

Case solution on abrasm company

Business



----- A ----- Case
Study ----- On ABRAMS COMPANY

----- Of -----

Management control System -----

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----- About The

company ----- US company

----- Manufacturing auto parts

----- Selling in Domestic as well as foreign

Market ----- Most of the Products related with....

----- Automobiles

----- Trucks& Buses

----- Farm Equipments

----- Product & Marketing Division

----- Production Division: *

----- Company works on Three Parts. 1.

----- Ignition Parts 2.

----- Transmission Parts.

3. -----

Engine Parts. ----- Marketing Division: *

----- Selling Through two Department. 1.

----- O.

E. M. department. 2. ----- A.

M. department. ----- EXHIBIT 1

----- Partial Organization Chart

Inside & Outside sales In 1992; * Total sales \$500 million Inside sales (to AM div) - \$100 million Outside Sales (to OEM)- \$400 million * Ignition parts sales- \$130million * Engine parts sales- \$90million * Transmission parts sales - \$100million * AM Division sales- \$180 million ROI for the Manufacturing Plants * Each Plant has to meet targeted ROI. $ROI = \frac{\text{Budgeted Profit}}{\text{Actual beginning-of-the -year net assets}}$ Where Budgeted Profit =(Expected Revenue- allocated O/H- tax) Actual beginning-of-the-year net assets = total assets-current liabilities. Actual 1992 ROI computation- Rochester Plant
Abrams company -Transmission PartsDivision ROCHESTER PLANT Profit & ROI Statement, Dec 31, 1992 Sales revenue.....\$124, 866
COGS.....

.....

73230 Gross Margin..... 51636 Operating expenses.....

20792 Division Expenses assigned.....

11340 corporate expenses assigned.... 3420 Profit before taxes.....

16084 Taxes Imputed.....

. 4825 Profit..... \$11259 * Net Assets Assigned as of

January 1, 1992 Total Assets: Cash & receivable..... \$25000

Inventories

. 12875 Property, plant & equipment at book value.....

.. 86560 Total Assets 124435

Less: current liabilities.....

26135 Net Assets..... \$98300 ROI = Profit / Net Assets =

\$11259/ 98300 = 11. 45% Suggestions to improve evaluation system: * ROI

can be used combination with other performance measures-balanced set of

long term/short term; financial/non-financial * EVA can be used instead of

ROI. Marketing Strategies * Top Management consider OEM & AM different. *

Each parts? OEM sales have to meet an Annual Sales Revenue.

* The OEM department have to..... 1. Minimize inventories. 2. Control cost. *

AM has to concentrate on availability of Parts.

Incentive compensation Plan Appropriate 50 line & staff managers under

plan. * Bonus given on basis of fixed formula. * Each participant get bonus

on standard bonus point(SBP). * SBP based on hierarchical position. Standard dollar award per point (SDAP) = total of SBP of all participants total bonus pool amount Standard Bonus in \$ = Standard Dollar ? Standard Bonus Point Award per point. of Participant.

if Actual Profit \wedge 4% more than budgeted, Manager get 25% more standard bonus. Evaluation of incentive compensation plan: * The performance is measured by compare of actual profit and budget profit. All the measurement is associate with data, sometimes the performance will be influence by variance elements, such as, economic environment, the demand level, material price, cost of labor, and government policy, so the measurement need to improve in some areas. Suggestions: * The non-financial performance measurement system should be established. * The balanced scorecard is a good choice for company measure performance. With a good performance measurement system, the incentive compensation plan will be improved.

Problems encountered with Management * Some dispute over transfer pricing. Bias with AM division on placing order of parts. * All divisions using too much inventories. Question- 1 Evaluate each of the concerns expressed by top management, & if necessary, make recommendations appropriate to the circumstances described in the case. Ans-1 * Management has 3 main problems: 1.

ROI Behavior. 2. Transfer Price disputes 3. Operational trouble shouting. Recommendations * Company should use EVA rather than ROI.

- * Company should control the investments separately using NPV and capital turnover measures.
- * Bonus should be based on the budgeted income level.
- * Company should change the TP method. It will give all internal partners full information about the cost structure and company will avoid “ upstream fixed costs”. Question- 2 What is your overall evaluation of Abrams? management control system ? Describe strengths or weakness that you identified but did not include in answering the previous question.

What changes, if any, would you recommend to top management ? Ans-2 *

Company Management Control System was poor. * Company failed to minimize the cost and to control inventory level. Strength * The company has a clear management structure. * The company has employed a bonus plan for employees. The AM Marketing division will input products from the other three divisions, and sell it to domestic and foreign market, it helps the company save cost when it input internal. Weakness * The Abrams Company has three totally independent divisions, and the three divisions are lack of connection.

- * The transactions between the three divisions dispute the transfer pricing. *
- OEM customers preferred than AM. Suggestions * Top management should try to control inventory level. * Company should use non financial measures like inventory turnover. * If it is an strategic issue company should connect this measure to the bonus system.