

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

KE5 – Commercial Insight for Management

September 2017

SECTION 1

Question 01

1.1

| |
|--|
| Learning Outcome/s: 3.1.1 |
| Discuss the organisational environment (including internal task and general, direct and indirect action, micro and macro environment). |
| Study text reference: Page 103 |
| Correct answer: C |

1.2

| |
|--|
| Learning Outcome/s: 2.7.1 |
| Discuss the concept of opportunity cost and scarcity and their relevance to economic choice. |
| Study text reference: Page 89 |
| Correct answer: A |

1.3

| |
|--|
| Learning Outcome/s: 3.5.1 |
| Identify the factors which influence market demand and supply. |
| Study text reference: Page 123 |
| Correct answer: B |

1.4

| |
|---|
| Learning Outcome/s: 3.11.1 |
| Explain the characteristics of perfect competition, monopolistic competition, monopoly, oligopoly and their impact on businesses. |
| Study text reference: Page 217 |
| Correct answer: C |

1.5

| |
|--------------------------------|
| Learning Outcome/s: 5.5 |
| Nature and scope of control |
| Study text reference: Page 377 |
| Correct answer: D |

1.6

| |
|--|
| Learning Outcome/s: 4.4.2 |
| Explain how demand management and supply management policies can be used to control inflation. |
| Study text reference: Page 279 |
| Correct answer: B |

1.7

| |
|--|
| Learning Outcome/s: 4.5.1 |
| Explain how exchange rates are determined and how changes in exchange rates affect businesses. |
| Study text reference: Page 307 |
| Correct answer: B |

1.8

| |
|--|
| Learning Outcome/s: 4.7.1 |
| Identify financial markets, financial intermediation and their benefits to business. |
| Study text reference: Page 308 |
| Correct answer: A |

1.9

| |
|--|
| Learning Outcome/s: 6.12 |
| Nature and scope of human resource management. |
| Study text reference: Page 501 |
| Correct answer: B |

1.10

| |
|--|
| Learning Outcome/s: 6.14 |
| Management information systems in organisations. |
| Study text reference: Page 524 |
| Correct answer: C |

(2 x 10 = Total: 20 marks)

Question 02

2.1

| Learning Outcome/s: 1.4 |
|---|
| Future directions of businesses. |
| Study text reference: Page 19 |
| <ul style="list-style-type: none">• Brevity• Flexibility/not too specific• Distinctiveness/uniqueness• Realistic• Strategic direction |

2.2

| Learning Outcome/s: 2.1.3 |
|--|
| Discuss the inter-relationships among the main functions of management. |
| Study text reference: Page 58 |
| <p>(a) 1. Planning 2. Organising 3. Leading 4. Controlling</p> <p>(b)</p> <ul style="list-style-type: none">• Planning – deciding what needs to happen in the future and generating a programme for action.• Organising – making optimum use of the resources required and promoting constructive relationships.• Leading – determining what needs to be done in a situation and getting people to do it.• Controlling – checking progress against plans. |

2.3

Learning Outcome/s: 2.3.2

Discuss the responsibilities of the different types of managers.

Study text reference: Page 59

Line authority is the authority a manager has over a subordinate, down the vertical chain of command (e.g. finance director giving instructions to the finance executive).

Staff authority does not entail the right to make or influence decisions in the advisee department. It is limited to one manager giving specialist advice to another manager, over which there is no line authority (e.g. head of the HR division advising the finance manager on selection/interviewing methods).

2.4

Learning Outcome/s: 2.8.2

Explain the types of economic goods (including normal goods, Giffen goods, inferior goods, Veblen goods and public goods)

Study text reference: Page 85

Normal goods are goods for which demand rises as household income rises.
E.g. televisions, clothes, internet connection.

Inferior goods – goods whose demand eventually falls as income rises.
E.g.

- Bread – when the income of consumers increase, they move towards the consumption of more nutritious food, and the demand for low-priced products like bread decreases.
- Public transportation – when income is low people use more of public transportation, which is not the case when their income increases.

| Learning Outcome/s: 3.3 |
|---|
| Customers and customer value |
| Study text reference: Page 191 |
| <ul style="list-style-type: none"> • It enables a company to focus resources on the most profitable areas. • It identifies unexpected differences in profitability among customers. • It helps to quantify the financial impact of proposed changes. • It helps to highlight the cost of obtaining new customers and the benefit of retaining existing customers. • It helps to highlight whether product development or market development is to be preferred. • An appreciation of the cost of servicing clients assists in negotiations with customers. • It helps R&D avenues. |

| Learning Outcome/s: 3.12.1 |
|--|
| Explain how businesses determine the optimum output, price and profit in the short and long run in different markets |
| Study text reference: Page 218 |
| <p>A firm in monopolistic competition will make only normal profits in the long run. Losses or supernormal profits in the short run cannot be maintained, as there is free entry and free exit.</p> <p>In the long run the firm's demand curve will be tangential to the average cost (AC) curve at the output level where profit is maximised. The firm will equate MC and MR to obtain the profit maximising level of output at Q_0. Although the firm is maximising profit, there are no abnormal profits being earned because average revenue (AR) equals average cost (AC) at output level Q_0.</p> |

2.7

Learning Outcome/s: 3.13.2

Discuss the roles of suppliers and distributors in a business.

Study text reference: Page 193

- Vulnerable to any disruption in supply.
- Buyer is dependent on the supplier.
- Supplier power will increase if there is no alternative supplier.
- Supplier is vulnerable to shifts in order levels.

2.8

Learning Outcome/s: 4.4.2

Explain how demand management and supply management policies can be used to control inflation.

Study text reference: Page 289

- Growth implies faster use of natural resources – without growth, these resources would last longer.
- Economic activities tend to create pollution – it leads to emissions, which threaten to produce disruptive climate changes through an increase in the greenhouse effect.
- It can create structural unemployment – some people will be unable to adapt to the demand for new skills and more training, and will not find jobs in a developing economy.
- It will require a cut in consumption, because firms need to invest more and this requires financing. Financing will come through higher savings, which in turn requires the population to consume less.
- It increases income disparity.

2.9

Learning Outcome/s: 4.9.1

Discuss the nature of modern development and their impact on business.

Study text reference: Page 255

- Outsourcing can remove uncertainty about cost.
- Long term contracts encourage planning for the future.
- Outsourcing can bring benefits of economies of scale.
- A specialist organisation is able to retain skills and knowledge for the core function.

Learning Outcome/s: 6.15

Fundamentals of project management

Study text reference: Page 540

- Proper planning with regard to time, cost and resource constraints.
- Involvement of users in development and delivery processes, to ensure that their needs are met.
- Competent and committed project staff, with the right skills.
- Ownership by senior managers on the basis of a clear business case.
- Careful management of constraints.
- Risk assessment and management.
- Clear criteria for business case and precise measurements of performance.

(Total: 30 marks)

SECTION 02

Question 03

| Learning outcome/s: 6.8 and 6.11 | |
|--|---|
| 6.8 | Nature and scope of marketing management. |
| 6.11 | Elements of a marketing programme. |
| Study text reference: Pages 461, 455 and 463 | |

- (a) Tangible attributes: availability and delivery, instructions, product variety, design, size, packaging, colour etc.

Intangible attributes: image, perceived value etc.

(b)

- Sales promotions – sales promotion activities are typically aimed at increasing short term sales volumes. The company can sell the product at a discounted price for a given period, arrange competitions, offer prizes to stimulate purchase of the product or provide some loyalty incentives to increase sales.
- Advertising – advertising is paid for mass communication. The company can use advertising effectively for a range of purposes such as promote sales, create an image, support personal selling, offset competitor advertising, remind and reassure.
- Branding – branding is a very general term covering brand names, designs, trade names etc. The company can rebrand cheese buttons as an alternative for croissants (branding as an accomplishment)
- Public relations – not applicable to this scenario.
- Direct marketing – not applicable to this scenario.

- (c) Target market is a market or segment selected for special attention by an organisation.

Mass marketing is to produce a single product and get as many customers as possible to buy it.

Differentiated marketing is when a company markets several product versions, each aimed at a different market segment.

(Total: 10 marks)

Question 04

Learning Outcome/s: 4.6

Monetary policy and fiscal policy.

Study text reference: Pages 283, 297 and 298

(a)

- Redistribution of income and wealth in ways that may be undesirable for creditors and fixed-income earners.
- Exports become more expensive and imports become relatively cheaper, causing the balance of payments to suffer.
- Create uncertainty of the value of money and prices. If there is hyperinflation money becomes worthless.
- Resource costs will be high.
- It is harmful to a country's economic growth and level of investment.
- Process of resource allocation is less efficient.

(b)

- **Money supply** – an increase in the money supply in the country will raise prices and income, and this will raise the demand for money to spend. As a result aggregate demand will increase. A decrease in money supply will have the reverse effect.
- **Interest rate** – a rise in the interest rate will raise the price of borrowing. Investments and profits will also fall as a result of higher interest payments. Individuals will also reduce or postpone consumption in order to reduce borrowings. As a result, aggregate demand will be impacted in a negative manner. The opposite will be experienced if interest rates fall.
- **Exchange rate** – if the domestic exchange rate is devalued, exports will become cheaper to overseas buyers and more competitive in the export market. Imports on the other hand will become more expensive. Devaluation will therefore stimulate exports and reduce the demand for imports.

(c)

The government's annual budget is a fiscal instrument that has a direct impact on the level of demand. **Raising public expenditure** will be expansionary as demand is increased, initially in the public sector and then transmitted to households.

Tax reductions are also expansionary as taxpayers are left with a high level of income and may be expected to spend more.

If the government keeps its spending at the higher level as well as reduce the level of taxation, it would stimulate aggregate demand in the economy as firms and households would have more of their own money, after tax, for consumption or saving/investing.

$$AD = C + I + G$$

$$\uparrow AD = \uparrow C + \uparrow I + \uparrow G$$

(Total: 10 marks)

Question 05

| |
|---|
| Learning Outcome/s: 5.4 |
| Nature and scope of leading as a management function. |
| Study text reference: Pages 360 and 362 |

- (a) "The activity of influencing people to strive willingly for group objective." **(Terry)**
OR
"Interpersonal influence exercised in a situation and directed through the communication process towards the attainment of a specialised goal or goals".
(Tannenba)
OR
"A process of influencing a group to achieve goals". **(Robbins & Coulter)**
- (b) The terms management and leadership are often used interchangeably. However, leadership and management involve two distinct sets of actions.
- Management is about coping with complexity. Leadership by contrast, is about coping with change.
- Management can be exercised over resources, activities, projects and other essential non-personal things. Leadership can only be exercised over *people*.
- (c) **Limitations of Trait Theories**
- Traits alone are not sufficient for identifying effective leaders since explanations based solely on traits ignore the interactions of leaders and their group members as well as situational factors.
 - The premise that certain traits are absolutely necessary for effective leadership has never been substantiated.
 - The list of traits proposed for effective leaders have been vast, varied and contradictory.

Limitations of Style Theories

- A manager's personality may simply not be flexible enough to utilise different styles effectively.
- The demand of the task, technology, organisation culture and other managers constrain the leader in the range of styles effectively open to him.
- Consistency is important to subordinates. If a manager adapts his or her style to changing situations, they may simply perceive the manager to be fickle or may suffer from insecurity and stress.

(Total: 10 marks)

Question 06

Learning Outcome/s: 6.2 and 6.7

6.2 Nature and scope of operations management.

6.7 Production concepts in businesses.

Study text reference: Pages 412 and 428

(a)

| Number of workers (L) | TP | AP = (TP/L) | MP = $\Delta TP \div \Delta L$ |
|-----------------------|------|-------------|--------------------------------|
| 1 | 600 | 600 | |
| 2 | 1400 | 700 | 800 |
| 3 | 2400 | 800 | 1000 |
| 4 | 3200 | 800 | 800 |
| 5 | 3800 | 760 | 600 |
| 6 | 4200 | 700 | 400 |
| 7 | 4400 | 628.57 | 200 |
| 8 | 4400 | 550 | 0 |
| 9 | 4200 | 466.67 | -200 |

(b) **Average product (AP) curve**

Initially this curve will rise due to the effects of division of labour and specialisation. However, after the 3rd worker it will start to fall because the marginal product of the 4th worker is less than the average product, and this pulls the average down

Marginal product (MP) curve

Initially when more and more variable factors are applied to a given amount of fixed factors in production in the short run, the extra output produced by each extra unit of variable factor will decrease due to increasing marginal returns (1 – 3 workers).

Decreasing marginal returns occur when the marginal product of an additional worker is less than the marginal product of the previous worker. In economic terms, the marginal product will rise at first, but eventually after the 4th worker it must decrease in the short run. This means that the extra production obtained from an increase in a variable input will eventually decline as more of the variable input is used together with the fixed inputs (4 – 8 workers).

After the 8th worker it will create a negative marginal product.

MP intersects AP (MP = AP) at the maximum point on the AP curve. Further, whenever MP > AP, the AP curve rises, and when MP < AP the AP curve falls

(c) **Technical economies**

- Use of modernised automated machinery for production and packaging will enable a high volume of production.
- Large warehouses and large vehicles for transportation will reduce the unit cost of holding and transporting products.

Commercial or marketing economies

- Bulk purchases of raw materials from local and foreign suppliers will lead to bulk discounts.
- Bulk selling will enable a large firm to make relative savings in distribution and advertising costs.

Organisational economies

- Centralisation of functions such as human resources, administration and marketing may reduce overhead costs.
- More efficient use of management.

Financial economies

- Larger firms are perceived to be less risky due to having more valuable assets to pledge as security and can therefore negotiate for cheaper finance.
- High negotiation power due to reputation of the firm and large nature of the business.
- Better assets/turnover ratio. As a result, they need to pay less interest relative to turnover due to low borrowings.

(Total: 10 marks)

SECTION 3

Question 07

| Learning Outcome/s: 3.5, 3.6 and 3.7 |
|--|
| 3.5 Demand, supply and market equilibrium in a competitive market. |
| 3.6 Concept of elasticity |
| 3.7 Impact of government intervention on a competitive market. |

(a)

Supply: $Q_s = 1800 + 240P$

Demand: $Q_d = 3550 - 266P$

By setting the quantity supplied equal to the quantity demanded, we can determine the market equilibrium price.

$$Q_s = Q_d$$

$$1800 + 240P = 3550 - 266P$$

$$506P = 1750$$

$$P = \$ 3.46 \text{ per bushel}$$

Substituting into the supply curve equation,

$$Q = 1800 + (240)(3.46) = 2,630 \text{ million bushels}$$

(b)

(i) The demand curve can be used to find the price elasticity of demand:

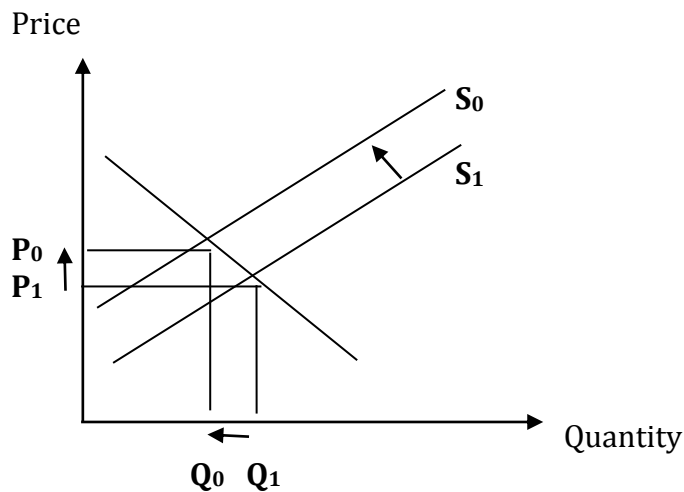
$$PED = P/Q * \Delta Q / \Delta P = 3.46/2630 * (-266) = \mathbf{-0.35}$$

(ii) Demand is price inelastic.

(iii) Consumers' household income is one of the determinants of demand. For most commodities an increase in household income will increase the demand for that good. But the exact effect on demand will depend on the type of good. Here the product is rice. This is the staple food of Country X, therefore it can be considered as a necessity good. Therefore income elasticity of demand is close to zero (inelastic). Thus a significant change in household income will not have a significant change in the demand for rice. Thus Q_d will not change at the same level as the change in income.

(c)

A subsidy is a payment made by the government to cover part of the cost of the good. A reduction of the subsidy will increase the unit cost of production and move the supply curve upwards (i.e. to the left). As a result, there will be a shift in the equilibrium quantity produced as shown in the following diagram.



Thus, a reduction of a subsidy will have two effects:

- Amount supplied in equilibrium will decrease
- Price will rise

If farmers sell the goods at the existing prices, product profitability will go down.

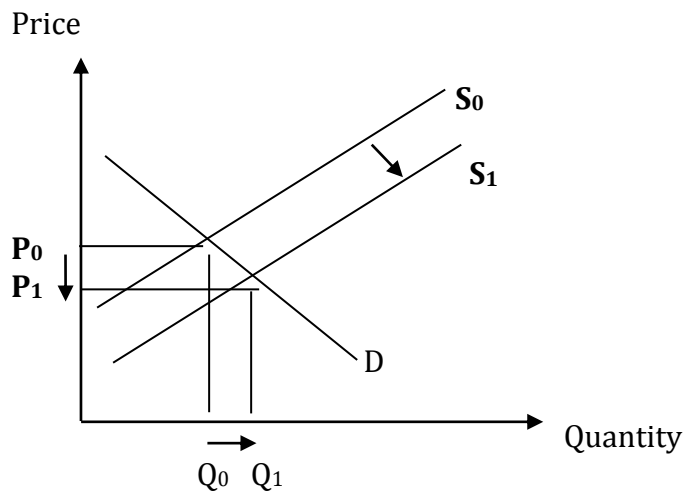
- (d) Quantity supplied of a good depends on different factors. According to the given scenario, with the introduction of this new disease-resistant seed at a lower price for the farmers, cost of making the good will go down. If the suppliers expect the price of the good to go down in the future due to low costs, they will increase the quantity supplied of the good now. As a result the supply curve will shift downwards.

OR

The development of the new disease-resistant seed strain is related to technology advancement. Technology is one of the variables that affect quantity supplied. This will reduce unit costs and increase production capabilities in the long run.

So the supply curve will shift downwards due to these reasons. As a result the price of the good will come down from P_0 to P_1 and quantity supplied will go up from Q_0 to Q_1 .

Accordingly, the equilibrium price will fall and equilibrium quantity will increase.



- (e) Minimum price legislation aims to ensure that suppliers earn at least the minimum price (floor price) for each unit of output they sell.

Floor price is set above the market price thus it will cause **excess supply**.

When trying to prevent over-supply and dumping of excess supply at lower prices, a system of production quotas might be introduced or the government could purchase the excess supply.

The problem with a floor price is that more of the goods will be produced than can be sold at the minimum price, so surplus quantities will build up. These goods will have to be either stored or destroyed. Therefore a floor price leads to a misallocation of resources, social costs and dead weight loss.

(Total: 20 marks)



Notice of Disclaimer

The answers given are entirely by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) and you accept the answers on an "as is" basis.

They are not intended as "Model answers", but rather as suggested solutions.

The answers have two fundamental purposes, namely:

1. to provide a detailed example of a suggested solution to an examination question; and
2. to assist students with their research into the subject and to further their understanding and appreciation of the subject.

The Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) makes no warranties with respect to the suggested solutions and as such there should be no reason for you to bring any grievance against the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka). However, if you do bring any action, claim, suit, threat or demand against the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka), and you do not substantially prevail, you shall pay the Institute of Chartered Accountants of Sri Lanka's (CA Sri Lanka's) entire legal fees and costs attached to such action. In the same token, if the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) is forced to take legal action to enforce this right or any of its rights described herein or under the laws of Sri Lanka, you will pay the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka) legal fees and costs.

© 2013 by the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka).

All rights reserved. No part of this document may be reproduced or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without prior written permission of the Institute of Chartered Accountants of Sri Lanka (CA Sri Lanka).
