Answers

1 (a) Report:

To: The Directors of TSC
From: Management Accountant
Subject: The performance of our depots

Date: 5 December 2008

(i) Summary analysis of points gained (1) or forfeited (0) for the year ended 31 October 2008

Revenue and Profit Statistics:	Donatellotown	Leonardotown	Michaelangelotown	Raphaeltown
Revenue	0	1	1	1
Profit (see note below)	1	0	1	0
Customer Care & Service Delivery Statistics:				
Late collection of consignments	1	0	1	0
Misdirected consignments	0	1	1	0
Delayed response to complaints	1	1	1	0
Vehicle breakdown delays	0	0	1	0
Lost items	1	1	1	0
Damaged items	1	0	1	1
Credit Control & Administrative Efficiency Sta	atistics:			
Average Debtor weeks	0	1	1	0
Debtors in excess of 60 days	1	1	1	1
Invoice queries (% of total)	1	1	1	1
Credit notes (% of revenue)	1	_1	_1	0
Total points gained	8	8	12	4

Workings:

(i) Profit point calculation:

Actual results:

e.g. Donatellotown = $2\cdot3/15 = 15\cdot3\%$ (1 point) Leonardotown = $2\cdot4/18 = 13\cdot3\%$ (0 point)

(ii) Debtors in excess of 60 days (% of total)

D	onatellotown	Leonardotown	Michaelangelotown	Raphaeltown
Revenue (\$'000)	15,000	18,000	14,000	22,000
Debtor weeks	5.8	4.9	5.1	6.2
∴ Debtors	1,673	1,696	1,373	2,623
Less than 30 days	(1,300)	(1,500)	(1,180)	(2,000)
31-60 Days	(321)	(133)	(153)	(552)
More than 60 days	52	63	40	71
Debtors in excess of 60 days (% of total)	3.1	3.7	2.9	2.7

- (iii) Value of credit notes raised as a % of revenue e.g. Donatellotown = \$45,000/\$15,000,000 = 0⋅3%
- (ii) The summary analysis in (a)(i) shows that using overall points gained, Michaelangelotown has achieved the best performance with 12 points. Donatellotown and Leonardotown have achieved a reasonable level of performance with eight points each. Raphaeltown has under performed, however, gaining only four out of the available 12 points.

Michaelangelotown is the only depot to have achieved both an increase in revenue over budget and an increased profit:revenue percentage.

In the customer care and service delivery statistics, Michaelangelotown has achieved all six of the target standards, Donatellotown four; Leonardotown three. The Raphaeltown statistic of achieving only one out of six targets indicates the need for investigation.

With regard to the credit control and administrative efficiency statistics, Leonardotown and Michaelangelotown achieved all four standards and Donatellotown achieved three of the four standards. Once again, Raphaeltown is the 'poor performer' achieving only two of the four standards.

(iii) The terms listed may be seen as representative of the dimensions of performance. The dimensions may be analysed into results and determinants.

The results may be measured by focusing on financial performance and competitiveness. Financial performance may be measured in terms of revenue and profit as shown in the data in the appendix of the question in respect of TSC. The points system in part (a) of the answer shows which depots have achieved or exceeded the target set. In addition, liquidity is another aspect of the measurement of financial performance. The points total in part (a) showed that Leonardotown and Michaelangelotown depots appear to have the best current record in aspects of credit control.

Competitiveness may be measured in terms of sales growth but also in terms of market share, number of new customers, etc. In the TSC statistics available in (a) we only have data for the current quarter. This shows that three of the four depots listed have achieved increased revenue compared to target.

The **determinants** are the factors which may be seen to contribute to the achievement of the results. Quality, resource utilisation, flexibility and innovation are cited by Fitzgerald and Moon as examples of factors that should contribute to the achievement of the results in terms of financial performance and competitiveness. In TSC a main **quality** issue appears to be customer care and service delivery. The statistics in the points table in part (a) of the answer show that the Raphaeltown depot appears to have a major problem in this area. It has only achieved one point out of the six available in this particular segment of the statistics.

Resource utilisation for TSC may be measured by the level of effective use of drivers and vehicles. To some extent, this is highlighted by the statistics relating to customer care and service delivery. For example, late collection of consignments from customers may be caused by a shortage of vehicles and/or drivers. Such shortages could be due to staff turnover, sickness, etc or problems with vehicle maintenance.

Flexibility may be an issue. There may, for example, be a problem with vehicle availability. Possibly an increased focus on sources for short-term sub-contracting of vehicles/collections/deliveries might help overcome delay problems.

The 'target v actual points system' may be seen as an example of **innovation** by the company. This gives a detailed set of measures that should provide an incentive for improvement at all depots. The points system may illustrate the extent of achievement/non-achievement of company strategies for success. For example TSC may have a customer care commitment policy which identifies factors that should be achieved on a continuing basis. For example, timely collection of consignments, misdirected consignments re-delivered at no extra charge, prompt responses to customer claims and compensation for customers.

(iv) The performance measurement system used by TSC appears simplistic. However, it may be considered to be measuring the right things since the specific measures used cover a range of dimensions designed to focus the organisation on factors thought to be central to corporate success, and not confined to traditional financial measures.

Internal benchmarking is used at TSC in order to provide sets of absolute standards that all depots are expected to attain. This should help to ensure that there is a continual focus upon the adoption of 'best practice' at all depots. Benchmarks on delivery performance place an emphasis upon quality of service whereas benchmarks on profitability are focused solely upon profitability!

Incentive schemes are used throughout the business, linking the achievement of company targets with financial rewards. It might well be the case that the profit incentive would act as a powerful motivator to each depot management team. However, what is required for the prosperity of TSC is a focus of management on the determinants of success as opposed to the results of success.

(Alternative relevant discussion would be acceptable)

(b) A central feature of many performance measurement systems is the widespread use of league tables that display each business unit's performance relative to one another. In the case of service organisations such as TSC the use of league tables emphasises the company's critical success factors of profitability and quality of service by reporting results on a weekly basis at the depot level. The fact that such league tables are used by management will actively encourage competition, in terms of performance, among depots. The individual position of a business unit in the league table is keenly observed both by the manager of that unit and his/her peers.

In theory, performance is transparent. In practice although each depot performs essentially the same function and is subject to the same modes of measurement, circumstances pertaining to different business units may vary significantly. Some depots may be situated near to the hub (main distribution centre), some may be located far away and some may be in urban zones with well developed road networks whilst others may be in remote rural areas. Measuring performance via a league table makes no allowance whatsoever for these relative differences, hence, inequality is built into the performance measurement system.

Moreover, depot managers might be held responsible for areas over which they have no formal control. The network nature of the business suggests that there will be a high degree of interdependence of depots; the depot responsible for collection will very often not be the depot responsible for delivery. Therefore, it is frequently the case that business may be gained for which the collecting depot receives the revenue, but for which the delivering depot bears the cost. Obviously this impacts upon the profit statements of both depots. The formal system might not recognise such difficulties, the corporate view being that 'the business needs to be managed'; the depots should therefore see any such anomalies as mild constraints to work around rather than barriers to break down. In such circumstances delivering depots and collecting depots should discuss such problems on an informal basis. Such informal discussions are aided by close communications between depots recognising the interdependencies of the business.

2 (a) To: Directors

From: Management Accountant Date: 5 December 2008

Subject: Financial performance of operations in Bonlandia and Karendia

Further to your recent request please find detailed below my analysis of the financial performance of our operations for the two-year period ended 30 November 2008. I have included operating statistics in the appendix which is attached to my report.

Sales revenue

The turnover in Bonlandia increased by 4.3% whereas the turnover in Karendia increased by 40% which is excellent bearing in mind that operations only commenced in 2006. The overall growth in turnover achieved during 2008 amounted to an acceptable level of 8.75%.

Profits

The operation in Bonlandia did not perform as well in 2008 with net profit falling by \$152,000 (5.6%). The operation in Karendia made a loss of \$348,000 in 2008 compared with a loss of \$750,000 in 2007. It appears that although turnover in Karendia increased by 40% during 2008 further growth in revenues (or cost reductions) will be essential in order for the Karendia operation to become profitable. The change in the structure of industry in Karendia may enable this growth to be achieved.

The overall profit of SSH has increased from \$1,050,000 to \$1,350,000, an increase of $28\cdot6\%$. Non-operating costs have increased from \$3,400,000 (2007) to \$3,842,000 (2008), an increase of 13%. It is worth noting that interest payable has fallen by \$50,000 which is a direct result of the repayment of \$500,000 of debt finance. The increased amount of marketing expenditure has enabled both operations to achieve growth in turnover. However, the additional revenue of \$600,000 in Bonlandia in 2008 appears modest. In this regard one might question the effectiveness of the marketing strategy of SSH. EBITDA (earnings before interest, taxation, depreciation and amortisation) rose from \$2,450,000 to \$2,760,000. The return on capital employed increased from $15\cdot9\%$ in 2007 to $16\cdot7\%$ in 2008.

Costs

Salaries have increased by 8.5% in Bonlandia and 4% in Karendia. These increases may reflect local conditions in the labour market for software specialists. Software and consumables costs have only increased by 2% and 8% respectively in Bonlandia and Karendia. Bearing in mind that turnover of each operation has increased then it is quite conceivable that SSH are benefiting from economies of scale that exist with regard to the provision of software and consumables. However, the increase of 8% in Karendia may be indicative of poor cost control. Other operating costs have increased by 2.9% in Bonlandia but increased by 9% in Karendia, which might be indicative of poor cost control.

Utilisation of non-current assets

The 2008 non-current assets utilisation ratios of Bonlandia and the overall business show a decrease over those of 2007. The ratio in respect of the Karendia operation indicates a decrease from 2 times to 1.75 times. However, this is acceptable given that operations in Karendia have been recently established. It might well be the case that, for example, recently acquired non-current assets may not yet have been brought fully into use or perhaps were acquired towards the end of 2008. The Karendia operation is clearly in a rapid-growth phase hence the need for such investments in non-current assets.

Other information

It would be useful to have data relating to previous years in order to observe longer term trends of revenues and costs for each operation. Certainly, data for 2006 in respect of the Karendia operation would enable a 'complete' picture to be taken. This would enable a much better assessment of current recent years.

It would be extremely useful to have competitor information in order to assess relative market share and establish how they are performing in the Bonlandia and Karendia markets compared with the operations established by SSH.

It is clear that long-term borrowings have decreased during 2008 and that SSH has sufficient cash flow to be repaying debt finance. However, it would be useful to have a detailed breakdown of the working capital of each operation in order to confirm this.

It would also be useful to have future market and financial projections in respect of operations in Bonlandia and Karendia which should reflect the actual results achieved in 2007 and 2008.

Signed: Management Accountant

Appendix						
		2008			2007	
	Bonlandia	Karendia	Group	Bonlandia	Karendia	Group
% growth in sales revenue	4.3	40	8.75			
Sales margin before interest (%)	17.45	(12.4)	12.64	19.3	(37.5)	12.2
Return on capital employed (%)			16.7			15.9
Earnings before interest, depreci	ation					
and amortisation (\$000)			2,760			2,450
Non-current asset turnover ratio	1.62	1.75	1.64	1.75	2.00	1.77
Debt:Equity ratio (%)			43.7			57.7
Gearing ratio (%)			30.4			36.6

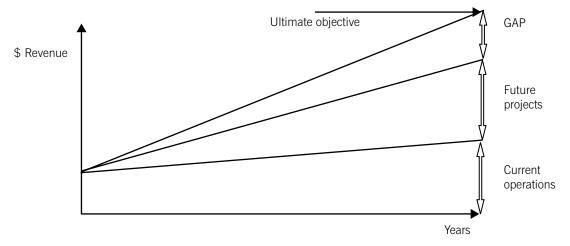
- (b) In a market place such as that in which SSH competes, product and service quality assumes critical significance. Quality is a key determinant of the financial results and the level of competitiveness achieved by SSH. This will always be the case and therefore quality may be viewed as a strategic necessity if SSH is to prosper in the future. Therefore, the statements of the manager of Bonlandia operations are myopic at best and unethical at worst! Businesses use software in a variety of different ways but poor quality software can do serious harm to businesses. Much will depend on the extent to which a business uses its information for strategic reasons as opposed to meeting operational needs. The more a business uses its information systems for strategic reasons then the greater the potential damage suffered as a consequence of poor quality software. It is wrong for the manager of Bonlandia operations to knowingly promote the installation of poor quality business software in clients' businesses. The effects can be costly to clients in terms of poor planning, control and decision-making with potential losses of client goodwill and reputation.
- (c) The following are important considerations regarding the quality of the business software:
 - The software is error-free as this will improve its reliability. Whilst in practice this might not always be achievable the directors of SSH must recognise the dangers involved in supplying bespoke software which may prove damaging to their clients' businesses with the resulting loss of client goodwill.
 - The software should meet quality control standards such as those specified by the ISO (International Standards Organisation).
 - The software must be delivered on time. Late delivery of business software will prove problematic since clients may rely
 on updated software to meet new customer needs or to fulfil revised business objectives.
 - The software must meet the initial specification of the customer. In meeting the specification SSH will be demonstrating
 that the software has been produced correctly with an appropriate focus on the requirements of end users.
 - The software must be usable i.e. as well as being able to do what it is supposed to do it is important that it is easy to use
 - The software should be capable of being updated in the light of future changes that occur in the clients' requirements.
- (d) The following performance measures which could be used to assess the quality of service provided to its clients:
 - The reliability of staff in keeping to scheduled appointment times with clients
 - The responsiveness of staff to client enquiries or requests for assistance
 - The quality of communications between SSH and its clients
 - The competence of its staff in providing training to its clients
 - The access times to staff upon the request of clients
 - The availability of staff to meet emergency needs of clients
 - The security of the data of its client base.

Notes: (i) Only six performance measures were required

- (ii) Other relevant performance measures would be acceptable.
- **3** (a) A 'planning gap' is the gap between the forecast position based upon an extrapolation of projected current activities and the forecast of the desired position. The planning gap is most often measured in terms of demand but may also be reported in terms of net profit, return on capital employed etc.

TMC has a projected market share of 22% at the end of 2010. It is clear from the information given that the directors of TMC have a target market share which is higher than this, hence the planning gap.

Gap analysis diagram:



An organisation will forecast the likely performance of its existing projects and also the expected contribution of future projects. This is far more difficult since future projects are subject to much greater uncertainty than current operations and therefore forecasts of future projects have a much wider margin of error.

Where a gap exists, additional strategies are required. In this respect the directors of TMC might make use of Ansoff's growth vector matrix which identifies various options that might be considered in order to close the planning gap.

A market penetration strategy aims to increase sales within existing markets.

A market development strategy aims to find additional markets for existing products.

A product development strategy aims to find additional products for an organisation's existing customers.

A diversification strategy aims to reduce the risks of a business or to increase its growth prospects by entering new industries.

The above strategies are not mutually exclusive. An organisation might well pursue a penetration strategy whilst seeking to enter new markets. However, such a strategy would not be pursued by TMC since there is a projected fall in the birth-rate in Happyland after 2010.

Other strategies that can be used include efficiency strategies which are designed to increase profits (or throughput) by making better use of resources in order to reduce costs. Also it is possible to reduce a planning gap that is measured in terms of profit by divesting of loss-making business units. This would obviously not be the case where a planning gap is measured in terms of sales revenue.

- (b) Three potential problems that TMC might encounter in the proposed acquisition of CBC are as follows:
 - (i) TMC is forecast to have a 22% share of the market for disposable nappies at the end of 2008. If TMC was to acquire CBC at that time it would then have a market share of (\$681m + \$155m)/\$3,095m = 27%. Much will depend on prevailing legislation. For example, in the UK it might be the case that the Director General of Fair Trading may ask the Competition Commission (CC) to investigate if any organisation controls 25% or more of the market. The Secretary of State may do likewise in circumstances where the proposed takeover would lead to the creation of a firm that would control 25% or more of the market. (Similar examples from other countries would be equally acceptable.)
 - (ii) The directors of TMC need to be aware of the precise nature of the cultural problems that CBC has experienced during recent years as this could be very damaging to its business if the acquisition of CBC goes ahead. In an extreme case the organisational cultures of TMC and CBC might be incompatible. The directors of TMC need to make a very careful assessment as to whether it would be possible to transform a negative culture into a positive one. If they consider that this would prove to be very difficult then they might be best advised not to proceed with the acquisition.
 - (iii) The directors of TMC have no experience of managing such acquisitions and this might mean that the integration of CBC into TMC would prove problematic. It is probable that the systems are different as well as the management styles, employee skills and business infrastructure.

(Alternative relevant discussion would be acceptable)

(c) The government of Happyland will be concerned by the negative impact on the environment. The growth in the number of children born in Happyland will have raised the demand for disposable nappies as is evidenced from the market size data contained in the question. In some countries disposable nappies make up around 4% of all household waste and can take up to five hundred years to decompose! The government will be concerned by the fact that trees are being destroyed in order to keep babies and infant children in nappies. The disposal costs incurred by the government in terms of landfill etc will be very high, hence its green paper on the effect of non-biodegradable products in Happyland. The costs of such operations as the landfill for such products will need to be funded out of increased taxation.

It might be beneficial for the directors of TMC to develop more eco-friendly products such as washable nappies which, by definition, are recyclable many times over during the life of the 'product'. Many parents are now changing to 'real nappies' because they work out cheaper and better for the environment than disposables.

- (d) Governments may act as an aid to business performance in the following ways:
 - A government can increase aggregate demand for goods and services by increased government spending and/or by reducing taxation so that firms (and individuals) have more after tax income available to spend.
 - Government policy may encourage firms to locate to particular areas. This is particularly the case where there is high unemployment in such areas.
 - Government policy via the use of quotas and import tariffs might make it more difficult for overseas firms to compete in domestic markets.
 - A government can regulate monopolies in particular with regard to the prices they charge and the quality of their goods and services.
 - Government policy can regulate the activities of those firms which do not act in the best interests of the environment.

(Alternative relevant discussion would be acceptable)

4 (a) (i) In order to facilitate BAG profit maximising decisions the following strategy should apply:

Division C should offer to transfer chemical CC to Division B at marginal cost plus opportunity cost. This would apply as follows:

- 40,000 kilograms of CC at \$105 per kilogram since this is the price that could be achieved from sales to external customers of BAG.
- 60,000 kilograms of CC at marginal cost of \$50 per kilogram since no alternative opportunity exists.

Division B has a sales forecast of 360,000 litres of product BF. This will require 360,000/4 = 90,000 kilograms of chemical CC input.

Based on the pricing by Division C indicated above, Division B would choose to purchase 60,000 kilograms of CC from Division C at \$50 per kilogram, since this is less than the \$55 per kilogram quoted by the independent supplier.

Division B would purchase its remaining requirement for 30,000 kilograms of CC from the independent supplier at \$55 per kilogram since this is less than the \$105 per kilogram at which Division C would offer to transfer its remaining output – given that it can sell the residual output to external customers of BAG.

(ii) Division B:

kilogram \$m 43·20
43.20
\$15 5·40
1 50
18.00
28.20
15.00
6.65
1.50
8.15
F 00
5·00 2·00
7.00
1.15
16.15
) 5

An alternative working – with data showing the consolidated BAG profit is as follows:

		\$m		\$m
Sales:				
Division B	360,000 x \$120	43.20	360,000 x \$120	43.20
Division C	40,000 x \$105	4.20		
External			70,000 x \$95	6.65
		47.40		49.85
Costs:				
Variable conversion costs	360,000 litres x \$15	5.40	360,000 litres x \$15	5.40
Material costs:				
Variable costs of manufacture	100,000 at \$50	5.00	100,000 kg at \$50	5.00
Variable costs of external purchases	30,000 kg x \$55	1.65	60,000 kg x \$55	3.30
Fixed costs – Division B		18.00		18.00
Fixed costs – Division C		2.00		2.00
		32.05		33.70
Net Profit		15.35		16.15

The financial viability of the change will be affected by the accuracy of the increased external sales level to 70,000 kilograms at \$95 per kilogram. A sensitivity analysis study could be used to monitor the impact on overall profit from a range of possible price:demand relationships.

(b) Quality costs may be monitored by measuring costs of non-conformance and costs of conformance.

Costs of non-conformance occur when the product fails to reach the design quality standards. Such costs may be subdivided into internal failure costs and external failure costs.

Internal failure costs occur when the failure is detected before the transfer of the product to the customer.

External failure costs occur when the failure to reach the required standards is not detected until after the product has been transferred to the customer.

Costs of conformance are those incurred in reducing or eliminating the costs of non-conformance. Such costs may be subdivided into appraisal costs and prevention costs.

Appraisal costs are those associated with the evaluation of items such as purchased material and services in order to ensure that they conform to the agreed specification.

Prevention costs are those associated with the implementation of a quality improvement programme. Such costs are planned in advance and their implementation should lead to continuous improvement.

Examples of quality costs relevant to Division C may include:

Internal failure costs: cost of materials scrapped due to poor receipt and storage procedures or losses of CC output due to poor processing routines.

External failure costs: cost of quality problems with batch of CC not detected until it has reached Division B. This may require free replacement of the batch and compensation for loss of output by Division B.

Appraisal costs: evaluation of purchased material and services in relation to the manufacture of CC to ensure that it conforms to the agreed specification; e.g. inspection and testing before use.

Prevention costs: the cost of implementation of staff training and the costs of equipment testing to ensure that it conforms to the specification standards required for the production of CC.

(Alternative relevant examples would be accepted)

5 (a) The management accountant of TOC would have calculated the variable costs per unit as follows:

Workings:

(i) Direct material cost per unit:

	Fountain	Goblin
Total costs (\$)	450,000	150,000
Production units	2,000	4,000
Cost per unit (\$)	225.00	37.50

(ii) Direct labour cost per unit:

	Fountain	Goblin
Total costs (\$)	300,000	100,000
Production units	2,000	4,000
Cost per unit (\$)	150.00	25.00

(iii) Variable overheads:

Material related overhead cost = $30\% \times \$2,400,000 = 720,000$

Labour related overhead cost = $70\% \times \$2,400,000 = \$1,680,000$

Material related overhead has material volume that is required as the cost driver.

Total volume factor =

	Units	Required per unit	
Fountain	2,000	4	8,000
Goblin	4,000	7	28,000
Other	16,000	4	64,000
Total volume factor =			100,000

Material related overhead per unit of volume = \$720,000/100,000 = \$7.20. Therefore, overhead cost per product unit will be as follows:

Product:

Fountain $$7.20 \times 4 = 28.80 Goblin $$7.20 \times 7 = 50.40 Labour related overhead has the number of operations that are performed as the cost driver.

Total operations factor =

	Units	Required per unit	
Fountain	2,000	6	12,000
Goblin	4,000	5	20,000
Other	16,000	4	64,000
Total volume factor =			96,000

Labour related overhead per operation = \$1,680,000/96,000 = \$17.50. Therefore, overhead cost per product unit will be as follows:

Product:

Fountain $$17.50 \times 6 = 105.00 Goblin $$17.50 \times 5 = 87.50

Product unit costs using an ABC approach to product costing would be:

	Fountain \$	Goblin \$
Direct material costs	225.00	37.50
Direct labour costs	150.00	25.00
	375.00	62.50
Variable overhead		
Material related	28.80	50.40
Labour related	105.00	87.50
Total variable cost	508.80	200-40

(b) SGG is willing to purchase the Fountain at \$750 per unit and the Goblin at \$150 per unit. At these prices TOC will achieve sales of 2,000 units of the Fountain and 4,000 units of the Goblin. The product costs per unit together with the respective contribution per unit may be calculated using either the existing basis for the absorption of variable overhead cost by product units or alternatively by employing an ABC approach which attempts to give recognition to the cost drivers which causes costs to occur.

Product information (by unit) is as follows:

	Fountain		Goblin		
	Current basis	ABC basis	Current basis	ABC basis	
	\$	\$	\$	\$	
Direct material cost	225.00	225.00	37.50	37.50	
Direct labour cost	150.00	150.00	25.00	25.00	
Variable overhead cost:					
Material related	90.00	28.80	15.00	50.40	
Labour related	157.50	105.00	26.25	87.50	
Total variable cost	622.50	508.80	103.75	200.40	
Selling price	750.00	750.00	150.00	150.00	
Contribution	127.50	241.20	46.25	(50.40)	
Contribution:sales (%)	17.00	32.16	30.83	(33.60)	

At present TOC will not undertake any work which does not yield an estimated contribution to sales ratio of 28%. The current basis of product costing would suggest that The Goblin should be produced as per the request of SGG as a contribution:sales ratio of 30.83% would be obtained. However, the current basis of product costing would suggest that TOC should not undertake production of The Fountain because at a selling price of \$750 per unit, the estimated contribution:sales ratio of 17% would be lower than the desired contribution:sales (%) of 28%.

Using an activity based costing approach which gives management greater visibility of the true costs of each product would lead TOC to a different production strategy. TOC would opt to produce The Fountain for SGG since a contribution:sales ratio of $32 \cdot 16$ would be obtained. However TOC would decline to undertake the production of the Goblin since it would result in a negative contribution:sales ratio of $(33 \cdot 60\%)$.

(c) Activity-based management (ABM) is a method of identifying and evaluating activities that a business performs using activity-based costing to carry out a value chain analysis or a re-engineering initiative to improve strategic and operational decisions in an organisation. Activity-based costing establishes relationships between overhead costs and activities so that overhead costs can be more precisely allocated to products, services, or customer segments. Activity-based management focuses on managing activities to reduce costs and improve customer value.

Kaplan and Cooper (1998) divide ABM into operational ABM and strategic ABM:

Operational ABM is about 'doing things right', using ABC information to improve efficiency. Those activities which add value to the product can be identified and improved. Activities that don't add value are the ones that need to be reduced to cut costs without reducing product value.

Strategic ABM is about 'doing the right things', using ABC information to decide which products to develop and which activities to use. This can also be used for customer profitability analysis, identifying which customers are the most profitable and focusing on them more.

A risk with ABM is that some activities have an implicit value, not necessarily reflected in a financial value added to any product. For instance a particularly pleasant workplace can help attract and retain the best staff, but may not be identified as adding value in operational ABM. A customer that represents a loss based on committed activities, but that opens up leads in a new market, may be identified as a low value customer by a strategic ABM process.

ABM can give middle managers an understanding of costs to other teams to help them make decisions that benefit the whole organisation, not just their activities' bottom line.

Professional Level – Options Module, Paper P5 Advanced Performance Management

December 2008 Marking Scheme

1	(a)	(i)	Revenue Profit		Marks 0.5 0.5	Marks
			Customer care & service delivery Credit control and administration efficiency		3 5 —	9
		(ii)	Overall comment on ranking Analysis of each of the three sections in table		1 5	Maximum 5
		(iii)	Inter-relationship of dimensions/results/determinants Definition/examples of financial performance 2 and competitiveness as aspects of results	2 x 1·5	2 3	
				x 1·5	6	Maximum 10
		(iv)	Comments (on merit)		5	Maximum 5
			Note – Requirement (a) includes 4 professional marks			Maximum 29
	(b)		efits		4	
		Prob	plems			$ \text{Maximum} \underline{6} \\ \text{Total} = 35 $
						10tal – <u>33</u>
2	(a)		nments (on merit) & calculations as of additional information		12 	Maximum 14
	(b)	Con	nments (on merit) 4	1 x 1	4	4
	(c)	Con	nments (on merit) 4	1 x 1	4	4
	(d)	Perf	ormance measures 6	S x 0·5	3	$Total = \frac{3}{25}$
3	(a)		lanation tegies 3	3 x 1	2 3	5
	(b)	Prol	olems 3	3 x 2	6	Maximum 5
	(c)		cerns of government rnative strategy		3 	Maximum 5
	(d)	Con	nments (on merit) 5	5 x 1	5	$Total = \frac{5}{20}$

4	(a)			Marks	Marks
		60,000 kgs of CC at marginal cost of \$50 per kg B requires 90,000 kgs of CC		2	
		B would purchase 60,000 kgs of CC from C		1	
		B would purchase 30,000 kgs of CC from IS		1	6
		(ii) Revenue		2	
		Costs		3	
		Profit		1	Maximum 6
		Comment			Maximum 6
	(b)	Categories of quality costs	4 x 2	8	8
					Total = 20
5	(a)	Product costs	2 x 4	8	8
	(b)	Contribution:sales ratios		2	
		Comments re the acceptability of products	4 x 1	4	6
	(c)	Comments (on merit)	3 x 2	6	6
	(0)	Comments (on monty	3 1 2	O	
					Total = 20