Paper – 15: Business Strategy & Strategic Cost Management

Time Allowed: 3 Hours **Full Marks: 100**

Whenever necessary, suitable assumptions should be made and indicate in answer by the candidates.

Working Notes should be part of your answer

(Section A)

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

Question 1.

The formation of Delta Pride Catfish in 1981 is an example of the power that a group of suppliers can attain if they exercise the threat of forward integration. Catfish farmers had historically supplied their harvest to processing plants run by large agribusiness firms such as ConAgra and Farm Fresh. When the farmers increased their production of catfish in response to growing demand, they found that processors were holding back on their plans to increase their processing capabilities in hopes of higher retail prices for catfish. Delta Pride responded by forming a cooperative and constructing their own processing plant, which they supplied them-selves. Within two years, ConAgra's market share had dropped from 35 percent to 11 percent and Farm Fresh's market share fall by over 20 percent.

Answer the following questions:

(a) "Strategic business manager seeking to develop an edge over rival firms can use Porter's five forces model to better understand the industry" — State the industry characteristics for which the intensity of rivalry is influenced. [10]

(b) Describe the actions, which can be taken by the Delta Pride Catfish in order to make them a powerful supplier. [5]

Question 2.

Industrial Credit & Investment Corporation of India (ICICI) was formed in 1955 by the initiative of the World Bank, the Government of India and representatives of Indian industry. In the 1990s, ICICI transformed its business from a development financial institution offering only project finance to a diversified financial services group offering a wide variety of products and services, both directly and through a number of subsidiaries and affiliates like ICICI Bank. Due to the changing business environment and after the adoption of liberalization, ICICI considered various corporate restructuring alternatives in the context of the emerging competitive scenario in the Indian banking industry. The managements of ICICI and ICICI Bank formed the view that the merger of ICICI with ICICI Bank would be the optimal strategic alternative for both the entities. Consequently, ICICI Bank was promoted in 1994 by ICICI Limited, an Indian financial institution, and was its wholly-owned subsidiary. In October 2001, the Board of Directors of ICICI and ICICI Bank approved the merger of ICICI and two of its wholly-owned retail finance subsidiaries, ICICI Personal Financial Services Limited and ICICI Capital Services Limited, with ICICI Bank. The below mentioned table gives details of all the mergers and amalgamations done by ICICI Bank.

Mergers by ICICI Bank Ltd. in India S. No.	Mergers by ICICI Bank Ltd. in India	Year of Merger

1.	SCICI	1996
2.	ITC Classic Finance Ltd.	1997
3	Anagram Finance	1998
4.	Bank of Madura Ltd.	2001
5.	ICICI Personal Financial Services Ltd	2002
6.	ICICI Capital Services Ltd.	2002
7.	Standard Chartered Grindlays Bank	2002
8.	Sangli Bank Ltd.	2007
9.	The Bank of Rajasthan Ltd. (BoR)	2010

Answer the following questions:

(a) Describe the various issues which are to be dealt with in Mergers. [4]

(b) There are three types of Merger. One of them is Conglomerate Merger. What is Conglomerate Merger? Describe the different types of Conglomerate Merger. State the reasons of Conglomerate Merger. Also state the benefits of the Conglomerate Merger. [2+3+1+1]

(c) What are the factors to be considered in case of merger and acquisition at pre-merger stage? What type of conclusion you can draw from the above case of merger of ICICI Bank? [2+2]

Question 3.

"An analysis of the strengths, weaknesses, opportunities and threats (SWOT) is very much essential for the business policy formulation." — How SWOT Matrix is used in the context of SWOT Analysis? State all the possible strategies which can be derived from the SWOT Matrix. Also state the criticisms which are associated with the SWOT Matrix. [3+4+3]

Question 4.

"BCG Growth-Share Matrix is developed to analyze the problem of resource deployment among the business units or products of multi-business firms." — Describe BCG Growth-Share Matrix on the basis of the significance of its four cells – Stars, Question Marks, Cash Cows and Dogs. List out the problems which can be found in using this matrix. [6+4]

Question 5.

(a) Write about the four perspectives of Balanced Scorecard. [4]

(b) What is Strategic Planning? State the features of Strategic Planning. Also state the usefulness of Strategic Planning. [1+2+3]

(Section-B)

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

Question 6.

(a) ABC Ltd. supports the concept of Life Cycle Costing for new investment decisions covering its engineering activities. The final side of this philosophy is now well established and its principles extended to all other areas of decision-making.

The company is to replace a number of its machines and the Production Manager is torn between the Exe Machine, a more expensive machine with a life of 12 years, and the Wye machine with an estimated life of 6 years. If the Wye machines chosen it is likely that it would be replaced at the end of 6 years by another Wye machine. The pattern of maintenance and running costs differs between the two types of machine and relevant data are shown below.

	Exe	**Wye**
Purchase price	₹19,000	₹13,000
Trade – in value	3,000	3,000
Annual repair costs	2,000	2,600
Overhaul costs	(at year 8) 4,000	(at year 4) 2,000
Estimated financing costs averaged over machine life	10% p.a.	10% p.a.

You are required to:

Recommend, with supporting figures, which machine to purchase, stating any assumptions made. [6]

(b) List out the benefits of Business Process Outsourcing. [4]

Question 7.

(a) The performance of Company at two levels of operations during a financial year is as under –

Capacity utilization	**50%**	**60%**
Direct Materials	₹ 1,00,000	₹ 1,20,000
Direct Wages	₹ 1,60,000	₹ 1,92,000
Production Overheads	₹ 6,00,000	₹ 6,50,000
Administration Overheads	₹ 1,20,000	₹ 1,20,000
Selling Overheads	₹ 2,20,000	₹ 2,40,000

The Company produced 12,000 units at 60% capacity utilization. The profit margin is 20% on sales.

During the next financial year, the Company is poised for increasing the capacity utilization to 75%. The Company desires to have the same profit margin as in the last financial year. The following percentage changes in costs are expected to be applicable in the next year.

- Direct Material prices will increase by 5%
- Direct Wage rates will increase by 3%
- Direct Labour efficiency will fall by 4%
- Variable Production Overheads will increase by 6%
- Fixed Production Overheads will increase by 10% up to 80% capacity utilization and by 22% thereafter.
- Variable Selling Expenses will increase by 10%.
- Fixed Selling Expenses will increase by 8%.
- Administrative Overheads will increase by 15%.

The Company expects to receive an export order for 3,000 units while operating at 75% capacity utilization. The anticipated export price offer is ₹ 92 per unit.

Required:

- Prepare a flexible budget for the next year and determine the cost per unit of output at the capacity utilization levels of 75% and 90%.
- Calculate the sales value and profit for the next year at 75% capacity.

- Advise Management as to whether or not the export orders at the price of ₹ 92 per unit should be accepted. [4+1+1+2+2=10]

(b) A Company using a detailed system of standard costing finds that the cost of investigation of variances is ₹ 20,000. If after investigation an out of control situation is discovered, the cost of correction is ₹ 30,000. If no investigation is made, the present value of extra cost involved is ₹ 1,50,000. The probability of the process being in control is 0.82 and the probability of the processes being out of control is 0.18. You are required to advice:
(i) Whether investigation of the variances should be undertaken or not;
(ii) The probability at which it is desirable to institute investigation into variances. [3+4]

(c) XYZ Ltd. has been approached by a customer who would like a special job to be done for him, who is willing to pay ₹ 22,000 for it. The job would require the following materials.

Material	Total units required	Units already in stock	Book value of units in stock	Realizable Value	Replacement Cost
P	1,000	0	-	-	₹ 6 p.u
Q	1,000	600	₹ 2 p.u	₹ 2.50 p.u	₹ 5 p.u
R	1,000	700	₹ 3 p.u	₹ 2.50 p.u	₹ 4 p.u
S	200	200	₹ 4 p.u	₹ 6.00 p.u	₹ 9 p.u

Material Q is used regularly by XYZ Ltd. and if units of Q are required for this job, they would need to be replaced to meet other production demand.
Material R and S are in stock as the result of previous over – buying and they have a restricted use. No other use could be found from material R, but the units of material S could be used in another job as substitute for 300 units of material T, which currently costs ₹ 5 per unit (of which the Company has no units in stock at the moment).Compute the Relevant Cost of Materials. [3]

Question 8.
(a) State the reasons for implementation of Enterprise Resource Planning (ERP). [5]

(b) A Company has two Divisions, viz., LD and KD. LD operates at full capacity and KD operates at 50% capacity.
LD produces two products, LX and LY using the same labour force for each product. The direct wage rate per production hour is ₹ 5. During the next year, its budgeted capacity of 42,000 direct labour hours involves a commitment to sell 6,000 kg. of LY. The balance capacity will be used for the production of LX. Cost data are:

	LX ₹/Kg	LY ₹/Kg
Direct materials	36	28
Direct wages	30	20

The Company's overheads amount to ₹ 7,56,000 per annum relating to LX and LY in proportion to other direct wages. At full capacity ₹ 4,20,000 of this overhead is variable. LD prices its products with 50% mark-up on its total costs.
KD wishes to buy 2,000 kg. of LX from LD for being processed into KX to be sold at ₹ 300 per kg. The processing materials and wage cost are ₹ 30 per kg. and the variable overheads amount to ₹ 4 per kg. The fixed costs amount to ₹ 1,00,000 per annum.

Prepare a report showing the profitability of LD and KD and the Company as a whole for each of the following transfer price methods:
(i) LD transfers LX at a price applicable to outside customers on the basis of total cost.
(ii) LD transfers LX at a price based on total costs less credit for selling and distribution

expenses of ₹ 4 per kg. which will not be incurred in respect of the sale of KD.

(iii) LD transfers LX at a price based on marginal cost as reduced by ₹ 4 per kg. of selling and distribution expenses.

(iv) LD manufactures the quantity of LX required by KD by employing overtime payable at double the normal wage rate and transfers at marginal cost less ₹ 4 per kg. being selling and distribution costs not incurred in respect of sale to KD. LD sells the entire regular production to outside customers at the usual price. [3+3+3+3+3=15]

Question 9.

(a) You are the management accountant of publishing and printing company which has been asked to quote for the production of programme for the local village fair. The work would be carried out in addition to the normal work of the company. Because of existing commitments, some weekend working would be required to complete the printing of the programme. A Trainee Accountant has produced the following cost estimate based upon the resources required as specified by the production manager:

Direct material	- Paper (book value)	₹ 5,000
	- Inks (purchase price)	2,400
Direct labour	- Skilled 250 hours @ ₹ 4.00	1,000
	- Unskilled 100 hours @ ₹ 3.50	350
Variable overhead	350 hours @ ₹ 4.00	1,400
Printing press depreciation	200 hours @ ₹ 2.50	500
Fixed production costs	350 hours @ ₹ 6.00	2,100
Estimating department cost		400
		13,150

You are aware that considerable publicity could be obtained for the company if you are able to win this order and the price quoted must be very competitive.

The following notes are relevant to the cost estimate above:

(i) The paper to be used is currently in stock at a value of ₹ 5,000. It is of an unusual colour which has not been used for some time. The replacement price of the paper is ₹ 8,000, whilst the scrap value of that in stock is ₹ 2,500. The production manager does not foresee any alternative use for the paper if it is not used for the village fair programmes.

(ii) The inks required are not held in stock. They would have to be purchased in bulk at a cost of ₹ 3,000. 80% of the ink purchases would be used in printing the programmes. No other use in foreseen for the remainder.

(iii) Skilled direct labour is in short supply, and to accommodate the printing of the programmes. 50% of the time required would be worked at weekends for which a premium of 25% above the normal hourly rate is paid. The normal hourly rate is ₹ 4.00 per hour.

(iv) Unskilled labour is presently under-utilised, and at present 200 hours per week are recorded as idle time. If the printing work is carried out at a weekend, 25 unskilled hours would have to occur at this time, but the employees concerned would be given two hours time off (for which they would be paid) in lieu of each hour worked.

(v) Variable overhead represents the cost of operating the printing press and binding machines.

(vi) When not being used by the company, the printing press is hired to outside companies for ₹ 6.00 per hour. This earns a contribution of ₹ 3.00 per hour. There is unlimited demand for this facility.

(vii) Fixed production costs are those incurred by and absorbed into production, using an hourly rate based on budgeted activity.

(viii) The cost of the estimating department represents time spent in discussions with the village fair committee concerning the printing of its programme.

Requirements:

1. Prepare a revised cost estimate using the opportunity cost approach, showing clearly the minimum price that the company should accept for the order. Give reasons for each resources valuation in your cost estimate.
2. Explain why contribution theory is used as a basis for providing information relevant to decision making.
3. Explain the relevance of opportunity costs in decision-making. [3+2+2=7]

(b) A small project is composed of seven activities, whose time estimates are listed below. Activities are identified by their beginning (i) and ending (j) node numbers:

Activity	**Estimated durations (in days)**		
(i-j)	**Optimistic**	**Most likely**	**Pessimistic**
1-2	2	2	14
1-3	2	8	14
1-4	4	4	16
2-5	2	2	2
3-5	4	10	28
4-6	4	10	16
5-6	6	12	30

(i) Draw the project network.

(ii) Find the expected duration and variance for each activity, what is the expected project length?

(iii) If the project due date is 38 days, what is the probability of meeting the due date?

Given:

Z	0.50	0.67	1.00	1.33	2.00
P	0.3085	0.2514	0.1587	0.0918	0.0228

[4+1+1+2+2=10]

(c) Write two differences between Lean Accounting and Traditional Standard Costing. Where does Lean Accounting Apply? [2+1]