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PART A

Amana Ltd is a small business that sells souvenirs to tourists. The business has been recently heavily impacted by the Covid restriction that stopped tourism. To try to protect the business, Amanda Ltd undertook several managerial decisions, e.g. decrease the selling price.

The following assessment will present the Original, Flexed and Actual Budget for Amana Ltd to determine the favourable and unfavourable variance, in order to critically analyse the business' performance. These information, in Management Accounting, are crucial for the process of decision making. Management Accounting is for internal audit, is focusing on providing information to the managers to direct and control their operation with an emphasis on the future (Atrill and McLaney, 2021). Recommendations will be provided at the end of the report analysis.

The following analysis of the report will assume that the cost decision undertaken by Amana Ltd are temporary and the original cost will be adopted again once the restriction will be released.

Items	Cost per Unit	Original (£)	Flexed (£)	Actual (£)	Variance (£)
Unit		100,000	80,000	80,000	0
Selling Price		25	25	20	5 UF
Revenue		2,500,000	2,000,000	1,600,000	400,000 UF
Variable Cost:					
Materials	2.50	250,000	200,000	280,000	80,000 UF
Labour	4	400,000	320,000	440,000	120,000 UF
Overhead	1.50	150,000	120,000	120,000	0
Contribution	17	2,420,000	1,360,000	760,000	600,000 UF
Fixed Overheads:					
Warehouse rental		200,000	200,000	170,000	30,000 F
Insurance		100,000	100,000	100,000	0
Full time warehouse supervisor salary		50,000	50,000	35,000	15,000 F
Profit		1,350,000	1,010,000	455,000	555,000 UF

The report above results in an unfavourable variance of £ 555,000 of profit comparing the flexed budget with the actual budget result. (Atrill and McLaney, 2018) The flexed budget has been prepared for a realistic comparison of the variance, as it revised the Standard Budget with the same Actual Budget's volume of output. The 54.95% of less profit is a large negative result that required the management to take rapid action because the business is risking failure.

- **Decrease of the selling price**

From the report is possible to see already at first glance that one of the factors that led to a decrease in profit is the adoption of a price off strategy without an increase in sales. As stated by Clow and Baack (2013) a price off strategy consists of a temporary decrease of selling price in order to increase the sale or to gain a price advantage over the competitors.

The price-offs resulted in a bad decision, because the consequence of the low purchasing was driven by the low demand for the product rather than by the high cost of the product.

(Sloman et al., 2019) When the demand of a good is not relatively affected by the change of price is classified in economic as an Inelastic product, vice versa when the demand of the product is price sensitive is classified as Elastic. Despite souvenirs are luxury good and are considered Elastic, Covid's travel restriction changed the scenario, and the souvenir became an Inelastic good. The change in the number of buyers, as there was no more tourist, led to a lack in demand at any given price. Calculating the Elasticity of Demand Coefficient, the result is that the product is now perfectly inelastic equal to 0.

$PED = \Delta\% \text{ Change in Quantity} / \Delta\% \text{ Change in Price}$

$PED = 20\% / 20\% = 0$

If the demand for the product does not depend on the change of price, reducing the latter is an ineffective strategy to increase the sale. The reduction of price, only led to a reduction of profit, without increasing the number of sales. Therefore, the price off strategy resulted in inefficient managerial decision.

In addition, according to Clow and Baack (2013), there are several risks involved in using a price off strategy. Besides the lower profit margin, using this strategy can lead to a negative buyer's perception of the brand and product and encourage them to be more price-sensitive for future choices, when the selling price will return to the original price.

- **Variable Cost: Material**

The variance for the Material Cost is also Unfavourable as resulted in a loss of £ 80,000. The unfavourable variance can be linked to the rise of price from the

supplier. Amanda Ltd is supplied from China and several factors could have raised the price from the supply.

According to Roye and et al. (2021), and Wang and Curran (2021), the increase of Covid cases and variants are leading to a disruption in the supply chain. With many factories shut down and key workers in quarantine, there is a global supply shortage that is rising the prices and placing the economy at risk. Manufacturers are struggling to find raw material and port congestion and shipping cost are continually increasing. Still according to Wang and Curran (2021), the price of shipping a container from Asia to Europe is ten times higher since May 2020. The prices are so uncertain that container liners are only signing for a short-term contract. All these factors are leading to significant stocking inflation that is raising the cost of the material.

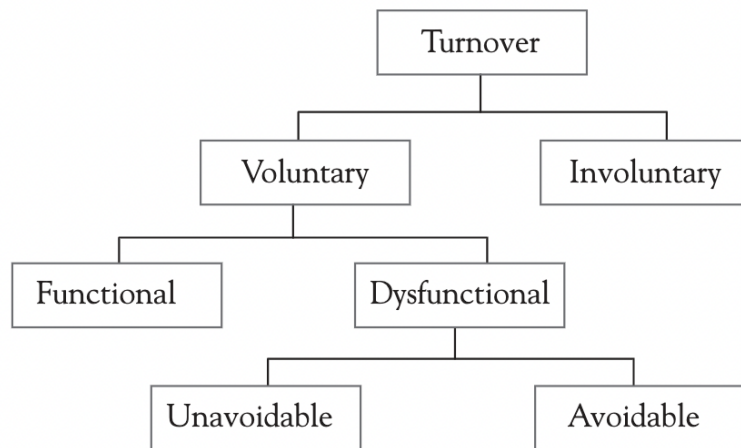
Consequently, besides the variance for the Material Cost that resulted unfavourable, it also resulted as unavoidable. Amanda Ltd is not responsible for having paid a higher cost for the material, as in the short run there was no other solution, and the higher cost was driven by external factors rather than inefficiently management. Differently, in the long run, if the price of the material cost will not return to its original price, will be required action taken from Amanda Ltd, e.g. find a less expensive supplier or renegotiate and fix the price with the actual supplier.

- **Variable Cost: Labour**

The variable cost for labour resulted as £ 1,200.00 unfavourable. This could be a consequence of various factors as: high employee turnover, pay wage rise, hours of labour allocated inefficiently. Below will be analysed the different scenarios:

- *High Employee Turnover*

A high turnover is usually not beneficial for the company; it negatively impacts the brand's perception and it required more paid hours of training (Allen and Bryant, 2012). The new staff is less productive than trained staff, and more hours of work will be required, raising the variable cost of labour. A high turnover can be a consequence of bad management, e.g., a manager that does not motivate the employee. However, it is hard to find the origin of the problem as the turnover can have numerous reasons and sometimes the manager it cannot avoid it. E.g.



(Source: Allen and Bryant, 2012 pp. 5)

- Pay wage rise

It can be the reason why the variable labour cost increased. On the one hand, is unconvincing that the employee received a pay rise during this period, considering the reducing of the selling price and the salary reduction of the full-time supervisor.

On the other hand, according to Atkinson (2021), the mix of the pandemic and Brexit brought the UK to an enormous shortage of workers in a wide range of sectors. The shortage, subsequently, led the companies to increase their salaries.

- Hours of labour allocated inefficiently

Another factor that can raise the cost of labour is when the hours of labour are allocated inefficiently, when the staff is working more hours than required. This scenario would be a consequence of inefficient management that made a wrong labour budget, and this mistake could have been avoided.

- **Warehouse Rental**

The rent of the Warehouse is a favourable variance as the price decreased from £ 200,000 to £ 170,000, and the company was capable to save £ 30,000. According to Gov.UK (2021) the commercial rent's payment has been one of the numerous issues during the pandemic, as many companies have seen their profit halved so that the government decided to intervene with new laws and code of practice in order to reduce the commercial rent debt and help the tenants to negotiate with

the landlords. Many other companies have been able to negotiate the rent payment on their own, and this seems to be the reason for Amana ltd.'s rent reduction.

- **Supervisor Salary**

The salary's reduction of the full-time supervisor from £ 50,000 to £ 35,000 is a favourable variance as let the company save £ 15,000. However, if the change of the salary is derived from a newly hired supervisor rather than decreasing the salary of the employed supervisor, can be unbeneficial for the company. The lower salary of the new supervisor could be justified as minor expertise. The consequence is that if on the one hand, the company is saving money for its salary, on the other hand, it might lose money for the lack of expertise, e.g. he could have made an incorrect labour budget that resulted in an unfavourable variance for the variable labour cost.

Recommendation

I think Amana ltd instead of saving on the cost of the salary of the supervisor should have concentrated more on the labour high cost. The favourable variance for the supervisor's salary is £ 15,000, while the unfavourable variance for the labour cost is much higher, equal to £ 120,000. A supervisor is a higher skilled employee, and his expertise could have helped to allocate the resources more efficiently. I would have reduced the working hours of the employee, as the sale fell there was no reason to have a total variable labour cost even higher than the one in the standard budget where units sold were 20,000 less.

As a manager, I would start looking for local suppliers. The prices for transport are too unstable and it seems they could increase even further. Many organisations have seen their profit suffer from supply chain disruption. Furthermore, Amana ltd is operating in the UK, where the issue of the chain supplier is more significant after Brexit (Landberg and Goodman, 2021).

In addition, a made in UK label product would add more value to the product and the brand and it would differentiate its souvenirs from the competitors, enticing more potential customers. Adding more value to the product, the company could also raise the price even further than its original selling price. It is important for the company, to raise the selling price. As emerged from the report, the decrease of the selling price heavily impacted the profit, as the company was not capable

to decrease the expenses. As the business environment results as uncertain and instable, because of the pandemic, Amana should be cautious on changing its price because of the risk that the marginal cost could became higher than the marginal revenue. For this reason, should focus on additional value that can increase the selling price, e.g., local labelled product.

PART B

Amana ltd is considering expanding the distribution channel for its products, from physical shop to online. The company could utilise direct distribution channel, improving its website, or indirect channel, selling on Amazon. As a manager is pivotal to consider the relevant cost involved in the decision.

- Relevant Cost

A relevant cost is an avoidable future cost that has not been incurred yet and differs depending on the option (Rhode and Garrison, 2019). According to Atrill and McInaney (2021), for a cost to be relevant it must fulfil all the following criteria:

- *It must relate to the objectives of the business.*

E.g. £ 150,000 the cost of setting up a delivery network, is related to the objective of the business of selling online. Inversely, if Amana ltd.'s objective was to open another physical branch, rather than selling online, the £ 150,000 would have not been a relevant cost in the process of decision making as is not related to the option to open another branch or not.

- *It must be a future cost.*

It is a cost that has not been incurred and can be avoidable. E.g. £ 150,000 the cost of setting up a delivery network is a future and relevant cost as has not been incurred yet and Amana ltd can avoid this cost if decide to do not open an online delivery network. Inversely, if Amana ltd would have been already incurred the cost of setting up a delivery network and after would have decided to step back, stopping selling online and reopen the physical stores, this would have been a past cost that is not more avoidable and relevant for the process of the new decision making. Whatever the company decides, cannot recover the £ 150,000. In this scenario, the £ 150,000 would have been instead a Sunk Cost. In accounting, a sunk cost, is a cost that has already been incurred, and is not avoidable regarding the decision taken, hence is not relevant. (Rhode and Garrison, 2019)

- *It must vary with the decision.*

The cost must differ between alternatives. E.g. if Amana ltd decides to do not start selling online, it would avoid the cost £ 150,000 of setting up a delivery network. This cost depends on the decision taken by the company.

Decision-making process

Between the two alternatives of selling online utilising a direct distribution channel with its website or utilising the indirect third part of Amazon. As a manager, I would advise the company the first option of utilising its website, for the following reasons:

- *More profitable*

Besides economics have different opinions regarding the purpose of the business, starting with Friedman (1970) claiming that is to maximize its profit, to Freeman (1984) that beliefs is to create value to the stakeholders or to Ducker (2006), that believes is to create customers: where they all agree is that the profit is a crucial part for the business.

After having taken into consideration all the relevant costs, amazon resulted as the less profitable choice. The selling annually forecast is 100,000 units for its website, while for Amazon the forecast is 65,000 units. Considering the selling price the same as the original price of £25.00, the annual revenue would be respectively £2,500,000 selling on the own website and £1,625,000 selling on Amazon. The incremental revenue that will result from selling on its website is £875,000.

However, £875,000 is the incremental revenue and not the profit. To compare both profits is required to subtract all the expenses. Besides, the expenses for selling on its website are higher than the expenses for selling on Amazon, the profit maintaining its website would be still higher.

	Own Website	Amazon
Revenue	2,500,000	1,625,000
Cost of setting up delivery network	(150,000)	
Cost of upgrading current website	(50,000)	
Salary of a fulltime IT programmer	(35,000)	
Amazon fulfilment fees		(50,000)
Profit	2,265,000	1,575,000

The result is that the profit for Amana ltd selling on its website would be £690,000 higher than selling on Amazon. £690,000 is not the difference of the total profit, which would have taken into consideration all the costs, e.g., the cost of running the physical shop, or insurance. £690,000 is the difference on profit that differs between the two alternatives. Considering costs like the insurance would be irrelevant as that cost is incurred in both alternatives.

- *The difference in the long run*

The choice of selling on its website, in the long run, will result on greater profit. While selling on Amazon requires an annual fee of £50,000, using the own website has a few costs that are required only for the setting up and are not repetitively cost during the following years. E.g. the cost of setting up a delivery network £150,000, and the cost of upgrading the current website £50,000, which are only the initial cost. In the long run, the decision to use its website would results in a profit of £890,000 higher than the profit using Amazon. The only future cost for the following years, selling on the own website, will be the salary for the IT programmer £35,000.

- *Major freedom*

Businesses selling on Amazon are restricted to follow the standards and the policies required from Amazon. If Amana decides of selling on its website, it would have the freedom to set its policies. In addition, on Amazon the competition is higher. On Amazon the products are automatically compared with other substitutes, hence factors as price and feedback are crucial to gain an

advantage over the competitors. Using its website decrease the exposure to the competitor.

- *Cons*

The only con on selling on its website, is that the procedure is longer and more difficult than selling on Amazon. Amazon does not require the company to hire an IT programmer and to develop the website, so the procedure is faster and required less paperwork. Nevertheless, the benefit of selling online on the own website are higher than selling on Amazon.

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