Paper 15 – Business Strategy and Strategic Cost Management

Case Study 1

G is a multinational company that designs, manufactures and sells consumer electronic products, such as portable media players (PMP), tablet computers (TAB), smartphones, personal computers (PC) and computer software packages.

G has its own retail outlets and also sells its products in other stores as well as online. The G brand and logo is recognised internationally and G has successfully applied a brand extension strategy for a number of years. Every time G launches a new product it publicises this widely to generate a high degree of enthusiasm amongst the public and its potential customers. G's product launches are highly effective: thousands of customers queue outside the stores, some even camping outside for several days, just to experience a product launch by G. Customers perceive G's products to offer higher value than those marketed by its competitors, but they are also more expensive. This has proved to be a highly profitable strategy to date for G and has been difficult for competitors to copy.

G is organised into four strategic business units (SBU's), each responsible for a particular product group.

The PC SBU - G was one of the first developers of personal computers in the 1980s and its unique software and quality design was popular with early PC customers. G's first product was the G PC with its own unique software and operating system. Despite G's early success in the PC market, it has failed to maintain its market share in recent years. PCs with software developed and sold by G's main rivals now dominate the PC market. However, the PC market is highly profitable and has huge potential for growth but competition is intense.

**The PMP SBU - The G PMP products have experienced massive growth in the market but now sales
are stagnant and predicted to decline. The PMP's can be used as external data storage devices and through the use of G's own developed software, can be used to transfer music, photos and games. G continuously rolls - out extension strategies, updating its PMP products with more features, colours, larger memory and faster processors. The cumulative effect is that these updates have increased the life cycle of its PMP products and its long-term sales potential, beyond that forecast a few years ago. G's PMP products have a high share of the PMP market and are popular amongst a wide range of customers.**

The Smartphone SBU -The G smartphone products include all of the features that the G PMP products have as well as telephone technology. G's retail outlets are becoming more and more focussed on its G smartphone customers and potential new customers. The smartphone products also have a high market share and are growing in popularity.

The TAB SBU - The G TAB has a high share of the rapidly growing tablet computer market. However, the G TAB is beginning to lose its initial high market share advantage as other manufacturers have launched their own tablet products with increasingly sophisticated features. G recognises that the combination of its overall competitive strategy and the strength of its brand must be maintained across its business portfolio in order to maintain and grow its market share.

Required

(a) Explain the benefits of a 'brand extension strategy' for G. Your answer should include a definition of the term 'brand extension'.
(b) Evaluate G's separate product SBUs, using the Boston Consulting Group Growth/Share Matrix.
(c) Discuss the impact that G's generic competitive strategy has had on the management of its product portfolio.

Case Study 2

Read the following case and answer the questions given at the end :

The ripple efforts of the 2008 Global Economic meltdown had begun to hurt the Rupees 1,268 crore J. K. Paper Ltd. also. Like all other business houses in India, J. K. Paper Ltd. was also finding the going though. The general trend of soaring prices and contraction in demand had started affecting the sale of J. K. Paper Ltd. products also. Its customers were focusing on correcting their inventory positions (using existing stocks of materials to keep production lines and marketing activities rolling). Consequently, they were not buying much from J. K. Paper Ltd. Even the investors did not like what they saw – J. K. Paper Ltd. stock fell from `57.20 on 1 January, 2008 to a low of `14.12 on 12 March, 2009. The company was in the midst of Economic crisis. Mr. Harshpati Singhania, Managing Director of the Company, realised that some strong measures must be taken to extricate the Company from its present crisis. To this end, Mr. Singhania held several brainstorming sessions with the top management team and finally identified the focus areas : Managing working capital flows, cutting costs and paying attention to employee productivity.

Moving away from the traditional approach one usually follows during the recessionary periods, Mr. Singhania instead of shutting down company's plants and cutting production, decided to continue to operate the Company's two plants at Gujarat and Orrisa at 100% capacity. To match sales with production, he planned to reach out to newer customers by widening Company's distribution network. He identified packaging boards to be marketed in rural areas where the meltdown had minimal effect. As the market conditions were still difficult, the company also decided to cut the prices by 2 to 3 per cent. Alongwith the price cut, its marketing thrust in rural areas ensured that the sales were not impacted much. Net sales remained flat throughout 2008-09, though the profitability of the Company suffered because of the lower margins it received from its rural thrust.

For raising capital, the Company did not approach banks and investors, rather it intensified it efforts to recover its debits from its clients. The efforts resulted in fast recovery of crores of rupees. Disputed debts were also settled expeditiously to raise more cash.

To cut costs further, the Company took steps to improve productivity and reduce its wage bill. Inefficient employees were asked to leave. No new appointments were made unless they were critically important. In addition, employees received lower increments for 2008-09; even Mr. Singhania did not take any increment.

When the global slowdown sent the international prices of the pulp, the main raw material for the paper industry, crashing from `36,960 per tonne in April, 2008 to `18,240 per tonne in September, 2008 the company bought enough pulp to last for about 9 months as against its policy of buying, in the normal course, pulp for about 2-3 months. According to Mr. Singhania, this decision also resulted in a huge saving.

Mr. Singhania and his senior management team also re-evaluated the organisational structure to improve efficiency in the organisation. When all the above strategic decisions had been successfully implemented, Mr. Singhania knew that the worst for the company was over. This was also reflected in gradual increase in the quarterly profits of the company, Mr. Singhania however sounded very modest about his stewardship of the Company while appreciating his Senior management team for the great job done to ride out the slowdown.

Answer the following questions:
(a) Where did the recession hit J. K. Paper Ltd.?
(b) Explain with reasoning the corporate strategy the Company had adopted for its survival.
(c) What functional strategies were undertaken by the Company to overcome its crisis?
(d) State the basic responsibilities of a strategic leader in a business house. Explain whether or not Mr. Singhania provided strategic leadership to the Company.
(e) What lessons are learnt from the experience of J. K. Paper Ltd. to ride out the economic meltdown?

Case Study 3

N.A. Fabricators Ltd. Have procured an order from the Railways for supply of 2,40,000 pieces of metal case-bonds of a special design. The supply is to be completed in not more than 12 months at the rate of 20,000 to 25,000 pieces per month at a price of ` 75 per piece with a bonus/ penalty of ` 2.75 per piece for supplies in excess/ short of 20,000 pieces per month.

It has promptly purchased a special machine with capacity to produce 20,000 $\pm$ 5% pieces per month. The machine which has cost ` 2 lakhs is expected to fetch a residual value of ` 50,000 on completion of the contract job. The cost details of the piece is estimated as follows :

Material	(`/unit)	50.00
Labour	(`/unit)	5.00
Variable production overheads – 40% of labour (`/unit)		2.00
Variable selling overhead	(`/unit)	0.25
Fixed production and selling/ delivery expenses (Total)		` 3 lakhs

A week before starting the job the suppliers of machine offer an advanced version of the same capable of 20% more output per hour. There will however be a material loss of 0.5%. This new machine costs ` 1.50 lakhs with no residual value. The supplier has agreed to take back the original machine for ` 1.50 lakhs. Fixed cost, by way of maintenance, will increase by ` 1,000 per month. Entire job can be completed in 10 months.

Advise whether they should go in for the improved model of the special purpose machine.

Case Study 4

A production department of a large manufacturing organisation has furnished the following data for May 2014 :

	Budget `	Actual `
Direct Materials	4,00,000	5,10,000
Direct wages	2,50,000	3,25,000
Repairs and Maintenance (` 1,00,000 Fixed)	2,00,000	2,20,000

Supervision (Fixed)	1,00,000	1,10,000
Consumable stores (Variable)	75,000	95,000
Factory Rent (Fixed)	50,000	50,000
Depreciation (Fixed)	1,00,000	1,00,000
Tools (Variable)	25,000	30,000
Power and Fuel (Variable)	1,50,000	1,80,000
Administration (Fixed)	2,50,000	2,65,000

The department has 50 identical machines. During May 2014 the budgeted and actual production of the department are 10,000 and 12,500 units respectively. However, if the department was closed and the machine production services were hired from outside, the cost of hiring the services of similar machines would be ` 150 per unit.

(i) You are required to present reports showing the evaluation of the performance of the department based on the concept of (a) Cost Centre (b) Profit Centre and (c) Responsibility Centre.

(ii) It is felt that since the total budgeted cost of production per unit is greater than the cost of hired services, the possibility of closing down the department and use of hired services should be explored if the budgeted production cannot be increased in June 2014. Assuming that the budgeted expenses and level of output planned for May 2014 will hold for June 2014 also, calculate the volume of output required to justify the continuance of the department.

Case Study 5

Watchwell T.V. Company ,manufacturing various components in their machine shop which are assembled along-with purchased components in an assembly shop. It is proposed by the production manager that an aluminium bracket which is manufactured in Machine shop should be procured from outside party as the cost of production is very high date of rejections and also due to the recent wages agreement.

The purchase department called quotations for this item. Two parties submitted their quotations as under.

Mr. Black : Basic Price ` 5 per 1000 nos.
Excise duty at 12% advalorem.
Sales Tax 15%
Transport at ` 1.10 per 1000 nos.
Octroi at 2% on total bill.

Mr. White: Basic Price 0.75 per 1000 nos., (labour charges only.)
Material to be supplied by Watchwell .
Scrap generated in process will not be returned.
Transport at ` 0.40 per 1000 nos.
Octroi at 2% on total price excluding materials cost.
Rejection allowance at 2% of gross materials cost.

The company gives you that following cost details the bracket presently being manufactured.

Materials cost per 1000 nos.		**` 6.00**
Less: scrap allowance.,	**` 2.00**	
Net materials cost for 1000 nos.	**` 4.00**	

Conversion cost : The part is manufacturing on a small press-having machine hour rate of ` 30 per hour of which 10% is fixed cost. The standard time for production 100 brackets is 0.6 minutes. Rejection is about 3% on works cost, Administration and selling overheads are 10% of works cost. The production Manager has assured that the released press as well as the labour will be employed on alternative job. It is understood from purchase department that the excise duty paid on purchase component will be set-off against excise duty payable on T.V. Sets.

You are required to evaluate to both the quotations and compare them with current costs assuming that purchasing and storing as well as handling efforts are same in each case. Also give your recommendation as to the source of supply of the components. If the released capacity of press only is not utilised will your recommendation change ?
Give your comments and assumptions in the evaluation wherever necessary.