FINAL EXAMINATION

GROUP III

(SYLLABUS 2012)

SUGGESTED ANSWERS TO QUESTIONS

JUNE 2016

Paper-15: BUSINESS STRATEGY AND STRATEGIC COST MANAGEMENT

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

The figures in the margin on the right side indicate full marks

SECTION A (50 marks)

(Business Strategy)

Answer* Questions No. 1, *which is compulsory carrying 20 marks.
Further, answer* any two *Questions from the rest of the questions
in this section, each carrying 15 marks.

1. (a) State three operative levels of strategy in corporate management structure. How they help the management?

(b) What are the guidelines to be followed to make competitive advantage more sustainable?

(c) Benchmarking exercise is based on 'best exercise' and not on 'best performance' - Explain in brief.

(d) Write the key roles of a senior strategic leader as a global thinker. Give a suitable example. (6+2)+6+3+3 = 20

Answer:

1. (a) The decision making hierarchy of a corporate structure firm typically comprises three operative levels of strategy as follows:

(i) **Corporate level** - At the highest level of the decision-making hierarchy is the corporate level, composed principally of a board of directors, chief executive and the administrative personnel. They are responsible for the firm's financial performance and for the achievement of the non-financial goals, such as enhancing the firm's image and fulfilling its social responsibilities. This top level strategy is mainly concerned with defining how the business will remain sustainable in the long run. They are focused on maximizing long term profitability and creating business growth and value.

(ii) **Business level** - In the middle of the decision-making hierarchy is the business level, composed principally of business and corporate managers. These managers must translate the statements of direction and intent generated at the corporate level

into concrete objectives and strategies for individual business divisions or Strategic Business Units (SBUs). This strategy is a comprehensive for providing objectives for SBUs, allocation of resources among functional areas and coordination between them for making contribution to the achievement of the corporate level objectives.

(iii) **Functional level** - At the bottom (i.e. operating divisions and departments) of the decision-making hierarchy is the functional level, composed principally of functional managers, such as production, marketing, personnel, finance, sales, HRM, R&D, etc. Decisions of the functional levels are often described as 'tactical decision'. The issues of functional level strategy are mainly related to business processes and the value chain. This strategy is focused on improving the effectiveness of a business at an operational level. This level strategy has the narrowest scope of the three strategy levels.

A clear understanding of the three operative levels strategy in decision making hierarchy help the organization in the following ways:

(i) To set-up realistic objectives,
(ii) To develop plans and policies for achieving the set objectives,
(iii) To ensure that the business remains sustainable and create business growth and business value in the long term.

These three strategy levels are not completely independent of each other and must be developed and implemented in a co-ordinate manner.

(b) Just because a company is market leader now, it does not mean it has sustainable competitive advantage. A company must create clear goals, strategies, and operations to sustain its competitive advantage over long-term. The corporate culture and the values of the employees must be in alignment with those goals, as well. It is very difficult to do all those things well, which is why very few companies can create sustainable competitive advantage.

Six major guidelines or conditions are mentioned below:

(i) The advantages should be 'lumpy' or 'durable' and not mere incremental or marginal.
(ii) The asset capability or the advantages should make a significant contribution to customer value.
(iii) The uniqueness of the capability or advantage should be clearly focused to ensure high visibility to the customers.
(iv) It should not be clear to the competitors how the capability or the source of advantage actually work out.
(v) The capability or advantage should be difficult to duplicate by the competitors.
(vi) Companies or businesses, particularly early movers, should be able to create barriers or counter the efforts of competitors.

(c) The term **'benchmarking'** is defined as the continuous process of measuring the products, services and business practices of a company against the toughest competitors or those companies search for industry's best practices that lead to superior performance. On the other hand it is a tool for improving performance by continuously identifying, understanding, adopting best practices and processes followed by an entity, both internally as well as externally.

From the above definition, it is evident that a benchmarking exercise has to be based on 'best practices' and not on 'best performances'. Practices signify continuity in use while performances may be flash in one time not in continuous way.

(d) Global thinkers understand and accept international cultural differences. They should behave in a way that accommodates people's varying perspectives. They also discern differences in individual styles and adopt their approaches accordingly.
Illustrations:
(i) Considers the implications of issues, decisions, and opportunities beyond the boundaries of own country and culture.
(ii) Understands the different perspectives and approaches in order to effectively handle cross-cultural challenges or individual differences.
(iii) Identifies the opportunities for global leverage (i.e., opportunities for develop R&D strategy from a global point of view).

2. Hero Honda joint venture formed in 1984 is a classic case of strategic alliance involving the Indian company Hero Group and Japanese automobile major company Honda Motorcycle. The alliance has been terminated with the entire 26% stake of Honda Motorcycle in the venture bought by the Hero Group. Selling out of the venture has given the Japanese company the freedom to go it alone in the world's second largest market for two-wheelers.
You are required to answer:
(a) Is joint venture the only way to enter into strategic alliance? If no, why?
(b) Alliances are not new, but in the competitive environment, some other forms of integration are also emerging. Identify them.
(c) What are the key success factors for managing an alliance?
(d) Write five reasons for the termination of the two companies' joint venture. 3+3+4+5=15

Answer:

2. (a) No, joint venture is not the only a way to enter into a strategic alliance. Apart from the joint venture, strategic alliance may be in the form of-

(i) Management contract,
(ii) Franchising,
(iii) Supply or purchase agreement,
(iv) Marketing and distribution agreement,
(v) Agreement to provide technical services,
(vi) Licensing of know-how, design, patent, etc.

(b) All alliances involve some measure of inter-corporate integration. In the new emerging competitive environment the companies are finding innovative ways of alliances with features meeting their requirements. Trading alliances are only a bit more complicated than traditional buy-sell relationship. Normally the objectives of such trading alliances include the need to secure supplies of product, buy or exchange knowledge/skills /technology and exploit market networks. The main features of such alliance are management in arm's length, implementation of a fast pace, exclusively, limited time frames with options to renew based on certain well-defined milestones.
On the other hand, partnership involving an integration of business resources can take the form of functional alliance. Functional alliances usually joint ventures or equity-based partnerships. They are characterized by management integration, open-ended collaboration, separate joint venture entity and long-term commitment.

(c) The key success factors for managing alliance are as under:

(i) **Mutual trust:** Mutual trust at senior management level carry ventures , through turbulent times.
(ii) **Ability to compromise:** When there are two strong companies, the ability to compromise is not easy to achieve. If you expect to receive some valuable technology, production or marketing know-how from a partner, you must be willing to give something.
(iii) **Favorable business condition:** Launching an alliance when favorable business conditions exist makes a venture life considerably easier for its partners.
(iv) **Alliance autonomy:** The autonomy mandates a high degree of responsibility and good judgment by the ventures.

(d) Reasons for termination of a successful joint venture are as follows:

(i) Different cultures, may quickly find the variations in their behavioral norms are creating breeding ground for misunderstanding, poor follow through, and eventual distrust.
(ii) Joint ventures are also potential for conflicts. They may result in disputes between or among partners due to varied interests.
(iii) Show down in decision making by partners.
(iv) Changes in I he business environment in two countries and changes in partner strength.
(v) Life cycle of joint ventures.

3. (a) Why are Environmental Threats and Opportunities Profile (ETOP) prepared for an organization?

(b) What information can an organization get from an ETOP?
(c) Classify the impact of the following items under appropriate category (opportunity /threat) and specify the respective environmental sectors of the ETOP of an established Indian sports-cycle manufacturing company for the domestic and export market:
(i) Large demand of the product.
(ii) Community requires the product of advanced technology and technology up gradation is in progress.
(iii) Imported raw materials is easily available.
(iv) Liberalization of technology import policy.
(v) Imports same types of cheap China products. 5+5+5=15

Answer:

3. (a) To identification of environmental factors is necessary for environmental analysis and diagnosis. Some environmental factors produce opportunities to the firms and some factors produce threats to the firm. An opportunity is major favourable situation like market segment, technological changes, etc. in the firm's environment and a threat is a major unfavourable situation like entrance of new competitors, slow market growth, etc. in the firm's environment. So identification and appraisal of such factors are necessary.
There are many techniques are available to structure the environmental analysis. One such technique is suggested by Glueck, is the ETOP.

The preparation of ETOP involves dividing the environment into different sectors, such as market, technology, supplier, government, competition, economic etc. and then analyzing the impact of each sector on the organization. A comprehensive ETOP requires sub-dividing each environmental sector into sub-factors and then requires analyzing the impact of each sub-factor on the organization.

(b) (i) ETOP provides the strategists with a clear picture of which sectors and the sub-factors in each sector have a favourable impact on the organization.

(ii) By means of an ETOP the organization can see where it stands with respect to its environment. This understanding can be of great helps to an organization in formulating appropriate strategies to take advantage of the opportunities and oppose the threats in its environment.

(iii) Based on this analysis the top management could focus on some areas and delegate others.

(iv) This analysis also provide data for revenue and cost implication of these factors as well as estimates on the likelihood that certain events will occur and their timing.

(v) ETOP provides the input for generating strategic change alternatives and determining whether gaps might exist between expected and desired outcomes.

(c)

Environmental Sectors	Impact (+) Opportunity / (-) Threat
Market	(+) Large demand of the product.
Technological	(+) Community requires products of advanced technology and technology up-gradation is in progress in the organization.
Supplier	(+) Imports of raw materials easily available.
Government	(+) Liberalization of technology import policy.
Competition	(-) Imports same type of cheap China products.

4. (a) What do you understand by 'Strategic Portfolio Analysis'? State the main objective of this analysis.

(b) What are the main contributions of General Electric (GE) and Boston Consulting Group (BCG) matrix in 'Strategic Portfolio Analysis'?

(c) State the important factors which affect competitive rivalry in a market.

(d) Write the main criticisms of BCG Matrix. (3+3)+2+4+3=15

Answer:

4. (a) **Strategic Portfolio Analysis,** alternatively termed business portfolio planning or portfolio strategy or policy-strategy profile or organizational portfolio plan, is a broad term and refers to a technique found in many different variations.

This analytical technique helps the management to satisfy the emerging need for centralized decisions on key strategic issues in MNCs. It provides a means of comparing numerous business activities in relation to each other, establishing priorilies and deciding between winners and losers. The formulation of the organizational portfolio plan is the final phase of the strategic planning process. It assumes that most organizations, at a particular time and in reality, are a portfolio of business.

The primary/main objective of this analysis is to determine the optimal allocation of cash resource among the various business activities comprising of a diversified corporate portfolio. In addition, it can help the top management in the following respects:

(i) What business activities the company should be in?
(ii) How performance of the different business SBUs should be evaluated?
(iii) Who should manage these SBUs?

(b) In the strategic portfolio analysis, General Electric (GE) and Boston Consultancy Group (IBCG) matrix made pioneering contributions.

GE introduced the concept of dividing business activities into SBUs with like characteristics, related to the product life cycles.
BCG consisted of a wide variety of products in different growth rates and market shares, search for investment strategies to allocate resources among them to optimize company's long-run profits.

(c) The following factors affect to a large extent the competitive rivalry:

(i) **Product life cycles:** Competitive rivalry depends, to a large extent, on the stages of the product life cycle. Competition is practically non-existent at the introduction stage (i.e., existence of few competitors), then starts growing steadily and become significant till the product enters the decline stage (i.e., exit of some competitors).

(ii) **Market growth rate:** Life cycle analysis also suggests this. During the growth phase, when industry growth rate is high, companies expect their own growth rates to be high because of market growth, but during the maturity, organizational growth have to be achieved by extracting market share from the competitors.

(iii) **The relative size or strength of competitors:** If competitors are of similar size, competition is also to be more intense than when the market is dominated by one or few big players and in this situation the smaller players accommodate themselves.

(iv) **The existence of exit barriers:** If there is strong exit barrier (may be in the form of high fixed investment with a long payback period), competition will be high. This can be quite true in capital goods industries.

(d) BCG Matrix provides a framework for allocating the resources among different SBUs allows one to compare many business units at a glance.
However, the approach has received some criticisms for the following reasons:

(i) The link between market share and profitability is questionable since increasing market share can be very expensive.

(ii) The approach may over emphasize high growth, since it ignores the potential of declining markets.

(iii) The model considers market growth rate to be a given. In practice the firm may be able to grow the market.

SECTION B (50 marks)

(Strategic Cost Management)

***Answer* question No. 5, which is compulsory, carrying 20 marks.**
Further, answer* any two *Questions from the rest of the questions in this section, each carrying 15 marks.

5. (a) Company A can manufacture 1,000 units bicycles in a month for a fixed cost of ₹ 3,00,000. The variable cost is ₹500 per unit. Its current demand is 600 units which it sales at ₹1,000 per unit. It is approached by Company B for an order of 200 units at ₹ 700 per unit. Should the company A accept the order? Give your views as a CMA.

(b) The public sector Bank of India (BOI), which targets to take its business to about ₹12 lakhs crore in next five years, mulls to implement Business Process Re-engineering (BPR) initiates to streamline its growing business. Seven consultants, including Ernst & Young, Boston Consulting Group (BCG) and McKinsey, have expressed interest to take up the job of evaluation and restructuring the organizational set-up by using 3Rs Model of BPR. What are the actions and resources to be considered for 3Rs Model of BPR for

expecting the results to BOI?

(c) Mention ten application areas of Operation Research in Strategic Cost Management.

(d) What are the impact of incremental revenue and incremental cost on a 'special order decision'? 5+6+5+4=20

Answer:

5. (a) The CMA will go ahead with the order because in his opinion the special order will yield ₹ 200 per unit. He knows that the fixed cost ₹ 3,00,000 is irrelevant because it is going to be incurred regardless of whether the order is accepted or not. Effectively, the additional cost which Company A would have to incur is the variable cost of ₹ 500 per unit. Hence, the order will yield ₹ 200 per unit (i.e. ₹ 700 - ₹ 500 of variable cost).

(b) BPR is achieving dramatic performance improvements through radical changes in organizational process, re-architecting of business and management process. It involves the redrawing of organizational boundaries, the reconsideration of jobs, tasks, knowledge and skills. This occurs with the creation and the use of models. In resuming the whole process of BPR in order to achieve the expected results is based on key steps-principles which include 3Rs (i.e., re-design, re-tool and re-orchestrate). Each step-principle embodies the actions and resources as presented in below:

Re-design	Re-tools	Re-orchestrate
Simplify	Networks	Synchronies
Standardize	Intranets	Processes
Empowering	Extranets	Information Technology
Employee-ship	Workflow	Human resources
Groupware		
Measurements		

(c) The following are the typical application areas of Operation research in Strategic Cost Management:

(i) Capital budgeting,
(ii) Asset allocation,
(iii) Portfolio selection,
(iv) Fraud prevention, Anti-money laundering,
(v) Benchmarking,
(vi) Channel optimization or Customer segmentation,
(vii) Direct marketing campaigns,
(viii) Supply chain problems,
(ix) Distribution, Routing, Scheduling, and Traffic flow optimization,
(x) Resource allocation,
(xi) Inventory problems,
(xii) Retail planning,
(xiii) Product mix and blending,
(xiv) Industrial waste reduction.

You may add these points also

(i) Finance
(ii) Accounting
(iii) Marketing

(iv) Personnel
(v) Construction
(vi) Facilities planning
(vii) Manufacturing
(viii) Purchasing and procurement
(ix) Maintenance and project scheduling
(x) Research and development
(xi) Government

(d) Special order decision involves determining whether a special order from a customer should be accepted or rejected. This type of decision is a one-time order that will not impact a company's regular sales. Effect of incremental revenue and incremental cost with the special order decision as follows:

(i) If incremental revenue is less than the incremental cost, reject the special order.
(ii) If incremental revenue is greater than the incremental cost, accept the special order.
(iii) If incremental revenue is equal to the incremental cost, focus primarily on qualitative characteristics to assess the decision for special order.

6. (a) Why is Transfer Pricing (TP) necessary in the organization? Show the impact of transfer prices to the 'selling' and 'buying' profit centers.

(b) The income statement of Ashok Gears Ltd. is summarized as below:

Net Revenue ……₹80,00,000

Less: Expenses (including ₹40,00,000 of Fixed Cost)……..₹88,00,000

Net Loss……₹8,00,000

The manager believes that an increase of ₹20,00,000 as fixed expenditure in advertising outlays will increase the sales substantially. His plan was approved by the Board.

You are required to calculate:

(i) At what sales volume will the company have Break Even?

(ii) What sales volume will result in a Net Profit of ₹4,00,000? (3+4)+(4+4) = 15

Answer:

6. (a) **'Transfer Pricing (TP)'** is needed to monitor the flow of goods and services among the divisions of a company and to facilitate the divisional performance measurement. The main use of transfer pricing is to measure the notional sales of one division to another division. Thus the transfer prices used in the organization will have a significant effect on the performance evaluation of the various divisions. It becomes necessary when there is internal transfer of goods or services and it is required to appraise the separate performances of the divisions departments involved.

If profit centers are to be used, transfer prices become necessary in order to determine the separate performances of both the 'buying' and 'selling' profit centers. If transfer prices are set too high, the 'selling center' will be favoured. On the other hand, if transfer prices are set too low, the 'buying center' will receive an unwarranted proportion of the profits.

(b) (i) Variable Expenses = ₹ (88,00,000 - 40,00,000) = ₹ 48,00,000
The Ratio of Variable Expenses and Total Revenue = 48,00,000 / 80,00,000 = 0.60

The Contribution Margin Ratio = (1 - 0.60) = 0.40
Let, Break Even Sales = S
Therefore, S = Variable Expenses + Fixed Expenses + Net Profit
= 0.60S (₹40,00,000 + ₹ 20,00,000) + 0
Or, S - 0.60S = ₹ 60,00,000
Or, 0.40S = ₹ 60,00,000
Therefore, S = ₹ (60,00,000 / 0.40 = ₹ **150,00,000**

Alternative Method: PV ratio = 40/100 = 40%
BE point = F. Cost/PV ratio
Therefore, Break Even Sales = 60,00,000 / 40% = ₹ **150,00,000**

(ii) Computation of sales level to earn a Net Profit of ₹ 4,00,000
Required Sales = (Fixed Expenses + Target Net Profit) / Contribution Margin Ratio
= ₹ (60,00,000 + 4,00,000) / 0.40 **= ₹ 160,00,000**

7. (a) Write the basic difference between 'quality-assurance' and 'quality control'.

(b) Define the term' value engineering'.

(c) The output of a production line is checked by an inspector for one or more of three different types of defects, called defects Major, Minor and Medium. If defect Major occurs, the item is scrapped. If defect Minor or Medium occurs, the items must be reworked. The time required for reworking for a Minor defect and a Medium defect is 15 minutes and 30 minutes respectively.

The probabilities of Major, Minor and Medium defects are 0.15, 0.20 and 0.10 respectively. You are required to present data table with random number assigned and the existence of defect in Major, Minor and Medium type separately.

For 10 items coming off the assembly line, determine tile number of items without any defects and with defects, the number of item scrapped and the total minutes of reworked time.

Use the following Random Numbers (RN) of three defects:

RN for Defect Major	**48**	**55**	**91**	**40**	**93**	**01**	**83**	**63**	**47**	**52**
RN for Defect Minor	**47**	**36**	**57**	**04**	**79**	**55**	**10**	**13**	**57**	**09**
RN for Defect Medium	**82**	**95**	**18**	**96**	**20**	**84**	**56**	**11**	**52**	**03**

2+2+(2+5+2+2)=15

Answer:

7. (a) The term 'quality assurance' and 'quality control' are often used interchangeably to refer to ways of ensuring the quality of services or products. The two terms, however, have different meanings.

Quality assurance refers the planned and systematic activities (i.e. engineering activities) implemented in a quality system so that the quality requirements for a product or service will be fulfilled. It is the act of giving confidence or the state being certain.
Quality control refers the operational techniques and activities used to fulfill requirements for quality and needed for corrective responses.

(b) Value engineering is an effective problem solving technique. It is essentially a process which uses function analysis, team-work and creativity to improve value.

'Societies of Japanese Value Engineering' defines the term 'value engineering' as: "a systematic approach to analyzing functional requirements of products and services for the purposes of achieving the essential functions at the lowest total cost".

(c) The probabilities of occurrence of **Major, Minor and Medium** defects are 0.15, 0.20 and 0.10 respectively. So, tile numbers 00 - 99 are allocated in proportion to the probabilities associated with each of the three defects.

Defect Major		Defect Minor		Defect Medium	
Exists	RN Assigned	Exists ?	RN Assigned	Exists ?	RN Assigned
Yes	00 -14	Yes	00 - 19	Yes	00 - 09
No	15 - 99	No	20 - 99	No	10 - 99

Simulation of output of the assembly line for 10 items:

Item No.	RN: Defect Major	RN: Defect Minor	RN: Defect Medium	Defect Exist or Not	Rework time (in min.)	Scrap
1	48	47	82	None	Nil	—
2	55	36	95	None	Nil	—
3	91	57	18	None	Nil	—
4	40	04	96	Minor	15	—
5	93	79	20	None	Nil	—
6	01	55	84	Major	Nil	Scrap
7	83	10	56	Minor	15	—
8	63	13	11	Minor	15	—
9	47	57	52	None	Nil	—
10	52	09	03	Minor & Medium	15 + 30 = 45	—

(i) During the simulated period, 5 items had defect and other 5 items had no defect.
(ii) One item was scrapped.
(iii) Total reworked time is required for four items = **15+15+15+45 = 90 minutes.**

8. (a) 1 ton of material input yields standard output of 1,00,000 units. The standard price of material is ₹ 20 per kg. The actual quantity of material used is 10 tons and the actual price paid is ₹ 21 per kg. Actual output obtained is 9,00,000 units.

Compute Material Cost Variance.

(b) Write the practical uses (three in each case) of Linear Programming in industrial and administrative applications.
(c) What are the pre-requisites of the effective 'Responsibility Accounting'?
(d) Write two conditions which are to be fulfilled for application of 'Optimality Test' in case of transportation problem. 3+3+5+4=15

Answer:

8. (a) Standard Material required per unit of output = 1 ton/1,00,000 = 1×1,000 kg/1,00,000
= 1/100 kg.

For 9,00,000 units required = 9,00,000 × 1/100 kg = 9,000 kg.

Actual Quantity of Material used = 10 tons = 10,000 kg.

Material Cost Variance =

(Standard Quantity for Actual Output × Standard Price) - (Actual Quantity × Actual Price)

= (9,000 × ₹20) - (10,000kg × ₹21)

= ₹ 1,80,000 - ₹2,10,000

= ₹30,000

(b) The following are the industrial application areas of Linear Programming:

Product-mix problems (production planning),

Blending problems (various compositions and prices of raw materials),

Diet problems, Trim problems (paper industry),

Advertising-mix problems.

The following are the administrative application areas of Linear Programming:

Operational scheduling problems in aircraft,

The investment portfolio selection problems (financial applications),

Several military problems (scheduling military tanker fleet, minimizing the number of carriers to meet a fixed schedule, etc.),

Cost cutting in business,

Agriculture applications (i.e., to maximize the return from the allocation activity or to minimize some defined cost).

(c) The following are the pre-requisites of the effective responsibility accounting:

(i) Each responsibility center and the operating purpose must be separable and clearly identifiable under the supervision of a manager.
(ii) The independent measurement of performance of each center must be capable of being done.
(iii) Each responsibility center should have clearly set targets.
(iv) The responsibility center's budget should be realized.
(v) The top management should fully support system.
(vi) All managers of responsibility centers should participate in the formulation of plans and policies relating to the responsibility center for the purpose of providing motivation.
(vii) For sincere performance of each responsibility center the organizational environments must be conducive.

(d) Once an initial solution is obtained, the next step is to check its optimality. The **'optimality test'** can be applied if it satisfies the following two conditions:

(i) It contains exactly m + n - 1 allocation where m and n represent the number of rows and column of the table respectively.
(ii) These allocations are independent i.e. a loop cannot be performed by them.