Case Study

Cost of Inefficiency and Revamping of Modern India Limited

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Backdrop of the Case:

Modern India Limited (MIL), a multinational firm engaged in manufacturing of alternator parts(P1, P2, P3 and P4) of generator for last fifty years. The product of the company has international market and it leads in term of cost efficiency and quality management. The company has manufacturing units in UK, USA, Japan, South Africa and Australia besides India. The company's financial performance during last five years is sluggish and depressive. All the manufacturing Units across the globe are functioning as individual Strategic Business Units(SBUs) and they compete with one another. However, they work on the principles of goal congruence. Each SBU is headed by a General Manager (Operations) and the organization structure of the company is of pyramidal and traditional headed by CEO Cum Managing Director. There is intra-SBU competition and one SBU can exercise option to buy input from another SBU or open market. Transfer Pricing Mechanism is in place. The company has four directorates and they are Marketing, Operations, Finance and Human Resource and all the board members and their immediate subordinates sit in the Headquarters of the company. The leaders of the SBUs function as an individual decision making entity and report to the CEO thorough the concerned directorates. The company works on the strong guiding principles of focus, cost leadership and product differentiation. The firm has a full -fledged Total Quality Management(TQM) cell and the total quality management cell of the company was very active and efficient at the initial years of operations and it did never make any compromise in quality control and quality management of the product keeping in view the international standards and parameters. This was the inherent strength of the company. The company was always watchful on market standing, productivity, management of financial resources, performance of the managers, attitude of the staff, professionalism, surplus creation and honouring corporate social responsibilities. These are the preambles of the company on which it is founded. But the company is not in a position to make its way in the roads of globalization. The case of the company's performance in totality can be understood from the foregoing account as is made hereunder.

Marketing Functions Perspectives:

The Marketing Directorate is headed by Director (Marketing) assisted by GM (Marketing) at the corporate level. The company is having a downward trend in sales over the years. The budgeted sales for each SBU is 12, 000 (in P1:P2:P3:P4: 1:1:1:1 Ratio) Order received for sales during last five years are as in Year-1, it was 14,000 units, year-2 it was 12, 000 units, year-3 it was 10,000 units, year-4 it was 9, 000 units and year -5 the order received for 7, 000 units. Actual orders received were almost in the above ratio in last five years for the products of the company. The marketing directorate placed its arguments in favour of downward order that both quality and cost in particular and selling price in general are having adverse impact on fulfilling sales target. Earlier, the company was the market leader for the products mentioned above. Now market is very competitive (and practically it became a 'red ocean' now) and after sales service are offered free for three years to five years by the competitors whereas MIL offers only one year after sales free service. The pricing policy is not reviewed for last two years. Market Research (MR) cell is not in a position to work in proper direction keeping pace with at least for the purpose it was created. The marketing information reports generated by the marketing wing of the company both at SBU levels as well as corporate levels reach late to the board for taking appropriate measures and decision. Director (Marketing) does not have sufficient information for reviewing the performance of the sales force periodically. Sales are the part and parcel of the marketing directorate. Advertising and Sales Promotion Budget, according to the CMA of the company, is devoid of justification in terms of result. The incentive for sales force is hardly linked with target achieved by the sales and marketing people. Sometimes, marketing people blames production people for untimely delivery to the customers. There is continuous complaint concerning production of sub-standard product which does not conform to the true requirements of the customers.

Operational Functions Perspectives:

The Operations Directorate of the company is headed by Director (Operations) and assisted by GM (Operations) at corporate level and all the SBUs are headed by GM (Operations) as already mentioned elsewhere. The engineering works of each SBU has 585 uniformly employees under different hierarchies starting from Operational Managers. It follows a scalar chain of 1:8 and it is maintained that 1-8-64-512 i.e. one GM(Operations), eight Dy. GMs, sixty four Managers and five hundred and twelve Operational Managers are approximately there in the payroll of a SBU. Operations Directorate is also controlling authority of Purchase functions and Research and Development and Research and Development Cell is responsible for value analysis and value engineering including product designing. Cost of product is alarmingly high and cost reduction and cost control policy and mechanism is in place in paper only. This is the age of automation and this hardly receives any priority in the Operations Directorate.

Employee cost is almost entirely fixed and nothing other than material cost is variable. Overhead is semi-variable and it may be within a range of 20% as variable and remaining 80 % is fixed. The Cost & Management Accountant (CMA) is of the view that activity based costing can bring about correct product costing and hence in product pricing. Each product should be burdened with its own cost and not that of others. It is the general tendency of GM (Operations), SBU-In-charge, to overrule the recommendations and suggestions of the CMA posted at the SBUs. The material cost variance, labour cost variance and overhead variance in most of the times are adverse and the principles of management by exception are the allergy of SBU-In-charge. Purchase manager is to work in conjunction with stores manager, production managers and finance managers and production managers are required to work in conjunction with marketing managers. Scientific inventory management techniques can help in managing inventory carrying cost and inventory ordering cost according to the CMA. Purchase manager can help in getting reasonable discount in following effective purchase policy. Work study was undertaken by the SBUs five years back and the recommendations of work study group are under the cover of dust.

Finance Functions Perspectives:

The Finance Directorate is headed by Director (Finance) and CFO and is assisted by GM (Finance) at corporate level and Finance Function at SBU level is headed by Dy. GM (Finance) who is essentially a qualified CMA as per the policy of the company. According to the periodical report generated by Finance Wing, cash flow is very weak and there is irregular flow of revenue to the coffer of the company. Collection cell is under the administrative control of Marketing Directorate and functionally responsible to the Finance Directorate. It violates the principles of unity of command and as result it causes an administrative problem for securing accountability and this has been brought to notice of the HR Directorate over time and again but no workable solution is generated so far. Financing working capital is dependent of the strength of cash flow. Purchase Department fails to secure more credit period from the sundry creditors than the collection period allowed to sundry debtors and the same is being practiced by the collection department without any review. The company is contemplating for diversification of its business from manufacturing alternator parts of generator to manufacturing of industrial cranes and for this purpose it needs injecting both debt and equity in terms of Rs.1,000 crores. But it is afraid as to whether people would subscribe to the equity since for last five years rate of dividend payment is marginal even less than that of savings bank interest rate. Currently the company has a capital base of Rs. 2,000 crores out of which 40% is invested in working capital and remaining 60% is locked up in physical and infrastructural assets.

The CFO of the firm is worried that operational cost is with upward trend and revenue earning is with downward trend and it is a very difficult situation to match revenue with escalating expenses. An Earnings per share is abruptly low and it is difficult to earn the confidence of the investors under such circumstances. There is accumulation of book debts and inventory and stores and this disturbs the short term liquidity of the business. The cost structure in terms of the cost of sales of the product comprises of 50%-material, 30% employee costs, 20% overhead and 5% of the cost of sales hardly contributes to profit. CFO feels that abnormal loss in material handling and overhead needs to be controlled and the performance based incentive scheme for the employees should be adopted in order to make the firm financially solvent.

Human Resource Functions Perspectives:

The HR Directorate is headed by Director (HR). The Company has a full-fledged Human Resource Directorate and it deals with recruitment, training and development and promotions of the people of the organizations in general. The HR Directorate functions and monitors the HR Budget as is framed by the company. There is centralization of HR Policy. It is the responsibility of the GM (HR) at corporate level to act as the chief coordinator among the SBU level HR Managers. The SBU HR Managers prepare HR Budgets annually and the same is incorporated in the Master Budget of the Company. It is has been observed that a substantial portion of the HR budget remained unutilized during the panned period and the GM (HR) could not justify the non-utilization of the HR Budget. Budget proposal is placed by SBU HR Managers and the same is forwarded by the GM (Operations) to Headquarters of the company located at Mumbai, India for adoption. Moreover GM (HR) takes lot of time to communicate the approved HR budget to the SBU HR Managers and SBU In-charges. The world is changing very fast keeping pace with advancement of science and technology. Staff cost is 30% of the cost of sales in general and every employee has to contribute positively to growth and prosperity of the company. The people of the organization have to work keeping in view of importance and significance of economy, efficiency and effectiveness. Non performers have to be identified and the company does not have a time-honoured mechanism and parameters for measuring the efficiency of the people. The company HR Policy is back dated. It is observed that a person who joined as Foreman/supervisor remained in the same position during last twenty or more years. The employees at all levels are found demoralized and de-motivated. The cost of inefficiency burdens the pricing of the product in particular and the firm in general. The people of the organization are concerned with mission, vision, objectives and goal of the company only in paper and it lacks initiative in translating vision into action and action into result. The leadership of the company is found to bureaucratic and sometimes it is autocratic. Chain of command and control is centralized at corporate level. There is mounting court cases between the unhappy workforce and the firm. The company is functioning in a closed ended system.

Conclusion:

It is evident from the above that the firm in our Case is ambitious for expansion of the business in one hand and on the other hand it is not in a position to manage the existing business in cost effective manner. It fails to generate reasonable rate of return on capital employed, could not pay good dividend, working capital financing is weak as a result of feeble cash flow, burdened with inefficient workforce and attributed with alarming rise in cost of production and attributed with declining trend of earning revenue. The cost of inefficiency is yet to be worked out. The Total Quality Management (TQM) hardly works. Internal failure cost, external failure cost, appraisal cost and correcting costs are major components of TQM but they remain unreported in most of the time. There is huge gap between contemplation and action. An organization means people and it fails to deal with its people in time-honoured conducive manner that can inspire and motivate the workforce of the company. The CMA has been giving continuously alarming bell but the management does not give due attention to it. It is now high time to draw the existing balanced scorecard and the budgeted one for the given firm. Both the principles of management by objectives and management by exception need to be made workable in cohesive manner. The sustainability and survival of the company under fierce competitive environment needs to be ensured. The CEO & Managing Director is not getting relevant information for the purpose of formulating appropriate strategy. Management Information System (MIS) is inactive, inefficient and ineffective. The whole organization is plagued by inefficiency and they ultimately have failed to deliver the result. Under the circumstances, the CEO & Managing Director requested the CMA as the business strategist to submit its report on the overall functioning of the firm incorporating its recommendations for revamping, sustainability under competitive environment, honouring the claims of various stakeholders and complying with the requirement of corporate social responsibility of multiproduct-multinational firm as the present one. It also should suggest an efficient transfer pricing mechanism that would promote goal congruency in the organization on overall count.

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