# Paper 15 - Business Strategy and Strategic Cost Management

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<br><br>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<br><br>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 |
| | | Illustrate | Use an example to describe or explain something |
| | APPLICATION<br><br>How you are expected to apply your knowledge | 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 |
| | | Tabulate | Arrange in a table |
| | ANALYSIS<br><br>How you are expected to analyse the detail of what you have learned | 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 |
| | | Produce | Create or bring into existence |
| | SYNTHESIS<br><br>How you are expected to utilize the information gathered to reach an optimum conclusion by a process of reasoning | Discuss | Examine in detail by argument |
| | | Interpret | Translate into intelligible or familiar terms |
| | | Decide | To solve or conclude |
| | EVALUATION<br><br>How you are expected to use your learning to evaluate, make decisions or recommendations | 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** **[20 marks]**

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 beng 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.

**(a)** What strategic alternative is followed by Tangy spices Ltd? [4]

**(b)** Is the hostile takeover by an Indian company appropriate? [6]

**(c)** Why the Tangy Spices Ltd. is interested in this takeover? [5]

**(d)** Why the promoters are reluctant to transfer the shares after the agreement? [5]

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

**(a) (i)** Describe the process of Strategy evaluation. [4]

**(ii)** Explain the natures and features of strategic planning [6]

**(iii)** Distinguish between PEST and SWOT. [5]

**(b) (i)** Describe the different types of Benchmarking. [10]

**(ii)** Difference between BCG and GE matrix. [5]

**(c) (i)** Describe the Differentiation Business Strategy and condition under which differentiation is used. [9]

**(ii)** List out the benefits of Vertical Integration [6]

**3. Read the case and answer the following questions. [20 marks]**

Gujarat Mineral Development Corporation (GMDC) has two divisions. The Mining Division makes toldine, which is then transferred to the Metals Division. The toldine is further processed by the Metals Division and is sold to customers at a price of ₹ 1,500 per unit. The Mining Division is currently required by GMDC to transfer its total yearly output of 4,00,000 units of toldine to the Metals Division at 110% of full manufacturing cost. Unlimited quantities of toldine can be purchased and sold on the outside market at ₹ 900 per unit.

The following table gives the manufacturing costs per unit in the Mining and Metals divisions for 2014:

| | Mining Division | Metals Division |
|---|---|---|
| Direct materials | ₹ 120 | ₹ 60 |
| Direct manufacturing labour costs | 160 | 200 |
| Manufacturing overhead costs | 320[a] | 250[b] |
| Total manufacturing costs per unit | ₹ 600 | ₹ 510 |

[a] Manufacturing overhead costs in the Mining Division are 25% fixed and 75% variable.

[b] Manufacturing overhead costs in the Metals Division are 60% fixed and 40% variable.

**(a)** Calculate the operating incomes for the Mining and Metals divisions for the 4,00,000 units of toldine transferred under the following transfer-pricing methods: (a) market price and (b) 110% of full manufacturing costs. [6+6]

**(b)** Suppose GMDC rewards each division manager with a bonus, calculated as 1% of division operating income (if positive). What is the amount of bonus that will be paid to each division manager under the transfer-pricing methods in requirement (i)? Which transfer-pricing method will each division manager prefer to use? [5]

**(c)** What arguments would Amit, manager of the Mining Division, make to support the transfer-pricing method that he prefers? [3]

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

**(a) (i)** A company manufactures around 200 mopeds. Depending upon the availability of raw materials and other conditions, the daily production has been varying from 196 mopeds to 204 mopeds whose probability distribution is as given below:

| Production per day | Probability |
|---|---|
| 196 | 0.05 |
| 197 | 0.09 |
| 198 | 0.12 |
| 199 | 0.14 |
| 200 | 0.20 |
| 201 | 0.15 |
| 202 | 0.11 |
| 203 | 0.08 |
| 204 | 0.06 |

The finished mopeds are transported in a specially designed three storeyed lorry that can accommodate only 200 mopeds. Using the following 15 random numbers 82, 89, 78, 24, 53, 61, 18, 45, 04, 23, 50, 77, 27, 54, 10, simulate the process to find out:

**(a)** What will be the average number of mopeds, waiting in the factory?

**(b)** What will be the average number of empty spaces on the lorry? [5+5]

**(ii)** List out the advantages of Just-In-Time (JIT) System. [5]

**(b) (i)** The following standards have been set to manufacture a product:

| | |
|---|---|
| Direct Material | ₹ |
| 2 units of A @ ₹ 4 per unit | 8.00 |
| 3 units of B @ ₹ 3 per unit | 9.00 |
| 15 units of C @ ₹ 1 per unit | 15.00 |
| | 32.00 |
| Direct labour 3 hrs. @ ₹ 8 per hour | 24.00 |
| Total standard prime cost | 56.00 |

The company manufacture and sold 6,000 units of the product during the year. Direct material costs were as follows:

12,500 units of A at ₹ 4.40 per unit

18,000 units of B at ₹ 2.80 per unit

88,500 units of C at ₹ 1.20 per unit

The company worked 17,500 direct labour hours during the year. For 2,500 of these hours the company paid at ₹ 12 per hour while for the remaining the wages were paid at standard rate. Calculate materials perice variances and usage variances and labour rae and efficiency variances. [5+5]

**(ii)** Define the "Simplex Method"? State its advantage over the Graphical method. [1+4]

**(c) (i)** Singular Products Co. Ltd. manufactured and sold in a year 15,000 units of a particular product fetching a sales value of ₹15 Lakhs. After charging direct material 30% on sales value, direct labour 20% on sales value, variable overheads ₹10 per unit, the company earned ₹16.67 per unit during the year.

The existing equipment can produce a maximum of 20,000 units per annum. In case, the demand exceeds the maximum output, new equipment will be required which will cost ₹10 Lakhs and it will have a life span of 10 years, with no residual value.

A prospective customer is willing to place an order on the company for 10,000 units per year regularly at 90% of the present selling price, which will be, if accepted, over and above the existing market for 15,000 units.

Irrespective of the fact whether or not the new order materializes, the cost increase with immediate effect is :

(a) 10% in the Direct Materials.

(b) 25% in the Direct Labour.

(c) ₹50,000 in Fixed overheads per year.

If the order of additional 10,000 units is accepted, the Fixed overhead will increase by another ₹50,000 by way of increased administration expenses.

You are required to recommend whether the company should accept the new business at the stipulated price or decline the new order and make a concerted sales drive to sell the present unused capacity at the present selling price? The sales drive will cost ₹60,000 per year.

Ignore the finincial charges on the cost of the equipment and assume there are no opening/closing stock inventories. Variable cost will increase in direct proportion to the output. [3+3+3+1]

**(ii)** Write a note on Kaizen Costing. [5]