MANAGEMENT ACCOUTING-BUSINESS STRATEGY – STAGE-6

Marks

Q.2 (a) Benefits of Strategic Management

Small business owners, chief executive officers, presidents, and managers of many for-profit and nonprofit organizations have recognized and realized the benefits of strategic management.

The principal benefit of strategic management has been to help organizations formulate better strategies through the use of a more systematic, logical and rational approach to strategic choice.

However, strategic management is not a guarantee for success; it can be dysfunctional if conducted haphazardly. 1

Financial Benefits

Organizations using strategic-management concepts are more **profitable** and successful than those that do not.

Business using strategic-management concepts show significant improvement in: **sales/ profitability and/ productivity** compared to firms without systematic planning activities. 2

Non-financial Benefits

Besides helping firms avoid financial demise, strategic management offers other tangible benefits, i.e., an enhanced awareness of external threats, an improved understanding of competitors' strategies, increased employee productivity, reduced resistance to change and a clearer understanding of performance reward relationship. 2

In an article Gordon Greenly stated that strategic management offers the following benefits:

It represents a framework for improved coordination and control of activities.

It minimizes the effects of adverse conditions and changes.

It allows:

- Major decisions to better support established objectives.
- Identification, prioritization, and exploitation of opportunities.
- More effective allocation of time and resources to identified opportunities.
- Fewer resources and less time to be devoted to correcting erroneous or ad hoc decisions.
- It encourages forward thinking.
- It creates a framework for internal communication among personnel.
- It helps integrate the behavior of individuals into a total effort.

It provides:

- An objective view of management problems.
- A basis for clarifying individual responsibilities.
- A cooperative, integrated and enthusiastic approach to tackling problems and opportunities.

It encourages a favourable attitude toward change.

It gives a degree of discipline and formality to the management of a business.

10 benefits @ ½ mark 5

(b) Characteristics of a Mission Statement

A Declaration of Attitude

Mission statement is a declaration of attitude and outlook. It is broad in scope for at least two major reasons. (1) A good mission statement allows for the generation and consideration of a range of feasible alternative objectives and strategies without unduly stifling management

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creativity. (2) Mission statement needs to be broad to reconcile differences effectively among, and appeal to, an organization's diverse stakeholders, the individuals and groups of individuals who have a special stake or claim on the company. Thus a mission statement should be **reconciliatory**.

A Customer Orientation

A good mission statement **describes** an organization's purpose, customers, products or services, markets, philosophy and basic technology.

A good mission statement reflects the **anticipations of customers**.

Good mission statements **identify the utility of a firm's products** to its customers. 1

Because a mission statement is often the most visible and public part of the strategic-management process, it is important that **it includes the nine characteristics** as summarized below:

- **Broad in scope;** do not include monetary amounts, numbers, percentages, ratios, or objectives
- Less than 250 words in **length**
- **Inspiring**
- Identify the **utility** of a firm's products
- Reveal that the firm is **socially** responsible
- Reveal that the firm is **environmentally** responsible
- Include **nine components**
  (Customers, products or services, markets, technology, concern for survival/ growth/ profits, philosophy, self-concept, concern for public image, concern for employees)
- **Reconciliatory**
- **Enduring**

Eight characteristics @ ½ mark 4

Q. 3 (a) **Competitive intelligence (CI),** is a systematic and ethical process for gathering and analyzing information about the competitors' activities and general business trends to further a business's own goal.

Good competitive intelligence in business, as in the military **is one of the keys to success**. The more information and knowledge a firm can obtain about its competitors, more likely it is that **it can formulate and implement effective strategies**. 1

Major competitors' weaknesses can represent external opportunities; major competitors' strengths may represent key threats. 1

Firms need an effective competitive intelligence (CI) program. The three basic objectives of a competitive intelligence program are:

- To provide a **general understanding** of an industry and its competitors, 0.5
- To identify areas in which competitors are **vulnerable** and to assess the **impact** strategic actions would have on competitors, 0.5
- To identify **potential moves** that a competitor might make that would endanger a firm's position in the market. 0.5

Sources of competitive information include trade journals, newspaper articles and government filing, as well as customers, suppliers, distributors, competitors themselves, and the Internet. 1

Unethical tactics such as bribery, wiretapping and computer break-ins should never be used to obtain information. 0.5

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(b) Value Chain Analysis:

According to Porter, the business of a firm can best be described as a **value chain**, in which **total revenues minus total costs of all activities** undertaken to develop and market a product or service yields value. Value chain analysis (VCA) refers to the process whereby a firm determines the **cost associated with organizational activities** from purchasing raw materials to manufacturing product(s) to marketing those products. 1

VCA aims to **identify where low-cost advantages or disadvantages exist** anywhere along the value chain from raw material to customer service activities. 1

VCA can enable a firm to better **identify its own strengths and weaknesses**, especially as compared to competitors' value chain analyses and their own data examined over time. 1

Substantial judgment may be required in performing a VCA because different items along the value chain **may impact other items positively or negatively**, so there exist complex interrelationships. For example, exceptional customer service may be especially expensive yet may reduce the costs of returns and increase revenues. 1

Despite the complexity of VCA the initial step in implementing this procedure is to **divide a firm's operations into specific activities** or business processes. Then the analyst attempts to **attach a cost to each discrete activity** and the cost could be in terms of both time and money. Finally, the analyst converts the cost data into information by looking for competitive cost strengths and weaknesses that may yield **competitive advantage or disadvantage**. 1

Benchmarking

Benchmarking is an analytical tool used to determine whether a firm's value chain **activities are competitive compared to rivals** and thus conducive to winning in the marketplace. 1

Benchmarking entails **measuring costs of value chain activities across an industry** to determine "best practices" among competing firms for the purpose of duplicating or improving upon those best practices. 1

Benchmarking enables a firm to take action to **improve its competitiveness** by identifying and improving upon value chain activities where rival firms have comparative advantages in cost, service, reputation, or operation. 1

The hardest part of benchmarking can be **gaining access to other firms' value chain activities** with associated costs. Typical **sources of benchmarking information**, however, include published reports, trade publications, suppliers, distributors customers, partners, creditors, shareholders, lobbyists, and willing rival firms. 1

Due to the **popularity of benchmarking today**, numerous **consulting firms gather benchmarking** data, conduct benchmarking studies, and distribute benchmark information without identifying the sources 1

Q. 4 (a) Types of cooperative arrangements include joint venture / partnering, merger/ acquisition, first mover advantages, outsourcing research and development partnerships, cross-distribution agreements, cross-licensing agreements, cross-manufacturing agreements, and joint-bidding consortia. 1

Joint venture / Partnering:

Joint venture is a popular strategy that occurs when two or more companies form a **temporary partnership or consortium** for the purpose of capitalizing on **some opportunity**. The two or more sponsoring firms form a separate organization and have shared equity ownership in the new entity. Joint ventures and cooperative arrangements are being used increasingly because they allow companies **to improve communications and networking to globalize operations and to minimize risk**. 1

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Firms often give away **too much information to rival firms** when operating under cooperative agreements. Multinational firms are becoming more globally cooperative, and increasing numbers of **domestic firms are joining forces with competitive foreign firms to reap mutual benefits**.

U. S. companies often enter alliances primarily to avoid investments, being more interested in reducing the costs and risks of entering new businesses or markets than in acquiring new skills. In contrast, learning from the partner is a major reason why Asian and European firms enter into cooperative agreements. U. S. 1

Joint ventures and partnerships are often used to pursue an **opportunity that is too complex, uneconomical, or risky** for a single firm to pursue alone.

Such business creations also are used when **achieving and sustaining competitive advantage** when an industry requires a broader range of **competencies and know-how** than any one firm can marshal. 1

Strategic partnering takes many forms, including outsourcing, information sharing, joint marketing and joint research and development. A major reason why firms are using partnering as a means to achieve strategies is globalization. 1

(b) Merger/ Acquisition

A **merger** occurs when **two organizations of about equal size unite** to form one enterprise. An **acquisition** occurs when **a large organization purchases (acquires) a smaller firm**. 1

When a merger or acquisition **is not desired by both parties**, it can be called a **takeover or hostile takeover**. 0.5

In contrast, if the **acquisition is desired** by both firms it is termed a **friendly merger**. Most mergers are friendly. 0.5

Among mergers, acquisitions, and takeovers in recent years, same-industry combinations have predominated. A general market consolidation is occurring in many industries, especially banking, insurance, defense, and health care, but also in pharmaceuticals, food, airlines, accounting, publishing, computers, retailing, financial services, and biotechnology. 1

Key Reasons why many mergers and acquisitions fail:

- Integration difficulties
- Inadequate evaluation of target
- Large or extraordinary debt
- Inability to achieve synergy
- Too much diversification
- Managers overly focused on acquisitions
- Too large an acquisition
- Difficult to integrate different organizational cultures
- Reduced employee morale due to layoffs and relocations

Indicating few (2 or 3) reasons of failure 1

Potential Benefits of merging with or acquiring another firm:

- To provide improved capacity utilization
- To make better use of the existing sales force
- To reduce managerial staff
- To gain economies of scale
- To smooth out seasonal trends in sales

1

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- To gain access to new suppliers, distributors, customers, products, and creditors
- To gain new technology
- To reduce tax obligations

Indicating few (2 or 3) potential benefits

(c) First Mover Advantages:

First mover advantages refer to the **benefits a firm may achieve by entering a new market or developing a new product or service prior to rival firms**. Some advantages of being a first mover include securing **access to rare resources**, gaining **new knowledge of key** factors and issues, and **carving out market** share and a position that is easy to defend and costly for rival firms to overtake. 1

Being the first mover can be especially wise when such actions (1) build a firm's image and **reputation with buyers**, (2) produce **cost advantages over rivals** in terms of new technologies, new components new distribution channels, and so on, (3) create strongly **loyal customers**, and (4) make imitation or duplication by a rival hard or unlikely. 2

To sustain the competitive advantage gained by being the first mover, such a firm also needs to be a fast learner.

There would, however, be risks associated with being the first mover, such as unexpected and unanticipated problems and costs that occur from being the first firm doing business in the new market. This situation does not occur often, so first mover advantages clearly offset the first mover disadvantages most of the time. 1

Therefore, being a **slow mover** (also called fast follower or late mover) can be effective when a firm can easily copy or imitate the lead firm's products or services.

If technology is advancing rapidly, **slow movers can** often leapfrog a first mover's products with improved second-generation products. However, **slow movers** often are relegated to relying on the first mover being a slow mover and making strategic and tactical mistakes. 1

(d) Outsourcing:

Business-process outsourcing (BPO) is a rapidly growing new business that involves companies taking over the functional operations, such as human resources, information systems, payroll, accounting, customer service, and even marketing of other firms. 1

Companies are choosing to outsource their functional operations more and more for several reasons:

(1) It is less expensive,
(2) It allows the firm to focus on its core businesses, and
(3) It enables the firm to provide better services.

2 reasons @ 1 mark 2

Other advantages of outsourcing are that the strategy:

(1) allows the firm to align itself with "best-in-world" suppliers who focus on performing the special task
(2) provides the firm flexibility should customer needs shift unexpectedly, and
(3) allows the firm to concentrate on other internal value chain activities critical to sustaining competitive advantage. BPO is a means for achieving strategies that are similar to partnering and joint venturing.

2 advantage @ 1 mark 2

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Q. 5 (a) (i) Advantages and disadvantages of a Functional Organizational Structure:

Advantages	Disadvantages
1. Simple and inexpensive	1. Accountability forced to the top
2. Capitalizes on specialization of business activities such as marketing and finance	2. Delegation of authority and responsibility not encouraged
3. Minimizes need for elaborate control system	3. Minimizes career development
4. Allows for rapid decision making	4. Low employee/ manager morale
	5. Inadequate planning for products and markets
	6. Leads to short-term, narrow thinking
	7. Leads to communication problems

@ ½ mark for 10 points out of 11 advantages and disadvantages 5

(ii) Advantages and disadvantages of a Divisional Organizational Structure:

Advantages	Disadvantages
1. Accountability is clear	1. Can be costly
2. Allows local control of local situations	2. Duplication of functional activities
3. Creates career development chances	3. Requires a skilled management force
4. Promotes delegation of authority	4. Requires an elaborate control system
5. Leads to competitive climate internally	5. Competition among divisions can become so intense as to be dysfunctional
6. Allows easy adding of new products or regions	6. Can lead to limited sharing of ideas and resources
7. Allows strict control and attention to products, customers, and / or regions.	7. Some regions/ products/ customers may receive special treatment

@ ½ mark for 10 points out of 14 advantages and disadvantages 5

(b) Criteria for evaluating strategies suggested by Rumelt:

(i) Consistency

A strategy should not present inconsistent goals and policies. Organizational conflict and interdepartmental bickering are often symptoms of managerial disorder, but these problems may also be a sign of strategic inconsistency. 1

Three guidelines help determine if organizational problems are due to inconsistencies in strategy:

- If managerial problems continue despite changes in personnel and if they tend to be issue based rather than people based then strategies may be inconsistent.
- If success for one organizational department means, or is interpreted to mean, failure for another department, then strategies may be inconsistent.
- If policy problems and issues continue to be brought to the top for resolution, then strategies may be inconsistent.

2 guidelines @ 1 mark 2

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(ii) Consonance

Consonance refers to the need for strategists to examine **sets of trends, as well as individual trends** in evaluating strategies. A strategy must represent an adaptive response to the external environment and to the critical changes occurring within it. Although single economic or demographic trends might appear **steady for many years, there are waves of change** going on at the interaction level. 1

One difficulty in matching a firm's key internal and external factors in the formulation of **strategy is that most trends are the result of interactions among other trends**. For example, the day care explosion came about as a combined result of many trends that included a rise in the average level of education, increased inflation, and an increase in women in the workforce. 1

(iii) Feasibility

A strategy must neither overtax available resources nor create unsolvable sub problems.

The final broad test of strategy is its feasibility; that is, **can the strategy be attempted within the physical, human, and financial resources of the enterprise?** The financial resources of a business are the easiest to quantify and are normally the first limitation against which strategy is evaluated. 1

A less quantifiable but actually more rigid, limitation on strategic choice is that **imposed by individual and organizational capabilities**. In evaluating a strategy, it is important to **examine whether an organization has demonstrated in the past that it possesses the abilities, competencies, skills, and talents needed to carry out a given strategy.** 1

(iv) Advantage

A strategy must provide for the **creation and/ or maintenance of a competitive advantage** in a selected area of activity. Competitive advantages normally are the result of superiority in one of three areas: ▫ resources, ▫ skills, or ▫ position. 1

The idea that the positioning of one's resources can enhance their combined effectiveness is familiar to military theorists, chess players, and diplomats. Position can also play a crucial role in an organization's strategy. Once gained, a good position is defensible meaning that it is so costly to capture that rivals are deterred from full scale attacks. Positional advantage tends to be self sustaining as long as the key internal and environmental factors that underlie it remain stable.

This is why entrenched firms can be almost impossible to unseat, even if their raw skill levels are only average. 1

Although not all positional advantages are associated with size, it is true that larger organizations tend to operate in markets and use procedures that turn their size into advantage, **while smaller** firms seek product/ market positions that exploit **other types of advantage**.

The principal characteristic of good position is that it permits the firm to obtain advantage from policies that would not similarly benefit rivals without the same position. Therefore, in evaluating strategy, organizations should examine the nature of positional advantages associated with a given strategy. 1

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Q. 6 (a) Statement of Incremental profit:

Amount in Rs.

	OPERATING LEVELS								
	2,500 Dresses (Dresses only)		**Combination of 3,000 Dresses (2,500 + 20%)**						
	Rs./ unit	Total	DRESS CAPS & HANDKECHIEF	DRESS & CAPS	DRESS & HANDKERCHIEF	DRESS ONLY	**Total**		Marks
%age of combination			68%	12%	9%	11%	=	**100%**	
Units of combination		**2,500**	2,040	360	270	330		**3,000**	
Sale price per unit	400		447	429	418	400			
Sales revenue		**1,000,000**	911,880	154,440	112,860	132,000		**1,311,180**	
Material (4 metres x Rs. 60)	240	**600,000**	489,600	86,400	64,800	79,200		**720,000**	
Scrap value	5	**12,500**				1,650		**1,650**	
Material cost - Net	235	**587,500**	489,600	86,400	64,800	77,550		**718,350**	
Other cost	48	**120,000**	117,300	19,620	13,770	15,840		**166,530**	
Cutting cost	20	**50,000**	57,120	10,080	7,560	6,600		**81,360**	
Total cost	303	**757,500**	664,020	116,100	86,130	99,990		**966,240**	
Cost per unit		**303**	326	323	319	308			
Contribution margin/ Profit		**242,500**	247,860	38,340	26,730	32,010		**344,940**	
Cont. M / Profit - per unit	97	**97**	122	107	99	97			
Incremental Profit - 102,440		3	+2	+2	+2	+2	=		11

As there is incremental profit of Rs. 102,440 the company should go in for caps and handkerchiefs along with dresses. 1

Working:		Rs.
Scrap value:	11% of 3,000 = 330 dresses @ Rs. 5	**1,650**
Cutting Cost:	11% of 3,000 = 330 dresses at Rs. 20	6,600
	89% of 3,000 = 2,670 at Rs.28	74,760
		81,360
Other Costs:	48 + 6.50 + 3 = 57.50 x 3,000 x 68%	117,300
	48 + 6.50 + 54.5 x 3,000 x 12%	19,620
	48 + 3 = 51 x 3,000 x 9%	13,770
	48 x 3,000 x 11%	15,840
		166,530
Sales.	400 + 29 + 18 = 447 x 3,000 x 68%	911,880
	400 + 29 = 429 x 3,000 x 12%	154,440
	400 + 18 = 418 x 3,000 x 9%	112,860
	400 x 3,000 x 11%	132,000
		1,311,180

THE END

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