K.J. SOMAIYA INSTITUTE OF MANAGEMENT STUDIES AND RESEARCH

MFM 2017-20 V Semester

Sub : Strategic Cost Management

Date : 18/11/2019 ***Marks 50.*** ***Duration : 3 hrs***

Question 1 is Compulsory. Attempt any 3 out of the remaining 5 questions

Question 1 (20 marks)

Established in the year 2000, XYZ Pharma is a credible drug-manufacturer which has strengthened in patented drugs over the last two decades and produces three products, X, Y and Z.

It did reasonably well in terms of market-share and penetration in the past but over the last 3 years or so it is facing stiff competition, sluggish demand and is unable to understand why; as there has been no drop-in product quality; as endorsed by the Quality Teams.

It hence appointed a drug-consultant to study the processes and furnished the following information to it, to conduct a due-diligence and examine and advise the suitable course of action in terms of way ahead. The drug-consultant has suggested that it should now switch to "Activity Based Costing" as:

- It has multiple products spread across geographies
- It is now fairly established and hence the cost-benefit case would suggest the switch as "financially viable"

An extract of the evaluation report is as under:

It requires 3 production runs to produce 5000 units of X, 5 production runs to produce 7500 Units of Y and 7 production runs to produce 10000 units of Z.

The material requirements are as under:

- 10,000 kgs @ Rs 10/kg for X
- 12,500 kgs @ Rs 8/kg for Y and
- 15,000 kgs @ Rs 6/ kg for Z

It takes a total of 15,000 hours each to produce X and Y and 8000 hours to produce Z respectively. Labour is paid @ Rs 20/hour.

The company also incurs Rs 760,000 on overhead costs. These are allocated amongst the products basis the labour hour rate. The desired margin is 25% on selling price for all divisions.

The company is struggling with inefficient pricing, in some cases it is not being able to penetrate the market as the products seem over-priced whereas in some cases, the products seem under-priced thereby eroding margins. Hence, it has decided to switch to Activity Based Costing.

It has split the overhead costs as under, after thorough evaluation of the costs, identification of cost drivers to enable assignment of activity costs to cost objects:

- ✓ Set Up Costs of Rs 450,000 (driver: Production Runs)
- ✓ Material Handling Costs of Rs 310,000 (driver: Material Consumption)

You are now required to arrive at the costs per unit of X, Y and Z and also estimate the selling prices if the desired margin is still mandated at 25% on selling price for all divisions.

1. Build upon the shortcomings of the legacy (absorption) costing method?
2. What are the costs & selling prices per unit if the legacy absorption costing system is followed?
3. Compare and contrast the legacy technique (absorption costing) with the new technique (activity-based costing)?
4. Demonstrate and establish the importance of "Value Engineering" in the context of the Activity Based Costing Technique?
5. What are the costs & selling prices per unit if the activity-based costing system is followed?
6. What is your observation, are the products accurately / under / over-priced?
7. Recommend the course of action in terms of way ahead for ABC Pharma?

Question 2 (10 marks)

The sports material manufacturing company budgeted the following data for the coming year.

	Rupees
Sales (1,00,000 units)	1,00,000
Variable cost	40,000
Fixed cost	50,000

Evaluate the situations below and populate the results in the table below:

		P/V Ratio	**Sales at BEP**	**Margin of Safety**
1.	Present Situation			
2.	20% increase in physical sales volume			
3.	5% increase in variable costs			
4.	10% increase in fixed costs			
5.	10% decreases in selling price and 10% increase in sales volume			

Question 3 (10 marks)

A firm is preparing a Product X. It has an annual installed capacity of 100,000 Units. The cost structure per unit is given as under:

Material	5 kgs required to produce one unit	Rs 10/kg
Labor	6 hours to produce one unit	Rs 5 per hour
Fixed Overheads	Rs 10,00,000	Based on Installed Capacity
Variable Overheads	Rs 750,000	Based on most recent production at 75% capacity utilization

a) What is the Cost per unit at 100% capacity utilisation?
b) Will that be different at the current 75% capacity utilisation? Why? Demonstrate with the necessary calculations?
c) At the current capacity utilisation, what should be the mandated Selling Price per unit assuming a budgeted margin on selling price of 25%?

Comment on the importance and relevance of "Capacity" in strategic decision making?

Question 4 (10 marks)

"Make vs Buy" could be an important strategic decision to make by Finance Managers. Enunciate with a necessary example highlighting the factors based on which informed decisions could be based? Could the decisions be swapped owing to increase / decrease in idle capacity? Demonstrate by citing necessary inferences.

Question 5 (10 marks)

Write short notes on the following in the context of strategic cost management and decision making?

a) Disposal and Waste Management – steps and importance
b) Project Monitoring Techniques (cost and effort) – measurement and relevance
c) Target Costing – a top down approach and the criticality of "value engineering"

Question 6 (10 marks)

A company produces a single product which sells for Rs 20/unit. The variable costs are @ Rs 15/unit. The fixed overheads for the year are Rs 630,000.

a) Calculate the sales value to earn a profit margin of 10% on selling price
b) Calculate the selling price / unit to bring the BEP down by 6000 Units
c) Calculate the Margin of Safety if Profits earned are Rs 60,000