Total Marks = 90

Q.2 (a) **Markets and hierarchies:**

Transaction cost analysis is an aspect of economics that deals with the way resources are organized for production. It is an important contribution to thinking about the nature of business and has important implication for both business strategy and business structure. In its simplest form, this analysis is concerned with the question of why firms exist and grow; and why production is not undertaken by self employed individuals contracting with one another for the supply of goods and services. This is referred to the "markets and hierarchies".

Problems with contracts:

The market or contractual approach was hampered in the long term by a combination of uncertainty and bounded rationality.

a. Environmental uncertainties means we must expect economic relationships to change as time passes.
b. Bounded rationality is our acceptance of the fact that we can not have perfect knowledge of those changes in advance.

Taken together uncertainty and bounded rationality mean that in longer term, satisfactory contracts are not feasible. The range of possibilities they must cover is impossibly large. The incessant search for economic advantage means that the contracting parties could not trust one another not to take advantage of a new opportunity to benefit at the other's expense.

Problems with hierarchies:

The problem with the hierarchy approach is that the tendency of mangers is to pursue personal or systems objectives like control or growth. Rather than the overall corporate objectives; the continued existed of inefficiency traceable to monopolistic practices; and the limit to organizational size and hierarchal complexity imposed by communication and control difficulties in large bureaucracies.

Transaction cost analysis has some important insights for the firms go about their business. Transaction cost analysis compares the relative cost advantage of organizing production on either a market or a hierarchy basis. It suggests that asset specificity may drive vertical integration and that outsourcing every activity that is not a core competence should be considered.

Q.2 (b) a. Internal Stakeholders: This includes employees and management who are well connected with the company their objectives are to have a strong influence on smooth running of project. They are interested in the following issues.

- The organization's continuation and growth. Management and employees have a special interest in the organization's existence.
- Managers and employees have individual interest and goals which can be enhanced to the goals of the organization.
- Managers and employees interests to defend include Jobs/careers, money, promotion, benefits and satisfaction.

  Their response risk includes pursuit of 'system goals' rather than shareholder interests, industrial action, negative power to impede implementation, refusal to relocate and resignation. r probabilities can be estimated.

b. Connected stakeholders: Shareholders will be happy if management performance is measured and rewarded by reference to changes in shareholder value because mangers are likely to encourage long term share price growth:

- Shareholders interests to defend include increase in shareholder wealth, measured by profitability, P/E ratios, market capital capitalization, dividends and yield and risk. benefits and satisfaction.

  Their response risk includes sell shares eg. to predator or get rid out management.

- Bankers (cash flows) interests to defend include security of loan, adherence to loan agreements.

  Their response risk includes denial of credit, higher interest charges, and receivership.

- Suppliers (purchase strategy) interests to defend include profitable sales, payment for goods and long term relationship.

  Their response risk includes refusal of credit, court action and wind down relationship.

- External Stakeholders: This includes government, local authorities, pressure groups, the community at large. Professional bodies-are likely to have diverse objectives.

  - Government interests to defend include jobs, training, and tax.

    Their response risk includes tax increase, regulation and legal action.

  - Interest/pressure groups interests to defend pollution, rights and others.

    Their response risk includes publicity, direct action, sabotage and pressure on government.

Q.3 (a) **Management Accounting** is 'the application of the principles of accounting and financial management to create, protect, preserve and increase value for the stakeholders of for profit and not-for-profit enterprises in the public and private sectors.

Management accounting is an integral part of management. It requires the identification, generation, presentation, interpretation and use of information relevant to:

- Inform strategic decisions and formulate business strategy
- Plan long, medium and short-run operations
- Determine capital structure and fund that structure
- Design reward strategies for executives and shareholders
- Inform operational decisions
- Control operations and ensure the efficient use of resources
- Measure and report financial and non-financial performances to management and other stakeholders
- Safeguard tangible and intangible assets
- Implement corporate governance procedures, risk management and internal controls'.

Strategic Management Accounting is a 'form of management accounting in which emphasis is placed on information which relates to factors external to the entity, as well as non-financial information and internally generated information'.

The challenge lies in providing more relevant information for decision making. Traditional management accounting systems may not always provide this.

(a) **Historical costs** are not necessarily the best guide to decision-making. One of the criticisms of management accounting in a strategic context is that management accounting information is biased towards the **past rather than the future.**

(b) **Strategic issues** are not easily detected by management accounting systems.

(c) **Financial models** of some sophistication are needed to enable management accountants to provide useful information.

In other words, to support strategic decisions, management accounting itself needs to become more strategic.

The difference between strategic management accounting and traditional management accounting are:

- External orientation towards customers and competitors, suppliers and stakeholders.

Example can be that in case of traditional management accountant would report on an organization's own revenues. The strategic management would report on market share or trends in market size and growth.

- Future orientation: In case of traditional management accounting the emphasis is on backward – looking and strategic management accountants will use relevant costs and revenues for decision making.
- Goal congruence. Strategic management accounting translates the consequences of different strategies into a common accounting language for comparison.

The role of the strategic management accountant can be analyzed as follows:

- Financial analysis which indicates the current position of a business and financial performance in comparison with competitors and breaking it down into product and customer profitability analysis.
- Financial planning quantifies the goals and objectives of the business for example in case of budget.
- Financial control. Financial information is an essential part of the feedback mechanism comparing planned with actual performance.

Q.3 (b) Goals and objectives derive from mission and support it. Goals for markets and marketing will involve the following types of decisions.

i. Market leadership: Whether the organization wants to be the market leader, or number two in the market, what rate of growth it desires and so on.
ii. Coverage: Whether the product range needs to be expanded.
iii. Positioning: Whether there should be an objective to shift position in the market – e.g. from producing low cost for the mass market to higher cost specialist products.
iv. Expansion: Whether there should be an objective of broadening the product range or extending the organization's market.

Goals for the products and services;

i. Labor productivity objectives are often quantified as targets to reduce unit costs and increase output per employee by a certain percentage each year.
ii. Capital productivity is measured less often, but it can denote how efficiently a firm is using its equipment.
iii. Quality objectives might be measured in low rejects. In some environments, targets may be set for service delivery, such as speed in answering the telephone, customer satisfaction and service quality.

Functions of objectives:

- Planning
- Responsibility
- Integration
- Motivation
- Evaluation

Q.4 (a) A resource audit identifies any gaps in resources and limiting factors on organizational activities. Firms do not have unlimited resources so they have to do the best from limited factors.

A resource audit is an internal review. The Ms model categories the limiting factors are follows;

<u>Resources</u>;

a. Machinery;- One has to analyze its age, condition, utilization rate, technologically up-to-date cost , replacement value

b. Make-up:- This information includes culture and structure, patents, goodwill, brands

c. Management:- Details of this item covers size, skill, loyal. Career, progress, structure

d. Management Information:- to know about the ability to generate and disseminate ideas, innovation, information system

e. Markets;- Products and customers

f. Materials;- This includes source, suppliers and partnering, waste, new materials, cost, efficiency, labour turnover, industrial relations

g. Men and women:- Number, skills, wage costs, proportion of total costs efficiency, labor turnover, industrial relations.

h. Method:- How are activities carried out? Capital intensive or labor intensive, out sourcing, JIT

i. Money:- To have knowledge about credit and turnover periods, cash surpluses/deficits, short-term and long term finance. Gearing levels.

It should be noted that resources are of no value unless they are organized into systems. A resource audit considers how well resources have been utilized.

Resource use in both the efficiency with which resources are used. and the effectiveness of their use in achieving the planning objectives of the business. Resources can be a source of competitive advantage when used efficiently and effectively. EFFICIENCY is how well the resources have been utilized irrespective of the purpose for which they have been employed. EFFECTIVENESS is whether the resources have been deployed in the best possible way.

Q.4 (b) **Organic Growth:**

Organic growth is a popular method for many organizations. It is achieved through the development of an organization's own internal resources, rather than combining with any other firms. Expansion of a firm's size, profits, activities achieved without taking over other firms.

Why might a firm pursue organic growth?

- The process of developing a new product gives the firm the best understanding of the market and the product.
- It might be the only sensible way to pursue genuine technological innovations.
- There is no suitable target for acquisition.
- The firm has sufficient current resources to comfortably plan, finance and deliver the growth itself.
- The same style of management and corporate culture can be maintained.
- There are no issues with trying to integrate the firm"s operating systems with those of another firm.
- May be less onerous on cash flow than an acquisition. Investment on internal growth can be funded in stages, but to make an acquisition a firm is likely to have to commit a large

amount of funds in one go.

- Hidden or unforeseen losses are less likely with organic growth. There are also no issues with having to value a potential acquisition.

If we assume that existing products have a finite life, a strategy of organic growth must include plans for innovation.

- It provides the organization with a distinctive competence, and with the ability to maintain such a competence.
- It maintains the organization's competitive advantage and market share.

Potential disadvantages of Organic Growth:

- Time. It will take longer for a firm to grow organically, than by acquiring another firm. This may be a problem in an industry which is changing rapidly, and where an acquisition could allow the firm to 'buy in' new skills and knowledge.
- It the firm is looking to break into new markets, it may lack the access to key suppliers or customers which established players have.
- The firm has to bear all the risk of any new product development or market entry strategies. By contrast if, for example, the firm entered into a joint venture, this risk would be shared with the venture partner.

Q.5 (a) Gap analysis quantifies the size of the gap between the objectives for the planning period and the forecast based on the extrapolation of the current situation and current prospects.

Gap analysis is a comparison between an entity's ultimate objectives and the expected performance of projects both planned and underway. Differences are classified in a way which aids the understanding of performance, and which facilities improvement. Gap analysis is based on the following:

- What are the organization targets for the achievement over the planning period?
- What would the organizational be expected to achieve if it 'did nothing' ie did not develop any new strategies, but simply carried on in the current way with the same product and selling to the same markets?

This difference is the gap. New strategies will then have to be developed which will close this gap, so that the organization can expect achieve its targets over the planning period.

<u>Analyzing an existing gap in sales</u>:

The demand gap is the difference between total market potential and current demand from users.

The distribution gap, product gap and competitive gap together make up the difference between current demand and total sales achieved.

a. The distribution gap arises from lack of access to or utilization of distribution channels.
b. The product gap arises from product failure or deliberate product decisions.
c. The competitive arises from failures of pricing or promotion.

The analysis is based on 4P's of the marketing mix. The organization needs to align product, place, price and promotion in order to market and product successfully., . i

<u>The profit gap:</u>

The profit gap is the difference between the target profits and the profits on the forecast.

a. First of all the firm can estimate the effects on the gap of any projects or strategies in the pipeline. Some of the gap might be filled by a new project.

b. Then, if a gap remains, new strategies have to be considered to close the gap.

There are some problems which must be considered during the analysis:

a. The financial propositions may be susceptible to inflation – there is no easy way of dealing with this problem.
b. More serious is the risk in which in many cases a higher return can equate to a higher risk. In seeking to develop strategies to give a higher return, the firm may, unwittingly, be raising its risk profile.

Q.5 (b) Though the terms risk and uncertainty are used interchangeably but there is a distinction between both.

Risk is sometimes used to describe situations where outcomes are not known, their probabilities can be estimated.

Uncertainty is present when the outcome cannot be predicted or assigned probabilities.

Who suffers risk?

Risk and return are related. An investor will want a higher return to compensate for the increased risk of a project.

There will a minimum return that shareholders will accept, allowing for the risk of the investment. Shareholders are able to diversify their portfolio i.e. that can invest in different firms depending upon the amount risk. Then it is observed that managers who are key decision makers and their perceptions of risk are likely to be different.

Different types of risk:

a. Physical risk: includes natural disaster like fire , earthquake, floods, global warming, drought etc.
b. Economic risk: in this case assumptions about the economic environment might turnout to be wrong, even government forecasts are not perfect.
c. Financial risk: Shareholders, businessmen. Investors, managers, all types of companies have to face this type of risk.
d. Business risks: New technology, changes in customers, suppliers, change in law and regulations, management misunderstanding of core competence, uncertain returns, change investors perceptions add to this type of risks.
e. Political risk: Nationalization, sanction, civil war, political instability, can all have impact on the business.
f. Exchange risk: Change in exchange rates affect the value of a transaction in a currency, or how it is reported.
g. Competitors risk: The risk to cash flows arising from the actions of competitors may be by introducing new product, reduce the price etc.

Q.6 (a) When the management is faced with resistance to change, they have two underlying choices for how to deal with that resistance:

i. Overcoming resistance through strengthening the driving forces for change, e.g. increasing management pressure, increasing fears of dismissal etc.
ii. Reducing resistance by weakening the forces that currently hold down output, i.e. through job redesign, adoption of a more people centered management style.

Six approaches to deal with resistance to change as highlighted by Kotter & Schlesinger are as follows:

a. Education and communication: This approach signifies that resistance is caused by ignorance. Thus education and communicating reasons for change will minimize the resistance. Moreover by telling the benefits of change may help to overcome negatives perception.

b. Participation and involvement: Make the participants involved in change process and make them feel they have contributed to the design of the changes. This may result in less resistance against the change.

c. Facilitation and support: Counseling services can encourage the concerned people to accept the change and take it in appositive way. Training programme for the staff members can contribute a lot and providing technical training may add to their confidence to accept the change.

d. Negotiation and agreement: In case of strong union negotiation can play a pivotal role, the change may be accepted as decided during the course of negotiation. This also involves discussion with employees to resolve areas of dispute about the change.

   The negotiations may involve offering incentives to workers to encourage them to accept the change.

e. Manipulation and co-optation: In this case resistance is undermined in a more cover manner. Perhaps by the way information is presented or by a political process.

f. Coercion, implicit and explicit: In case the management has power then the problem of acceptance of change can be resolved easily. Individuals are forced to accept change. This sort of tactic can often be successful if rapid change is required. However such aggressive tactics are not always desirable because people may resent them,

Each approach is suited to different circumstances, based on the respective power of each party and type of change being experienced.

Q.6 (b) When a business is in terminal decline and faces closure or takeover, there is a need for rapid and extensive change in order to achieve cost reduction and revenue generation. This is known as turnaround strategy. The seven elements of turnaround strategy are as follows:

a. Crisis stabilization:

   Here the emphasis is on reducing cost and increasing revenues. It is better to reduce direct costs then to emphasize to reduce overheads.

   Severe cost cutting is a common response to crisis but it is unlikely to be enough by itself. The wider causes of decline must be addressed.

b. Management changes;

   i. The old management allowed the situation to deteriorate and may be held responsible by key stakeholders.
   ii. Experience of turnaround management may be required
   iii. Managers brought from outside will not be prisoners of the paradigm.
   iv. A directive approach to change management will probably be required

c. Communication with stakeholders:

A stakeholder analysis should be carried out so that the various stakeholders groups can be informed and managed appropriately.

d. Attention to target markets:

The management should focus on appropriate target market segments, this is very essential. In fact a lack of such focus is a common cause of decline. It is better to become customer oriented and it should be made sure that it has good flow of information

e. Concentration of effort:

Resources should be concentrated on the best opportunities to create value. It is better to review products and market segments and eliminate any distractions and poor performers. The same type of review of internal activities would also show up several candidates for outsourcing.

f. Financial restructuring:

This is also required to judge the position of the project. The worst position may involve trading out of insolvency. If necessary capital restructuring may be required, both to provide cash for investment and to reduce cash outflows in the shorter term.

g. Prioritization:

The eventual success of a turnaround strategy depends in part on management's ability to prioritize necessary activities.

Q.7 (a) a. Net present value NPV is as follows:

(In Rs.)

Year	Cash flow (Profit before Dep.)	Discount Factor 15%	Present Value
0	-200000	1.000	-200000
1	72000	0.870	62640
2	72000	0.756	54432
3	72000	0.658	47376
4	72000	0.572	41184
		NVP	5632

b).

(In Rs.)

Year	Profit	Net book value of equipment (mid yr.value	ROCE %
1	22000	175000	12.6
2	22000	125000	17.6
3	22000	75000	29.3
4	22000	25000	88.0

However, if the investment is measured year by year according to the accounting ROI it has earned, it is found that its return is less than 15% in year 1, but more than 15% in years 2,3 and 4.

c).

i) Strictly speaking here investment decision should be based on NPP, and should not be guided by short term accounting ROI.

ii) Even if accounting ROI is used as a guideline for investment decisions, ROI should be looked at over the full life of the investment, not just in the short term. In the short term (in the first year or so of a projects life) the accounting ROI is likely to be low because the net book value of the asset will still be high.

It is conceivable that the group's management might disapprove of the project because of its low accounting ROI in year. This approach is short-termist, but nevertheless can make some sense to a company or group of companies which has show a satisfactory profit and ROI to keep the shareholders satisfied with performance.

Q.7 (b) (i) Useful ratios to assess operations might be as follows:

a. Machine down time:
b. Customer rejects/return/component rejects:
c. Deliveries late:
d. Value added time:

(ii) The four over-arching measures for manufacturing environments are as follows:

i. Cost: This includes non-financial and partly financial elements. The areas which may be covered are quantity of raw material inputs, equipment productivity, maintenance efforts, overtime costs, product complexity, quantity of output, product obsolescence, employees, employees' productivity and customer focus.

ii. Quality: Integrating quality into performance measurement system suggests attention to quality of purchased components, equipment failure, maintenance efforts waste, quality of output, safety, reliability, quality commitment, employee morale, leadership impact and customer awareness. The TQM can help in comprehensive system planning and controlling all business functions.

iii. Time: Just in time system is an ideal to which many manufacturing firms are striving. Time based competition is also important for new product development. The management accounting focus might be on throughput, bottlenecks, customer feedback and distribution.

iv. Innovation: Performance indicators for innovation can support the innovation and learning perspective on the balance scorecard. This may include the ability to introduce new products, flexibility to accommodate change reputation of innovation.

THE END