Financial Management. Reading carries more of the preparation here than it does elsewhere; do not prepare this chapter by working sums alone. Read the split with care: the chapter carries only 2 classified questions, so a single question moves it several points.

Topic 1: Cost and Benefits of Trade Credit

L2P6-A-C9.5-T01

Read first Read ICAI Study Material Chapter 9, Unit V - Management of Payables (Creditors), on the costs of availing trade credit.

NOTES

The question asks for the **cost** of availing trade credit and the answer is a **five-head list** with a short paragraph under each: Price, Loss of Goodwill, Cost of Managing Trade Credit, Opportunity Cost of Capital, and Cash Flow Constraints. Name all five before you explain any of them - on four marks the count of heads is what the marks follow.

Price is the **foregone early-payment discount**. Delaying payment means giving up the discount the supplier offers for paying early, so the company ends up paying a **higher effective price** for the same goods or services. This is the head that topic 2 then puts figures to.

Loss of goodwill is the relationship cost. Paying late, or using trade credit irresponsibly, **strains the supplier relationship** and harms the company's reputation, and the supplier may withdraw favourable terms or refuse credit altogether. Cost of managing trade credit is the **administrative overhead** of running accounts payable - monitoring credit terms, tracking due dates, coordinating with suppliers - and it grows with the number of suppliers.

Opportunity cost of capital is the head most often mis-stated. Availing trade credit means using **the supplier's money** as short-term finance, and the answer's point is that the company's **own funds stay tied up** instead of going into growth, research and development, or paying down higher-interest debt. Cash flow constraints follow where the credit period is **not aligned with the**

collection cycle, leaving the company short when its own obligations fall due.

The question word is cost, and the answer stays on cost. The opening line concedes that trade credit **also brings benefits**, but a single clause is all the Scanner gives it. Do not spend half a four-mark answer on the advantages of credit.

Understanding explain it, and place it in context · 1 question

- Explain each head with the reason the printed answer gives - the foregone discount, the strained relationship, the administrative burden, the funds tied up, the mismatch with collections.

TQ 1.1 · MTP 2024-Jul [4] (a) · DESC · 4M · Pg 578

LEVEL I
Understanding

Medium

Topic 2: Computation of Cost of Payables

L2P6-A-C9.5-T02

Read first Read ICAI Study Material Chapter 9, Unit V - Management of Payables (Creditors), on computing whether an early-payment discount offered by a supplier is worth taking.

NOTES

The set-piece is a discount for early payment, funded by an overdraft, with tax on both sides. The answer **compares the after-tax benefit with the after-tax cost of finance** and then states a decision. Taking the discount net of tax but the interest gross is the commonest way to lose the question.

The direct method, in the 2026 answer's order. Discount = $2\% \times ₹75,000 = ₹1,500$; after tax at 30% the **net benefit is ₹1,050**. The amount borrowed is **the invoice less the discount**, $75,000 - 1,500 = ₹73,500$, not the full invoice. Interest = $P \times R \times T = 73,500 \times 10\% \times 2/12 = ₹1,225$, which after tax is ₹857.50. Net saving = $1,050 - 857.50 = ₹192.50$.

The period is the **time saved, not the credit period**. Normal terms are three months and payment is made within one, so the overdraft runs for **two months** and 2/12 is what enters the interest line. Reading 3/12 off the question is the slip this answer is built to catch.

End on the verdict in words, not on the figure. The company gains a net benefit, so **B Ltd. should accept the discount offer**. A working that stops at ₹192.50 has not answered the question, which asked **whether** the offer should be accepted.

The Scanner prints an alternative in rates and accepts it. **Annualised benefit** = $2/98 \times 12/2 \times 100 = 12.245\%$; post-tax, $12.245 \times (1 - 0.3) = 8.571\%$; the post-tax overdraft rate is $10\% \times (1 - 0.3) = 7\%$; the benefit exceeds the cost, so the discount is accepted. Note the **2/98** - the discount is measured against the amount actually paid - and the **12/2**, the same two-month saving annualised.

Whichever route you take, apply tax to both sides of the comparison. Even on the rate method the Scanner post-taxes both figures before setting them against each other - **8.571% against 7%**. Say at the top which method you are using, and never compare a post-tax benefit with a pre-tax cost.

Application use the rule - work the problem · 1 question

- Set the benefit and the cost out as two labelled lines, both after tax, then a third line for the net saving and a fourth for the decision.
- Borrow the discounted amount, and run the interest only for the months saved. Each of those is worth a mark on its own.
- Finish with a decision sentence that names the company and the action.

PQ 2.1 · PYQ 2026-May [2] (b) · 3M · Pg 580

LEVEL II
Application

Easy

SECTION A · FINANCIAL MANAGEMENT · CHAPTER 9.6

Management of Working Capital - Financing of Working Capital

3 Topics · 1 Classified Questions · Importance: D

ICAI SKILL PROFILE ICAI band for Financial Management: Level I 20-30% · Level II 70-80% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge **100.0%** 4 of 4 marks

Level II — Analysis & Application **0.0%** 0 of 4 marks

Above this Section's Level I ceiling: 100% of this chapter's marks are Comprehension and Knowledge, against ICAI's 20-30% for Financial Management. Reading carries more of the preparation here than it does elsewhere; do not prepare this chapter by working sums alone. Read the split with care: the chapter carries only 1 classified question, so a single question moves it several points.

Topic 1: Sources of Finance

L2P6-A-C9.6-T01

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 9, Unit VI - Financing of Working Capital, on the sources from which working capital is financed.

NOTES

The Scanner declares **no PYQ, RTP or MTP** against this head and prints no question on it. There is no model answer here, so read the Study Material section for the vocabulary and do not try to manufacture one.

Everything this unit has actually been examined on sits in topic 3, **the forms of bank credit**. A question that opens on sources of working capital finance will in practice want that list, because that is the list the printed answer gives.

Keep the reading here light and put the time into topic 3. A nil frequency is a record of past sittings rather than a guarantee about the next one, but it does tell you where the return on a revision hour is.

Topic 2: Working Capital Finance from Banks

L2P6-A-C9.6-T02

CONCEPT BASE — no exam question asked yet · essential for full preparation

Read first Read ICAI Study Material Chapter 9, Unit VI - Financing of Working Capital, on working capital finance obtained from banks.

NOTES

Again **no questions are printed** and the Scanner declares no frequency. Read this head as the bridge into topic 3: the bank is the source, and **the forms of bank credit** are what the examiner asks you to name.

Treat the two heads as one answer. Where a question asks how a company approaching its bankers can be financed, the printed answer in topic 3 - **a numbered list of forms of credit**, each with a line of definition - is the shape the Scanner accepts.

Do not write about lending norms, margins or sanctioned limits. **None of that is in the pack**, and nothing the Scanner prints for this unit will support it in the marking.

Topic 3: Forms of Bank Credit

L2P6-A-C9.6-T03

Read first Read ICAI Study Material Chapter 9, Unit VI - Financing of Working Capital, on the forms of bank credit available to a company.

NOTES

This is a **naming question**, set twice - 2024 May and 2012 Nov - and it asks for **any four forms** for four marks. Read that as **one mark per form**: the name, then the single line of definition the answer gives. There is no credit for a preamble on bank finance in general.

The first four in the Scanner's list are the safe four. **Cash credit** - a credit facility given to a customer, up to a certain amount, on a continuous basis. **Bank overdraft** - a short-term borrowing facility made available where funds are needed urgently. **Bill discounting** - the company selling on credit draws a bill on the buyer, who accepts it and sends it back to the seller. **Bill acceptance** - the company draws a bill of exchange on the bank to obtain finance.

The next four, if the question asks for more or you want a fuller answer. **Line of credit** - a bank's commitment to lend on demand, specifying the maximum amount. **Letter of credit** - the issuing bank, on a customer's instructions or its own behalf, undertakes to pay, accept or negotiate against stipulated documents on specified terms. **Bank guarantee** - a facility the commercial bank extends on behalf of its client in favour of a third-party beneficiary. **Short-term loan** - the whole advance disbursed at one time against securities such as shares, government securities, life policies or fixed deposit receipts.

The remaining heads are the security-based advances, and their definitions are the specific ones. **Clean overdraft** is entertained only from parties that are financially sound and of good repute,

because the bank relies on the **personal security of the borrower**. **Advance against goods** is secured by **pledge or hypothecation** of movables offered to the bank. **Usance bills** maturing at a future date are discounted for approved parties: the borrower is paid **the present worth** and the bank collects the full amount on maturity.

Two more complete the thirteen. **Advance against documents of title to goods** - a bill of lading, a dock warehouse keeper's certificate, a railway receipt - where a pledge of the document is a pledge of the goods themselves. **Advance against supply of bills** - bills for supply of goods to government or semi-government departments against firm orders, the debt being assigned to the bank by endorsement and an **irrevocable power of attorney** to collect.

The trap is over-answering. The question says **any four**, and thirteen bare names score less than four names each carrying its defining line. Name four, define each, and stop at the number asked.

Understanding explain it, and place it in context · 1 question

- Where the question caps the number, give exactly that number and define each, rather than listing everything you can recall.

TQ 3.1 · PYQ 2024-May [4] (b) · DESC · 4M · Pg 586

LEVEL I
Understanding

Medium

P A R T

B

Strategic Management

5 chapters

SECTION B · STRATEGIC MANAGEMENT · CHAPTER 1

Introduction to Strategic Management

6 Topics · 41 Classified Questions · Importance: C

ICAI SKILL PROFILE ICAI band for Strategic Management: Level I 30-55% · Level II 45-70% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge

62.6%

122 of 195 marks

Level II — Analysis & Application

37.4%

73 of 195 marks

Above this Section's Level I ceiling: 63% of this chapter's marks are Comprehension and Knowledge, against ICAI's 30-55% for Strategic Management. Reading carries more of the preparation here than it does elsewhere; do not prepare this chapter by working sums alone.

Topic 1: Meaning and Nature of Strategic Management

L2P6-B-C1-T01

Read first Read ICAI Study Material Chapter 1, Introduction to Strategic Management, on the meaning and nature of strategic management and the relationship between efficiency and effectiveness.

NOTES

Efficiency is **doing things right**; effectiveness is **doing the right things**. Efficiency is operational — producing faster and at lower cost. Effectiveness is strategic — producing what the market actually needs. The answers keep the two on separate axes and never treat one as a degree of the other, because the marking of this topic turns on holding them apart.

The four situations come from crossing **strategy formulation (effectiveness)** with **operational efficiency**, and the answers name them in this order: efficient and effective — **Thrive**; efficient but ineffective — **Die Slowly**; inefficient but effective — **Survive**; inefficient and ineffective — **Die Quickly**. Give the condition and the verdict word for all four. Marks follow the count of cells named, not the length of the explanation.

A firm that has automated, cut cost and raised output but whose products miss customer needs is **efficient but ineffective** — cell 2, dying slowly. State that diagnosis first, in those words, before you offer any advice. The printed scenario answers always place the company in one named cell before prescribing anything.

The prescription runs in one order: **effectiveness first, then efficiency**. Align operations with customer preferences through sound strategy formulation, then implement that strategy efficiently. A firm that perfects execution before it has settled direction only reaches the wrong place faster.

The trap is answering this question with an operations essay. Automation, cost reduction and

throughput all sit on the efficiency axis; not one of them moves the firm on the effectiveness axis. **Integrating customer feedback into strategic planning** is the corrective the answers state, and an answer that stops at process improvement forfeits the second half of the marks.

Understanding explain it, and place it in context • 1 question

- Define efficiency and effectiveness in one line each, using the doing things right and doing the right things wording, before you draw the grid.

TQ 1.1 • RTP 2025-Sep [15] • DESC • Pg 590

LEVEL I
Understanding

Medium

Topic 2: Concept of Strategy

L2P6-B-C1-T02

Read first Read ICAI Study Material Chapter 1, Introduction to Strategic Management, on the concept of strategy and its proactive and reactive elements.

NOTES

Strategy is the way an organisation **responds to dynamic and often hostile external forces** while pursuing its vision, mission and long-term objectives. It is brought in to **reduce uncertainty and complexity**, and it relates the goals of the organisation to the means of achieving them. The answers also call it a **long-range blueprint** of the firm's desired image, direction and destination — what it wants to be, what it wants to do, how it wants to do things and where it wants to go.

The line the examiner keeps returning to is that strategy is **partly proactive and partly reactive**. In the proactive part, management analyses possible environmental scenarios and builds a strategic framework after proper planning, working to set procedures in a predetermined manner. The reactive part is triggered by environmental change and supplies the means to **face unforeseen developments** and to **adjust and adapt to unanticipated risks**.

When the question says 'differentiate', use the three bases the answer tabulates, in order — **Meaning, Nature, Objective**. Proactive strategy is **preventive, planned and future-oriented**, aimed at creating growth opportunities and a competitive edge. Reactive strategy is responsive, flexible and based on current situations, aimed at overcoming challenges, minimising risk and adjusting to changed conditions.

In a case scenario, the firm that chalks out initiatives ahead of its rivals is **proactive**; the one that copies after seeing the positive buzz is **reactive**. Where you are asked which is better, the answers choose proactive, for four stated reasons: it utilises available opportunities, reduces the adverse impact of changing circumstances, enhances demand for its products, and gains the **first-mover advantage**.

Every organisation needs both, and the answers give four reasons: proactive planning **achieves long-term goals**; reactive strategy **enables quick response** to new competitors, technology, economic change, regulation or shifted customer preferences; the combination **increases flexibility and adaptability**; and together they improve survival and competitiveness. Close with the conclusion sentence that actual business strategy is a blend of the two.

Strategy is formulated at the **corporate, divisional and functional levels**, and corporate-wide strategies are operationalised by the divisional and functional ones. One line on this belongs in a short note on the concept of strategy, because the Scanner's own short note carries it.

The trap is treating reactive strategy as a failure of planning. The answers are explicit that no company can forecast the internal and external environment exactly and that everything cannot be planned in advance, so reacting is **an adaptive response, not a lapse**. Say that first, and only then explain why proactive action is preferable where both are open to the firm.

Remembering reproduce what you have learnt · 1 question

- A short note on strategy needs the definition, the uncertainty-reduction purpose, the three levels and the proactive-reactive blend. Four elements, five marks.

TQ 2.3 · PYQ 2026-Jan [8] (Or) (b) · SN · 5M · Pg 594

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 1 question

- Define proactive and reactive in one line each before you contrast them. A contrast with no definitions loses the opening mark.

TQ 2.1 · PYQ 2015-May [12] (b) · DESC · 3M · Pg 592

LEVEL I
Understanding

Easy

Analysis break it down and take the parts separately · 3 questions

- Where two ideas are set against each other, use a two-column distinguish table with a stated basis for each row. Where a scenario is given, name the concept first, then tie it to the facts.
- Close with the answer to the question asked — which approach the company should take, in one sentence.

TQ 2.4 · PYQ 2026-May [8] (Or) (b) · DESC · 5M · Pg 594

LEVEL II
Analysis

Medium

CSQ 2.1 · PYQ 2021-Jul [6] {C} · 5M · Pg 596

LEVEL II
Analysis

Medium

TQ 2.2 · MTP 2025-Aug S2 [2] (a) · DESC · 5M · Pg 593

LEVEL II
Analysis

Hard

Topic 3: Strategic Management -Importance and Limitations

L2P6-B-C1-T03

Read first Read ICAI Study Material Chapter 1, Introduction to Strategic Management, on the meaning, objectives, benefits and limitations of strategic management.

NOTES

Learn the definition as printed: strategic management is the set of **decisions and actions resulting in formulation and implementation** of strategies designed to achieve the objectives of an organisation. In the wider sense the answers add that it deals with fundamental organisational renewal and growth, with the strategies, structures and systems needed to achieve it, and with the systems needed to manage formulation and implementation.

The objectives are given as two, and only two: to **create a competitive advantage** over competitors, and to **meet the opportunities and threats with challenge** — that is, to guide the company through environmental change by responding appropriately. A question asking for the 'overall objective' wants these two, not the benefits list.

The benefits, in the order the answers give them: it makes the organisation **proactive rather than reactive**; it gives clear direction by defining goals and mission; it provides a **framework for all major decisions** on businesses, products, markets, manufacturing facilities, investments and organisational structure; it helps identify opportunities and ways to exploit them; it serves as a **corporate defence mechanism** against mistakes and pitfalls; it enhances the longevity of the business; and it builds **core competencies and competitive advantages**. Seven items — name them all before explaining any.

The limitations are four, each with its own heading: **environment is highly complex and turbulent**, so the firm's estimate of its future shape may go badly wrong and jeopardise the plans; **strategic management is time-consuming**, and the effort impedes daily operations; **it is a costly process**, because expert planners and environmental analysis are expensive, especially for small and medium organisations; and **competition is unpredictable**, because rivals' responses to your strategy cannot be clearly estimated.

For the statement that strategic management is not a panacea for all corporate ills — **agree first, then give the four limitations**. Every printed answer opens by accepting the statement. An answer that argues against it, however well written, is answering a different question.

In a scenario — the bookshop that loses sixty percent of its sales to online retailers, the hotel chain hit by a pandemic — **name the limitation, then attach the facts**. The complex and turbulent environment is the one the answers reach for most, followed by the difficulty of forecasting future developments and the small firm's inability to predict how larger rivals will manoeuvre. Naming alone is half the work; the marks are in tying the named limitation to what the case says.

The trap is mixing the lists. Benefits are not objectives, and limitations are not the company's weaknesses — **they are limits of the discipline itself**: the environment cannot be fully known, the

process costs time and money, and competitors are unpredictable. Keep the lists separate, because one question often asks for a benefit and a limitation inside the same five marks.

Understanding explain it, and place it in context • 3 questions

- Open with the definition of strategic management in the answer's own words before you discuss benefits or limitations.

TQ 3.3 • PYQ 2021-Dec [10] (a) • DESC • 5M • Pg 600	LEVEL I Understanding	Medium
CSQ 3.1 • RTP 2023-Nov [9] • Pg 604	LEVEL I Understanding	Medium
TQ 3.2 • PYQ 2019-May [7] (a) • DESC • 5M • Pg 599	LEVEL I Understanding	Hard

Analysis break it down and take the parts separately • 4 questions

- Define, then take the limitations one by one. A question that gives a scenario wants each limitation matched to something in the scenario, not a general list.
- Where the statement is put to you as a proposition, agree or disagree in the first line and then support it.

TQ 3.1 • PYQ 2018-May [10] (a) • DESC • 5M • Pg 597	LEVEL II Analysis	Medium
TQ 3.4 • RTP 2024-Sep [8] • DESC • Pg 601	LEVEL II Analysis	Medium
TQ 3.5 • MTP 2024-Dec S2 [4] (a) • DESC • 5M • Pg 602	LEVEL II Analysis	Medium
TQ 3.6 • PYQ 2026-May [8] (b) • DESC • 5M • Pg 603	LEVEL II Analysis	Hard

Topic 4: Strategic Intent (Vision, Mission, Goals, Objectives and Values)

L2P6-B-C1-T04

Read first Read ICAI Study Material Chapter 1, Introduction to Strategic Management, on strategic intent and its components — vision, mission, goals, objectives and values.

NOTES

Strategic intent explains what the organisation aims to do and why it seeks to do it, and it is the foundation of the vision and mission statements. Its components are named in this order: **vision, mission, goals, objectives and values**. Every question on this topic points at one of those five, so

identify which before you write a word.

A strategic vision is a **road map of a company's future** — giving specifics about technology and customer focus, the geographic and product markets to be pursued, the capabilities it plans to develop, and the kind of company management is trying to create. It answers '**where we are to go**'. Its four essentials: thinking creatively about preparing the company for the future; an exercise in **intelligent entrepreneurship**; creating enthusiasm among the members of the organisation; and wording that **clearly illuminates the direction** the organisation is headed.

A mission statement is focused on the **present business scope** — who we are and what we do — describing present capability, customer focus, activities and business make-up. The seven reasons for having one, in the printed order: unanimity of purpose; a basis for **allocating organisational resources**; a basis for motivating their use; a general tone or organisational climate; a **focal point** for those who identify with the organisation's purpose and direction; translation of objectives and goals into a work structure assigning tasks; and specification of purposes so that **cost, time and performance can be assessed** and controlled.

The distinction the examiner returns to: **vision concentrates on the future, mission on the present**. Vision outlines what the organisation wants to be, is a source of inspiration and provides clear decision-making criteria; mission states the fundamental purpose, defines the customer and the critical processes and informs you of the desired level of performance. Put plainly, **vision answers 'where we want to go'** and mission answers 'what business we are in and why we exist'. Use Meaning, Time Period and Focus as your three bases when the question says distinguish.

Values are **principles or standards guiding behaviour and decision-making** for individuals and organisations. Internally they shape employee behaviour, trust, morale and a consistent culture; externally they shape how customers, investors and society perceive the company. The common examples listed are **integrity, trust, accountability, humility, innovation and diversity**. Distinguish values from intent, because the question asks it directly: intent is the purpose behind doing business, the long-term direction, while values are the ethical standards guiding conduct — and **values drive intent**, making them broader and more foundational.

Characteristics of ideal objectives, all ten: define the organisation's relationship with its environment; be facilitative towards achievement of mission and purpose; provide the basis for strategic decision-making; provide standards for performance appraisal; be **concrete and specific**; be **related to a time frame**; be **measurable and controllable**; be challenging; correlate with each other; and be set within the constraints of organisational resources and the external environment. Marks follow the count, so list them before you elaborate on any.

Asked to draft a vision and mission for a named brand, follow the fixed shape the answers use: **define the term, then give the statement**. Vision — 'vision implies the blueprint of the company's future position' — then **one sentence** positioning the brand as a leader in its stated field. Mission — 'mission delineates the firm's business, its goals and ways to reach the goals' — then **three bullets**, each opening 'To ...'. On Drucker's question, 'what business are we in' must be answered in terms of the **customer need being satisfied, not the product made**, because a product definition

dates as soon as technology or taste moves.

Remembering reproduce what you have learnt · 4 questions

- Seven reasons for a mission, four essentials of a vision, ten characteristics of objectives, six common values. List before you explain; the count is the mark.

TQ 4.7 · PYQ 2025-May [6] (a) · DESC · 5M · Pg 609	LEVEL I Remembering	Medium
TQ 4.10 · RTP 2025-Sep [7] · DESC · Pg 612	LEVEL I Remembering	Medium
TQ 4.11 · PYQ 2026-Jan [8] (b) · DESC · 5M · Pg 613	LEVEL I Remembering	Medium
CSQ 4.1 · RTP 2023-Nov [12] · Pg 616	LEVEL I Remembering	Medium

Understanding explain it, and place it in context · 8 questions

- Define vision and mission in one line each before contrasting them, and use Meaning, Time Period and Focus as your bases in a distinguish-between question.

TQ 4.2 · PYQ 2018-May [7] (b) {C} · DESC · 2M · Pg 606	LEVEL I Understanding	Easy
TQ 4.3 · PYQ 2019-Nov [8] (a) · DESC · 5M · Pg 606	LEVEL I Understanding	Medium
TQ 4.4 · PYQ 2020-Nov [9] (b) · DESC · 5M · Pg 607	LEVEL I Understanding	Medium
TQ 4.5 · PYQ 2024-May [7] (b) · DESC · 5M · Pg 608	LEVEL I Understanding	Medium
TQ 4.6 · RTP 2025-Jan [8] · DESC · 5M · Pg 609	LEVEL I Understanding	Medium
TQ 4.9 · PYQ 2025-Sep [6] (a) · DESC · 5M · Pg 611	LEVEL I Understanding	Medium
CSQ 4.3 · PYQ 2025-May [5] (a) {C} · 5M · Pg 618	LEVEL I Understanding	Medium
TQ 4.13 · PYQ 2026-Sep [6] (a) · DESC · 5M · Pg 615	LEVEL I Understanding	Hard

Application use the rule - work the problem · 1 question

- When a scenario describes a company's aspirations, name the component of strategic intent it points to in the first line, then explain that component, then give its essentials.

CSQ 4.2 · MTP 2024-Jul [1] (a) {C} · 5M · Pg 617	LEVEL II Application	Medium
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Analysis break it down and take the parts separately · 2 questions

- A distinguish question needs a stated basis per row — scope, time horizon, what it answers. Do not write two paragraphs and leave the examiner to find the contrast.
- Where a company's vision is quoted, quote it back and test it against the essentials before you comment.

TQ 4.1 · PYQ 2015-May [13] (b) · DB · 3M · Pg 605

LEVEL II
Analysis

Medium

TQ 4.8 · MTP 2025-Jul S1 [1] (a) · DESC · 5M · Pg 610

LEVEL II
Analysis

Medium

Synthesis integrate the material and construct · 1 question

- A drafting question wants the definition, then the statement. Write the vision as a single sentence and the mission as three To-do bullets built from the facts the scenario gives you.
- Where values must be inferred, quote the phrase from the vision or mission and name the value it implies, one pair at a time.

TQ 4.12 · RTP 2026-May [7] · DESC · Pg 614

LEVEL II
Synthesis

Hard

Topic 5: Strategic Levels in Organisation

L2P6-B-C1-T05

Read first Read ICAI Study Material Chapter 1, Introduction to Strategic Management, on the strategic levels in an organisation and the networks of relationship between them.

NOTES

There are **three levels of strategy — corporate, business and functional**. They exist because a multidivisional, multilocal organisation competing in several different businesses keeps a separate self-contained division to manage each. Name all three before you describe any of them.

The **corporate level** is the chief executive officer and other top-level executives, who occupy **the apex of decision making**. Their role is to oversee the development of strategies for the whole organisation — defining the mission and goals, determining what businesses the firm should be in, and allocating resources among those businesses.

Where a case asks what a CEO does, give the eight-item list the answers repeat: oversee development of strategies for the whole organisation; define the mission and goals; determine what businesses it should be in; allocate resources among the different businesses; formulate and implement strategies that span individual businesses; provide leadership; ensure corporate and business-level strategies are **consistent with maximising shareholders' wealth**; and **manage the**

divestment and acquisition process.

The **business level** is the general manager of a self-contained division with its own finance, production and marketing, whose strategic role is to **translate corporate direction into concrete strategies** for that individual business. The **functional level** covers managers of single activities — human resources, purchasing, product development, customer service — and a functional manager's sphere is **confined to one organisational activity**, where a general manager oversees a whole company or division.

Functional managers sit at the bottom of the hierarchy but carry a real strategic role, and one whole question is set on it. They **develop functional strategies** supporting the objectives set above; they supply the **operational and customer information** that lets corporate and business managers frame realistic strategies; their closeness to frontline staff and customers throws up ideas that sometimes become major strategic initiatives; and they **carry the implementation** of corporate and business plans at operational level.

Three networks of relationship are named: **functional and divisional**, where each function or division is managed independently and business-level managers report to corporate-level managers; **horizontal**, a flat structure of similar hierarchical status that promotes equality, openness and idea-sharing and suits start-ups; and **matrix**, which combines departments into project-based teams working under several business-level managers and suits large organisations with diverse operations. Asked to choose for a cross-functional, innovation-led firm, the answer is **matrix**.

The identification rule the case scenarios test: capital allocation between units, divestment, group dividend policy and the portfolio of businesses are **corporate level**; competitive advantage and profitability inside one SBU are **business level**; a marketing or sales manager designing campaigns is **functional level**. The trap is reading seniority instead of scope — judge by **the scope of the decision, not the title** of the person taking it.

Remembering reproduce what you have learnt · 2 questions

- Name corporate, business and functional before describing any one of them, and give the CEO's eight duties as a numbered list.

TQ 5.1 · PYQ 2018-Nov [7] (a) {C} · DESC · 2M · Pg 619

LEVEL I
Remembering

Easy

CSQ 5.1 · PYQ 2021-Jan [8] (a) · 5M · Pg 624

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 5 questions

- One line on what each level does and who sits there. Add the contrast that a functional manager covers one activity while a general manager oversees a whole company or division.

TQ 5.2 • PYQ 2025-Jan [7] (a) • DESC • 5M • Pg 621	LEVEL I Understanding	Medium
TQ 5.3 • MTP 2025-Nov S1 [1] (a) • DESC • 5M • Pg 622	LEVEL I Understanding	Medium
CSQ 5.3 • PYQ 2023-Nov [10] (Or) (b) • 5M • Pg 626	LEVEL I Understanding	Medium
CSQ 5.6 • RTP 2024-Sep [7] • Pg 630	LEVEL I Understanding	Medium
CSQ 5.7 • RTP 2025-Jan [7] • Pg 631	LEVEL I Understanding	Medium

Application use the rule - work the problem • 1 question

- Identify the level in the first sentence, then justify it from the scenario's own facts, then set out that level's roles and responsibilities.
- Case questions here often come in parts — level, then a limitation or a benefit. Answer each part under its own heading.

CSQ 5.5 • PYQ 2024-May [5] (b) {C} • 5M • Pg 628	LEVEL II Application	Medium
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Analysis break it down and take the parts separately • 3 questions

- Name the level the scenario is at before you do anything else, then give that level's responsibilities. Most of the marks ride on getting the level right.

TQ 5.4 • MTP 2025-Dec S2 [4] (b) • DESC • 5M • Pg 623	LEVEL II Analysis	Medium
CSQ 5.2 • PYQ 2023-Nov [6] {C} • 5M • Pg 624	LEVEL II Analysis	Medium
CSQ 5.4 • MTP 2024-Mar [1] (a) {C} • 5M • Pg 627	LEVEL II Analysis	Medium

Topic 6: Business Ethics and Strategic Management

L2P6-B-C1-T06

Read first Read ICAI Study Material Chapter 1, Introduction to Strategic Management, on business ethics and on cooperative strategy, including strategic alliances.

NOTES

The one question printed under this heading is answered on the **strategic alliance** as a form of cooperative strategy. A strategic alliance is a **relationship between two or more businesses** that enables each to achieve strategic objectives neither could achieve on its own.

The identifying features are what you quote when naming the form in a scenario: the partners **remain independent entities**, they share the benefits and control of the partnership, and they **contribute resources until the alliance is terminated**. Two firms collaborating on design, development and marketing while keeping their operations separate is an alliance, not a merger and not an acquisition.

Set the benefits out under the **three headings the answer uses**. Organisational advantages — learning new skills, combining complementary strengths, enhancing credibility in the market. Economic advantages — sharing the costs and risks of development, economies of scale, improved efficiency. Strategic advantages — pooling resources to accelerate innovation, create competitive advantage and enter new markets. **Name the heading, then the items under it**; three grouped points read as a framework, nine loose ones do not.

The answer states what each partner brings before it states what both gain — hardware design, manufacturing capacity and distribution on one side, **AI capability, software skills and innovation** on the other. Work in that order: **identify the form, define it**, split the contributions, then list the advantages under the three headings.

Understanding explain it, and place it in context · 1 question

- Define the cooperative strategy you name in one line, using the independence, shared benefits and control, and contributed resources wording.

TQ 6.1 · MTP 2025-Aug S2 [1] (b) · DESC · 5M · Pg 632

LEVEL 1
Understanding

Hard

SECTION B • STRATEGIC MANAGEMENT • CHAPTER 2

Strategic Analysis: External Environment

6 Topics • 46 Classified Questions • Importance: A

ICAI SKILL PROFILE ICAI band for Strategic Management: Level I 30-55% • Level II 45-70% — this chapter reads **on profile**

Level I — Comprehension & Knowledge **54.2%** 122 of 225 marks

Level II — Analysis & Application **45.8%** 103 of 225 marks

This chapter sits inside ICAI's own band for Strategic Management — 54% Level I against 30-55%. Prepare it in those proportions: know the method, then drill it.

Topic 1: Strategic Analysis

L2P6-B-C2-T01

Read first Read ICAI Study Material Chapter 2, Strategic Analysis: External Environment, on the scope of strategic analysis and the categories of external influence that shape strategy.

NOTES

Strategic analysis begins outside the firm. The pack sorts external influence into **five categories**: demographic, economic, political-legal, technological and socio-cultural. Learn them as a counted set, because a scenario that describes a company studying population data, income levels and lifestyle before it fixes a price wants the **demographic environment** named first, and then the other four explained.

Each category has fixed content and the answers keep it to a line. Demographic covers population size, age distribution, income, education and occupation. Economic covers purchasing power, inflation and general economic conditions. Political-legal covers government policy, regulation and compliance. Technological covers change in production, product design, marketing and distribution. Socio-cultural covers lifestyle, health consciousness, social values and consumer attitudes. **One line each is enough** at five marks.

On managing strategic uncertainty in a rapidly changing environment the answer gives **five proactive measures, in order**: flexibility, so strategy can be adapted quickly; diversification of product portfolio, markets and customer base, so no single area carries the whole risk; monitoring and scenario planning, so alternative futures are prepared for in advance; building resilience through operational, financial and risk-management capability; and collaboration and partnerships, to pool resources, share risk and reach expertise the firm does not hold.

The verbs the examiner wants are **anticipate and respond**. The answers never say uncertainty can be avoided, only that it can be prepared for. Scenario planning is the term for preparing in advance; resilience is the term for withstanding and recovering from a disruption that has already

happened. Keep the two apart when you explain them.

The trap is the two-part scenario question. It asks which external factor was considered and then asks for the major categories. **Answer both, in that order.** An answer that lists the five categories without first naming the demographic environment for the scenario loses the identification mark, and the identification is usually worth as much as the list.

Understanding explain it, and place it in context · 2 questions

- Define each category in one line and tie it to the decision it affects, as the answers do - demographic to pricing, political-legal to rollout.

TQ 1.1 · PYQ 2024-May [6] (b) · DESC · 5M · Pg 638

LEVEL I
Understanding

Medium

TQ 1.2 · RTP 2025-Sep [9] · DESC · Pg 639

LEVEL I
Understanding

Medium

Topic 2: Strategy and Business Environment

L2P6-B-C2-T02

Read first Read ICAI Study Material Chapter 2, Strategic Analysis: External Environment, on the business environment, the PESTLE framework, globalisation and internationalisation.

NOTES

Business environment means **all external factors, forces and conditions** that influence the decisions, plans and operations of a business. Three separate answers open with that sentence, so learn it as it stands. Add the two riders the answers add: the environment is **highly dynamic** and changes continuously, and a firm's success depends not only on internal capability but on how well it relates and responds to what is outside it.

The benefits of interaction with the environment come as **five fixed headings, in this order**: determining opportunities and threats; providing direction for growth; continuous learning; image building; and meeting competition. Four printed answers use exactly this list. In the scenario versions - Yash in Bengaluru, Aarav in Pune - the headings do not change and only the illustration does, so **keep the heading and change the example**.

PESTLE is the framework for the macro-environment and it is six factors: **political, economic, social, technological, legal, environmental**. Political is policy, stability, regulation and taxation; economic is interest rates, inflation, exchange rates and growth; social is demographic trends, lifestyle, cultural norms and attitudes; technological is innovation, advancement and infrastructure; legal is business law, employment regulation, health and safety and compliance; environmental is ecological issues, sustainability and environmental regulation. Close with the sentence the answers close with: PESTLE gives a **comprehensive view of the macro-environment**

so the firm can anticipate change, adapt strategy and decide on informed grounds.

For globalisation, define before you list. A company is global when **it has several manufacturing locations around the world** and offers products in several diversified industries, and when it can compete in its domestic market against foreign competitors; such a firm is called a **multinational (MNC) or transnational (TNC)**. The reasons run: business growth; advancement in technology and communication; a limited domestic market; access to resources, including cheaper labour and raw material; lower transportation and distribution cost; opportunities in foreign markets; growth of the service sector and regional cooperation; removal of trade barriers; and strategic partnerships. Where the question says **any five reasons**, give exactly five with headings.

Internationalisation is examined as a **four-step planning sequence**: evaluate global opportunities and threats against internal capability; define the scope of operations; create global business objectives; and develop specific corporate strategies. The framing sentence is that internationalisation raises profitability, opens cheaper resources, gives economies of scale and **extends the product life cycle**, but is complex because the factors and connections differ from domestic operations.

One question in this topic is really a consumer-behaviour question - a luxury skincare brand whose sales spike after celebrity endorsement. Answer it through the **four conceptual domains**: external influences, internal influences, the decision-making process and post-decision processes. Endorsements and social media promotion are **external influences**; changed perception, motivation and aspiration are internal.

The trap is treating **define business environment** as a warm-up sentence. It carries its own mark. Give the definition, apply it to the named city or firm in one sentence, and only then start the list of benefits.

Understanding explain it, and place it in context • 5 questions

- Define business environment in the answers' own words, then say it is dynamic and continuously changing. Both halves are marked.

TQ 2.1 • PYQ 2020-Nov [8] (b) • DESC • 5M • Pg 640	LEVEL I Understanding	Medium
TQ 2.2 • PYQ 2025-Jan [6] (a) • DESC • 5M • Pg 641	LEVEL I Understanding	Medium
TQ 2.3 • MTP 2025-Apr S2 [2] (b) • DESC • 5M • Pg 642	LEVEL I Understanding	Medium
TQ 2.5 • MTP 2025-Dec S2 [1] (a) • DESC • 5M • Pg 644	LEVEL I Understanding	Medium
CSQ 2.2 • PYQ 2024-May [5] (c) {C} • 5M • Pg 649	LEVEL I Understanding	Medium

Application use the rule - work the problem · 1 question

- In a location or expansion scenario, attach every heading to a fact from the scenario. A generic list with no mention of the firm loses the application marks.
- For PESTLE applied to entering a new country, take the six factors in order and say what the firm should assess under each, then close with the overall conclusion.

CSQ 2.1 · MTP 2024-Mar [1] (b) {C} · 5M · Pg 648

LEVEL II
Application**Medium****Analysis** break it down and take the parts separately · 3 questions

- Where a proposition is quoted, take a position in the first line. Then give the benefits of interaction as a numbered list and tie each one back to the quoted words.
- Where a framework is named in the question, use that framework's own component names as your headings.

TQ 2.4 · PYQ 2025-Sep [8] (a) · DESC · 5M · Pg 643

LEVEL II
Analysis**Medium**

TQ 2.6 · RTP 2026-May [10] · DESC · Pg 645

LEVEL II
Analysis**Medium**

TQ 2.7 · PYQ 2026-May [7] (a) · DESC · 5M · Pg 646

LEVEL II
Analysis**Medium****Topic 3: Understanding Product and Industry**

L2P6-B-C2-T03

Read first Read ICAI Study Material Chapter 2, Strategic Analysis: External Environment, on understanding the product and the industry, including value chain analysis and the product life cycle.

NOTES

Value chain analysis is a strategic tool that examines **each business activity to determine how it adds value**. Put **Michael Porter** in the first line; the questions say 'as stated by Michael Porter' and expect the name back. The purpose sentence the answers use is improved efficiency, identification of cost-saving opportunities and competitive advantage through better coordination of internal processes.

Primary activities are five, in this order: inbound logistics, being the receiving, warehousing and inventory management of raw materials and components; operations, the processes that transform inputs into finished products, including manufacturing, assembly and packaging; outbound logistics, the distribution of finished products through warehousing, order processing and transport; marketing and sales, which create demand through advertising, promotion, sales force management and pricing; and service, which maintains value after the sale through customer

support, repairs and maintenance.

Support activities are four: procurement, the processes for acquiring resource inputs; technology development, covering research and development, product design, process development and improvement of materials; human resource management, covering recruiting, managing, training, developing and rewarding; and infrastructure, the systems and routines that support the whole organisation, including planning, finance, quality control, information management and organisational culture. Note the distinction the answer draws - **procurement is how resources are sourced**, not the resources themselves.

Asked whether primary and support activities are intertwined, **agree and say why:** support activities significantly enhance the effectiveness of primary activities, so the two are interdependent, and both are crucial to creating value and gaining competitive advantage. **Open with 'Yes, I agree'**, give the reason in a sentence, then deliver whichever of the two lists the question actually asked for.

The characteristics of a business product are a list of five: a product may be **tangible or intangible**, a car or a laptop as against banking or insurance; every product has a price, and the **market price is where quantity supplied equals quantity demanded**, so a firm competing on price must cut cost rather than add profit to cost; every product has features that provide customer satisfaction; the product is the **core of all business activities**, from manufacture to marketing; and every product has a useful life and passes through a life cycle. The same five headings answer the differentiation scenario - tangible and intangible aspects, pricing strategies, product features, product-centric approach and product life cycle management.

For the product life cycle the pack works two stages in detail. **Introduction:** slow sales growth, limited markets, high prices, almost negligible competition and limited customer knowledge of the product. **Growth:** demand expands rapidly, prices fall, competition increases and the product gains market acceptance as customers become aware of its benefits. A question that recites those symptoms wants the **stage named and justified from the symptoms**, not a tour of all the stages.

Understanding explain it, and place it in context · 1 question

- Define value chain analysis in one line, then say what it achieves - efficiency, cost saving, competitive advantage.

CSQ 3.1 · RTP 2023-Nov [10] · Pg 654

LEVEL I
Understanding

Medium

Application use the rule - work the problem · 1 question

- In a differentiation scenario, use the five product characteristics as headings and put the firm's own example under each.

TQ 3.1 · PYQ 2024-Sep [6] (b) · DESC · 5M · Pg 651

LEVEL II

Hard

Application

Analysis break it down and take the parts separately · 2 questions

- Where the question recites symptoms - slow growth and high prices, then rapid growth and falling prices - name each life cycle stage and tie it to the symptom that identifies it.

TQ 3.2 · PYQ 2025-May [7] (a) · DESC · 5M · Pg 652

LEVEL II
Analysis

Medium

TQ 3.3 · MTP 2024-Dec S2 [1] (b) · DESC · 5M · Pg 653

LEVEL II
Analysis

Medium

Topic 4: Industry Environment Analysis

L2P6-B-C2-T04

Read first Read ICAI Study Material Chapter 2, Strategic Analysis: External Environment, on industry and competitive analysis - Porter's five forces, barriers to entry, economies of scale, the experience curve and key success factors.

NOTES

Michael Porter identified **five basic forces** which determine the intensity and state of competition in an industry and whose collective impact determines its **long-run profit potential**. Name them in the order the answers use: degree of competitive rivalry among competitors; threat of entry posed by potential entrants; threat of actual or potential substitutes; bargaining power of suppliers; and bargaining power of customers. The logic stated first is that competitive forces are the **more immediate external influences**, the ones a firm can overcome directly by its own actions.

The conditions in which rivalry turns cut-throat and industry profitability falls are **six, and the most repeated item in the chapter**: no clear industry leader, so nobody disciplines a price war; numerous competitors, so pricing expectations cannot be communicated; high fixed costs, which push firms with spare capacity to cut price; high exit barriers, because specialised assets find no buyer and firms that want to leave stay and fight; little opportunity to differentiate, so competition falls back on price; and slow or diminished growth, so rivals fight harder for existing share. **Give the heading, then the mechanism** - the mark sits in the mechanism sentence.

Barriers to entry answer every question on the threat of new entrants. The list runs: **economies of scale; capital requirement; access to distribution channels**; cost advantages irrespective of size; product differentiation and brand identity; expected retaliation by existing players; cost of switching; and government policy and legislation. **Economies of scale** carries its own short definition - the **decline in per-unit cost as volume grows**, letting a large firm produce high volumes at successively lower cost, which is why it acts as a barrier.

Supplier power determines the **cost of raw materials and other inputs** and therefore the industry's attractiveness and profitability. It is high where suppliers are concentrated or a supplier

enjoys a monopoly, where switching cost is high because the item is specialised or differentiated, where the supplier can integrate forward, and where the customer is of little importance to the supplier. Buyer power affects **not only prices but also costs and investments**, because powerful buyers demand better service that the producer must invest in. It is high where buyers know the sources and the substitutes, where they purchase in large volume, where the product is not critical and switching is easy, and where they can threaten **backward integration**.

Two cost concepts sit inside this topic. The **experience curve** is efficiency gained through repetitive productive work: **unit costs decline as cumulative production volume grows**, on the idea that we learn as we grow. It arises from learning effects, economies of scale, product redesign and technological improvement, and its strategic relevance is that larger firms gain a cost advantage, so the curve works as an **entry barrier** and a way to build market share. **Key success factors** are the prerequisites for success in an industry - the strategy elements, product attributes, resources, competencies, capabilities and business outcomes that separate profit from loss.

In a five-forces scenario the printed answers do not treat all five at equal length. They **take each force to the facts given** and say plainly where the facts run out: 'there is no information relating to substitutes and bargaining power of customers in the information given in scenario.' **Write that sentence** when a force is unsupported; it earns a mark and inventing facts does not. Where the facts cut both ways, the answers grade the force as **moderate** and state the condition that would raise it.

The distinction the examiner keeps returning to is **macro-environment against industry environment**. PESTLE answers the first; five forces answers the second. A scenario about established brands, low-priced local players and substitute drinks reflects the **competitive or industry environment**, not the general environment. Name which one it is, say why, and only then analyse the forces.

Remembering reproduce what you have learnt · 2 questions

- Name all five forces before you explain any of them. The marks follow the count.
- Rivalry has six conditions and entry has its barrier list. Learn both as counted lists, not as prose.

TQ 4.13 · RTP 2025-Jan [10] · DESC · Pg 667

LEVEL I
Remembering

Medium

TQ 4.15 · PYQ 2025-Sep [6] (b) · DESC · 5M · Pg 669

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 11 questions

- Define the force in one line, then state its effect on industry profitability. The profitability sentence is what closes the answer.
- For economies of scale or the experience curve, give the definition and then the reason it is an entry barrier.

TQ 4.2 · PYQ 2018-Nov [7] (d) {C} · DESC · 2M · Pg 657	LEVEL I Understanding	Easy
TQ 4.1 · PYQ 2018-May [11] (a) · DESC · 5M · Pg 655	LEVEL I Understanding	Medium
TQ 4.4 · MTP 2020-Oct [6] (a) · DESC · 5M · Pg 660	LEVEL I Understanding	Medium
TQ 4.6 · PYQ 2021-Dec [10] (Or) (b) · DESC · 5M · Pg 661	LEVEL I Understanding	Medium
TQ 4.8 · RTP 2022-Nov [15] · Pg 662	LEVEL I Understanding	Medium
TQ 4.10 · PYQ 2024-Sep [8] (a) · DESC · 5M · Pg 664	LEVEL I Understanding	Medium
TQ 4.14 · MTP 2025-Apr S2 [1] (a) · DESC · 5M · Pg 668	LEVEL I Understanding	Medium
TQ 4.16 · PYQ 2026-Jan [8] (a) · DESC · 5M · Pg 670	LEVEL I Understanding	Medium
TQ 4.18 · PYQ 2026-Sep [7] (a) · DESC · 5M · Pg 671	LEVEL I Understanding	Medium
CSQ 4.1 · MTP 2026-Apr S2 [1] (c) {C} · 5M · Pg 672	LEVEL I Understanding	Medium
CSQ 4.2 · PYQ 2026-Sep [5] (b) {C} · 5M · Pg 673	LEVEL I Understanding	Medium

Application use the rule - work the problem · 1 question

- Take each force in turn and anchor it to a fact from the scenario. Where the scenario says nothing about a force, say so expressly rather than inventing facts.
- Identify the key success factors from the customer priorities the scenario lists, then say what the firm must do to outperform on each.

TQ 4.12 · PYQ 2025-Jan [8] (a) · DESC · 5M · Pg 666	LEVEL II Application	Medium
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Analysis break it down and take the parts separately · 6 questions

- Where the question asks which forces are significant, grade them - significant, moderate, low - and give the reason from the facts behind each grade.

TQ 4.3 · PYQ 2019-Nov [9] (a) · DESC · 5M · Pg 658	LEVEL II Analysis	Medium
TQ 4.5 · PYQ 2021-Jul [9] (a) · DESC · 5M · Pg 661	LEVEL II Analysis	Medium
TQ 4.7 · PYQ 2022-May [10] (Or) (b) · DESC · 5M · Pg 662	LEVEL II Analysis	Medium
TQ 4.11 · MTP 2024-Dec S2 [2] (a) · DESC · 5M · Pg 666	LEVEL II	Medium

	Analysis	
TQ 4.17 • RTP 2026-May [9] • DESC • Pg 670	LEVEL II Analysis	Medium
TQ 4.9 • PYQ 2023-May [8] (b) • DESC • 5M • Pg 663	LEVEL II Analysis	Hard

Topic 5: Market and Customer

L2P6-B-C2-T05

Read first Read ICAI Study Material Chapter 2, Strategic Analysis: External Environment, on the market and the customer, particularly consumer behaviour.

NOTES

The market and customer material is examined through **consumer behaviour**, which the answers define as going beyond identifying who the customers are to **how they purchase** - their preferences, perceptions and shopping patterns. Give that definition before any list; it is the framing mark.

Consumer behaviour is set out in **four conceptual domains**, used as headings in this order: external influences; internal influences; decision making; and post-decision processes. External influences are advertisements, celebrity endorsements, peer recommendations and social norms - the marketing stimuli. **Internal influences** are the psychological processes inside the consumer: motivation, attitudes and perception.

The decision-making domain has its own **four-step sequence**: problem recognition; search for alternatives; information seeking and evaluation; and final choice. Post-decision processes are the part most answers drop, and they are separately marked: a satisfied buyer **repeats the purchase and recommends** the brand, sustaining the higher sales, while a dissatisfied one experiences **dissonance** and does not return.

Where the question asks for a marketing strategy rather than a description, keep the same four headings and turn each into an action. External influences become tech forums and influencer partnerships; internal influences become the unique selling points to stress; decision making becomes detailed specifications and comparisons for buyers who evaluate before they commit; post-decision becomes after-sales support and encouraged reviews. **Four headings, four actions.**

Close with the reason the answers give for studying behaviour at all: understanding the external and internal influences, the decision stages and the post-purchase reaction lets a firm **communicate effectively and design relevant campaigns**, deliver products that meet consumer needs and retain customers for repeat sales.

Analysis break it down and take the parts separately • 1 question

- Segment first, then target, then position. The recommendation at the end must follow from the segments you named, not from general marketing advice.

CSQ 5.1 · MTP 2024-Nov [1] (b) {C} · 5M · Pg 674

LEVEL II
Analysis

Medium

Topic 6: Competitive Strategy

L2P6-B-C2-T06

Read first Read ICAI Study Material Chapter 2, Strategic Analysis: External Environment, on competitive strategy - understanding the competitive landscape, key success factors and stakeholder analysis.

NOTES

The competitive landscape is a **business analysis that identifies the competitors**, direct and indirect, and that comprehends their vision, mission, core values, niche market, strengths and weaknesses. Understanding it requires the application of **competitive intelligence**. That definition earns its own mark before any step is written, and every scenario question in this topic expects it in the opening lines, applied to the firm the question names.

The steps to understand the competitive landscape are **five, always in this order**: identify the competitor, with actual data on respective market share; understand the competitors, using market research reports, the internet, newspapers, social media and industry reports; determine the strengths of the competitors; determine the weaknesses of the competitors, drawn from consumer reports and reviews in various media; and put all the information together, to infer what they are not offering and **what the firm can do to fill the gaps**.

Each step carries the question it answers, and quoting the question is what lifts the answer above a bare list: who are the competitors; what are their products and services; what gives them cost and price advantages and what are they likely to do next; where are they lacking; and what will the business do with this information. **Step five is where the recommendation lives**, and every scenario in this topic ends there.

Key success factors are the few things that must go well to ensure success - the **prerequisites for success** in an industry, covering strategy elements, product attributes, resources, competencies, capabilities and business outcomes. The three questions that identify them are: **on what basis do customers choose between competing brands**; what resources and competitive capabilities are essential for success; and what is required to achieve a sustainable competitive advantage. The headings the longer answer gives are managing and developing people, strategic focus, operations, physical resources and customer relations.

Close a key success factor answer with the consequence sentence, because both halves of it are marked: a company that **outperforms rivals on one or more key success factors** gains a sustainable competitive advantage, while one that misjudges their significance ends with a misguided strategy and competitive failure.

Mendelow's Matrix classifies stakeholders on **power and interest** into four groups: key players, high power and high interest, to be managed closely, fully engaged and involved in decision making; keep satisfied, high power and low interest, to be consulted often and given regular information but not over-communicated with; keep informed, low power and high interest, to be kept adequately informed and consulted in their area of expertise; and low priority, low power and low interest, to be monitored only with occasional general communication. In a scenario, **name the quadrant first** and justify it from the power and interest facts, then give all four.

Two questions set here come from elsewhere in the chapter and the framing does not change the content: the **six conditions of cut-throat rivalry** from the five forces material, and the **characteristics of business products** - tangible or intangible, priced where supply meets demand, features that satisfy the customer, the core of all business activity, and a finite useful life. Answer them from those lists.

Understanding explain it, and place it in context · 4 questions

- Define competitive landscape and key success factors in the answers' own words. The definition is marked separately from the list.

TQ 6.2 · PYQ 2019-May [7] (b) · DESC · 5M · Pg 677	LEVEL I Understanding	Medium
TQ 6.5 · RTP 2025-Sep [11] · DESC · Pg 680	LEVEL I Understanding	Medium
TQ 6.6 · RTP 2026-Jan [10] · DESC · Pg 682	LEVEL I Understanding	Medium
CSQ 6.1 · PYQ 2023-Nov [10] (a) · 5M · Pg 685	LEVEL I Understanding	Medium

Application use the rule - work the problem · 2 questions

- Put each named competitor under the step it belongs to, and finish at step five with what the firm should actually do about the gap.
- For a stakeholder scenario, name the quadrant first, justify it from the power and interest described, then set out all four categories.

TQ 6.3 · PYQ 2025-May [8] (a) · DESC · 5M · Pg 679	LEVEL II Application	Medium
TQ 6.4 · MTP 2025-Jul S1 [1] (b) · DESC · 5M · Pg 679	LEVEL II Application	Medium

Analysis break it down and take the parts separately · 4 questions

- Name the factors, then say what each one does to competitive position. A scenario question wants the factors that are actually in the scenario, not the full list.

- Where the question quotes a proposition about competition, answer the proposition before you expand the framework.

TQ 6.1 · PYQ 2018-Nov [12] (Or) (b) · DESC · 3M · Pg 675	LEVEL II Analysis	Medium
TQ 6.7 · PYQ 2026-Jan [5] (c) {C} · DESC · 5M · Pg 683	LEVEL II Analysis	Medium
TQ 6.8 · PYQ 2026-May [6] (a) · DESC · 5M · Pg 684	LEVEL II Analysis	Medium
CSQ 6.2 · RTP 2025-Jan [9] · Pg 687	LEVEL II Analysis	Medium

SECTION B • STRATEGIC MANAGEMENT • CHAPTER 3

Strategic Analysis: Internal Environment

5 Topics • 40 Classified Questions • Importance: B

ICAI SKILL PROFILE ICAI band for Strategic Management: Level I 30-55% • Level II 45-70% — this chapter reads **on profile**

Level I — Comprehension & Knowledge **43.6%** 85 of 195 marks

Level II — Analysis & Application **56.4%** 110 of 195 marks

This chapter sits inside ICAI's own band for Strategic Management — 44% Level I against 30-55%. Prepare it in those proportions: know the method, then drill it.

Topic 1: Understanding Key Stakeholders

L2P6-B-C3-T01

Read first Read ICAI Study Material Chapter 3, Strategic Analysis: Internal Environment, on understanding key stakeholders and Mendelow's Matrix.

NOTES

Mendelow's Matrix is the framework every question on this topic wants. It is a grid-based tool that plots each stakeholder on two axes: **power** to influence the project or organisation, and **interest** in its success. The answers say power is assessed from authority, resources and expertise, and interest from the level of involvement, expectations, and the potential benefits or risks the stakeholder carries. Name the tool and both axes in your opening line.

The printed answers take five steps, always in this order: **identify the stakeholders**; assess their power and interest; plot them on the grid; develop a strategy for each quadrant; and **monitor and adapt**. The fifth step is the one candidates drop. Stakeholders move between quadrants as circumstances change, so the engagement strategy has to be reviewed and adjusted, and saying so earns a mark on its own.

Four quadrants, named with their power and interest combination. **Key Players** are high power, high interest: engage fully, involve them in decision-making, keep them informed, examples being CEOs and shareholders. **Keep Satisfied** are high power, low interest: give regular updates and address concerns so they do not become detractors. **Keep Informed** are low power, high interest: communicate regularly to sustain goodwill and harvest their feedback. **Low Priority** are low power, low interest: monitor occasionally, minimal resources. Marks follow the count, so give all four with their treatments.

In a caselet the marks are for placing the question's own stakeholders and then prescribing the matching treatment. Environmentally conscious consumers who shape industry standards were placed in **Key Players**; the government bodies, investors, suppliers, local communities and

environmental groups on a smart-city project were sorted one at a time. **Place first, then prescribe.** An answer that describes the grid in the abstract without putting the named stakeholders into it loses the application marks.

One question filed under this head asked instead for the **internal strategic drivers** a firm was responding to, and the answer gave industry and markets, customers, products/services and channels. Internal analysis and stakeholder analysis sit side by side in this chapter, so read the question stem for which of the two it wants before you start writing.

The recurring trap: a quadrant is fixed by the **pair** of power and interest, never by one of them alone. High power with low interest is Keep Satisfied, not Key Players. High interest with low power is Keep Informed, not Low Priority. Read both attributes out of the caselet, state both, and only then name the quadrant.

Understanding explain it, and place it in context • 1 question

- Define power and interest in one line each before you use them, using the sources the answers give - authority, resources, expertise for power; involvement, expectations, benefits and risks for interest.
- Close with the purpose sentence: the matrix lets engagement be tailored to each group's needs, raising the likelihood of project success.

CSQ 1.1 • MTP 2024-Nov [1] (a) {C} • 5M • Pg 695

LEVEL I
Understanding

Medium

Analysis break it down and take the parts separately • 4 questions

- Draw the matrix in words before you apply it: the two axes, then the four quadrants with their treatment. Then place each stakeholder the question names in a quadrant and justify the placement.
- Every stakeholder named in the scenario must be placed. An unplaced stakeholder is a lost mark.

TQ 1.1 • MTP 2024-Mar [4] (b) • DESC • 5M • Pg 690

LEVEL II
Analysis

Medium

TQ 1.2 • PYQ 2025-Jan [6] (b) • DESC • 5M • Pg 692

LEVEL II
Analysis

Medium

TQ 1.3 • MTP 2025-Dec S2 [1] (b) • DESC • 5M • Pg 693

LEVEL II
Analysis

Medium

TQ 1.4 • RTP 2026-Jan [11] • DESC • Pg 694

LEVEL II
Analysis

Medium

Topic 2: Strategic Drivers

L2P6-B-C3-T02

Read first Read ICAI Study Material Chapter 3, Strategic Analysis: Internal Environment, on the key strategic drivers of an organisation, strategic group mapping and channels.

NOTES

Strategic drivers are the crucial internal elements that influence an organisation's ability to differentiate itself and gain competitive advantage. They assess current performance and point to the areas needing attention. The answers name four, and always in this order: **industry and markets, customers, products and services, channels**. Give the four names before you explain any of them.

Taking them in turn as the answers do. **Industry and markets**: understand your relative position - industries group similar companies by primary product, markets are defined by the interaction of buyers and sellers, and strategic group mapping is the tool used here. **Customers**: segment them by needs and spending capacity, and distinguish the **customer who buys from the consumer who uses**, because pricing, design and usability follow from that. **Products and services**: assess and categorise the offering and build strategies for differentiation, branding and pricing. **Channels**: direct, digital or relationship-based routes that decide accessibility and customer satisfaction.

Strategic Group Mapping is the named tool for analysing the competitive position of rival firms. A strategic group is a set of rival firms with **similar competitive approaches and positions** in the market. The four-step procedure: identify the competitive characteristics that differentiate firms; plot the firms on a two-variable map using a pair of those characteristics; assign firms falling in about the same strategy space to the same group; and **draw circles proportional to each group's share** of total industry sales revenue. The fourth step carries a mark of its own.

The typical differentiating variables the answers list are price/quality range (high, medium, low), geographic coverage (local, regional, national, global), degree of vertical integration (none, partial, full), product-line breadth (wide, narrow), use of distribution channels (one, some, all) and degree of service offered (no-frills, limited, full). The insights the map yields: competitive positioning, **who your direct competitors are**, market gaps or underserved segments, **mobility barriers** between groups, and the intensity of competition within and across groups. Firms in the same group compete more directly with each other than with firms in other groups.

Channels are the **distribution system or pathway** through which the organisation delivers its products or provides its services to customers. Channel analysis matters when the strategy is to **scale up and expand beyond current geographies** - to reach new customers a business must develop or leverage channels. Wider and stronger channels improve market coverage, raise customer satisfaction and make it harder for rivals or new entrants to capture the same market.

Three channel types, and the answers always give an example with each. The **sales channel** is the intermediaries who sell the product through to the end user - the question is who needs to sell to whom, as fashion designers use agencies to sell to retailers. The **product channel** is the intermediaries who physically handle the product from producer to end user, such as a courier delivering an online purchase. The **service channel** is the entities providing supporting services during and after the sale, such as a Bosch contracted plumber installing a dishwasher sold in a Bosch showroom.

Older questions under this head reach into marketing. **Marketing** means identifying customer needs and satisfying them profitably, through creating, communicating, delivering and exchanging offerings of value. **Augmented marketing** is deliberate and accelerated effort to get better marketing returns through additional means - additional services and benefits built around the core and actual product, such as movies on demand, online computer repair and secretarial services. For social versus service marketing, set it out as a table: social marketing markets ideas, causes and social messages for the **welfare of society**, service marketing markets intangible services for **customer satisfaction and profit**.

Remembering reproduce what you have learnt · 2 questions

- Name all four strategic drivers before explaining any. Industry and markets, customers, products and services, channels - the order is the answers' order and costs nothing to keep.
- For channels, the three types and one example each. A type named without its example reads as half an answer.

TQ 2.1 · PYQ 2017-May [14] (b) · SN · 3M · Pg 696

LEVEL I
Remembering

Easy

TQ 2.4 · PYQ 2025-Jan [8] (Or) (b) · DESC · 5M · Pg 698

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 1 question

- Define the term in one line, then give the example the answers give. Augmented marketing without movies on demand or online repair services is a definition, not an answer.
- For a distinguish question, use a table with a Basis column and the bases the answer uses - meaning, objective, nature of offering, focus, example.

TQ 2.5 · RTP 2025-Jan [12] · DESC · Pg 699

LEVEL I
Understanding

Medium

Analysis break it down and take the parts separately · 5 questions

- Name the tool the question is fishing for, then give its procedure as ordered steps, then apply it to the facts.
- Where two related terms are to be distinguished, use a stated basis per row rather than two loose paragraphs.

TQ 2.2 · PYQ 2018-May [11] (b) · DESC · 5M · Pg 697

LEVEL II
Analysis

Medium

TQ 2.3 · PYQ 2024-May [8] (Or) (b) · DESC · 5M · Pg 697

LEVEL II
Analysis

Medium

TQ 2.6 · RTP 2026-May [11] · DESC · Pg 700

LEVEL II
Analysis

Medium

TQ 2.7 · MTP 2026-Mar S1 [1] (a) {C} · DESC · 5M · Pg 701

LEVEL II
Analysis

Medium

TQ 2.8 · PYQ 2026-May [7] (b) · DESC · 5M · Pg 702

LEVEL II
Analysis

Medium

Topic 3: Role of Resources and Capabilities: Building Core Competency

L2P6-B-C3-T03

Read first Read ICAI Study Material Chapter 3, Strategic Analysis: Internal Environment, on the role of resources and capabilities in building core competency.

NOTES

The definition the examiner wants, almost word for word: a core competence is a **unique strength of an organisation** which may not be shared by others. Core competencies are those capabilities **critical to a business achieving competitive advantage**. To qualify as a core competence, the competency must differentiate the business from any other similar business. Two-mark questions want exactly these three sentences and nothing more.

C.K. Prahalad and Gary Hamel identify major core competencies in three areas, and the authors' names are worth stating. **Competitor differentiation**: the competence is unique and difficult for competitors to imitate, so better products and services can be offered without fear of copying. **Customer value**: it must deliver a fundamental benefit to the end customer and be the real reason they choose to buy - without that impact it will not affect the company's market position. **Application of competencies to other markets**: it must be applicable to the whole organisation, not one specialised area, however crucial that area is to a particular activity.

The three conditions a competence must meet to be regarded as a core competency: it must provide potential **access to a wide variety of markets**; it must make a significant contribution to **perceived customer benefits** of the end product; and it must be **difficult to imitate**. All three must hold together. A competence satisfying only one or two is a strength but not a core competency, and saying so plainly is what the last marks are for.

Four specific criteria of sustainable competitive advantage, used to decide which capabilities are core competencies. **Valuable**: they let the firm exploit opportunities or avert threats, and human capital matters in creating that value. **Rare**: very few competitors possess them, because capabilities shared with many rivals cannot be a source of advantage for any one of them. **Costly to imitate**: rivals cannot develop them easily - Intel's fast R&D cycle time could not be copied even when the product could. **Non-substitutable**: there is no strategically equivalent resource, as with Tata's culture and human capital behind its low-cost strategy, or Apple's iOS capabilities. Strategic value rises as substitution gets harder.

Four major characteristics of resources and capabilities that determine how long an advantage lasts. **Durability**: how long before they deteriorate or become obsolete - patents age fast in technology, strong brand names are highly durable. **Transferability**: how easily a rival can acquire

them, by hiring key people or buying technology; the harder the access, the more sustainable the advantage. **Imitability**: how easily they can be replicated - complex processes, specific routines and a unique culture resist imitation, while unprotected financial-services innovations do not.

Appropriability: who captures the returns from the resource base, since an advantage may exist and yet the owners may not collect its returns.

The trap is mixing the two four-item lists. **Valuable, rare, costly to imitate, non-substitutable** are the criteria for deciding whether a capability is a core competency. **Durability, transferability, imitability, appropriability** are the characteristics governing how sustainable the advantage is. Imitation appears in both, which is why the lists get merged - read the stem for whether it asks which capabilities are core competencies or what makes an advantage sustainable, and give only that list.

Understanding explain it, and place it in context • 2 questions

- Open with the unique-strength definition in the answer's own words, then the qualifying test - it must differentiate the business from any other similar business.
- Give each criterion its heading and then one explanatory sentence. The examples the answers use - Intel, Tata, Apple - are worth carrying because they show the criterion rather than restate it.

TQ 3.1 • PYQ 2018-May [7] (d) {C} • DESC • 2M • Pg 703

LEVEL I
Understanding

Easy

TQ 3.5 • PYQ 2026-Sep [8] (a) • DESC • 5M • Pg 707

LEVEL I
Understanding

Medium

Application use the rule - work the problem • 2 questions

- Where the question asks whether something is a core competency, run it against all three conditions and say expressly that all three must hold. Concluding that a strength is not a core competency is a valid answer if the facts support it.

TQ 3.3 • PYQ 2022-May [9] (b) • DESC • 5M • Pg 705

LEVEL II
Application

Medium

TQ 3.4 • PYQ 2025-May [6] (b) • DESC • 5M • Pg 706

LEVEL II
Application

Medium

Analysis break it down and take the parts separately • 1 question

- Answer the proposition first, then give the three areas and the tests a competency must pass. The tests are what turn a description into analysis.

TQ 3.2 • PYQ 2021-Jan [9] (a) • DESC • 5M • Pg 703

LEVEL II
Analysis

Medium

Topic 4: Combining Internal and External Analysis (SWOT Analysis)

L2P6-B-C3-T04

Read first Read ICAI Study Material Chapter 3, Strategic Analysis: Internal Environment, on combining internal and external analysis through SWOT analysis.

NOTES

SWOT analysis is a tool used by organisations for **evolving strategic options for the future**. The axis the whole topic turns on: **strengths and weaknesses are internal**, opportunities and threats are **external**. Say that sentence early. Every scenario question on this topic is really testing whether you can sort facts across that internal/external line.

The four definitions in the answers' own words. **Strength**: an inherent capability of the organisation which it can use to gain strategic advantage over its competitors. **Weakness**: an inherent limitation or constraint which creates strategic disadvantage. **Opportunity**: a favourable condition in the external environment which enables the organisation to strengthen its position. **Threat**: an unfavourable condition in the external environment which causes risk or damage to its position. Four definitions, one line each.

The stated purpose: to enable management to create a **firm-specific business model** that will best **align, fit or match** organisational resources and capabilities to the demands of the environment in which it operates. That sentence is the standard closing line of a short note on SWOT and is worth learning as it stands.

Why do a SWOT before formulating strategy - the reasons the answers list. It puts internal and external factors in front of management so **every aspect is reviewed** before a decision. It generates recommendations by **using strengths and opportunities** while reducing weaknesses and threats. It shows both what is working and what needs improvement, so resources can be aligned to objectives. Done regularly, it keeps strategies relevant as circumstances change. And it **converts complex issues into a simple framework** managers can read quickly.

In a caselet, draw the grid. The answers set out a **four-box grid** with Strengths and Weaknesses on the top row, Opportunities and Threats below, and two to four short points in each box drawn from the facts given. Then close with a one-line evaluation of what the analysis implies for the decision - leverage the strengths, address the weaknesses, capitalise on the opportunities, mitigate the threats. A question asking you to **evaluate** the factors wants that closing line; a bare list will not do.

The commonest error, named expressly in the answers: filing **limited experience as a threat**, or **global competition as a weakness**. Internal against external is the axis the marks follow. Test each fact by asking whether it lives inside the organisation or outside it, before asking whether it is good or bad.

Analysis break it down and take the parts separately · 5 questions

- Put the four heads down as a grid and fill each from the scenario. Misfiling an internal factor as external, or a strength as an opportunity, is the error the answers keep correcting.
- Finish by saying what the grid implies for strategy. A grid with no conclusion is only half the answer.

TQ 4.1 · RTP 2025-May [12] · SN · Pg 708	LEVEL II Analysis	Medium
TQ 4.2 · PYQ 2025-Sep [7] (a) · DESC · 5M · Pg 709	LEVEL II Analysis	Medium
CSQ 4.1 · MTP 2024-Jul [1] (b) {C} · 5M · Pg 710	LEVEL II Analysis	Medium
CSQ 4.2 · RTP 2025-Jan [11] · Pg 711	LEVEL II Analysis	Medium
CSQ 4.3 · PYQ 2026-Sep [5] (c) {C} · 5M · Pg 712	LEVEL II Analysis	Medium

Topic 5: Competitive Advantage Using Michael Porter's Generic Strategies

L2P6-B-C3-T05

Read first Read ICAI Study Material Chapter 3, Strategic Analysis: Internal Environment, on competitive advantage using Michael Porter's generic strategies.

NOTES

Michael Porter says competitive advantage is derived from three generic strategies: **cost leadership, differentiation and focus**. Name Porter and all three before you develop the one the question wants - this is the single most examined topic in the chapter and the opening line is free marks. Cost leadership and differentiation address a **broad market**; focus addresses a **narrow segment**.

Cost leadership is where the firm's competitive advantage lies in a **lower cost of products or services** relative to competitors. It means producing standardised products at a very low per-unit cost for price-sensitive customers, achieved through higher productivity and continuous cost reduction across development, production, marketing and distribution. Sustained cost leadership makes a firm an above-average performer provided it can command prices at or near the industry average. Actions to achieve it: forecast demand promptly; optimum utilisation of resources; **economies of scale**; standardisation for mass production; invest in cost-saving technology; and resist differentiation until it becomes essential.

Conditions in which cost leadership gives an advantage: **price-sensitive buyers** in large numbers; **limited opportunities to differentiate** the product; low brand preference among buyers; and buyers with strong bargaining power. Its risks and disadvantages: competitors **imitate the cost-reduction techniques** and price competition erodes industry profits; **technological breakthroughs**

make the existing cost advantage ineffective; buyers shift preference from low price to differentiating features; success depends on achieving high sales volume; and keeping costs down by cutting advertising, market research and R&D proves expensive in the long run.

Differentiation aims at producing products and services **considered unique industry-wide**, directed at consumers who are **relatively price-insensitive**. Uniqueness may come from design features, technological leadership, unique uses, quality, environmental impact, brand image, dealer network or customer service. Three bases: **product** (innovative offerings, costly in R&D and marketing but a large payoff), **pricing** (either the lowest price or superiority signalled by a higher one), and **organisation** (brand power, location advantage, name recognition, customer loyalty). Six measures to achieve it, in the answers' order: offer utility matched to tastes and preferences; elevate product performance; promise high quality for buyer satisfaction; rapid product innovation; enhance brand image and brand value; and price on unique features and the customer's buying capacity.

Differentiation's advantages are set out **against the five forces**, and that is how the answers structure them. **Rivalry**: brand loyalty safeguards the firm and buyers become less price-sensitive. **Buyers**: they do not negotiate on price because of the special features and the fewer options available. **Suppliers**: the premium price lets the firm absorb higher input costs. **Entrants**: innovative features are expensive, so new entrants cannot match them at a comparable price. **Substitutes**: they cannot replace a product with high brand value and customer loyalty. The disadvantages: uniqueness is hard to sustain as rivals imitate; excessive prices push customers to cheaper alternatives; and differentiation fails if customers do not value the unique features.

Focus concentrates on a particular group of customers, geographic market or product-line segment, to serve a **well-defined but narrow market** better than competitors serving a broad one. It is most effective when consumers have **distinctive preferences or requirements** and rivals are not attempting to specialise in the same segment. It splits into **focused cost leadership** (low price within the niche) and **focused differentiation** (unique features within the niche), and one firm may run both. Advantages: premium prices can be charged, and deep expertise makes it difficult for rivals and new entrants to compete. Disadvantages: firms lacking distinctive competencies cannot pursue it; limited demand keeps costs high; and in the long run the niche may disappear or be taken over by a larger competitor acquiring the same competencies.

Two extras the recent papers add. The **best-cost provider strategy** combines low cost with premium features to deliver **greater value for money** - costs and prices below rivals offering similar products, while still giving better quality; an affordably priced SUV carrying a 5-star safety rating and advanced technology is the printed example. Separately, one caselet distinguished **proactive** deliberate planned action, such as building brand identity and innovating, from **reactive** adaptation to competitors' moves and pricing, and recommended a **blended approach**. The recurring trap across this topic: decide **broad market or narrow market first**, then decide cost or uniqueness. A premium niche brand is focused differentiation, not plain differentiation, and calling it differentiation costs the identification mark.

Remembering reproduce what you have learnt · 3 questions

- Open by naming Porter and all three generic strategies, then develop the one asked for. That single sentence is earned before you have analysed anything.
- Learn the achieving-measures as numbered lists of six for both cost leadership and differentiation. Marks follow the count of measures named.

TQ 5.2 · PYQ 2019-Nov [10] (Or) (b) · SN · 5M · Pg 714	LEVEL I Remembering	Medium
TQ 5.4 · PYQ 2022-Nov [8] (b) · DESC · 5M · Pg 716	LEVEL I Remembering	Medium
TQ 5.6 · PYQ 2025-May [7] (b) · DESC · 5M · Pg 718	LEVEL I Remembering	Medium

Understanding explain it, and place it in context · 9 questions

- Define the strategy in one line, then give its basis of advantage. Cost leadership is lower cost relative to competitors; differentiation is uniqueness industry-wide for price-insensitive buyers.
- Where the question asks for circumstances or conditions, answer with the market conditions listed - price-sensitive buyers, few differentiation opportunities - not with the firm's own actions.

TQ 5.1 · PYQ 2019-May [9] (b) · DESC · 5M · Pg 713	LEVEL I Understanding	Medium
TQ 5.3 · PYQ 2021-Jan [8] (b) · DESC · 5M · Pg 715	LEVEL I Understanding	Medium
TQ 5.5 · MTP 2023-Mar [6] (b) · DESC · 5M · Pg 717	LEVEL I Understanding	Medium
TQ 5.7 · MTP 2025-Apr S2 [1] (b) · DESC · 5M · Pg 719	LEVEL I Understanding	Medium
TQ 5.8 · RTP 2025-May [11] · DESC · Pg 720	LEVEL I Understanding	Medium
CSQ 5.2 · PYQ 2020-Nov [6] {C} · 5M · Pg 722	LEVEL I Understanding	Medium
CSQ 5.4 · PYQ 2022-Nov [6] {C} · 5M · Pg 725	LEVEL I Understanding	Medium
CSQ 5.6 · PYQ 2025-Jan [5] (b) {C} · 5M · Pg 727	LEVEL I Understanding	Medium
CSQ 5.8 · PYQ 2026-May [5] (b) {C} · 5M · Pg 730	LEVEL I Understanding	Medium

Application use the rule - work the problem · 3 questions

- Identify the strategy by name first, in one sentence, then justify it from the facts in the caselet, then give the advantages or disadvantages the question asks for.
- Where the caselet names several firms, take each one in turn with its own heading and its own strategy. Marks are allotted per firm.

- Ask whether the target market is broad or narrow before you ask whether the advantage is cost or uniqueness. That order is what separates focus from the other two.

CSQ 5.3 · PYQ 2021-Dec [6] {C} · 5M · Pg 723	LEVEL II Application	Medium
CSQ 5.5 · PYQ 2024-Sep [5] (c) {C} · 5M · Pg 726	LEVEL II Application	Medium
CSQ 5.7 · PYQ 2025-Sep [5] (a) {C} · 5M · Pg 729	LEVEL II Application	Medium

Analysis break it down and take the parts separately · 2 questions

- Where two partners or two firms take opposite approaches, set the low-price high-volume route against the perceived-value premium-price route and name each one separately before commenting.

TQ 5.9 · PYQ 2026-Jan [6] (b) · DESC · 5M · Pg 720	LEVEL II Analysis	Medium
CSQ 5.1 · PYQ 2018-Nov [9] (b) · 5M · Pg 721	LEVEL II Analysis	Medium

SECTION B · STRATEGIC MANAGEMENT · CHAPTER 4

Strategic Choices

3 Topics · 50 Classified Questions · Importance: A

ICAI SKILL PROFILE ICAI band for Strategic Management: Level I 30-55% · Level II 45-70% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge

58.2%

138 of 237 marks

Level II — Analysis & Application

41.8%

99 of 237 marks

Above this Section's Level I ceiling: 58% of this chapter's marks are Comprehension and Knowledge, against ICAI's 30-55% for Strategic Management. Reading carries more of the preparation here than it does elsewhere; do not prepare this chapter by working sums alone.

Topic 1: Strategic Choices

L2P6-B-C4-T01

Read first Read ICAI Study Material Chapter 4, Strategic Choices, on corporate level strategy and the generic alternatives — stability, expansion and diversification, including mergers, acquisitions and strategic alliances.

NOTES

Corporate level strategy is concerned with the choice of business, direction and scope of the organisation as a whole: what businesses it should be in and how the portfolio is managed for growth and stability. Glueck and Jauch give **four generic strategic alternatives** — stability, expansion, retrenchment and combination — and the answers call these **directional strategies** because they provide the basic direction for strategic action towards long-term objectives. Name all four before you discuss any one. A combination strategy is two of them run at the same time, as where a firm expands its profitable packaged food division abroad while closing its loss-making units. Where the question asks for the dimensions of strategic decisions, the answers list seven: top management involvement, thinking in totality of the organisation, commitment of organisational resources, consideration of factors in the external environment, significant impact on long-term prosperity, future orientation, and major multifunctional or multi-business consequences.

Stability strategy safeguards existing interests and strengths. The firm continues in the same or similar markets with the same products and services, makes few functional changes and maintains operational efficiency — but the answers insist it is **not a 'do nothing' strategy**. It is meaningful when the firm intends to serve the same markets with the same products, when its products have reached the **maturity stage of the product life cycle** or it already holds a substantial share it wants to retain, and when it needs to consolidate after rapid expansion and optimise returns from committed resources. The reasons the answers give are product maturity, staff preference for

fewer changes and lower risk, a relatively stable external environment, consolidation after growth, and that expansion is not advisable because it may be perceived as threatening. On a start-up the answers say stability is generally unsuitable: start-ups need speed, flexibility, agility and rapid market penetration.

Expansion strategy redefines the business by enlarging its scope and substantially increasing investment in it; the answers equate it with **dynamism, vigour, promise and success** and treat it as the opposite of stability. The reasons for adopting it: the environment demands an increase in the pace of activity, strategists are more satisfied by the prospect of growth, expansion gives greater control over the market against competitors, and advantages accrue from the experience curve and scale of operations. Its characteristics are redefinition of business scope, a **high risk – high reward** nature, facilitation of substantial growth, renewal of the organisation through fresh investment, and versatility through two routes — **intensification**, growth within existing business areas, and **diversification**, growth by entry into new business areas.

Diversification is entry into new products or markets involving substantially different skills, technology and knowledge; firms use it to employ excess capacity and capability more effectively and to gain synergy. The distinction the examiner returns to is concentric against conglomerate, and the answers compare them on three bases. **Occurrence**: concentric occurs when a firm adds related products or markets, conglomerate when it diversifies into areas unrelated to its current line of business. **Linkages**: in concentric the new business is linked to the existing one through process, technology or marketing and is a spin-off from existing facilities, so synergy follows; in conglomerate no such linkage exists and the new business is disjointed from the existing one in process, technology and function. **Reason**: concentric is pursued where opportunities in the existing line of business are available, conglomerate where those opportunities are limited or outside opportunities are highly lucrative. In a scenario, test whether customer groups, customer functions and technology overlap.

In **vertically integrated diversification** the firm stays within the same product-process chain and moves forward or backward, entering specific product or process steps with the intention of making them into new businesses. **Backward integration** creates an effective supply by entering the business of input providers — purchasing or building a business that increases the firm's own supply capability. **Forward integration** moves forward in the value chain into business lines that use the existing product, typically the distribution channels. **Horizontally integrated diversification** is expansion by acquiring similar or complementary businesses at the same stage of production. The point the answers make plainly is that vertical integration is a form of **related, concentric diversification**, and its risk is that the organisation loses continued focus on its original business.

A merger combines two or more companies to expand business operations, concluded on friendly terms, with the owners of the merging entities sharing in the profits of the newly formed entity; **an acquisition is one organisation taking over another** and gaining control of its assets and operations, generally a financially stronger firm taking over a weaker one, the combined operations continuing under the stronger entity's name and sometimes on unfriendly terms. Four types of merger are examined: **horizontal**, between direct competitors in the same industry, for

economies of scale and removal of duplication; **vertical**, between firms at different stages of production or distribution, backward or forward; **co-generic**, between firms related through production processes, markets or technologies, extending the product line or acquiring components needed in daily operations; and **conglomerate**, between firms in unrelated industries, to diversify risk and broaden the portfolio. In a scenario, a new entity formed by two firms is a merger; one firm ceasing to exist is an acquisition.

A **strategic alliance** is a relationship between two or more businesses that enables each to achieve strategic objectives neither could achieve on its own, the partners remaining **independent and separate entities** while sharing the benefits and control. Its advantages come under four heads in the answers' order: **organisational** — learning skills and capabilities from partners, enhanced productive capacity, a distribution system or extended supply chain, and legitimacy from a respected partner; **economic** — costs and risks spread across members, greater economies of scale, and co-specialisation; **strategic** — rivals cooperating instead of competing, vertical integration along the supply chain, pooled resources and skills, and access to new technology or joint research and development; and **political** — entry into a foreign market past local prejudice or legal barriers. On innovation, the answers hold that it helps solve complex problems, increases productivity and provides competitive advantage, while its risks are high cost and financial risk, uncertain returns, technological uncertainty and implementation risk.

Understanding explain it, and place it in context • 16 questions

- Define the strategy in one line the way the answers define it, then set out the reasons or characteristics as a numbered list. A definition on its own will not carry a five-mark question.
- Where you are asked to justify a statement, such as stability being the opposite of expansion, describe both strategies and then state the contrast in a closing sentence.

TQ 1.2 • PYQ 2018-May [7] (c) {C} • DESC • 2M • Pg 736	LEVEL I Understanding	Easy
TQ 1.3 • PYQ 2018-May [7] (e) {C} • DESC • 2M • Pg 736	LEVEL I Understanding	Easy
TQ 1.7 • PYQ 2023-Nov [9] (b) • DESC • 5M • Pg 740	LEVEL I Understanding	Medium
TQ 1.9 • PYQ 2024-May [8] (b) • DESC • 5M • Pg 741	LEVEL I Understanding	Medium
TQ 1.10 • PYQ 2024-Sep [7] (b) • DESC • 5M • Pg 742	LEVEL I Understanding	Medium
TQ 1.11 • PYQ 2025-May [8] (b) • DESC • 5M • Pg 743	LEVEL I Understanding	Medium
TQ 1.13 • PYQ 2026-Jan [7] (b) • DESC • 5M • Pg 745	LEVEL I Understanding	Medium
TQ 1.14 • RTP 2026-May [13] • DESC • Pg 746	LEVEL I Understanding	Medium

CSQ 1.2 · PYQ 2022-May [10] (a) · DESC · 5M · Pg 749	LEVEL I Understanding	Medium
CSQ 1.3 · MTP 2022-Sep [2] {C} · 5M · Pg 749	LEVEL I Understanding	Medium
CSQ 1.4 · PYQ 2023-May [8] (a) · 5M · Pg 750	LEVEL I Understanding	Medium
CSQ 1.6 · MTP 2024-Nov [4] (a) · 5M · Pg 752	LEVEL I Understanding	Medium
CSQ 1.8 · PYQ 2026-May [5] (c) {C} · 5M · Pg 754	LEVEL I Understanding	Medium
CSQ 1.9 · PYQ 2026-May [6] (b) · 5M · Pg 756	LEVEL I Understanding	Medium
TQ 1.4 · MTP 2021-Mar [5] (a) · DESC · 5M · Pg 737	LEVEL I Understanding	Hard
TQ 1.5 · PYQ 2021-Dec [9] (b) · DESC · 5M · Pg 737	LEVEL I Understanding	Hard

Application use the rule - work the problem · 2 questions

- Scenario questions want the name first. Identify the strategy in your opening line, then quote the facts from the case that support it, then explain the strategy in general terms.
- For a diversification case, test the overlap in customer groups, customer functions and technology before you choose between concentric and conglomerate.
- A case that lists several divisions and a different decision for each wants a separate named strategy for each decision, not one answer for the company.

CSQ 1.7 · PYQ 2026-Jan [5] (b) {C} · 5M · Pg 753	LEVEL II Application	Medium
TQ 1.8 · PYQ 2024-May [6] (a) · DESC · 5M · Pg 741	LEVEL II Application	Hard

Analysis break it down and take the parts separately · 5 questions

- Distinguish-between answers are marked on the number of bases compared. Use a table on occurrence, linkages and reason, one row per basis.
- Where the case gives two people proposing different moves, label each move separately and state the risk attached to each.

TQ 1.1 · PYQ 2016-May [13] (a) · DB · 4M · Pg 734	LEVEL II Analysis	Medium
TQ 1.6 · PYQ 2023-Nov [8] (b) · DESC · 5M · Pg 739	LEVEL II Analysis	Medium
TQ 1.12 · PYQ 2025-Sep [7] (b) · DESC · 5M · Pg 744	LEVEL II Analysis	Medium

CSQ 1.1 · PYQ 2019-May [6] {C} · 5M · Pg 747

LEVEL II
Analysis

Medium

CSQ 1.5 · MTP 2024-Jul [1] (c) {C} · 5M · Pg 751

LEVEL II
Analysis

Medium

Topic 2: Strategic Exits

L2P6-B-C4-T02

Read first Read ICAI Study Material Chapter 4, Strategic Choices, on strategic exits — the retrenchment strategies of turnaround, divestment and liquidation.

NOTES

Retrenchment is followed when an organisation **substantially reduces the scope of its activity**. It becomes necessary for coping with hostile and adverse conditions in the environment and when any other strategy would be suicidal; it is adopted because management no longer wishes to remain in the business partly or wholly after continuous losses, because the environment faced is threatening, or because stability can be ensured by reallocating resources from unprofitable to profitable businesses. It takes three forms and the marks are in picking the right one: **turnaround, divestment and liquidation**. The distinction the examiner keeps returning to is that **turnaround is internal retrenchment**, laying emphasis on improving internal efficiency, while **divestment is external**, adopted when a business turns unprofitable and unviable because of outside factors or after a turnaround has failed.

Turnaround returns an underperforming or distressed company to normalcy in terms of acceptable profitability, solvency, liquidity and cash flow. The reasons the answers give for adopting it: performance has deteriorated to the point where a **radical change of direction** in strategy, and possibly in structure and culture, is needed; it is a highly targeted effort to return the organisation to profitability and raise positive cash flows to a sufficient level; and it is used when threats and weaknesses together make basic survival difficult. To achieve its objectives, turnaround must reverse the causes of distress, resolve the financial crisis, achieve a rapid improvement in financial performance, regain stakeholder support and overcome internal constraints and unfavourable industry characteristics.

The **six danger signals** that point to a turnaround are asked directly and open most of the scenario answers: persistent negative cash flow from the business, uncompetitive products or services, declining market share, deterioration in physical facilities, over-staffing with high employee turnover and low morale, and mismanagement. Read the facts of the case back against this list and quote the ones that match. An answer that names the strategy without tying it to these indicators loses the **identification marks**, and where the question asks for key problems it wants them drawn from the facts, not stated in the abstract.

The work plan has **five named stages, in order**. **Stage One – assessment of current problems**: get to the root causes and the extent of the damage, then focus resources on correcting the

immediate issues. Stage Two – analyse the situation and develop a strategic plan: judge the chances of survival, look for viable core businesses, adequate bridge financing and available organisational resources, analyse strengths and weaknesses in competitive position, then set specific goals and detailed functional actions. Stage Three – implementing an emergency action plan: **stop the bleeding** through human resource, financial, marketing and operations actions to restructure debt, improve working capital, reduce costs, prune product lines and establish a positive operating cash flow quickly. Stage Four – restructuring the business: cash forecasts, analysis of assets and debts, repositioning the product mix, closing facilities or withdrawing from markets, and the people mix through reward and compensation systems. Stage Five – returning to normal: signs of profitability, return on investment and enhanced economic value added, with new products added carefully, improved customer service, alliances and increased market share.

Where the question asks for the **elements** of turnaround rather than the stages, the answers give eight: changes in top management, initial credibility-building actions, neutralising external pressures, identifying quick payoff activities, quick cost reductions, revenue generation, asset liquidation for generating cash, and better internal co-ordination. A case that mentions the appointment of a young and visionary executive is pointing at the first of these, so say so expressly. Note the warning the answers attach to the long-term recovery question: an answer that **stops at cost cutting** has answered only the first stage.

Divestment is the **sale or liquidation of a portion of the business**, a major division, profit centre or SBU, and is usually part of a rehabilitation or restructuring plan. The reasons, in the order the answers give them: a turnaround has been attempted and has proved unsuccessful; a business that had been acquired proves a mismatch and cannot be integrated within the company; **persistent negative cash flows** from one business create financial problems for the whole company; the severity of competition and the firm's inability to cope with it; technological upgradation is required for survival but the firm cannot invest in it; and a better alternative for investment is available. The answers add that divestment should be seen as an **integral part of corporate strategy** and not with stigma, where the aim is to restore overall business viability.

Liquidation is the most extreme and unattractive of the retrenchment strategies: closing down the firm and selling its assets. Set it against divestment on four bases. Meaning: divestment sells a portion of the business, liquidation closes the firm down. When adopted: divestment as part of a rehabilitation plan after an unsuccessful turnaround; liquidation only in severe and critical conditions where neither turnaround nor divestment is a solution or both have been attempted and failed. Objective: survival of the organisation, against **last resort**. Consequences: divestment keeps the organisation alive and retains personnel at least to some extent, while liquidation brings loss of employment, termination of future opportunities, the stigma of failure and loss of goodwill. The one concession the answers make is that where **a dead business is worth more than alive**, liquidation is a good proposition.

Remembering reproduce what you have learnt • 3 questions

- Learn the six danger signals and the five stages by name and in order. Most of the marks in this topic are for the naming.
- The eight elements of a turnaround are a different list from the five stages. Read which one the question asks for before you start writing.

TQ 2.2 • PYQ 2017-Nov [8] (c) {C} • DESC • 3M • Pg 758	LEVEL I Remembering	Easy
CSQ 2.5 • PYQ 2024-Sep [5] (b) {C} • 5M • Pg 769	LEVEL I Remembering	Medium
CSQ 2.6 • RTP 2024-Sep [13] • Pg 770	LEVEL I Remembering	Medium

Understanding explain it, and place it in context • 5 questions

- Name the strategy, then give the reasons or the stages in order. Where an action plan is asked for, write it as numbered steps a CEO could follow, not as a description of turnaround.
- A scenario question wants the diagnosis first — say what has gone wrong — before the plan.

TQ 2.1 • PYQ 2016-Nov [14] (Or) (b) • DESC • 3M • Pg 757	LEVEL I Understanding	Easy
TQ 2.4 • PYQ 2021-Jul [8] (a) • DESC • 5M • Pg 759	LEVEL I Understanding	Medium
TQ 2.7 • MTP 2025-Jul S1 [1] (c) • DESC • 5M • Pg 762	LEVEL I Understanding	Medium
TQ 2.8 • RTP 2025-Sep [13] • DESC • Pg 763	LEVEL I Understanding	Medium
CSQ 2.7 • PYQ 2025-May [5] (c) {C} • 5M • Pg 771	LEVEL I Understanding	Medium

Application use the rule - work the problem • 6 questions

- Open by naming the retrenchment strategy, then give the reasons drawn from the facts of the case rather than in the abstract.
- Where the case says a turnaround was tried and failed, the answer is divestment. Where the board decides to continue the business and appoints a new executive, the answer is turnaround.
- A case that dates two moves, one in an earlier year and one later, wants two strategies named separately with the year attached to each.

CSQ 2.1 • PYQ 2018-May [9] (a) • 5M • Pg 764	LEVEL II Application	Medium
CSQ 2.2 • PYQ 2019-Nov [6] {C} • 5M • Pg 766	LEVEL II Application	Medium

CSQ 2.3 · PYQ 2021-Jan [7] (b) · 5M · Pg 767	LEVEL II Application	Medium
CSQ 2.4 · PYQ 2022-Nov [8] (a) · 5M · Pg 768	LEVEL II Application	Medium
CSQ 2.8 · PYQ 2025-Sep [5] (b) {C} · 5M · Pg 772	LEVEL II Application	Medium
CSQ 2.9 · PYQ 2026-Sep [5] (a) {C} · 5M · Pg 773	LEVEL II Application	Medium

Analysis break it down and take the parts separately · 3 questions

- Where two exit routes are to be distinguished, use a stated basis per row: what is sold, who continues, what happens to the entity.
- Where indicators are asked for, give them as a list and say what each one signals; the marks are in the count.

TQ 2.3 · PYQ 2020-Nov [10] (b) · DESC · 5M · Pg 758	LEVEL II Analysis	Medium
TQ 2.5 · PYQ 2021-Dec [8] (b) · DESC · 5M · Pg 761	LEVEL II Analysis	Medium
TQ 2.6 · MTP 2024-Mar [3] (b) · DESC · 5M · Pg 761	LEVEL II Analysis	Medium

Topic 3: Strategic Options

L2P6-B-C4-T03

Read first Read ICAI Study Material Chapter 4, Strategic Choices, on strategic options — Ansoff's product-market growth matrix, the BCG, ADL and GE matrices, and strategic group mapping.

NOTES

The **Product-Market Growth Matrix**, proposed by **Igor Ansoff**, helps a business identify future growth opportunities by asking whether the products and the markets are existing or new. Name the four strategies in this order: **market penetration**, growth through existing products in existing markets by advertising, promotion, competitive pricing or higher usage among current customers; **market development**, existing products taken into new markets, whether new geographical regions, alternative distribution channels or new segments; **product development**, new or modified products introduced into existing markets; and **diversification**, new products marketed in new markets. The choice among them depends on the organisation's resources, infrastructure, market position, location and budget.

In the scenarios the answers treat **diversification as the highest risk cell** and reach it whenever a firm enters new markets with products created or tailored for them: both the fashion brand and the organic food company went abroad with region-specific products and both were graded as

diversification, not market development. Where the existing product is carried into a new region unchanged and only the packaging and marketing message are aligned to local preferences and regulations, the answer is **market development**. Read the facts for whether **the product itself is new**; that single fact decides the cell, and the answer must name the cell before it explains it.

The **BCG Growth-Share Matrix** plots **relative market share against market growth rate**, not profitability, and that is the point of the examiner's favourite contrast question. **Stars** have high share in a high-growth market and need investment to hold position. **Cash cows** have high share in a low-growth market: highly profitable, but further investment earns little, so they are milked rather than fed. **Question marks** have low share in a high-growth market: currently weak and often unprofitable, but the growth means share can still be bought, so they absorb heavy investment selectively. **Dogs** have low share in a low-growth market and are candidates for divestment. Where the question asks why the most profitable business is not getting the largest allocation, the final mark is for saying the **cash cow is funding the others** and the portfolio is managed as a whole.

Once the units are classified, four strategies follow: **build**, increasing market share through continued investment in marketing, distribution and product development; **hold**, maintaining current share and profitability by optimising resources and preserving the brand's reputation; **harvest**, taking short-term cash; and **divest**, selling or liquidating. The application the answers set is the star: build and hold both suit it, while **harvest and divest are wrong for a star** because they put short-term cash ahead of the long-term growth on which the classification rests. Say expressly why the two unsuitable options are unsuitable — the printed answers do, and the marks sit there.

The limitations of the BCG matrix are asked as part of a five-mark question. **Complexity and cost**: implementing the matrix is difficult, time-consuming and expensive. **Subjectivity**: defining SBUs and measuring market share or growth accurately is challenging. **Focus on the present**: it emphasises current business conditions and offers limited guidance for future strategic planning. **Overemphasis on growth**: this can lead to unwise investment in high-growth markets or premature divestment of established products. Close on the sentence the answers close on — the matrix is a simplified framework and should be used **alongside other strategic tools**.

The **ADL matrix** takes its name from **Arthur D. Little** and is a portfolio analysis method based on the product life cycle, forming a two-dimensional matrix on **stage of industry maturity** and the firm's **competitive position**. Its role is to assess that competitive position against five criteria, named in this order: **dominant**, a comparatively rare position attributable to monopoly or strong and protected technological leadership; **strong**, with considerable freedom over the choice of strategies and a market position not unduly threatened by competitors; **favourable**, arising where the industry is fragmented and no one competitor stands out, leaving a reasonable degree of freedom; **tenable**, performing satisfactorily and able to justify staying in the industry but vulnerable to stronger and more proactive rivals; and **weak**, generally unsatisfactory performance although opportunities for improvement exist.

Two further tools appear on scenarios. The **GE matrix** is a **nine-cell grid** assessing business units on **industry attractiveness and business unit strength** and sorting them into **grow, hold or harvest**

zones for resource allocation: a strong unit in a highly attractive industry is a go-ahead for further investment, a weak unit in a less attractive industry is a be-careful with investment minimised.

Strategic group mapping analyses competition inside a saturated industry by grouping firms that follow similar strategies, and its procedure has four steps — identify the competitive characteristics that differentiate firms, such as price or quality range, geographic coverage, degree of vertical integration, product-line breadth, distribution channels used and degree of service; plot the firms on a two-variable map using selected pairs of those characteristics; assign firms falling in the same strategy space to the same strategic group; and draw circles round each group **proportional to its share of industry sales.**

Remembering reproduce what you have learnt · 1 question

- Name all four Ansoff cells, all four BCG cells or all five ADL positions before you explain any one of them. The count is the mark.
- Credit the author where the printed answers do: Igor Ansoff for the product-market matrix and Arthur D. Little for the ADL matrix.

TQ 3.2 · RTP 2020-Nov [10] · DESC · Pg 775

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 5 questions

- Give the two axes of the matrix before you describe any cell. An answer that describes cells without the axes has not explained the tool.
- Where the question asks how a tool is useful, close with the factors the answers say the choice depends on, not with a general remark about growth.

TQ 3.1 · PYQ 2017-May [11] (b) · DESC · 3M · Pg 774

LEVEL I
Understanding

Easy

TQ 3.4 · PYQ 2025-Jan [8] (b) · DESC · 5M · Pg 776

LEVEL I
Understanding

Medium

TQ 3.5 · MTP 2025-Mar S1 [1] (c) · DESC · 5M · Pg 777

LEVEL I
Understanding

Medium

TQ 3.6 · MTP 2025-Apr S2 [2] (a) · DESC · 5M · Pg 778

LEVEL I
Understanding

Medium

CSQ 3.2 · RTP 2025-Jan [13] · Pg 781

LEVEL I
Understanding

Medium

Application use the rule - work the problem · 2 questions

- Classify the business in the case into one named cell in your first line, then justify the classification from the facts given about share and growth.
- After classifying, state the strategy that follows for that cell and say which strategies would be wrong for it and why.

CSQ 3.3 · PYQ 2026-Jan [5] (a) {C} · 5M · Pg 782

LEVEL II
Application**Medium**

CSQ 3.4 · MTP 2026-Mar S1 [1] (c) {C} · 5M · Pg 783

LEVEL II
Application**Medium****Analysis** break it down and take the parts separately · 2 questions

- When the question sets up an apparent contradiction about investment, resolve it by restating the axes first, then explain how one cell funds another across the portfolio.
- Where a case describes competitors rather than the firm's own units, the tool wanted is strategic group mapping; set out its steps in order rather than describing the industry.

TQ 3.3 · RTP 2024-May [13] · DESC · Pg 775

LEVEL II
Analysis**Medium**

CSQ 3.1 · PYQ 2025-Jan [5] (c) {C} · 5M · Pg 780

LEVEL II
Analysis**Medium**

SECTION B · STRATEGIC MANAGEMENT · CHAPTER 5

Strategy Implementation and Evaluation

8 Topics · 61 Classified Questions · Importance: A

ICAI SKILL PROFILE ICAI band for Strategic Management: Level I 30-55% · Level II 45-70% — this chapter reads **theory-heavy**

Level I — Comprehension & Knowledge

66.0%

202 of 306 marks

Level II — Analysis & Application

34.0%

104 of 306 marks

Above this Section's Level I ceiling: 66% of this chapter's marks are Comprehension and Knowledge, against ICAI's 30-55% for Strategic Management. Reading carries more of the preparation here than it does elsewhere; do not prepare this chapter by working sums alone.

Topic 1: Strategic Management Process

L2P6-B-C5-T01

Read first Read ICAI Study Material Chapter 5, Strategy Implementation and Evaluation, on the strategic management process and the linkage between strategy formulation and implementation.

NOTES

The answers give **eight principal aspects of strategy execution**, and they give them in this order: developing budgets that steer ample resources into activities critical to strategic success; staffing the organisation with the needed skills and expertise and building strategy-supportive competencies and capabilities; ensuring policies and operating procedures facilitate rather than impede execution; using the best-known practices for core business activities and pushing for continuous improvement; installing information and operating systems; motivating people to pursue the target objectives; creating a culture and work climate conducive to execution; and exerting the internal leadership needed to drive implementation forward. **Number all eight.** The marks follow the count, not the length of the explanation.

Open with what execution is: an **operations-oriented activity** concerned with converting strategic plans into effective actions and desired results. Close with the sentence the answers close with — good execution means creating strong **fits between strategy and organisational capabilities**, between strategy and the reward structure, between strategy and internal operating systems, and between strategy and the organisation's work climate and culture.

Formulation and implementation are joined by **two linkages**. Forward linkages: the elements of formulation, from objective setting through environmental and organisational appraisal to strategic alternatives, choice and the plan, determine the course the organisation adopts, so a new or reformulated strategy forces change in the structure and in the style of leadership. Backward linkages: the formulation process is itself affected by implementation, because **past strategic actions determine the choice of strategy** and organisations tend to adopt strategies that can be

implemented with the present structure of resources plus some additional effort. Such incremental changes, over time, take the organisation from where it is to where it wishes to be.

The distinction the examiner keeps returning to. Formulation is **placing the forces before the action**; implementation is **managing forces during the action**. Formulation is an entrepreneurial activity based on strategic decision-making, implementation an administrative task based on strategic and operational decisions. Formulation emphasises **effectiveness**, implementation **efficiency**. Formulation is primarily intellectual and rational, implementation primarily operational. Formulation needs co-ordination among a few individuals at the top, implementation among many at middle and lower levels. Formulation needs initiative, logical, conceptual, intuitive and analytical skills; implementation needs specific motivational and leadership traits. Formulation precedes implementation.

Do not confuse that with **strategic planning versus operational planning**, which is a separate distinguish question. Strategic planning shapes the organisation and its resources, assesses the impact of environmental variables, takes a holistic view, develops overall objectives and strategies, is concerned with **long-term success** and is a senior management responsibility. Operational planning deals with current deployment of resources, develops tactics rather than strategy, projects current operations into the future, modifies business functions without fundamental change, is concerned with short-term success and is the responsibility of **functional managers**.

Strategic uncertainty is the unpredictability of future events and circumstances that can affect an organisation's strategy and goals, arising from technology, customer preferences, competition, government policy or economic conditions. The five ways the answer manages it: maintain strategic flexibility; diversify business activities; carry out continuous monitoring and **scenario planning**; develop organisational resilience through financial strength, operational efficiency and risk management; and promote collaboration and strategic partnerships. The printed answer ends with a conclusion paragraph — write one.

The recurring case trap. A scenario reporting improper use of resources, undesirable tendencies of workers, non-conformance to norms and standards and unforeseen challenges is asking you to name one function of the strategic management process: **strategic control**. Name it in the first sentence, then give its elements — setting objectives as **measurable and controllable standards**, monitoring and measuring performance, comparing actual results with standards and identifying deviations, and using feedback to take corrective action.

Remembering reproduce what you have learnt · 2 questions

- Number the eight aspects of the execution process. An undifferentiated paragraph makes the examiner count them for you and you lose the easy marks.

TQ 1.2 · PYQ 2021-Dec [7] (b) · DESC · 5M · Pg 787

LEVEL I
Remembering

Medium

TQ 1.3 · PYQ 2021-Jan [7] (a) · DESC · 5M · Pg 788

LEVEL I

Medium

Remembering

Understanding explain it, and place it in context · 3 questions

- Define strategy execution as an operations-oriented activity in your opening line, then list. The definition is worth a mark on its own.
- Finish a linkages question by naming both linkages expressly; an answer that describes only the forward direction has answered half the question.

TQ 1.1 · MTP 2019-Mar [4] (a) · DESC · 5M · Pg 786

LEVEL I
Understanding

Medium

TQ 1.4 · PYQ 2022-May [9] (a) · DESC · 5M · Pg 790

LEVEL I
Understanding

Medium

TQ 1.5 · MTP 2024-Nov [4] · DB · 5M · Pg 790

LEVEL I
Understanding

Medium

Application use the rule - work the problem · 1 question

- When the case describes symptoms rather than naming a framework, identify the function first and only then list its elements.
- Tie each element back to the company's stated problem. A generic list of control elements without the link to misused resources and unmet norms loses the application marks.

CSQ 1.1 · PYQ 2025-Sep [5] (c) {C} · 5M · Pg 793

LEVEL II
Application

Medium

Analysis break it down and take the parts separately · 2 questions

- For a distinguish question, set out the two sides point by point on a stated basis, in the order the answers use. Seven matched points beat a loose comparative paragraph.

TQ 1.6 · PYQ 2025-Sep [8] (b) · DESC · 5M · Pg 791

LEVEL II
Analysis

Medium

TQ 1.7 · PYQ 2026-May [8] (a) · DESC · 5M · Pg 792

LEVEL II
Analysis

Medium

Topic 2: Strategic Changes Through Digital Transformation

L2P6-B-C5-T02

Read first Read ICAI Study Material Chapter 5, Strategy Implementation and Evaluation, on strategic change and managing change through digital transformation.

NOTES

Strategic change is the complex process of modifying existing strategies or bringing out new ones

when environmental forces shift. The areas it focuses on are **new markets, products, services and new ways of doing business**. Give that phrase before you list anything: a question asking for the areas to be focused on wants exactly those four, and a question asking for the concept wants the sentence that it is a complex process, not a one-off event.

Three steps to initiate strategic change, in order. 1. Recognise the need for change — diagnose which facets of the present corporate culture are strategy-supportive and which are not. 2. Create a shared vision to manage change — the objectives of individuals and of the organisation should coincide with no conflict between them, and management must convince all concerned that the change in business culture is not superficial or cosmetic. 3. Institutionalise the change — the action stage, which requires implementation of the changed strategy and a sustained attitude towards change so that **the firm does not slip back into old ways**.

Kurt Lewin's three-stage change process moves an organisation from its present state to the desired future state. **Unfreezing** prepares employees to recognise the need for change; they must be informed in advance, because sudden and unannounced change is counterproductive and lowers morale. **Changing** modifies existing behaviour patterns through compliance (rewards and punishments), identification (psychologically impressive role models) and internalisation (an internal change in thought processes, with freedom to learn new behaviour). **Refreezing** occurs when the new behaviour becomes the normal way of working and permanently replaces the old, reinforced continuously. Name the three methods under Changing — answers giving only the three stages leave marks behind. And say expressly that the model is **not a one-time process**: businesses face new challenges and technologies continuously, so the cycle repeats.

For managing change in a small or mid-sized business during digital transformation, the answers give **five best practices**: begin at the top, with unified and committed leadership creating a culture that embraces change; ensure the change is necessary and desired, because too much change too quickly is counterproductive; reduce disruption by communicating early, equipping employees with tools and training, empowering change agents such as project managers and involving IT proactively; encourage open two-way communication so concerns are addressed and collaboration across departments grows; and recognise that **change is the norm, not the exception**.

A question on the **pointers for navigating change during digital transformation** wants a different list of five: specify the transformation's aims and objectives; always communicate, regularly and transparently, with employees, clients and other stakeholders; **be ready for resistance** and have a strategy to address it; implement changes gradually rather than all at once; and offer assistance and training. Close with the printed conclusion — without proper change management these efforts are more likely to fail.

Change management in the digital transition has **four essential elements**: defining the goals and objectives of the transformation; assessing the current state of the organisation and identifying gaps; creating a roadmap for change setting out the steps to the desired state; and implementing and managing the change at every level. Where a scenario walks through digital objectives, a gap assessment, a phased roadmap and roll-out across all levels, it is being matched to these four —

map the facts to the elements one by one and then name the concept.

The trap in the mixed scenario. Where a CEO is asked what stages to follow in developing and executing a new strategy after an environmental shock, the answer runs the **five-stage managerial process** first — developing a strategic vision; environmental and organisational analysis; formulation of strategy; implementing and executing the strategy; strategic evaluation and control — and only then the three steps for initiating strategic change. **Both lists, in that order.**

Understanding explain it, and place it in context · 9 questions

- Define strategic change in one line and name the four areas it focuses on before you reach the steps.
- Where the question asks why change management matters in digital transformation, answer the 'why' as well as the 'how'; the concluding line about failure without it is a mark.

TQ 2.2 · PYQ 2023-May [10] (a) · DESC · 5M · Pg 796	LEVEL I Understanding	Medium
TQ 2.4 · PYQ 2024-Sep [8] (Or) (b) · DESC · 5M · Pg 797	LEVEL I Understanding	Medium
TQ 2.5 · MTP 2025-Apr S2 [1] (c) · DESC · 5M · Pg 798	LEVEL I Understanding	Medium
TQ 2.7 · MTP 2026-Mar S1 [4] (Or) (b) · DESC · 5M · Pg 800	LEVEL I Understanding	Medium
TQ 2.8 · PYQ 2026-Sep [8] (b) · DESC · 5M · Pg 801	LEVEL I Understanding	Medium
CSQ 2.2 · MTP 2024-Nov [2] (a) · 5M · Pg 804	LEVEL I Understanding	Medium
CSQ 2.3 · PYQ 2025-May [5] (b) {C} · 5M · Pg 804	LEVEL I Understanding	Medium
CSQ 2.4 · PYQ 2026-May [5] (a) {C} · 5M · Pg 806	LEVEL I Understanding	Medium
TQ 2.1 · PYQ 2018-Nov [12] (a) · SN · 7M · Pg 794	LEVEL I Understanding	Hard

Application use the rule - work the problem · 3 questions

- Identify the model by name in your first sentence, then take the scenario's own facts stage by stage. Awareness sessions and training are Unfreezing; phased roll-out with feedback is Changing; revised policies and reward systems are Refreezing.
- Where the question ends with a direct sub-question such as whether this is a one-time process, answer it in a separate closing line so the examiner cannot miss it.

TQ 2.6 · RTP 2026-May [15] · DESC · Pg 799	LEVEL II Application	Medium
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CSQ 2.1 · PYQ 2022-May [8] (a) · 5M · Pg 802

LEVEL II
Application

Medium

TQ 2.3 · MTP 2024-Mar [1] (c) {C} · DESC · 5M · Pg 796

LEVEL II
Application

Hard

Topic 3: Organisational Framework

L2P6-B-C5-T03

Read first Read ICAI Study Material Chapter 5, Strategy Implementation and Evaluation, on the organisational framework and the McKinsey 7S Model.

NOTES

Every question in this topic turns on one model: the **McKinsey 7S Model**, used to analyse organisational design and effectiveness. Its premise is that **seven internal elements are interrelated**, so a change in one has a ripple effect on the others and all seven must be aligned for the organisation to be effective. Any scenario that mentions hard and soft elements, a ripple effect, or a questionnaire on organisational design is this model — name it in the first sentence.

Three Hard Elements, comparatively easy to identify and directly controlled by management.

Strategy: the direction and plan of the organisation to build core competencies, achieve competitive advantage and accomplish its objectives. **Structure**: the organisational framework adopted, considering the availability of resources and the desired degree of centralisation or decentralisation. **Systems**: the processes, procedures, daily tasks and operations through which organisational goals and objectives are executed efficiently and effectively.

Four Soft Elements, harder to define and largely influenced by organisational culture. **Shared**

Values: the core values and beliefs reflected in the organisational culture and the code of ethics.

Style: the leadership and management style, and the way it influences strategic decisions, employee motivation and the achievement of goals. **Staff**: the people and talent pool available within the organisation. **Skills**: the core competencies and key capabilities possessed by the employees and the organisation. Name all seven, grouped hard and soft, before you explain any of them.

The model carries **four limitations**, and a question asking for the model and its limitations carries marks for both. It ignores the external environment and focuses on internal elements; it does not clearly explain the concept of organisational effectiveness or performance; it is **relatively static** and less flexible for decision-making; and it may fail to identify the actual gaps between conceptualisation and execution of strategy.

How the answers apply it. Take the scenario's facts element by element — training programmes go to **Skills** and **Staff**, technology and communication systems to **Systems**, the founder's values and principles to **Shared Values**, the investment choice to **Strategy**, the reporting set-up to **Structure**, the leadership approach to **Style**. Then end on the verdict the answers end on: the company should test whether the seven are **properly aligned and mutually reinforcing**. The

recommendation is the alignment, not the list.

Understanding explain it, and place it in context · 1 question

- Give the ripple-effect sentence as part of your definition; it is why the model exists and it is what most scenarios are built to test.

TQ 3.1 · RTP 2024-May [15] · DESC · Pg 808

LEVEL I
Understanding

Medium

Analysis break it down and take the parts separately · 2 questions

- The scenario describes a company outgrowing its structure. Name the structure it has, name the structure it needs, and give the reasons for the change from the facts given.

CSQ 3.1 · PYQ 2024-May [5] (a) {C} · 5M · Pg 809

LEVEL II
Analysis

Medium

CSQ 3.2 · RTP 2025-Jan [16] · Pg 811

LEVEL II
Analysis

Medium

Topic 4A: Organisational Framework: Organisational Structure

L2P6-B-C5-T04A

Read first Read ICAI Study Material Chapter 5, Strategy Implementation and Evaluation, on the organisational framework, covering organisational structures and network relationships.

NOTES

Divisional structure rests on extensive delegation of authority. Its advantage is that **accountability is clear** — divisional managers can be held responsible for sales and profit levels, and managers and employees can easily see the results of good or bad performance. Its most important limitation is that it is **costly**: each division requires functional specialists who must be paid, and there is duplication of staff services, facilities and personnel. Where the scenario is a small firm whose activities are accounts, administration, marketing, after-sales service, vendor coordination and operations, the answer is a **functional structure**, and the question usually wants it drawn.

A **Strategic Business Unit** is a part of a large business organisation that is treated separately for strategic management purposes, serving product markets with readily identifiable competitors. It is created by **adding another level of management in a divisional structure**, after the divisions have been grouped under a divisional top-management authority on the basis of common strategic interests. It becomes imperative as the **number, size and diversity** of businesses increase, and it relieves a span of control that has become too large at the top.

The **three characteristics of an SBU**: it is a single business or a collection of related businesses

offering scope for independent planning, which might feasibly stand alone from the rest of the organisation; it has its own set of competitors; and it has a manager responsible for strategic planning and profit performance who controls the profit-influencing factors. The **six benefits**: establishing coordination between divisions with common strategic interests; facilitating strategic management and control; determining accountability at the level of distinct business units; allowing strategic planning at the most relevant level; making strategic review by top executives more objective and effective; and helping allocate resources to areas with better opportunities.

In a **matrix structure** the functional and product forms are combined simultaneously at the same level, and employees have **two superiors** — a product or project manager and a functional manager. The home department is usually functional and reasonably permanent, and people are assigned temporarily to product units or projects. It is the **most complex of all designs** because it depends on both vertical and horizontal flows of authority and communication, and it may raise overhead costs through extra management positions. It appears where **three conditions** exist: ideas need cross-fertilising across projects or products; resources are scarce; and abilities to process information and make decisions need improving. Its advantages are resource optimisation, flexibility, enhanced communication and clear project goals; its disadvantages are complexity and confusion from dual reporting, high coordination costs, and power struggles over resources and priorities.

Network structure is sometimes called a **non-structure**, because it eliminates many in-house functions and outsources them extensively; firms adopting it are called **virtual organisations**, sets of project teams or collaborations connected through non-hierarchical, web-like structures. It is most useful when the environment is **unstable and expected to remain so**, with a strong need for innovation and quick response. Instead of salaried employees the firm contracts with people for a specific project or length of time, and long-term contracts with suppliers, manufacturers, logistics partners and distributors replace vertical integration. The organisation is in effect only a shell, with a small headquarters acting as broker, electronically connected to owned divisions, partly owned subsidiaries and independent organisations. Merits: flexibility and responsiveness, and cost efficiency from outsourcing non-core functions. Demerits: **loss of control** over processes, quality and timelines, dependency on partners, complexity in managing many partners, and employees feeling less connected and less willing to engage in learning.

Hourglass structure has three layers with a **constricted middle** — a short and narrow middle management level — because information technology connects the top and bottom directly and has replaced much of the work middle managers did. The remaining middle managers coordinate a wide range of lower-level activities. Its benefits are **lower costs** and improved responsiveness, because decision-making is simplified and authority moves closer to the source of information. Its cost is that **promotion opportunities shrink** significantly for the lower levels.

Where the question says **network relationships**, three are to be named and matched to the divisions described. The **functional and divisional relationship**: divisions operate independently under a business-level head reporting to corporate management, each with its own functional teams — specialisation, clear accountability, focused decisions. The **matrix relationship**: cross-

functional or project teams where employees report to more than one manager, giving resource sharing and coordination at the cost of complexity in reporting and authority. The **horizontal relationship**: collaboration and idea sharing across levels, promoting transparency, quick decisions and innovation. The marks are in saying **why each suits that division**, not in defining it.

Remembering reproduce what you have learnt · 2 questions

- For SBU questions, the three characteristics and the six benefits are separate lists. Give whichever the question asks for, numbered.
- Where the question says 'discuss any four attributes', stop at a numbered four and make each a distinct point rather than one point restated.

TQ 4A.4 · PYQ 2022-Nov [10] (Or) (b) · SN · 5M · Pg 815

LEVEL I
Remembering

Medium

TQ 4A.7 · PYQ 2025-Sep [8] (Or) (b) · SN · 5M · Pg 818

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 7 questions

- Define the structure in one line before listing features, advantages and disadvantages; the definition carries a mark of its own.
- For network structure, say why it suits unstable environments. The circumstance is the question, not an aside.

TQ 4A.2 · PYQ 2020-Nov [7] (a) · DESC · 5M · Pg 813

LEVEL I
Understanding

Medium

TQ 4A.3 · PYQ 2021-Jan [10] (Or) (b) · DESC · 5M · Pg 814

LEVEL I
Understanding

Medium

TQ 4A.5 · MTP 2025-Mar S1 [1] (a) · DESC · 5M · Pg 816

LEVEL I
Understanding

Medium

CSQ 4A.3 · PYQ 2022-May [8] (b) · 5M · Pg 821

LEVEL I
Understanding

Medium

CSQ 4A.4 · PYQ 2024-Sep [5] (a) {C} · 5M · Pg 821

LEVEL I
Understanding

Medium

CSQ 4A.6 · PYQ 2025-Jan [5] (a) {C} · 5M · Pg 824

LEVEL I
Understanding

Medium

CSQ 4A.8 · MTP 2026-Apr S2 [1] (a) {C} · 5M · Pg 826

LEVEL I
Understanding

Medium

Application use the rule - work the problem · 2 questions

- Name the structure in your first sentence, then justify it from the facts given: dual reporting means matrix, outsourcing and a lean head office means network, independent units with their own heads means divisional or SBU.

- If the question asks for merits and demerits as well, head them separately and give the number asked for.

TQ 4A.1 • PYQ 2021-Jan [10] (a) • DESC • 5M • Pg 812	LEVEL II Application	Medium
CSQ 4A.1 • PYQ 2018-Nov [9] (a) • 5M • Pg 818	LEVEL II Application	Medium

Analysis break it down and take the parts separately • 4 questions

- Where a scenario describes several divisions run differently, deal with each division separately and name the relationship that fits it before commenting on suitability.

TQ 4A.6 • MTP 2025-Jul S1 [4] • DESC • 5M • Pg 817	LEVEL II Analysis	Medium
CSQ 4A.2 • PYQ 2021-Dec [7] (a) • 5M • Pg 819	LEVEL II Analysis	Medium
CSQ 4A.5 • RTP 2024-Sep [15] • Pg 823	LEVEL II Analysis	Medium
CSQ 4A.7 • MTP 2026-Mar S1 [1] (b) {C} • 5M • Pg 825	LEVEL II Analysis	Medium

Topic 4B: Organisational Framework: Organisational Culture

L2P6-B-C5-T04B

Read first Read ICAI Study Material Chapter 5, Strategy Implementation and Evaluation, on the organisational framework, covering organisational culture.

NOTES

Corporate culture refers to a company's values, beliefs, business principles, traditions, ways of operating and internal work environment. Every corporation has one, shaped by its philosophy, history, values, rituals and ingrained ways of doing things, and it exerts a **powerful influence on the behaviour of managers** — not only how they behave inside the organisation but also the decisions they make about the organisation's relationships with its environment and about its strategy.

Culture as a strength: it can facilitate communication, decision-making and control and create cooperation and commitment. A culture is **strong and cohesive** when the organisation conducts its business according to a clear and explicit set of principles and values, which management devotes considerable time to communicating to employees and which are shared widely across the organisation.

Culture as a weakness: it can obstruct the smooth implementation of strategy by **creating resistance to change**. A culture is weak when many subcultures exist, few values and behavioural

norms are shared, and traditions are rare; in such organisations employees have no sense of commitment and loyalty. Split the answer into these two halves under their own headings — the statement is set as one to be explained, and the split is the structure the examiner is looking for.

Where corporate culture comes from — **five sources**, in the order the answer gives them. The values and business principles that management preaches and practices; organisational history and traditions, including past successes, failures, stories and legends repeated within the organisation; **leadership behaviour and supervisory practices**; stakeholder relationships with employees, unions, shareholders, vendors and the community; and formal and informal systems — policies, procedures, reward systems, communication patterns, peer pressure and organisational politics.

Close the way the printed answer closes: culture emerges **over time from multiple sociological forces** operating at different levels, and acts as a guiding force for employee behaviour, strategy execution and organisational performance. That sentence ties culture back to implementation, which is what the chapter is about.

Remembering reproduce what you have learnt · 1 question

- The five sources of corporate culture are a numbered list. Name all five; the marks follow the count.

TQ 4B.2 · PYQ 2026-Jan [6] (a) · DESC · 5M · Pg 828

LEVEL I
Remembering

Medium

Understanding explain it, and place it in context · 1 question

- Define corporate culture in the words the answers use — values, beliefs, business principles, traditions, ways of operating and internal work environment — before you elaborate.
- For 'culture is a strength that can also be a weakness', write two clearly headed halves and give the strong-culture and weak-culture conditions in each.

TQ 4B.1 · PYQ 2018-Nov [10] (a) · DESC · 5M · Pg 827

LEVEL I
Understanding

Medium

Topic 5: Strategic Leadership

L2P6-B-C5-T05

Read first Read ICAI Study Material Chapter 5, Strategy Implementation and Evaluation, on strategic leadership and leadership styles.

NOTES

Strategic leadership is a manager's ability to anticipate and envision future trends, maintain flexibility and empower others to create strategic change in response to external conditions.

Strategic leaders are those at the top of the company, but the answers also count **the board of directors**, the top management team and divisional general managers. The most critical skill a strategic leader possesses may be **the ability to manage human capital**. As a strategic leader the manager sets direction, formulates and implements strategy, and acts as visionary, strategist, administrator, culture builder and motivator.

A **managerial frame of reference** is the set of assumptions, premises and accepted wisdom that bounds a manager's understanding of the company, the industry in which it competes and the core competencies it exploits in the pursuit of strategic competitiveness. Its significance is that in a rapid and complex environment an **outdated frame filters out the signals that matter**, so leaders must be willing to examine and revise it.

The **five leadership roles in pushing for good strategy execution**, and they are asked for again and again. 1. Staying on top of what is happening, closely monitoring progress and working through issues and obstacles. 2. Promoting a culture that mobilises and energises organisational members to execute strategy and perform at a high level. 3. Keeping the organisation responsive to changing conditions, alert for new opportunities and ahead of rivals in developing competitively valuable competencies and capabilities. 4. **Ethical leadership**, insisting that the organisation conducts its affairs as a model corporate citizen. 5. Pushing corrective actions to improve strategy execution and overall strategic performance. The question is the same whether it is put to a CEO, a manager or an SBU head — answer it as five numbered roles.

Where the question asks instead for the **responsibilities of a strategic leader**, draw them from the standard set: managing human capital; determining strategic direction; effectively managing the organisation's resource portfolio; sustaining an effective organisational culture; emphasising ethical practices; and establishing balanced organisational controls. If the question says any six, **give six, numbered** — fewer loses marks that are there for the taking, and a long undifferentiated paragraph makes the examiner count them.

The distinction the spice-brothers and software-firm scenarios turn on. **Transactional leadership** focuses on designing systems and controlling the organisation's activities, uses the **authority of office to exchange rewards** such as pay and status, prefers a formalised approach to motivation with clear goals and explicit rewards or penalties, and builds on the existing culture and enhances current practices. **Transformational leadership** uses charisma and enthusiasm to inspire people to exert themselves for the good of the organisation, offers excitement, vision, intellectual stimulation and personal satisfaction, gives followers a **dream or vision of a higher calling**, stretches abilities, raises self-confidence and promotes innovation throughout the organisation.

When each is appropriate, because the question often asks for the conditions as a separate part. Transactional suits a **static environment**, mature industries and organisations that are performing well; it is better at persuading people to work efficiently and run operations smoothly. Transformational suits **turbulent environments**, industries at the very start or the very end of their life cycles, and poorly performing organisations that need to embrace major change. A three-part question wants the style, the conditions and the characteristics — answer each under its own

number.

Understanding explain it, and place it in context · 3 questions

- Define strategic leadership and, where asked, the managerial frame of reference in the answers' own words before elaborating.
- Add the line that managing human capital may be the most critical skill; it is short and it is in every printed answer.

TQ 5.1 · PYQ 2019-May [9] (a) · DESC · 5M · Pg 829	LEVEL I Understanding	Medium
TQ 5.3 · PYQ 2025-May [8] (Or) (b) · DESC · 5M · Pg 831	LEVEL I Understanding	Medium
TQ 5.4 · PYQ 2026-Sep [7] (b) · DESC · 5M · Pg 832	LEVEL I Understanding	Hard

Analysis break it down and take the parts separately · 3 questions

- Where two managers are described, identify each style by name first, then set the characteristics of the two side by side rather than describing one at length and the other in a line.
- If the question has parts (a), (b) and (c), head your answer (a), (b) and (c). The conditions part is frequently dropped and it carries its own marks.

TQ 5.2 · RTP 2021-May [19] · DESC · Pg 830	LEVEL II Analysis	Medium
CSQ 5.1 · PYQ 2018-May [9] (b) · 5M · Pg 833	LEVEL II Analysis	Medium
CSQ 5.2 · PYQ 2023-May [6] {C} · 5M · Pg 834	LEVEL II Analysis	Medium

Topic 6: Strategic Control

L2P6-B-C5-T06

Read first Read ICAI Study Material Chapter 5, Strategy Implementation and Evaluation, on strategic control, its types, and the elements of the control process.

NOTES

Strategic control is the process of **evaluating strategy while it is being formulated and implemented**. It helps identify problems, changes in the underlying assumptions and the adjustments needed. Open every answer with its **two basic questions**: is the strategy being implemented as planned, and are the results produced by the strategy the intended ones? That

pair of questions is a mark on its own and it frames everything that follows.

There are **four types of strategic control**, and the answers always take them in this order. **Premise control**: a strategy is formulated on certain assumptions or premises about the organisation and its environment, and premise control is the systematic and continuous monitoring of the environment to verify that those premises remain valid and accurate. It monitors **environmental factors** — economic (inflation, liquidity, interest rates), technological, social and regulatory — and **industry factors** — competitors, suppliers and substitutes. **Strategic surveillance**: general and unfocused monitoring of many sources of information — newspapers, business magazines, meetings, conferences, discussions and observations — to pick up unexpected developments that may affect the strategy.

Special alert control becomes necessary when unexpected events require immediate reconsideration of the strategy: a sudden change of government, a natural disaster, a terrorist attack, an unexpected competitive merger, an industrial disaster or another major crisis. Organisations may establish **crisis-management teams** to respond. **Implementation control** is directed at assessing the need for changes in the overall strategy in light of unfolding events and the results of the incremental steps by which managers convert major plans into concrete, sequential actions.

Implementation control takes **two forms**, and both must be named. **Monitoring strategic thrusts** — the important programmes undertaken to implement the strategy — tells managers whether the overall strategy is progressing as desired or needs readjustment. **Milestone reviews** segregate all key activities in terms of time, events or major resource allocation, and at each milestone a complete reassessment of the strategy is made, including whether to continue or refocus the organisation's direction. State expressly that implementation control **is not a replacement for operational control**: unlike operational control, it continuously monitors the basic direction of the strategy.

The distinguish question. **Management control** asks whether we are moving in the right direction, proactively and continuously questions the basic direction of strategy, guides the organisation towards its future direction, focuses primarily on the **external environment**, has a long-term orientation, is exercised by top management with support from middle and lower levels, and uses environmental scanning, information gathering, questioning and review. **Operational control** asks how we are performing, ensures proper allocation and utilisation of resources, is concerned with day-to-day functioning, focuses on the **internal environment**, has a short-term orientation, is exercised mainly by executive or middle-level management under the direction of top management, and uses budgets, schedules and standards. Answer on those seven bases, in that order.

Control is **making something happen the way it was planned to happen**, and its process has four elements: setting the objectives of the business system as **measurable and controllable standards**; monitoring and measuring the system's performance; comparing actual results with the standards, identifying deviations and gaining new insight about the appropriateness of the standards themselves; and providing feedback and corrective action to keep the system on the desired

course. Where planning is sound but resources are misused and norms are not met, say plainly that this is a **failure of control, not of planning**, before you list the elements.

Remembering reproduce what you have learnt · 1 question

- Name all four types of strategic control before explaining any of them, and keep them in the printed order: premise, surveillance, special alert, implementation.
- Under implementation control, the two forms — monitoring strategic thrusts and milestone reviews — are a separate pair of marks.

TQ 6.1 · PYQ 2015-Nov [14] (b) · SN · 3M · Pg 835

LEVEL I
Remembering

Easy

Understanding explain it, and place it in context · 5 questions

- Begin with the definition and the two basic questions. An answer that starts straight at the four types has already dropped a mark.
- For premise control, give both categories of factors monitored, with the examples the answers print.

TQ 6.4 · PYQ 2020-Nov [7] (b) · DESC · 5M · Pg 839

LEVEL I
Understanding

Medium

TQ 6.5 · PYQ 2023-May [9] (b) · DESC · 5M · Pg 839

LEVEL I
Understanding

Medium

TQ 6.6 · MTP 2025-Dec S2 [1] (c) · DESC · 5M · Pg 840

LEVEL I
Understanding

Medium

CSQ 6.2 · RTP 2025-Jan [15] · Pg 842

LEVEL I
Understanding

Medium

TQ 6.2 · PYQ 2016-Nov [10] · DESC · 7M · Pg 836

LEVEL I
Understanding

Hard

Application use the rule - work the problem · 1 question

- In a scenario, take each control in turn and tie it to a named feature of the case: assumptions about input prices to premise control, progress reviews to implementation control, competitor or regulatory shifts to surveillance, sudden disruptions to special alert.
- Where the case shows good planning but poor results, diagnose it as a control failure in the opening line, then set out the four elements of the control process.

CSQ 6.1 · PYQ 2021-Jan [9] (b) · 5M · Pg 841

LEVEL II
Application

Medium

Analysis break it down and take the parts separately · 1 question

- For management control against operational control, use a basis-by-basis comparison. Seven matched bases, each named, read as a table even when written in prose.

TQ 6.3 · PYQ 2017-Nov [13] (a) · DB · 4M · Pg 838

LEVEL II
Analysis

Medium

Topic 7: Strategic Performance Measures

L2P6-B-C5-T07

Read first Read ICAI Study Material Chapter 5, Strategy Implementation and Evaluation, on strategic performance measures.

NOTES

Strategic Performance Measures (SPM) are metrics an organisation uses to assess and monitor the effectiveness of its strategies in achieving its goals and objectives. They give a **structured approach to measuring performance** in the key areas crucial to the success of the strategy, show whether the organisation is making progress towards its desired outcomes, and enable adjustments to improve performance. Put that definition first whenever the question begins 'what do you mean by'.

Four reasons they are essential, in the printed order. Goal Alignment: strategies stay aligned with goals and objectives so the organisation is on track to achieve its desired outcomes. Resource Allocation: the information needed to prioritise effort and allocate resources where they will have the greatest impact on performance. Continuous Improvement: a framework for tracking progress and making adjustments over time. External Accountability: a clear and **transparent picture of performance** for stakeholders — shareholders, customers and regulatory bodies. Close with the summary sentence the answers close with.

Six types of strategic performance measure, each with the examples the answers print, because the examples are what separate a full answer from a thin one. **Financial**: revenue growth, return on investment, profit margins. **Customer satisfaction**: satisfaction, retention and loyalty. **Market**: market share, customer acquisition, referrals. **Employee**: satisfaction, turnover rate, engagement. **Innovation**: R&D spending, patent applications, new product launches. **Environmental**: energy use, waste reduction, carbon emissions.

Selecting the right measures turns on **four factors**: Relevance — the measure must be relevant to goals and objectives and give actionable, meaningful information; Data Availability — it must rest on data that is readily available and can be collected and analysed in a timely manner; Data Quality — the data must be accurate and reliable; and Data Timeliness — the data must be current and up to date so decisions can be made in time. Add the closing line: measures should be relevant, meaningful, easy to understand and **regularly reviewed and updated** so they stay aligned with the organisation's goals.

Where the question asks how SPM **eliminates silos**, the point is that a common set of measures cascaded from one strategy gives every function the same definition of success, makes the interdependence between functions visible, and replaces **local optimisation with a shared**

objective.

A question asking for the **insights particular measures provide** must go measure by measure rather than describing the system again. Financial measures show whether the strategy is translating into results; customer measures show whether the value proposition is landing with the market; internal process measures show where performance is created or lost inside the organisation; and learning and growth measures show whether the **capability to sustain performance** is being built.

In a scenario the four reasons become the answer to named problems, so match them one by one: goal alignment where departments are pulling in different directions, resource allocation where investment choices must be prioritised, continuous improvement where delivery timelines and quality must be tracked, external accountability where stakeholder confidence and transparency are at stake. Name the reason, then **tie it to the company's stated difficulty**.

Understanding explain it, and place it in context • 5 questions

- Define SPM in one line before you list anything, and end with the summary sentence about alignment, resource use, improvement and accountability.

TQ 7.1 • MTP 2024-Mar [4] (a) • DESC • 5M • Pg 843	LEVEL I Understanding	Medium
TQ 7.3 • PYQ 2025-Jan [7] (b) • DESC • 5M • Pg 845	LEVEL I Understanding	Medium
TQ 7.5 • PYQ 2026-Jan [7] (a) • DESC • 5M • Pg 847	LEVEL I Understanding	Medium
TQ 7.6 • PYQ 2026-Sep [8] (Or) (b) • DESC • 5M • Pg 847	LEVEL I Understanding	Medium
CSQ 7.1 • MTP 2024-Nov [1] (c) {C} • 5M • Pg 848	LEVEL I Understanding	Medium

Application use the rule - work the problem • 1 question

- Take the company's stated challenges in the order the question gives them and answer each with the measure or reason that addresses it. A general essay on SPM leaves the application marks on the table.

TQ 7.2 • PYQ 2024-Sep [8] (b) • DESC • 5M • Pg 844	LEVEL II Application	Medium
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Analysis break it down and take the parts separately • 1 question

- Name the measurement framework, give its perspectives or components, then map the company's stated problems onto them one at a time before recommending.

TQ 7.4 • RTP 2025-May [15] • DESC • Pg 846	LEVEL II	Medium
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Analysis

AT THE END OF THE BOOK

Corrigendum

Every printed Topic-Wise Question Frequency table in this Scanner was reconciled against the questions printed under it — topic by topic, on each of the PYQ, RTP and MTP columns separately, counting a question once for the sitting it was set in and once more for every repeat and every "Or" alternative printed on its head. The tables do not reconcile on this edition, and the gap is large enough that it is stated here in full rather than topic by topic. The questions, answers and page references themselves are sound: every one of the 581 printed questions carries a readable head, a source, a sitting and an answer, and every question sits under the block its own number gives it.

The frequency tables declare more appearances than the book prints

Both Sections, all 19 chapters

Printed: Added across the 133 declared topics the tables come to 400 PYQ, 362 RTP and 324 MTP appearances — 1,086 in all. Each individual row adds up correctly: all 133 rows satisfy PYQ + RTP + MTP = Total.

Read: The questions actually printed, with every repeat line and every "Or" alternative counted, come to 390 PYQ, 192 RTP and 250 MTP — 832. 55 of the 133 rows reconcile on all three columns; 106 of 133 reconcile on the PYQ column alone.

The PYQ column is very nearly right; the shortfall is 170 RTP and 74 MTP appearances. Either the tables count appearances the book does not show, or the "second line" that lists a question's other sittings has been dropped from a large number of question heads. Stated as arithmetic, not as a verdict. These Notes count the questions the book prints, so nothing in them depends on the tables.

Section A, chapter 8, Dividend Decisions — topic 12, Stock Splits

Printed: The table declares no appearance at all on any column.

Read: TQ 12.1, PYQ 2025-Sep, is printed under block 12 with a worked answer.

The clearest single instance of the gap: a printed question with a nil row above it.

Section A, chapter 8 — topic 14, Integrated Problems

Printed: The table declares 1 PYQ appearance.

Read: The one question printed under block 14 is TQ 14.1, RTP 2025-May.

The appearance is declared in the wrong column.

An answer key printed against the wrong question

Section B, chapter 2, Strategic Analysis: External Environment — TQ 4.18, PYQ 2026-Sep [7] (a), page 671

Printed: The question asks the candidate to explain value creation before, during and after the sale using an appropriate strategic framework. The Answer Key and Solution Hints beneath it set out the circumstances in which raising funds by an issue of debentures is advantageous — trading

on equity, unused debt capacity, security, control, the deductibility of interest.

Read: That answer belongs to a Section A question on Types of Financing. The Section B question is a value-chain question and has no answer printed against it.

The most serious item in this list, because a student working the chapter is handed Financial Management content under a Strategic Management heading. The Notes for this topic are written from the genuine value-chain answers elsewhere in the chapter.

A topic head that does not match the question under it

Section B, chapter 1, Introduction to Strategic Management — topic 6, page 632

Printed: The block head reads "Business Ethics and Strategic Management".

Read: The single question printed under it, TQ 6.1, is on identifying a strategic alliance as a form of cooperative strategy. Nothing on business ethics appears in the chapter.

Either the head or the question is in the wrong place. The Notes say so plainly.

Typographical and keying slips

Section A, chapter 7, Investment Decisions — page 364

Printed: The question number is set as "PQ 7A .4", with a space before the full stop.

Read: It is PQ 7A.4.

Read and carried as PQ 7A.4.

Section A, chapter 7 — pages 398 and 400

Printed: Two different questions are both numbered PQ 7A.16 — MTP 2026-Mar S1 and PYQ 2026-Sep.

Read: The topic runs to seventeen questions, so the last should be PQ 7A.17.

Both are carried; the Question Register distinguishes them by sitting.

Six places across both Sections

Printed: The answer label is printed as "Answers:" (chapter A/3 p.141, A/5 p.257, B/2 p.642) or as "Answer" with the colon dropped to the next line (A/2 p.49, A/4 p.192, A/8 p.431).

Read: Every other answer in the book is labelled "Answer:".

Cosmetic; no answer is missing.

Section A, chapter 8 — topic 8 block head, page 446

Printed: "Theories of Divided : Walter's Model".

Read: "Theories of Dividend", as topics 7, 9 and 11 have it.

The Notes print the corrected spelling.

Section B, chapter 2 — odd-page running head

Printed: "Chapter-2: Strategic Analysis; External Environment", with a semicolon.

Read: A colon, as the Contents and the chapter cover have it.

Cosmetic.

Front Matter, In This Edition, page vii

Printed: "A chapter-wise MCQ bank for Paper 1 comes free with this book".

Read: Paper 6.

The wrong paper number in this paper's own front matter.

Counted afresh on this edition: 581 questions across 134 topics, of which 104 carry questions and 30 are declared but not yet examined. 2,884 marks are carried on the question heads and imputed where the Scanner prints none. Questions from the newest sitting carry the Scanner's own answer key and solution hints rather than a worked answer, as the Front Matter explains.