

Ollscoil na hÉireann, Gaillimh
National University of Ireland, Galway

Semester II Examinations 2002
Bachelor of Commerce Degree Examination

Strategic Management Accounting (AY 323)

Professor N. Garrod
Professor S. Collins
Mr. J. Currie
Dr. M. Fahy
Dr. B. Sweeney

Time Allowed: Two Hours.

Answer two questions from each section, a total of four questions.

Separate answer books are not required for each section.

Section A

(Answer Two of the Three Questions)

Question 1:

Colura Ltd manufactures beaded jewellery and is considering expanding its product range to include a celtic necklace. Beads for this new product can be purchased for 50 cent and the cost of wire is 30 cent. The labour cost is €2 for assembling the necklace. Colura Ltd wish to achieve a 20% mark up on cost. The company has previously adopted a cost-plus approach to pricing but has recently heard that target costing is now used by companies to price products. Market research indicates that the necklace can be sold for €3.

Required:

- (a) Explain the difference between cost-plus pricing and target costing, using the above information to illustrate your answer. (7 Marks)
 - (b) Discuss the methods used by companies to achieve target costs. (13 Marks)
- (Total: 20 Marks)

Question 2:

Newco Plc. issued a total of 10,000,000 ordinary shares which were valued at €2.50 each when the company was formed and admitted to a stock exchange listing in early January 1997.

The following information is available on Newco's dividends per share for each of the past five years, and its share price at the beginning and the end of each year:

Year	2001	2000	1999	1998	1997
Dividend per Share	€0.10	€0.09	€0.08	€0.06	€0.05
Share Price:					
End of Year	€3.20	€3.10	€3.24	€2.55	€2.73
Beginning of Year	€3.10	€3.24	€2.55	€2.73	€2.50

Required:

- (a) Calculate the Total Shareholder Return (TSR) during each of the past five years and for the five-year period as a whole since the company was formed, and calculate the average annual TSR over the five year period. (8 Marks)
 - (b) Assuming that shareholders' funds on Newco's balance sheet amounted to €28.9 million at the end of 2001, calculate the Market Value Added (MVA™) for the company. (4 Marks)
 - (c) Comment on the performance of Newco since its foundation to the extent the data allows, and suggest what additional information is required to more adequately assess company performance. (8 Marks)
- (Total: 20 Marks)

Question 3 begins on the next page

P.T.O. ⇒

Question 3:

Airlines are often classified into two groups, *viz.*, 'traditional airlines' (*e.g.*, Aer Lingus, Air France, Lufthansa) and 'low-cost airlines' (*e.g.*, Ryanair, Easyjet, Buzz). In recent months, several traditional airlines have suffered major trading losses, while many of the low-cost airlines have recorded substantial profits.

It is often claimed that the high profitability of the low-cost airlines is attributable to (i) their particular cost structures, and (ii) their use of cost driver information in the management of their business.

You are required to evaluate this claim.

(20 Marks)

Section B

(Answer Two of the Three Questions)

Question 4:

“Home-Shop TV Channel (HSTV)” is broadcast on cable television systems in several Irish cities. The main source of income is the fees charged to manufacturing companies who advertise their goods for sale on HSTV.

In recent months, HSTV has earned some additional income by providing a warehousing/distribution facility to some of the manufacturing companies who advertise their products on the channel. These companies deliver their products in bulk to a warehouse operated by HSTV. The products are stored in the warehouse, and subsequently packed and dispatched to television viewers (who order by telephone).

HSTV has provided the following data concerning a typical month's operation of the warehouse:

- Volume of business handled for each customer:

Anna Manufacturing Ltd.	Barbara Products Ltd.	Ciaran Manufacturing Ltd.	Total
5,000 kg.	10,000 kg.	25,000 kg.	40,000 kg.

- Budgeted costs:

Rent	Labour	Administration	Packaging	Total
€244,000	€138,000	€210,000	€336,000	€928,000

HSTV sets its price for the warehousing/distribution service so as to earn a profit of 20% on cost. All three customers pay the same price per kilogram for the service. When asked for their opinions of the price charged, Anna and Barbara have said that it is 'very reasonable' but Ciaran has warned that 'it is too high to be acceptable in the long run'.

The financial controller of HSTV wishes to gain a fuller understanding of the costs of providing the service, and has established the following facts:

- The 'packaging costs' are variable in proportion to the amount of packaging materials used. The number of sheets of packaging material used when packing 1 kilogram of product for each customer is:

Anna Manufacturing Ltd.	Barbara Products Ltd.	Ciaran Manufacturing Ltd.
5 sheets	3 sheets	2 sheets

Question 4 is continued on the next page P.T.O. ⇒

Question 4 (Continued)

- The warehousing/distribution service provided to customers consists of three activities (receipt, storage and dispatch). The extent to which the costs of rent, labour and administration relate to each of these activities is:

	Rent	Labour	Administration
Receipt	15%	40%	45%
Storage	75%	10%	25%
Dispatch	10%	50%	30%
Totals	100%	100%	100%

- The resources consumed in providing each of the three activities for 1 kilogram of each customer's product is:

	Anna Manufacturing	Barbara Products	Ciaran Manufacturing
Receipt	14 minutes	10.26 minutes	8 minutes
Storage	5 cubic metres	4.12 cubic metres	4 cubic metres
Dispatch	5 minutes	2.82 minutes	1 minute

Required:

- (a) Determine cost driver rates for the three activities (receipt, storage and dispatch), and calculate the profit which HSTV earns from each customer in respect of the warehousing/distribution service. (20 marks)
- (b) Briefly explain the concept of a 'whale curve' in customer profitability analysis, and show calculations for the case of HSTV to illustrate your answer. (4 marks)
- (c) Discuss how HSTV can use the information which you have provided in answer to parts (a) and (b) for strategic management purposes. (6 marks)

(Total: 30 marks)

Question 5 begins on the next page

P.T.O. ⇒

Question 5:

- (a) The 'Balanced Scorecard' specifies a linked set of measures that define both the long-term strategic objectives, as well as the mechanisms for achieving those objectives. The measures incorporate a balance between external measures and internal measures, and between outcome measures and measures that drive future performance.

Discuss this statement, using descriptive examples to illustrate your answer.
(15 Marks)

- (b) **Oldco plc.** is a decentralised organisation with five autonomous business units. Business unit managers are evaluated each year on the basis of the return on investment (ROI) earned by their business units, and a special year-end bonus is payable to the top-ranked manager among the five on realised ROI performance for the year.

Mairéad is the manager of the Oldco Office Products division. The operating results for the present financial year are expected to be as follows:

Sales	€10,000,000
Variable Expenses	€6,000,000
Contribution Margin	€4,000,000
Fixed Expenses	€3,200,000
Operating Income	€800,000
Divisional Operating Assets	€4,000,000

Last year, the overall average of the ROIs of the five business units was 15%. Mairéad's Office Products division has led the company in terms of ROI performance for the past three years, for which Mairéad was awarded the competitive bonus on each occasion.

At present, Mairéad is considering investing in a new product line, with the following operating revenues, costs and asset investment:

Sales	€2,000,000
Variable Expenses (60% of Sales)	€1,200,000
Contribution Margin	€800,000
Fixed Expenses	€640,000
Operating Income	€160,000
Product Line Operating Assets	€1,000,000

She knows that Corporate Head Office is anxious that she goes ahead with the new product line investment, but she is also worried that her measured financial performance and her bonus payments may be adversely affected by a positive decision on the project.

Question 5 is continued on the next page P.T.O. ⇒

Question 5 (Continued):

Required:

- (i) Estimate the impact the new product line would have on the ROI performance of Mairéad's Office Products division, and suggest how Mairéad may react to such information. (6 Marks)
 - (ii) Suppose instead the Residual Income is used as a basis for performance assessment, with a cost of capital of 12% charged on asset investment. Estimate the effect of the new product line on the residual income performance of Mairéad Office Products division, and re-assess Mairéad's attitude to the project in these new circumstances. (6 Marks)
 - (iii) Explain briefly why Residual Income would probably be less appropriate than ROI in identifying the winner of the annual inter-divisional bonus competition. (3 Marks)
- (Total: 30 Marks)

Question 6

*If you select this question, answer **any two** of its three parts.*

- (A) Outline and critically evaluate Berliner & Brimson's proposed model for managing investments in advanced manufacturing technology. (15 Marks)
- (B) In the past the contribution of Enterprise Resource Planning(ERP) systems has been largely confined to improving the efficiency of firms operating processes. In the last eighteen months however ERP vendors have begun to extend the scope of their systems to include so called "Strategic Enterprise Management" capability. Prepare a short briefing memorandum for the management of a large financial services organisations on the following issues.
 - (i) The nature of Strategic Enterprise Management Systems and their relationship to traditional ERP software (8 Marks)
 - (ii) The type of functionality which SEM software offers (7 Marks)(Total: 15 Marks)
- (C) "In a typical company, operational automation has produced volumes of data that resides in disparate systems. Even companies that have consolidated their operational systems into a unified ERP solution still find it a challenge to identify and make effective use of all the data".

Discuss the above statement and in particular the difficulties associated with delivering effective decision support for senior executives from ERP systems. (15 Marks)

[Total for TWO parts: 30 Marks]

End of Question Paper
