

Management Accounting Assignment 2

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Introduction

Budgeting is an integral part of any business as it enables effective planning and control of resources available in the firm (Shim, Siegel and Shim, 2011). Thus, budgeting is the basis for any business success as it will allow the manager to monitor and control finances in the firm. Besides, through budgeting, a business can effectively meet its objectives and make firm financial decisions such as ensuring the firm has enough cash flow for future investment projects. Concerning the topic of budgeting, this report aims to shed light and expound more on budget, variances and how budgets help in making different viable decisions that lead the business into achieving success.

Part A: Monthly control report showing original, flex budgets and variances

Fig 1: Amana Ltd Original Budget

units sold	100,000	
sales price	25	
sales		2,500,000
	Costs per unit	
costs of sales		
Material	2.5	250,000
Labour	4	400,000
variable overhead	1.5	150,000
Less; Total variable cost		(800,000)
Contribution	17	1,700,000
Less: Fixed overhead		
rent		200,000
Insurance		100,000
salary		50,000
Total fixed costs		(350,000)
Gross profit		1,350,000

Fig 2: Amana Ltd flexed budget

unit sold	80,000	
selling price	20	
sales	160,000	1,600,000
Cost of goods		
direct material	280,000	
direct labour	440,000	
variable overheads	120,000	
Contribution	760,000	
Less; Fixed overheads		
rent	170,000	
Insurance	100,000	
salary	35,000	
Total cost of goods sold		1,145,000
Gross profit		455,000

Table three: Variances in the two budgets (original and flexed budgets)

Items	Original budget		Actual budget	Variances	favorable/unfavorable
units sold	100,000		80,000	(20,000)	unfavorable
sales price	25		20	(5)	unfavourable
sales	2,500,000		1,600,000	(900,000)	unfavorable
	per unit cost				
costs of sales					
material	2.5	250,000	280,000	(30,000)	unfavorable
labour	4	400,000	440,000	(40,000)	unfavourable
variable overhead	1.5	150,000	120,000	30,000	favorable
Contribution margin		1,700,000	760,000	(940,000)	Unfavorable
Less; fixed overhead					
rent		200,000	170,000	30,000	favorable
Insurance		100,000	100,000	0	
salary		50,000	35,000	15,000	favorable

Total fixed cost	(350,000)	(305,000)	45,000	favorable
Gross profit	1,350,000	455,000	(895,000)	unfavorable

A report on Amana's performance during the year 2020

A decrease in units sold- as seen from Amana's budget there was a huge unfavourable variance in the actual sold units from the original volume that had been estimated. The variance in units sold in Amana was 20,000 units which resulted in a decrease in total sales from the original budget. A decrease in sales could be associated with an increase in costs of production. When the production costs go high, a firm may produce and sell fewer units. As seen from the actual budget Amana, incurred a high cost in procuring material and labour which could be associated with the reduction of units sold. On the other hand, a decrease in unit sold could be a result of a decreased level of quality of the products which may discourage tourists from buying the souvenirs (Patty Graybeal, 2019). From the report, it could be possible to say Amana may be failing in their process of production which then may lower the quality of products hence a decrease in sales. Besides, external market factors such as the outbreak of the covid-19 pandemic negatively affected sales in Amana as their major customers include the tourists (Uğur and Akbıyık, 2020). Due to increased lockdown, movement restriction and lack of an online shop could be some of the major reason for Amana's to have unfavourable variances in units sold.

Selling price- from the budget above Amana's introduced a price reduction strategy that could be aimed at increasing sales. Amana's found cutting the price of its products as one of the major policy that could help the firm attract more tourists/customers amidst the economic downturn as a result of the impacts of the covid-19 pandemic on the world economy (Uğur and Akbıyık, 2020). Reducing price could in the short run help Amana's in gaining customers as consumers will switch to a cheaper product. However, in the long-run price cut is not a sustainable strategy. The price reduction may force the company to run into huge losses in future if the costs of production continue to hike. Assuming costs of production remains the same or goes high lowering prices to increase sales lowers the profit margin of each unit sold in the company (Patty Graybeal, 2019). As seen from the budget the costs of material and labour have significantly increased which can be associated with inflation in the economy, thus, the increased costs have in turn lowered the

profit margin of each unit sold by Amana. Thus, Amana requires to identify another pricing strategy that can help the firm to remain competitive in the long run.

Variance in material and labour- from the budget report Amana's had unfavourable variances in both labour and material. There was a significant increase in costs of material and labour in the flexed budget. Thus, Amana's was forced to lower variable costs to minimise the costs of goods sold. However, as seen from Amana even if the variable costs have a favourable variance of 20,000, the costs of production still were high during the 2020 financial year which resulted in an unfavourable variance of 895,000 in the expected profits. This is a huge negative variance that requires Amana to improvise effective policy that can help the firm to acquire a sustainable competitive edge and be profitable in the long run.

Reduction on fixed overheads- the success of any business rests on the ability to adjust and improve on revenue. Due to the covid-19 negative impacts on business Amana has been forced to find creative ways to the problem of costs in the firm. The budget reports show that the cost of rent and salary have a favourable variance. A decrease in salary could be associated with increased layoffs and pay cuts resulting from negative impacts of covid-19 pandemic (Alonso et al., 2020). However, according to study conducted by Sanjeev, Jauhari and Vij (2012) it is important to understand that a non-strategic layoff and salary cut could be one door to the failure of a business. Such strategies lower employee morale and increase inefficiency in production. Thus, Amana's should have considered layoffs and pay cut as the last resort for quick cost reduction. On the other hand, a favourable variance in rent significantly enables Amana to cut production costs. Thus, from Amana's performance report, several suggestions on areas the firm need to improve have been provided below.

Recommendations to Amana's CEO on areas of improvement

Find a cheaper supplier of raw material- raw material contributes the essential component for every manufacturing company and also contribute to a huge part of overall production costs. Thus, Amana should look for other suppliers who are cheaper and have good track records. Amana can hire a commodity broker who will be finding the best deals on behalf of the company. Having supplied raw material at a cheaper price will lower variable costs and in general boosts the profit margin in Amana's business (Boyd et al., 2014). Amana can conduct a deep market survey including assessing its competitors' suppliers.

Increase production efficacy- Amana needs to evaluate its production processes and standards to increase production efficiency. Producing quality products will not only help retain customers but also gain more new customers from referrals. In return, Amana will be able to sell more units if the quality meets customers' desires. Hence, Amana may increase efficiency in the firm by training employees and conducting market research on the latest designs for souvenirs. Besides, Amana should ensure waste/scrap is significantly reduced to lower the costs of production (Holtzman and Hood, 2013). Other things to consider include eliminating unnecessary product features which require additional production process and materials which increase the firm expenditures.

Come up with a competitive pricing strategy- Amana requires establishing a competitive pricing policy that will be sustainable rather than introducing a temporary price reduction. Some of the pricing policy that can help the firm to remain competitive and profitable include competitive based pricing and premium pricing strategies (Patty Graybeal, 2019). The competitive-based policy will help the firm sell its product at a relative price that is almost similar to that of the competitors. On the other hand, a premium pricing policy will enable Amana to target high-class income tourist and in return earn high revenues. Most of the consumers will associate a premium price with high quality and will tend to buy the product at any given price.

Create more brand awareness -alternatively, Amana could opt at marketing its brand through doing rigour advertising across various social media platforms such as Facebook, YouTube, Instagram, Twitter and LinkedIn. Increasing brand awareness will help generate increased sales, gain a higher market share and increase the customer base (Tritama and Tarigan, 2016). Most of the tourist on social media platform searching for products that can make their tourism experience unique and memorable. Thus, displaying the souvenirs on the online platform will create awareness to the target customers.

Pat B: deciding on whether to sell products on Amazon or own online shop

Due to the increased lockdown and social movement restrictions imposed to curb covid-19 spread many businesses have been left with no option rather trading on the online platform. Amana is not an exception the business is the most hit as its main customer target are tourists (Pham et al., 2021). Therefore, the decision to sell the company's product on the online stores is one of the most favourable and competitive decision Amana can make. However, instead of establishing its online shop, it would be recommendable for Amana to sell its products through Amazon taking into

consideration of factors of opening its online shop and trading through Amazon as discussed below.

Relevant costs- if Amana decides to open its online shop the business may incur a high starting capital. As provided in the cost of capital required for Amana to start an online shop it requires £150,000 for setting up the delivery network, £50,000 for upgrading the business current website to facilitate and enable handling of the large volume of sales. Besides, the firm will require to have £35,000 to pay for an IT programmer who will be working full time in managing and maintaining the site. Thus, in total, the firm will require a working capital of £235,000 to own an online shop. However, if Amana decides to sell its products through Amazon the only costs that will be incurred will entail a fulfilment fee of £50,000. Thus, it would be wiser for Amana to settle with Amazon as this decision will help in avoiding relevant costs such as managerial, maintenance, and other start-up costs, that could have been incurred if the firm was to start its online shop.

Quick reach and high customer acquisition using Amazon- Amazon is the world's largest online retailer. According to statistics collected by Dayton (2019) each month more than 197 million people across the globe visits Amazon.com needless to say the online platform is the leader in online sales with no signing of slowing down any time soon. Thus, selling product through Amazon can easily enable Amana to reach a wide customer target and also in acquiring a higher number within a short period. On the other side, starting and growing own online shop for Amana will require time to generate increased traffic on the site as Amazon do. Therefore, Amana should consider selling its products through Amazon which is an already established and high brand equity in the online market.

Increased returns- as aforementioned more than 197 million people in the world visits Amazon.com (Dayton, 2019). Thus, the probability of selling a high number of units is very high with Amazon unlike in a new online shop. People like buying from a trusted brand. Hence, with Amazon, Amana can generate increased sales and revenue. Amazon has a product cataloguing system that will ensure Amana's products are placed in the most appropriate location such as the souvenir section for any Amazon user to find the product (Coppola, 2021). Additionally, Amazon invests hugely in paid Google search which is a shared benefit that Amana will acquire. Therefore, the chances of gaining high revenues through selling products on Amazon are very high. From the report provided if Amana was to start its online shop, there would be a guaranteed sales of 100,000

units annually, on the other hand, if trading on Amazon Amana will have a guaranteed sales of 65,000 units annually with a high potential to grow depending on demand which is a more reason for Amana to settle at selling its products through Amazon.

However, it is also important to consider some of the limitations Amana will face while selling its product through Amazon. Some of the major limitations include;

Increased competition- as mentioned earlier on Amazon focuses on product rather than the brand. Thus, their site will have several types of souvenirs from different companies. Besides, if Amazon notices success on Amana's products, they may replicate the products and outcompete the firm (Bain, 2021). Thus, it will require Amana to implement other marketing and selling strategies to remain competitive in the long run.

Lack of control- When Amana signs to trade its product through Amazon it will lose its control over price control and returns policy, Amana will be forced to abide by Amazon's rules. Mainly Amazon focuses on products and not the seller thus Amana has a limited chance to showcase their brand presence in such a global online shop (Bain, 2021). Besides, Amana cannot assess crucial customer information as Amazon restrict other third parties from accessing their customers' information. Hence, it will be difficult for Amana to personalise the customer experience with any customer who buys their products. Besides, Amazon set the pricing strategy and charge a fee for each unit sold which can hinder the effective growth of sales and revenue in Amana.

Unable to conduct B2B selling through Amazon- B2B is one of the most lucrative ways of selling business products. It has high returns and great economies of scales. On the contrary, Amazon is an e-commerce platform that is generally focused on B2C selling and so by putting all eggs in Amazon's basket, Amana is likely to lose potential B2B customers in the long run (Bain, 2021). This will require Amana to come up with more selling strategies in other sites apart from Amazon.

Bottom line is, there are both benefits and limitations of selling Amana's products on Amazon. One of the biggest drawbacks is the lack of control of the brand where Amana cannot even track the record of their customers. However, Amana can significantly benefit from the idea of selling its products through Amazon in that the firm will successfully meet its main objective of increasing sales, market share and size. Reach, credibility, and high customer acquisition gained from

Amazon will help Amana grow its sales without incurring huge website start-up costs, managerial and maintenance of the site.

Conclusion

In summary, this report has analysed how budget reports help in identifying variances and in making a viable business decision. The paper presents a budget report of Amana during the 2020 financial year, identified variances and analysed the financial performance of the firm during the said period. The report has provided various recommendations needed by Amana to improve on some key areas noted to bring the huge variances. The recommendations are aimed at helping Amana to gain a competitive niche in the market. Lastly, through budget evaluation, the report has also helped Amana to decide to sell their products online through Amazon and not through creating their online shop considering several factors such as costs.

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