



Assessment 2

Lecturer Rita Ukachi-Lois

Marcin Klytta

Student nr 1919648, Level 5 term 2

Module LCBB5002 Management Accounting

The purpose of the following report is to provide recommendations for improving budget management at Amana Ltd.

The report consists of 2 parts. In part A, a budget analysis will be carried out, and recommendations for improving the cost policy and the income and profit generated by the company. Part B will determine which distribution channels - online sales or alternative sales via Amazon, will be more attractive for the company financially and in terms of image.

Part A

To thoroughly analyze the data presented in the budget, it is necessary to define an audit report showing its deviations from the assumptions of the static budget. It will be helpful to define a flexible budget.

A flexible budget typically more accurately reflects the company's cash flow requirement and projected sales earnings than a static budget. Cost volatility is the main reason a company chooses to use a flexible budget. A flexible budget is based on cost volatility and allows for a better interpretation of how variable costs behave. These costs change as production changes. A flexible budget consists in adjusting the budget on which the company works to the realized production. (Seal, W. et al., 2019) Such a budget enables a comparison of sales effectiveness and costs incurred. Deviations from the funding will help us verify which budget areas require intervention. (Chen, J. 2020)

	cost per unit	Original (£)	Flexed (£)	Actual (£)	Variance	
Units		100 000	80 000	80 000	0	
Selling price	25	25	25	20	(5)	UF
Revenue		2 500 000	2 000 000	1 600 000	(400 000)	UF
Variable costs:						
Materials	2,50	250 000	200 000	280 000	(80 000)	UF
Labour	4	400 000	320 000	440 000	(120 000)	UF
Overhead	1,5	150 000	120 000	120 000	0	
Contribution	17	1 700 000	1 360 000	760 000	(600 000)	UF
Fixed overheads:						
Warehouse rental	200 000	200 000	200 000	170 000	30 000	F
Insurance	100 000	100 000	100 000	100 000	0	
Fulltime warehouse supervisor salary	50 000	50 000	50 000	35 000	15 000	F
Profit		1 350 000	1 010 000	455 000	(555 000)	UF

The surveyed company Amana Ltd identified several areas that needed special attention. The outbreak of the global Covid-19 pandemic and the introduction of government restrictions caused significant fluctuations in demand for the company's products. In turn, it influenced the changes in the production volume, which differs significantly from the budgeted production volume.

Selling price

The principal owner's assumption was to reduce the unit price of each unit by £ 5 to balance the amount of revenue. By lowering the price, the company predicted that the number of products sold would be greater than before the reduction. Reducing the cost in such a situation may cause that the profit is lower (in this case, the deviation at the level of - 555,000), while due to the increase in sales, the company's global income increases. Another reason for the price reduction was the sellers' desire to maintain or increase market share. The desire to maintain a market share occurs in those enterprises whose market share is declining. In such a situation, deciding to lower prices may stop this phenomenon. Increasing the market share and even the desire to gain a dominant position. (LaMarco N., 2019) The fall in price did not increase revenue; on the contrary, it is worth noting a negative variance of 400,000.

A recommendation for the company is to gradually increase the price of a unit of the product sold to reduce costs. Consumers, as a rule, accept gradual increases in prices with less reluctance than sharp increases in prices. Therefore, it is essential to gain knowledge of customer behaviour about product price changes. (Dholakia U., 2021)

In the process of setting prices, owners should take into account, in particular, the expectations of buyers, the demand for the product existing on the market, prices of similar products, the originality of the product and the costs incurred by the enterprise in connection with the production of the product. It is also recommended to penetrate the market and increase advertising costs thoroughly. (Kotler & Armstrong, 2012) It will also be helpful to ask the government for subsidies.

Materials

Theoretically, the price deviation of direct materials informs the efficiency of the procurement department's work. The variation, in this case, is unfavourable - £ 80,000. This information may suggest that the procurement department worked inefficiently because it could not purchase materials at standard prices. The main recommendation for the company is to find a cheaper material supplier. Unfortunately, this simple reasoning is not always correct as

the causes of price variation may be multiple and may arise from activities other than the procurement department of the responsibility centres. For example, the variation in direct material prices may be caused by a general increase in direct material prices in the marketplace and, therefore, may be partly or wholly beyond the control of the purchasing department. (Javed R., 2021) Another reason for the deviation in the prices of direct materials may be the purchase by the procurement department of materials of a different specification and quality than specified in the standards. (Seal W. et al., 2019) If, for example, the procurement department purchases inferior quality materials, this will most often result in a favourable price variation - but this does not necessarily mean that the procurement department is working well. The seemingly good variances of the prices of direct materials may cause their greater consumption, more complicated and time-consuming processing, more material losses, shortages, and complaints. It may harm many other areas of the company's activity.

The company must carefully examine the material supplier in terms of price and quality and consider another significant factor, such as appropriate production planning. (Mula J. et al., 2006) It is crucial to avoid intervention purchases of materials (for example, purchases may be made in smaller batches, which may increase transport costs per unit). As a result, the capital involved in the financing of inventories and the costs related to storage and their insurance may increase. (Meyers S., 2020)

Labour

The variance in employees' salaries is unfavourable, which indicates that the limit of employees' wages is exceeded. The deviation of £ 120,000 makes it clear that the company has no control over the proper management of employees.

The main reason may be an imperfect HR policy in the company, for example, firing people too quickly after signals about reducing orders from customers, then hasty recruitment of new ones. There is no effort on the owners to retain the best, well-trained employees - inadequate use of resources and tools to reward, motivate and promote. The company may also hire unqualified staff and delegate responsibilities to younger and inexperienced staff. As a result, the working time devoted to a given task increases. (Wood & Sangster, 2005)

Another factor increasing staff expenses in the budget may be inadequately planned working time, which increases the number of hours. Also, these working hours can be inefficiently used by employees. (Hamermesh D., 2021) Also, the lack of control over the wage system can lead to a situation where workers are paid for hours not worked. (Raiborn C. et al., 2013)

Therefore, the recommendation is to create a correct working time system to eliminate laziness and lack of discipline in some subordinates. It is essential to verify the working environment and define long-term plans. It may turn out that the multitude of solutions used in the company complicates the functioning and slows down essential processes. (Coyne K. et al., 2010) Perhaps the company should automate some free office or sales applications. The company should also consider increasing labour costs due to periodic price increases. (Palmer S., 2019)

In the case of the analyzed company, only variable costs are favourable. These costs vary depending on the production volume, the number of goods produced, or the scale of services offered. (Ames & Hlavacek, 1990) As the company decided to lower the unit price, the company's revenue automatically dropped. Therefore, when analyzing variable costs, such as warehouse rental fees and employee remuneration, the change in production should be considered. If it grows, variable costs will also increase, and if production decreases, prices will drop. The deviations of 30,000 and 45,000 evidence this. The company has saved in this case, but in the future, owners should systematically verify the rental prices of the warehouse and negotiate long-term contracts to be sure that the prices will not increase in the future.

Part B

The following calculation of costs and projected profit will allow the owner of Amana Ltd to decide which option he should consider expanding sales and save time.

	own website	Amazon
units	100 000	65 000
price per unit	20	20
Revenue	2 000 000	1 300 000
costs:		
labour	35 000	
variable	150 000 + 50 000	50 000
profit	1 815 000	1 250 000

The above figures show that it would be more advantageous to invest in the sale through the own website to sell 100,000 units, giving an income of GBP 2,000,000 (with a unit price of GBP 20). The online store undoubtedly allows to obtain the highest margin and gives a unique opportunity to build a brand, and thus - recognition on the market. The own store is entirely independent and can implement the entrepreneurial vision. The online store theoretically

allows reaching an extensive range of users. However, it should be borne in mind that it is associated with many works and resources. First, it needs to position its online store and build a new brand on the market to build capacities. (Kaplan K., 2020) More funds must also be invested in advertising to convince e-consumers that it is worth trusting the brand. However, this does not always guarantee sales success.

Creating a supply network places high demands on the standards of operation and the amount of generated costs. Amana Ltd invests £ 150,000 in developing a supply network and £ 50,000 in updating the site. However, these will never be the final amounts, because usually when creating e-commerce, it should be further developed, and with this assumption invested in internet marketing. (Niersbach P., 2021) For internet marketing activities to be effective and efficient, a solid foundation is needed in the form of a well-designed, mainly technically, logically and experienced in running an online store.

The company wants to hire an IT specialist and allocate £ 35,000 for this purpose. However, it is worth remembering that specialists' salaries' market prices are fluid and depend on the employee's experience and professionalism. It is uncertain whether the person will resign from work or raise the rate of remuneration for the job later. This risk is significant for the company, especially since the compensation offered by the company is lower than the market average. (Glassdoor, 2021)

A more profitably option for the company is the sale by Amazon, even though the guaranteed sale is at the level of 65,000 units and the value of revenue is expected at the level of GBP 1,250,000 (at a comparable unit price of GBP 20). Amazon is a leader in the e-commerce industry and, however, one of the most recognizable brands in the world. (McAfee E., 2021)

In the Fulfillment by Amazon model, Amana Ltd will lose control of its products. It will not modify the delivery or handling of returns because Amazon deals with all such matters. In addition, it will not be able to promote its brand because the goods are delivered to customers in packages under the Amazon logo. Although the Amazon FBA sales system is a desirable option for entrepreneurs who want to minimize fixed costs and bypass barriers to entry into new foreign markets, it also has some disadvantages. These are set fees and commissions, fierce competition, loss of control over the goods and the customer service system. (Danziger P., 2018) Owners still must consider the risk of creating a competitive product by other companies. (Forbes, 2021) Suppose something sells exceptionally well on Amazon, and the company has an idea of how to introduce a competitive solution or make it its own. In that case, it buys a competitor or creates its product. In the first case, Amazon has enough capital for the

development to be successful; it is also wasted money on it for years. The second case artificially lowers prices to lead the competition to bankruptcy. (Rao A. et al., 2000)

On the other hand, the significant advantage, apart from logistic facilitation and reduction of initial costs related to the necessity to have and operate the own warehouse, are also marketing issues. By entering the world's largest sales platform, the company will gain the ability to reach millions of new customers, and this allows for quick expansion and exponential business growth, especially if the offer turns out to be competitive. Also, by listing products on Amazon, Amana Ltd will gain credibility and trust, especially in a pandemic time. Some users are more likely to buy the product from Amazon than from a store they have never heard of. (Boggs J., 2021) Amazon is basically a giant search engine for buyers who are ready to buy a certain product or search for a specific category. Therefore, listing on the platform gives exposure to potential customers with high purchase intent.

Amana Ltd will also not have to invest in its warehouses, employees responsible for receiving and issuing goods, packing, and shipping. There is also no need to handle complaints and returns in more advanced variants. When choosing a sales platform, the company will use a ready-made infrastructure that is well-thought-out in terms of the sales process. Owners will not have to worry about setting up a site with online shopping, warehouse, or suppliers. The company, opting for an e-commerce platform, will save time and will be able to focus, for example, on an effective pricing policy. At the same time, Amazon employees handle the orders and deliveries. (Danziger P., 2018)

The e-commerce industry is booming today, creating great opportunities for both new entrepreneurs and those who have been developing businesses in the offline sector for years. Some people start by selling through an online store and as their business grows, they look for new places to sell online. On the other hand, others take their first steps on various shopping platforms, only to launch their own online store later.

A recommendation for the company is to choose the option of selling through Amazon as a place to build a customer base. Later, you should think about updating your website as your sales destination. There is also nothing to prevent you from integrating your own e-shop with Amazon and selecting sales strategies in such a way as to generate profits from both sources.

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