Paper 15 - Business Strategy and Strategic Cost Management

Section A

Question No. 1 & 2 are compulsory. Answer any two questions from the rest.

1. Agrico Ltd. was in chemical, fertiliser and pesticide business since 2005. The company had reasonable earnings till 2010. For the next 3 years, sales in all the divisions went on declining and by 2013, the company was in the red. The Managing Director was thinking of internal benchmarking as a possible way out. A senior executive suggested that functional benchmarking would be more appropriate. The Finance Manager was of the view that the problem was that of economic recession in the relevant product lines. The M.D. was unable to decide on the matter.

(a) What is benchmarking? Discuss different type of benchmarking with their appropriate uses. **[10]**

(b) Suggest the most suitable benchmarking for Agrico Ltd. with justification. **[5]**

2. Fifty years ago, the typical automobile manufacturing companies purchased most of their parts from other manufacturers. They did little more than assemble the parts into complete automobiles. Currently many manufacturers of automobiles, large ones mainly, manufacture 75 to 80 p.c. of the parts that go into a typical automobile.

(a) Discuss what kind of business strategy the company is taking.

(b) What are the advantages and disadvantages of the said strategy?

(c) Give possible reasons underlying this shift towards more integrated production. **[3 + 6 + 6]**

3. (a) Distinguish between 'Strategy' and 'Policy'. **[3]**

(b) Explain the significance of Strategy Evaluation. **[3]**

(c) What are the problems of strategy evaluation? **[4]**

4. (a) What do you understand by "Corporate Restructuring"? What are the different Corporate Level Restructuring Strategies? **[5]**

(b) "Differentiation Strategy is not without pitfalls". — Identify the common pitfalls. **[5]**

5. (a) Discuss how a firm can create and sustain 'Competitive Advantage'. **[6]**

(b) Successful pursuit of competitive advantage requires an understanding of the 'industrial value chain'. — Discuss. **[4]**

Section B

Question No. 6 is compulsory. Answer any two questions from the rest.

6. Five lathes are to be allotted to five operators. The weekly output figures are given below:

Operator	Weekly output in lathes				
	L1	L2	L3	L4	L5
P	20	22	27	32	36
Q	19	23	29	34	40

R	23	28	35	39	34
S	21	24	31	37	42
T	24	28	31	36	41

Profit per piece is ₹ 25. Find the maximum profit per week. **[10]**

7. **(a)** Vijay is the Manager of the athletic shoe division of Action Shoes. Action Shoes is a company that has just purchased Relaxo, a leading shoe company. Relaxo has long term production contracts with suppliers in two states, Uttar Pradesh and Bihar. Vijay receives a request from Anil, president of Action Shoes. Vijay and his controller, Mohan are to make a presentation to next Board of Directors meeting on the cost competitiveness of the Relaxo. This report should include budgeted and actual procurement costs for 2011 at its Uttar Pradesh and Bihar supply sources.

Mohan decide to visit the two supply operations. The budgeted average procurement cost for 2011 was ₹ 120 per pair of shoes. This cost includes payment to the shoe manufacturer and all other payments to conduct business in each state. Mohan reports the following to Vijay:

- Uttar Pradesh. Total 2011 procurement costs for 2,50,000 pairs of shoes were ₹ 3,32,50,000. Payment to the shoe manufacturer was ₹ 2,65,00,000. Very few receipts existed for the remaining ₹ 67,50,000. Kickback payments are viewed as common in Uttar Pradesh.
- Bihar. Total 2011 procurement costs for 9,00,000 pairs of shoes were ₹ 10,48,50,000. Payment to the shoe manufacturer were ₹ 8,64,00,000. Receipts existed for ₹ 70,50,000 of the other costs, but Mohan said he is skeptical of their validity. Kickback payments are a "Way of Business" in Bihar.

At both Uttar Pradesh and Bihar plants, Mohan was disturbed by the employment of young children (Many of them younger than 15 years). He was told that all major shoe-producing companies had similar low-cost employment practices in both states.

Vijay is uncomfortable about the upcoming presentation to the board. He was a leading advocate of the acquisition. A recent business magazine reported that Relaxo acquisition would make Action Shoes the global low-cost producer in its market lines. The stock price of Action Shoes jumped 21% the day Relaxo acquisition was announced. Mohan likewise is widely identified as a proponent of the acquisition. He is seen as a "rising star" due for a promotion to a division manager in the near future.

Required:

(i) What summary procurement cost variances could be reported to the Board of Directors of Action Shoes?

(ii) What ethical issues do (a) Vijay and (b) Mohan faces when preparing and making a report to the Board of Directors?

(iii) How should Mohan address the issues you identify in requirement (ii)? **[4+4+4=12]**

(b) A manufacturing concern has a multi-purpose plant capable of operating at full capacity at 5,000 machine hours per month. It may produces three products inter-changeably, for which the output and cost details are as follows-

Product	Output per machine hour	Material Costs
A	500 units	₹ 42.50 per 1,000 units
B	250 units	₹ 17.50 per 1,000 units
C	1,000 units	₹ 30.00 per 1,000 units

Labour Cost is ₹ 15 per machine hour while Variable Overheads will be ₹ 5 per machine hour.
The Fixed Costs of this department is ₹ 1,00,000 per monthly production period

The Company estimates from past experience that the full capacity can be used at all times if machine time can be freely moved from one product to another as dictated by demand and is anxious to establish suitable product selling prices (per 1,000 units). The three price fixing methods under consideration are:

- To fix prices at product cost plus 20%
- To fix prices so as to give a contribution of ₹ 35 per machine hour
- To fix prices arbitrarily (per 1,000 units) as Product A- ₹150, Product B- ₹ 230 and Product C- ₹ 90.

Prepare a comparative statement of prices that would be charged under the three methods. Suggest which method should be adopted. **[6+2]**

8. (a) What are the pre-requisites for successful Benchmarking? **[4]**

(b) ABC Ltd. is a small Company manufacturing a lathe attachment for the Turett Lathe market. The data for manufactures attachment are as follows -

(For each Batch of 10 Turett Lathes)

Component	A	B	C	D	E	Total
Machine Hours	10	14	12			36
Labour Hours				2	1	3
	₹	₹	₹	₹	₹	₹
Variable Cost	32	54	58	12	4	160
Fixed Cost (apportioned)	48	102	116	24	26	316
Total Component Costs	80	156	174	36	30	476

Assembly costs (all variables) ₹ 40 per 10. Selling Price ₹ 600 per 10.

General-purpose machinery is used to make components A, B, C and is already working to the maximum capability of 4,752 hours and there is no possibility of increasing the machine capacity in the next period. There is labour available for making components D and E and for assembling the product.

The Marketing Department advises that there will be 50% increase in demand in the next period so the Company has decided to buy one of the machine-made components from an outside supplier in order to release production capacity and thus help to satisfy demand.

A quotation has been received from XYZ Ltd for the components, but because this Company has not made the components before, it has not been able to give single figure prices, its quotation is as follows –

Component	Pessimistic		Most Likely		Optimistic	
	Price	Probability	Price	Probability	Price	Probability
A	96	0.25	85	0.5	54	0.25
B	176	0.25	158	0.5	148	0.25
C	149	0.25	127	0.5	97	0.25

It has been agreed between the two companies that audited figures would be used to determine which one of the three prices would be charged for whatever component is brought out.

Required:

(i) Show in percentage form - the maximum increased production availability from the three alternatives, i.e. buying A or B or C.

(ii) Analyse the financial implications of the purchase and assuming a risk neutral attitude, recommend which component to buy out, noting that the production availability will be limited to a 50% increase.

(iii) Prepare a profit statement for the period assuming that the component chosen in (ii) is bought out and that the extra production is made and sold. **[4+5+4=13]**

(c) Explain how the PRAISE process can be smoothly implemented. **[3]**

9. **(a)** The following were the expenses incurred by a company in operating two lorries (for the conveyance of Raw Material) and a bus (for the conveyance of staff) during a selected months.

(₹)

Particulars	**Monthly Cost**		
	Lorry A	**Lorry B**	**Bus**
Driver's salaries	110	115	120
Cleaner's wages	120	120	60
Petrol	170	240	110
Oil	18	25	20
Repairs	150	150	100
Depreciation	330	220	350
Supervision	70	70	70
Garage overhead	130	110	75
Road and other tax	35	40	20
Other overhead expenses	45	45	30

The above vehicles carried the following Raw Materials and Passengers during the Month:

Lorry A	100 tonnes of raw material
Lorry B	120 tonnes of raw material
Bus	25 Passengers daily for 25 days.

At the same time their respective mileage during the same period were:

Lorry A	3,000
Lorry B	4,500
Bus	2,000

From the above statistics prepare an operating cost sheet in summary for the three vehicles. Also calculate the cost per tonne or passenger miles. **[8+2]**

(b) AML Ltd. is engaged in production of three types of ice-cream products: Coco, Strawberry and Vanilla. The Company presently sells 50,000 units of Coco at ₹ 25 per unit, Strawberry 20,000 units at ₹ 20 per unit and Vanilla 60,000 units at ₹ 15 per unit. The demand is sensitive to selling price, and it has been observed that every reduction of ₹1 per unit in selling price increases the demand for each product by 10% to the previous level. The Company has the production capacity of 60,500 units of Coco, 24,200 units of Strawberry and 72,600 units of Vanilla. The Company marks up 25% on cost of the product.
The Company management decides to apply ABC Analysis. For this purpose, it identifies four activities and the rate as follows:

Activity	Cost Rate
Ordering	₹800 per purchase order
Delivery	₹700 per Delivery
Shelf Stocking	₹199 per Hour

Customer Support and Assistance	₹1.10 p.u.sold

The other relevant information for the product are as follows:

Particulars	Coco	Strawberry	Vanilla
Direct material p.u. (₹)	8	6	5
Direct Labour p.u.(₹)	5	4	3
No. of purchase orders	35	30	15
No. of deliveries	112	66	48
Shelf Stocking Hours	130	150	160

Under the traditional costing system, store support costs are charged at 30% of prime cost. In ABC these costs are coming under Customer Support and Assistance.

Required:

(i) Calculate Target Cost for each product after a reduction of selling price required to achieve the sales equal to the production capacity.

(ii) Calculate the total cost and unit cost of each product at the maximum level using Traditional Costing.

(iii) Calculate the total cost and unit cost of each product at the maximum level using Activity Based Costing.

(iv) Compare the cost of each product calculated in (i) and (ii) with (iii) and comment on it.

[2+2+3+3=10]