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Assignment 2 - Report

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Introduction

The report is prepared based on the scenario presented regarding the operational performance of Amana Ltd. The performance of the company has been evaluated by preparing the flexible budget, control report, etc., and analyzing the price and efficiency variance. Based on the analysis, the company has been advised to take some actions to improve the performance of the firm. In this report, the CEO of Amana Ltd has been suggested the option, that is, choosing between setting own delivery network and selling on Amazon.

Part A: Performance Analysis using Managerial Accounting Tools

1. Monthly Control Report: Original and Flexible Budget and Variances

The monthly control report evaluates the actual figures of sales, costs, and profit against the budgeted figure to examine the performance of Amana Ltd. There are two types of variances (efficiency and price) that can cause actual amounts to differ from budgeted figures (Selto, Curry, and Horngren, 2018).

1.1 Original Budget

The management of the company forecasts how much sales it will generate during a particular period, how much it will incur to support those sales and how much profit it will earn, and all this information is condensed in the original budget (Hansen and Mowen, 2017). For example, the accountants of Amana Ltd prepared a budget where they thought they would make a sale of £2.5 million, offering each product for £25.

	Original budgeted Figure (£)	Original Budget (£)	Formula	Formula (Amount)
Units	100,000			
Selling price	25	2500000	Budgeted Sales Unit + Budgeted Sales price per souvenir	100000*25
Variable costs:				
Materials	2.5	250000	Budgeted Materials * Budgeted Material price per product	100000* 2.5
Labour	4	400000	Budgeted labour costs per product * Budgeted Total Production	100000* 4
Overhead	1.5	150000	Budgeted overhead costs per product * Budgeted Total Production	100000* 1.5
Contribution Margin		1700000		
Fixed overheads:				
Warehouse rental	200,000	200,000		
Insurance	100,000	100,000		
Fulltime warehouse supervisor salary	50,000	50,000		
Profit		1,350,000		

Figure 1: Original budget of Amana Ltd Source: Author

The original budget the firm also showed that it was expected to spend £800000 on variable costs like materials, labour, and overhead and incur another £350000 on fixed costs.

1.2 Flexible Budget

The flexible budget is central to the control report analysis, which is calculated by multiplying the actual sales unit by budgeted sales price and costs per unit (Ekholm and Wallin, 2019). The flexible budget is compared with the original budget to identify the efficiency variance. As the price in the calculation of both the budget is the same, the difference between these budgets originates from quantity or efficiency variance (Selto, Curry, and Horngren, 2018). For example, the comparison showed that the company would incur a revenue of £2 million against £2.5 million and a profit of £1.01 million against £1.35 million of budgeted profit.

	Original budget (£)	Actual (£)	Flexible Budget	Formula (Actual Quantity of Input at Original Price)	Formula (Amount)
Units	100,000	80000			
Selling price	25	20	2000000	Actual Sales Unit + Budgeted Sales price per souvenir	80000*25
Variable costs:					
Materials	2.5	3.5	200000	Actual Materials * Budgeted Material price per product	80000* 2.5
Labour	4	5.5	320000	Actual Production * Budgeted Labour per product	800000000* 4
Overhead	1.5	1.5	120000	Budgeted overhead costs per product * Actual Total Production	800000000* 1.5
Contribution	17	9.5	1,360,000		
Fixed overheads:					
Warehouse rental	200,000	170,000	200,000		
Insurance	100,000	100,000	100,000		
Fulltime warehouse supervisor salary	50,000	35,000	50,000		
Profit			1,010,000		

Figure 2: Flexible budget for Amana Ltd Source: Author

The flexible budget, on the other hand, is compared against the actual activity to calculate the price variance (Rhode, and Garrison, 2019). For example, the company would make a revenue and profit of £2 million and £1.01 million, but it actually made revenue and net profit of £1.6 million.

1.3 Variance Analysis: Price and Efficiency Variance (Control Report)

The variance analysis evaluates the actual figures, flexible and original budget to determine the price and efficiency variance (Burgstahler et al., 2011), which can be both favorable and unfavorable.

	Individual Figure		Budget			Variance	
	Original budgeted Figure (£)	Actual Figure (£)	Original Budget	Flexible Budget	Actual Output	Price/Rate	Efficiency or Quantity
Units	100,000	80000	2500000	2000000	1600000	-400000	-500000
Selling price	25	20					
Variable costs:							
Materials	2.5	3.5	250000	200000	280,000	-80,000	50000
Labour	4	5.5	400000	320000	440,000	-120,000	80000
Overhead	1.5	1.5	150000	120000	120,000	0	30000
Contribution Margin	17	9.5	1,700,000	1,360,000	760,000		
Fixed overheads:							
Warehouse rental	200,000	170,000	200,000	200,000	170,000	30,000	
Insurance	100,000	100,000	100,000	100,000	100,000	0	
Fulltime warehouse supervisor salary	50,000	35,000	50,000	50,000	35,000	15,000	
Profit			1,350,000	1,010,000	455,000		

Figure 3: Variance analysis using control report Source: Author

If the actual sales price is higher (lower) than the flexible budgeted sales price and actual costs are lower than flexible budgeted sales, the price variance is favorable (Claiborne and Cole, 2015). On the other hand, if the total materials used in the production is less than the budgeted amount, the variance is favorable and vice versa. The variance analysis is conducted in detail in the next segment.

2. Analyzing the performance using information from the Control Report

2.1 Sales Revenue: Price and Efficiency Variance

The company experienced a fall in sales due to the covid-19 pandemic, which caused the firm to sell only 80000 products while it expected to sell 100000 units, resulting in an unfavorable quantity variance of 20000 units. The weak online presence of the firm prevented it from shifting the offline sales to the online platform (Epler and Leach, 2021). Besides, the comparison of flexible and original budget revealed that there was a price variance of £5 per product during the pandemic period. The firm may have been pushed to sell products on discounts to ramp up sales figures as the demand for souvenir shapely fall following the inability of the tourists to travel during Easter Sundays.

2.2 Variable Costs: Price and Efficiency Variance

The company only used materials for 80000 units of souvenir, which caused it to use fewer materials than budgeted, culminating in a favorable efficiency variance of £50,000. However, the analysis showed that the company spends £3.5 on each material though its budgeted figure was £2.5, which led to a negative price variance of £80,000, and hence, the total variance of the materials went against the favor of the company. The inefficiency of the procurement manager can be blamed for the unfavorable price variance.

Following the materials, the company also saw an unfavorable labour rate variance of £120000 because it paid around £1.5 for labour wage per product more than what the company expected to pay. The lack of productivity among the labors caused them to spend more time on each product (Selto, Curry, and Horngren, 2018), which raised the labour costs per souvenir. Amana Ltd, on the other hand, had a favorable quantity variance of £80,000 because of producing fewer products.

The last item in the variable costs is the manufacturing overhead. Amana Ltd saw a favorable variance of £30,000 because it produced only 80000 units. Unlike the other two costs, the firm did not see a negative price variance on this variable expense, which means the company could hold a grip on the variable manufacturing overhead.

2.3 Fixed Costs: Price Variance

As these costs are fixed regardless of the output level, the efficiency variance is out of the picture (Moriarty and Allen, 2015). The actual figure showed that the company paid lesser rental charges than expected. The reason behind is that some owner provided a rebate on the rental fees as the businesses are suffering financially. Also, the company cut the salary of the warehouse supervisor by £15000, which resulted in a favorable price variance.

3. Recommendations to the CEO of Amana Ltd.

The variance analysis using the control report showed that the company paid more for labour and material and sold fewer products at a lower price. Hence, there are some areas, where the company can attempt to improve. Currently, the company only harnesses the online platform to advertise. The firm should strengthen its online presence and start selling products online, which will enable the firm to recover the loss in physical stores. The company should take advantage of the surge in online sales in the UK following the changing consumer behaviour and post-covid-19 behaviour (Moon, Choe, and Song, 2021). Also, the company should conduct heavy promotions to rejuvenate the brand once again, which will enable it to gain customer confidence and affect sales positively.

Amana Ltd should arrange training for its procurement manager so that s/he can bring better deals for the company and reduce the costs of materials, thus enhancing the profitability of the firm. The company can try to contact other raw materials suppliers, who can provide good quality materials at a lower price. Also, the firm should reduce the number of strategic partners and should develop a close relationship with the supplier, which will permit the company to procure products at lower prices (Burgstahler et al., 2011). Besides, if the firm reduces the number of suppliers, it will source more material from one supplier, which will allow the firm to bargain better prices.

The company should also get its labours trained so that their productivity can increase and they can produce more products per hour, which will allow the company to control labour wages per product (Selto, Curry and Horngren, 2018). Also, the company can think of bringing automation to reduce the labour-related costs, which will also augment the

defect rate. Hence, applying these recommendations, Amana Ltd can ameliorate its performance.

Part B Evaluating the Decision to Go online and the options available and Suggesting the Course of Action

The sales of Amana Ltd took a hit following the imposition of countrywide lockdowns. Besides, the travel bans, stopping international flights, etc. caused many tourists not to travel during the peak season like Easter Sundays, which affected the sales adversely. The post-pandemic behaviour still bars many tourists from traveling even if the lockdowns have been lifted after the first wave of the Coronavirus. Besides, there is a change in the consumer buying pattern, that is, more and more customers prefer ordering online and getting home delivery rather than visiting crowded stores (Moon, Choe, and Song, 2021). The competitors of the company have taken advantage of the opportunity. Another major benefit of selling online is that it helps the company to reach a wider customer group, for example, the competitors of Amana Ltd sold their products to customers in not only the UK but also in the US and Europe.

Hence, in order to remain competitive and cater to the changing customer behaviour, Amana Ltd has also decided to sell online considering the bright sides of the decisions. However, the main dilemma of the CEO regards to whether it should develop its own delivery channel to serve online customers or it should sell products on amazon's fulfillment centers. Regardless of which option Amana Ltd chooses, the sales revenue of the company will surpass the budgeted amount, for example, if the company chooses to sell products on Amazon, it will be able to sell approximately 120000 souvenirs with a guaranteed sales 60000 units and if the firm decides to develop its own infrastructure, its will be able to market around 200000 units of products with a guaranteed sales 100000 units. There are some advantages and disadvantages of both the options, which the company needs to explore to decide the right option for the company.

Evaluating the Options

Option 1: Developing Company's Own Delivery Network

The major benefit of this approach is that it will lift the sales more than the other option. Besides, if Amana Ltd chooses to develop its own network, the firm will have better control over pricing, return policy, etc., which will help the company to pass any price increase to consumers and adopt any return policy that suits the firm. Also, the company will be able to reinforce its brand unlike the other option (Song, Chen, and Li, 2017), where the company's brand name will be overshadowed by the brand name of Amazon. The disadvantage of this approach is that the company will enjoy no economies of scale in terms of delivery costs per product and handling a delivery network of its own may be very challenging for the firm. In addition, the company will have to make a hefty investment of £200,000 in setting the network and have a hire a full-time programmer for another £35,000. This will put the firm under tremendous financial pressure.

	Advantages	Disadvantages
Option 1	1. Better control over pricing and return policy 2. Reinforcement of the brand 3. Higher sales level 4. Less fierce competition	1. No economies of scale in delivery costs per product 2. Financial burden
Option 2	1. Low capital requirement 2. The firm will not have to hire a full-time programmer 3. Focus on core business	1. Better control over pricing and return policy 2. High competition 3. Hindrance to the long-term growth of the brand

Figure 4: Evaluating the options Source: Author

Option 2: Selling Souvenir on Amazon.com

If Amana Ltd decides to choose this option, it will be able to sell online using the platform of Amazon, which is a popular e-commerce site. The company will require only £50,000 in fulfillment fees and will not have to invest £200,000 and hence, the company can avoid

the financial burden. Also, the company will not have to hire a full-time programmer, and it can concentrate on its core business without having to worry about online sales. Amazon is likely to use drones for home delivery, which will deliver the products within 30 minutes (Sherr, 2021), which will enhance customer experience and prompt many customers to buy the products of the firm from Amazon. However, selling on Amazon means Amana Ltd will have to comply with the pricing policy of Amazon and will also have no control over the return and refund policy (Sun, Lyu, and Teo, 2020). The brand of the company will be overshadowed by the powerful brand name of Amazon, which will not be good for the company's growth. Also, the company will face huge competition from the vendors who are also selling their products on Amazon.

Suggesting the Choice: Developing Own Delivery Network

Considering the advantages and disadvantages, the company is advised to develop its own delivery network. If the company chooses to sell on Amazon, it will be a short-sighted decision from the firm. The lack of control over its business policies can hinder its growth. However, the biggest demerit of the second option is that the company's own brand name will be overshadowed (Song, Chen, and Li, 2017), that is, the customers may not even notice the company's whose product they are buying on Amazon. The high investment may put some financial burden and increase the business risks, its high returns from the first option totally justify the higher risks. The company will be able to differentiate its brand using the approach. Besides, once Amana Ltd boosts its online presence and starts selling on higher volume, the economies of scale issue will also be resolved. Hence, the company should go with the first option, which may cause the firm to suffer a bit in the short-term but will benefit the firm a lot in the long term.

Conclusion

The sales of the company plunged due to Covid-19, which also affected the price it could charge the customers. The control report depicted that there was also unfavorable price variance in variable costs like materials and labour, and hence, the company needs to take actions to control prices and costs. The analysis of the options to sell online revealed that selling on Amazon may provide some short-term benefits and may seem lucrative, but it would not be good for the growth of the company in the future, which is why the first option has been recommended.

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