

Paper 15 - Business Strategy and Strategic Cost Management

This paper contains 4 questions. All questions are compulsory, subject to instruction provided against each questions. All workings must form part of your answer. Assumptions, if any, must be clearly indicated.

Section A

1. DD is the India's premier public service broadcaster with more than 1,000 transmitters covering 90% of the country's population across an estimated 70 million homes. It has more than 20,000 employees managing its metro and regional channels. Recent years have seen growing competition from many private channels numbering more than 65, and the cable and satellite operators (C & S). The C & S network reaches nearly 30 million homes and is growing at a very fast rate.

DD's business model is based on selling half-hour slots of commercial time to the programme producers and charging them a minimum guarantee. For instance, the present tariff for the first 20 episodes of a programme is ₹30 lakhs plus the cost of production of the programme. In exchange the producers get 780 seconds of commercial time that he can sell to advertisers and can generate revenue. Break-even point for producers, at the present rates, thus is ₹ 75,000 for a 10 second advertising spot. Beyond 20 episodes, the minimum guarantee is ₹65 lakhs for which the producer has to charge ₹1,15,000 for a 10 second spot in order to break-even. It is at this point the advertisers face a problem - the competitive rates for a 10 second spot is ₹50,000. Producers are possessive about buying commercial time on DD. As a result the DD's projected growth of revenue is only 6-10% as against 50-60% for the private sector channels. Software suppliers, advertisers and audiences are deserting DD owing to its unrealistic pricing policy. DD has three options before it. First, it should privatize, second, it should remain purely public service broadcaster and third, a middle path. The challenge seems to be to exploit DD's immense potential and emerge as a formidable player in the mass media.

Required:

- (i) Discuss the best option, in your view, for DD.
- (ii) Analyze the SWOT factors the DD has.
- (iii) Explain the proposed alternatives which you suggested.
- (iv) State the basic objectives for conducting SWOT analysis. **[6+6+4+4]**

2. Answer any two questions [2×15 =30 marks]

- (a) (i) "Choice of strategy is influenced by some factors"- State the factors that influence the choice of strategy.
- (ii) Discuss about the Organizational Development and its characteristics.
- (iii) Distinction between Strategic Management and Strategic Planning **[5+5+5]**
- (b) (i) Enumerate the advantages of Strategic Planning.
- (ii) Discuss the benefits of Strategic Alliance.
- (iii) Describe about the Internal and Competitive Benchmarking. **[5+5+5]**
- (c) (i) Explain about the BCG Matrix.
- (ii) State the drawbacks of Vertical Integration. **[10+5]**

Question.3 (Compulsory) [20 marks]

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- (a) (i) State Bank of India (SBI) is examining the profitability of its premier Account, a combined saving and checking account. Depositors receive a 7 percent annual interest rate on their average deposit. SBI earns an interest rate spread of 3 percent (the difference between the rate at which it lends money and the rate it pays depositors) by lending money for home loan purpose at 10 percent. Thus, SBI would gain ₹60 on the interest spread if a depositor has an average premier Account balance of ₹2,000, that is $₹2,000 \times 3\% = ₹60$

The premier Account allows depositors unlimited use of services such as deposits, withdrawals, checking accounts, and foreign currency drafts. Depositors with premier Account balances of ₹1,000 or more receive unlimited free use of services. Depositors with minimum balances of less than ₹1,000 pay a ₹20-a-months service fee for their premier Account.

SBI recently conducted an activity-based costing study of its services. It assessed the following costs for six individual services. The use of these services in current year by three customers is as follows:

Particulars	Activity-based Cost per Transaction	Nitin	Arvinder	Sanjay
Deposit/withdrawal with teller	₹2.50	40	50	5
Deposit/withdrawal with automatic teller machine (ATM)	0.80	10	20	16
Deposit/withdrawal on prearranged monthly basis	0.50	0	12	60
Bank checks written	8.00	9	3	2
Foreign currency drafts	12.00	4	1	6
Inquiries about account balance	1.50	10	18	9
Average premier account balance for current year		₹1,100	₹800	₹25,000

Assume Nitin and Sanjay always maintain a balance above ₹1,000, whereas Arvinder has a balance below ₹1,000.

Required:

- I. Compute the current year profitability of Nitin, Arvinder and Sanjay's premier Accounts at SBI.
- II. What evidence is there of cross-subsidization among the three premier Account? Why might SBI worry about the cross-subsidization if the premier account product offering is profitable as a whole?
- III. What changes would you recommend for SBI's premier account?
[6+5+3]

- 3.(a) (ii) Explain the important terms which is used in Activity Based Costing. [6]

Question.4 Answer any two questions

[2×15 =30 marks]

(a) (i)

A company produces two products X and Y, the production cost of which are show below:

	X (₹)	Y (₹)
Direct material cost	10	10
Direct labour cost	5	9
Variable overhead	5	9
Fixed overhead	5	9
	25	37

Fixed overhead is absorbed on the basis of direct labour cost.

The product passes through two processes, Assembly and Finishing. The associated labour cost is ₹10 per direct labour hour in each. The direct labour associated with the two products for these processes are shown below:

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Process	Time taken	
	Product X	Product Y
Assembly	10 minutes	40 minute
Painting	20 minutes	15 minutes

The current market price for X is ₹65 and for Y it is ₹52. At these prices, the market will absorb as many units of X and Y as the company can produce. The capacity of the company to produce X and Y is limited by the available capacity of the two processes. The company operates two shifts of 8 hours each. Painting is a single process line and two hours in each shift will be down time. Assembly can process two units simultaneously, although this will double the requirement of direct labour. Painting can operate for full 16 working hours each day.

What production plan should the company follow in order to maximize profit under (I) Traditional Costing System and (II) Throughput Accounting System?

[3+3]

4(a) (ii)

A company has developed a special purpose Electronic Security Device and once introduced in the market, the same expected to have a life cycle of 3 years from the time of its introduction in the market before the device becomes obsolete due to technological advancement of other competitive products.

You have been asked by the company to prepare a product life cycle budget.

The following information is available:

	Year 1	Year 2	Year 3
No. of units to be manufactured and sold	50,000	2,00,000	1,50,000
Price per device (₹)	500	400	350
R & D and Design cost (₹)	9,00,000	1,00,000	Nil
Production cost:			
Variable cost per device (₹)	200	150	150
Fixed cost (₹)	70,00,000	70,00,000	70,00,000
Marketing cost:			
Variable cost per device (₹)	100	70	60
Fixed cost (₹)	30,00,000	25,00,000	25,00,000
Distribution cost:			
Variable cost per device (₹)	50	50	50
Fixed cost (₹)	10,00,000	10,00,000	10,00,000

Prepare the budgeted life cycle operating profit.

It has been further indicated that if a discount of 10% is given to customer, the unit to be sold per year will increased by 5%. Would you recommend introduction of such discount?

[3+6]

4(b).(i)

Explain the theory of constraints?

[5]

4(b).(ii)

Apollo Company prepares its budgeted output and sales at its maximum capacity of 20,000 units for 2014. However, due to efficiency improvements, Apollo was able to sell 22,000 units for the year. Other data for 2014 follows as:

Budgeted fixed overhead costs	₹5,00,000
Budgeted selling price	100
Budgeted variable cost per unit	40

- I. Calculate the budgeted profit per unit, the operating income based on the budgeted profit per unit, and the flexible-budget operating income.

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- II. Compute sales-volume variance and production-volume variance. What do each of these variance measures?

[4+6]

Question.4 (c) (i)

An automobile production line turns out about 100 cars a day, but deviations occur owing to many causes. The production is more accurately described by the probability distribution given below:

Production per day	Probability	Production per day	Probability
95	0.03	101	0.15
96	0.05	102	0.10
97	0.07	103	0.07
98	0.10	104	0.05
99	0.15	105	0.03
100	0.20	Total	1.00

Finished cars are transported across the day, at the end of the each day; by ferry has space for only 101 cars.

Required:

- I. What will be the average number of cars waiting to be shipped?
- II. What will be the average area of empty space on the boat?

The fifteen random numbers are given: 20, 63, 46, 16, 45, 41, 44, 66, 87, 26, 78, 40, 29, 92, & 21

[3+3]

4 (c).(ii)

Two similar products A and B, manufactured by a company for a production period have the following data:

Particulars	Product A	Product B
Selling price (₹/unit)	50	70
Variable cost (₹/unit)	30	40
Labour hours per unit	2	6

Total fixed costs that have to be incurred irrespective of the type of product amounts to ₹ 1,80,000. Besides, there are specific fixed costs of ₹ 60,000 to be incurred only if A is produced and ₹ 72,000 to be incurred only if B is produced. Assume no inventory. At present, 7,500 units of A and 7,500 units of B are sold.

Required:

- I. What is the current Break-Even Point (BEP)?
- II. What is the minimum number of units to achieve BEP?
- III. If there are only 10,000 labour hours possible in production period, what would be the optimum product-mix?

[2×3=6]

4 (c).(iii)

"Kaizen Costing is an approach that explicitly incorporates continuous improvement during the budget period" Discuss the statement. [3]