Star Rating

On the basis of Maximum marks from a chapter	Nil
On the basis of Questions included every year from a chapter	Nil
On the basis of Compulsory questions from a chapter	Nil

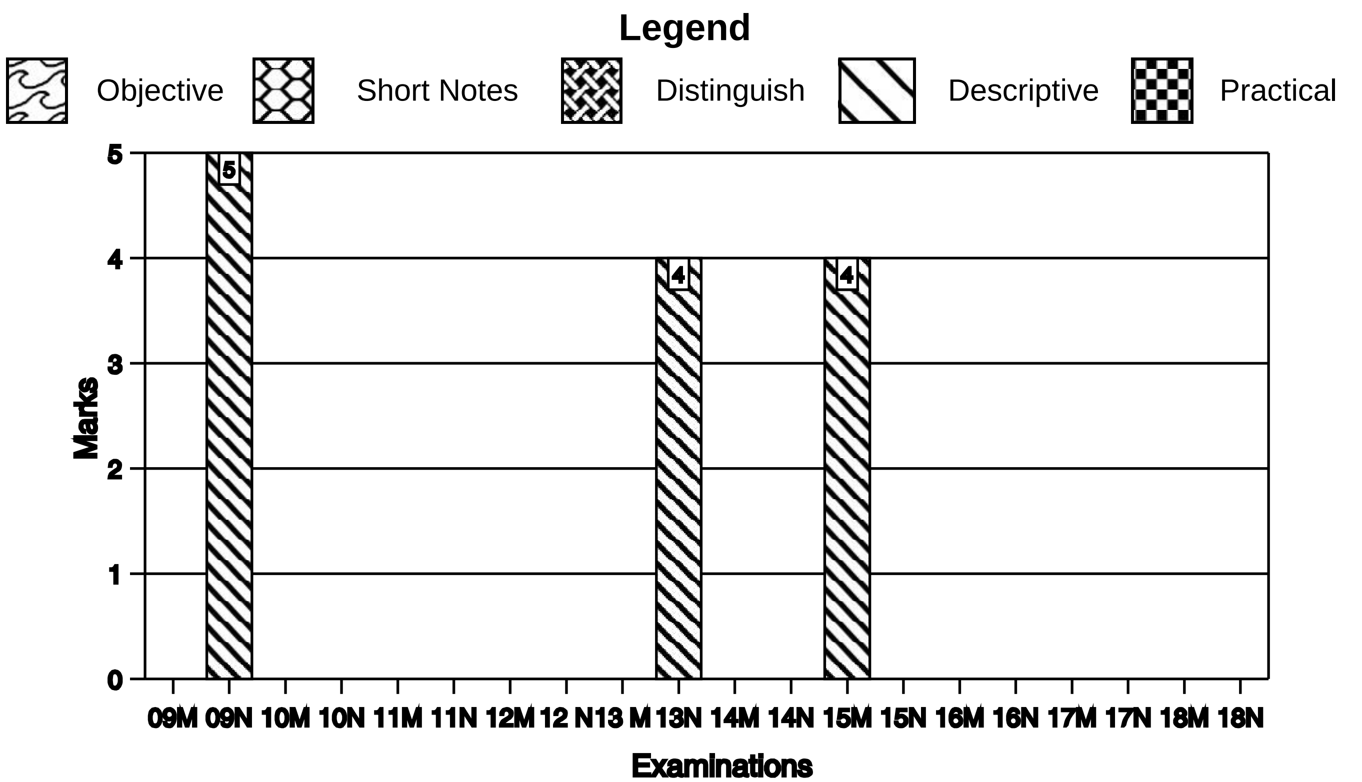
CHAPTER 1

Introduction to Strategic Cost Management

THIS CHAPTER COMPRISES OF

☞ Traditional Cost Management ☞ Strategic Cost Management ☞ Strategic Frameworks for Value Chain Analysis ☞ Superior Performance and Competitive Advantage ☞ The Value Chain Approach for Assessing Competitive Advantage ☞ Vision, Mission and Objectives and SCM ☞ Value Shop Model or Service Value Chain ☞ The Role of the Management Accountant.

Marks of Short Notes, Distinguish Between, Descriptive & Practical Questions



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◗ DISTINGUISH BETWEEN

2008 - Nov [2] (b) Differentiate between 'Traditional Management Accounting' and 'Value Chain Analysis in the strategic framework'. (5 marks)

Answer:

	Basis	**Value Chain Analysis**	**Traditional Management Accounting**
1.	**Focus**	Focus is external.	Focus is internal.
2.	**Nature of Data**	Both external and internal informations.	Only internal information.
3.	**Cost preference**	Focus not only on cost control and cost reduction but also on gaining competitive advantage.	Focus only on cost control and cost reduction.
4.	**Number cost drivers**	Multiple cost drivers are adopted which may be (i) Structural drivers. (ii) Executional drivers.	A single cost driver is adopted.
5.	**Use of Cost Drivers**	For each value activity a set of unique cost driver is used.	Cost driver is applied at the overall firm level.
6.	**Cost Containment Philosophy**	It views cost containment as a function of cost drivers regulating each value activity.	It seeks adhoc cost reduction solutions by focusing on variance analysis performance evaluation.
7.	**Bench marking**	It focuses on full fledged bench marking, "learning from competitors", but exploiting one's own strengths to gain advantage.	Bench marking is partially present and is restricted only to the financial level and not operational level.

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◗ DESCRIPTIVE QUESTIONS

2009 - Nov [3] (c) How can value analysis achieve cost reduction?

(5 marks)

Answer:

In order that a firm survives and prospers in an industry it must meet two criteria.

(i) it must supply what customers want to buy.

(ii) it must survive competition. A firm can gain competitive advantage not merely by matching or surpassing its competitors but by satisfying customers needs and wants and even exceeding customer's expectations. This is done through Value Chain Analysis.

The idea of value chain was first suggested by Michael Porter (1985) to depict how customer value accumulates along a chain of activities that lead to an end product or service.

Porter described the value chain as the internal processes or activities a company performs "to design, produce, market, deliver and support its product." He further stated that "a firm's value chain and the way it performs individual activities are a reflection of its history, its strategy, its approach of implementing its strategy, and the underlying economics of the activity themselves."

Value Chain Analysis - as a cost reduction tool: In value analysis each and every product or component of a product is subjected to a critical examination so as to ascertain its utility in the product, its cost, cost benefit ratio, and better substitute etc. When the benefits are lower than the cost, advantage may be gained by giving up the activity concerned or replacing it for betterment. The best product is one that will perform satisfactorily at the lowest cost.

The various steps involved in value analysis are:

1. identification of the problem;
2. Collecting information about function, design, material, labour, overhead costs, etc., of the product and finding out the availability of the competitive products in the market; and
3. exploring and evaluating alternatives and developing them.

2013 - Nov [7] Answer the following:

(b) In Value Chain analysis, business activities are classified into primary activities and support activities. Classify the following under the more appropriate activity.

(i) Order processing and distribution
(ii) Installation, repair and parts replacement
(iii) Purchase of raw material and other consumable stores
(iv) Transforming inputs into final products
(v) Selection, promotion, appraisal and employee relations preferential
(vi) Material handling and warehousing
(vii) General management, planning, finance, accounting
(viii) Communication, pricing and channel management (4 marks)

Answer :

Activity		**Primary Activity/ Support Activity**
(i)	Order processing and distribution	Primary Activity
(ii)	Installation, repair and parts replacement	Primary Activity
(iii)	Purchase of raw material and other consumable stores	Support Activity
(iv)	Transforming inputs into final products	Primary Activity
(v)	Selection, promotion, appraisal and employee relations	Support Activity
(vi)	Material handling and warehousing	Primary Activity
(vii)	General management, planning, finance, accounting	Support Activity
(viii)	Communication, pricing and channel management	Primary Activity

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2015 - May [7] Answer the following:

(c) Classify the following business activities into primary and support activities under value chain analysis:

(i) Material Handling and Warehousing.

(ii) Purchasing of raw materials, supplies and other consumables.

(iii) Order processing and distribution.

(iv) Selection, placement and promotion of employees. (4 marks)

Answer:

Classification of Business Activities into Primary and Support Activities

Sl. No.	Business Activities	Primary/ Support
(i)	Material Handling and Warehousing	Primary Activity
(ii)	Purchasing of raw materials, supplies and other consumables	Support Activity
(iii)	Order processing and distribution	Primary Activity
(iv)	Selection, placement and promotion of employees	Support Activity

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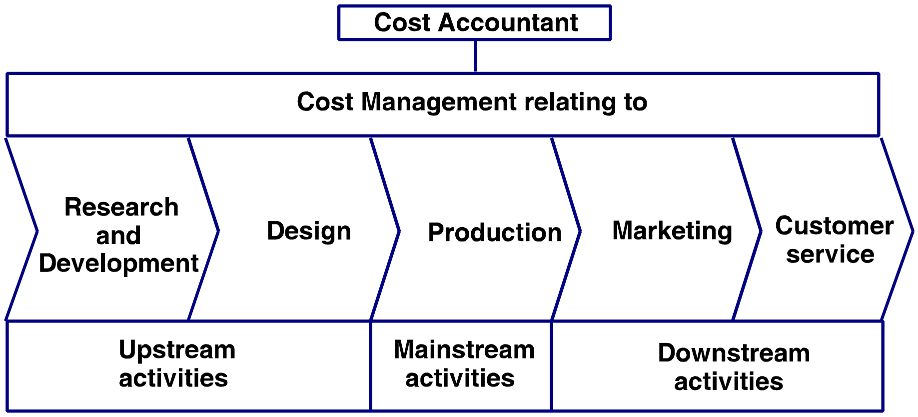
2017 - June [2] (a) What is Value Chain ? How does it help modern cost management? (2+4 = 6 marks) *[CMAFG III]*

Answer:

A value chain is the sequence of business functions in which utility (usefulness) is added to the products or services of the firm. Through proper analysis and management of each segment of the value chain, customer value is enhanced. Non- value creating activities are eliminated.

In value chain analysis, each of the business functions is treated as an essential and valued contributor and is constantly analyzed to enhance value relative to the cost incurred. Like business functions, in value chain approach also, it is important that the efforts of all functions are integrated and co-ordinated to increase the value of the products or services to the customers.

The following diagram shows the important functions or activities of a firm and the role of the cost accountant in cost management.



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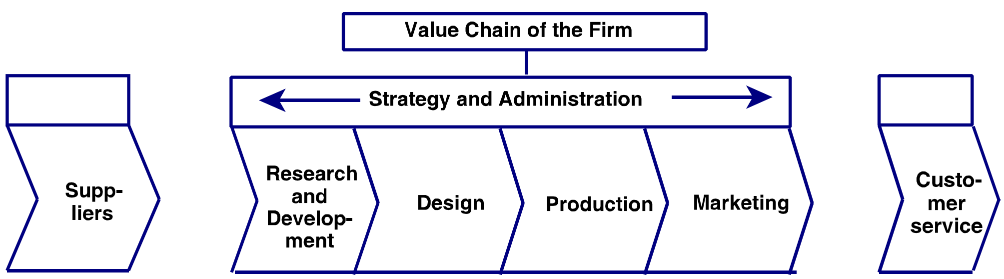
Porter described the value chain as the internal processes or activities a company performs "to design, produce, market, deliver and support its product." He further stated that "a firm's value chain and the way it performs individual activities are a reflection of its history, its strategy, its approach of implementing its strategy, and the underlying economics of the activity themselves." When the supplier and customers are included, the firm is viewed as an extended value chain as shown below:



Importance of Value Chain Analysis for Cost Management:

The firms use the value chain approach to better understand which segments, distribution channels, price points, product differentiation, selling propositions and value chain configurations will yield them the greatest competitive advantage.

Competitive advantage with regard to products and services takes two possible forms. The first one is an offering or differentiation advantage. If customers perceive a product or service as superior, they become more willing to pay a premium price relative to the price they will have to pay for competing offerings. The second is relative low-cost advantage, under which customers gain when a company's total costs undercut those of its average competitor.

These types of analysis are not mutually exclusive. Rather, firms begin by focusing on their internal operations and gradually widening their focus to consider their competitive position within their industry.

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2017 - June [2] (b) (i) What are the problems of Traditional Costing arising out of volume-based cost allocation to products? (1 mark) *[CMAFG III]*

Answer:

Under traditional costing, overhead which occupies and important share of the total cost structure of the firm is generally allocated based on volume-based allocation rates viz. rates per labour hour, rate per machine hour, % of labour cost, etc. It does not take into consideration disproportionate consumption service department services. As a result, the product cost gets distorted i.e., some products are over costed while others are under costed. The basic assumption in cost allocation is; the higher the volume, the greater the share of indirect costs to the product or service. This simplistic assumption dies not hold good in reality.

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