Business Strategy and Strategic Cost Management

Section A

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

1. Dr. Sukumar inherited his father's Dey's Lab in Delhi in 1995. Till 2002, he owned 4 labs in the National Capital Region (NCR). His ambition was to turn it into a National chain. The number increased to 7 in 2003 across the country, including the acquisition of Platinum lab in Mumbai. The number is likely to go to 50 within 2-3 years from 21 at present. Infusion of ₹ 28 crores for a 26% stake by Pharma Capital has its growth strategy.

The lab with a revenue of ₹ 75 crores is among top three Pathological labs in India with Atlantic (₹ 77 crores) and Pacific (₹ 55 crores). Yet its market share is only 2% of ₹ 3,500 crores market. The top 3 firms command only 6% as against 40-45% by their counterparts in the USA.

There are about 20,000 to 1,00,000 stand alone labs engaged in routine pathological business in India, with no system of mandatory licensing and registration. That is why Dr. Sukumar has not gone for acquisition or joint ventures. He does not find many existing laboratories meeting quality standards. His six labs have been accredited nationally whereon many large hospitals have not thought of accreditation; The College of American pathologists accreditation of Dey's lab would help it to reach clients outside India.

In Dey's Lab, the bio-chemistry and blood testing equipments are sanitised every day. The bar coding and automated registration of patients do not allow any identity mix-ups. Even routine tests are conducted with highly sophisticated systems. Technical expertise enables them to carry out 1650 variety of tests. Same day reports are available for samples reaching by 3 p.m. and by 7 a.m. next day for samples from 500 collection centres located across the country. Their technicians work round the clock, unlike competitors. Home services for collection and reporting is also available.

There is a huge unutilised capacity. Now it is trying to top other segments. 20% of its total business comes through its main laboratory which acts as a reference lab for many leading hospitals. New mega labs are being built to Encash preclinical and multi-centre clinical trials within India and provide postgraduate training to the pathologists.

Required

(i) What do you understand by the term Vision? What is the difference between 'Vision' and 'Mission'? What vision Dr. Sukumar had at the time of inheritance of Dey's Lab? Has it been achieved? (2+2+2 =6)

(ii) For growth what business strategy has been adopted by Dr. Sukumar? (3)

(iii) What is the marketing strategy of Dr. Sukumar to overtake its competitors? (3)

(iv) In your opinion what could be the biggest weakness in Dr. Sukumar's business strategy ? (3)

2. BB Ltd., is a business organized as three divisions and head office. The divisions are based on market groupings, which are retail, wholesale and Government. The divisions do not trade with each other.

The main method of control of the divisions has been the requirement to earn a return on investment (ROI) of 15% p.a. The definition of return and capital employed is provided by head office, at the criterion ROI rate of 15%.

The recent experience of BB Ltd., is that the group as a whole has been able to earn the 15% but there have been wide variations between the results obtained by different division. This infringes another group policy that forbids cross-subsidization, i.e. each and every division must earn the criterion ROI.

BB Ltd. Is now considering divestment strategies and this could include the closure of one or more of its divisions.

The head office is aware that the Boston Product Market Portfolio Matrix (BPMPM) is widely used within the divisions in the formulation and review of marketing strategies. As it is so widely known within the group and is generally regarded by the divisions as being useful, the head office is considering employing this approach to assist in the divestment decision.

You are required to:
(i) Evaluate the use by BB Ltd. of the concept of ROI and its policy that forbids cross-subsidization. (5)
(ii) Describe the extent to which the BPMPM could be applied by BB Ltd. in its divestment decision. Evaluate the appropriateness of the use of the BPMPM for this purpose. (5)
(iii) Recommend, and justify, two other models that could be used in making a divestment decision. Demonstrate how BB Ltd. could utilize these models to make this decision. (5)

3. (a) What is Strategy? Why it is done? (2+3= 5)
(b) Define Strategic Alliance. (5)

4. (a) Sylva Food Processing company has proposed you as a management consultant. The firm seeks to implement the balanced scorecard tool in an attempt to monitor performance.
The management of Sylva has no idea about the balanced scorecard model and has approached you for guidance regarding the approach to implement it and the challenge such a model presents.
(i) Explain the steps that Sylva can take in designing and implementing the balanced scorecard. (5)
(ii) Evaluate why the cost of implementing the balanced scorecard can outweigh the benefits derived from the use of the model. (5)

5. (a) What is the purpose of SWOT analysis? Why is it necessary to do a SWOT analysis before selecting a particular strategy for a business organization. (4+2=6)
(b) An important part of strategic management process is implementation of strategy. Discuss the relationship of soundness of strategy with the quality of implementation (4)

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

6. A product comprised of 10 activities whose normal time and cost are given as follows:

Activity	1-2	2-3	2-4	2-5	3-5	4-5	5-6	6-7	6-8	7-8
Normal Time (days)	3	3	7	9	5	0	6	4	13	10
Normal cost (₹)	50	5	70	120	42	0	54	67	130	166

Indirect Cost is ₹ 9 per day.
1. Draw the Network and identify the critical path.
2. What is the project Duration and Associated Cost?
3. Find out the Total Float associated with each activity. (4+2+4=10)

7. (a) Ravi, an entrepreneur runs two convenience stores, one in Gurgaon and the other in Noida. Operating income for each store in 2011 is as fallows:

	Gurgaon Store	Noida Store
Revenues:	₹1,07,00,000	₹86,00,000
Operating Cost		
Cost of goods sold	75,00,000	66,00,000
Lease rent (renewable each year)	9,00,000	7,50,000
Labour Costs (paid on an hourly basis)	4,20,000	4,20,000
Depreciation of equipment	2,50,000	2,20,000
Utilities (electricity heating)	4,30,000	4,60,000
Allocated corporate overhead	5,00,000	4,00,000
Total operating costs	1,00,00,000	88,50,000
Operating income (loss)	7,00,000	(2,50,000)

The equipment has zero disposal value. Mohan the accountant makes the fallowing comment, "Ravi can increase his profitability by closing down the Noida Store or by adding another store like it"

Required :

(i) By closing down the Noida store, Ravi can reduce overall corporate overheads costs by ₹4,40,000. Calculate Ravi's operating income if it closes the Noida store. Is Mohan's statement about the effect of closing the Noida Store correct? Explain

(ii) Calculate Ravi's operating income if it keeps the Noida store Open and opens another store with revenues and costs identical to the Noida store (including a cost of ₹2,20,000 to acquire equipment with a one year useful life and zero disposal value). Opening this store will increase corporate overhead costs by ₹40,000. Is Mohan's statement about the effect of adding another store like the Noida store correct? Explain. (6+7=13)

(b) Whirlpool India Ltd. assembles washing machines at its Auburn plant. In December 2012, 60 tumbler units that cost ₹ 44 each (from a new supplier who subsequently went bankrupt) were defective and had to be disposed of at zero disposal value. Whirlpool India Limited was able to rework all 60 washing machines by substituting new tumbler units purchased from one of its existing suppliers. Each replacement tumbler cost ₹ 50.

Required

(i) What alternative approaches are there to account for the material costs of reworked units?

(ii) Should Whirlpool India Limited use the ₹ 44 tumbler or ₹ 50 tumbler to calculate the costs of materials reworked? Explain.

(iii) What other costs might Whirlpool India Limited include in its analysis of the total costs of rework due to the tumbler units purchased from the (now) bankrupt supplier? (2+2+3=7)

8. (a) State Bank of India (SBI) is examining the profitability of its Premier Account, a combined saving and checking account. Depositors receive a 7 percent annual interest rate on their average deposit. SBI earns an interest rate spread of 3 percent (the difference between the rate at which it lends money and the rate it pays to depositors) by lending money for home loan purpose at 10 percent. Thus, SBI would gain ₹60 on the interest spread if a depositor has an average Premier Account balance of ₹2,000, that is ₹2,000 × 3% = ₹60

The Premier Account allows depositors unlimited use of services such as deposits, withdrawals, checking accounts, and foreign currency drafts. Depositors with Premier Account balances of

₹1,000 or more receive unlimited free use of services. Depositors with minimum balances of less than ₹1,000 pay a ₹20-a-months service free for their Premier Account.
SBI recently conducted an activity-based costing study of its services. It assessed the fallowing costs for six individual services. The use of these services in current year by three customers is as follows:

Particulars	Activity-based Cost per Transaction	Nitin	Arvinder	Sanjay
Deposit/withdrawal with teller	₹2.50	40	50	5
Deposit/withdrawal with automatic teller machine (ATM)	0.80	10	20	16
Deposit/withdrawal on prearranged monthly basis	0.50	0	12	60
Bank checks written	8.00	9	3	2
Foreign currency drafts	12.00	4	1	6
Inquiries about account balance	1.50	10	18	9
Average premier account balance for current year		₹1,100	₹800	₹25,000

Assume Nitin and Sanjay always maintain a balance above ₹1,000, whereas Arvinder has a balance below ₹1,000.
Required:
(i) Compute the current year profitability of Nitin, Arvinder and Sanjay's Premier Accounts at SBI.
(ii) What evidence is there of cross-subsidization among the three Premier Accounts? Why might SBI worry about the cross-subsidization if the Premier Account product offering is profitable as a whole?
(iii) What changes would you recommend for SBI's Premier Account? (6+6+3=15)

(b) Discuss the role of a Firm's suppliers in its Value Engineering or Cost Reduction drive. (5)

9. (a) The following figures are available. Find out the missing figures, given appropriate formulae –

Particulars	₹	₹
Budgeted Profit		15,000
Less: Adverse variances: Contribution Price variance	10,600	
Direct Material variance	1,000	
Fixed Overhead variance	600	12,200
		2,800
Add: Favourable Variances: Contribution Quantity Variance	1,800	
Direct Wages Variance	600	
Variable Overhead Variance	1,800	4,200
Actual Profit		7,000

There is no inventory. Also, Production units = Sales units for both actual and budget.

Other information:

Standard selling Price	₹ 18 per unit	Actual Labour Hours at Actual rate	₹ 63,000
Standard Variable Cost	₹ 15 per unit	Actual Labour Hours at Standard rate	₹61,950
Standard Contribution	₹3 per unit	Variable Overhead Standard rate	₹2
Actual selling Price	₹ 17 per unit	Standard Hours of Production	4 per unit
Budgeted sales	10,000 units	Variable Overhead at Standard rate	₹ 84,800
Std Material Cost p.u	Re.1(5 kg. at 20 paise/kg)	Variable Overhead Expenditure Variance	400 (A)
Material Usage variance	400(Adv)	Budgeted Fixed overhead	₹ 15,000

Find out the following:

(i) Actual sales Units	(v) Actual Variable Overhead in rupees
(ii) Actual sales Rupees	(vi) Variable Overhead Efficiency Variance
(iii) Actual Quantity of Raw Materials used	(vii) Actual Fixed Overheads
(iv) Labour Efficiency variance	(viii) Operating Profit Variance

(8 x 2 = 16)

(b) State how ZBB is superior to Traditional Budgeting. (4)