# Paper 15- Business Strategy & Strategic Cost Management

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

### Section - A

**Answer Question No. 1 which is compulsory and Carries 20 Marks.**

1. (a) "The process of Strategy formulation basically involves six main steps" – Explain these six steps. Discuss the relationship of soundness of strategy with the quality of implementation. [8]

(b) ABC Ltd. Initiated a quality improvement program at the beginning of the year. Efforts were made to reduce the number of defective units produced. By the end of the year, reports from the production manager revealed that scrap and rework had both decreased. Though pleased with the success, the President of the company wanted some assessment of the financial impact of the improvements. To make this assessment, the following financial data were collected for the current and preceding year: -

| | Preceding Year (2014-2015) | Current Year (2015-2016) |
|---|---|---|
| Sales | 1,00,00,000 | 1,00,00,000 |
| Scrap | 4,00,000 | 3,00,000 |
| Rework | 6,00,000 | 4,00,000 |
| Product inspection | 1,00,000 | 1,25,000 |
| Product warranty | 8,00,000 | 6,00,000 |
| Quality training | 40,000 | 80,000 |
| Materials inspection | 60,000 | 40,000 |

You are required to classify the costs as prevention, appraisal, internal failure, or external failure. [3]

(c) ABC Co. manufactures and sells 20,000 units of a product. The Full Cost per unit is ₹300. The Company has fixed its price so as to earn a 25% Return on Investment of ₹20,00,000. In response to competitive pressures, the Company must reduce the price to ₹310 next year, in order to achieve sales of 20,000 units. The Company also plans to reduce its investment to ₹18,00,000. If a 25% Return on Investment should be maintained, what is the Target Cost per unit for the next year? [3]

(d) Two similar products A and B, manufactured by a company for a production period have the following data:

| Particulars | Product A | Product B |
|---|---|---|
| Selling price(₹/unit) | 50 | 70 |
| Variable cost (₹/unit) | 30 | 40 |
| Labour hours per unit | 2 | 6 |

Total fixed costs that have to be incurred irrespective of the type of product amounts to ₹1,80,000. Besides, there are specific fixed costs of ₹60,000 to be incurred only if A is produced and ₹ 72,000 to be incurred only if B is produced. Assume no inventory. At present, 7,500 units of A and B are sold. Now, what is the current Break-Even point (BEP)? [3]

(e) What are the reasons for implementation of an ERP (Enterprise Resource Planning) package by the companies? [3]

## Section - B

**Answer any five questions from the following and each question carries 16 marks.**

**2. (a) Now –a-days, the multinational companies presume to follow either and International Strategy or Multi Domestic Strategy or Global Strategy or Transnational Strategy. Define each of them, with all their respective advantages and disadvantages.**

**(b) (i) Explain the relationship of synergy with strategic realignment in the context of merger.**

**(ii) What are the problems of strategy evaluation. [6+10]**

**3. (a) Enumerate the advantages of strategic planning.**

**(b) Define Strategic Drift. Describe how an organisation prevents strategic drift. [6+10]**

**4. (a) Critics of Nike often complain that it's shoes cost almost nothing to make, yet cost the consumer so much. Identify the strategic marketing planning steps which provide value that add to Nike's offering and result in the high price of Nike's shoes.**

**(b) Distinguish between Cost Reduction and Cost Management. [10 + 6]**

**5. (a) Dramatic cost advantages can emerge from finding innovative ways to restructure processes and tasks, cut frills and provide the basics more economically.**

**(i) List the primary ways by which companies can achieve a cost advantage by reconfiguring their value chains.**

**(ii) Explain the way a cost leadership strategy can help a firm in handling the five competitive forces. [8]**

**(b) An electro-mechanical equipment has a purchase price of ₹7,000. Its running costs per year and resale values are given here:**

| Year: | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 |
|---|---|---|---|---|---|---|---|---|
| Running Costs (₹) | 2,000 | 2,100 | 2,300 | 2,600 | 3,000 | 3,500 | 4,100 | 4,600 |
| Resale Value (₹) | 4,000 | 3,000 | 2,200 | 1,600 | 1,400 | 700 | 700 | 700 |

**At which year is the replacement due? [8]**

**6. (a) What is Product Life Costing? State its characteristics. Explain how an organisation would benefit from a Product Life-Cycle Costing exercise? [8]**

**(b) A businessman is considering taking over a certain new business. Based on past information and his own knowledge of the business, he works out the probability distribution of the monthly costs and sales revenues, as given here:**

| Cost (in ₹) | Probability | Sales Revenue (₹) | Probability |
|---|---|---|---|
| 17000 | 0.10 | 19000 | 0.10 |
| 18000 | 0.10 | 20000 | 0.10 |
| 19000 | 0.40 | 21000 | 0.20 |
| 20000 | 0.20 | 22000 | 0.40 |
| 21000 | 0.20 | 23000 | 0.15 |
| | | 24000 | 0.05 |

**Use the following sequences of random numbers to be used for estimating costs and revenues. Obtain the probability distribution of the monthly net revenue.**

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Sequence 1 | 82 | 84 | 28 | 82 | 36 | 92 | 73 | 91 | 63 | 29 | 82 |
| | 27 | 26 | 92 | 63 | 83 | 02 | 10 | 39 | 10 | 10 | 27 |
| Sequence 2 | 39 | 72 | 38 | 29 | 71 | 83 | 19 | 72 | 92 | 59 | 39 |
| | 49 | 39 | 72 | 94 | 04 | 92 | 72 | 18 | 09 | 00 | 49 |

**[8]**

7. (a) A manufacturer has an order for one lakh units. With his present equipment they cost 80 paise each to make and there is a 6% fraction defective. However, he may install special controls which together with their cost of development, cost ₹18,000. His variable cost per unit, then falls to 60 paise each; but the process may be less reliable. How much less reliable can the process be, before he should reject the special controls? [6]

(b) A manufacturing company produces a chemical product which passes through two processes factory and finishing. It has the capacity to process an input of 1,00,000 kgs. of raw material. Normal scrap will be 10% and 5% of input in factory and finishing processes respectively. The realisable value of such scrap is ₹4 and ₹8 per kg. respectively for factory and finishing processes to be credited against the cost of respective process. Relevant cost data for the coming year are:

| | Factory Process (₹) | Finishing Process (₹) |
|---|---|---|
| Direct wages | 6,00,000 | 5,50,000 |
| Overheads | 2,28,000 | 4,22,900 |

There are three possible sources of purchase of raw materials:

| Supplier | Purchase price per kg. (₹) | Maximum quantity |
|---|---|---|
| X | 5.00 | 60,000 kgs. |
| Y | 5.60 | 80,000 kgs. |
| Z | 5.30 | Provided entire quantity of 1,00,000 kgs is ordered, otherwise at ₹ 5.80 per kg. |

In each case the company is required to collect the raw materials from the godown of supplier.

Variable transport cost depends upon the distance involved. The same are as under:

| Supplier | X | Y | Z |
|---|---|---|---|
| Transport cost (per kg) | 30 paise | 25 paise | 25 paise |

Fixed transport cost would be ₹ 1,00,000 per annum irrespective of the supplier to be contracted.

The output of the finishing process can be sold to three prospective customers, their offer being as follows:

| Customer | Price per kg. Of output (₹) | Trade discount (%) | Conditions |
|---|---|---|---|
| A | 32.50 | 2 | Maximum quantity 40,000 kgs. |
| B | 32.00 | 2 | Maximum quantity 80,000 kgs. |
| C | 30.90 | --- | Provide the entire output is sold to him. |

In case of supplies to customers A and B, the fixed delivery costs will be ₹ 1,500 per month and the variable delivery costs will be 65 paise and 36 paise per kg. respectively.
Customer C will collect the entire output from the warehouse of the company.
You are required to indicate with reasonings:
(i) Choice of supplier with comparative cost tables.
(ii) Choice of customer with comparative tables of net realisations. [10]

8. (a) Chakra Ltd. manufactures Mixer Grinders. The manufacture involves an assembly of various parts which are processed in the machine shop and purchased components.

The on/off switch is presently being purchased from a vendor at ₹4.50 each, annual requirement being 20,000 pieces.

The production manager has put a proposal 2 months back to make the switch in the machine shop. He had suggested that the company will save profit and taxes on bought-out switch. The costing department was asked to make an estimate of making the item which showed that the cost of making was ₹4.73. The purchase department continued buying the item on the basis of the cost estimate given to them. Recently, the vendor has sent a letter requesting the purchase department to grant increase in price by 10% minimum per switch as the input costs had gone up. The costing department was once again requested to estimate cost of making the switch.

The costing department re-estimated the costs using current prices and observed that the cost of making has gone up to ₹5.33. Purchase department again decided to continue buying as it was cheaper to buy than make. The cost estimates prepared by costing department were as under:

| | Annual Costs | |
|---|---|---|
| | Previous ₹ | Current ₹ |
| Direct Materials | 40,000 | 48,000 |
| Direct Labour ₹2 per hour | 20,000 | 22,000 |
| Overheads at ₹3 per hour | 30,000 | 31,500, |
| Total cost | 90,000 | 1,01,500 |
| Add: Expected increase @ 5% | 4,500 | 5,075, |
| Expected manufacturing cost | 94,500 | 1,06,575 |
| Cost per piece | 4.73 | 5.33 |

Twenty five percent of the overheads are fixed.
Do you agree with the decision of buying considering the relevant costs? If the cost of making or buying is more or less same, what factors other than cost will influence the making decision? **[6]**

(b)

| | 31-3-2016 | 31-3-2017 |
|---|---|---|
| | ( ₹ In lakhs) | ( ₹ In lakhs) |
| Sales | 120 | 129.6 |
| Prime cost of sales | 80 | 91.1 |
| Variable Overheads | 20 | 24.0 |
| Fixed expenses | 15 | 18.5 |
| PROFIT | 5 | (4.0) |

During 2016-17, average prices increased over these of the previous years (1) 20% in case of sales (2) 15% in case of prime cost (3) 10% in case of Overheads.

Prepare a profit variance statement from the above data. **[10]**