

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

KE5 – Commercial Insight for Management

March 2019

SECTION 1

Answer 01

1.1

Learning outcome/s: 1.4.1

Define 'vision', 'mission', 'goals' and 'objectives' of business organisations.

Study text reference: Page 19

Correct answer: A

1.2

Learning outcome/s: 2.2.1

Define efficiency and effectiveness with respect to productivity of an organisation.

Study text reference: Page 72

Correct answer: D

1.3

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: B

1.4

Learning outcome/s: 3.4.1

Identify the behaviour of rational consumers using cardinal and ordinal utility theories.

Study text reference: Page 109

Correct answer: D

1.5

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 86

Correct answer: C

1.6

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 105

Correct answer: D

1.7

Learning outcome/s: 3.11.1

Explain characteristics of perfect competition, monopolistic competition, monopoly, oligopoly and their impact on businesses.

Study text reference: Page 170

Correct answer: B

1.8

Learning outcome/s: 4.6.1

Define monetary policy, fiscal policy and the tools of monetary and fiscal policies.

Study text reference: Page 290

Correct answer: A

1.9

Learning outcome/s: 5.4.2

Discuss the main areas of leading (motivation, leadership and communication).

Study text reference: Pages 300 and 372

Correct answer: B

1.10

Learning outcome/s: 6.14.1

Identify basic information systems.

Study text reference: Page 531

Correct answer: C

(Total: 20 marks)

Answer 02

2.1

Learning outcome/s: 1.2.1

Identify the value offerings made by business organisations in serving their customers (including goods, services, events, person, experience, place, properties, information, organisation and idea).

Study text reference: Page 14

- Intangibility – services cannot be touched or tasted
- Inseparability – services cannot be separated from the provider
- Heterogeneity – lack of sameness. Standard of service will vary with each delivery
- Perishability – services cannot be stored for future provision
- Ownership – service purchase does not transfer ownership of property

2.2

Learning outcome/s: 3.6.1

Explain the concepts of price elasticity of demand and supply, income elasticity, cross price elasticity and advertising elasticity on business decisions.

Study text reference: Page 61

- (a) $PE_D = 1.5$
- (b) The product has elastic demand, hence a reduction in price will decrease the total revenue as the percentage change in quantity demanded is greater than the percentage change in price.

2.3

Learning outcome/s: 2.3.1

Identify the types of managers in organisations, from horizontal and vertical aspects (top, middle and lower managers, functional managers, line and staff managers, value stream managers).

Study text reference: Pages 59 and 355

- (a) Middle managers are responsible for units within an organisation, departments or branches. They are accountable to senior management for their units of function. Their work involves directing and organising their units to implement plans in accordance with corporate policies and objectives.
- (b) Expert power
Legitimate power
Negative power

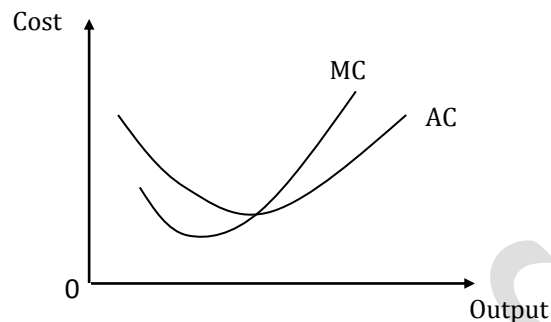
2.4

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 426

The U-shape of the AC curve in the short-run is attributed to increasing and diminishing returns from a fixed-size plant, because the size of the plant is not variable in the short run. This is known as the operation of the law of diminishing marginal returns in the short-run.



2.5

Learning outcome/s: 4.3.2

Define the concepts of national income (including GDP, nominal and real GNP and NNP).

Study text reference: Page 274

- GDP is derived from economic activity within the country.
- GNP is GDP plus net property income from abroad, as some national income arises from overseas investments, whilst some income within the country is earned by non-nationals (income generated by the nationals of a country is GNP).
- NNP is GNP minus the consumption of fixed capital and natural resource depletion.

2.6

Learning outcome/s: 3.13.1

Identify the types of suppliers and distributors.

Study text reference: Page 194

- Quality control is difficult to maintain.
- Loss of confidentiality if products use trade secrets.
- Competitors may utilise the same external organisation, so it is unlikely to be a source of competitive advantage (or it would be difficult to obtain a competitive advantage).

2.7

Learning outcome/s: 4.4.2

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

Study text reference: Page 284

- (a) Structural unemployment
This occurs where long-term changes occur in the conditions of an industry, and a mismatch occurs between industry expectations and labour skills.
- (b) Seasonal unemployment
This occurs in certain industries, for example building, tourism, and farming, where the demand for labour fluctuates in seasonal patterns throughout the year.

2.8

Learning outcome/s: 4.8.1

Discuss the nature of the prevailing socio-cultural conditions and their impact on businesses.

Study text reference: Page 247

- Introducing “green products” (i.e. ecological friendly products).
- Changing practices – traditional practices/techniques are changed due to environmental concerns and/or bad publicity.
- Education and confusions – consumers may be imperfectly educated about environmental issues.
- Carrying out environmental impact assessments prior to the launch of new businesses.
- Taking a variety of measures designed to deal with pollution.

2.9

Learning outcome/s: 6.2.2

Discuss the role of operations management in a business.

Study text reference: Page 393

- Manufacturers of machine tools – where training, consultancy and technical support is provided for installation and as part of after-sales services.
- Education and training organisations – provide study notes, tutes, and handouts along with lectures and workshops.
- Restaurants – provide products in the form of food and drink. But the overall dining experience essentially includes a service component.

2.10

Learning outcome/s: 6.15.1

Identify the basic concepts of project management.

Study text reference: Page 537

- Quality – the end-result should conform to the project specifications.
- Budget – the project should be completed within the budget.
- Timescale – the progress of the project must follow the planned process so that the result is ready for use at the agreed date.

SECTION 2

Answer 03

Learning outcome/s: 6.6 and 6.7

6.6 Production methods

6.7 Production concepts in businesses.

Study text reference: Pages 418, 425 and 426

- (a) The end-products of jobs have the following characteristics.
- They are one-off items
 - They are made to customer specific orders
 - Products are non-standard
 - The product range will be highly diverse
- (b)
- Speed of delivery
 - Quality of the final product
 - Ability to meet a range of different customer requirements by selling a 'set of capabilities'.

(c)

Total workers employed (N)	Total products from factory	MP	AP
1	10	-	10
2	22	12	11
3	36	14	12
4	48	12	12
5	58	10	11.6
6	64	6	10.6
7	66	2	9.4
8	64	-2	8

- (d) After recruiting the 3rd employee diminishing marginal returns begin to operate.

(Total: 10 marks)

Answer 04

Learning outcome/s: 6.12

Nature and scope of human resource management.

Study text reference: Pages 485, 492 and 496

(a)

- Helps to recruit good quality workers to the organisation.
- Through HR planning, organisations avoid sudden employee shortages and surpluses.
- Helps organisations to assess the current human resources.
- Enables organisations to meet future HR needs.
- Helps to retain skilled employees and reduce staff turnover.
- Helps training and retaining employees to enhance the skill base.
- Helps in budgeting and cost control.

(b)

- In the absence of a proper performance appraisal system, managers and supervisors may obtain random impressions of employees' performance.
- Managers and supervisors may have a fair idea of employees' shortcomings when a performance appraisal system is in place.
- Judgements are easy to make, but less easy to justify in detail, in writing or to the subject's face.
- Unless stimulated to do so, managers rarely give their staff adequate feedback on their performance.
- Different assessors may apply a different set of criteria/standards in the absence of a proper performance appraisal system.

(c)

- Management problems
- Lack of control over staff
- Rise in operational costs
- Fear of being laid off

(Total: 10 marks)

Answer 05

Learning outcome/s: 5.2

Organising and organisation structure.

Study text reference: Pages 340 and 350

(a) Advantages

- Expertise is pooled due to the division of work into specialised areas.
- Avoids duplications.
- Facilitates the recruitment, management and development of functional specialists.
- Suits centralised businesses.

Disadvantages

- Focuses on internal processes and inputs, rather than customers and outputs.
- Communication problems may arise between functions.
- Poor co-ordination, especially if rooted in a tall organisation structures. Decisions by one function/department involving another might have to be referred upward and dealt with at a higher level, thereby increasing the senior management.
- Functional structures create vertical barriers to information and workflow.

(b)

- (i) Virtual organisations – the organisation may consist of individuals, teams, companies or stakeholders. The organisation usually exists electronically on the Internet, without any physically premises.
- (ii) Hollow organisations – human resources and activities are split between core and non-core competences. All non-core processes and activities are then outsourced. Hollow organisations then focus on their core activities.
- (iii) Modular organisations – different elements or components of the product or service that the organisation produces are outsourced to different suppliers. The people remaining within the organisation assemble or combine these elements to produce the final product or service. This structure enables the organisation to be more flexible and respond to market needs more quickly.

(Total: 10 marks)

Answer 06

Learning outcome/s: 4.5

Importance of exchange rates on business.

Study text reference: Pages 306 and 307

(a)

- Governments do not have to spend or even hold foreign currency reserves.
- Balance of payments deficits and surpluses are automatically corrected.
- Governments need not adopt economic policies that may be undesirable for other reasons in order to maintain exchange rates.
- Encourages efficient allocation of resources since exchange rates will reflect economic conditions.
- Automatic adjustment to trade shocks.
- The Central Bank retains 'lender of last resort' capability for rescuing banks.
- Monetary independence.

(b)

- The company's finance costs will get inflated – when the domestic currency of a country weakens against the USD, the USD denominated liabilities become worth more in their domestic currency terms and so will finance costs.
- Loan repayments will also increase.
- The company could have gained more from their international voice business as they were invoicing in USD. However, USD earnings will dry up largely due to the lack of international calls.
- As a result the company's profit will come down.

(c)

- Translational foreign currency losses could be minimised if the borrower generates revenues in USD, providing a natural hedge against currency volatility.
- Company could buy USD "forwards" in advance of when they need it at a fixed and known price. Or enter into SWAPs, futures contracts etc.
- Outsource activities to the local market.

(Total: 10 marks)

SECTION 3

Answer 07

Learning outcome/s: 3.5.1, 3.7.1 and 3.11.1

3.5.1 Identify the factors which influence market demand and supply.

3.7.1 Demonstrate the impact of government intervention on competitive markets and business activities, through ceiling price, floor price, taxes, subsidies and quotas.

3.11.1 Explain characteristics of perfect competition, monopolistic competition, monopoly, oligopoly and their impact on businesses.

Study text reference: Chapter 6

(a)

At equilibrium,

$$Q_d = Q_s$$

$$1,300 - 2P = 100 + 2P$$

$$P = \text{A\$ } 300$$

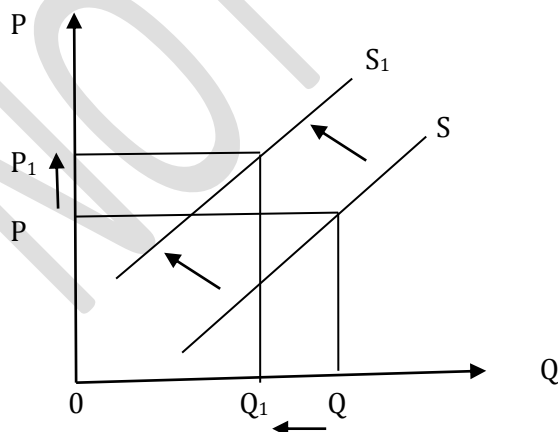
$$Q = 700$$

(b)

(i) Shortage of labour supply

A shortage of labour supply will increase wages, which will increase cost of production. This will shift the supply curve to the left (S to S_1).

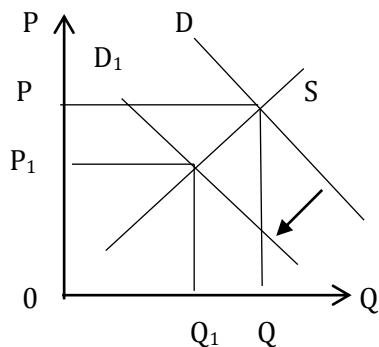
Thus, there will be a rise in price (from P to P_1) and a reduction in quantity (from Q to Q_1).



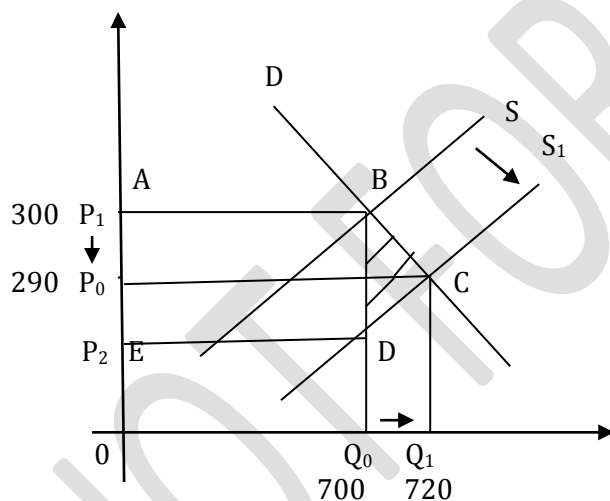
(ii) Low price of artificial cinnamon

Due to the low price of artificial cinnamon, the demand for it will go up, thus reducing the demand for natural cinnamon.

The demand curve shifts inwards (from D to D_1) reducing prices (from P to P_1) and quantity (from Q to Q_1).



(c)



When the government introduces a subsidy, the supply curve will shift from S to S_1 . As a result there will be a shift in the equilibrium quantity produced to Q_1 , which can be sold on the market for P_0 .

The amount supplied in equilibrium will increase from Q_0 to Q_1 .

The price will fall (from P_0 to P_1) but the decrease in price will be less than the value of the subsidy itself ($P_1 - P_0$).

Cost of subsidiary = ABDE

Deadweight loss = BCD

(d)

- Impose indirect taxes (import duties/tariffs) on artificial cinnamon. This will reduce supply and increase prices, which would result in a reduction of the quantity bought in Arkistan.
- Impose restrictions on imports of artificial cinnamon. This would reduce the availability of artificial cinnamon in Arkistan.
- Grant subsidies for local farmers.

(e)

- A large number of farmers cultivate cinnamon.
- The product could be homogeneous.
- One farmer thus might not be able to influence prices.
- Further, there appears to be no entry and exit barriers.

Thus the market structure is perfect competition.

(f)

Given the shortage of labour and competition from artificial cinnamon, farmers have been making losses (costs are far too high).

Since there are no entry/exit barriers, farmers have left the industry. However, due to the subsidy granted to farmers, losses incurred previously have come down.

Exit would stop once farmers make normal profits.

(Total: 20 marks)

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