PAPER – 15: Business Strategy and Strategic Cost Management

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

Section A

Answer Question No. 1 which is compulsory and Carries 20 Marks.

1. (a) Johnson and Scholes define strategy as follows:
"Strategy is the direction and scope of an organisation over the long-term: which achieves advantage for the organisation through its configuration of resources within a challenging environment, to meet the needs of markets and to fulfill stakeholder expectations".

In other words, strategy is about:

* What resources (skills, assets, finance, relationships, technical competence, facilities) are required in order to be able to compete? (resources)?
* What external, environmental factors affect the businesses' ability to compete? (environment)?
* What are the values and expectations of those who have power in and around the business? (stakeholders)

Strategy in short, bridges the gap between "where we are" and "where we want to be". A method or plan chosen to bring about a desired future, such as achievement of a goal or solution to a problem. "The framework which guides those choices that determine the nature and direction of an organization."

Strategy is significant because it is not possible to foresee the future. Without a perfect foresight, the firms must be ready to deal with the uncertain events which constitute the business environment.

Strategy deals with long term developments rather than routine operations, i.e. it deals with probability of innovations or new products, new methods of productions, or new markets to be developed in future. Strategies dealing with employees will predict the employee behavior. Strategy is a well defined roadmap of an organization. It defines the overall mission, vision and direction of an organization. The objective of a strategy is to maximize an organization's strengths and to minimize the strengths of the competitors.

(b) (Selling Price – Material Cost)/ Time of bottleneck resource
= [(₹ 50 - ₹20)/10 minutes] × 60 = ₹ 180 per hour.

(c)

Units	Average Time (hours)	Total Time (hours)
1	4000	4000
2	3600	7200
4	3240	12960
8	2916	23328

Total time for 5^{th} to 8 units = 23328 – 12960 = 10368 hrs.

(d)

Demand	Price (₹)

20,000	100
40,000	90
80,000	80

Target Cost = ₹ 80 – (25% of 80) = ₹ 80 – 20 = ₹ 60

(e) MS=Profit/PV Ratio = ₹ 4 Lakh: MS=50%; BE Sales = (1-0.50) = 0.50
Hence BES = ₹ 4 lakh
Fixed Cost 25% of ₹ 4,00,000 = ₹ 1,00,000.

Sec-B:
Answer any 5 Questions from the following.
Each Question carries 16 Marks

2. (a) Value chain is defined as "the linked set of value-creating activities all the way from basic raw material sources for component suppliers to the ultimate end-use product or service delivered to the customer."

Porter depicts the value chain, comprising the above interrelated primary and secondary activities, shown in the above figure. Porter classified the full value chain into nine interrelated primary and support activities. Primary activities can be related to actions which the organization performs to satisfy external demands while secondary activities are performed to serve the needs of 'Internal Customers'.

Primary activities are the fundamental activities performed by an organization in order to be operative. They are: (a) Inbound logistics, (b) Operations, (c) Outbound logistics, (d) Marketing and sales and (e) Service.

Secondary activities are support activities, i.e. those activities required to ensure the efficient performance of the primary activities. Support activities are: (a) Infrastructure, (b) Human resources management, (c) Technology development, and (d) Procurement.

Primary Activities

- **Inbound Logistics** - Inbound logistics cover all the activities performed to have goods and services available for the operational processes as and when they will be required. This may include buying, transport, receiving, inspection, storage, etc.
- **Operations** - These are the operations the organization performs to convert its raw materials or products into a state for resale. In the case of a manufacturing concern these may be various production-related activities such as production control, machining, finishing, etc. For a retail business these maybe the merchandising and display activities used to offer goods to customers for sale.
- **Outbound Logistics** - These are the activities performed to move merchandise between the seller and the purchaser. They may include selection, scheduling, transport, etc. of deliveries. Some businesses such as cash-and-carry wholesalers may not have such activities as these tasks are performed by the customer.
- **Marketing** - This includes all the activities performed to create demand for the organization's products and services and includes advertising, sales, market research, etc.
- **Service** - It pertains to the services rendered to the customer. These include financing services such as financing the outstanding balance, or after-sales service to products, or services to handle customer queries and complaints, etc.

Support Activities

- **Infrastructure** - This consists of the management structure which services the whole organization as well as structures such as reception, general postal services, messengers, financial accounting and other general activities. An attempt to trace these costs to any specific cost object will result in an inordinate amount of work. The total amount of such cost should be relatively small in comparison with total cost and this cost is usually considered to be untraceable. The cost of the physical infrastructure (plant, equipment, etc.) is considered part of the cost of activities where the infrastructure is used.
- **Human Resources Management**- This is the basic activity of overseeing the acquisition, maintenance and severance of staff and principally services the primary activities. Personnel departments, in-house medical services and even sports clubs may be part of this major activity.
- **Technology Development** - The development of technology today may require large sums of money take place over a lengthy period of time and ultimately benefit a multitude of users in the organization. This cost must thus be seen as any capital project which cannot be charged to users before the project is operative. Technology development cost could thus be capitalized and expensed to users over the useful life of the project. Cost of operating technology must, however, be traced to users on a usage basis. An example may be a large computer project which may take several years to complete. Users will only benefit from the project once it is operative and there is no point in charging this cost before such time.
- **Procurement** - The procurement activity services the organization as a whole by acquiring all necessary goods and services which the organization may require. If the activity is specifically related to the acquisition of, say, raw materials it could be seen as part of the inbound logistics process, i.e. a primary activity. If, however, the procurement activity cannot be linked to purchases for primary activities, it will be considered a secondary (support) activity.

The above value chain activities can, to a greater or lesser extent, be found in most businesses. The value chain serves as a useful mechanism to analyze an organization in order to determine what activities it performs to convert inputs to outputs. It also helps to develop a good understanding of the primary and support activities.

(b) Advantages of the Global Strategic Alliance

There are many specific advantages of a global strategic alliance. You can:

- Get instant market access, or at least speed your entry into a new market.
- Exploit new opportunities to strengthen your position in a market where you already have a foothold.
- Increase sales.
- Gain new skills and technology.
- Develop new products at a profit.
- Share fixed costs and resources.
- Enlarge your distribution channels.
- Broaden your business and political contact base.
- Gain greater knowledge of international customs and culture.
- Enhance your image in the world marketplace.

Disadvantages of the Global Strategic Alliance

There are also some inevitable trade-offs to consider:

- Weaker management involvement or less equity stake.
- Fear of market insulation due to local partner's presence.
- Less efficient communication.
- Poor resource allocation.
- Difficult to keep objectives on target over time.
- Loss of control over such important issues as product quality, operating costs, employees, etc.

3. (a) Corporate restructuring refers to the process by means of which a firm makes an assessment and evaluation of itself at a point of time and refocuses itself to specific tasks of performance for improvements. It looks upon every activity as a green field project and question the firm's basic premise in order to engineer radical change rather than aim for just incremental gains. The concept is sometimes referred to as business process re-engineering as it involves consideration of at least: business portfolio revaluation; financial engineering; and organisational redesign. Corporate level restructuring strategies can be thought of from two aspects: hardware and software. Hardware restructuring involves redefining and/or modifying the structure of the organisation so as to make it more efficient in decision-making, responsiveness and intra-organisational communication etc. Some suggested strategies are:

- Identification of core competency and portfolio pruning
- Flattening of organisational layer
- Downsising
- Creation of self directed teams
- Benchmarking.

Software restructuring involves cultural and process changes required to create collaborative environment for a firm's growth. Suggested steps are:
- Business strategy communication
- Co-ordination
- Trust
- Stretch
- Empowering people
- Industry foresight
- Training.

(b) Vertical Integration:
Vertical integration represents an expansion or extension of the firm by integrating preceding or successive productive processes. That is, the firm incorporates more processes toward the original source or raw materials (backward integration) or toward the ultimate consumer (forward integration). For example, an automobile manufacturer might supply its own parts or make its own engines to secure sources of supply.

Drawbacks of Vertical Integration
While some of the benefits of vertical integration can be quite attractive to the firm, the drawbacks may negate any potential gains. Vertical integration potentially has the following disadvantages:
- Capacity balancing issues. For example, the firm may need to build excess upstream capacity to ensure that its downstream operations have sufficient supply under all demand conditions.
- Potentially higher costs due to low efficiencies resulting from lack of supplier competition.

- Decreased flexibility due to previous upstream or downstream investments. (Note however, that flexibility to coordinate vertically-related activities may increase).
- Decreased ability to increase product variety if significant in-house development is required.
- Developing new core competencies may compromise existing competencies.
- Increased bureaucratic costs.

4. (a) Strategic leadership refers to a manager's potential to express a strategic vision for the organization, or a part of the organization, and to motivate and persuade others to acquire that vision. Strategic leadership can also be defined as utilizing strategy in the management of employees. A few characteristics of effective strategic leaders that do lead to superior performance are as follows:

- Loyalty- Powerful and effective leaders demonstrate their loyalty to their vision by their words and actions.
- Keeping them updated- Efficient and effective leaders keep themselves updated about what is happening within their organization. They have various formal and informal sources of information in the organization.
- Judicious use of Power- Strategic leaders makes a very wise use of their power. They must play the power game skillfully and try to develop consent for their ideas rather than forcing their ideas upon others. They must push their ideas gradually.
- Have wider perspective/outlook- Strategic leaders just don't have skills in their narrow specialty but they have a little knowledge about a lot of things.
- Motivation- Strategic leaders must have a zeal for work that goes beyond money and power and also they should have an inclination to achieve goals with energy and determination.
- Compassion- Strategic leaders must understand the views and feelings of their subordinates, and make decisions after considering them.
- Self-control-Strategic leaders must have the potential to control distracting/disturbing moods and desires, i.e., they must think before acting.
- Social skills- Strategic leaders must be friendly and social.
- Self-Awareness- Strategic leaders must have the potential to understand their own moods and emotions, as well as their impact on others.
- Readiness to delegate and authorize- Effective leaders are proficient at delegation. They are well aware of the fact that delegation will avoid overloading of responsibilities on the leaders. They also recognize the fact that authorizing the subordinates to make decisions will motivate them a lot.
- Articulacy- Strong leaders are articulate enough to communicate the vision (vision of where the organization should head) to the organizational members in terms that boost those members.
- Constancy/Reliability- Strategic leaders constantly convey their vision until it becomes a component of organizational culture.

To conclude, Strategic leaders can create vision, express vision, passionately possess vision and persistently drive it to accomplishment.

(b) Important characteristics of corporate level strategy

- The corporate level strategy is formulated by the top management of the organization.
- It is formulated on the basis of a clear and collective point of view about the future.
- The corporate level strategy defines the overall direction of the organization and the broad boundaries based on which the business unit strategy and functional strategy are formulated.
- It is formulated on the basis of an analysis of available resources on the one hand

and environmental opportunities on the other.

- The corporate level strategy deals with decision relating to the two-way flow of resources and information between corporate level and product/service lines and businesses. This is done through a coordination mechanism formulated by the top management with inputs from top management of SBUs.
- It is applicable for a long period of time.

5. (a) Strategic Planning: Strategic planning refers to the formulation of a unified, comprehensive and integrated plan to get the strategic advantages by challenging the environment. It is concerned with appraising the environment in relation to the firm, identifying the strategies for the future with the best possible knowledge of their probable outcome. Thus strategic planning provides the framework within which future activities of firm are expected to be carried out.

Features of Strategic Planning: Strategic planning has the following features —

(i) Strategic planning is a forward-looking exercise, which determines the future condition and attitude of the firm with special reference to its product market, profitability, size, rate of innovation etc.
(ii) It is a systematic and disciplined exercise to formulate two types of plans—operating and strategic plan. The different units in an organisation implement the operating plans.
(iii) Strategic plans are implemented through projects.
(iv) It relates to the enterprise as a whole or to particular unit.

Usefulness of Strategic Planning: The usefulness of Strategic Planning are as follows —

(i) According to different research studies, strategic planning contributes positively to the performance of enterprise and predicts better outcomes and isolates key factors of the firm.
(ii) It is concerned with .the allocation of resources to product market opportunities and concerned to realise the company's profit potential through selected strategies.
(iii) It measures the strengths and weaknesses of the firm.
(iv) It selects the optimum strategy from the alternatives considering the interest of the firm, personal values of top management and social responsibility of the firm.
(v) With fast changing product market condition, technology economic condition the strategic planning is the only means by which future opportunities and problems can be anticipated by company executives.
(vi) It enables executives to provide necessary direction for the firm, to take full advantage of new opportunities and to minimize the risk.

(b) Let x_1 be the no. of units of product P
Let x_2 be the no. of units of product Q
Let x_3 be the no. of units of product R

Objective function: Max. $Z = 3x_1+5x_2 + 4x_3$
Subject to constraints:
$2x_1+3x_2 \le 8$
$3x_1+2x_2 + 4x_3 \le 15$
$2x_2+5x_3 \le 10$
And $x_1, x_2, x_3 \ge 0$

6. (a) Internal Benchmarking

It involves looking within the organization to determine other departments, locations and projects which have similar activities and then defining the best practices amongst them. It involves seeking partners from within the same organization. For example, from business units located in different areas. The main advantages of internal benchmarking are that access to sensitive data and information are easier; standardized data is often readily available; and usually less time and resources are needed. There may be fewer barriers to implementation as practices maybe relatively easy to transfer across the same organization. However real innovation may be lacking and best in class performance is more likely to be found through external benchmarking.

Competitive Benchmarking

It involves examining the products, services and processes of competitors and then comparing them with their own. It involves the comparison of competitors' products, process and business results with own. It requires that the company perform a detailed analysis of its competitors' products, services, and processes. Benchmarking partners are drawn from the same sector. However to protect confidentiality it is common for the companies to undertake this type of benchmarking through trade associations or third parties.

(b) Profit Matrix

6	-2	3	80
6	-2	2	110
1	-4	2	150
0	0	0	40
150	100	130	380

Loss Matrix

0 40	8 40	3	80/40/0	3/3/5
0 110	8	4	110/0	4*
5	10 20	4 130	150/20/0	1/1/6*
6	6 40	6	40/0	0/0/0
150 40 0	100 0	130 0		

0	2	1
5*	2	1
	2	1

	$\boxed{0}$ 40	$\boxed{8}$ 40	$\boxed{3}$ 1	0	U_i
	$\boxed{0}$ 110	$\boxed{8}$ 0	$\boxed{4}$ 2	0	
	$\boxed{5}$ 3	$\boxed{10}$ 20	$\boxed{4}$ 130	2	
	$\boxed{6}$ 4	$\boxed{6}$ 40	$\boxed{6}$ 6	-2	
V_j	0	8	2		

As there are m+n-1 allocations, optimality test can be performed since $\Delta_{ij} \geq 0$,

		Quantity	Maximum Profit
F1	W1	40 × 6	240
	W2	40 × -2	-80
F2	W1	110 × 6	660
F3	W2	20 × -4	-80
	W3	130 × 2	260
F4 Dummy	W2	40 × 0	0
		380	₹ 1000

Profit ₹ 1,000/-

7. (a)

COMPUTATION OF REQUIRED VALUES

(1) SRSH	(2) SRAH	(3) SRBH	(4) ARAH
5 × 1000	5 × 800	5 × 1200	8 × 800
5000	4000	6000	6400

SRSH - SRBH = Volume Variance
SRSH – 6000 = -1000
SRSH = 5000
SRSH – ARAH = Cost Variance
5000-ARAH = -1400
ARAH = 6400

1) SRSH = Standard Cost of Standard Overheads = ₹5,000
2) SRAH = Standard Cost of Actual Overheads or Overheads recovered = ₹4,000
3) SRBH = Budgeted Fixed Overheads = ₹6,000
4) ARAH = Actual Fixed Overheads = ₹6,400

a. Overhead expenditure variance = 6000 – 6400 = 400 (A)

b. Actual OH's incurred = ₹ 6,400
c. Actual hours for actual production = 800
d. Overheads capacity variance = 4,000 – 6,000 = ₹ 2,000 (A)
e. Overheads efficiency variance = 5000 – 4000 = 1,000 (F)
f. Standard hours for actual production = 1000

(b)

Statement showing computation of expected profit as per Budget 1989:

		Pessimistic	Most Likely	Optimistic
I.	No. of Units	8000	10,000 (8000+2000)	15,000
		₹	₹	₹
II.	Contribution per unit	6.5 (19 – 9 – 2 - 1.5)	8 (20 – 8 – 3 – 1)	9
III.	Total Contribution	52,000	80,000	1,35,000
IV.	Fixed Cost	60,000	50,000	48,000
V.	Profit/Loss	(8000)	30,000	87,000
	Probability	0.2	0.7	0.1
	Expected Profit/Loss	(1600)	21,000	8,700

The expected value of profit is ₹ 28,100.

8.

Computation of labour and overhead rate

	Core making	Melting & pouring	Moulding	Cleaning & grinding
Labour & overheads (₹)	18,000.00	26,000.00	9,000.00	6,500.00
Labour & overheads per hour (₹)	9.00	6.50	6.00	5.20
No. of hours	2,000.00	4,000.00	1,500.00	1,250.00
Variable overhead per hour (₹)	1.50	0.25	0.67	0.80
Labour rate per hour (₹)	5.00	4.00	4.00	3.60
Hours required for new order	1,350.00	2,250.00	900.00	900.00
Labour cost required for order (₹)	6,750.00	9,000.00	3,600.00	3,240.00
Variable overhead cost for order (₹)	1,620.00	563.00	600.00	270.00

Revised monthly labour and overheads cost budget reflecting the additions of the order

	Core making	Melting & pouring	Moulding	Cleaning & grinding	Total
	₹	₹	₹	₹	₹
Labour	10,000.00	16,000.00	6,000.00	4,500.00	
Labour for the order	6,750.00	9,000.00	3,600.00	3,240.00	
	16,750.00	25,000.00	9,600.00	7,740.00	
Variable overheads	3,000.00	1,000.00	1,000.00	1,000.00	
Variable overheads for the order	1,620.00	563.00	600.00	270.00	
	4,620.00	1,563.00	1,600.00	1,270.00	
Fixed cost	5,000.00	9,000.00	2,000.00	1,000.00	
Total	26,370.00	35,563.00	13,200.00	10,010.00	85,143.00
Add : additional fixed cost					1,000.00
				Total:	86,143.00

Computation of total price for the order

		₹
Material	(15000 × 1)	15,000.00
Labour & overheads	(86143 - 59500)	26,643.00
		41,643.00
Total price for the order	(41643 × 6)	249858