Mock Test Paper - Series II: December, 2024

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INTERMEDIATE: GROUP – II

PAPER – 6: FINANCIAL MANAGEMENT & STRATEGIC MANAGEMENT

PAPER 6A : FINANCIAL MANAGEMENT

Suggested Answers/ Hints

PART I – Case Scenario based MCQs

1. (b) $Ke = \frac{D1}{P0} + g$

$= \frac{2}{20} + 0.05 = 15\%$

2. (b) $K_d = \frac{I(1-t) + \frac{(RV-NP)}{n}}{\frac{(RV+NP)}{2}} = \frac{9(1-0.35) + \frac{(100-102.90)}{10}}{\frac{(100+102.90)}{2}} = 5.48\%$

3. (a) $K_p = \frac{PD + \frac{(RV-NP)}{n}}{\frac{(RV+NP)}{2}}$

$K_p = \frac{11 + \left(\frac{100-102.82}{10}\right)}{\left(\frac{100+102.82}{2}\right)} = 10.57\%$

4. (a) Calculation of WACC using market value weights

Source of capital	Market Value	Weights	After tax cost of capital	WACC (K_o)
	(₹)	(a)	(b)	(c) = (a)×(b)
Debentures (₹ 105 per debenture)	2,88,750	0.1672	0.0548	0.0092
Preference shares (₹ 106 per preference share)	2,38,500	0.1381	0.1057	0.0146
Equity shares (₹ 24)	12,00,000	0.6947	0.1500	0.1042
	17,27,250	1.00		0.1280

WACC (K_o) = 12.80%

5. (a) Current Market Price $= \frac{D_1}{Ke-g}$

$= \frac{2}{0.10-0.05}$ = ₹ 40 per share

6. (c) DFL $= \frac{EBIT}{EBT}$

DFL = 4,00,000/3,00,000 = 1.33

Interest Coverage Ratio $= \frac{EBIT}{Interest\ Expense}$

= 4,00,000/1,00,000 = 4

Operating Profit Margin $= \frac{Sales}{EBIT} x100$

Operating Profit Margin = (4,00,000/16,00,000) × 100 = 25%

7. (c) COGS = Sales x (1−Gross Profit Margin)

COGS = 6,00,000 x (1−0.20) = 6,00,000 x 0.80 = 4,80,000

The velocity of stock is 3 months.

stock turnovers per year (12/3) = 4

Stock Turnover Ratio = COGS / Average Stock

Average Stock = 4,80,000/4 = 1,20,000

Average Stock = (Opening Stock + Closing Stock)/2

Closing Stock = 1,50,000

8. (d) 1, 2 and 3

PART II – Descriptive Questions

1. (a) Balance Sheets of Alpha Limited

Liabilities	₹		*Assets*	₹	
	31 March 2023	*31 March 2024*		*31 March 2023*	*31 March 2024*
Equity share capital (₹ 10 each fully paid)	20,00,000	20,00,000	Fixed Assets (₹18,90,000– ₹90,000)	18,00,000	15,39,000
Reserve and Surplus (balancing)	1,30,000	1,30,000	Long term investment	–	2,96,600
Profit & Loss A/c (15% of sales)	2,70,000	6,15,600	**Current Assets** (₹ 10,00,000)		

Current Liabilities			Stock	4,00,000	5,20,000
Bank Overdraft	1,00,000	–	Sundry Debtors	3,00,000	4,95,000
Creditors	3,00,000	4,15,000	Cash at Bank (Balancing)	3,00,000	3,10,000
Total	**28,00,000**	**31,60,600**	**Total**	**28,00,000**	**31,60,600**

Calculation for 31st March, 2023

(i) Calculation of Current Liabilities

Suppose that Current Liabilities = x, then current assets will be 2.5 x

Working capital = Current Assets – Current Liabilities

6,00,000 = 2.5x – x

x = 6,00,000 / 1.5 = ₹ 4,00,000 (C.L.)

Other Current Liabilities (Creditors) = Current Liabilities – Bank Overdraft = 4,00,000 – 1,00,000 = ₹ 3,00,000

Current Assets = 2.5 x 4,00,000 = ₹ 10,00,000

(ii) Liquid Ratio $= \frac{\text{Liquid Assets}}{\text{Current Liabilities}}$

$1.5 = \frac{\text{Liquid Assets}}{4,00,000}$

Liquid assets = ₹6,00,000

Liquid assets = Current Assets – Stock

6,00,000 = 10,00,000 – Stock

So, Stock = ₹ 4,00,000

(iii) Calculation of fixed assets: Fixed assets to proprietary fund is 0.75, working capital is therefore 0.25 of proprietary fund. So,

Fixed Assets = 6,00,000 / 0.25 x 0.75 = ₹ 18,00,000

(iv) Sales = (14,40,000 / 80) × 100 = ₹ 18,00,000

(v) Debtors $= \frac{2}{12}$ x Sales

2 / 12 × 18,00,000 = ₹ 3,00,000

(vi) Net profit = 15% of ₹18,00,000 = ₹ 2,70,000

Calculation for the year 31st March, 2024

(vii) Sales = 18,00,000 + (18,00,000 × 0.2) = 21,60,000

(viii) Calculation of fixed assets

	₹		₹
To Opening balance	18,00,000	By Banks (Sale)	90,000
		By Loss on sales of Fixed asset	90,000
		By P & L (Dep.) (5% as in previous year)	81,000
		By Balance b/d	15,39,000
Total	18,00,000		18,00,000

(ix) Net profit for the year 2011, 16% × 21,60,000 = ₹ 3,45,600

Total Profit = 2,70,000 + 3,45,600 = ₹ 6,15,600

(b) EBIT = ₹ 3,00,000

Less: Interest = ₹ 10,00,000 × 10% = ₹ 1,00,000

Earnings available to equity shareholders = ₹ 2,00,000

Equity capitalization rate = 12.5%

Market value of equity = $\frac{₹\ 2,00,000}{12.5\%}$ = ₹ 16,00,000

Market value of debt = ₹ 10,00,000

Market value of the firm = ₹ 26,00,000

Overall cost of capital = $\frac{₹\ 3,00,000 \times 100}{₹\ 26,00,000}$ = 11.54%

(c) (i) Increase in taxable income if sales increase by 6%.

Combined Leverage= $\frac{\text{Contribution}}{\text{EBT}} = \frac{₹\ 1,40,000}{₹\ 35,000} = 4$

If the sales increases by 6%, EBT will increase by 24%. (4 × 6%)

(ii) Increase in EBIT if sales increase by 10%.

Operating Leverage= $\frac{\text{Contribution}}{\text{Earnings before interest and tax}} = \frac{₹1,40,000}{₹\ 40,000} = 3.5$

If sales increases by 10%, EBIT will increase by (3.5× 10) 35%.

(iii) Increase in taxable income if EBIT increase by 6%.

Financial Leverage = $\frac{\text{Earnings before interest and tax(EBIT)}}{\text{EBT}} = \frac{₹\ 40,000}{₹35,000}$

=1.14

If EBIT increases by 6%, EBT will increase by 6.8%. (1.14 × 6%)

2. (a) Problem mentions that the company has applied to the Private Bank for financing its working capital needs. Ideally, banks would not finance for Depreciation cost being a non-cash cost and it would also not finance the profit for you. So, problem needs to be solved using Cash Cost Basis.

Estimation of working capital required (cash cost basis)

	Particulars		Amount
	A) Current Assets		
	A1) Stock of RM	15,84,960 x 30/360	1,32,080.00
	A2) Stock of WIP	(From Cost Statement)	4,77,360.00
	A3) Stock of FG	(From Cost Statement)	2,37,500.00
	A4) Debtors	32,74,686 x 45/360	4,09,335.75
	A5) Cash & Cash Equivalents	(Given)	1,25,000.00
	Gross Working Capital		**13,81,275.75**
Less:	**B) Current Liabilites**		
	B1) Creditors	17,17,040 x 30/360	1,43,086.67
	B2) Lag in Wages Payment	9,20,400 x 15/360	38,350.00
	Excess of Current Assets Over Current Liabilites	(A) - (B)	**11,99,839.08**
Add:	Safety Margin @ 15% Of Net Working Capital		2,11,736.31
	Net Working Capital		**14,11,575.39**

WN -1: Calculation of Profit

Profit = 25% of total cost i.e 20% of sales price

= {(31,200-2,500) x 150} x 20% = Rs. 8,61,000

WN – 2:

	Completed Units	WIP Units
	31,200	9,360
Raw Mat. Consumed	12,48,000	3,36,960
Direct Wages	7,80,000	1,40,400
Overheads	9,36,000	1,68,480
	29,64,000	6,45,840
Gross Factory Cost	**36,09,840**	

Add: Op WIP	-
Less: Cl. WIP **(At Prime Cost**)	4,77,360
Cost of Production	**31,32,480**
Add: Op FG Stock	-
Less: Cl. FG Stock	2,37,500
Cash Cost of Goods Sold	**28,94,980**
Add: Selling & Distribution Expenses (Bal. Figure)	3,79,706
Cost Of Sales	**32,74,686**
Profit*	8,61,000
Sales	**41,35,686**

*It is assumed that profit is unchanged

WN 3 - Calculation of WIP stock (units) and WIP stock amount

WIP UNITS = 30% of FG produced units i.e 30% of 31,200 units

= 9,360 units

WIP amount (at prime cost)

Raw materials = 9,360 x 40 x 90% = 3,36,960

Direct wages = 9,360 x 25 x 60% = 1,40,400

WN 4 - Calculation of purchases from suppliers

Raw Materials Consumed = OP RM Stock + Purchases - Closing RM Stock

15,84,960 = 0 + Purchases – 1,32,080

Purchases = 17,17,040

WN 5 – Calculation of safety margin

Safety Margin = 15% Of Net Working Capital Needs

Excess Of CA Less CL	85	11,99,839.08
Safety Margin	15	2,11,736.31
Net Working Capital	100	1411575.388

(b) EPS = ROE x BVPS (WN 1)

EPS = 0.15 x 125 = ₹ 18.75

Growth = ROE x Retention Ratio

= 0.15 x 0.65

= 9.75%

D1 = Do (1 + g)

= (18.75 x 35%)(1 + 0.0975)

= ₹ 7.20

Intrinsic Value of share today - Gordon's Formula

$$Po = \frac{D_1}{Ke - g}$$

$$= \frac{7.20}{0.20 - 0.0975}$$

Po = ₹ 70.24

Intrinsic Value of share today - Walter's Model

$$Po = \frac{D + \frac{r}{K_e}(E - D)}{K_e}$$

Here D = Do assuming it would remain constant through infinity

$$Po = \frac{6.5625 + \frac{0.15}{0.20}(18.75 - 6.5625)}{0.20}$$

Po = ₹ 78.51

WN 1 - Relationship between ROE-EPS-BVPS

$$ROE = \frac{\text{Earnings for Equity Shareholders}}{\text{Equity shareholders funds}}$$

If we divide the numerator and denominator with "**No of equity shares**"

$$ROE = \frac{\text{Earnings for Equity Shareholders / No of equity shares}}{\text{Equity shareholders funds / No of equity shares}}$$

Therefore, ROE = EPS / BVPS

3. Calculation of NPV (Amount in crores)

Year	1	2	3	4	5	6	7	8	9	10
EBT	2.000	2.500	4.000	4.750	6.000	6.400	6.150	5.250	3.800	2.900
Add: Interest	0.195	0.195	0.195	0.252	0.252	0.252	0.252	0.252	0.252	0.252
Add: Allocated Common Cost	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125	0.125
Project Profit Before Tax	2.320	2.820	4.320	5.127	6.377	6.777	6.527	5.627	4.177	3.277
Less: Tax	-	-	-	1.154	1.435	1.525	1.469	1.266	0.940	0.737
Profit After Tax	2.320	2.820	4.320	3.973	4.942	5.252	5.058	4.361	3.237	2.539
Add: Depreciation	2.410	2.410	2.410	2.410	2.410	2.410	2.410	2.410	2.410	-
Cash Inflows	4.730	5.230	6.730	6.383	7.352	7.662	7.468	6.771	5.647	2.539

Add: Release Of Working Capital	-	-	-	-	-	-	-	-	-	5.000
Add: Net Cash Inflow from sale of asset (Net Of Tax) (WN-3)	-	-	-	-	-	-	-	-	-	3.471
Total Cash Inflows	4.730	5.230	6.730	6.383	7.352	7.662	7.468	6.771	5.647	11.010
DF @ 15%	0.870	0.756	0.658	0.572	0.497	0.432	0.376	0.327	0.284	0.247
PV Cash Inflow	4.113	3.955	4.425	3.650	3.655	3.312	2.808	2.213	1.605	2.722

TOTAL PV CI = 32.458 Crores

(-) TOTAL PVCO = 30.000 Crores (Initial Outlay + Working Capital)

NPV = 2.458 Crores

ADVISE - Since NPV is positive, company should go for the project.

Notes - 1. Allocated common costs are to be excluded from cash inflows

2. Dividend distribution are deemed irrelevant for cash flow analysis
3. Discounting rate = MCLR + premium = 12 + 3 = 15%
4. Interest exp is to be excluded from the cash inflows as it is already getting covered in the discounting rate above
5. Professional fees paid for project report and R&D costs being sunk costs are irrelevant for decision making

WN 1 – Calculation of applicable taxes each year

For the first 3 years, tax will be zero and for the next 7 years tax rate applicable would 22.5% (30 x 0.75) as balance tax will be paid in Australia, so it will have no relevance under India perspective calculations.

WN – 2 Calculation of interest expense each year

Since post tax interest rate is given in the question, firstly it needs to be converted to pre-tax rate. However, for the first 3 years of the project, post-tax and pre-tax rate would be same owing to zero taxes

Interest Expense (first 3 years) = 3,00,00,000 X 6.5% = 19,50,000 or 0.195 crores

Interest Expense (next 7 years) = 3,00,00,000 x 8.39% = 25,17,000 or 0.2517 crores

$$\text{Pre-tax Interest Rate} = \frac{\text{Post tax Rate}}{1 - \text{India Tax Rate}}$$

= 6.5 / (1 - 0.225)

= 8.39%

WN 3 – CALCULATION OF CAPITAL GAINS INCOME IN YEAR 10

Cost of Asset remaining in the block at the beginning of Year 10

= 3,31,00,000 (2,41,00,000 + 90,00,000)

(+) New Asset purchased during the year = 0

(-) Sale Value of the Asset = 3,50,00,000

Capital Gains Income before tax = 19,00,000

(-) Capital Gains tax = 19,00,000 x 15% = 2,85,000

Net Cash Inflow after tax = 3,50,00,000- 2,85,000

= 3,47,15,000

B) Current Payback Period = 4 + 1.927 /7.352

= 4.262 years

Target Payback Period = 3.5 years

Some key measures to reduce your Payback period are as follows (Only illustrative):

i. Emphasizing on reduction of operational costs

ii. Improving marketing thereby resulting into higher sales

iii. Incorporate product-led growth strategies

iv. Judicious efforts in bringing down the overall cost of capital thereby reducing the discounting rate and in turn better Payback period.

v. Leveraging out the presence of the fixed cost

4. (a)

Particulars	Factoring	Forfaiting
A) Meaning	**Factoring** involves sales of receivables to the financial institution called factor in exchange for immediate cash payment	**Forfaiting** is a form of export financing where the exporter sells the rights to trade receivables to a forfaiter and receives instant cash
B) Recourse or non-recourse	May be on Recourse or Non-recourse basis	Always non-recourse
C) Amount paid	Firms are generally paid 80% to 90% upfront	100% on the value of exported goods is paid
D) Type of receivables	Receivables may either domestic or international	Receivables are international
E) Cost	Factoring cost in the form of factor commission or fees is to be borne by the seller	Overseas Buyer bears the forfaiting cost, if any

F) Secondary market	Factoring does not involve a secondary market for the receivables, meaning that the transaction is complete once the receivables are sold to the factor.	Forfaiting has a secondary market where the receivables can be traded, enhancing liquidity and providing additional opportunities for investors

(b) Some of the tasks that demonstrate the importance of good financial management

- Taking care not to over invest in fixed assets
- Balancing cash-outflows with cash-inflows
- Ensuring that there is a sufficient level of working capital
- Setting sales revenue targets that will deliver growth
- Increasing the Gross profit by setting the correct pricing for products or services
- Controlling the level of general and administration expenses by finding more cost-efficient ways of running the day-to-day business operations
- Tax Planning that will minimize the taxes a business has to pay

(c) A drop lock is an arrangement whereby the interest rate on a floating-rate note becomes fixed if it falls to a specified level. Above that level the rate floats based on a benchmark market rate, typically with a semi-annual reset. In other words, drop lock bonds marry the attributes of both floating-rate securities and fixed-rate securities. The drop lock effectively sets a floor on the rate and a guaranteed minimum return to

Or

(c) Advantage to the Company - Stock dividends are suitable in the situation of cash crunch and deficiency faced by the company and suitable when restrictions are imposed by lenders to pay the cash dividend

Advantage to the investor – Improves liquidity in the hands of the investors as bonus shares leads to breaking down of higher priced shares into lower priced shares and hence give a choice to shareholders to sell some of the lower priced shares and get some liquidity

PAPER 6B: STRATEGIC MANAGEMENT

ANSWERS

PART I

1. (A) (i) (c) (ii) (c) (iii) (d) (iv) (b) (v) (d)

1. (B) (i) (a) (ii) (c) (iii) (b)

PART II

1. (a) The scenario being referred to is culture in *Jupiter Electronics*. Strong culture promotes good strategy execution when there's fit and impels execution when there's negligible fit. A culture grounded in values, practices, and behavioral norms that match what is needed for good strategy execution helps energize people throughout the organization to do their jobs in a strategy-supportive manner. A culture built around such business principles as listening to customers, encouraging employees to take pride in their work, and giving employees a high degree of decision-making responsibility. This is very conducive to successful execution of a strategy of delivering superior customer service.

A strong strategy-supportive culture makes employees feel genuinely better about their jobs and work environment and the merits of what the company is trying to accomplish. Employees are stimulated to take on the challenge of realizing the organizational vision, do their jobs competently and with enthusiasm, and collaborate with others.

(b) To maintain a competitive edge in the face of increased competition, *Reshuffle Corp* can differentiate its products in several ways:

- **Tangible and Intangible Aspects:** *Reshuffle Corp* can focus on the tangible aspects of its products, such as using high-quality materials and innovative designs to create furniture that is both functional and aesthetically pleasing. Additionally, they can emphasize the intangible aspects of their products, such as excellent customer service and a strong brand reputation for reliability and durability.
- **Pricing Strategies:** While market prices are often dictated by competition, *Reshuffle Corp* can work on cost optimization to maintain profitability. They can also consider offering value-added services, such as free installation or extended warranties, to justify a higher price point.
- **Product Features:** By continually optimizing their product features based on customer feedback and market trends, *Reshuffle Corp* can ensure that their products deliver maximum satisfaction to their target customers. This may include features that enhance functionality, design, quality, and overall user experience.
- **Product Centric Approach:** *Reshuffle Corp* should keep their products at the center of their strategic activities, ensuring that all

business processes, from production to sales and marketing, are aligned to meet customer needs and expectations.

- **Product Life Cycle Management:** *Reshuffle Corp* should be aware of the life cycle of their products and plan for reinvention or replacement accordingly. They can introduce new product lines or upgrade existing ones to keep up with changing customer preferences and market trends.

(c) By concentrating primarily on the market for consultancy services in environmental management, the firm is pursuing a **focus strategy**. Its provision of audit services, which rival firms do not offer, highlights a **differentiation strategy** within this specific market niche. Therefore, the firm is following a **focused differentiation strategy**.

A focused differentiation strategy involves offering unique features that cater to the specific needs of a narrow market segment. As with the focused low-cost strategy, narrow markets can be defined differently depending on the context. For instance, some firms using this strategy focus on a particular sales channel, such as exclusively selling online, while others may target specific demographic groups. Firms that compete on uniqueness while addressing the needs of a narrow market exemplify the **focused differentiation strategy**.

2. (a) As industry's Key Success Factors (KSFs) are those things that most affect industry members' ability to prosper in the marketplace – the particular strategy elements, product attributes, resources, competencies, competitive capabilities and business outcomes that spell the difference between profit & loss and ultimately, between competitive success or failure. KSFs by their very nature are so important that all firms in the industry must pay close attention to them. They are the prerequisites for industry success, or, to put it in another way, KSFs are the rules that shape whether a company will be financially and competitively successful.

(b) SBU is a part of a large business organization that is treated separately for strategic management purposes. The concept of SBU is helpful in creating an SBU organizational structure. It is a separate part of large business 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 based on the common strategic interests.

Very large organisations, particularly those running into several products, or operating at distant geographical locations that are extremely diverse in terms of environmental factors, can be better managed by creating strategic business units. SBU structure becomes imperative in an organisation with increase in number, size and diversity. SBUs helps such organisations by:

- Establishing coordination between divisions having common strategic interest.

- Facilitate strategic management and control.
- Determine accountability at the level of distinct business units.
- Allow strategic planning to be done at the most relevant level within the total enterprise.
- Make the task of strategic review by top executives more objective and more effective.
- Help to allocate resources to areas with better opportunities.

3. **(a)** Capabilities that are valuable, rare, costly to imitate, and non-substitutable are core competencies. A small chemist shop has a local presence and functions within a limited geographical area. Still, it can build its own competencies to gain competitive advantage. Rohit Patel can build competencies in the areas of:

(i) Developing personal and cordial relations with the customers.

(ii) Providing home delivery with no additional cost.

(iii) Developing a system of speedy delivery that can be difficult to match by online sellers. Being in the central part of the city, he can create a network to supply at wider locations in the city.

(iv) Having extended working hours for convenience of buyers.

(v) Providing easy credit or a system of monthly payments to the patients consuming regular medicines.

(b) The vision describes a future identity while the Mission serves as an on-going and time-independent guide.

The vision statement can galvanize the people to achieve defined objectives, even if they are stretch objectives, provided the vision is specific, measurable, achievable, and relevant and time bound. A mission statement provides a path to realize the vision in line with its values. These statements have a direct bearing on the bottom line and success of the organization.

A mission statement defines the purpose or broader goal for being in existence or in the business and can remain the same for decades if crafted well while a vision statement is more specific in terms of both the future state and the time frame. Vision describes what will be achieved if the organization is successful.

4. **(a)** Vikram Patel is facing declining sales due to a significant shift of customers toward online platforms. Although he employs strategic management tools, they cannot always overcome every obstacle or guarantee success. The limitations of strategic management in Vikram's situation include:

- The environment in which strategies are developed is highly complex and unpredictable. The entry of online bookstores, a new

type of competitor, introduced a different dynamic to the book retail industry. These online platforms, with their extensive reach and pricing power, have dominated the market, posing a formidable challenge to traditional bookstores.

- Another limitation of strategic management is the difficulty in forecasting future developments. Despite his strategic management efforts, Vikram Patel did not anticipate the extent to which online bookstores would impact his sales.
- While strategic management is a time-consuming process, it is crucial for Vikram to continue managing strategically. These challenging times demand increased effort and adaptability on his part.
- Strategic management can be costly. Vikram Patel might consider hiring experts to understand customer preferences better and adjust his strategies to offer more personalized services. These customized offerings could be difficult for online stores to replicate, giving him a competitive edge.
- The bookstores owned by Vikram Patel are much smaller in scale compared to online stores. This makes it challenging for him to predict how online platforms will manoeuvre strategically.

(b) In the BCG growth-share matrix portfolio of investments are represented in two-dimensional space. The vertical axis represents market growth rate, and the horizontal axis represents relative market share. The strategic implications for various business types under BCG in the corporate portfolio are:

Stars are products or businesses that are growing rapidly and are the best opportunity for expansion. *Stars may follow the Build* strategy. They need heavy investments to maintain their position and finance their rapid growth potential.

Cash Cows are low-growth, high market share businesses or products. They generate cash and have low costs. They are established, successful, and need less investment to maintain their market share. *A strategic alternative advocated for cash cows is Harvest.*

Question Marks are low market share businesses in high-growth markets. *A strategic option for them is Hold for which t*hey need heavy investments. Question marks if left unattended are capable of becoming cash traps.

Dogs are low-growth, low-share businesses and products. *The relevant strategy is Divest.* Dogs may generate enough cash to maintain themselves, but do not have much future. Dogs should be minimized by means of divestment or liquidation.

OR

Strategic alliances are formed if they provide an advantage to all the parties in the alliance. These advantages can be broadly categorised as follows:

(i) **Organizational:** Strategic alliances may be formed to learn necessary skills and obtain certain capabilities from the strategic partner. Strategic partners may also help to enhance productive capacity, provide a distribution system, or extend supply chain. A strategic partner may provide a good or service that complements each other, thereby creating a synergy. If one partner is relatively new or untried in a certain industry, having a strategic partner who is well-known and respected will help add legitimacy and creditability to the venture.

(ii) **Economic:** Alliances can reduce costs and risks by distributing them across the members of the alliance. Partners can obtain greater economies of scale in an alliance, as production volume increases, causing the cost per unit to decline. Finally, partners can take advantage of co-specialization, where specializations are bundled together, creating additional value.

(iii) **Strategic:** Organizations may join to cooperate instead of competing. Alliances may also create vertical integration where partners are part of the supply chain. Strategic alliances may also be useful to create a competitive advantage by the pooling of resources and skills. This may also help with future business opportunities and the development of new products and technologies. Strategic alliances may also be used to get access to new technologies or to pursue joint research and development.

(iv) **Political:** Sometimes there is need to form a strategic alliance with a local foreign business to gain entry into a foreign market either because of local prejudices or legal barriers to entry. Forming strategic alliances with politically influential partners may also help improve overall influence and position.