E-Book

Strategic and Financial Management

The Institute of Chartered Accountants of India

(Set up by an Act of Parliament)

Southern India Regional Council

Chennai

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This e-book has been authored by

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FOREWORD

Strategic Management is all about identification and description of the strategies that managers can carry so as to achieve better performance and a competitive advantage for their organization. It helps us to identify the direction in which an organization is moving.

This e-book highlights the nuances of Strategic Cost and Financial Management and the need of organizations to address the same for a better growth/future. It covers the topic in detail right from understanding the concept to levels of strategy required, advantages/disadvantages of Strategic Management and the process.

This e-book also contains various case studies on the subject matter with appropriate solutions, advantages/disadvantages for better understanding and grasp. The language used by the author is very raw and easily connectable.

This e-book, one in a series of member centric publications planned by SIRC, aims to serve as a Handbook and Guide for the professionals who intend to understand the importance of Strategic Cost and Financial Management and also to make use of the same in the various corporate decisions which they need to make.

On behalf of SIRC, I wish to place our sincere gratitude and appreciation to CA. P G Subramanian, for sharing his rich experience and expertise on the Strategic Cost and Financial Management amongst our members through this e-book. I also take the privilege of thanking CA. Vijayasundhar S I for reviewing the basic draft of e-book and adding value to the substance of the e-book.

Comments and suggestions on the e-book are welcome at sirc@icai.in

CA.K.JALAPATHI

Chairman, SIRC of ICAI

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STRATEGIC COST AND FINANCIALMANAGEMENT

Chapter-1

NEED FOR STRATEGIC COST AND FINANCIAL MANGEMENT

Business today is faced with challenges of the magnitude never witnessed before. Global economic slowdown in the last decade meant that economies around the world faced massive upheavals. Organizations which were doing well on all fronts showing consistent growth and profitability year after year suddenly found themselves in deep trouble. Pandemic situation has only accentuated the already existing bleak situation.

Companies both in Manufacturing and Service Sector were turning out handsome turnover and profits year after year. All this changed when the economic crisis hit like never before. All of a sudden, the same Companies found to their dismay that sales and profits were beginning to dwindle putting enormous pressure on sustainability. So much so, ManyOrganizations found it difficult to sustain and survive.

While the going was good, not much attention was paid to Strategy, cost or efficiency which are inherent in any organization. These were masked by the huge demand for products and services at prices set by the organizations. This made organizations complacent. In fact, warning signals started emerging post 2011 when demand started slowing down and there was immense pressure on pricing. What was sellers market suddenly turned into buyers market.

Obvious result of this scenario is wakeup call to organizations to either ship or shape out. Many of them had to re orienttheir business strategy and look at each aspect carefully to stay in business. Organizations which failed to respond and act went downhill. Ready example that comes to mind is the Hospitality Sector. There was huge demand for Rooms in cities like Bangalore thanks to Software companies and other business thriving. Demand was chasing supply and there was severe dearth of good 5* rooms which were in great demand. Occupancy levels used to hit more than 100% mark on most of the days. Average Room Rent used to be in the range of Rs. 10,000/- to Rs.15,000/- per day for 5 * hotel located in Central Business District with rates inching closer to Rs.25,000/- to Rs.30,000/- for leading brands like TAJ, Oberoi , Hyatt etc. Same scenario played out in manufacturing sector with products of normal quality commanding high prices like color televisions of 23” commanding price of Rs.25,000/-.

But all good things have to come to an end. Both Manufacturing and Service Sectors suddenly found themselves staring at drop in demand and prices. As usual, panic button was pressed and there was big scramble to reinvent and re- arrange. Quick and workable solutions were need of the hour. Gone were the days when Organizations could react.
What was required was proactive approach.

Following things emerged –

1. Customer became the king.
2. There was suddenly over supply of both products and services with very few takers.
3. Customers started to pick and choose.
4. Companies which had invested huge sums of money in facilities by resorting to heavy borrowing found the going tough since there was not much demand resulting in their defaulting on their commitments.
5. There was a shakeout and consolidation in industries with organizations having deep pocket gobbling up theones with no resource to withstand.
6. Companies started looking for different markets. This was also necessitated by rapid Globalization of businessand trade policies adopted by Nations.
7. Companies could no longer hope to survive by catering to their home market alone.
8. Globalization of business meant cross border investment by Global companies forcing companies to lookoutward.
9. Customers have become choosy and want the best of products at competitive rates. Their loyalty is ever shifting.
10. Organizations today are faced with several challenges like
    a. Need to constantly innovate their offering.
    b. Pay attention to Business Strategy and align them to current need.
    c. Look at all the processes critically, improve operational efficiency, reduce wastage at each and every stage,Revisit all areas including manpower, procurement, inventory levels to name a few.
    d. Shift focus to pricing and leverage costing analysis to decide price.
    e. Put in place robust operating systems and procedures with emphasis on MIS for all practicable activities.
    f. Do constant review of performance to iron out inefficiencies and avoid committing the mistakes.
    g. Recognize the fact that resources are scarce and need to be managed.
    h. Ensure top class Financial Management covering all areas more critically working capital, loans etc.
    i. Leverage strengths of Technology to the full extent so that real time information is available to take correctdecision.
    j. Adopt business strategy and costing like never before.
    k. Understand the nuances of Strategic Cost and Financial Management into distinct area and ensure alignmentseamlessly.

STRATEGY, COST AND FINANCIAL MANAGEMENT- AN ANALYSIS

STRATEGY- The concept of Strategy is central to understanding the process of Strategic Management. The term 'Strategy' is derived from the Greek word ' Strategos' which means generalship i.e. Strategy is art of war, the skill inmanaging any affair or the use of trick in order to succeed in some purpose. In business parlance, there is a definite meaning assigned to Strategy. It is often used loosely to mean different things.

A Strategy could be-

- A plan or course of action or a set of decision rules making a pattern or creating a common thread.
- The pattern or common thread related to the organization's activities which are derived from the policies,objectives and goals.
- Related to pursuing those activities which move an organization from its current position to a desired futurestate.
- Concerned with the resources necessary for implementing a plan or following a course of action.
- Connected to the Strategic positioning of the Firm making trade-offs between the different activities and creating a fit among these activities; and
- The planned or actual co-ordination of the Firm's major goals and actions in time and space that continuouslyco-align the firm with its environment.

In simple terms, a strategy is the means to achieve objectives. In complex terms, it may possess all the characteristics mentioned above.

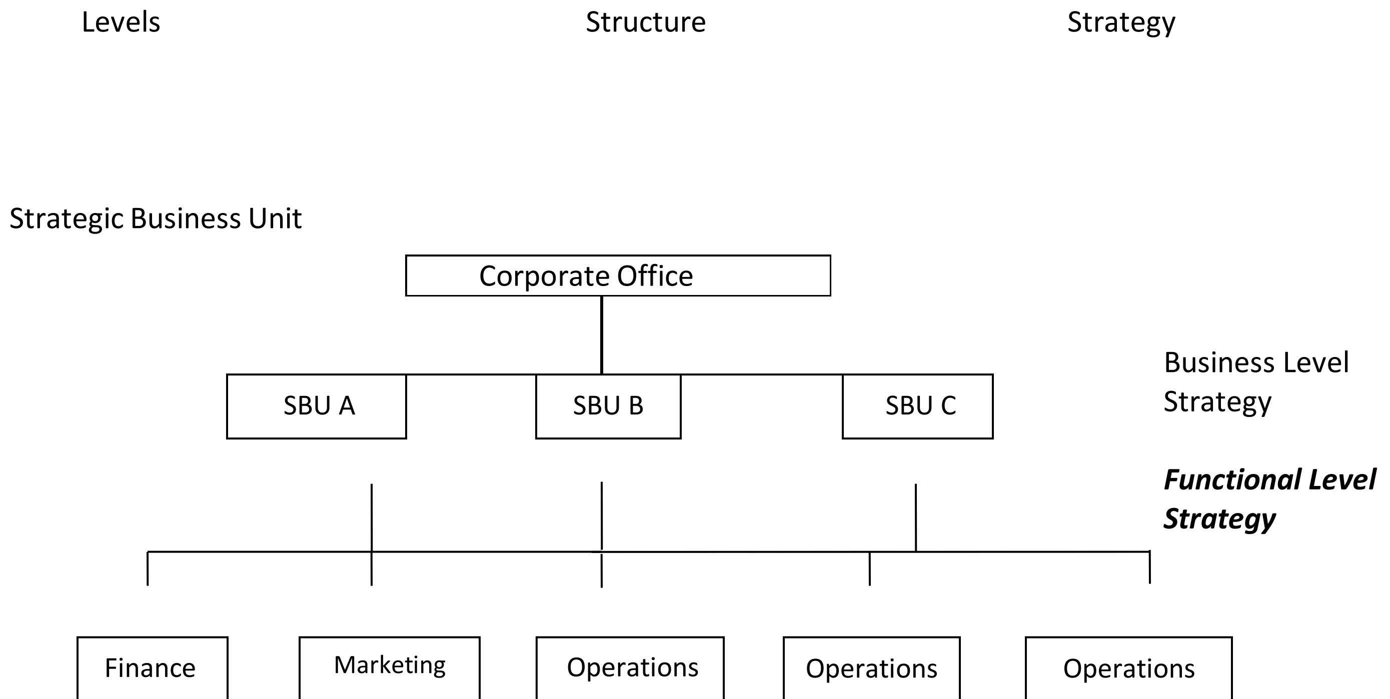
LEVELS OF STRATEGY-

It is not uncommon to find many companies, or a group of Companies, that while being under the same top management, are working in different business lines with regard to products/services, markets or technology. Someexamples are as follows,-

- Hindustan Unilever- The venerable multinational subsidiary organizes itself into four businesses of Home andPersonal care, Foods, New ventures and Exports.
- ITC – Another behemoth which has diversified interests like Tobacco, Food, Agri business, Personal Care, Clothing, Hospitality and Exports.

For such Companies, a single strategy is not only inadequate but also inappropriate. The need is for multiple strategiesat different levels. In order to segregate different units or segments each performing a common set of activities, such companies organize on the basis of operating divisions or simply divisions. These divisions may also be known as Profit centers or Strategic Business Units (SBUs). An SBU. As defined by Sharpin is,

“Any part of a business organization which is treated separately for Strategic Management purpose”.The following figure depicts the three levels of Strategic Management as structured in practice



The advantages of Strategic Management

- Discharges Board Responsibility
- Focus on Objective Assessment
- Provides a frame work for Decision Making
- Supports understanding and Buy in.
- Enables measurement of progress.
- Provides an Organizational perspective.

The disadvantages of Strategic Management

- The future does not unfold as anticipated.
- It can be expensive.
- Long term benefit v/ s immediate result.
- Impedes flexibility

Strategic Management

Strategic Management analyzes the major initiatives taken by a Company's top management on behalf of owners, involving resources and performance in external environments. It entails specifying the organization's mission. Vision and objectives, developing polices and plans often in terms of projects and programs which are designed to achieve these objectives and allocating resources to implement the policies and plans, projects and programs.

Strategic Management is all about identification and description of the strategies that manager can carry so as toachieve better performance and a competitive advantage for their organization. An organization is said to have acompetitive advantage if its profitability is higher than the average profitability for all companies in its industry.

Strategic Management can also be defined as a bundle of decisions and acts which a manager undertakes and which decide the firm's performance. The Manager must have a thorough knowledge and analysis of the general and competitive organizational environment so as to take right decisions. They should conduct a SWOT analysis (Strengths, Weaknesses, Opportunities and Threats) i.e. they should make best possible utilization of strengths, minimize the organizational weaknesses, make use of arising opportunities from the business environment and should not ignore thethreats. Strategic Management is nothing but planning for both predictable as well as unpredictable contingencies.

It is applicable to both small as well as large organizations as even the smallest organization face competition and by formulating and implementing appropriate strategies, they can attain sustainable advantage.

Strategic Management is a way in which strategists set the objectives and proceed about attaining them. It deals with making and implementing decisions about future direction of an organization. It helps us to identify the direction in which the organization is moving.

Strategic Management is defined as the set of decisions and actions that result in the formulation and implementationof plans designed to achieve a company's objectives. It comprises nine critical tasks.

1. Formulate the Company's mission, including broad statements about its purpose, in the formulation and philosophy and goals.
2. Conduct an analysis that reflects the Company's internal conditions and capabilities.
3. Assess the Company's external environment including both the competitive and the general contextual factors.
4. Analyze the Company's options by matching its resources with the external environment.
5. Identify the most desirable options by evaluating each option in light of Company's mission.
6. Select a set of long term objectives and grand strategies that will achieve the most desirable options.
7. Develop annual objectives and short term strategies that are compatible with the selected set of

long term objectives and grand strategies.

8. Implement the strategic choices by means of budgeted resource allocations in which the matching of tasks,people, structures, technologies and reward system is emphasized.
9. Evaluate the success of the Strategic process as an input for future decision making.

In simple terms the purpose of strategic management is to achieve sustained strategic competitiveness of the firm and above average returns of the organization. This would be done by developing and implanting a value creating strategy. By implanting a value creating strategy, those competitors present and potential are not simultaneously implementing and that the competitors are unable to duplicate benefits of such strategy. The organization thus achieves a sustained orsustainable competitive advantage.

STRATEGIC MANAGEMENT PROCESS

In today's highly competitive business environment, budget oriented planning or forecast based planning methods are insufficient for a large corporation to survive and prosper. The firm must engage in **Strategic planning** that clearly defines objectives and assesses both the external and internal situation to formulate a strategy, implement the strategy,evaluate the progress and make adjustment as necessary to stay on track.

Strategic Management is defined as the dynamic process of formulation, implementation, evaluation and control ofstrategies to realize the organization's strategic intent.

This definition states the four phases of the strategic management process as formulation, implementation, evaluation andcontrol.

Each phase of Strategic Management process consists of a number of elements which are noted below-

(i) Establishing the hierarchy of strategic intent. (Aim)
(ii) Formulation of Strategies at each stage
(iii) Implementation of Strategies.
(iv) Performing Strategic evaluation and Control.

]

STRATEGIC INTENT

By Strategic intent we refer to the purposes the organization strives for. These may be expressed in terms of a hierarchy of Strategic intent. Strategic intent is a statement that provides a point of view of the means by which your organizationaims to achieve its vision in the long term. It therefore provides a sense of direction and the opportunity to explore new competitive possibilities. Moreover, strategic intent provides clarity, focus and inspires employees to work harder in order to achieve the Company's vision.

STRATEGY MAP

Businesses and Companies create Strategy maps to show case their plans for success. Robert Kaplan and David Norton developed the strategy mapping concept while they were working on their “Balanced Scorecard”. The strategy map is broken down into sub topics that all work forward the business’ ultimate goal.

A strategy map is a visual illustration of a business' strategy for turning its resources into accomplishments. Resources do not include only concrete assets, but also refer to knowledge and customs. These assets are applied in a way that willhelp the Company to reach its objectives. Strategy mapping shows the relationship between the Company's resources and objectives via a detailed table.

PERSPECTIVE	
CUSTOMER	Improve Customer satisfaction. Be a provider of Choice improve public confidence
FINANCIAL	Improve rate competitiveness, enhance cost control, increase real income
INTERNAL RESOURCES	Improve budget efficiencies, Improve customer management processes, Improve safety of physical plant, Improve marketing
LEARNING AND GROWTH	Improve knowledge of Governance Improve inter departmental relations Improve CRM knowledge, Increase electricity production, capacity Improve knowledge of customers

The top of the strategy table shows the business' main objective, which is the No.1 reason why the business exists. Next, financial strategies like productivity and revenue growth are included in the map. Revenue can be increased by either raising the number of highly valued customers or by raising the amount of revenue per customer. Productivitycan be improved by cutting out any activity that ultimately does not add value to the business.

The business must decide whether it is most likely to reach operational excellence, solid customer relationships or product leadership. While a lot of Companies skip this step, it is crucial to determine which business practices are not helping the Company reach its goal. Clearly focusing your business proposition will streamline what areas need the mostattention.

The last portion of the Strategy map includes employees, technology and corporate culture. These assets are necessary to actually put the strategy map into action. The businesses overall performance in all areas rests on the performance of the corporation's players.

Strategy mapping is used to help businesses and companies manage their approach. With a strategy map, managementcan detect which areas of the business need to be improved. A problem in the business plan is evident if the different areas of the strategy map do not logically and easily flow into the next one. Strategy mapping lays out the business' direction and encourages employees come together and discuss and share ideas.

STRATEGY FORMULATION

Strategy formulation requires a series of steps performed in sequential order. The steps must be taken in order because they build upon one another. However, there are two processes that are continually performed throughout strategy formulation: ***environmental scanning*** and ***continuous implementation***. Environmental scanning is simply the process of paying attention to the external environment for factors that may affect your business' performance, which needs to beaddressed in strategy formulation process. For example, you will pay attention to what you competitor is doing and make adjustments to your strategic plan as necessary throughout the process. Continuous is simply implementing partsof the strategy that must be implemented in order for the next step of the strategy formulation to be undertaken.

Strategy formulation refers to the process of choosing the most appropriate course of action for the realization of organizational goals and objectives thereby realizing organizations vision. The process of Strategy formulation basicallyinvolves six main steps. Though these steps do not follow a rigid chronological order, they are very rational and can befollowed in this order.

- Setting Organization's objective.
- Evaluating the Organizational Environment.
- Setting Quantitative targets.
- Aiming context with divisional plans.
- Performance Analysis.
- Choice of Strategy

STRATEGY IMPLEMENTATION

Strategy implementation is the translation of chosen strategy into organizational action so as to achieve strategic goals and objectives. Strategy implementation is also defined as the manner in which an organization should develop, utilize and amalgamate organizational structure, control systems and culture to follow strategies that lead to competitive advantage and a better performance. Organizational structure allocates special value developing tasks and roles to the employees and states how these tasks and roles can be correlated so as to maximize efficiency, quality and customer satisfaction – the pillars of competitive advantage. But, the organizational structure is not sufficient in itself to motivate the employees.

An organizational control system is also required. The control system equips managers with motivational incentives for employees as well as feedback on employees and organizational performance. Organizational culture refers to the specialized collection of values, attitudes, norms and beliefs shared by organizational members and groups.

Following are the main steps in implementing a strategy

• Developing an Organization having potential of carrying out strategy successfully
• Disbursement of abundant resources to strategy essential activities
• Creating strategy encouraging policies
• Employing best policies and programs for constant improvement
• Linking reward structure to accomplishments of results
• Making use of strategic leadership
• Institutionalization of strategy
• Setting proper organizational climate
• Developing appropriate operating plans
• Developing appropriate organization structure
• Periodic review of Strategy

STRATEGY EVALUATION AND CONTROL (SEC)

STRATEGIC EVALUATION – The purpose of strategic evaluation is to evaluate the effectiveness of a strategy in achieving organizational objectives. Thus, strategic evaluation and control could be defined as the process of determining the effectiveness of a given strategy in achieving the organizational objectives and taking corrective actionwhenever required.

The nature of strategic evaluation is judgmental. Through evaluation it is checked whether the strategy is n agreementwith the environment and objectives.

Strategy evaluation is as significant as strategy formulation because it throws light on the efficiency and effectivenessof the comprehensive plans in achieving desired results. The managers can also assess the appropriateness of the current strategy in today's dynamic world with socio economic, political and technological innovations. Strategic Evaluation is the final phase of Strategic Management.

The significance of strategy evaluation lies in its capacity to co-ordinate the task performed by managers, groups, departments etc. through control of performance. Strategic Evaluation is significant because of various factors such as
– developing inputs for new strategic planning, the urge for feedback appraisal and reward, development of the strategic management process, judging the validity of the strategic process etc.

The process of Strategy Evaluation consists of the following process-

- Fixing benchmark of performance
- Measurement of performance
- Analyzing variance
- Taking corrective action

Importance of Strategic Evaluation

- Feedback
- Reward
- Future planning.

Barriers in evaluation

- The limits of control
- Difficulties in measurement
- Motivational problems

Evaluation Criteria

The critical factors that could help in evaluating a strategy may broadly be classified into two categories: QuantitativeFactors and Qualitative Factors.

Quantitative Factors

Quantitative criteria commonly employed in evaluating strategies are financial ratios, which strategists use to makethree important comparisons.

(I). Comparing the Firms' performance over different periods. (II). Comparing the Firms' performance to competitors and (III). Comparing the Firms' performance to Industry averages.

Some key financial ratios those are particularly useful as criteria for strategy evaluation may be stated thus-

- Return on investment
- Return on Equity
- Z score
- Employee Turnover
- Employee satisfaction index
- Return on Capital Employed
- Profit Margin
- Market share
- Debt to Equity
- Earnings per share
- Sales Growth
- Asset Growth

Qualitative Factors

Many Managers feel that qualitative organizational measurements are best arrived at simply by answering a series ofimportant questions or revealing important facets of organizational operations. Some qualitative questions those are useful in evaluating strategies

1. Is the Strategy internally consistent?
2. Is the Strategy consistent with the environment?
3. Is the Strategy appropriate in view of available resources?
4. Does the Strategy involve an acceptable degree of risk?
5. Does the Strategy have an appropriate time framework?
6. Is the Strategy workable?

The Control Process

Regardless of the type or levels of control systems an organization needs, control may be depicted as a six step feedbackmodel

1. Determine what to control
2. Set Control standards
3. Measure performance
4. Compare performance to standards
5. Determine the reasons for the deviation
6. Take corrective action

Characteristics of an Effective Control System

Effective control systems tend to have certain qualities in common. These can be stated thus-

1. Suitable
2. Simple
3. Selective
4. Sound & Economical
5. Flexible
6. Forward Looking
7. Reasonable
8. Objective
9. Responsibility for failures
10. Acceptable

STRATEGIC DECISION MAKING

Strategic decision concept is based on strategy which is a major action in an organization. Strategic decision making is amajor choice of actions concerning allocation of resource and contribution to the achievement of organizational objectives. It has following characteristics-

(i) The strategic decision affects the whole part of organization and largely relates to the responsibilities ofSenior Management.

(ii) It contributes directly to the achievement of objectives.

(iii) It has normally three elements-
   - (a) Action element - which specifies the work to be done.
   - (b) Result element - which specifies the desired results to be achieved through implementation of decision
   - (c) Commitment element - which directs to undertake the course of action, makes personal involvement forattaining the objective

Various theories or models have been suggested about how decisions are made. Such as-

- Rational - Analytical Decision model
- Intuitive - Emotional Decision model
- Political - Behavioral Decision model

Mintzberg's analysis of Strategic decisions–making (mode of decision making)

- **Entrepreneurial mode**
- **Adaptive mode**
- **Planning model**

1.11. Strategy into action

Strategy into action is an embedded business process for deploying strategic goals deep into the heart of an organization, whilst aligning leaders and engaging employees to achieve strategic intent.

Strategy in action is dynamic – a continuous, evolutionary process of aligning people on a goal, getting and analyzing results and connecting it all back to strategy formulation. The outcomes of Strategy implementation are feedback intothe strategy to galvanize further strategic action.

This approach to strategy improves organizational vitality and performance. It focuses both on present and future organizational health. Its goal is to optimize the performance of the entire system.

Strategy in action is versatile enough to work in various organizational settings in business.

The Difference in strategy in action and Traditional Planning

Traditional Planning	Strategy-in- action
Stable, Static	Dynamic
Linear	Nonlinear
Strategic and Functional Fit	Strategic tension between now and future
People as objects or recipients	People as Agents and Co- Authors
Focus on Structure	Focus on ideas and perceptions
Structural Development	People Centered Development
Cognitive	Both cognitive and intuitive
Competitive / Adversarial	Competitive / self improving
Either / Or	Contextual
Mechanical	Organic
Separating / Isolating	Integrative / Comprehensive

STRATEGIC PLANNING

Strategic planning is an organizational management activity that is used to set priorities, focus energy and resources, strengthen operations, ensure that employees and other stakeholders are working towards common goals, establish agreement around intended outcome / results and assesses and adjust the organization's directions in response to a changing environment. It is a disciplined effort that produces fundamental decisions and actions that shape and guidewhat an organization is, who it serves, what it does and why it does it with a focus on the future. Effective strategic planning articulates not only where an organization is going and the actions needed to make progress but also how it will know whether it is successful.

Strategic planning is defined by Harvey as "long range planning which focuses on the organization as a whole. Managers consider the organization as a total unit and ask themselves what must be done in the long run to attain organizational goals. The most successful managers are those who are able to encourage innovative strategic thinking within their organizations."

A strategic plan is a document used to communicate with the organization the organization goals, the actions needed toachieve those goals and all of the other critical elements developed during the planning exercise.

Strategic planning has following advantages or usefulness-

(i) According to different research studies, strategic planning contributes positively to the performance ofenterprise and predicts better outcomes and isolates key factors of the firm.

(ii) It is concerned with allocation of resources to product market opportunities and concerned to realize thecompany'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 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 strategic planning is the onlymeans by which future opportunities and problems can be anticipated by Company Executives.

(vi) It enables executives to provide necessary direction to the firm, to take full advantage of new opportunitiesand to minimize risk.

As success of firm depends on multiple factors, strategic planning is a necessary condition but not sufficient conditionfor success.

Pitfalls of Strategic Planning

The common pitfalls in strategic planning are as follows-

- Non availability of correct and accurate data.
- Doing strategic planning only to satisfy accredition or regulatory requirements.
- Failing to communicate the plan to the people who execute the plan.
- Top management making intuitive decisions that conflict with format plan.
- Failing to use plans as a standard for measuring performance.
- Delegating tasks to a few persons rather than involving all managers.
- Failing to involve all employees in key phases of planning.
- Failing to create an environment conducive to change.
- Lack of flexibility and creativity.
- Strategic planning usually restricted to hard business concerns.
- Strategic planning sometimes becomes a routine exercise without having proper attention to strategic issues.
- The planning process is isolated from the external groups that critically affect the Company like labourunions, consumer, advocates, social service organizations etc.

Strategic Management & Strategic Planning- Distinction

The basic difference between Strategic planning and Strategic management is as follows-

Strategic Management	**Strategic Planning**
1. It is focused on producing strategic results: new markets: new products: new technologies etc.	1. Is focused on making optimal strategic decisions.
2. It is management by result	2. It is management by plans
3. It is an organizational action process	3. It is an analytical process
4. It broadens focus to include psychological, sociological and politicalvariables	4. It is focused on business, economic and technological variables.
5. It is about choosing things to do and also about the people who will do them.	5. It is about choosing things to do.

STRATEGIC COST & FINANCIAL MANAGEMENT- MEANING AND ANALYSIS

STRATEGIC COST MANAGEMENT- MEANING

Every organization strives to be cost effective, efficient and alert to the needs of stakeholders which include shareholders, employees, members of the public and customers. But the way organizations go about achieving these yardsticks differ. If all the organizations religiously go in pursuit of their stated goals, we would have a situation where there will be no need for economic disparities, unemployment, wealth creation to name a few. This is an ideal situationto be in. But reality is different; In everyday life we find so many disparities and lop sided growth. What could possibly be the reason for this? Let us analyze a few factors responsible for such a scenario-

- Inability of the organization to manage its resources efficiently. By resources it is meant raw materials, components, external resources like power, logistics, customer satisfaction, employees, poor financial management, improper allocation of resources, being reactive instead of being proactive to name few. Success or failure of an organization depends on how effectively organization tackles the everyday challenges thrown at it.
- Recent turmoil in business environment caused by the huge upheaval and disruption caused by the pandemic has meant loss of business, employment, loss of customer base, reduced demand, pressure on finances etc. It is a huge challenge for organizations to come out of the situation and survive. Many organizations have shut down since they could not cope up with the environment. Those who have survived, have shown remarkable alacrity and re-invented themselves to face the new realities and challenges posed.
- Practically every organization and economic activity has been impacted. It is here that strategically managing thecost and resources becomes the focal point. To give an example, Cutting Tool industry caters to the demand of practically every manufacturing activity and industry. Main demand comes from Automobile sector which has witnessed unprecedented fall in demand. Fortunes of the cutting tool manufacturers' nosedived to a new low.

  Added to this, pressure on availability of critical raw material like tungsten carbide has made matters worse. The industry depends on China for its requirement and the recent border situation and resultant relations with China meant disruption in supplies. Industry had to import the material through circuitous route pushing up the cost of procurement. This has a chain reaction on all the areas. How the industry has managed the situation and continued operations is interesting to note.

  a. First of all, serious efforts have been initiated aimed at reducing dependence on single source like China. Emphasis is on increasing output of Tungsten Carbide locally by increasing the mining capacity which had been neglected due to combination of various factors. Added to this, lot of used tungsten carbide is recycled for use in industry globally. This was a neglected aspect of the industry in India with very few units engaging in such activity despite its potential. This is due to heavy cost of capital investment required. But then tough times call for tougher actions and adoption of appropriate strategy. The industry has been given a jolt and ithas become wiser and would not like to face uncertainties.

b. Having seen the scenario, adoption of appropriate costing and financial measures is called for. Faced with the prospect of increased cost of procurement of critical raw material and consequent rise in prices, tough measures are required. Hence the industry has geared up to face the challenges and Government has stepped in to accord the importance the industry deserves. All the processes are being revisited including reduction of wasteful activities, better financial management, renegotiating contracts with vendors for long term supplies, increase in final price of finished products to name a few.

c. Another ready example that comes to mind is the strategy adopted by a leading MNC to turn around the fortunes of a local Transmission and Distribution equipment manufacturer which was taken over. The local manufacturer was a classic case fit for winding up. It was beset with low employee morale and dissatisfaction, loss of customer confidence, quality problems, huge outstanding from customers, high cost ofraw material and components to name a few. The new management had a huge task on hand. It had to quickly analyze and take control of the situation before it gets out of hand. Due diligence conducted had revealed serious flaws in running the organization. Quick analysis revealed the following-

   - Equipments manufactured are capital in nature and mainly used by power utilities. Thanks to poor quality and delays in delivery, customer base had shrunk. Power utilities require warranties and servicing. Company faltered on this count badly. This resulted in utilities imposing liquidated damageson the Company which further dented the financial position and reputation.
   - Thanks to delayed and faulty equipment supplies, recoveries of debt were never going to be a smoothaffair. Debts which were required to be received within 60 days took almost 180 days to one year.
   - Critical Raw Material and Component suppliers had lost confidence and faith in the company's ability to meet its commitment. Delays in payments to suppliers were accepted norm. This resulted in increase in price of items supplied pushing the cost of raw material to close to 75% of total cost. Suppliers started demanding Letter of Credit facility from the Company to ensure realization of dues. Bankers were unwilling to establish Letter of credit facility to the Company thanks to regular devolvement of Letter of Credit opened earlier.
   - Employee dues such as salaries were not paid on time including statutory dues. This created huge employee dissatisfaction. The Company was also top heavy with no accountability. It was also overstaffed.
   - No investments were done to streamline process, improve planning, quality or technology.

The new management had a daunting task of rectifying each and every flaw so that the tide could be turned around. The challenge of reducing the cost and instill financial discipline was enormous. The parent Company while pumping in the required funds gave the new management exactly one year to ship or shape out. It was by no means an easy task. Apprehensive of the new management, cooperation was not forthcoming from any quarter. Added to this, the need to culturally align every stakeholder most important being employees and suppliers. The challenge was accepted. The newmanagement quickly put in place an action plan to overcome the situation and demonstrate its commitment.

Employees were addressed first. Assurance was given to them that all their outstanding dues will be cleared forthwith which was carried out in letter and spirit. Salaries were paid on time including meeting commitment relating to statutory dues. This meant half the battle was won. Word started spreading about the intentions of the Company.

1. Task force was set up to identify potential areas which required urgent attention like revamping of planning,production process, realigning equipment to meet production targets, improving customer and supplier confidence, setting up technology oriented systems to name a few with clear deadlines.
2. Reduction in cost and focus on proper financial management was given top priority. Suppliers were called andtold clearly that all their past dues will be settled over a period of six months with current dues being met on time. In return, they were asked to reduce the prices by 10 %. Commitments were kept up which improved theconfidence of suppliers and prices were reduced. This was only the beginning. Target was to reduce the cost ofraw material from 75 % to 60% within one year. To attain this goal, further steps were initiated. Suppliers wereinformed that Letter of Credit facilities will no more be extended since payments have been streamlined. Plus annual contracts for supplies will be the norm going forward. Plus reliance on few suppliers will be dispensed with alternate suppliers being scouted and empanelled. Entering into annual contracts meant assured demandfor suppliers through the year and assured quantity with potential for increase. Annual contracts were entered into for critical raw materials and components constituting 80% in value and volume. Leveraging its position further discount of 5% was negotiated with suppliers making a total of 15%. Added to this, quantity discount was also obtained from suppliers.
3. Simultaneously, immediate measures were adopted to stream line production process, arrest wastage, strictermonitoring of production process, quality control, timely delivery, improved service to customers, aligning planning to meet demand.
4. Dead wood were identified and removed. Every employee was told clearly about his/her role and commitment.Strong message was sent that inefficiency will not be tolerated.
5. Focus shifted to customer and building and winning their confidence.
6. Debt recovery was accorded top priority. Along with old dues, current dues were also required to be collected. Special teams were deployed. The task became easy since action was initiated to improve customer confidencewith focus on time delivery with little or no quality issues, prompt response to complaint, adherence to tendering process etc
7. Emphasis was on strict financial discipline with meeting commitments on time, strong recovery process,budgeting and cash flow management to name a few.

8. Better terms were negotiated with bankers with nil or no fee for facilities, no margin money requirement. Banks fell in line thanks to their experience with the new management. Banks which did not toe the line were dispensed with.
9. Strong emphasis was laid on technology and systems and procedures with constant monitoring on all fronts. Nonadherence was promptly dealt with.
10. Excess manpower was identified and given golden handshake which included redundant people at the top.
11. In short, the aim was to bring about all round efficacy in terms of cost reduction, processes and systems besidesfinancial management and prudency.
12. The result was there to see within 6 months with raw material cost declining to 60%, wastage reduced from highof 105 to 5%, employee cost coming down to around 15% from 25%. This meant that the company turned cash positive.
13. Not resting on its laurels, sustained efforts were put to reduce costs further, reduce turnaround time, improve turnover etc. thus in its first full year of operations, the sales were up by a whopping 300%, Raw Material costwent down further to 54% with other costs coming down further. Thus the company clocked net profit in very first year itself. This helped to reinforce the confidence of the parent company which converted the loan into equity. Company also repaid its term loan in second year and became debt free.
14. It is classic example of how strategic cost system deployment along with financial discipline and managementcan help.

RELEVANT CASE STUDIES AND CASE SCENARIOS

CASE STUDY-1

BUSINESS PROCESS INNOVATION

Leisure Hotels Pvt. Ltd. operates 5 properties in holiday segment under lease arrangement. Under this, Leisure Hotels is responsible for operating the properties including day to day operations consisting all areas. Leisure Hotels pays a fixedsum as lease rental to the owners each month. Corporate office of Leisure Hotels is located in Delhi. Total inventory ofall properties put together is 250. Each property offers different types of accommodation ranging from Standard to Luxury. Properties range from Three Star to Four Star category.

Out of the 5 properties, two are located in Shimla, two in North Goa while one is located in Jammu. While the properties in Shimla and Jammu are fully operational, properties in Goa will be handed over to Leisure hotels in the nextcouple of months. Properties in Goa are also operational under different management. Leisure hotel USP is location of its properties which are in most sought after locales for holiday makers. Leisure Hotels mission statement is -

“

Enhance the holiday experience of the guests in every possible way that they remember the time spent in the properties for a long time to come”

Keeping this in mind Leisure hotel strives to maintain the standard to make the stay of guests’ comfortable and guest satisfaction is the core of its business philosophy. Promoters have years of experience in hospitality industry having worked in leading chains handling marketing and guest relations. They also possess experience in running travel house prior to entering the hospitality sector catering to primarily tourism.

Thanks to the philosophy of keeping guests satisfaction at its core, properties enjoy decent occupancy levels through theyear at 65%. Summer as well as winter records equal business in Shimla due to preference of tourists to vacation at different times. Occupation of properties at Goa is subject to seasonal factors like rains when occupancy levels dip. But this is slowly changing thanks to a section of tourists preferring to travel during the monsoon months as well to enjoy the rains and the cool and lush environment. Operations of the properties including the ones at Goa are profitable in that there is no cash loss. They offer great potential to offer decent returns after all expenses are met and lease rental obligations are met. Thanks to individual set up and management of each unit, the profit parameters.

As mentioned above, Leisure Hotels has the responsibility of managing and running the properties. This requires enough expertise at all operating levels starting from individual property to Corporate Office so that operations are smoothly conducted. Need to have proper controls and systems including monitoring operations unit wise is an absolute must.

Information provided indicates that present system is that each unit operates as independent entity on matters relating to accounts, procurement and other areas. Payments are made for supplies / services by each property independently and policy decisions are taken at individual level.

Leisure Hotels wants to revamp the system at all levels and would like to centralize the main function relating to Finance/ Procurement policy with operating freedom to individual units to procure items which may not be possible to procure through centralized process. The need to undertake revamping arises due to dissipated nature of operations with no worthwhile monitoring system relating to operations. Individual units procure items required and payments areeffected locally. Corporate Office comes to know the details only after the transaction is completed through vouchers sent across. Thus Corporate Office is totally in dark and would like to change the system retaining the required operational freedom. Management is convinced that centralization of core areas will bring in transparency and help in optimizing operations. Switching over to centralize system of payment, for example, through cheques or digital methodwill ensure better discipline and will be in line with objective of the present Government which wants to digitalize all monetary transactions. Use of cash, which is high now, needs to be brought down to bare minimum. Further information gathered reveals that the existing system of accounting does not lend itself to meaningful analysis and interpretation. Thanks to the operating structure, each unit operates in a silo. There is a need to consolidate the operations and exercise centralized control over critical areas so that the operations are better managed and turns in better revenue and profit.

As an expert in handling such situations, Management wants your help in setting up controls and systems including streamlining the operations including review systems.

Management has set a target of doubling the turnover in the next three years leveraging the goodwill the propertiesenjoy and potential strength. Your help is sought in laying the required road map.

1. ***Brief analysis of the business model followed by Leisure Hotels Pvt. Ltd. and advantages / disadvantages of themodel.***
2. ***Strategy to bring about innovative approach to achieve the desired objective and take the business to nextlevel.***

SOLUTION-

1. ***Brief analysis of the business model-***

Leisure Hotels Pvt. Ltd. follows asset light model for running the hotels under its management. It has entered into a Lease Agreement with the owners to operate and manage the property. Leisure Hotels are required to pay fixed lease rent every month to the owners irrespective of the volume of business generated. It is assumed that apart from lease rent, no other payments are to be made. Having said this advantages and disadvantage of the business model followed can be examined and analyzed as follows-

A. Advantage of the model:

- Being a lease based operation, the need to invest in infrastructure including facilities required to buildthe hotels is not needed.
- This means there is no need to borrow money in the form of term loan from Banks/ Institutions and service the same. Normally, term Loans for Hospitality Sector is expensive and carries stiff margin requirement some times as high as 50% and carries higher rate of interest. This acts as a deterrent to many since many promoters find it difficult to raise the margin money required and service the interest payment and repayment of loan. Gestation period in the Industry is normally very long.
- By opting to go in for Lease Model, Leisure hotels have avoided the need to borrow and take on theresponsibility to service the loans.
- Lease Model enables management of the properties in concentrated manner since the lessee is freedof the need to service loan/ carry out necessary refurbishment etc. which is the responsibility of the lessor.
- Location of each property in choice locales which are preferred holiday destinations offers great advantage and will help in generating steady business as well as increase in business over a period of time. The fact that persons behind the venture are experienced

hospitality and tourism professionalsmakes it easy.

B. Disadvantages of the model:

- Unless Lease Agreement terms are clearly defined with clauses for operations/ roles and responsibilities/ revenue sharing or rental alone/ maintenance of properties/ Human resources/ treatment of bookings received from owners if any etc. It can lead to lot of friction and misunderstanding which eventually can result in termination of the agreement.
- Operations through lease model places restriction on carrying out necessary changes including refurbishments required to meet customer trends since this has to be done by the lessor at his cost. Unless he commits himself for this, it can result in reduction in business over a period of time.
- Lessor also needs to ensure that properties are maintained and routine repairs are carries out to ensure that properties are in good shape. Many a time, this is an area of disagreement since funds need to be committed.
- Full operational freedom without the interference of Lessor is a must for the model to succeed.
- Total commitment from the lessee as well as the lessor is an absolute must to manage the properties and it should for the long haul. Fence sitting and short term outlook will result in total collapse of the business and lease arrangement.

2. ***Strategy to bring about innovative approach -*** Managing and ensuring control over operations of multi locationalproperties offer both an opportunity as well as challenges. Opportunities in the form of cost advantage and efficiency since this will be centralized and controlled. It also means opportunity in the form of additional business since guests will definitely prefer to use other properties in the chain if their experience is good in one property. Also Guests can be offered alternate choice from among the different properties if a particular property chosen is not available. Thus business can be retained within the group properties which otherwise maygo to others. On the other hand challenges are in the form of location and different regional culture. Managing multi locational units seamlessly is not an easy task and requires proper and reliable man power aligned to the cultural ethos and expectations. Finding the right mix is the main challenge. Locational advantage and strong background of the operator should be fully leveraged. Having said this, centralized system of monitoring the operations and other areas require careful planning and putting in place a robust mechanism to ensure smooth functioning. Following frame work is suggested-

- First and foremost, align all the properties including ones which are joining the fold into one mother unitfor easy tracking and consolidation as well as controls and systems.
- With technology offering immense possibilities in managing various areas through monitoring, this shouldbe fully exploited with lesser manual intervention. Centralized server with connectivity to individual units is the solution to ensure smooth functioning.
- Each area to be monitored and controlled to be defined. In this case, Payments, reporting formats, procurement, MIS systems, consolidation are the key areas which require special attention.
- Begin by preparing Standard Operating Procedure (SOP) which is common for all properties

across with modification only for local requirements. SOP must cover each area and must not have any ambiguity. If required, SOP need to be revisited and revised to suit requirements. SOP is sacrosanct and should be followed to the tee.

- Ensure that all operating personnel are well briefed and trained to follow the SOPs.
- Purchase and install proper centralized server which connects each unit with accessibility controls to individuals in the units. Senior Management Personnel operating in corporate office will have access to all important information relating to units on real time basis. Individual server in the units will be connected to central server in corporate office and information will get up dated on an on-going basis.
- Individual units will have its' own accounts department headed by a controller. Each unit will have access to finance and other operating software. They will prepare unit accounts on monthly basis and forward the same to Corporate Office for consolidation.
- Formulate policies for deployment of human resources in each unit depending upon local conditions. However, senior personnel will be engaged purely on merit and experience and they may be transferred /redeployed as required.
- Procurement of critical items of major value like poultry, meat, guest amenities, linen, housekeeping supplies etc. need to be centralized and controlled from corporate office. This need to be done through centralized contracts with requirements of units estimated and built in. All operating supplies must come under this. This will ensure better control on quantity as well as price due to the large volume.
- Ensure that Purchase Orders are released in Corporate Office on individual suppliers with copy to concerned units. Orders for regular items can be made as a whole with suitable annexure for quantity tobe delivered to individual units. Individual units will raise indent for items required indicating the available stock, last purchase, consumption and justification for requirement if stocks are available. Indents must be raised at fixed intervals and must take into consideration lead time required for delivery especially in areas like Shimla where weather conditions can affect supply. Emergency and usual items can be procured locally through local Purchase Order. Payment however will be released from Corporate Office.
- Payments will be processed and effected from corporate office for all supplies made to individual units. Concerned hotels will forward the invoice after duly processing the same including inventory accounting and certification on weekly basis to Corporate Office for processing and payment.
- Emergency cash purchase will be permitted to meet exigencies alone with predefined limit for cash purchase through a system of imprest.
- All revenue will flow to Corporate Office alone. Individual units will have access to Bank accounts for the purpose of deposits alone. Cash collections, if any need to be banked on daily basis with proper reporting to corporate office on daily basis. Deviations, if any need to be explained.
- Local units will have limited access to banking operations with separate account opened for the purposeto which funds will be transferred to meet commitments related to salary/ legal payments etc. Only the General manager and Finance in charge will have authority to operate the designated bank account.
- System of daily reporting through structured format must be made compulsory. Such report

will give alldetails relating to-

- Sales division wise with occupation percentage
- Collections
- Details of amounts deposited into bank including cheques/ credit card collections/ cash if any etc.
- Details of LPG consumed
- Food cost
- Corporate Office will ensure that communication is sent to individual unit relating to bookings affected. Corporate office will confirm booking based on availability of rooms/ other facilities in units. It is a good practice to centralize the bookings to avoid confusion and have better control. Tariff needs to be fixed by corporate office and no deviation is permitted.
- Individual units can sell the rooms/ halls etc. if they are available within the overall frame work. Certainamount of operational freedom relating to sales need to be given in the overall interest of business. Proper control system needs to be in place to monitor this.
- Corporate office will have consolidated reporting system to monitor daily activities relating to all areas so that proper monitoring is possible to take corrective action where required.
- Institute a system of operating budget for each unit with consolidated budget at corporate level with clear and achievable targets for sales/ cost and profit. Occupancy levels and Room rent need to be fixed in advance and cannot be deviated unless circumstance warrants it.
- Budget must be prepared on participative basis taking into consideration inputs from local units so that there is whole hearted co-operation and effort to achieve the target. Suitable system of reward must be put in place for achievingthe target.
- Reports must be reviewed on regular basis like - daily/ weekly/ monthly as required and corrective actioninitiated where required. Reporting system must be strong and units as well corporate office must subscribe to it.
- Cash being king, utmost importance must be given to collection of outstanding/ control over pricing/procurement cost/ consumption/ food cost/ breakages/ inventory controls etc.
- Periodic visits to individual units by corporate personnel is a necessity to understand the ground realityand monitor the operations, up keep of property, staff views etc.
- Measures outlined herein, if implemented earnestly will ensure smooth operations and profitability.

STRATEGIC COST MANAGEMENT AND PERFORMANCE EVALUATION

CASE SCENARIO- 1- BUDGETING

Elixir Enterprises Private Limited runs a business hotel under the brand name - “The Chancery Pavilion”. Hotel commenced operations in the year 2007. It is categorized as a 5* hotel. USP of the hotel is its location in the central business district of the City with proximity to all important offices including Government departments and is the preferred choice of business traveler. It also boasts of ample parking space in

It has 325 rooms divided into various categories ranging from Standard to Suites and tariffs are based on demand in agiven season. The hotel has a published tariff but cannot follow it all the time due to business scenario. Thus the Average Room Rent varies from time to time depending on the demand. The business is seasonal in nature with the second half of the financial year witnessing a big demand while the first half is rather slow.

The hotel has a 24 hour coffee shop serving cuisines from different region and menu changes are effected regularly. Besides this the hotel has a roof top Pan Asian Restaurant along with a business meeting facility. Hotel also has lobby level outlet which serves snacks and beverages through the day. It also serves liquor. Besides this, it has a separate bar and discotheque where weekend events are organized. Food festivals are organized on regular basis besides the regular Sunday brunch which is crowd puller.

Banqueting facilities include halls seating capacity ranging from 40 to 500 and has all the facilities.

Hotel offers the guest all the amenities expected from 5* hotel and has Business Centre as well as Board Room includingcurrency exchange facility.

Business scenario was very good till about 4 years back since competition was virtually non-existent for hotel of this class. However, the situation has changed with the advent of larger hotels of leading brands in the vicinity posing serious challenge. The industry itself has seen a churn with economic condition changing and travelers prefer to avoid stay inhotels unless it is inevitable. Thus pricing pressure is high.

Budgeting exercise happens every year with Finance Department playing a major role in the exercise besides marketing. Other departments participate to the extent that they give their requirements for the year. General Manager sets the tone for Budget making three months in advance of commencement of new financial year with the help of Finance Head. Finance head circulates the template for budget to all the Departments containing details of previous year's actual figures to help in budget making. Marketing Department gives its projection of estimated revenue from various streams while other departments give their projection for expenses including major repairs if any, capital expenditure etc. The figures are then collated and a draft is prepared and discussed by the GM and Finance Head with other departmental heads. Arising out of the discussions, some adjustments including revision upwards relating to sales and reduction in expenses is done before the same is finalized. Targets fixed for both revenue as well as expenses are not realistic with a certain amount of uncertainty in achieving the targets creeping in. Revenue targets are set at achieving increase of around 15% over the previous year and likewise, expenses are either pegged at existing levels or increase anticipated is minimal across the board. Management and the Board do not wholly approve of such type of Budget making and would like to have a budget which is more realistic and capable of achievement and also allows course correction along the way. Management finds that the targets set are not achieved both on sales and expense front with too many variations which puts enormous pressure on the cash flow and final result.

REQUIRED-

1. Analysis of the shortcoming of the budget process.
2. Process involved in Budget preparation with achievable goals.

SOLUTION

1. Analysis of the short coming of the Budget Process

Careful analysis of the business of the hotel and Budget making exercise reveal that not much thought goes into the budget making exercise. Instead, an attempt at the exercise to fulfil the budget making requirement is done without giving thought and analysis to the whole process. The hospitality industry is going through a difficult phase with number of rooms increasing exponentially in the 5* category in the City. Added to this is the growth in Home stays which offer bed and breakfast options at lesser rates. Travelers prefer to stay in such places to save on cost. The Economic downturn has not helped maters with any cost cutting exercise aiming at either reducing or eliminating the hotel stays altogether. In such a scenario, different thinking and approach is the need of the hour. For example, dependency on business traveler must be reduced. Hotel's USP is its central location and infrastructure in the form of ample car parking. This

2. Process involved in Budget preparation with achievable goals

For Budget to be effective well laid procedure needs to be followed so that the budget is effective and is capable ofbeing implemented. Towards this the following steps needs to be adopted-

- Start by preparing a template for Budget, department wise containing all the details including department manpower requirement, expenses involved etc;
- Template must be split into revenue and expense.
- The template must contain details relating past two years data head wise. This makes the forecasting exercise easy since there is a guideline available. Ensure that each head is also represented by percentage of the total. Start the budget making exercise by having a meeting with all Departmental heads concerned where the whole process is explained in detail and clarifications given. This needs to be done by the Finance Head along with the General Manager. Emphasis must be on involving all the concerned staff to make it participative.
- Finance Head will circulate the template prepared department wise and seek their input with a request to fill upall the details. Any doubts need to be discussed and clarified before the template is filled up. Ensure that concerned departments take care to prepare a need based budget which is capable of being met. For example, expense under each head can be met only if revenue stream is available. Revenue targets must be fixed taking into consideration the expected market scenario and must be department wise. Similarly, expenses must be in line with revenue expected to be generated.
- Once the Draft Budget is ready, the same should be discussed by the Finance Head with other Department Heads. Corrections need to be carried out at this stage if required. Along with the draft Budget, forecast BalanceSheet/ profit & Loss account and cash flow need to be drawn up.
- The Draft Budget is presented to the Board and top management where each department head explains therationale behind the forecast made and they are required to justify the figures assumed.
- Changes, if any, suggested by the Management and Board need to be carried out before a Final blueprint is prepared.
- Finance Head needs to ensure that all parameters on Revenue/ expenses like accepted norms are properly factored in including a reasonable increase in cost keeping in mind the inflation factor.
- Need to maintain the Gross Operating Profit (GOP) at certain level cannot be lost sight of since reduction willaffect the ultimate profitability.
- Last but not the least; targets must be specific to each individual which he is capable of achieving. This can be converted into KPI with performance and achievement being rewarded.
- It is a good practice to review the actual performance v/s the Budget on regular basis including variance analysiswith reasons for deviation with plans to correct the same

CASE SCENARIO 2- FOOD & BEVERAGE COSTING

World Resorts Limited operates a 5* deluxe hotel with 150 rooms of various categories ranging from Standard to Presidential suites. In addition, the hotel has 4 dining outlets including a 24 hour coffee shop which also serves buffet lunches and dinners with 100 covers. Other outlets are specialty Restaurants serving varied fare ranging from Indian to International cuisines. The hotel also has a well-run bar including pool side bar which is open for dinner.

The hotel also has banqueting facilities numbering 6 capable of accommodating small functions to large corporate events and weddings. Besides this the hotel organizes pool side events regularly since the area around the pool is capable of organizing big events and can cater to 500 guests at a time. Sunday brunches are a big draw among theclientele.

Since the hotel is located off the city, it attracts more of corporate events like get together, day outs, and residential conferences including big weddings. In addition it undertakes regular outdoor catering for events like exhibitions thanksits proximity to a big facility where big exhibitions are organized on regular basis.

The operations are headed by the Vice President who has a well-knit team under him to man various departments. The Food and Beverages Department is headed by Executive Chef under whom well trained chefs and support staff work.

Operations being of a big scale require constant monitoring of areas related to procurement of ingredients including various items for food, gas and power, manpower, beverages etc. to ensure that cost is closely monitored and controlled to ensure that it is within the parameters laid down. The hotel also employs staff on contract basis dependingupon the size of the event.

The Management has a monitoring system of Food & Beverage Cost (F&B) through Cost Controller who submits a report every month on total F & B costs incurred. The system does not allow a proper analysis of the total cost incurred in a particular month. Instead it gives only a global view of the cost incurred when the requirement is to understand the exact cost incurred under each head and take steps to control the same as well as ensure that pricing leaves the hotel with a decent margin. It may be noted that the total cost of Food & Beverage including overheads cannot exceed 35%

The Management is concerned that the norms are not met and month after month the cost is hovering around 40 to 45%. This a serious cause of concern since margins are under pressure due to inability to raise prices beyond a certainlevel save for special events and requests by the customer.

Required-

1. Possible reasons for high cost of Food & Beverage
2. Suggested Strategy and control measures to keep costs under control.

COST CONTROL SOLUTION

(i)- In any operating hotel with so many operating outlets and banqueting facilities including outdoor catering, it is essential that a tight leash is maintained on costs incurred in conducting each event. Even a small variation in costs by apercentage point can drastically alter the picture and lead to loss of margin. From what is stated, it is evident that not much is being done by way of analysis to find the reason for cost being on the higher side and adopt course correction. Merely preparing a monthly report on global basis is not sufficient to get a clear picture of the reasons for the spiraling cost. A number of steps including close co-ordination between operating departments is a must who must come on board in the larger interest of

the Organization. F & B department plays a major role in contributing to the maintenance of cost since they contribute to the bulk of procurement cost. It is evident that this is not the case here and lack of control

and co-ordination has contributed to the present situation. Other operating departments like F & B Service, HR etc. need to contribute equally.

(ii)- ***Suggested Measures-***

a. To begin with, a robust Operating Budget system must be put in place. This must be done Department wise. Theoverall Budget must be annual one with clear achievable targets relating to Sales and expenses as well as gross operating margin to be achieved and Net Profit goal. The Budget must be broken into monthly / quarterly calledoperating budget to enable analysis and comparison on monthly basis and do course correction as required. It must be ensured that each operating departmental head is involved in the budget making exercise. They will ensure that staff is involved in the process.
b. System of Cost Control in respect of Food & Beverage must ensure that all operating parameters including procurement cost is built in to enable review and reporting.
c. Standard Costing needs to be put in place for each item in the menu by adopting recipe and menu costing. This exercise involves close co-ordination with F & B department including executive chef who lays down the menu as well as ingredients used. This standard needs to be compared with actual cost at least once in a quarter so that correction can be made either to reduce the cost or find alternate method of preparing a particular dish without compromising on quality. Possibility of increase in rates may be explored in discussion with the marketing department.
d. System of event wise costing must be put in place so that the profit/ loss relating to each event can be assessedand set a bench mark for similar events in future. In some cases, such costing needs to be prepared based on estimates to enable quote to be given for an event or decide the price below which the event cannot be done.
e. Cost Controller must ensure that all operating parameters are analyzed each month with respect to F & B cost including procurement and compared with budget. A report including analysis on variation must be submittedas part of monthly MIS.
f. Reasons for variance must be analyzed with individual department responsible for providing services providingexplanations and solutions to control costs. Areas where wasteful practice is in place must be identified and eliminated. Example is employing contract staff more than what is required.
g. For any system to function efficiently, it is necessary that proper internal control systems are put in place. Standard Operating Procedures (SOP) are a must for each operating department which must be followed to the tee and reviewed for deviation and corrective action. The SOP's must be constantly revised to keep pace with requirements.

h. Constitution of Purchase Committee headed by the CFO is a vital requirement. The Committee consists of key managerial personnel and meets every fortnight to review the procurement and other aspects. All procurementneeds the approval of the committee.
i. Eye for detail and constant monitoring of procurement activities including inventory control must be in place.Tendering process for annual contracts needs to be rigorously followed.
j. Incentives and discounts available while procuring big items must be availed. For example, Government of India offers various incentives under Service from India Scheme to encourage Foreign Exchange Earnings. Duty Credit scrip are given based on forex earnings which can be used to procure all consumables including beverages free of duty. This must be taken advantage of.
k. Robust system of Contracts for procurement of F & B items as well as Services must be put in place. This must be reviewed regularly to ensure that at no point in time there is overcharging by any supplier. This can be done by regular comparison of prices charged/ paid by other hotels including market visits. It must be ensured that Contractors abide by all applicable laws including labour laws/ licenses absence of which will entail huge liability to the hotel as principal employer. This will unnecessarily add to cost.
l. Last but not the least, at no point in time cost can be allowed to exceed the laid down parameters since it affects the margin and bottom line. Constant monitoring of new developments / best practice like adopting alternate source of energy must be explored.

CASE STUDY 2

BUILDING BLOCK MODELHEALTH CARE

Laven Health Care Services Pvt. Ltd has been formed by a team of professionally qualified Doctors who are from the same family. Out of five promoters one is a senior general physician with over 43 years of standing in the profession while the second one is an anesthetist specializing in administering anesthesia to patients and has a standing of over 35years in the profession. Besides this, she is also a visiting professor in a leading medical college. Third one is qualified dentist specializing in modern dentistry and has a well-equipped clinic. Fourth one is a qualified homeopath and has specialized in advanced homeopathic treatment technology. Fifth one has specialized in Gynecology and related field incancer treatment.

All the five doctors have built a reputation for their knowledge and awareness on latest trends in medical profession andapply it diligently. The setup is housed in own premises and has ample space for expansion. Thanks to long standing in the field, clientele is fairly large and come from a cross section of society. Main promoters of the Company are Dental Surgeon and homeopathy physician who are husband and wife team. The Dental Surgeon has undergone advanced courses in various disciplines other than dentistry including an MBA from a leading institute on Hospital Management, Sleep apnea treatment and advanced course on training methods for dentists including training on dentistry abroad and criteria required to be fulfilled if one aspires to settle down abroad as a dentist. Homeopath doctor has recently qualified to become a practicing doctor in the prestigious hospital in Canada which requires a rigorous set of criteria including passing of certain examinations prescribed by the local authority. Armed with such a background and specialization across various disciplines, it is natural that they would like to leverage it for further usage which is possible only through a formal set up. Hence the decision to formally launch a limited Company which brings all good practices and governance. Main driving force behind the setup is dentist and homeopath who are young and are ambitious to achieve further professional glory. All the five doctors are equal stake holders in the Company. Besides this, they have taken on Board a senior finance professional to guide them in all finance and operational matters. Competition from existing health care providers is a real threat for the kind of treatment the company proposes to offer except for specialized training which faces little or no competition.

Company has decided to utilize the existing infrastructure to build the necessary facility to facilitate operations. TheCompany has a business plan which includes-

i) People are looking for specialized health care at competitive rates under one roof. Present day lifestyle, which putslot of stress on an average individual. Added to this is the life style including food habits, lack of

ii) proper exercise, sleep deprivation etc. All contribute to health problems in today’s youngsters. It is this opportunity which promoters want tocash on.

iii) Expand the existing dental practice to include advanced dental treatment which otherwise is available only overseas.

iv) Establish a facility to offer all treatments under one roof since promoters are well versed in virtually all forms and disciplines of medical treatment.

v) Set up a training facility to train aspiring dentists who wish to go abroad including guiding them on the process to be followed. Besides this, Company plans to impart training on advanced dentistry and treatment to doctors across the country. Training sessions will be conducted both through class room method as well as through web. Company has entered into tie ups with leading institutes of the world to offer training on regular basis. Tie up has also been done forfacilitating migration.

vi) Leverage the expertise gained in treatment of sleep disorders including sleep apnea. This is a specialized treatment given to patients under simulated conditions for sleep disorder like snoring which, according to a study can cause deathof the patient if not detected and treated early in acute cases.

vi)) Tie up with specialized diagnostics clinics and hospitals to offer treatment to patients since all facilities may not bepossible to build.

vii) Necessary infrastructure including facility for virtual and web based training, facility for advance dental treatmentand other areas in the existing facility which has enough space to be created.

viii) Existing set up has all the necessary equipment and facility to render medical assistance except advanced treatment.

ix) USP of the setup is ready availability of infrastructure located in centre of the city and easily accessible plus team ofvastly experienced medical professionals in diverse areas.

x) Based on the plan, a strategy has been chalked out to scale up the operations by quickly setting up the facility and publicize the various facilities on offer through website as well as mailers among the patients and doctors. Pilot projects have already been run and response has been encouraging. Plan also includes training to be conducted in campus of medical colleges and hospitals to ensure that all are able to avail the same.

xi) It has been decided that no compromise will be made on either the training methods or treatment and towards thisall available resources will be tapped.

xii) Since training and treatment will be of high standard with medical experts and institutes from overseas offering training, pricing will be higher. Still it will be way below the amount which may be required to be spent if someone optsfor training abroad.

xiii) With Medical tourism catching up in a big way and going forward will be a big avenue for boosting revenue,Company plans to foray into this segment in the next stage,

xiv) Turnover is expected to be in the region of 5 million in the first year and plans are afoot to scale it up to 3 cr by thefourth year. Promoters expect returns (net) of around 10% in the first year and going up to 20% in the fourth year. Promoters have studied the opportunities available to render such services over a period of several years including continuous interaction with leading doctors abroad before deciding to take the plunge.

xv) It is estimated that close to around 1 cr will be required to create the necessary infrastructure including

equipment required for treatment and training to begin with apart from funds required towards working capital.

xvi) Convinced about the Company's plans as well as the background of promoters few Private Equity firms have evincedinterest in investing in equity of the Company. Promoters want to tread carefully and would like to have an ideal mix of equity and borrowings since they would like to retain control of company in the initial stages.

REQUIRED

Advice and suggestion on the way forward through building block model.SOLUTION

Laven Health Services has forayed into the highly competitive health care segment and has set itself ambitious target relating to turnover as well as profit. The sector is highly competitive with so many specialty hospitals and diagnostic centers having come up in the last few years. They have been set up by experienced professionals in the field and arewilling to splurge cash to attract top talent and ensure that the patient gets the best of facility and treatment.

Having said this, pricing is a major determinant besides affordability to pay. The super specialty centers and hospital cater to a particular segment whose pockets and ability to pay are deep. This leaves the less fortunate middle class and vulnerable without proper medical care since they cannot afford the costly treatment. Studies show that for every patient who is cured, equal or more succumb. The bridge between high class medical care as well as affordable and good medical care is widening. This bridge needs to be closed. It is here that Laven scores over others. Thanks to the setup which is on a small scale, overheads are less helping in competitive pricing which will help in driving volumes.
However, focus on quality treatment must not be lost sight of. Experience and expertise of the promoters in different areas is the USP of Laven which will help scaling up.
Laven Health Services need to put in place performance measurement at the core of its activity which requires

1. What is that the Company will measure?
2. How will performance standards be set?
3. What is the support system including infrastructure required to achieve the desired results?

1. Laven Health Services need to measure the performance of various specialized services rendered regularly through monitoring system along with performance of individual Doctors including of those who are hired from outside, trainers who impart training on dentistry and migration aspects on a scale of 1 to 4 with scale 1 indicating poor or no performance while 4 indicates the optimum level achieved.
2. Setting performance standards includes-
    - Setting of Goals which are measurable and are capable of being achieved. For example, Laven wants tohit the revenue target of 5 million in the first year. This can be done only if clearly laid down parametersare known item wise and people wise.

- These goals must be broken down into measurable silos preferably month wise to begin with. This is necessary because Laven is testing the waters with host of services and time only

will tell how market perceives it and helps in turning in revenue.

- Pricing is another factor which will determine to a large extent the success of the model. It may be necessary to offer discounted pricing in the beginning or offer value add-on to attract patients. To this extent Company may have to bear losses. This can be discontinued once operations stabilize and patientsget the comfort level.
- Monetary goal must not be lost sight of since promoters are putting their hard earned money in theventure and also plan to raise loan from Banks/ Institutions which need to be serviced.
- Brain storming on regular basis some times on a daily basis will be required to evaluate the performance of its various services including foot falls, services opted, revenue generated etc. and plan the next move if required.
- Focus should not be lost sight of.
- Best way to measure the performance is to treat each service offering as a SBU and build system to measure profitability/ loss of each activity. It is best to have operating Budget for each area covering allaspects broken month wise. Emphasis must be on achieving breakeven, operating profit and decent return on capital employed. Course correction should be taken including shutting down of some area if found unviable.
- Important aspect to keep in mind is measurements of performance of Doctors and trainers including those are brought in to render service. These people being specialists in their chosen area are pre-occupied with multiple assignments and hence may not focus on the job in hand. Agreement with such Doctors must be very clear and should enable termination if required. At the same time, they should be motivated to join Laven. Revenue sharing model is the best option whereby a Doctor earns 70% of the fee for each case he/she handles with 30% flowing to Laven. To make the deal sweeter, incentive scheme can be introduced if the number of patients exceeds the target set for the Doctor.
- As mentioned in the previous para, specific targets must be set for each area and doctors as well as trainers and efforts must be put in to achieve the same so that total revenue target is not lost sight of.
- Trained and informed support staff must be recruited. It is also necessary to give on the job training onthe various treatments offered on a continuous basis so that staff is updated on latest technology including handling of equipment.
- Lay down clear HR policies even if the setup is small since this will go a long way to attract the right talent and retain them. It is worthwhile investing in human resources who are the main assets and motivate them to perform by giving appropriate compensation including benefits.

3. Support system required including infrastructure-
    - First and foremost, a detailed business plan must be prepared indicating all technical aspects, treatments and training on offer, investment required, breakeven point, expected revenue and profit expected to be earned. Seven year projections need to be prepared which will include all aspects including Projected Profit & Loss Account, Balance Sheet, Cash flow statement, breakeven analysis etc.
    - List out the equipment to be procured including furnishing and infrastructure required for training including web based training. Keeping in mind future requirements, infrastructure

must be created sincefunding on intermittent basis does not show the enterprise in proper light.

- Institute proper information management system to help in decision making and monitoring performance on regular basis.
- Investment in hardware and software including training tools, immigration procedure, accounting, dailyreporting etc. is necessary with updates carried out on regular basis.
- Tie up funding including working capital funding if needed. Specialized schemes at attractive terms are available for healthcare which must be tapped.
- Proper agreement must be executed with all concerned parties who are required to provide services. Legal aspects including applicable international laws must be taken care to avoid future litigations. Exit clause must be very carefully drafted.
- Create a sound support system including personnel to take care of operations, finance and compliance so that promoters can concentrate on business development and treatment.

CASE STUDY 3

STRATEGIC COST MANAGEMENT- DECISION MAKING

Wipro is examining the profitability and pricing policies of its Software Division. The Software Division develops Software Packages for Engineers. It has collected data on three of its more recent packages - (a) ECE Packagefor Electronics and Communication Engineers,
(b) CE Package for Computer Engineers, and (c) IE Package forIndustrialEngineers.
Summarydetailsoneachpackageovertheirtwoyearcradletograveproductlivesare-

Package	SellingPrice	Numberofunitssold	
		Year1	**Year2**
ECE	`250	2,000	8,000
CE	`300	2,000	3,000
IE	`200	5,000	3,000

Assumethatnoinventoryremainsonhandattheendofyear2.Wiproisdecidingwhichproductlinest oemph asize initssoftwaredivision.Inthepasttwoyears,theprofitabilityofthisdivisionhasbeenmediocre.

Wipro is particularly concerned with the increase in R & D costs in several of its divisions. An analyst at the SoftwareDivision pointed out that for one of its most recent packages (IE) major efforts had been made to reduce R&Dcosts.

Lastweek,
Amit,theSoftwareDivisionManager,decidestouseLifeCycleCostinginhisowndivision.Hecollect sthefollowingLifeCycleRevenueandCostinformationforthepackages(in`)-

Particulars	PackageECE		PackageCE		PackageIE	
	Year1	**Year 2**	**Year1**	**Year2**	**Year 1**	**Year2**
Revenues	5,00,000	20,00,000	6,00,000	9,00,000	10,00,000	6,00,000
Costs						
R&D	7,00,000	-	4,50,000	-	2,40,000	-
DesignofProduct	1,15,000	85,000	1,05,000	15,000	76,000	20,000

Manufacturing	25,000	2,75,000	1,10,000	1,00,000	1,65,000	43,000
Marketing	1,60,000	3,40,000	1,50,000	1,20,000	2,08,000	2,40,000
Distribution	15,000	60,000	24,000	36,000	60,000	36,000
CustomerService	50,000	3,25,000	45,000	1,05,000	2,20,000	3,88,000

PresentaProductLifeCycleIncomeStatementforeachSoftwarePackage.Whichpackageismostprofitableandwhichistheleastprofitable?Howdothethreepackagesdifferintheircoststructure(thepercentageoftotalcostsineachcategory)?

Answer:

Lifecycle IncomeStatement(in`000s)

Particulars	PackageECE				PackageCE				PackageIE			
	Y1	**Y2**	**Total**	%	**Y1**	**Y2**	**Total**	%	**Y1**	**Y2**	**Total**	%
Revenues	500	2,000	2,500	100%	600	900	1,500	100%	1,000	600	1,600	100%
Costs												
R&D	700	-	700	28%	450	-	450	30%	240	-	240	15%
Design	115	85	200	8%	105	15	120	8%	76	20	96	6%
Manufacturing	25	275	300	12%	110	100	210	14%	165	43	208	13%
Marketing	160	340	500	20%	150	120	270	18%	208	240	448	28%
Distribution	15	60	75	3%	24	36	60	4%	60	36	96	6%
Cust.Service	50	325	375	15%	45	105	150	10%	220	388	608	38%
TotalCosts	1065	1,085	2150	86%	884	376	1260	84%	969	727	1696	106%
Profit			**350**	**14%**			**240**	**16%**			**(96)**	**-6%**

Observation:PackageECE is mostprofitable,whilepackageIEisleastprofitable.

Company X is forced to choose between two machines A and B. The two machines are designed differently,buthaveidenticalcapacityanddoexactlythesamejob.MachineAcosts`1, 50,000andwilllastfor3years.Itcosts

`40,000 per year to run. Machine B is an 'economy' model costing only ` 1, 00,000, but will last only for 2 years, andcosts ` 60,000 per year to run. These are real cash flows. The costs are forecasted in rupees of constant purchasingpower.Ignoretax.Opportunitycostofcapitalis10%.WhichmachineCompanyXshouldbuy?

Answer:

Compoundpresentvalueof3years@10%	=2.486	
P.V.ofrunningcostofMachineAfor3years	=`40,000x2.486	=`99,440
Compoundpresentvalueof2years@10%	=1.735	
P.V.ofrunningcostofMachineBfor2years	=`60,000x1.735	=`1,04,100

StatementShowingEvaluationofMachinesAandB (`)

Particulars	MachineA	MachineB
Cost ofpurchase	1,50,000	1,00,000
Add:P.V.ofrunningcostfor3years	99,440	1,04,100
P.V.ofCashoutflow	2,49,440	2,04,100
	2,49,440	2,04,100
Equivalentpresentvalueofannualcashoutflow	2.486	1.735
	= 1,00,338	= 1,17,637

Analysis: SincetheannualcashoutflowofMachineBishighest,MachineBcanbepurchased.

Equivalentpresentvalueofannualcashoutflow	2.486	1.735
	= 1,00,338	= 1,17,637

Analysis: SincetheannualcashoutflowofMachineBishighest,MachineBcanbepurchased

CASE STUDY 4

Illustration

B manufacturing company sells its product at `1,000 per unit. Due to competition, its

competitors are likely toreduce price by 15%. B wants to respond aggressively by cutting price by 20% and expects that the presentvolumeof1,50,000unitsp.a.willincreaseto2,00,000.Bwantstoearna10%targetprofitons ales.Basedon

Particulars	**Existing (`)**	**Target (`)**
Directmaterialcostperunit	400	385
Directmanufacturinglabourperunit	55	50
Directmachinerycostsperunit	70	60
Directmanufacturingcostsperunit	525	495
Manufacturingoverheads:		
No.oforders(`80perorder)	22,500	21,250
Testinghours(`2perhour)	4,500,000	30,00,000
Unitsreworked(`100perunit)	12,000	13,000

Manufacturingoverheadsareallocatedusingrelevantcostdrivers.Otheroperatingcostsperunitf ortheexpectedvolumeareestimatedasfollows:

ResearchandDesign	`50
Marketingandcustomerservice	`130
	`180

Required:

(i) Calculatetargetcostsperunitandtargetcostsfortheproposedvolumeshowingbreakupofdif ferentelements.

(ii) Preparetargetproductprofitabilitystatement.

Solution:

(i)

Targetsellingprice : `1,000 less20%	`800
Less: Targetprofitmargin(10%)	`80
Targetcostsperunit	`720

Thebreak-upof`720perunitisasfollows:

TargetCostsperunit

Particulars		Perunit(`)
Directmaterials		385

Directmanufacturinglabour		50
Directmachiningcosts		60
Directmanufacturingcosts		495

Add: Manufacturingoverheads:		
Orderingandreceiving	8.50	
(21,250x`80)÷2,00,000		
Testingandinspection	30.00	
(30,00,000x`2)÷2,00,000		
Rework	6.50	
(13,000x`100)÷2,00,000		45
Totalmanufacturingcosts		540

CASE STUDY 5

Illustration

ModernCoproduces3products,A,BandC,detailsofwhichareshownbelow:

Particulars	**A**	**B**	**C**
Sellingpriceperunit(`)	120	110	130
Directmaterialcostperunit(`)	60	70	85
Variableoverhead(`)	30	20	15
Maximumdemand(units)	30,000	25,000	40,000
Timerequiredonthebottleneck	5	4	3
resource(hoursperunit)			

Thereare3,20,000bottleneckhoursavailableeachmonth.

Required:

Calculatetheoptimumproductmixbasedonthethroughputconcept.

Solution:

Particulars	**A**	**B**	**C**
Sellingpriceperunit(`)	120	110	130
Directmaterialcostperunit(`)	60	70	85
Throughputperunit(`)	60	40	45
Timerequiredonthebottleneck resource(hoursperunit)	5	4	3
Returnperfactoryhour(`)	12	10	15
Ranking	2	3	1
TotalAvailablehours		= 3,20,000	=1,20,000

(-)HoursusedforC(40,000x3)

(-) Hours used forA (30,000 x5) = 1,50,000 = 2,70,000

=50,000

BalancehoursavailableforB

No.ofunitsthatcanbemadeinbalance hours=50,000/4 =12,500units.

Statementshowingoptimummix:

A **B** **C**

No.ofunits	30,000	12,500	40,000

CASESTUDY-6

I

belowisthebasicdatarelatingtoNewIndiaCompanyforthreeyears:

	Year1	Year2	Year3
ProductionandInventorydata			
Plannedproduction(inunits)	2,500	2,500	2,500
Finishedgoods inventory(in units), Jan1	0	0	750
Actualproduction(inunits)	2,500	2,500	2,500
Sales (in units)	2,500	1,750	3,250
Finishedgoods inventory(inunits),Dec31	0	750	0

Revenue and cost data ,all three-years Sales price per			`48
unitManufacturingcost			
sperunit			12
Direct material Directlabor			8
Variablemanufacturingoverhea dTotalvariablecostperunit			4
Usedonlyunderabsorptioncosting:			2
Fixedmanufacturingoverhead=AnnualfixedOH/AnnualProduction			4
=`30,000/`2,500			
Totalabsorptioncostperunit			12
Variablesellingandadministrativecostperunit			
Fixedsellingandadministrativecostpery ear			`36
			`4
			`5,000

YouarerequiredtoPrepare:

(a) AbsorptionCostingIncomeStatement

(b) VariableCostingIncomeStatement.

Solution:

Statement as per Variable Costing

Particulars	**Year1 (`)**	**Year2 (`)**	**Year3 (`)**
Salesrevenue(at`48perunit)	1,20,000	84,000	1,56,000
Less: Variableexpenses:			
Variablemanufacturingcosts			
(atvariablecostof`24perunit)	60,000	42,000	78,000
Variableselling&admn.Costs	10,000	7,000	13,000
(at`4perunit)			
Contributionmargin	50,000	35,000	65,000
Less: Fixed expenses :			
Fixedmanufacturingoverhead	30,000	30,000	30,000
Fixedselling&admn.Expenses	5,000	5,000	5,000
OperatingIncome	15,000	0	30,000

(a) ReconciliationofIncomeunderAbsorptionandVariableCosting

NewIndiaCompany

ReconciliationofIncomeunderAbsorptionandVariableCosting

Particulars	**Year1 (`)**	**Year2 (`)**	**Year3 (`)**
Costofgoodssoldunderabsorptioncosting	90,000	63,000	1,17,000
Variablemanufacturingcostsundervariablecosting	60,000	42,000	78,000
Difference	30,000	21,000	39,000
Fixedmanufacturingoverheadasaperiodexpenseundervariable costing.	30,000	30,000	30,000
Balance	0	(9,000)	9,000
OperatingIncomeundervariablecosting	15,000	0	30,000
Operatingincomeunderabsorptioncosting	15,000	9,000	21,000

Differenceinoperatingincome	0	(9,000)	9,000

Thefollowingtableshows,thisdifferenceintheamountoffixedoverheadexpensesexplainsthediff erenin reported income under absorption and variable costing.

Year	Change inInventory (inunits)	FixedOverhea dRate	DifferenceinFixe dOverheadExpe nses	AbsorptionCostingIncome M inusVariableCostingIncome
Year1	0	x `12=	= 0	= 0
Year2	750increase	x `12=	= `9,000	= `9,000
Year3	750decrease	x `12=	= (9,000)	= (9,000)

CASE STUDY 7

(a) ThroughputCostingIncomeStatement

NewIndiaCompany

IncomeStatementasperThroughputCosting

Particulars	Year1 (`)	Year2 (`)	Year3 (`)
Salesrevenue(at`48perunit)	1,20,000	84,000	1,56,000
Less: Costofgoodssold(atthroughputcost: Direct–materialcost)[1]	30,000	21,000	39,000
Throughput	90,000	63,000	1,17,000
Less: Operatingcosts:			
Directlabour	20,000	20,000	20,000
Variablemanufacturingoverhead	10,000	10,000	10,000
Fixedmanufacturingoverhead	30,000	30,000	30,000

VariableSelling&Admn.Costs	10,000	7,000	13,000
Fixedselling&Admn.Costs	5,000	5,000	5,000
TotalOperatingcosts	75,000	72,000	78,000
OperatingIncome	15,000	(9,000)	39,000

1. Standarddirect-materialcostperunitof`12multipliedbysalesvolumeinunits.
2. Assumethatmanagementhascommittedtodirectlaboursufficienttoproducetheplannedan nualpro duction volumeof2500units;directlabourcostisusedatarateof`8perunitproduced.
3. Assumes management has committed to support resources sufficient to produce the planned annualproduction volume of ` 2500 units; variable overhead cost is used at a rate of ` 4 per unit produced. Fixedoverheadis`30,000peryear.
4. Variablesellingandadministrativecostsusedamountto`1perunitsold.Fixedsellingandadmi nistrativecostsare`5,000peryear.
5. Standarddirect-materialcostperunitof`12multipliedbysalesvolumeinunits.
6. Assumethatmanagementhascommittedtodirectlaboursufficienttoproducetheplannedan nualpro duction volumeof2500units;directlabourcostisusedatarateof`8perunitproduced.
7. Assumes management has committed to support resources sufficient to produce the planned annualproduction volume of ` 2500 units; variable overhead cost is used at a rate of ` 4 per unit produced. Fixedoverheadis`30,000peryear.
8. Variablesellingandadministrativecostsusedamountto`1perunitsold.Fixedsellingandadmi nistrativecostsare`5,000peryear.

MarginalCosting:

Marginal costing is ''the ascertainment of marginal costs and of the effect on profit of changes in volume or typeof incremental costing are usedmoreorlesssynonymouslywithmarginalcosting.

Example:

Ever Forward Ltd is manufacturing and selling two products: Splash and Flash, at sellingprices of `3 and `4respectively.Thefollowingsalesstrategyhasbeenoutlinedfortheyear2015.

(i) Salesplannedforyearwillbe`7.20lakhsinthecaseofSplashand`3.50lakhsinthecaseofFlas h.

(ii) Break-evenisplannedat60%of-thetotalsalesofeachproduct.

(iii) Profitfortheyeartobeachievedisplannedat`69,120inthecaseofSplashand`17,500inthecas eofFlash.This would be possible by launching a cost reduction programme and reducing the present annualfixedexpensesof`1,35,000allocatedas`1,08,000toSplashand`27,000toFlash.

ThesellingpriceofSplashandFlashwillbereducedby20%and12.5%respectivelytomeetthecompe tition.

Youarerequiredtopresenttheproposalinfinancialtermsgivingclearlythefollowinginformati on.

(a) NumberofunitstobesoldofSplashandFlashtobreak-evenaswellasthetotalnumberofunitsofSplashandFlashtobesoldduringtheyear.

(b) Reductioninfixedexpensesproduct-wisethatisenvisagedbythecostReductionProgram.

S.S.ComputationofBreakeven,total no of unitstobesold&reductionincosts

		Splash	Flash	Total
I	Sales	7,20,000	3,50,000	10,70,000
II	SP	2.4	3.5	
III	No.ofunitstobesold $\left(\frac{7,20,000}{2.4}\right)$	3,00,000	1,00,000	4,00,000
IV	Breakevenunits60%	1,80,000	60,000	
V	Breakevensales	4,32,000	2,10,000	6,42,000
VI	M/s	2,88,000	1,40,000	4,28,000
VII	ProjectPlanned	69,120	17,500	86,620
VIII	P/VRatio	24%	12.5%	
IX	FC (Breakevensales×P/VRatio)	1,03,680	26,250	1,29,930
X	PreviousFC	1,08,000	27,000	1,35,000
XI	ReductioninFC(X–IX)	4320	750	5070

CASE STUDY -8

Strategic costing – Breakeven pointIllustration

AccelerateCo.Ltd.,manufacturesandsellsfourtypesofproductsunderthebrandnamesofA,B,CA NDD.Thesalesmixinvaluecomprises331/3%,412/3%,162/3%and81/3%ofproductsA,B,CandDre spectively.Thetotalbudgetedsales(100%are`60,000p.m.).operatingCostsare:

VariableCosts:

Product A 60% of selling Price Product B 68% of selling Price Product C 80%of selling PriceProductD40%ofsellingPrice

FixedCosts:`14,700p.m.

(a) Calculatethebreak-even-pointfortheproductsonoverallbasisand

(b) Alsocalculatebreak-even-point,ifthesalesmixischangedasfollowsthetotalsalespermonthremainingthe same.

(Mix:-A-25%:B-40%:C-30%:D-5%)

Solution:

(a) Statementshowingcomputationofbreak-evenpointonoverallbasis:

		A	B	C	D	TOTAL
a)Sales	`	20000	25000	10000	5000	60000
b)Variablecost	`	12000	17000	8000	2000	39000
c) Contribution	`	8000	8000	2000	3000	21000
d)Fixedcost	`					14700
e)Profit	`					6300
f)P/Vratio	%	40%	32%	20%	60%	35%
g)Breakevensales	`	14700/35%= 0				420 0

(b) Statementshowingcomputationofbreak-evenpointifthesalesmixischanged:

		A	B	C	D	TOTAL
Sales	`	1500 0	2400 0	1800 0	300 0	60000
Variablecost	`	9000	1632 0	1440 0	120 0	40920
Contribution	`	6000	7680	3600	180 0	19080
Fixedcost	`					14700

P/Vratio	%	40%	32%	20%	60%	(19080/60000)x100=31.8%
Breakevensales	`					14700/31.8%=46266

CASE STUDY 9

Illustration.

PHLtd.,hasaproductivecapacityof2,00,000unitsofproductBXEperannum.Thecompanyestimateditsnormalcapacityutilisationat90%for1986-87.Thevariablecostsare`22perunitandthefixedfactoryoverheadswerebudgeted at `7,20,000 per annum. The variable selling overheads amounted to `6 per unit and the fixed sellingexpenseswerebudgetedat`5,04,000.Theoperatingdatafor1986-87areasunder:

Production	1,60,000units
Sales@`40perunit	1,50,000unitsOpeningstockoffinishedgoods
	10,000units

Thecostanalysisrevealedanexcessspendingofvariablefactoryoverheadstotheextentof`80,000.Therearenovariancesinrespectofotheritemsofcost.

Required:

(i) Determinethebudgetedbreak-evenpointfor1986-87

(ii) Whatincreaseinpricewouldhavebeennecessarytoachievethebudgetedprofit?

(iii) Presentstatementsofprofitabilityfor1986-87using:

(a) Marginalcostingbasis.

(b) Absorptioncostingbasis.

Solution:

Fixedcost=Fixedoverheads+sellingexpenses=720000+504000=1224000

	`
ISellingprice	40.00
IIVariablecost	28.00
IIIContribution	12.00

Breakevenatbudget=(1224000/12)=102000units

(i) Contribution at budget=[(200000x90%)x12] 2160000

	`
Contributionperunit(2160000/150000)	14.40
Add:Variablecost	28.00
	42.40
Standardvariableproductioncost	22.00
Add:Standardfixedcost(720000/200000x9 0 %)	4.00
	26.00

ProfitunderAbsorptionCosting

		Units	`	`
StandardVariablecost	(160000x22)			3,520,000.00
Add:Variance				80,000.00
				3,600,000.00
Add:Fixedproductioncost absorbed	(160000x4)		680,000.00	
Add:Underrecovery	(720000-680000)		40,000.00	720,000.00
		160,000.00		4,320,000.00
Add:openingstock		10,000.00		260,000.00
				4,580,000.00
Less:Closingstock		20,000.00	(43.2x2/1.6)	540,000.00
				4,040,000.00
Add : selling& dis. Cost				
Variable	(150000x6)		900,000.00	
Fixed			504,000.00	1,404,000.00
Total cost				5,444,000.00
profit(b/f)				556,000.00
Sales	(150000x40)			6,000,000.00

				Profit under marginalcosting
i)Sales				6,000,000.00
ii)Variablecost				
Production			3,600,000.00	
Add:opening	(10000x22)		220,000.00	
			3,820,000.00	
Less:closing	20000x36/10)		450,000.00	3,370,000.00
Selling&distribution				900,000.00
				4,270,000.00
iii)Contribution				1,730,000.00
iv)Fixedcost				1,224,000.00
v)Profit				506,000.00

CASE STUDY 10

Illustration

The Officers' Recreation Club of a large public sector undertaking has a cinema theaterfor the exclusive use ofthemselvesandtheirfamilies.Itisabitdifficulttogetgoodmotionpicturesforshowandsopictur esarebookedasandwhenavailable.

The theater has been showing the picture 'Blood Bath' for the past two weeks.This picture,which is strictly foradults only has been a great hit and the manager of the theater is convinced that the attendance will continueto be above normal for another two weeks, if
the show of 'Blood Bath' is extended.However, another popularmovie, eagerly looked forward to by both adults and children alike, 'Appu on the Airbus' is booked for next twoweeks.Evenif'BloodBath'isextendedthetheaterhastopaytheregularrentalon'Appuonthe Airbus'aswell.

Normal attendance at theater is 2,000 patrons per week, approximately one fourth of whom are children underthe age of 12.Attendance of 'Blood Bath' has been 50% greater than the normal total.The manager believesthat this would taper off during the second two weeks, 25% below that of the first two weeks, during the third weekand331/3%belowthatofthefirsttwoweeks,duringthefourthweek.Attendancefor'Appuo ntheAirbus'wouldbeexpectedtobenormalthroughoutitsrunregardlessoftheduration.

All runs at the theater are shown at a regular price of `2 for adults and `1.20 for children fewer than 12.The rentalchargefor'BloodBath'is`900foroneweekor`1,500fortwoweeks.For'AppuontheAirbus'iti s`750foroneweekor`1,200fortwoweeks.Allotheroperatingcostsarefixed- `4,200perweek,exceptforthecostofpotatowafersandcakes,whichaverage60%oftheirsellingpr ice,salesofpotatowafersandcakesregularlyaverage `1.20perpatron,regardlessofage.

The Manager can arrange to show ‘Blood Bath’ for one week and ‘Appu on the Airbus’ for the following week

orhecanextendtheshowof‘BloodBath’fortwoweeksorelsehecanshow‘AppuontheAirbus’fort woweeksasoriginallybooked.

Showbycomputation,themostprofitablecourseofactionhehastopursue.

Solution:

Statementshowingevaluationofalternatives

		Bloodbath	Bloodbath&Appuontheairbus	Appuontheairbus
		`	`	`
No.ofspectators				
Adults:				
Thirdweek	3,000x75%	2,250.00	2,250.00	1,500.00
fourthweek	3,000x2/3	2,000.00	1,500.00	1,500.00
		4,250.00	**3,750.00**	**3,000.00**
Children:				
Thirdweek				500.00
fourthweek			500.00	500.00
			500.00	**1,000.00**
Totalspectators:		**4,250.00**	**4,250.00**	**4,000.00**
Revenue:				
Bysaleoftickets		8,500.00	8,100.00	7,200.00
				(3,000x2+1000x1.2)
Add:contributionfromsnacks		2,040.00	2,040.00	1,920.00
		10,540.00	**10,140.00**	**9,120.00**
Less:Incrementalcost		1,500.00	900.00	
		9,040.00	**9,240.00**	**9,120.00**

ItisfoundthatthenetrevenueismoreattheoptionofrunningbloodbathandAppuontheAirbusaweekeach, it mustbechosen.

A manufacturing company currently operating at 80% capacity has received an export order from Middle
East,whichwillutilise40%ofthecapacityofthefactory.Theorderhastobeeithertakeninfullandexecutedat10
% belo wthecurrentdomesticpricesorrejectedtotally.

Thecurrentsalesandcostdataaregivenbelow. Sales `16.00lakhs.

(ii) DirectMaterial `5.80lakhs.
(iii) DirectLabour `2.40lakhs.
(iv) VariableOverheads `0.60lakhs.
(v) FixedOverheads `5.20lakhs. Thefollowingalternativesareavailabletothemanagement:

Continuewithdomesticsalesandrejecttheexportorder.

Accept the export order and allow the domestic market to starve to the extentof excess of

demand.Increasecapacitysoastoaccepttheexportorderandmaintainthedomesticdemandby

Purchasingadditionalplantandincreasing10%capacityandtherebyincreasingfixedoverheadsby

`65,000and Workingovertimeatoneandhalftimethenormalratetomeetbalanceoftherequiredcapacity.

Youarerequiredtoevaluateeachoftheabovealternativesandsuggestthebestone.

Solution:

Statementshowingcomputationofprofitatdifferentalternatives:

(InLakhs)

	Particulars	I **PresentSales80 %**	II **40%-Foreign 60%-Domestic**	III **40%-Foreign 80%-Domestic**
I.	Sales(`)	16	19.2 (7.2+12)	23.2 (7.2+16)
II.	VariableCost(`)			
	DirectMaterial(`)	5.8	7.25	8.70
	DirectLabour(`)	2.4	3.00	3.60
	VariableOverheads(`)	0.6	0.75	0.90
	OvertimePremium(`)	--	--	0.15
		8.80	11.00	13.35
III	Contribution(`)	7.20	8.20	9.85
IV	FixedCost(`)	5.20	5.20	5.85 (5.20+ 0.65)
V	Profit(`)	2.00	3.00	4.00

From the above computation,it was found thatthe profit ismore at the IIIalternativei.e.accepting theforeign orderfullyandmaintainingthepresentdomesticsales,itisthebestalternativetobesuggeste d.

CASE STUDY-11

Strategic costing – transfer pricing

Yourcompanyfixestheinter-divisionaltransferpricesforitsproductsonthebasisofcost,plusareturnoninv estmentinthedivision.TheBudgetforDivisionAfor1981-82appearsasunder:

`

FixedAssets	5,00,000
Currentassets	3,00,000
Debtors	2,00,000
AnnualFixedCostoftheDivision	8,00,000
VariableCostperunitofProduct	10
BudgetedVolume	4,00,000unitsperyear
DesiredROI	28%

DeterminethetransferPriceforDivisionA.

Solution:

`

VariableCost		10.00
FixedCostperunit	8,00,000 ÷4,00,000	2.00
requiredReturn	$\frac{10,00,000 \times 28\%}{4,00,000}$	0.70
TotalcostorTransferprice		**12.70**

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