Paper 15 - Business Strategy and Strategic Cost Management

The following table lists the learning objectives and the verbs that appear in the syllabus learning aims and examination questions:

	Learning objectives	Verbs used	Definition
LEVEL C	KNOWLEDGE What you are expected to know	List	Make a list of
		State	Express, fully or clearly, the details/facts
		Define	Give the exact meaning of
	COMPREHENSION What you are expected to understand	Describe	Communicate the key features of
		Distinguish	Highlight the differences between
		Explain	Make clear or intelligible/ state the meaning or purpose of
		Identity	Recognize, establish or select after consideration
		Illustrate	Use an example to describe or explain something
	APPLICATION How you are expected to apply your knowledge	Apply	Put to practical use
		Calculate	Ascertain or reckon mathematically
		Demonstrate	Prove with certainty or exhibit by practical means
		Prepare	Make or get ready for use
		Reconcile	Make or prove consistent/ compatible
		Solve	Find an answer to
		Tabulate	Arrange in a table
	ANALYSIS How you are expected to analyse the detail of what you have learned	Analyse	Examine in detail the structure of
		Categorise	Place into a defined class or division
		Compare and contrast	Show the similarities and/or differences between
		Construct	Build up or compile
		Prioritise	Place in order of priority or sequence for action
		Produce	Create or bring into existence
	SYNTHESIS How you are expected to utilize the information gathered to reach an optimum conclusion by a process of reasoning	Discuss	Examine in detail by argument
		Interpret	Translate into intelligible or familiar terms
		Decide	To solve or conclude
	EVALUATION How you are expected to use your learning to evaluate, make decisions or recommendations	Advise	Counsel, inform or notify
		Evaluate	Appraise or asses the value of
		Recommend	Propose a course of action

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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 [20 marks]

Meters Limited is a company engaged in the designing, manufacturing, and marketing of instruments like speed meters, oil pressure gauges, and so on, that are fitted into two and four wheelers. Their current investment in assets is around ₹ 5 crores and their last year turnover was ₹ 15 crores, just adequate enough to breakeven. The company has been witnessing over the last couple of years, a fall in their market share prices since many customers are switching over to a new range of electronic instruments from the range of mechanical instruments that have been the mainstay of Meters Limited.

The Company has received a firm offer of cooperation from a competitor who is similarly placed in respect of product range. The offer implied the following:
(i) transfer of the manufacturing line from the competitor to Meters Limited;
(ii) manufacture of mechanical instruments by Meters Limited for the competitor to the latter's specifications and brand name; and
(iii) marketing by the competitor.

The benefits that will accrue to Meters Limited will be better utilization of its installed capacity and appropriate financial compensation for the manufacturing effort. The production manager of Meters Limited has welcomed the proposal and points out that it will enable the company to make profits. The sales manager is doubtful about the same since the demand for mechanical instruments in shrinking. The chief Executive is studying the offer.

(i) What is divestment strategy? Do you see it being practised in the given case? Explain. [2+3]
(ii) What is stability strategy? Should Meters Limited adopt it? [$2^1/_2+2^1/_2$]
(iii) What is expansion strategy? What are the implications for Meters Limited in case it is adopted? [3+3]
(iv) What are your suggestions to the Chief Executive? [4]

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

2. (a) (i) Porter's Model helps with the structural analysis of the environment. How does this model work? [10]
(ii) State the drawbacks of Vertical Integration. [5]

2. (b) (i) Describe the barrier of Strategic Evaluation. [4]
(ii) Enumerate the characteristic of strategic decisions. [3]
(iii) Discuss the problems in using the BCG Matrix. [8]

2. (c) (i) Explain about the BCG Matrix. [10]
(ii) Distinguish between competitive advantage and core competency. [5]

3. Read the case and answer the following questions. [20 marks]

Jet Airways has leased a single jet aircraft that it operates between Delhi and Bangalore. Only economy class seats are available on this plane. An analyst has collected the following information:

Seating capacity per plane	360 passengers
Average number of passengers per flight	200 passengers
Average one-way fare	₹ 5,000
Variable fuel costs	₹ 1,40,000 per flight
Food and beverage service costs (no charge to passenger)	₹ 200 per passenger
Commission to travel agents paid by Air India (all tickets are booked by travel agents)	8 % of fare
Fixed annual lease costs allocated to each flight	₹ 5,30,000 per flight
Fixed ground-services (maintenance, check in, baggage handling) costs allocated to each flight	₹ 70,000 per flight
Fixed flight-crew salaries allocated to each flight	₹ 40,000 per flight

For simplicity, assume that fuel costs are unaffected by the actual number of passengers on a flight.

1. Calculate the total contribution margin from passenger that Jet Airways earns on each one-way flight between Delhi and Bangalore. [3]
2. The Market Research Department of Jet Airways indicates that lowering the average one-way fare to ₹ 4,800 will increase the average number of passenger per flight to 212. On the basis of financial considerations alone, should Jet Airways lower its fare? Show your calculations. [1+3]
3. Travel International, a tour operator, approaches Jet Airways on the possibility of chartering its aircraft. The terms of charter are as follows: (a) For each one-way flight, Travel International will pay Jet Airways ₹ 7,45,000 to charter the plane and to use its flight crew and ground-service staff; (b) Travel International will pay for fuel costs; and (c) Travel International will pay for all food costs. On the basis of financial considerations alone, should Jet Airways accept Travel International offer? Show your calculations. What other factors should Jet Airways consider in deciding whether to charter its plane to Travel International? [1+2+3]
4. State the areas where Management Accountant can take the decision. [7]

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

4. (a) (i) Boraco Ltd. has been offered supplies of special ingredients S at a transfer price of ₹15 per kg by chhotaco Ltd. which is part of the same group of companies. Chhotaco Ltd processes and sells S to customers external to the group at ₹15 per kg. Chhotaco Ltd. bases its transfer price on cost plus 25% profit mark-up. Total cost has been estimated as 75% variable and 25% fixed.

You are required to:

Discuss the Transfer prices at which Chhotaco Ltd. should offer to transfer special ingredient S to Boraco Ltd. in order that group profit maximizing decisions may be taken on financial ground in each of the fallowing situations:-

(i) Chhotaco Ltd. has an external market for all of its production of S at a selling price of ₹15 per kg. Internal transfers to Boraco Ltd. would enable ₹1.50 per kg of variable packing cost to be avoided.

(ii) Conditions are as per (i) but Chhotaco Ltd has production capacity for 3,000 kg of S for which no external market is available.

(iii) Conditions are as per (ii) but Chhotaco Ltd has an alternative use for some of its spare production capacity. This alternative use is equivalent to 2,000 kg of S and would earn a contribution of ₹6,000. [3+1$^1/_2$+1 ½]

(ii) A manufacturing company currently operating at 80% capacity has received an export order from Middle East, which will utilize 40% of the capacity of the factory. The order has to be either taken in full and executed at 10% below the current domestic prices or rejected totally.

The current sales or cost data are given below:

Items	₹ in lakhs
Sales	16.00
Direct Material	5.80
Direct Labour	2.40
Variable Overheads	0.60
Fixed Overheads	5.20

The following alternatives are available to the management:
(i) Continue with domestic sales and reject the export order.
(ii) Accept the export order and allow the domestic market to starve to the extent of excess of demand.
(iii) Increase capacity so as to accept the export order and maintain the domestic demand by -
(a) Purchasing additional plant and increasing 10% capacity and thereby increasing fixed overheads by ₹65,000, and
(b) Working overtime at one and half time the normal rate to meet balance of the required capacity.

You are required to evaluate each of the above alternatives and suggest the best one. [9]

4. (b) (i) Fit straight line by the least square method to the following figures of production of Sugar Factory. Estimate the production for the year 2016.

Year	2009	2010	2011	2012	2013	2014	2015
Production(in Lakh tons)	76	87	95	81	91	96	90

[7]

(ii) List out ten steps of quality improvement which has been conceptualized by Philip Crosby. [5]

(iii) Enumerate the steps involved in target costing? [3]

4. (c) (i) At 100% capacity (1,00,000 hours), the monthly production overhead budget for a factory was as follows:

	₹	Category
Salaries	40,000	C
Indirect wages	8,000	B
Repairs and maintenance	5,000	B
Consumable stores	4,000	A
Miscellaneous	5,000	B
Spoilage	2,000	A
Fuel and Power	15,000	A
	79,000	

The behavior of various categories of expenses was as follows:

Activity as a % of capacity	Multiplier A	Applicable B	To Budget

80	0.85	1.00	1.00
90	0.93	1.00	1.00
100	1.00	1.00	1.00
110	1.06	1.00	1.00
120	1.12	1.00	1.00
130	1.18	1.10	1.00
140	1.23	1.10	1.00
150	1.28	1.10	1.20

There were three products and in a month, the total production was expected to be:

X	10,000 units
Y	15,000 units
Z	5,000 units

The standard hours per unit of the three products were agreed to be 5 for X, 4 for Y and 6 for Z. Prepare the Production Overhead Budget for the concerned month. [5]

(ii) 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 7,500 units of B are sold.

Required:

(A) What is the current Break-Even Point (BEP)?

(B) What is the minimum number of units to achieve BEP?

(C) If there are only 10,000 labour hours possible in production period, what would be the optimum product-mix? [6]

(iii) Why Lean Accounting Needed? [4]