PAPER – 15: Business Strategy and Strategic Cost Management

Paper – 15 : Business Strategy and Strategic Cost Management

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

Section A

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

1. **(a)** Distinguish between Strategy and Policy

Policy	Strategy
Policy is a statement of an organization's intention to act in certain ways in specific situation. It represents a general decision establishing a normal pattern of conduct.	Strategy is the determination of the basic long-term goals and objectives of an enterprise and the adoption of the courses of action and the allocation of resources necessary for carrying out these goals.
It is a guideline to the thinking of final decision.	It concerns with the direction in which resources applied.
It is contingent decision.	It is a rule for taking decision.
Since the policy is prescribed for the people so it can be delegated downward in the organization.	Since strategy requires last minute executive decisions so it cannot be delegated downward.

(b) (1) If the company accepts the Deluxe order, it will lose export sales due to shortage of materials.
(2) Contribution per unit ₹ 2 (SP 5 – MC 3)
(3) Contribution per Rupee 1 of material = ₹ 4 (on export sale)
(4) Each Deluxe model uses Rupee 1 worth of raw material.

The company must obtain a contribution of at least ₹ 4/unit – the opportunity cost of raw material.
The minimum price therefore would be: -

	₹
Direct material	1.0
Direct Labour	2.0
Variable Overhead	0.5
Required contribution	4.0
Selling price per unit	**7.5**

(c) Optimum order quantity = $\sqrt{\frac{2 \times 3000 \times 150}{10}}$ = 300units

Total relevant cost when quantity is 300 units.
Ordering cost + carrying cost = (3000 / 300) x 150 + (1/2 x 300 x 10) = ₹ 3,000

(d)

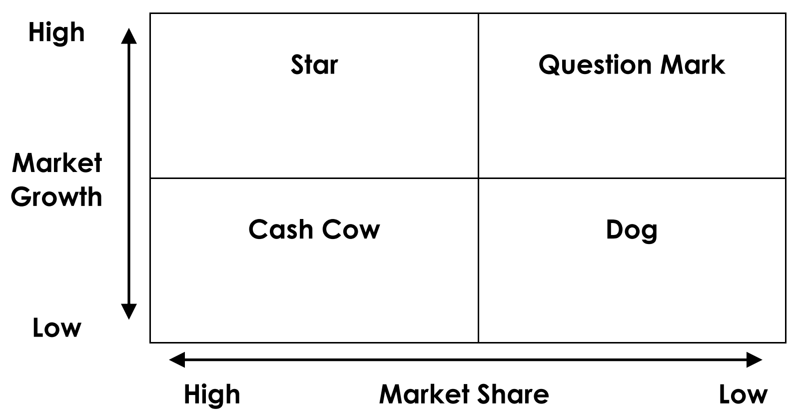
	₹
Cost of goods sold	8,00,000
(Less) Material cost	(3,60,000)
Conversion cost allocated	4,40,000
Conversion cost incurred	4,80,000
Excess charged to cost of goods sold account	40,000

Total debit on cost of goods sold account = ₹ 8,00,000 + ₹ 40,000 = ₹ 8,40,000.

(e) Total moves in material handling = 5+15=20
Percentage move for Product A = 5/20=25%
Material handling cost to be allocated to Product A = ₹ 60,000/25% = ₹15,000
i.e., ₹ 15,000/30 = ₹500 per unit.

Sec-B:
Answer any 5 Questions from the following.
Each Question carries 16 Marks

2. (a) The Boston Consulting Group (BCG) have developed a matrix, based on empirical research, which analyses products and businesses by market share and market growth. This growth/ share matrix for the classification of products into cash cows, rising stars and questions marks is known as the Boston classification.



(1) Stars are products with a high share of a high growth, market. In the short term, these require capital expenditure, possibly in excess of the cash they generate, in order to maintain their market position, but promise high returns in the future.

(2) In due course, however, stars will become **cash cows,** with a high share of a low-growth market. Cash cows need very little capital expenditure and generate high levels of cash income. The important strategic feature cash cows are that they are generating high cash returns, which can be used to finance the stars.

(3) A **question mark** (sometimes called **problem child)** is a product in a high growth market, but has a low market share. A decision needs to be taken about whether the product justifies considerable expenditure in the hope of increasing its market share, or whether it should be allowed to die quietly as it are squeezed out of the expanding market by rival products. Because, considerable expenditure would be needed to turn a question mark into a star by building up market share, question marks will usually be poor cash generators and show a negative cash flow.

(4) Dogs are products with a low share of a low growth market. They may be ex-cash cows that have now fallen on hard times. Dogs should be allowed to die or should be killed off. Although they will show only a modest net cash flow or even a modest cash inflow, they are cash traps which tie up funds and provide a poor return on investment, and not enough to achieve the organization's target rate of return.

(5) There are also **infants** (i.e. products in an early stage of development) and **warhorse** (i.e. products that have been cash cows in the past, and still are making acceptable sales and profits even now) and **dodos** (low share, negative growth, and negative cash flow).

(b) Limitations of Value Chain Analysis

The important drawbacks of value chain analysis are as follows:

- Finding the costs, revenues and assets for each value chain activity poses/gives rise to serious difficulties. There is no scientific approach and much depends upon trial and error and experimentation methods.
- Value chain analysis is not easily understandable to all employees and hence may face resistance from employees as well as managers.
- Internal data on costs, revenues and assets used for value chain analysis are derived from financial information of a single period. For long-term strategic decision-making changes in cost structures, market prices and capital investments etc. may not be readily available.
- Isolating cost drivers for each value creating activity, identifying value chain linkage across activities and computing supplier and customer profit margins present serious challenges.
- Identifying stages in an industry's value chain are limited by the ability to locate at least one firm that particulars in a specific stage.
- Value chain analysis is not an exact science. It is more an 'art' than preparing precise accounting reports. Certain judgment and factors of analysis are purely subjective and differ from person to person.

3. Strategic Alliance is an agreement for cooperation among two or more independent firms to work together toward common objectives. A Strategic Alliance is a relationship between two or more parties to pursue a set of agreed upon goals or to meet a critical business need while remaining independent organizations. This form of cooperation lies between mergers & acquisitions and organic growth.

Partners may provide the strategic alliance with resources such as products, distribution channels, manufacturing capability, project funding, capital equipment, knowledge, expertise or intellectual property.

There are four types of strategic alliances: joint venture, equity strategic alliance, non-equity strategic alliance and global strategic alliances.

Joint Venture: It is a strategic alliance in which two or more firms create a legally independent company to share some of their resources and capabilities to develop a competitive advantage.

Equity Strategic Alliance: It is an alliance in which two or more firms own different percentages of the company they have formed by combining some of their resources and capabilities to create a competitive advantage.

Non-Equity Strategic Alliance: It is an alliance in which two or more firms develop a contractual relationship to share some of their unique resources and capabilities to create a competitive advantage.

Global Strategic Alliances: Working partnership between companies (often more than two) across national boundaries and increasingly across industries, sometimes formed between company and a foreign government or among companies and governments.

Benefits of Strategic Alliance

Nowadays, strategic alliance has become a common strategy to businesses. Two or more enterprises choose to form a partnership and work cooperatively to achieve their mutually beneficial objectives.

In a plain view, strategic alliance just reflects the desire of enterprises to achieve their independent business objectives cooperatively. But, in the true fact of today's globalizes and complex market place, there is the need to make such a business arrangement in order to gain competitive advantages among the fierce competitors in the market place. Enterprises that enter into strategic alliance usually expect to benefit in one or more ways. Some of the potential benefits that enterprises could achieve are such as:

- **Gaining capabilities**
  An enterprise may want to produce something or to enquire certain resources that it lacks in the knowledge, technology and expertise. It may need to share those capabilities that the other firms have. Thus, strategic alliance is the opportunity for the enterprise to achieve its objectives in this aspect. Further to that, in later time the enterprise also could then use the newly acquired capabilities by itself and for its own purposes.
- **Easier access to target markets**
  Introducing the product into a new market can be complicated and costly. It may expose the enterprise to several obstacles such as entrench competition, hostile government regulations and additional operating complexity. There are also the risks of opportunity costs and direct financial losses due to improper assessment of the market situations. Choosing a strategic alliance as the entry mode will overcome some of those problems and help reduce the entry cost. For example, an enterprise can license a product to its alliance to widen the market of that particular product.
- **Sharing the financial risk**
  Enterprises can make use of the strategic arrangement to reduce their individual enterprise's financial risk. For example, when two firms jointly invested with equal share on a project, the greatest potential that each of them stand to lose is only half of the total project cost in case the venture failed.
- **Winning the political obstacle**
  Bringing a product into another country might confront the enterprise with political factors and strict regulations imposed by the national government. Some countries are politically restrictive while some are highly concerned about the influence of foreign firms on their economics that they require foreign enterprises to engage in the joint venture with local firms. In this circumstance, strategic alliance will enable enterprises to penetrate the local markets of the targeted country.
- **Achieving synergy and competitive advantage**
  Synergy and competitive advantage are elements that lead businesses to greater success. An enterprise may not be strong enough to attain these elements by itself, but it might possible by joint efforts with another enterprise. The combination of individual strengths will enable it to compete more effectively and achieve better than if it attempts on its own.

4. (a) The various PEST Analysis factors that a firm needs to consider and research in order to enter the restaurant business in a new environment may be depicted as follows:-

Political Factors:

- Government regulations regarding hygiene, health and food regulations, food standards, etc.
- Economic policies of government regarding the restaurant industry and running eating joints; these may include licenses, inspections by Health and Food Ministry departments, etc.

Economic Factors:

- Interest rate would impact the cost of capital, the rate of interest being directly proportionate to the cost of capital.

- Rate of inflation determines the rate of remuneration of employees and directly affects the price of the restaurant's products. Again, the proportion between the inflation rate and wages/prices is direct.
- Economic trends act as an indicator of the sustenance and profitability of your business in the chosen region and help you in deciding your marketing strategy.

Social Factors:

- Certain cultures abhor certain foods. For instance, Hindus will not eat beef and Muslims would not even touch pork. Therefore knowledge of these cultural facts about your business environment will help you decide whether or not you'll be able to do any business there.
- Eating habits of the people in your chosen business environment may, and certainly will, affect your marketing decisions.
- Ratio of people preferring to eat out regularly.

Technological Factors:

- A good technical infrastructure would lead to better production, procurement and distribution logistics, resulting in reduced wastage and lower costs.
- Sound technology may be a decisive factor for food technology innovation, better presentation, more effective business marketing, etc.

That was a sample PEST report. Hotel and food processing businesses would also have a similar PEST structure with some changes here and there. All in all, PEST analysis is a great way of getting to know the battlefield environment before you jump headlong into it.

(b) Strategic leadership is the ability of influencing others to voluntarily make decisions that enhance prospects for the organisation's long-term success while maintaining short-term financial stability. It includes determining the firm's strategic direction, aligning the firm's strategy with its culture, modeling and communicating high ethical standards, and initiating changes in the firm's strategy, when necessary. Strategic leadership sets the firm's direction by developing and communicating a vision of future and inspire organization members to move in that direction. Unlike strategic leadership, managerial leadership is generally concerned with the short-term, day-to-day activities.

Two basic approaches to leadership can be transformational leadership style and transactional leadership style.

Transformational leadership style use charisma and enthusiasm to inspire people to exert them for the good of the organization. Transformational leadership style may be appropriate in turbulent environments, in industries at the very start or end of their life-cycles, in poorly performing organizations when there is a need to inspire a company to embrace major changes. Transformational leaders offer excitement, vision, intellectual stimulation and personal satisfaction. They inspire involvement in a mission, giving followers a "dream" or "vision" of a higher calling so as to elicit more dramatic changes in organizational performance. Such a leadership motivates followers to do more than originally affected to do by stretching their abilities and increasing their self-confidence, and also promote innovation throughout the organization.

Whereas, **transactional leadership** style focus more on designing systems and controlling the organization's activities and are more likely to be associated with improving the current situation. Transactional leaders try to build on the existing culture and enhance current practices. Transactional leadership style uses the authority of its office to exchange rewards, such as pay and status. They prefer a more formalized approach to motivation, setting clear goals with explicit rewards or penalties for achievement or non-achievement. Transactional leadership style may be appropriate in settled environment, in growing or mature industries, and in organizations that are performing well. The style is better suited in persuading people to work efficiently and run operations smoothly.

5. (a) The basic difference between Strategic management and Strategic planning are as follows:

Strategic Management	**Strategic Planning**
It is focused on producing strategic results; new markets, new products, new technologies.	It is focused on making optimal strategic decisions.
It is management by results.	It is management by plans.
It is an organizational action process.	It is an analytical process.
It is broadens focus to include psychological, sociological and political variables.	It is focused on business, economic and technological variables.
It is about choosing things to do and also about the people who will do them.	It is about choosing things to do.

(b) (i) Statement showing profit of division A:

Sale per day(units)	Sale value	Cost	Profit/(loss)
	₹	₹	₹
1000	1,200	1,500	(300)
2000	2,400	2,400	-
3000	3,600	3,300	300
4000	4,800	4,200	600
5000	6,000	5,100	900
6000	7,200	6,000	1,200

Profit of division B:

No of units	Sales	Transfer price	Other manufacturing cost	Total cost	Profit/(loss)
	₹	₹	₹	₹	₹
1000	5,250	1,200	3,750	4,950	300
2000	7,960	2,400	4,500	6,900	1,060
3000	9,900	3,600	5,250	8,850	1,050
4000	11,120	4,800	6,000	10,800	320
5000	12,000	6,000	6,750	12,750	(750)
6000	12,060	7,200	7,500	14,700	(2,640)

(ii) Profitability of the company at the output level where division A's net profit is maximum :

	₹
Profit of division A at 6000units	1,200
Profit of division B at 6000units	(2,640)
Profit /(loss)	(1,440)
Division B's net profit is maximum:	
Profit of division A at 2000 units	-
Profit of division B at 2000units	1,060
	1,060

(c) When the company is not organized on profit centre basis

Profit at different levels of output

Units	Division A	Division B	Total
	₹	₹	₹
1000	(300)	300	-----
2000	-----	1,060	1,060
3000	300	1,050	1,350
4000	600	320	920
5000	900	(750)	150
6000	1,200	(2,640)	(1,440)

Best output level is 3000 units

6. (a) Balanced scorecard is a framework of financial and non financial measures that can be made ahead of the traditional financial measures. The four perspectives associated with it are as follows:

1. **Financial** — satisfying the stakeholders in the company - owners, employees, suppliers. The objectives of this perspective would be to achieve a certain level of profitability, or growth.
2. **Customer or Market** — satisfying the customers such that they buy product and services to support the financial perspective, e.g. increase customer satisfaction, introduce a new product.
3. **Internal Business Processes** — supporting the Financial and Customer perspectives through having appropriate and well operated processes or procedures e.g. the sales process, the product implementation process etc.
4. **Learning, Innovation and Growth** — supporting the Financial, Customer and Internal Business Process perspectives through having the ability to change, improve and innovate through the acquisition of new knowledge, skills and technology.

(b)

	Inter-arrival time				Service time		
Minutes	Probability	Cumulative probability	Range	Minutes	Probability	Cumulative probability	Range
2	.22	.22	00-21	4	.28	.28	00-27
4	.30	.52	22-51	6	.40	.68	28-67
6	.24	.76	52-75	8	.22	.90	68-89
8	.14	.90	76-89	10	.10	1.00	90-99

Sl. No.	Random No. for inter arrival	Inter arrival time	Entry time in queue	Service start time	Random no for service.	Service time	Service end time	Waiting time of customer	Idle time
1	78	8	8.08	8.08	44	6	8.14	-	8
2	26	4	8.12	8.14	21	4	8.18	2	-
3	94	10	8.22	8.22	73	8	8.30	-	4
4	08	2	8.24	8.30	96	10	8.40	6	-
5	46	4	8.28	8.40	63	6	8.46	12	-
6	63	6	8.34	8.46	35	6	8.52	12	-
7	18	2	8.36	8.52	57	6	8.58	16	-

8	35	4	8.40	8.58	31	6	9.04	18	-
9	59	6	8.46	9.04	84	8	9.12	18	-
10	12	2	8.48	9.12	24	4	9.16	34	-
11	97	10	8.58	9.16	05	4	9.20	18	-
12	82	8	9.06	9.20	37	6	9.26	14	-
							Total Validity Time	**140**	**12**

Average waiting time spent by the customer = 140/12 = 11.67 minutes

Probability of idle time of petrol station = 12/86 = 0.1395

7. (a) Statement showing computation of profit at the current Mix:

	Elite (₹)	Levels (₹)	Fresh (₹)	Janata (₹)	Total (₹)
I) SP	3.50	3.00	2.50	1.50	
II) VC:					
DM	0.50	0.40	0.35	0.45	
DL	0.20	0.20	0.15	0.10	
Prod. Exp.	0.10	0.10	0.50	0.50	
AOH	0.15	0.05	0.10	0.05	
SOH	0.45	0.20	0.25	0.05	
	1.40	0.95	0.90	0.70	
III) Contrib.	2.10	2.05	1.60	0.80	
IV) Total Cont.	1,05,000	2,05,000	1,20,000	1,60,000	5,90,000
V) F.C:					
Prod. Exp.	0.20	0.25	0.20	0.20	
Adv. Exp.	0.30	0.40	0.25	0.30	
S & D Exp.	0.80	0.60	0.45	0.10	
	1.30	1.25	0.90	0.60	
VI) Total F.C	65,000	1,25,000	67,500	1,20,000	3,77,500
VII) Profit	40,000	80,000	52,500	40,000	2,12,500

Statement showing computation of profit by adopting sales manager's scheme:

		Elite	Levels	Fresh	Janata	Total
No. of Units		1,10,000	2,40,000	1,75,000	4,00,000	
Contribution per unit	₹	2.10	2.05	1.60	(0.8 – 0.5) 0.30	
Total Contribution	₹	2,31,000	4,92,000	2,80,000	1,20,000	11,23,000
F C	₹					8,62,500
Profit	₹					2,60,500

(b)

Calculation of selling price

		₹
Variable cost	(8 × 10,000)	80,000.00
Add : Fixed cost		30,000.00
Total cost		1,10,000.00
Profit		(10,000.00)
Sales		1,00,000.00
Selling price	(100000/10000)	₹ 10

Statement showing evaluation of alternatives and the number of units required to attain the targets of respective managers

	Finance Manager	**Sales Manager**	**Production Manager**
i) Selling price (₹)	10.00	10.00	9.70
ii) Variable cost (₹)	8.50	8.00	8.00
iii) Contribution per unit (₹)	1.50	2.00	1.70
iv) Fixed cost (₹)	30,000.00	35,000.00	30,000.00
v)Target (₹)	B.E.P	Profit or ₹5000	Profit of ₹4000
	(30000/1.5)	(40000/2)	(34000/1.7)
	20,000.00	20,000.00	20,000.00
Additional units required	10,000.00	10,000.00	10,000.00

8. Statement showing original budget and standard cost per unit:

Element	Actual (₹)	Variance (₹)	Standard Cost 4800 (₹)	Standard Cost Per unit (₹)	Original Budget 5000 units (₹)
Material	29,700	300A	28,800	6.00	30,000
Direct Wags	44,700	750	46,200	9.00	45,000
		2250A			
Value Overhead	75,750	3000	72,000	15.00	75,000
		3750A			
Fixed Overhead	39,000	1500A	37,500	7.50	37,500
	1,86,150	3750F	1,81,500	37.50	1,87,500
Profit (b/f)	36,600	8400A	34,500	7.50	37,500
		2100F			
Sales	2,22,750	6750F	2,16,000	45.00	2,25,000

Statement showing reconciliation of budgeted profit with Actual profit:

	(₹)
Budgeted Profit	37,500
Add: All favourable variances	10,500
	48,000
Less All adverse variance	8,400
	39,600
Less: (5000-4800) 7.5 profit variances	1,000
Less: (5000-4800) 7.5 profit variances	1,500
Actual Profit	36,600
(or)	
Standard Profit	34,500
Add	10,500
	45,000
Less:	8,400
Actual Profit	36,600
Budgeted Profit	37,500
Less: 8400 + 9000	17,400
	20,100
Add:	3,750
Variable Cost	6,000
Sales price variance	6,750
Actual Profit	36,600