

Paper 15 - Business Strategy and Strategic Cost Management

PTP_Final_Syllabus 2012_Dec2015_Set 1

The following table lists the learning objectives and the verbs that appear in the syllabus learning aims and examination questions:

	Learning objectives	Verbs used	Definition
LEVEL C	KNOWLEDGE What you are expected to know	List	Make a list of
		State	Express, fully or clearly, the details/facts
		Define	Give the exact meaning of
	COMPREHENSION What you are expected to understand	Describe	Communicate the key features of
		Distinguish	Highlight the differences between
		Explain	Make clear or intelligible/ state the meaning or purpose of
		Identity	Recognize, establish or select after consideration
	APPLICATION How you are expected to apply your knowledge	Illustrate	Use an example to describe or explain something
		Apply	Put to practical use
		Calculate	Ascertain or reckon mathematically
		Demonstrate	Prove with certainty or exhibit by practical means
		Prepare	Make or get ready for use
		Reconcile	Make or prove consistent/ compatible
		Solve	Find an answer to
	ANALYSIS How you are expected to analyse the detail of what you have learned	Tabulate	Arrange in a table
		Analyse	Examine in detail the structure of
		Categorise	Place into a defined class or division
		Compare and contrast	Show the similarities and/or differences between
		Construct	Build up or compile
		Prioritise	Place in order of priority or sequence for action
	SYNTHESIS How you are expected to utilize the information gathered to reach an optimum conclusion by a process of reasoning	Produce	Create or bring into existence
		Discuss	Examine in detail by argument
		Interpret	Translate into intelligible or familiar terms
	EVALUATION How you are expected to use your learning to evaluate, make decisions or recommendations	Decide	To solve or conclude
Advise		Counsel, inform or notify	
Evaluate		Appraise or asses the value of	
	Recommend	Propose a course of action	

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.

Full Marks: 100

Time allowed: 3 hours

1. Read the case and answer the following questions.

Dr. Sukumar inherited his father's Dey's Lab in Delhi in 1995. Till 2002, he owned 4 labs in the National Capital Region (NCR). His ambition was to turn it into a National chain. The number increased to 7 in 2003 across the country, including the acquisition of Platinum lab in Mumbai. The number is likely to go to 50 within 2-3 years from 21 at present. Infusion of ₹ 28 crores for a 26% stake by Pharma Capital has its growth strategy.

The lab with a revenue of ₹ 75 crores is among top three Pathological labs in India with Atlantic (₹ 77 crores) and Pacific (₹ 55 crores). Yet its market share is only 2% of ₹ 3,500 crores market. The top 3 firms command only 6% as against 40-45% by their counterparts in the USA.

There are about 20,000 to 1,00,000 stand alone labs engaged in routine pathological business in India, with no system of mandatory licensing and registration. That is why Dr. Sukumar has not gone for acquisition or joint ventures. He does not find many existing laboratories meeting quality standards. His six labs have been accredited nationally whereon many large hospitals have not thought of accreditation; The College of American pathologists accreditation of Dey's lab would help it to reach clients outside India.

In Dey's Lab, the bio-chemistry and blood testing equipments are sanitised every day. The bar coding and automated registration of patients do not allow any identity mix-ups. Even routine tests are conducted with highly sophisticated systems. Technical expertise enables them to carry out 1650 variety of tests. Same day reports are available for samples reaching by 3 p.m. and by 7 a.m. next day for samples from 500 collection centres located across the country. Their technicians work round the clock, unlike competitors. Home services for collection and reporting is also available.

There is a huge unutilised capacity. Now it is trying to top other segments. 20% of its total business comes through its main laboratory which acts as a reference lab for many leading hospitals. New mega labs are being built to Encash preclinical and multi-centre clinical trials within India and provide postgraduate training to the pathologists.

Required:

- (i) What do you understand by the term Vision? What is the difference between 'Vision' and 'Mission'? What vision Dr. Sukumar had at the time of inheritance of Dey's Lab? Has it been achieved? [2+2+3]
- (ii) For growth what business strategy has been adopted by Dr. Sukumar? [3]
- (iii) What is the marketing strategy of Dr. Sukumar to overtake its competitors? [5]
- (iv) In your opinion what could be the biggest weakness in Dr. Sukumar's business strategy? [5]

2. Answer any two questions from (a), (b) and (c): [2 x 15 =30]

- (a) (i) Distinguish between Strategic Management and Strategic Planning. [5]
- (ii) State the advantages of Strategic Planning. [5]
- (iii) List out the characteristics of Learning Organization. [5]

PTP_Final_Syllabus 2012_Dec2015_Set 1

- (b) (i) Discuss the benefits of the strategic alliance. [5]
- (ii) State Corporate Portfolio Analysis. Describe its advantages. [3+2]
- (iii) List the important characteristics of corporate level strategy. [5]
- (c) (i) Enumerate the merits and demerits of Benchmarking. [3+5]
- (ii) Analyze what is meant by the term 'Strategic drift'. [4]
- (iii) List the importance of Strategic Evaluation. [3]

3. Read the case and answer the following questions.

The GE India Ltd. has a machining facility specializing in jobs for the aircraft-components market. The previous job-costing system had two direct-cost categories (direct materials and direct manufacturing labor) and a single indirect-cost pool (manufacturing overhead, allocated using direct manufacturing labor-hours). The indirect cost-allocation rate of the previous system for current year would have been ₹230 per direct manufacturing labor-hours.

Recently a team with members from product design, manufacturing, and accounting used an ABC approach to refine its job-costing system. The two direct-cost categories were retained. The team decided to replace the single indirect-cost pool with five indirect-cost pools. The cost pools represent five activity areas at the facility, each with its own supervisor and budget responsibility. Pertinent data are as follows:

Activity Area	Cost-allocation Base	Cost-allocation Rate
Material handling	Parts	₹ 0.80
Lathe work	Lathe turns	0.40
Milling	Machine-hours	40.00
Grinding	Parts	1.60
Testing	Units tested	30.00

Information-gathering technology has advanced to the point at which the data necessary for budgeting in these five activity areas collected automatically.

Two representative jobs processed under the ABC system at the facility in the most recent period had the following characteristics.

Particulars	Job 410	Job 411
Direct materials cost per job	₹ 9,700	₹ 59,900
Direct manufacturing labor cost per job	₹ 750	₹ 11,250
Number of direct manufacturing labor-hours per job	25	375
Parts per job	500	2,000
Lathe turns per job	20,000	60,000
Machine-hours per job	150	1,050
Units per job (all units are tested)	10	200

- (i) Compute the manufacturing costs per unit for each job under the previous job-costing system.
- (ii) Compute the manufacturing costs per unit for each job under the activity-based costing system.
- (iii) Compare the per unit cost figures for Jobs 410 and 411 computed in requirements (i) and (ii). Why do the previous and the activity-based costing systems differ in the

PTP_Final_Syllabus 2012_Dec2015_Set 1

manufacturing costs per unit for each job? Why might these differences be important to Tracy Corporation? [4+6+(3+5+2)]

4. Answer any two questions from (a), (b) and (c): [2×15=30 marks]

(a) (i) The Videocon Company is an electronics business with eight product lines. Income data for one of the products (XT-107) for June are:

Revenues, 200,000 units at average price of ₹ 1,000	₹ 20,00,00,000
Variable costs	
Direct materials at ₹ 350 per unit	₹ 7,00,00,000
Direct manufacturing labour at ₹ 100 per unit	2,00,00,000
Variable manufacturing overhead at ₹ 50 per unit	1,00,00,000
Sales commissions at 15 % of revenues	3,00,00,000
Other variable costs at ₹ 50 per unit	<u>1,00,00,000</u>
Total variable costs	<u>14,00,00,000</u>
Contribution margin	6,00,00,000
Fixed costs	<u>5,00,00,000</u>
Operating income	<u>₹ 1,00,00,000</u>

Delhi Electronics an instruments company, has a problem with its preferred supplier of XT-107 components. This supplier has had a three-week labour strike. Delhi Electronics approaches the sales representative, Sachin, of the Videocon Company about providing 3,000 units of XT-107 at a price of ₹ 800 per unit. Sachin informs the XT-107 product manager, that he would accept a flat commission of ₹ 60,000 rather than the usual 15% of revenues if this special order were accepted. Videocon has the capacity to produce 3,00,000 units of XT-107 each month, but demand has not exceeded 2,00,000 units in any month in the past year.

1. If the 3,000-unit order from Delhi Electronics is accepted, how much will operating income increase or decrease? (Assume the same cost structure as in June.)
2. Production Manager ponders whether to accept the 3,000-unit special order. He is afraid of the precedent that might be set by cutting the price. He says, "The price is below our full cost of ₹ 950 per unit. I think we should quote a full price, or Delhi Electronics will expect favored treatment again and again if we continue to do business with them." Do you agree with Production Manager? Explain. [5+5]

(a) (ii) H Ltd. has produced its first 10 units of product B. The customer is enquiring about the cost of a further 30 units of product B. The total cost of the original 10 units was:

Materials	3,000
Variable labour costs (500 hours at ₹ 10 per hour)	5,000
Variable overheads*	1,000
Other overheads**	1,000
Machine tool costs***	2,000
Total cost	<u>12,000</u>

* Directly affected by variable labour costs.

** Estimated at 20% of variable labour costs.

*** All machine tools can still be used although all costs recovered on first order.

PTP_Final_Syllabus 2012_Dec2015_Set 1

Use an 80% learning curve to estimate the total costs for a new batch of 30 units of Product B. [5]

4. (b) (i) A company is organised into two divisions namely A and B produces three products, K, L and M.

Data per unit are:

		K	L	M
Market price (₹)		120	115	100
Variable costs (₹)		84	60	70
Direct labour hours		4	5	3
Maximum sales potential (units)		1,600	1,000	600

Division B has demand for 600 units of product L for its use. If Division A cannot supply the requirement, Division B can buy a similar product from market at ₹ 112 per unit.

What should be the transfer price of 600 units of L for Division B, if the total direct labour-hours available in Division A are restricted to 15,000? [8]

- (b) (ii) INTEL Project is having the following activities and their time estimates :

Activity	Predecessor	Time (days)		
		Optimistic (a)	Likely(m)	Pessimistic (b)
A	-	2	4	6
B	A	8	12	16
C	A	14	16	30
D	B	4	10	16
E	C, B	6	12	18
F	E	6	8	22
G	D	18	18	30
H	F, G	8	14	32

Calculate the mean deviation and variance of the project. [3+4]

4. (c) (i) Explain the theory of constraints? [5]

- (c) (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 I	Year II	Year III
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:			

PTP_Final_Syllabus 2012_Dec2015_Set 1

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?

[4+(5+1)]