Paper 15 - Business Strategy and Strategic Cost Management

This paper contains 4 questions. All questions are compulsory, subject to instruction provided against each questions. All workings must form part of your answer. Assumptions, if any, must be clearly indicated.

Full Marks: 100 **Time allowed: 3 hours**

1. **Read the case and answer the following questions**

In 2006-07 PTC Food division decided to enter the fast growing (20-30% annually) snacks segment, an altogether new to it. It had only one national competitor-Trepsico's Trito. After a year its wafer snack brand Ringo, fetched 20% market share across the country. Ringo's introduction coincided with the cricket world cup. The wafer snacks market is estimated to be around ₹ 250 crores.

The company could take the advantage of its existing distribution network and also source potatoes from farmers easily. Before the PTC could enter the market a cross-functional team made a customer survey through a marketing research group in 14 cities of the country to know about the snacks eating habits of people. The result showed that the customers within the age-group of 15-24 years were the most promising for the product as they were quite enthusiastic about experimenting new snack taste. The company reported to its chefs and the chefs came out with 16 flavours with varying tastes suiting to the target age-group.

The company decided to target the youngsters as primary target on the assumption that once they are lured in, it was easier to reach the whole family.

Advertising in this category was extremely crowded. Every week two-three local products in new names were launched, sometimes with similar names. To break through this clutter the company decided to bank upon humour appeal.

The Industry sources reveal that PTC spent about ₹ 50 crores on advertisement and used all possible media print and electronic, both including the creation of its own website, Ringoringoyoungo.com with offers of online games, contests etc. Mobile phone tone downloading was also planned which proved very effective among teenagers. The site was advertised on all dotcom networks. Em TV, Shine TV, Bee TV and other important channels were also used for its advertisement along with FM radio channels in about 60 cities with large hoardings at strategic places.

Analysts believes that Ringo's success story owes a lot to PTC's widespread distribution channels and aggressive advertisements. Humour appeal was a big success. The 'Ringo' was made visible by painting the Railway bogies passing across the States. It has also been successful to induce Lovely Brothers' Future Group to replace Trito in their Big-Bazaar and chain of food Bazaars. PTC is paying 4% higher margin than Trepsico to Future group and other retailers.

Ringo to giving Trepsico a run for its money. Trito's share has already been reduced considerably. Retail tie-ups, regional flavours, regional humour appeals have helped PTC. But PTC still wants a bigger share in the market and in foreign markets also, if possible.

Required:

(i) Define SWOT Analysis.
(ii) Explain the strength of PTC.
(iii) Describe the weaknesses of PTC for entering into the branded snacks market.
(iv) Discuss different kind of marketing strategy was formulated and implemented for Ringo.
(v) What else need to be done by Ringo so as to enlarge its market? [4+4+4+4+4]

2. **Answer any two questions from (a), (b) and (c): [2 x 15 =30]**

(a)
(i) Discuss the Simultaneous and Sequential games

(ii) List any eight advantages and any four disadvantages of the Global Strategic Alliance.
(iii) Difference between Policy and Strategy. [5+6+4]

(b)
(i) Discuss different types of Value Chain Activities.
(ii) Mention any eight qualities of Strategic Leaders. [7+8]

(c)
(i) "The various PEST Analysis factors that a firm needs to consider and research in order to enter the restaurant business." – Discuss the various factors.
(ii) List the steps of implementing of Strategy.
(iii) Distinguish between Concentric Diversification and Conglomerate Diversification.
[8+3+4]

3. Read the case and answer the following questions.

The Northern Division of Steel Craft and Furnishings makes and sells tables and beds. The following estimated revenue and cost information from the division's activity-based costing system is available for 2014.

	4,000 Tables (₹)	5,000 Beds (₹)	Total (₹)
Revenues (₹ 1,250 x 4,000; ₹ 2,000 x 5,000)	50,00,000	1,00,00,000	1,50,00,000
Variable direct materials and direct manufacturing labor costs (₹ 750 x 4,000; ₹ 1,050 x 5,000)	30,00,000	52,50,000	82,50,000
Depreciation on equipment used exclusively by each product line	4,20,000	5,80,000	10,00,000
Marketing and distribution costs ₹ 4,00,000 (fixed) + ₹ 7,500 per consignment x 40 consignments ₹ 6,00,000 (fixed) + ₹ 7,500 per consignment x 100 consignments	7,00,000	13,50,000	20,50,000
Fixed general administration costs of the division allocated to product lines on the basis of revenues	11,00,000	22,00,000	33,00,000
Allocated corporate-office costs allocated to product lines on the basis of revenues	5,00,000	10,00,000	15,00,000
Total costs	57,20,000	1,03,80,000	1,61,00,000
Operating income (loss)	(7,20,000)	(3,80,000)	(11,00,000)

Additional information includes:

- On January 1, 2014, the equipment has a book value of ₹ 10,00,000 and zero disposal value. Any equipment not used will remain idle.
- Fixed marketing and distribution costs of a product line can be avoided if the line is discontinued.
- Fixed general administration costs of the division and corporate-office costs will not change if sales of individual product lines are increased or decreased or if product lines are added or dropped.

(i) On the basis of financial considerations alone, should the Northern Division discontinue the table's product line, assuming the released facilities remain idle? Show your calculations.

(ii) What would be the effect on Northern Division's operating income if it were to sell 4,000 more tables? Assume that to do so the division would have to acquire additional equipment costing ₹ 4,20,000 with a one-year useful life and zero terminal disposal value. Assume further that the fixed marketing and distribution costs would not change but that the number of consignments would double. Show your calculations.

(iii) Suppose Steel Craft has the opportunity to open another division, the Southern Division, whose revenues and costs are expected to be identical to the Northern Division's revenues and costs (including a cost of ₹ 10,00,000 to acquire equipment with a one-year useful life and zero terminal disposal value). Opening the new division will have no effect on corporate office costs. Should Steel Craft open the Southern Division? Show your calculations.

(iv) Given the Northern Division's expected operating loss of ₹ 11,00,000, should Steel Craft and Furnishings shut it down? Assume that shutting down the Northern Division will have no effect on corporate-office costs but will lead to savings of all general administration costs of the division. Show your calculations.

(v) Suppose the manager at corporate headquarters responsible for making the decision of whether to shut down the Northern Division will be evaluated in 2014 on the Northern Division's operating income after allocating' corporate-office costs. Will the manager prefer to shut down the division? Is the decision model consistent with the performance evaluation model? Explain. [(2+2)+3+(3+2)+3+(3+2)]

4. Answer any two questions from (a), (b) and (c): [2×15=30 marks]

(a)

(i) The data of running costs per year and resale price of equipment A whose purchase price is ₹2,00,000 are as follows:

Year-	I	II	III	IV	V	VI	VII
Running cost (₹ '000)	30	38	46	58	75	90	110
Resale value (₹ '000)	100	50	25	12	8	8	8

I. What is the optimum period for replacement?

II. When equipment A's age is two years old, equipment B which is a new model for the same usage is available. The optimum period for replacement is 4 years with an average cost of ₹ 72,000. Should equipment A be changed with equipment B? If so, in which year it will be replaced? [3+1+3]

(ii) Discuss the role of a Firm's suppliers in its Value Engineering or Cost Reduction drive. [4]

(iii) Fit straight line by the least square method to the following figures of production of Sugar Factory. Estimate the production for the year 2015.

Year	2008	2009	2010	2011	2012	2013	2014
Production(in Lakh tons)	76	87	95	81	91	96	90

[4]

(b)

(i) Distinguish between Cost Reduction and Cost Management. [3]

(ii) Hazra Ltd presently has its inventory turnover (based on Cost of Goods Sold ÷ Average Inventory) at 10 times p.a., as compared with the industry average of 4. Average Sales are ₹4,50,000 p.a. Variable Cost of Sales are 70% of Sales and Fixed Costs are ₹10,000 per annum. Carrying Costs of inventory (excluding financing costs) are 5% per annum. Sales force complained that low inventory levels are resulting in lost sales due to Stock-outs. The Sales Manager has made an estimate based on stock-out reports as under –

Inventory Policy	**Inventory Turnover**	**Sales**
Current	10	₹4,50,000
A	8	₹5,00,000
B	6	₹5,40,000
C	4	₹5,70,000

On the basis of the above estimates and assuming a 40% tax rate and an after-tax required return of 20% on investment in inventory, which policy would you recommend? [6]

(iii) A Factory manufactured a Tape Recorder , the estimated costs of which are as follows:

Direct Material	₹20 each
Direct wages	10 hours at Re.1.00 per hour
Overhead absorption Rate	₹2.00 per hour.(50% fixed overhead included)

During this period, 10,000 units will be produced and sold as follows:-

9,000 units of first at	₹60 each
500 units of second at	₹50 each
500 units of third at	₹30 each

Present information to management showing the loss due to the production of inferior units.

By reprocessing the inferior units, taking the full re-processing time of a further 3 hours and adding further materials, costing ₹14 per unit, these 'seconds' and 'thirds' can be converted into 'firsts'

Present information to the management. [6]

(c)

(i) HN Ltd., has a productive capacity of 2,00,000 units of product BXE per annum. The company estimated its normal capacity utilisation at 90% for 2013-14. The variable costs are ₹22 per unit and the fixed factory overheads were budgeted at ₹7,20,000 per annum. The variable selling overheads amounted to ₹6 per unit and the fixed selling expenses were budgeted at ₹5,04,000. The operating data for 2013- 14 are as under:

Production	1,60,000 units
Sales @ ₹38 per unit	1,50,000 units
Opening stock of finished goods	10,000 units

The cost analysis revealed an excess spending of variable factory overheads to the extent of ₹80,000. There are no variances in respect of other items of cost.

Required:

I. Determine the budgeted break-even point for 2013-14

II. What increase in price would have been necessary to achieve the budgeted profit?

III. Present statements of profitability for 2013-14 using:

- Marginal costing basis.
- Absorption costing basis. [2+2+3+3]

(ii) Distinguish between PERT (Program Evaluation and Review Technique) and CPM (Critical Path Management). [5]