

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

KE5 – Commercial Insight for Management

March 2018

SECTION 1

Question 01

1.1

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|-------------------------------|
| Learning Outcome/s: 1.2.1 |
| Study text reference: page 12 |
| Correct Answer: C |

1.2

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|-------------------------------|
| Learning Outcome/s: 2.2 |
| Study text reference: page 72 |
| Correct Answer: B |

1.3

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| Learning Outcome/s: 2.5 |
| Study text reference: page 71 |
| Correct Answer: B |

1.4

| |
|--------------------------------|
| Learning Outcome/s: 4.3.2 |
| Study text reference: page 274 |
| Correct Answer: D |

1.5

| |
|--------------------------------|
| Learning Outcome/s: 4.1 |
| Study text reference: page 234 |
| Correct Answer: A |

1.6

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| Learning Outcome/s: 3.6.1 |
| Study text reference: page 132 |
| Correct Answer: D |

1.7

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| Learning Outcome/s: 5.3.1 |
| Study text reference: page 358 |
| Correct Answer: C |

1.8

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| Learning Outcome/s.: 6.7.1 |
| Study text reference: page 425 |
| Correct Answer: B |

1.9

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| Learning Outcome/s: 6.5.1 |
| Study text reference: page 417 |
| Correct Answer: B |

1.10

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|--------------------------------|
| Learning Outcome/s 6.14.1 |
| Study text reference: page 528 |
| Correct Answer: D |

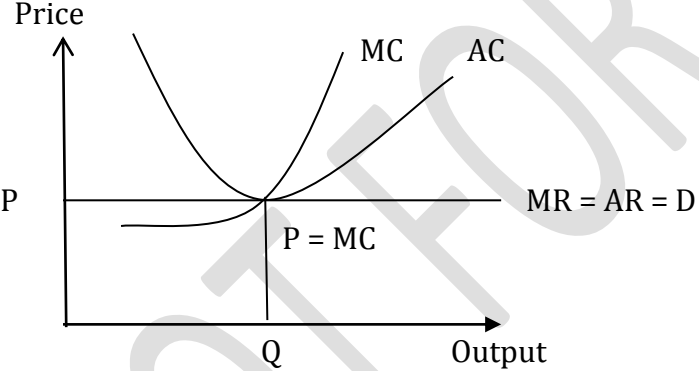
(2 x 10 = Total: 20 marks)

Question 02

2.1

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| Learning Outcome: 1.4 |
| Study text reference: page 18 |
| Vision – A vision is an overall aspiration for the future, which represents the organisation’s overall strategic intent. |
| Mission – describes the organisation’s basic function in society, in terms of the products and services it produces for its clients. |

2.2

| |
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| Learning Outcome/s: 3.10 |
| Study text reference: page: 216 |
| The long run equilibrium position under perfect competition is unique because it is the only market condition which achieves allocative efficiency. In the long run, firms in the industry will have $MC=Price$ because this position earns the entrepreneur the desired return on their capital, ensures that resources are allocated in an optimal way (allocative efficiency). This means that firms operate their most cost effective point at the long run equilibrium. |
|  |

2.3

Learning Outcome/s: 4.8.1

Study text reference: page 241

- Population and labour market – changing age structure of the labour force will have an impact on businesses. When the old population is growing their need for medical care and insurance can grow up. When women increase in their participation in the labour force, the demand for part-time jobs and day care facilities for their children could go up.
- Family life cycle – by analysing the family life cycle, the various stages through which households progress can be identified. Goods and services can be marketed to people at specific stages of the life cycle such as age, marital status, career status, and presence or absence of children.
- Socio- economic position, income and wealth – sometimes people’s life styles are a reflection of their economic condition in society, not the reason for their position.

2.4

Learning Outcome/s: 4.9

Study text reference: page 253

1. Cost of outsourcing – organisations should not only consider the fee that the provider will charge, but also the cost of dealing with the provider, monitoring its activities and insuring against loss.
2. Further, organisations should consider whether their requirements are likely to change and avoid entering into long term outsourcing agreements if the requirement is likely to change.
3. Organizations should also consider whether the outsourcing service is of strategic importance to the organisation and if so, such services are not recommended to be outsourced as they are require a high degree of specific business knowledge.
4. In addition, organizations should consider whether the outsourcing service is relatively isolated.

2.5

Learning Outcome/s: 5.2.2

Study text reference: page 348

- Greater flexibility of people/workflow and decision-making/task and culture
- Inter-disciplinary co-operation and a mix of skills and experience, along with improved communication and co-ordination
- Motivation and employee development
- Market awareness
- Horizontal workflow

2.6

Learning Outcome/s: 5.3.2

Study text reference: page 353

Power is the ability to get things done. There are many types of power in an organisation: position or legitimate power, expert power, personal power, resource power etc.

Authority relates to position power. It is the right to take certain decisions within certain boundaries.

2.7

Learning Outcome/s: 5.5.2

Study text reference: page 378

1. Tactical planning
2. Budgeting
3. The development and implementation of procedures
4. Monitoring

2.8

Learning Outcome/s: 6.6.1

Study text reference: page 421

- They are produced in high volume
- They tend to be made to stock rather than to specific customer orders
- They are highly standardised
- The range of products is not diverse

2.9

Learning Outcome/s: 6.7.2

Study text reference: page 415

External economies of scale occur as an industry grows in size.

- A large skilled labour force is created and external educational services can be geared towards training new entrants. This saves the firm's cost on training.
- Specialized ancillary industries will develop to provide components, transport finished goods, trade in by-products, etc.
- Government assistance may be granted to industries that promise large amounts of export earnings, tax benefits, etc.

2.10

Learning Outcome/s: 6.10

Study text reference: page : page: 445

Marketing orientation is an approach to business that focuses on satisfying the needs and wants of its customers. The organisation needs to interpret customer needs and then produce products and services that meet them at a price that customers accept.

Production orientation means management believe that success is achieved through producing goods or services of optimum quality as cost efficiently as possible.

SECTION 02

Question 03

Learning outcome : 2.8/2.7

Study text reference: page: 84-90/129

(a)

Land – is rewarded with rent. Land is not only the property (land) but also **all the natural resources** that grow on the land or that are extracted from it.

Labour – is rewarded with wages. Labour consists of both mental and physical resources of human beings.

Capital – is rewarded with interest. Capital refers to man-made items such as plant, machinery, tools, etc. which are used to aid the production of goods and services.

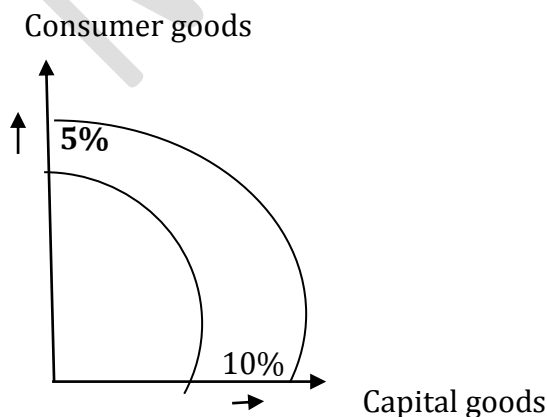
Enterprise or entrepreneurship – is rewarded with profit. This is undertaking the task of organizing the other three factors of production in a business enterprise and in doing so bears the risk of the venture.

(b)

- Inferior goods – when the household income increases the demand for inferior goods falls because they start to move towards quality goods instead of inferior goods and vice versa. Here the income elasticity of inferior goods is negative.
- Luxury goods – when the household income increases the demand for luxury goods will increase rapidly and vice versa. Therefore there is a positive income elasticity of demand for luxury goods.

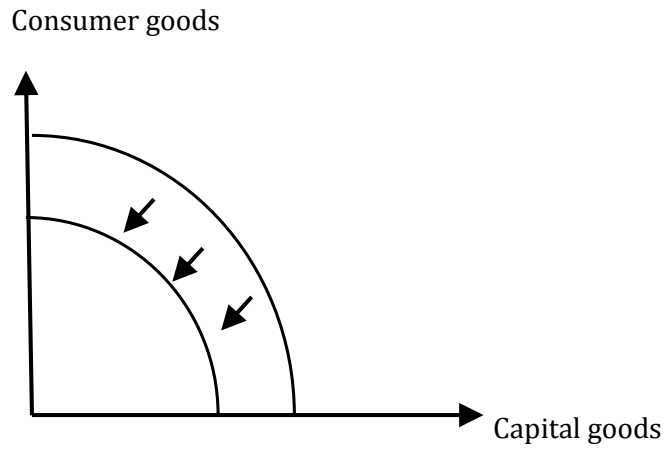
(c)

- (i) When the technology is improved in production of capital goods than that of consumer goods more capital goods can be produced with the given resources in an economy than the consumer goods. For an example, if production of consumer goods increased by 5%, capital goods can be increased by 10% .



(ii)

Economic recession, is portrayed as a shift inwards. This is because a recession results in the reduction of production capabilities due to a negative/decline in economic growth.



(Total: 10 marks)

Question 04

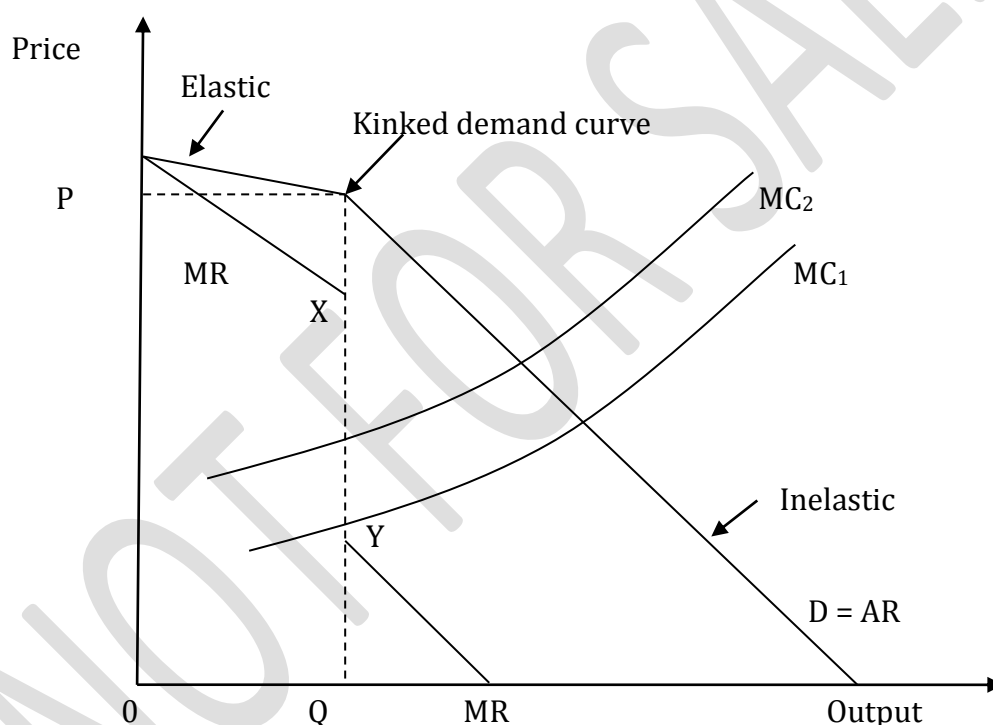
Learning Outcome/s : 3.12

Study text reference: page 221

(a)

- A few large firms dominate the market.
- There are barriers to entry – thus in the long run it is possible to sustain economic profits.
- Oligopolies with Homogenous products (e.g. oil) or differentiated products (e.g. telecommunication, cigarettes etc.) can be seen.
- Since there are few firms, firms' production decisions are interdependent. One firm cannot decide price and output without considering rivals' reaction. (behavioral relationship between firms)
- Both price and non-price competition.

(b)



The oligopolies' cost structure can change but as long as the MC curve cuts the MR curve through its vertical portion, the oligopolies' price and output will not change. If the MC curve shifts from MC_1 to MC_2 , the price and quantity will remain unchanged. So the changes in cost will not affect output and price.

(c)

- The success of a cartel depends on whether most or all of the producers are included in the cartel. If not, the cartel price cannot succeed as other producers will not sell at the cartel price.
- Further, the success also depends on whether there are no close substitutes for the product. If there are close substitutes the cartel will not succeed as consumers will switch to a close substitute.
- The ease of regulating supply – if not for the ease of regulating supply it would be difficult to establish a cartel price.
- The price elasticity of demand has to be more inelastic. This ensures that a rise in price will not reduce the quantity demanded substantially.
- Whether the producers can agree on their individual shares of the total restricted supply. If not the cartel would fail.

(Total: 10 marks)

Question 05

(a)

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|---------------------------|
| Learning Outcome/s: 4.4.3 |
|---------------------------|

| |
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| Study text reference: page 282 |
|--------------------------------|

- A rise in interest rates reduces the rate of growth in consumer spending. This could be due to the fact that people who borrow will have to pay more in interest out of their income. This leaves less income for them to spend on other commodities.
- High interest rates discourage people from borrowing and so there would be reduction in loans for consumption and less spending with borrowed funds.
- High interest rates could also encourage savings thus reducing consumption.
- High interest rates will depress the value of non-monetary assets such as houses.

(b)

- The company can buy currencies forward – in advance of when they need it at a fixed and known price.
- Dealing in a hard (stable) currency lessens the risk attached to volatile currencies.
- Operations can be managed so that the proportion of sales in one currency is matched by an equal proportion of purchases in that country.
- Invoicing in the domestic currency. The risk is transferred to the customer. However the customer must have low bargaining power for this method to be effective.
- A company can aim at segments in the market which are not partially price sensitive.
- Use of currency derivatives such as options and futures.

Any other suitable answer.

(Total: 10 marks)

Question 06

| |
|--------------------------------|
| Learning Outcome/s: 6.12, 6.13 |
| Study text reference: page 498 |

(a)

- To establish the key deliverables an individual has to produce to enable the organization to achieve its objective.
- To compare the individual's level of performance against a standard as a means of quality control.
- To identify training and development requirements.
- To monitor organization's initial selection procedures against subsequent performance.
- To improve communication between different levels in the hierarchy.
- Identify areas that need required improvements.

(b)

1. Training and development attract new recruits and ensure that the organization has a supply of suitable managerial and technical staff to take over when people retire.
2. Minimize the learning cost of obtaining the skills that the organization needs. It ensures staff and the whole organisation have the right skills required to deliver the business strategy.
3. Lower cost and increased productivity – training helps for employees to work efficiently and effectively by using different methods and improving skills thereby lower the cost of the organization.
4. Fewer accidents and better health and safety.
5. If people are trained they can get on with the job and managers can concentrate on other things. So that less supervision is needed.
6. This will increase employee's motivation to work and achieve organizational goals.
7. Training ensures that people have a variety of skills.
8. This helps organizations to manage change.
9. This can be used to build a conducive corporate culture.

(c)

- Job rotation
- Temporary promotion
- Assistant to position
- Action learning
- Committees
- Project work
- Coaching
- Demonstration/instruction

(Total: 10 marks)

SECTION 3

Question 07

Learning Outcome: 3.5/3.6/3.7/3.8

Chapter 06/ Page 160

(a)

$$P = 500 - 2Q_d$$

$$P = -100 + Q_s$$

$$500 - 2Q_d = -100 + Q_s$$

$$600 = 3Q$$

$$\underline{200 = Q}$$

$$\underline{100 = P}$$

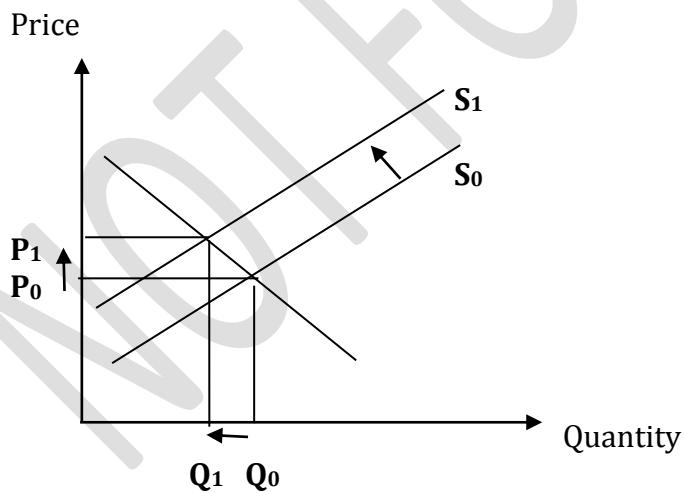
(b)

Quantity demanded at price USD 100 = 200

Price elasticity is thus $0.5 \cdot 100 / 200 = \underline{0.25}$

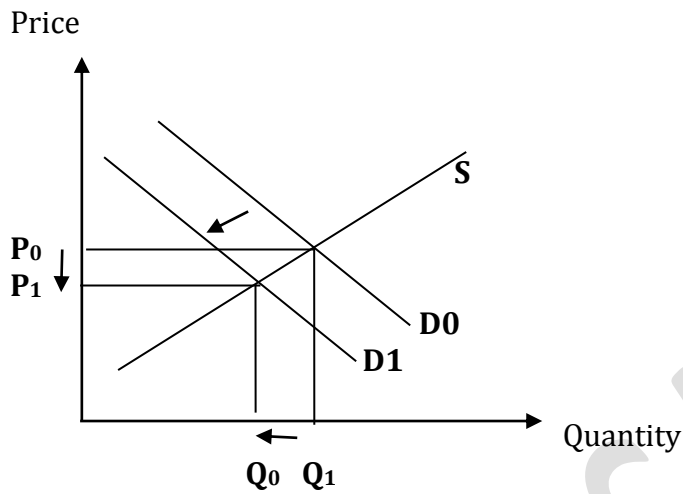
(c)

- (i) Increase in demand for labour, increases the wages. This increases cost of production of tea. This discourages the supply of tea. Thus the price would rise and the quantity will fall.



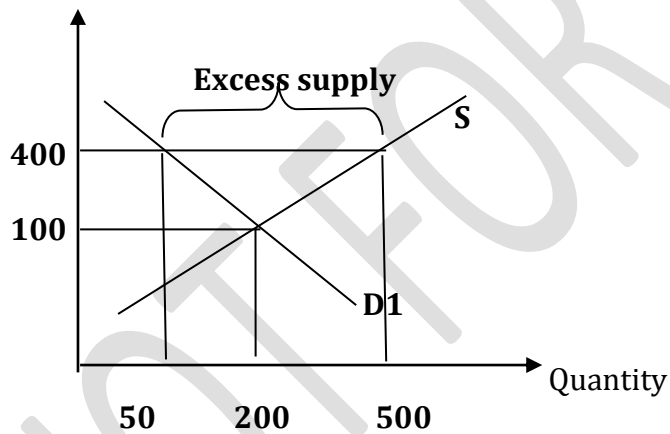
(ii)

When quality is compromised the demand would get discouraged. As a result both price and quantity will reduce.



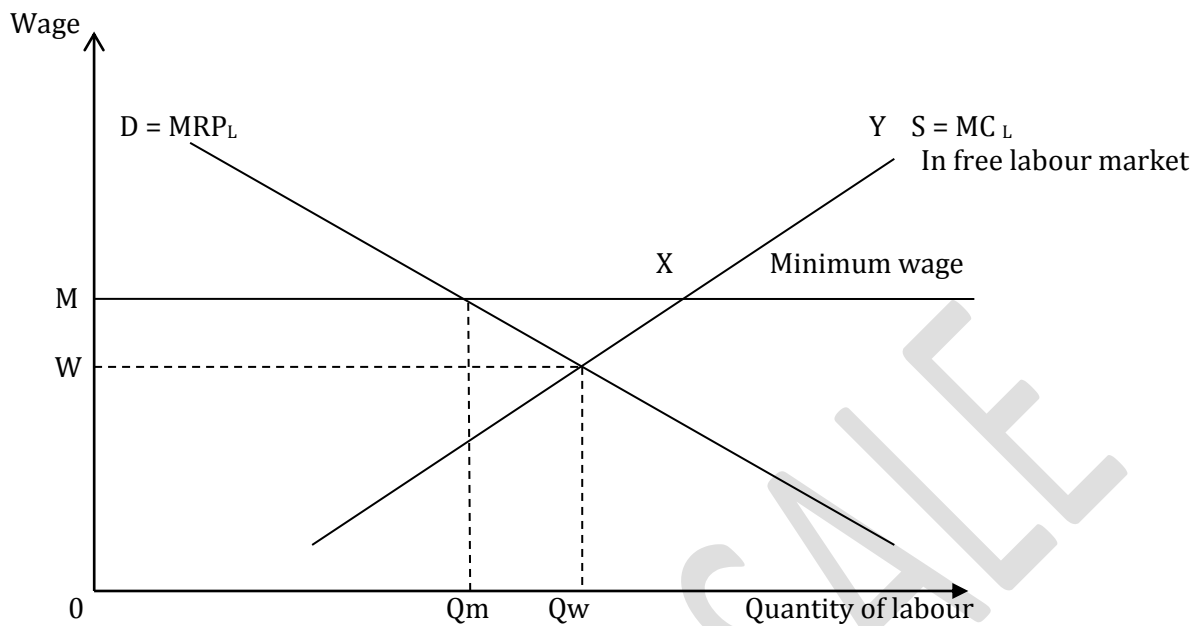
(iii)

Price



When the government sets a price of USD 400 in the market, which is above the market price, suppliers are encouraged to supply more at that price. But consumers are willing to purchase only 50 tonnes at USD 400 and as a result quantity demanded would decrease to 50 tonnes. The quantity supply would be 500 tonnes. Thus an excess supply of 450 tonnes is created.

(d)



Minimum wages will help low paid workers to earn enough money to have an acceptable standard of living. If a minimum wage is enforced by the government, it should be above the current wage level as mentioned in the above diagram. Without the minimum wage Q_w workers will be employed at wage rate at W . When higher wages are imposed by law, it will be easier to recruit the employees at the higher rate but on the other hand demand for labour may reduce and this may cause job losses.

(e)

There are many firms in the market which provide similar tea bags (monopolistic competition) as produced by the Highland Tea. So that when the Highland Tea charges a higher price in the market, customers will shift to the other brands provided by the other suppliers and demand for Highland Tea will reduce by a higher proportion. (Demand is elastic). Therefore, an increase in price of the Highland Tea will reduce the total revenue of the Company.

(f)

- Competitor's goals – the company should have an idea of their competitor's goals such as their long-term and short-term objectives, organizational structure, etc.
- The competitors' assumptions – here the company should understand the competitors' beliefs about the future of the industry, competitors' beliefs to be its relative position in the industry, etc.
- The competitors' current and potential situations and strategies – when doing the competitor analysis, Highland Tea should to pay attention to the competitors' financial strengths, distribution channels, marketing and selling capabilities, research, engineering, etc.
- Competitors' capabilities – they should look at what are the core competencies of other competitors and their ability to expand in the market. And also what are the competitive advantages and disadvantages that they possess.

(Total: 20 marks)

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