Paper 15 - Business Strategy & Strategic Cost Management
Section A

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

1. Tangy spices Ltd, the countries' biggest spices marketer has decided to launch a hostile bid for Italy's major spice marketer Chilliano. This is a rare case of an Indian company making an unsolicited hostile bid for a foreign company. The Tangy Spices Ltd. has competencies in Indian spices. The major destination markets for the Tangy spices Ltd. exports have been the Europe and America. The competencies of Chilliano lie in Italian herbs and spices. The Indian company with the takeover wishes to synergies its operations in the world market. It also wants to take advantage of the reach enjoyed by the Italian company in several countries where its products are not being sold presently.

The move of hostile takeover follows Chilliano's rejection to an agreement entered a year back. At that time Chilliano was suffering losses and it offered majority shares at a price of € 2.25. A total of 20% shares were transferred at that time. In one year Chilliano was able to turnaround its operations and the company made handsome profits in the last quarter. The promoters who have residual holding of 35% in the company are reluctant to transfer the shares now. They have rejected the agreement with a plea that the earlier offer price was not sufficient.

Tangy spices Ltd has revised its offer to € 2.95. By this lucrative offer some of the large shareholders of Chilliano reveal their interest for selling their stakes. On the other hand, promoters maintained their position on this matter. Through the process of buying of shares in the market the Tangy spices Ltd. gradually consolidated its holding in Chilliano to 45%. Being a major shareholder they were ready for a takeover. At the same time, Tangy spices Ltd. was trying hard to improve their position so that they do not leave any space for Chilliano's promoters in future.

Read the above case and answer the following questions:

(i) What strategic alternative is followed by Tangy spices Ltd? **[4]**
(ii) Is the hostile takeover by an Indian company appropriate? **[3]**
(iii) Why the Tangy Spices Ltd. is interested in this takeover? **[4]**
(iv) Why the promoters are reluctant to transfer the shares after the agreement? **[4]**

2. 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 Rs. 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 angle 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.

Read the above case and answer the following questions:

(i) What is divestment strategy? Do you see it being practised in the given case? Explain. **[4]**

(ii) What is stability strategy? Should Meters Limited adopt it? **[4]**

(iii) What is expansion strategy? What are the implications for Meters Limited in case it is adopted? **[4]**

(iv) What are your suggestions to the Chief Executive? **[3]**

3. (a) What is the difference between the corporate strategy and business strategy ? **[2]**

(b) Write short note on Merger / Acquisition Strategy. **[4]**

(c) Explain the linkage between environmental analysis and strategic management. **[4]**

4. Why Environmental Scanning? Explain in detail. **[10]**

5. Write a note on Tows Matrix. **[10]**

Section B

Question No.6 is Compulsory. Answer any two questions from the rest.

6. A Company is engaged in the manufactured of edible oil. It has three divisions as under:

(i) Harvesting Oil seeds and transportation thereof to the oil mill.

(ii) Oil Mill, which processes oilseeds and manufactures edible oil.

(iii) Marketing division, which packs the edible oil in 2 kg. Containers for sale at ₹150 each.

The oil Mill has a yield of 1,000 kg. of oil from 2,000 kg. of oilseeds during a period. The marketing Division has a yield of 500 cans of edible oil of 2 kg. each from every 1,000 kg. of oil.
The net weight per can is 2 kg. of oil.
The cost data for each division for the period are as under:

Harvesting division:	
Variable cost per kg. of oilseed	₹2.50
Fixed cost per kg. of oilseed	₹5.00
Oil Mill Division:	
Variable cost of processed edible oil	₹10.00 per kg.
Fixed cost of processed edible oil	₹7.50 per kg.
Marketing Division:	
Variable cost per can of 2 kg. of oil	₹3.75
Fixed cost per can of 2 kg. of oil	₹8.75

The fixed costs are calculated on the basis of the estimated quantity of 2,000 kg. of oilseeds harvested. 1,000 kg. of processed oil and 500 cans of edible oil packed by the aforesaid divisions respectively during the period under review.

The other oil mills buy the oilseeds of same quantity at ₹12.50 kg. in the market. The market price of edible oil processed by the oil mill, if sold without being packed in the marketing division is ₹62.50 per kg. of oil.

Required:

(i) Compute the overall profit of the Company of harvesting 2,000 kg. of oilseeds, processing it into edible oil and selling the same in 2 kg. cans as estimated for the period under review.

(ii) Compute the transfer prices that will be used for internal transfers from (1) Harvesting Division under the following pricing methods:

1. Shared contribution in relation to variable costs: and

2. Market price.

(iii) Which transfer pricing method will each divisional manager prefer to use? **(3+3+4)**

7. (a) The performance data for the last year and current year of an organization are shown below:

	Last Year	Current Year
Sales	₹80,00,000	92,84,000
Material Cost	50,00,000	61,48,000
Variable Overheads	5,00,000	5,40,000
Labour Cost (fixed)	10,00,000	11,50,000
Fixed Overheads	8,00,000	8,50,000
Total Cost	73,00,000	86,88,000
Profit	7,00,000	5,96,0000

Assess the impact of different factors responsible for decline in profit during the current year, given the following information:

Average price rise in materials	6%
Average increase in rate or expenses (both variable and fixed)	8%
Average increase in wage rates	10%
Average increase in selling price	5.5%

(10)

(b) The Marketing Director of a Company engaged in the manufacture and sales of a range of products wants to increase the market share and for the purpose proposes to spend ₹5,00,000 on advertisement campaign.

Two alternatives sales budget have been put forward as under:

Products	**A**	**B**	**C**	**D**
Budget: (Units'000)				
A:Before advertisement	360	560	520	300
B:After advertisement	380	590	545	315
The selling prices on variable cost data are as under:				
Selling price/Units	₹20	₹24	₹50	₹42
Direct materials/Unit	₹8	₹11	₹25	₹21
Direct Labour/Units	₹3	₹3	₹6	₹5
Variable Overheads/Unit	₹2	₹2	₹4	₹3

Direct labour hour rate is ₹5 per hour. Fixed overheads amount to ₹51,40,000 per annum. The production capacity is limited to ₹15,00,000 direct labour hour for the ensuring year. A and C however, could be bought on subcontract basis at ₹17 and ₹40 per unit respectively for sale.

Required:

Present a statement showing profitability of the proposed scheme and state weather the investment in the advertisement campaign is worthwhile. **(10)**

8. (a) The most recent audited summarized Balance Sheet of Stop and Shop Financial services is given below:

Liabilities	(₹ in lakhs)	Assets	(₹ in lakhs)
Equity Share capital	65	Fixed Assets:	
Reserve & Surplus	110	-Assets on lease (Original cost: ₹550 lakhs)	375
Term Loan from IFCI	80	-Other fixed assets	50
Public Deposits	150	Investments (on wholly owned subsidiaries)	20
Bank Borrowings	147	Current assets	
Other Current Liabilities	50	-Stock on hire	80
		-Receivables	30
		-Other current assets	35
		Miscellaneous expenditure (not written off)	12
	602		602

The Company intends to enhance its investment in the lease portfolio by another ₹1,000 lakhs. For this purpose it would like to raise a mix of debt and equity in such a way that the overall cost of raising additional funds is minimized. The following constraints apply to the way the funds can be mobilized:

(i) Total debt divided by net owner funds, cannot exceed 10.
(ii) Amount borrowed from financial institutions cannot exceed 25% of the net worth.
(iii) Maximum amount of bank borrowings cannot exceed three times the net owned funds.
(iv) The Company would like to keep the total public deposit limited to 40% of the total debt.

The post-tax costs of different sources of finance are as follows:

Equity	25%
Term Loans	8.5%
Public Deposit	7%
Bank Borrowings	10%

Formulate the funding problem as an LPP.
[Note: Total Debt=Term loans from financial institutions + Public Deposits + Bank Borrowings

Net Worth=Equity Share Capital + Reserve & Surplus
Net Owned Funds=Net Worth – Miscellaneous Expenditures.] **(10)**

(b) Computo Ltd manufactures two parts 'p' and 'Q' for computer Industry.

- P: Annual production and Sales of 1,00,000 units at a Selling price of ₹100.05 per unit.
- Q: Annual production and Sales of 50,000 units at a Selling price of ₹150 per unit.

Direct and Indirect Costs incurred on these two parts are as follows:- (₹ in thousands)

Particulars	P	Q	Total
Direct Material Cost (Variable)	4,200	3,000	7,200
Labour Cost (Variable)	1,500	1,000	2,500
Direct Machining Costs (See Note)	700	550	1,250
Indirect Costs:			
Machine set Up Cost			462
Testing Cost			2,375

Engineering Cost			**2,250**
Total			**16,037**

Note: Direct Machining Costs represent the cost of machine capacity dedicated to the production of each product. These costs are fixed and are not expected to vary over long-run horizon.

Additional information is as follows:-

Particulars	P	Q
Production Batch Size	1,000 units	500 units
Set up time per batch	30 hours	36 hours
Testing time per unit	5 hours	9 hours
Engineering Cost incurred on each product	₹8,40,000	₹14,10,000

A foreign Competitor has introduced product very similar to 'P'. To maintain the Company's share and profit, Computo Ltd. has to reduce the price to ₹86.25. The Company calls for a meeting and comes up with a proposal to change design of product 'P'. The expected effect of new design is as follows:

- Direct material Cost is expected to decrease by ₹5 per unit.
- Labour Cost is expected to decrease by ₹2 per unit.
- Machine time is expected to decrease by 15 minutes, previously took 3 hours to produce 1 unit of 'P'. The machine will be dedicated to the production of new design.
- Set up time will be 28 hours for each set up.
- Time required for testing each unit will be reduced by 1 hour.
- Engineering Cost and Batch Size will be unchanged.

Required:

(i) Company Management identifies that cost driver for Machine Set-Up Costs is 'set up hours used in batch setting' and for Testing Costs is 'testing time'. Engineering Costs are assigned to products by special study. Calculate the full cost per unit foe 'P' and 'Q' using Activity-Based Costing.

(ii) What is the Mark-up on full cost per unit of P?

(iii) What is the Target Cost per unit for new design to maintain the same mark up percentage on full cost per unit as it had earlier? Assume cost per unit of cost drivers for the new design re0mains unchanged.

(iv) Will the new design achieve the cost reduction target?

(v) List possible management actions that the Computo Ltd. should take regarding new design. **(3+1+2+2+2)**

9. (a) A Small project is composed of seven activities, whose time estimates (in days) are listed below. Activities are identified by their beginning (i) and ending (j) node numbers.

Activity (i -j)	**1-2**	**1-3**	**1-4**	**2-5**	**3-5**	**4-6**	**5-6**
Duration t_o	2	2	4	2	4	4	6
Duration t_m	2	8	4	2	10	10	12
Duration t_p	14	14	16	2	28	16	30

(i) Draw the project Network.

(ii) Find the expected duration and variance for each activity. What is the expected project length?

(iii) If the project due date is 38 days, what is the probability of meeting the due date? **(4+3+3)**

(b) What is Margin of Safety? How it is calculated? How it can be improved? **(2+1+2)**

(c) What is cost of quality? How it can be reduced? **(2+3)**