

Paper 15 - Business Strategy and Strategic Cost Management

Time Allowed: 3 hours

Full Marks: 100

This paper contains 4 questions, representing two separate sections as prescribed under syllabus 2012. All questions are compulsory, subject to the specific guidance/ instructions stated against each question. All workings, wherever necessary, must form a part of your answer. Assumptions, if any, should be clearly stated.

Question No. 1. (Read the Case and Answer the following Questions)

1. Lenovo Group is one of the leading IT companies in China and it has now become the 3rd PC provider in the world market after the acquisition of IBM's Personal Computing Division. As a global company after the alliance with IBM, it has a number of more than 19,000 employees worldwide. Lenovo has always aspired to become a global company. On December 8th, 2004, Lenovo announced that it would acquire IBM's global PC business for US\$ 1.25 billion and a five-year brand licensing agreement. According to the terms of the agreement, the acquisition included IBM's desktop and notebook computer business, as well as its PC-related R&D centers, manufacturing plants, global marketing networks, and service centers. As part of the transaction, Lenovo and IBM also entered a broad-based, strategic alliance of warranty and maintenance services and preferred supplier of customer leasing and channel financing services to Lenovo. On April 30th, 2005, Lenovo completed the landmark acquisition with IBM and entered a new era of globalization, making the new Lenovo a PC leader in the global market, with approximately 8 per cent of the worldwide PC market by shipments, followed after Dell (16.4%) and HP (13.9%).

Answer the following questions —

- (1) Describe the motives of a company toward Strategic Alliances.
- (2) What are reasons can be considered for the failure of strategic alliance among different companies? State in details.
- (3) What was the necessity to form the strategic alliance between Lenovo and IBM? Also state the motives toward Lenovo & IBM's Strategic Alliance. **[7+5+(2+6)]**

Question No. 2. (Answer **any two** questions. Each question carries **15 marks**)

- 2.(a) (i) What do you mean by strategic leadership? What are two approaches to leadership style? **[2+2+2=6]**
- 2.(a) (ii) Under what conditions would you recommend the use of Turnaround strategy in an organization? **[4]**
- 2.(a) (iii) An important part of strategic management process is implementation of strategy. Discuss the relationship of soundness of strategy with the quality of implementation. **[5]**

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2. (b)(i) Define Strategic Alliance. [5]
- 2.(b) (ii) What do you understand by "Strategy"? Explain the four generic strategies as discussed by Glueck and Jauch. [2+8=10]
- 2.(c) (i) Dramatic cost advantages can emerge from finding innovative ways to restructure processes and tasks, cut frills and provide the basics more economically
- (1) List the primary ways by which companies can achieve a cost advantage by reconfiguring their value chains.
- (2) Explain the way a cost leadership strategy can help a firm in handling the five competitive forces.
- (3) Identify the elements in the marketing mix that would be particularly relevant to a manufacturer of domestic washing machine. [4+4+4=12]
- 2.(c) (ii) How emergent strategy is different from deliberate strategy? [3]

Question No. 3. (Read the Case and Answer the following Questions)

3. Hero Cycles has two divisions, A and B, which manufacture expensive bicycles. Division A produces the bicycle frame, and Division B assembles the rest of the bicycle onto the frame. There is a market for both the subassembly and the final product. Each division has been designated as a profit center. The transfer price for the subassembly has been set at the long-run average market price.

The following data are available for each division:

	₹
Selling price for final product	3,000
Long-run average selling price for intermediate product	2,000
Incremental costs for completion in Division B	1,500
Incremental costs in Division A	1,200

The manager of Division B has made the following calculation:

	₹	₹
Selling price for final product		3,000
Transferred-in costs (market)"	2,000	
Incremental costs for completion	1,500	3,500
Contribution (loss) on product		(500)

Required:

- (1) Should transfers be made to Division B if there is no unused capacity in Division A? Is the market price the correct transfer price? Show your computations.

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- (2) Assume that Division A's maximum capacity for this product is 1,000 units per month, and sales to the intermediate market are now 800 units. Should 200 units be transferred to Division B? At what transfer price? Assume that for a variety of reasons, Division A will maintain the ₹ 2,000 selling price indefinitely. That is, Division A is not considering lowering the price to outsiders even if idle capacity exists.
- (3) Suppose Division A quoted a transfer price of ₹ 1,500 for up to 200 units. What would be the contribution to the company as a whole if a transfer were made? As manager of Division B, would you be inclined to buy at ₹1,500? Explain. **[8+5+7]**

Question No. 4. (Answer **any two** questions. Each question carries **15 marks**)

- 4.(a) (i) Shoab Ltd. makes two products – X and Y, with the following cost patterns.

	Product X	Product Y
Direct materials	27	24
Direct Labour at ₹ 5 per hour	20	25
Variable production overheads at ₹ 6 per hour	3	6
	50	55

Production fixed overheads total ₹3,00,000 per month and these are absorbed on the basis of direct labour hours. Budgeted direct labour hours are 25,000 per month. However, the company has carried out an analysis of its production support activities and found that its 'fixed cost' actually vary in accordance with non-volume-related factors.

Activity	Cost-driver	Product X	Product Y	Total cost (₹)
Set-ups	Production runs	30	20	40,000
Materials handling	Production runs	30	20	1,50,000
Inspection	Inspections	880	3,520	1,10,000
				3,00,000

Budget Production is 1,250 units of product X and 4,000 units of product Y.

Required:

Given that the company wishes to make a profit of 20% on full production costs calculate the prices that should be charged for products X and Y using the following.

- (1) Full cost pricing
 (2) Activity based cost pricing
 (3) Offer your comments on the figures arrived at (1) and (2). **[2+4+2=8]**

- 4.(a) (ii) A Company has sales of 1,00,000 units at a price of ₹200.00 per unit and profit of ₹40.00 Lakhs in the current year. Due to stiff competition, the Company has to reduce its price of product next year 5% to achieve same volume target of sales. The cost structure and profit for the current year is given as below:

Particulars	(₹ Lakhs)
Direct Materials	60.00
Direct Wages	45.00

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Variable Factory Overheads	20.00
Fixed Overheads including Sales & Admin Expenses	35.00
Total Cost	160.00

To achieve the Target Cost to maintain the same profit, the Company is evaluating the proposal to reduce Labour Cost and Fixed Factory Overheads. A Vendor supplying the Machine suitable for the Company's operations has offered an advanced technology Semi-Automatic Machine of ₹20 Lakhs as replacement of Old Machine worth ₹5.0 Lakhs. The Vendor is agreeable to take back the Old Machine at ₹2.70 Lakhs only. The Company's policy is to charge depreciation at 10% on WDV. The Maintenance Charge of the Existing Machine is ₹1.20 Lakhs per annum whereas there will be warranty of services free of cost for the New Machine first two years. There are ten (10) Supervisors whose Salary is ₹1.50 Lakhs per annum. The New Machine having Conveyor Belt is expected to help in cost cutting measures in the following ways –

- (1) Improve productivity of workers by 20%
- (2) Cut-down Material Wastage by 1%
- (3) Elimination of services of Supervisors because of automatic facilities of the machine
- (4) Saving in Packaging Cost by 1.5 Lakhs

Assuming Cost of Capital to be 15%, calculate how many supervisors should be removed from the production activities to achieve the Target Cost. **[7]**

- 4.(b) (i)** After observing heavy congestion of customers over a period of time in a petrol station, Mr. Khan has decided to set up a petrol pump facility on his own in a nearby site. He has compiled statistics relating to the potential customers arrival pattern and service pattern as given below. He has also decided to evaluate the operations by using the simulation technique.

Arrivals		Services	
Inter-arrival time (minutes)	Probability	Inter-arrival time (minutes)	Probability
2	0.22	4	0.28
4	0.30	6	0.40
6	0.24	8	0.22
8	0.14	10	0.10
10	0.10		

Assume:

- The clock starts at 8.00 hours
- Only one pump is set up
- The following 12 Random Numbers are to be used to depict the customer arrival pattern.
 - 78, 26, 94, 08, 46, 63, 18, 35, 59, 12, 97 and 82.

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- The following 12 Random Numbers are to be used to depict the customer service pattern.
- 44, 21, 73, 96, 63, 35, 57, 31, 84, 24, 05 and 37.

Your are required to find out the

- (1) Probability of the pump being idle and
(2) Average time spent by a customer waiting in queue **[8+2=10]**

- 4.(b) (ii)** A Company produces three products A, B and C. The following information is available for a period:

Product	A	B	C	Throughout Accounting Ratio
Contribution (₹ per unit) (Sales – Direct Materials)	30	25	15	
Machine hours required per unit of production:				
Machine 1	10 hours	2 hours	4 hours	133.33%
Machine 2	15 hours	3 hours	6 hours	200.00%
Machine 3	5 hours	1 hour	2 hours	66.67%

Estimated Sales Demand for A, B and C are 500 units each and machine capacity is limited to 6,000 hours for each machine. You are required to analyze the above information and apply Theory of Constraints process to remove the constraints. How many units of each product will be made? **[5]**

- 4. (c) (i)** X uses traditional standard costing system. The inspection and setup costs are actually ₹ 1,760 against a budget of ₹ 2,000.

ABC system is being implemented and accordingly, the number of batches is identified as the cost driver for inspection and setup costs. The budgeted production is 10,000 units in batches of 1,000 units, whereas actually, 8,800 units were produced in 11 batches.

- (1) Find the volume and total fixed overhead variance under the traditional standard costing system.
(2) Find total fixed overhead cost variance under the ABC system. **[4+6=10]**

- 4.(c) (ii)** Write down the quality management principle for improved organization performance. **[5]**