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THE INSTITUTE OF  
**CHARTERED** ACCOUNTANTS  
OF SRI LANKA

# **SUGGESTED SOLUTIONS**

**KE5 – Commercial Insight for Management**

**September 2018**

# SECTION 1

## Answer 01

1.1

<b>Learning outcome/s: 5.5</b>
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Nature and scope of control
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Study text reference: Pages 378 and 379
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<b>Correct answer: C</b>
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1.2

<b>Learning outcome/s: 3.1.1</b>
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Discuss the organisational environment (including internal task and general, direct and indirect action, micro and macro environment)
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Study text reference: Page 103
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<b>Correct answer: D</b>
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1.3

<b>Learning outcome/s: 3.4.1</b>
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Identify the behaviour of rational consumers using cardinal and ordinal utility theories.
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Study text reference: Page 108
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<b>Correct answer: C</b>
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1.4

<b>Learning outcome/s: 3.6.2</b>
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Compute the different types of elasticity.
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Study text reference: Page 126
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<b>Correct answer: C</b>
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1.5

<b>Learning outcome/s: 3.10.1</b>
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Explain the total revenue/total cost approach and marginal revenue/marginal cost approach in profit maximisation only using graphical means.
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Study text reference: Pages 208 and 209
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<b>Correct answer: D</b>
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1.6

<b>Learning outcome/s: 4.5.3</b>
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Discuss the factors affecting demand and supply of foreign currencies.
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Study text reference: Page 304
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<b>Correct answer: A</b>
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1.7

**Learning outcome/s: 4.7**

Financial markets and intermediation

Study text reference: Pages 308 and 309

**Correct answer: B**

1.8

**Learning outcome/s: 5.2.1**

Identify the “functions of organising” and types of organisational structures.

Study text reference: Page 349

**Correct answer: B**

1.9

**Learning outcome/s: 6.3**

Cost concepts in businesses

Study text reference: Pages 394 – 397

**Correct answer: C**

1.10

**Learning outcome/s: 6.15.1**

Identify the basic concepts of project management

Study text reference: Page 544

**Correct answer: D**

**(2 x 10 = 20 marks)**

## Answer 02

2.1

<b>Learning outcome/s: 1.4</b>
Future directions of businesses
Study text reference: Page 22
<ul style="list-style-type: none"><li>• Customer perspective</li><li>• Internal business perspective</li><li>• Innovation and learning perspective</li></ul>

2.2

<b>Learning outcome/s: 1.5</b>
Role of the accountant in business
Study text reference: Page 41
<p>Particularly in small business organisations, the accountant may have wider experience of other businesses that most or all other staff lack. Also, he/she may be the only person with a business or finance related qualification. This can mean that the accountant is called on for general guidance on business matters even beyond his/her expertise. Sometimes the accountant may also have the best idea of where to find the right answer to a problem (for example if multiple roles are played by the accountant, HR, marketing, IT, treasury)</p>

2.3

<b>Learning outcome/s: 2.9</b>
Economic vs. accounting profits
Study text reference: Page 91
<p>(a) Accounting profit = sales revenue – explicit costs of the business Economic profit = sales revenue – (explicit costs + implicit cost) (Economic profit consists of sales revenue minus both the explicit costs and the implicit costs)</p> <p>(b) Implicit costs are benefits forgone by not using the factors of production in their next most profitable way. These costs have already occurred but are not necessarily shown or reported as a separate expense. They represent an opportunity cost.</p> <p>In Economics, implicit costs are also called imputed costs, implied costs or notional costs.</p>

## 2.4

### Learning outcome/s: 3.3.2

Discuss the importance of customer value and customer satisfaction with special reference to the role of an accountant in the organisation.

Study text reference: Page 191

- It enables a company to **focus resources** on the most profitable areas.
- It identifies unexpected **differences in profitability** between customers.
- It helps quantify the **financial impact** of proposed changes.
- It helps highlight the **cost of obtaining new customers**
- It helps to highlight whether **product** development or **market** development is to be preferred.
- An appreciation of the costs of servicing client's assets in **negotiations** with customers.

## 2.5

### Learning outcome/s: 3.5.1

Identify the factors which influence market demand and supply

Study text reference: Page 122

As the price of a good changes, other things being equal, the quantity changes due to two reasons; namely income effect and substitution effect. A normal good is a good that has a positive effect on quantity demanded as price decreases.

**Substitution effect** – as the price of a good decreases it will become cheaper than other goods that fulfill the same requirement. Thus, other people who consume a more expensive good will shift to the cheaper good.

**Income effect** – if the price of a good decreases, consumers feel better off as their real income has increased. Thus, consumption increases.

## 2.6

### Learning outcome/s: 5.1.1

Identify the planning process and advantages of planning to an organisation.

Study text reference: Page 320

- **Single-use plans:** plans that focus on a unique situation or one specific event. These plans are unlikely to be repeated (e.g. plan for a particular project, budget for a particular single financial period).
- **Standing plans:** plans that focus on repeated situations or overall policies, procedures and rules designed to ensure that internal operations are running smoothly.
- **Contingency plans:** plans that are formulated in advance and implemented when certain specific events occur. These events are often adverse events (e.g. disaster recovery plan)

**Learning outcome/s: 6.4**

Introduction to production capacity planning

Study text reference: Pages 404 and 405

- (a) Undercapacity means more production is being demanded than is able to be produced. In other words, it is a situation in which companies in an industry are making and supplying fewer products than customers are buying or are expected to buy.

In the service industry undercapacity may result in slower or less comfortable service, thereby reducing customer satisfaction and customer retention.

- (b) - Loading  
- Sequencing  
- Scheduling  
- Monitoring and controlling

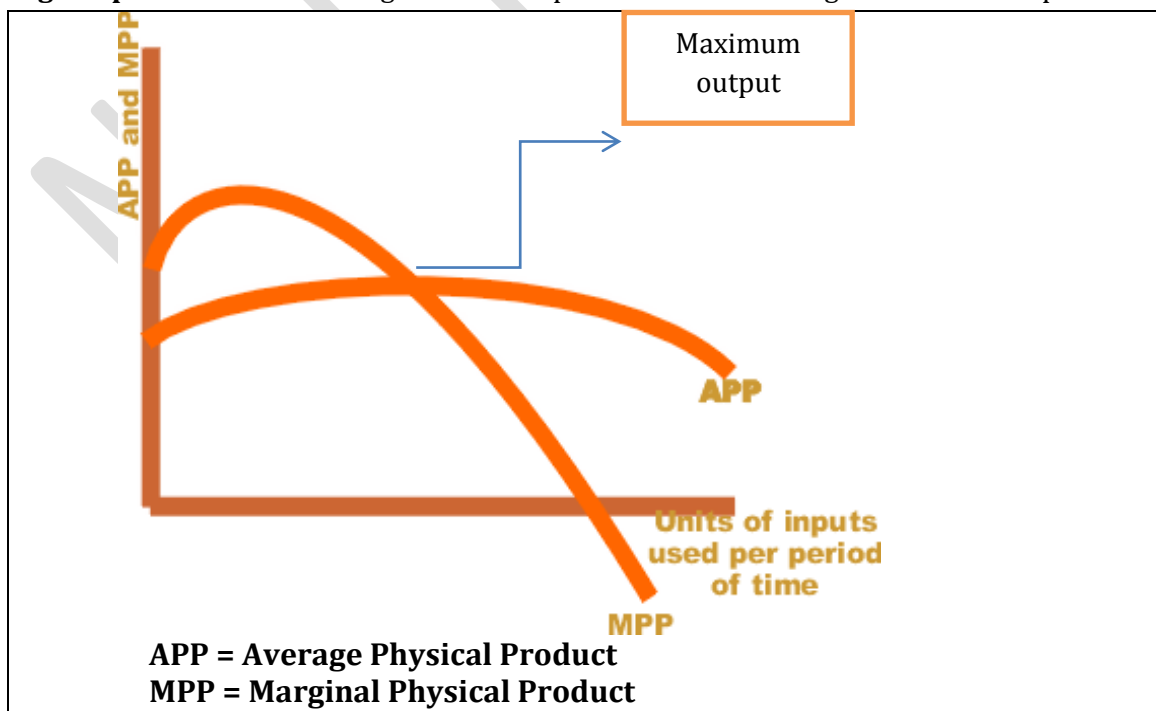
**Learning outcome/s: 6.7.1**

Define short run and long run production concepts and related production measurements (total production, average production, marginal production), using graphical means.

Study text reference: Page 423

**Average product** – is total production divided by the number of units of the factor production. Average product is likely to vary as more of the input factor of production is employed.

**Marginal product** – is the change in total output due to a unit change in the factor input .



**Learning outcome/s: 5.4**

Nature and scope of leading as a management function

Study text reference: Page 363

The contingency approach to leadership considers effective leadership to be dependent on a number of variable or contingent factors. There is no one right way to lead that will fit all situations. The ability of a manager to be a leader and influence his/her subordinate work group depends on the particular situation and will vary from case to case.

(That is why Gillen suggests that using only one leadership style is a bit like a stopped clock. It will be right only twice a day)

Therefore leaders need to interact with their teams in different ways in different situations, depending on the circumstances of the situation. This is what Gillen meant in making that statement.

**Learning outcome/s: 6.16**

Fundamentals of change management

Study text reference: Page 550

- Underestimation of the forces of resistance
- Failure to muster forces in favour
- Failure to attack root causes of resistance
- Management quickly shift their attention elsewhere
- Failure to ensure implementation

## SECTION 2

### Answer 03

<b>Learning outcome/s: 6.11</b>
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Elements of marketing programme
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Study text reference: Pages 459, 469, 473 and 474
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- (a)
- People
  - Processes
  - Physical evidence
- The role of employees is particularly important in service marketing, *like in a commercial bank*, because of the inseparability of the service from the service provider. Well-trained **front-line office staff** are deployed with particular attention to customer care and public relations.
  - Efficient **loan processing** in a bank not only increases customer satisfaction, it also cuts down the time taken to complete lending.
  - Physical evidence is also about the customer experience. When a customer first engages with a bank for the first time, he/she is not familiar with the products or services. Therefore it is customary to provide customers with physical evidence, distributing brochures, that inspires confidence.
- (b) The 4Cs marketing model was developed by Robert F. Lauterborn in 1990. It is a modification of the 4Ps model. Marketing textbook authors describe the 4Cs marketing model as the four customer focus 'C' equivalents.
- Cost – consider how customers perceive value for money. Price is not the only cost incurred when purchasing a product. Cost of conscience or opportunity cost is also part of the cost of product ownership.
  - Choice – consider how customers make choices. A company should only sell a product that addresses consumer demand. Therefore marketers and business researchers should carefully study consumer wants and needs.
  - Communication – have dialogue with customers. Inform and support their decision-making. Communication is *cooperative*. Marketers should aim to create an open dialogue with potential clients based on their needs and wants.
  - Convenience – consider what customers find convenient. The product should be readily available to consumers. Marketers should strategically place the products in several visible distribution points.
- (c)
- Costs – cost is the most important influence on price. Many organisations base price on simple cost-plus rules.



- Competition – level of competition is the next prime influence on price. In some market structures price competition may be avoided by cartels and informal agreements. Severe competition even leads to price wars.
- Customers – an organisation may base its pricing strategy on the intensity and elasticity of demand. Strong demand may lead to a higher price.

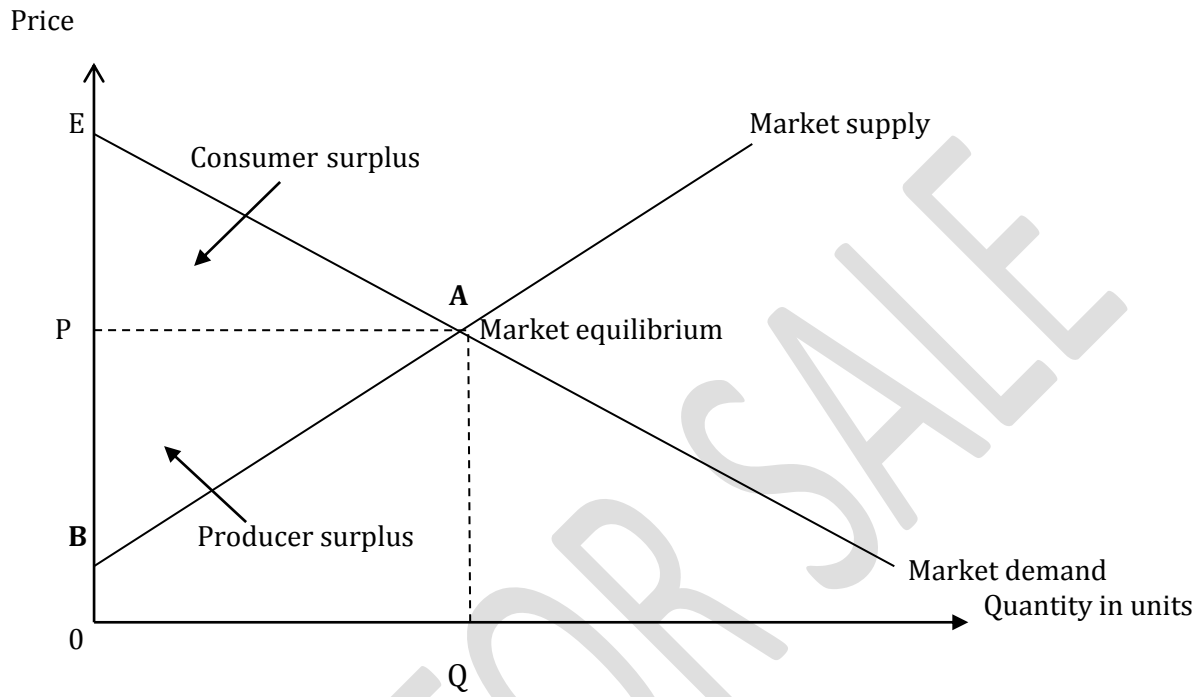
**(Total: 10 marks)**

NOT FOR SALE

**Answer 04**

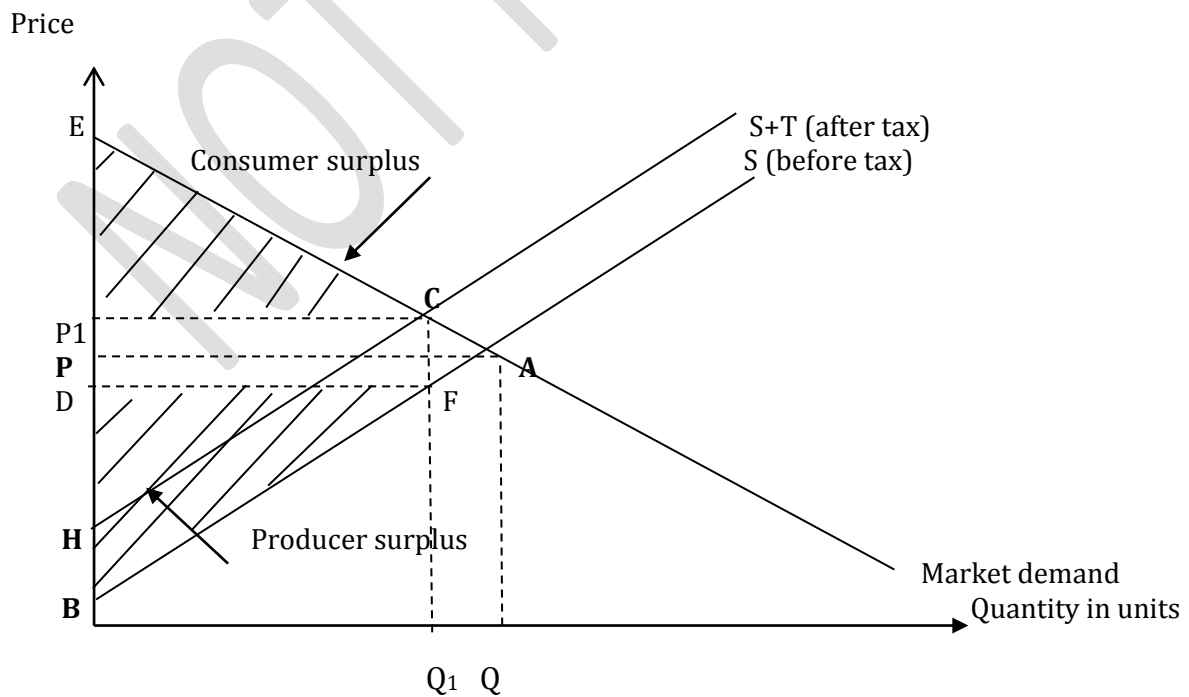
<b>Learning outcome/s: 3.7</b>
Impact of government intervention on competitive markets
Study text reference: Page 148

(a)



**Diagram 1**

(b)



**Diagram 2**

Under the newly determined market price after the imposition of the sales tax per every unit sold, the quantity demanded in the market for that product would come down-

Due to the revenue earned by the government after the imposition of the tax, the size of the consumer surplus and producer surplus would also come down, as demonstrated in Diagram 2. As such the consumer loses a part of their consumer surplus and the producer loses a part of their surplus.

Prior to the imposition of the sales tax consumer surplus is shown by the area PAE, and after the sales tax it is shown by the area  $P_1CE$ . Loss of consumer surplus is represented by  $PP_1CA$ .

Prior to the imposition of the sales tax producer surplus is shown by the area PAB, and after the sales tax it is  $P_1CH$ , which is equal to DFB. Loss of producer surplus is represented by PAFD.

Tax earned by the government is represented by the area  $P_1CFD$ .

- (c) Deadweight loss is a loss of economic efficiency when the market equilibrium for a good is not *optimal* due to monopoly pricing. Price ceilings or taxes/subsidies imposed by the government lead to deadweight loss.

According to Diagram 2 above,

Loss of consumer surplus is represented by  $PP_1CA$ .

Loss of producer surplus is represented by PAFD.

Therefore total loss to consumers and producers =  $P_1CAFD$

Tax revenue earned by the government is  $P_1CFD$ . Therefore area CAF is part of the loss incurred by the consumer and producer but not gained by any other party.

Accordingly, deadweight loss is the economic benefit foregone as illustrated in Diagram 2 by the area CAF. Deadweight loss is the value of the trades that are not made due to the sales tax imposed.

**(Total: 10 marks)**

## Answer 05

<b>Learning outcome/s: 2.4 and 2.5</b>
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2.4 Managerial roles
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2.5 Managerial skills
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Study text reference: Pages 63, 64, 65 and 70
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(a)

- Interpersonal – based on the manager’s formal authority or position. He plays this role as a figurehead/leader/liaison.
- Informational– based on the manager’s access to upward and downward channels and many external contacts. He plays this role as a monitor/spokesperson/ disseminator.
- Decisional– based on the formal authority and access to information that allows decisions to be taken relating to the work of the departments as a whole. He plays this role as an entrepreneur/resource allocator/negotiator/distribution handler.

(b)

- Unity of command – an employee should receive orders from one superior, or no subordinate in an organisation should report to more than one superior.
- Scalar chain – Fayol defines the **scalar chain** as the chain of supervisors ranging from the ultimate authority to the lowest rank. An employee should feel free to contact his supervisor about anything through the **scalar chain**.
- Esprit de corps – teamwork is fundamentally important to an organisation. Work teams and extensive face-to-face verbal communication encourage teamwork

(c)

- The development of a true science of work – all knowledge that had hitherto been kept in the heads of workmen should be gathered and recorded by management. Every single subject, large and small, becomes the question for scientific investigation for reduction to law.
- The scientific selection and progressive development of workers – workers should be carefully trained and given jobs which they are best suited to.
- The application of techniques to plan, measure and control work for maximum productivity.
- The constant and intimate co-operation between management and workers – the relations between employers and men form without question the most important part of this art.

**(Total: 10 marks)**

## Answer 06

### Learning outcome/s: 4.6

Monetary policy and fiscal policy

Study text reference: Pages 290, 293, 297 and 300

(a)

- To achieve economic growth and growth in income per capita
- To control price inflation and achieve stable prices
- To achieve full employment
- To achieve a balance between exports and imports over a period of years, or to achieve a balance between the country's balance of payment accounts.

(b)

Decision	Discussion
1. Output capacity	Grants or tax incentives to invest
2. Competition	Forbid or allow takeovers/mergers. Anti-competitive practices Opening markets to new entrants
3. Monopolies	Break them up, regulate them
4. Sales demand	Government policy to affect demand

(c)

- A policy of low interest rates or the absence of any form of credit control through monetary policy might stimulate bank lending, which in turn would increase aggregate demand in the economy.
- High interest rates might act as a deterrent to borrowing, and thus reduce spending in the economy.
- Strict credit controls might act as a deterrent to reduce lending and thereby reduce demand in the economy.
- Monetary policy contributes best to maintaining macroeconomic stability by anchoring inflation expectations at a level consistent with price stability. A forward-looking, medium-term oriented monetary policy provides the best framework for this purpose. Fiscal policies too should have a medium to long-term orientation and largely rely on automatic stabilisers in the short-term.

**(Total: 10 marks)**

## SECTION 3

### Answer 07

#### Learning outcome/s: 3.11, 3.12 and 4.4

3.11 Theoretical dimensions of market structures

3.12 Optimal output, price and profit decisions in competitive market structures.

4.4 Role of inflation

Study text reference: Pages 168, 218, 219, 280 and 281

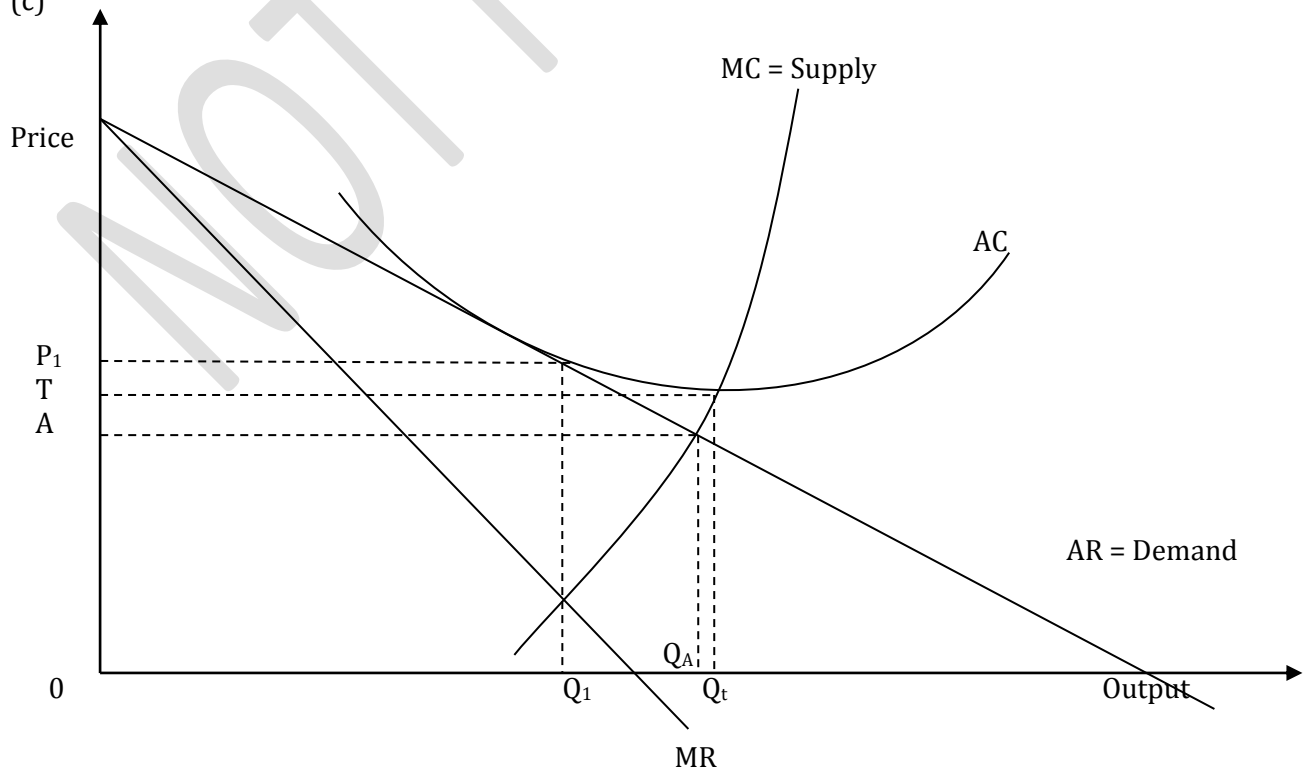
(a)

- Many firms in the market.
- Product differentiation – each firm has a downward sloping demand curve.
- No significant barriers to entry.
- Non-price competition.
- Independent decision-making.
- Some degree of market power.
- Buyers and sellers do not have perfect information (imperfect information).
- Firm will have a short-run equilibrium in which it can make supernormal profits and a long-run equilibrium in which it is not possible.

(b)

- Profit maximising output under monopolistic competition is lower than it would be under perfect competition, and it is at a point where average costs are not minimised. A firm may not be of the optimum size.
- It is wasteful to produce a wide variety of differentiated versions of the same product. Economies of scale as with large volume production might not be achievable. Monopolistic competition prevents standardisation of products.
- Some methods that are used to create product differentiation are a waste of resources (e.g. advertising costs).

(c)



Allocative efficiency occurs where price equals marginal cost. However, per the figure above, price ( $P_1$ ) is higher than marginal cost at output level  $Q_1$ . This means that output could be increased so some people could be made better off, without others suffering. Allocative efficiency would be achieved at quantity  $Q_A$  and price  $A$ .

Technical efficiency is not achieved because the average cost of the equilibrium output is not at the lowest point on the average cost curve ( $T$ ). This would be achieved where output quantity equals  $Q_T$ . The figure above also shows that the firm has excess capacity, as output at the level of technical efficiency ( $Q_t$ ) is greater than the current output of  $Q_1$ .

(d)

- Cost-push inflation – inflation resulting from an increase in the cost of production of goods due to high import costs (import cost-push inflation).
- A significant increase in wages
- A fall in value of currency
- Expectational inflation – inflation becomes a relatively permanent feature due to general public's expectation that it will occur.

(e)

- Take steps to reduce production costs and price rises, including deregulation of labour markets, encouraging greater productivity in the country and applying controls over wage and price rises.
- Take steps to reduce the import quantities or the price of imports by trying to achieve a change in the exchange rate.
- Enter into FTAs (Free Trade Agreements) with countries from where essential imports are imported.
- Introduce import substitutes.
- Pursue clear policies that indicate the government's determination to reduce the rate of inflation.

(f) The wage-price spiral is a macroeconomic theory used to explain the cause-and-effect relationship between rising wages and rising prices, or inflation. The wage-price spiral suggests that rising wages increase disposable income, thus raising the demand for goods and causing prices to rise

Regardless of whether the factors that have caused inflation are still persistent or not, there will be a generally held view that prices and wages will be raised from time to time to protect the future real income.

Thereby wages and prices will be raised by the expected amount depending on the prevailing inflation. This can lead to the vicious cycle known as the wage-price spiral, in which inflation becomes a relatively permanent feature, because of people's expectations that it will occur.

**(Total: 20 marks)**

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