CA FINAL - PAPER-6: INTEGRATED BUSINESS SOLUTIONS

"Good business leaders create a vision, articulate the vision, passionately own the vision, and relentlessly drive it to completion."

– Jack Welch, Former CEO of General Electric

Integrated Business Solutions

Business decisions, both short-term and long-term, are based on *strategic objectives*. Effective decisions are those that have a positive impact on productivity & profitability and enhance the *growth prospects* of a business. Effective decision making requires the decision maker to consider a complete, *holistic view* of the business rather than having a siloed approach. Business does not work in silos, it is integrated and interconnected where decisions taken in one area can have a significant impact on other areas. Considering these principles, students are encouraged to integrate their professional values, practical work experience, and knowledge gained from specific academic studies. The goal is to cultivate a skillset capable of crafting well-organized, integrated business solutions.

Integral to the Integrated Business Solutions (IBS) is the 'Case Study', a vital aspect of the CA Final Level. Here, students must apply their knowledge gathered from the five core subjects – Financial Reporting, Advanced Financial Management, Advanced Auditing, Assurance and Professional Ethics, Direct Tax Laws & International Taxation, Indirect Tax Laws; and Self-paced Modules Set A & B. In this journal, we are focussing on those case studies which involve making of 'strategic decisions'. Each 'Case Study' unfolds a unique business situation, presenting a scenario complete with mission, vision, objectives, challenges, key stakeholders, and relevant data. The strategic aspects have been discussed in detail in the answers solely for enhancing your understanding of the concepts. Concept insights have been incorporated at the relevant places. **These case studies are in addition to the case studies webhosted at the BoS Knowledge Portal at URL: https://boslive.icai.org/sm_chapter_details.php?p_id=18&m_id=74.** The aim is to provide a variety of case studies covering different subjects at Final Level and Set A & Set B. Students are advised to work out the case studies webhosted at the portal at the above link and case studies given in the journal to understand the *manner of integration* of different subjects in solving a 'Case Study'.

Strategic decision-making involves a meticulous analysis of the business model and subsequent strategic adaptations. Decisions may range from new product development and market exploration to considering diversification, whether in related or unrelated areas. The choice between related and unrelated areas presents challenges, as stakeholders may resist the later due to perceived risks, potentially impacting market capitalization. In the case of a strategic shift towards a related area, exploration of options such as horizontal integration or vertical integration (whether forward or backward integration) in the supply chain is crucial.

These strategic moves require a lot of financial decisions. In addition to that there is need of robust financial risk management system. Moreover, proper adherence to accounting standard, tax laws and other statutory compliances under the various corporate legislations are fundamental to the strategic decision. Adhering to these standards ensures legal compliance, shielding the company from legal repercussions and fines. It also aids management in allocating resources efficiently and evaluating the performance of various business units or projects based on reliable financial data.

On top of that, good corporate governance, fostering ethical business practices, influences an organization's strategy and performance. This emphasis on ethics is essential not only for business organisations but also for CAs, as stakeholders place enormous confidence in their role. The increasing instances of corporate frauds and subsequent failures, with ripple effects on economies, have increased the responsibilities of CAs to ensure that organizations discharge their reporting responsibilities diligently.

Hence, the integrated approach advocated in Core Paper-6 at the CA Final Level emphasizes the importance of considering interrelated issues spanning finance, accounting standards, assurance, direct tax laws, indirect tax laws, company law, and SEBI compliances alongside strategic decision making.

Solving multidisciplinary 'Case Study' will enhance analytical skills and decision-making skills of students. This holistic and integrated approach ensures that students emerge well-equipped to tackle the challenges presented in the constantly changing business environment.

Indian Tea Sector
An Industry Analysis in Strategic Context

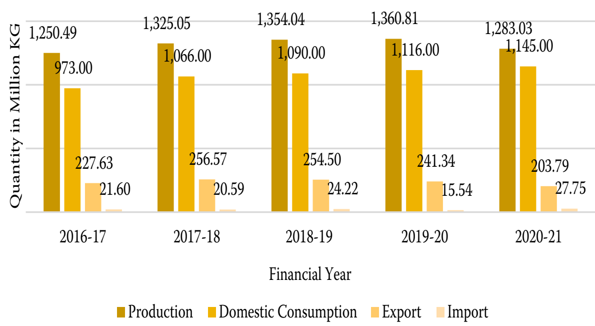
Global Outlook[1]

Tea is a much-loved popular beverage all around the world. It is grown in 36 countries, the major tea producing and exporting countries being India, China, Kenya, and Sri Lanka. Together they account for 81% of the world's tea production and 72% of the world's exports. Per capita consumption of tea varies widely among countries. As per statistics, the per capita consumption in 2018-20 was highest in Turkey (3.20 kg) followed by Libya (2.64 kg), Ireland (2.10 kg), Morocco (2.09 kg), Hong Kong (1.65 kg), United Kingdom (1.61 kg) and India (0.83 kg). The per capita consumption in India is lower due to its huge population size. India accounts for 19.50% of global tea consumption and almost 82% of the total production of tea in India is consumed within the country. This shows that domestic demand for tea is very strong.

Domestic Trends

Tea contributes significantly to the National Agricultural Income and overall Gross Domestic Product of India. It employs around 1.2 million people and contributes to sizeable foreign exchange earnings. Tea is cultivated in 15 Indian States with major producers being Assam, West Bengal, Tamil Nadu, and Kerala. India produces around 1,300 million kgs of tea annually[2]. Major bulk of tea production is from the Northeast India particularly Assam and West Bengal.

Production, Domestic Consumption, Export and Import of Tea 2016 to 2020-21



Tea Processing

Tea plants (botanical name *Camellia Sinensis*) are grown on well drained fertile-acidic soil on high lands. Tea plants are propagated from seed and cuttings. Within three years the plants ready for harvest. If left undisturbed these plants can grow up to 16 meters. However, they are trimmed and pruned to waist height for ease of plucking[3]. Tea is derived from tea leaves. Black, Green, Oolong, White and Pu-erh are the different types of tea produced. Categories of tea are distinguished by the processing they undergo.

Harvesting of tea in different seasons is known as flush that give different variety of tea each season. First / spring flush, second/ monsoon flush and autumn flush are the different harvesting seasons. Green tea leaves are plucked from the tea plants and transformed into "made tea" which is used by the end user to make the beverage. Antioxidants, anti-inflammatory and detoxification properties have given renown to tea as a beverage with health benefits. Global Hot Tea industry is estimated to be around USD 45-50 billion[4]. Black tea remains the largest segment, while non-black varieties are also gaining popularity due to their health benefits.

Producers include plantation companies and small green leaf growers[5]. Many of them operate processing centres where tea is dried, fermented, and cut. In cases where the producer does not have processing centres of their own, the tea leaves are sold to bought leaf factories[6]. Processed tea is then sold to tea companies, which consist of blenders / packers. The tea companies then blend, flavour, and pack the processed tea into tea packets. These tea packets are sold in the market through wholesalers and retailers.

Some tea companies integrate plantation activities with other processes that are involved in the blending, packing, and marketing of tea such that they can exercise control over the different activities in supply chain of the tea industry. The cost structure of these integrated plantation companies includes plantation related costs (labour, agro-chemicals, estate development and maintenance of plantations where tea is grown), various manufacturing-related expenses and marketing costs.

Scheme of Supply Chain[7]

A common scheme of supply chain may be as follows:

Producers: Tea plantation owners who grow tea leaves (plantation companies and small green leaf growers)

Processing centres: Drying, fermenting, and cutting of tea leaves is done here. Most producers own processing centres, typically located within the tea plantation estate.

(processing activities can also be done by the 'bought leaf factories' who convert tea leaves procured from producers into processed tea)

Trade between producers and tea companies (buyers): Tea leaves (processed tea) are sold to tea companies (blenders / packers) primarily through auctions, facilitated through brokers.

(brokers communicate information about demand and supply and thereby can indirectly determine the price of tea)

Tea companies (packers/ blenders): Tea leaves (processed tea) bought from various auctions are then blended together, packed and marketed by tea companies. Hence, they are also called packers or blenders.

Wholesale and Retail dealers: Brings the tea packages to the market to be sold to the final customer.

Consumers: Tea is a global beverage, widely consumed both domestically in tea producing countries as well as international markets.

Do You Know?

Tea industry in India is regulated by the Tea Act, 1953. The Tea Board of India (TBI) constituted by the Government of India (GOI) to performs various regulatory, research and development and marketing functions. Few of the functions include:

(i) Regulate the production and cultivation of tea in India. Tea growers are registered with the Board and are issued licenses to carry out activities like cultivation, manufacturing, sale, and export of tea.

(ii) Monitoring of the tea auction system where bulk tea is sold.

(iii) Improve the quality of tea, promote and assist in research in the field.

(iv) Regulate the sale and export of tea.

(v) Look after the working conditions and pay of workers.

Cost Structure[8]

The tea industry has been facing difficult times in the recent years. On one hand, tea prices have stagnated. On the other hand, tea industry is a fixed cost intensive industry. India has the highest cost of production among major tea producing countries in the world. Productivity of tea plantation determines the cost of production. Unproductive old tea bushes are a major reason for lower productivity, resulting in higher cost of production. The cost of production of tea can be segregated into:

(i) Cost of green leaf: Includes materials, wages and other costs related to the cultivation of tea.

(ii) Cost of conversion of green leaf to made tea:

- Processing cost (power and fuel, repair and maintenance of machinery, depreciation of machinery, factory wages etc.).
- Welfare cost (housing, medical, sanitation, ration, firewood etc. provided to workers).
- Other cost (lease rent, rates, travelling expenses, tea cess, green leaf cess, electricity, water tax, license and selling and distribution expenses and head office expenses).

Cost of production is linked to the productivity factors of different resources like land, plant, labour, machinery, and materials used for the cultivation and production process. For proper planning to reduce the cost of production, it is essential to collect data/ information regarding various cost components of production and analysis of the same.

For long term sustainability of the industry, higher tea prices that can sufficiently cover the cost of production along with a reasonable profit margin would be required. Tea is a labour-intensive industry. There is a shortage of plantation workers due to many of them migrating to other jobs. To combat shortage of labour and to reduce cost of production, mechanization is being gradually adopted by the industry[9] .

Ways to improve profitability[10]

As per a report by ASSOCHAM on the tea industry, suggestions for improving profitability in the long term include:

(i) Increase exports (value and volume): Tea consumption has traditionally been restricted few markets. Exports need to work on expanding their export base by entering new markets and promoting tea consumption there. Improving the quality of tea supplied to traditional markets can help to provide a basis for increasing the average export price. Exports in value added forms like tea bags / packets can also help to support average prices.

(ii) Increase domestic consumption: Increased marketing efforts will be needed to spread awareness about tea, different variety and quality etc. Per capital consumption should be increased from the current level of 0.8 kg.

(iii) Control of supply and quality of tea: Avoid oversupply of tea which can suppress prices. Better tea garden (plantation) practices can improve the quality of tea produced.

(iv) Meeting changing consumer preferences: Health and wellness aspects of tea need to be promoted since current consumption practices are focussed on these aspects. Green tea, herbal tea and other healthy beverages can be promoted in order to meet customer preferences. There is also a preference tea to be available in value added forms like packets and tea bags.

With this strategic perspective in mind, the following are few case studies drafted about the tea industry:

Refresh Tea: This Case Study looks into the integration of a plantation company with other processes within the supply chain to enhance business control. It includes strategies such as exploring new markets through the acquisition of controlling stake in foreign company, implementing customer-centric initiatives like selling tea in the form of tea bags for improved end-user connection. The case study also explores the application of the theory of constraints (TOC) to address bottleneck resources, particularly the available hours at the blending machine. Additionally, it delves into the comprehension of transfer price methodologies.

Prime Tea 1: This Case Study explores the influence of the Just-In-Time production system on the availability of tea packages in the market. It also explores into the application of target costing to enhance profitability, customer profitability analysis, pricing strategy, and the implications of notification no. 12/2017 CT(R) dated 28.06.2017 related to GST.

Prime Tea 2: This Case Study investigates into strategies for enlarging its customer base in the domestic market by restructuring distribution channels, facilitating direct sales to small grocers or local shops. It involves customer profitability analysis, compliance with the Foreign Exchange Management (Overseas Investment) Rules, 2022 concerning the acquisition of a plantation company in a neighbouring country, the use of forward contracts and interest rate swaps.

Note- The Case Studies presented herein include more than the required number of questions, offering students the opportunity to practice a diverse range of concepts.

[1]Source: Report of the CAG on 'Role of Tea Board India in Development of Tea in India' (2023), p.6

[2]Source: Report of the CAG on 'Role of Tea Board India in Development of Tea in India' (2023), p.7-8

[3]Source: Report of the CAG on Role of Tea Board India in Development of Tea in India (2023), p.3

[4]Source: Tata Consumer Products Limited, Integrated Annual Report (2022-23), p.192

[5]Tea growers having land holding of their plantation up to 10.12 hectare (25 acres) are considered small tea growers

[6]Bought-leaf factories are units that buy these tea leaves and convert them into the processed tea

[7]This basic supply chain is designed to assist students to understand the industry in Indian scenario only

[8]Source: Report of the CAG on Role of Tea Board India in Development of Tea in India (2023), p80

[9]Source: Report of the CAG on Role of Tea Board India in Development of Tea in India (2023), p.82

[10]Source: Tea industry at the crossroads (ASSOCHAM), p.17

Case Study-1

About Case Study	
Industry	Tea- Plantation, Drying, Fermenting, and Cutting
Subjects	Strategic Cost Management, Financial Reporting, Auditing, Direct Tax
Topics	Porter's Five Forces, Control of the Supply Chain via Horizontal or Vertical Integration, Ind (AS) 41, SA540, Mendelow's Matrix, Value Proposition, Theory of Constraints, Transfer Pricing, Agriculture Income

Refresh Tea Ltd.

Refresh Tea Ltd. (RTL) was established in 1935 and headquartered in Kolkata. The company owns several plantations in North-East India (Assam and West Bengal) and South India (Kerala, Tamil Nadu, and Karnataka). It started out as a producer of tea leaves. They have their own processing centre within their plantation estates (or tea gardens) to dry, ferment, and cut the tea leaves. The company would then auction the leaves to traders, who in turn would sell them to tea companies (downstream supply chain) in order to be blended, packed, and resold to the customer. RTL continued to be a producer of tea leaves until the mid-1980s, until which time it only auctioned the tea leaves to the traders.

Over the decades, the popularity of tea as a beverage increased manifold due to clever and attractive marketing campaigns. Marketed as a health drink that could provide relief for ailments like cold, flu or body ache, tea as a beverage slowly became popular across the country. Tea has both an organized branded (pre-packaged) market as well as unorganized unbranded market (loose lot sale). Different versions of brewing and making tea were practiced, and this concocted a success story of exponential proportion.

Increasing popularity of the beverage prompted RTL to expand the scope of its business. It wanted to continue its plantation business, but now it also wanted to expand its business to include the blending, packaging, and marketing of tea. RTL would increase the production of tea leaves in its plantations using both its existing estates as well by acquiring newer tea estates to increase production capability. All tea leaves will be processed further (dried, fermented, and cut) at the processing centres within its plantations. The management of RTL decided that it would from this point, also start blending, packaging, and marketing its own tea. For this, it built and gained ownership of the necessary factory resources and infrastructure for blending, packaging, and marketing its tea. Production resources and infrastructure were owned and controlled by RTL. This packaged tea will be sold directly to wholesalers and retailer dealers who would in turn sell it to the final customer.

When RTL decided to become a full-fledged tea company by the mid-1980s, the market was saturated with many sellers. Most of them bought tea leaves from traders at various auctions, blended, packaged, and marketed the tea. For these other suppliers, it took approximately 80 days from the time the tea leaf was plucked to the time the consumer purchased it. They catered to consumers from all strata of society. Premium tea dominated the branded market, while people who could not afford it were satisfied with the unbranded loose tea that could be bought as per their individual requirements. RTL decided to establish itself in the branded market. Unbranded loose tea was perceived to be of lesser quality as compared to branded pre-packaged tea and therefore could not command much price in the market.

RTL conducted detailed market research and found that consumers from different regions had different taste preferences. For example, consumers in Bihar and Jharkhand preferred tea leaf while consumers in Maharashtra and Gujarat preferred tea dust. RTL therefore created different brands that catered to different markets (in terms of taste preference - leaf or dust tea) as well as different price bands (economy or premium). The quality of RTL's pre-packaged branded tea was kept higher than the unbranded tea sold in loose lots, and at the same time, the price of its packaged tea was kept slightly lower than the other premium varieties available in the market. Thus, RTL decided to place itself in the middle of this market spectrum in terms of quality and cost. So, it sold premium brand leaf tea as well as economy brand leaf tea in Bihar and Jharkhand, while it sold premium dust tea and economy dust tea in Maharashtra and Gujarat. As part of its marketing strategy, it created a separate brand for each target customer audience so that the quality and price could be easily recognized by the end user. RTL further aimed to deliver the tea to the final customer within 20 days from the time the tea leaf was plucked from its gardens.

The new vision statement of RTL was then reframed as *"to be the most admired tea company across the globe."*

The new mission statement of RTL was then reframed as *"to enhance customer experience by making tea a global beverage of choice. Understand and influence tastes and preferences by bringing unique, quality, affordable tea to the discerning palate of customers."*

Today, in 2023, the total Indian tea market is estimated to be ₹34,400 crore, with branded businesses constituting approximately 74% of the total market value. The global tea market is estimated to be $45-50 billion, with the main demand coming from the black tea segment. RTL has emerged as the market leader, commanding 60% of the domestic Indian tea market. It is now a listed company at BSE and NSE stock exchanges. Demand in other segments like green tea, fruit & herbal, decaf, and speciality tea among others is also picking up. Taking note of this new trend, RTL conducted market research and a survey done of the entire beverage industry to gather market intelligence and emerging customer choices. The findings reveal that consumers are becoming more health conscious in their choices. In the past 2 years, demand for fruit juices, coconut water, almond milk, and milk shakes has increased. According to the study, the shift towards healthier beverage choices like fruit juices, coconut water, almond milk, and milkshakes is projected to grow and encompass at least 8% of the beverage market within the next three years.

Tea King Plc. (TKP) is a UK based company that produces tea bags. Small sachets of tea (tea bags) are dipped into hot water in order to brew conveniently within a cup. The sachets can be conveniently disposed of after use. Tea bags are hugely popular across the globe, primarily due to the convenience of use and disposal. "Anywhere-Anytime" is a highly recognized tagline for TKP's tea bags. The company has a net worth almost three times that of RTL. TKP has a deep market presence in the United Kingdom and the United States of America, as well as a few other European countries where tea is relished as a beverage. Despite its huge global presence and scale, the ownership of TKP has changed hands frequently every few years. This is because the profitability of the business is constantly under pressure due to the high input costs of tea, driven by inflationary conditions. TKP imports tea leaves (its raw material) from various countries, and the cost of imports has become more expensive over the years.

RTL has recently gained the opportunity to own a controlling stake in TKP. This is a prestigious development for RTL, as it has been trying to increase its global footprint, particularly in the UK and USA. The advantage the company has that most of the previous owners of TKP did not have, is that RTL has better control over the supply of raw materials. India is one of the major tea producing countries. RTL has been in the plantation business since its inception. Hence, RTL is much better positioned to scale up tea leaf production to meet TKP's raw material requirements in a cost-effective way, thereby countering any inflationary pressure. However, since the size of the deal is much bigger than even RTL's net worth, it has to resort to taking significant amount of debt to finance the deal. The deal has the approval of the majority shareholders, and other regulatory approvals are in place.

In the dynamic field of tea production, external factors such as unpredictable weather conditions can severely affect operations. Recognizing the importance of proactive risk management, RTL has implemented a comprehensive strategy to mitigate potential disruptions and protect its plantations specifically in northeastern region. This includes ensuring adequate insurance coverage, positioning RTL to effectively navigate the uncertainties associated with cyclones and adverse weather events. RTL's financial statements are prepared in accordance with Indian Accounting Standards (Ind AS) notified under the Companies Act, 2013.

Scenario-1

The induction program for new hires is underway. They are being introduced to the history of tea in India as well as how RTL grew to be a leading player in this market. One of the new inductees asks:

"What is the rationale behind RTL's decision in the mid-1980s to expand its operations into a saturated market? It could have maintained the status quo as a plantation company producing tea leaves. Why did it have to get into the blending, packaging, and marketing business as well? Also, how did RTL manage to become a market leader despite the competition?"

Required

You are being the Deputy Manager (Finance & Strategy) at RTL, have been requested to provide your explanation behind the rationale behind this business decision taken in the mid-1980s. Also, based on the information in the case study, ASSESS the company's success in a competitive market.

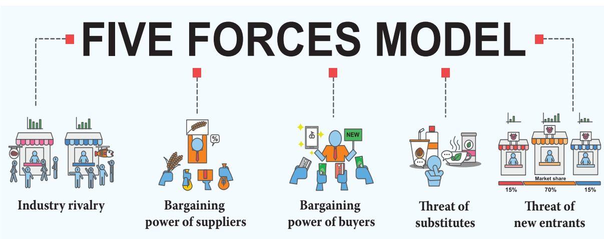
Answer

In a competitive environment, a business must craft its strategies not just to survive but also to sustain itself. RTL started out as a tea leaf producer, owning plantation tea estates to grow tea. While it had control over the production, it did not have as much control over the price at the auction. If you refer to scheme of Supply Chain for Tea, it is the brokers who had more influence over the auction price as they had more complete information about both the supply and demand for tea. Hence, the revenue generation flexibility for RTL was being limited by the influence of brokers, who acted as the middlemen for the plantation owners (tea growers) and the tea companies (tea blenders and marketers). Over the decades, the popularity of tea as a beverage increased the competition. Recognizing this change, the management of RTL had ***to study the external environment*** and understand how it could determine its strategy in order to survive and thrive within this competitive business. RTL became agile and responsive to change. This resilience made it competitive and became the primary reason for its success in the competitive market.

Concept Insight

The study of the external environment requires the study of the remote environment and operating environment of the industry including the competitive environment. To analyse the operating environment of an industry, it is important to consider all the factors that affect profitability as well as the competitive position of business organisations within it. These factors can be grouped into elements such as customers, competitors (existing as well as potential entrants), suppliers, advocacy groups, regulations, regulatory groups, and many other elements such as industry life cycle, supplier's suppliers, and buyer's buyers, etc. Basically, it considers the wider picture through factors that are capable to decide the growth trajectory in addition to future profitability. Intensity of industry competition can be understood using Michael Porter's five forces model.

Porter's five forces helped RTL to identify where power lied in business situation. This was useful both in understanding the strength of RTL's current competitive position and the strength of a position that RTL might consider entering.



The five forces that were enumerated by this model are given below:

Threat of new entrants: Tea as a beverage was gaining popularity, so demand growth was increasing at an exponential pace. In turn, this made the *industry attractive* for new players to enter. This meant that *competition in the market was likely to increase* across the value segments (including the production of tea leaves) within the tea industry. RTL was an incumbent in this sector, as it already owned many plantations for producing tea leaves.

To Counter Competition, the management expanded its scale of operations. It increased the production of tea leaves (the raw material source) and branched out into allied processes within the industry value chain like blending, packaging, and marketing. It also owned and controlled its resources. This increase in *scale of operations* gave it a competitive advantage that not many new entrants may have had.

Bargaining power of suppliers: As mentioned in the case, many of the sellers in the saturated tea market bought tea leaves from traders at various auctions, blended, packaged, and marketed the tea. These brokers at auctions could influence the price of tea since they had information on both the demand and supply sides of the business. RTL was already a supplier of tea leaves (the raw material) and had wanted to branch out further in the industry value chain by expanding its operations. Moreover, it wanted to reduce the operating cycle by delivering good quality tea to the customers within 20 days. As part of its brand strategy, RTL also wanted to bring variety to its product offerings in terms of both quality (premium vs. economy) and type (leaf vs. dust). *Uninterrupted supply of appropriate quality tea leaves is a critical requirement to ensure both a quick operating cycle and ability to produce a variety of tea catering to different brand requirements.*

Therefore, *it increased the scale of its production of tea leaves (raw materials) by increasing production in existing plantations as well as acquiring newer plantations. Ownership of these plantations gave the company better control over the supply of tea leaves. Unlike other sellers in the market, it did not depend on auctions to procure tea leaves.* All this helped it to gain control over the supply of its tea leaf requirements. Reduced dependency on auctions or other suppliers also contributed to its success.

Bargaining power of buyers: RTL entered a market that was both saturated and highly competitive. When RTL entered the market, there was a premium segment and an economy segment. *The presence of many suppliers indicates that buyers had a choice to switch between different tea offerings; therefore, there was no preference for a specific brand. In order to build a loyal customer base, RTL had to differentiate itself from other tea offerings.*

RTL redefined itself with as a customer centric business model. The *quality of tea was kept higher than in the unbranded category by reducing the operating cycle and ensuring that the tea reaches the customer in its freshest form. At the same time, the price of its tea was kept lower as compared to other premium tea in the market.* Its multi brand strategy, based on different quality and price expectations, helped it to connect with the different sets of customers, each with unique tastes and preferences. Each brand had a unique identity that the customer could easily understand and know what to expect from the product. This multi brand strategy established an important connection with the end user, helping it build a loyal customer base.

Threat of substitutes: Until the recent year, *there was no immediate threat of substitute.*

Note- The recent market research and study of the beverage industry reveal that RTL needs to consider healthier options like fruit juice, coconut water, almond milk and milk shakes as possible substitutes for tea. These healthy drinks may constitute approximately 8% of the total beverage market in 3 years. RTL *has to consider this as a rising threat of substitutes and strategize accordingly.*

Rivalry among existing firms: Rivalry was addressed by RTL by changing its scope and scale of business operations so that it could exercise better control over different processes in the value chain. Having *better control over supply side of business while having the resources to remain agile to the requirements of the demand side of business helped RTL become a leader in the market despite the competition.*

Overall, RTL used its multi brand strategy, based on different quality and price expectations, to help build a product differentiation strategy. By expanding its operations into other processes in the value chain like blending, packing, and marketing, *the company could study about the variety and change in taste and preferences of customers.* This gave the company *more credible information about the demand side of the business.* The company could segment the market based on certain criteria so that customer demand could be catered to by addressing their unique needs. This customer centric business model for RTL helped it identify differentiating factors that can help it beat competition.

Scenario-2

At RTL's Darjeeling plantation site, manufacturing process commences with the plucking of tea leaves from the plantation. Once the tea leaves are harvested, they are transported to the internal processing centres to continue the manufacturing process.

The local accountant at the site is currently preparing site's financials in accordance with Indian Accounting Standards (Ind AS) under your supervision.

Required

She has raised the following questions –

(i) Whether these plucked tea leaves are agriculture produce as per Ind AS 41 or not?

(ii) How should such plucked tea leaves be initially measured?

(iii) What will be subsequent measurement of such tea leaves in line with Ind AS 41 and Ind AS 2? [VERB- APPLY]

Answer

(i) Paragraph 3 of Ind AS 41, Agriculture states that:

Ind AS 41 is applied to agricultural produce, which is the harvested produce of the entity's biological assets, at the point of harvest. Thereafter, Ind AS 2, 'Inventories' or another applicable Standard is applied. Accordingly, Ind AS 41 does not deal with the processing of agricultural produce after harvest; for example, the processing of grapes into wine by a vintner who has grown the grapes. While such processing may be a logical and natural extension of agricultural activity, and the events taking place may bear some similarity to biological transformation, such processing is not included within the definition of agricultural activity in Ind AS 41.

In the given case, RTL produces tea by processing tea leaves after they are plucked from tea plants, i.e., after they are harvested. Accordingly, any processing of harvested agricultural produce (processing of tea leaves into tea) will not be within the scope of Ind AS 41 as per aforementioned paragraph 3 of Ind AS 41.

Paragraph 5 of Ind AS 41, 'Agriculture' defines agricultural produce:

As per the standard as the harvested product of the entity's biological assets.

A biological asset is a living animal or plant.

Based on above definitions, at the point of harvest, the plucked leaves are the harvested product of tea plants which are the biological assets of RTL, hence such plucked tea leaves are agricultural produce as per Ind AS 41.

(ii) Paragraph 13 of Ind AS 41 states that:

Agricultural produce harvested from an entity's biological assets shall be measured at its fair value less costs to sell at the point of harvest. Such measurement is the cost at that date when applying Ind AS 2 'Inventories' or another applicable Standard.

Therefore, in line with paragraph 13 of Ind AS 41, the fair value less costs to sell of the plucked leaves at the point of harvest would be the cost of such plucked leaves at the date of applying Ind AS 2.

(iii) Subsequently, such plucked tea leaves will be measured as inventory as per the accounting principles of Ind AS 2, 'Inventories'.

Scenario-3

In the process of preparing the financial statements for the financial year ending on 31.03.2023, the management of RTL has made several accounting estimates and affirmed to the auditor that all necessary accounting estimates have been recognised, measured, and disclosed in the financial statements are in accordance with the applicable financial reporting framework. However, in the course of the audit, auditor has observed some changed circumstances giving rise to the need for an accounting estimate.

Required

ENUMERATE some circumstances, change of which would prompt inquiries from the management of RTL.

Answer

As per SA 540, "Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures", inquiries of management about changes in circumstances may include, for example, inquiries about whether:

- The entity has engaged in new types of transactions that may give rise to accounting estimates.
- Terms of transactions that gave rise to accounting estimates have changed.
- Accounting policies relating to accounting estimates have changed, as a result of changes to the requirements of the applicable financial reporting framework or otherwise.
- Regulatory or other changes outside the control of management have occurred that may require management to revise, or make new, accounting estimates.
- New conditions or events have occurred that may give rise to the need for new or revised accounting estimates.

During the audit, the auditor may identify transactions, events and conditions that give rise to the need for accounting estimates that management failed to identify. SA 315 deals with circumstances where the auditor identifies risks of material misstatement that management failed to identify, including determining whether there is a significant deficiency in internal control with regard to the entity's risk assessment processes.

MCQ-1

Which of the following statement is true regarding the current expansion plan of RTL (acquisition of TKP) and the expansion of RTL in the mid-1980s?

(a) Current expansion plan of RTL (acquisition of TKP) is horizontal integration, while expansion in the mid-1980s is vertical integration

(b) Current expansion plan of RTL (acquisition of TKP) is vertical integration, while expansion in the mid-1980s is horizontal integration

(c) Current expansion plan of RTL (acquisition of TKP) and the expansion in the mid-1980s are both vertical integration

(d) Current expansion plan of RTL (acquisition of TKP) and the expansion in the mid-1980s are both horizontal integration

Answer

The correct answer is - (a) Current expansion plan of RTL (acquisition of TKP) is horizontal integration, while expansion in the mid-1980s is vertical integration.

Reason

TKP is in the same business as RTL. There is a difference, TKP produces tea bags while RTL produces tea packages. However, both belong to the same industry, catering to different requirements within the tea market. The acquisition of TKP will help RTL grow in size and revenue by diversifying into new markets with newer products of tea. Therefore, this is a horizontal integration.

The expansion of RTL in the mid-1980s to include other processes in the value chain like blending, packing, and marketing is a vertical integration. RTL, at that point in time, was only in the plantation business. As expanded into other activities in order to get better control of the supply chain, RTL gained control over additional processes in the production of tea as well as the cycle time to deliver to customers. This helped to penetrate the existing tea market in India. This is vertical integration.

MCQ-2

The regulatory authorities in India have to assess whether there is any breach of the anti-competition laws. Which type of stakeholder will the regulatory authorities be classified as using Mendelow's Matrix?

(a) The regulatory authority is a marginal player with low interest and low power

(b) The regulatory authority is a key player with high interest and high power

(c) The regulatory authority is an influencer with low interest and high power

(d) The regulatory authority is an affected player with high interest and low power

Answer

The correct answer is- (c) the regulatory authority is an influencer with low interest and high power.

Reason

The authorities have a low interest in whether the acquisition is successful or not. However, they have a high power since if there is any indication that this acquisition can give RTL unfair advantage to stifle competition, they can refuse to approve the acquisition deal or may take action against the business. Hence, enough information should be provided to keep them satisfied in order to not face any adverse action.

MCQ-3

TKP has used the tag line "Anywhere-Anytime" to market its tea bags. With reference to the value proposition map, please match the following –

Particulars	Element of the value proposition map
a. Brewing tea	i. Customer Profile: Gain
b. Customer health	ii. Value Map: Gain Creator
c. Green tea	iii. Value Map: Pain Reliever
d. Tea bag	iv. Customer Profile: Pain

Options

(a) a- i, b- ii, c- iii, and d- iv

(b) a- i, b- iv, c- iii, and d- ii

(c) a- iv, b- i, c- iii, and d- ii

(d) a- iv, b- i, c- ii, and d- iii

Answer: The correct answer is- (d) a- iv, b- i, c- ii, and d- iii.

Reason:

Brewing tea is a pain that the customer faces; Customer Profile: Pain.

Customer Health is a gain or aspiration for the customer; Customer Profile: Gain.

Green tea addresses the customer's aspiration for good health; Value Map: Gain Creator.

Tea Bag brings the convenience of brewing tea anywhere at anytime; Value Map: Pain Reliever.

MCQ-4

The blending machine at Nagaon (Assam) Factory blends tea leaf varieties produced in the plantations of RTL. Due to increased seasonal demand during the monsoon, the production of tea increases in this factory for the months of May, June, and July. Due to this, the availability of time on the blending machine is limited during these months. There is no immediate plan to increase the blending machine capacity since this is a seasonal variation in demand, and hence the constraint is short term in nature. At the same time, the production manager at Nagaon Factory wants to determine the order and quantity of tea blend to produce in order to maximize profits. The selling price and cost per kg., as well as bottleneck production details are as below:

Particulars	Blend 1	Blend 2	Blend 3
Selling price (in ₹)	500	600	800
Material and other variable cost (in ₹)	300	400	500
Time required at the blending machine (minutes); Bottleneck resource time	20	30	40

The factory cost is ₹5 per minute. The manager wants to rank the blends based on the throughput accounting ratio. This will be used to plan the production schedule for the months when blending time is a bottleneck constraint.

Which of the following statements is true?

(a) Ranking based on throughput accounting: Rank 1 – Blend 1, Rank 2 – Blend 2, and Rank 3 – Blend 3

(b) Ranking based on throughput accounting: Rank 1 – Blend 1, Rank 2 – Blend 3, and Rank 3 – Blend 2

(c) Ranking based on throughput accounting: Rank 1 – Blend 2, Rank 2 – Blend 1, and Rank 3 – Blend 2

(d) Ranking based on throughput accounting: Rank 1 – Blend 3, Rank 2 – Blend 2, and Rank 3 – Blend 1

Answer

The correct answer is (b) Ranking based on throughput accounting: Rank 1 – Blend 1, Rank 2 – Blend 3, and Rank 3 – Blend 2.

Reason

The calculation is as below:

Particulars	Blend 1	Blend 2	Blend 3
Selling Price (in ₹)	500	600	800
Less: Material and Other Variable Cost (in ₹)	300	400	500
Throughput Contribution (in ₹)	200	200	300
Time Required at the blending machine (minutes)	20	30	40
Contribution per minute (in ₹)	10.00	6.66..	7.50
Factory Cost *per minute* (in ₹)	5	5	5
Throughput Accounting Ratio (*TA Ratio = Contribution per minute / Factory Cost per minute*)	2.00	1.33..	1.50
Ranking as per TA ratio	I	III	II

MCQ-5

RTL has divisions like plantation, processing, blending, packaging, etc. The popularity of tea has increased the demand for tea leaves in the market. Many tea companies do not own any plantations of their own. They purchase the tea leaf directly from the tea auctions. RTL uses only the tea leaf produced within its own plantations in order to have control over the quality and price of different tea blends. The tea leaves, once plucked, are transferred to the processing units within the plantations. The company has a transfer pricing policy for any internal transfer within the divisions. Plantations are producing at their full capacity. Brokers from the external market are offering the plantation division a price of ₹200 per kg. of plucked tea leaves, while the marginal cost of production has been determined at ₹170 per kg. The net marginal price (selling price – marginal cost) at the processing division is ₹210 per kg., while the price at which the processing centre can purchase tea leaves (procurement price of similar quality) from other plantation suppliers is ₹205 per kg. Note, selling price for the processing division is actually the transfer price it charges the blending division for each kg. of processed tea.

The managers of each unit have their performance assessed based on the surplus each division generates. Which of the following transfer pricing range will bring goal congruence between the plantation division and the processing division?

(a) Minimum ₹170 per kg. – maximum ₹210 per kg. of tea leaves

(b) Minimum ₹200 per kg. – maximum ₹210 per kg. of tea leaves

(c) Minimum ₹200 per kg. – maximum ₹205 per kg. of tea leaves

(d) Minimum ₹170 per kg. – maximum ₹205 per kg. of tea leaves

Answer

The correct answer is- (c). Transfer price range for tea leaves should be minimum ₹200 per kg. – maximum ₹205 per kg. of tea leaves.

Reason

The plantation division is operating at full capacity, with an external demand for its tea leaves at ₹200 per kg. Hence, although its marginal cost is only ₹170 per kg., it should charge the opportunity cost of ₹30 per kg. that it would have earned had it otherwise sold in the external market. For the processing division, tea leaves can be bought externally at ₹205 per kg. Hence, although its net marginal revenue is ₹210 per kg., that it can afford to pay upto ₹210 per kg. and still remain profitable, the division will be unwilling to pay beyond ₹205 per kg. (external procurement price). Hence, the transfer price range that can promote goal congruence will be minimum ₹200 per kg. – maximum ₹205 per kg. of tea leaves.

The ideal transfer price should be ₹200 per kg. which will give the plantation division the normal profit it would have otherwise earned from external sales, while the processing unit can procure it at a much lower cost than the external buy-in price. The transfer price will be negotiated by the managers of the respective division; hence, the final price within the above range will depend on the bargaining skills of each manager.

MCQ-6

In August'2023, RTL's tea estate in Jellalnagar, Karimganj district, received ₹10,00,000/- as compensation from an insurance company for severe damage to green leaves caused by a hailstorm. A trainee accountant (tax) at the Head Office believes that the entire receipt under the insurance policy, pertaining to damage caused by the hailstorm to tea leaves, will be assessable as income from other sources. Evaluate this view.

(a) The accountant's view is correct; the entire compensation is assessable as income from other sources.

(b) The accountant's view is incorrect; no part of the compensation consists of manufacturing income, and it cannot be apportioned under rule 8 between manufacturing income and agricultural income. Therefore, income will be agricultural income.

(c) The accountant's view is incorrect; only a portion of the compensation is assessable as business income.

(d) The accountant's view is incorrect; the entire income would be treated as business income.

Answer

Option B is correct.

Reason

Compensation received from an insurance company for damage caused by hailstorm to the green leaf is fully agricultural income and no part of such compensation consists of manufacturing income. Therefore, cannot be apportioned under rule 8 between manufacturing income and agricultural income.

Concept Insight

Vertical integration is a competitive strategy wherein an organisation takes complete control over one or more stages in the production or distribution of a product. It can involve integrating with units that supply raw materials (backward integration) or with the distribution channels that carry its products to the end-consumers (forward integration). On the other hand, *horizontal integration* is another competitive strategy employed by organisations. Horizontal integration takes place when an organisation acquires a competing business.

Case Study-2

About Case Study	
Industry	Tea- Blending and Packaging
Subjects	Strategic Cost Management, Indirect Tax Laws, Corporate and Economic Laws, Auditing
Topics	Just in Time, Customer Profitability Analysis, Startup, Target Costing, Pricing Strategy, Notification No. 12/2017 CT(R) dated 28.06.2017, Schedule 1 Transactions - FEMA 1999, Internal Control Questionnaire

Prime Tea Private Limited-1

Prime Tea Private Limited (PTPL) was established in 1938, headquartered in Kolkata. The company is privately owned by the Triboovandas family members, who have been in the tea business for the past 3 generations. Mr. Bhushan Triboovandas started out as a broker in the Siliguri Auction Centre. In due course, he started a tea blending and packaging company, PTPL in Kolkata. Tea leaves are blended and packed at its production facilities and sold further to tea distributors. Tea distributors in turn sell the packages to other smaller wholesalers or large retail outlets. Retail chains across India stock tea packages blended by PTPL.

In smaller cities and towns, where there is no presence of proper distributors, PTPL has local sales agents that it hires on contract to sell tea to small grocery stores and other local shops. Goods are sent to these local agents on consignment. Tea packages have a long shelf life and can be stored up to a year if stored in appropriate conditions. PTPL commands a moderate 8% market share in terms of sales in the Indian Market.

PTPL has been a profitable business for most of the years of its existence. The past many years have seen significant inflationary trends in the economy. Like many other companies, PTPL too has been enduring the increase in tea leaf price, which is the primary raw material. To combat reducing profit margins due to inflation, it has concocted a uniform blend that it sells under the brand name "A1 Tea". The blend is prepared by mixing few popular tea flavours into one. This concoction was done with the help of an expert tea sommelier a decade back. PTPL has used same composition over the last many years. The tea that PTPL prepares under the "A1 Tea" is of the black tea variety, which is the most popular tea variety consumed in India.

The Indian marketplace is crowded with many tea companies like PTPL. In retail outlets and grocery stores shelves stocking tea beverage have many brands stocked together. There is nothing much to differentiate PTPL's "A1 Tea" brand from the rest. Brands have to fight to gain visibility among customers and this is done using attractive packaging, increasing advertisement spend, etc. Hence, customers are more price sensitive rather than conscious about quality of tea.

Today, in 2023 the total Indian Tea market is estimated to be ₹34,400 crore with branded business constituting approximately 74% of the total market value. The global tea market is estimated to be $45-50 billion with the main demand coming from the Black Tea segment. Demand in other segments like Green Tea, Fruit & Herbal, Decaf, Speciality among others is also picking up. Despite optimistic prospects, the management at PTPL observes stagnation in tea sales rather than growth.

Currently, PTPL supplies tea to 300 distributors across India. An investigation into this revealed that many of the distributors are also distributors for competitors of PTPL. The investigation further revealed that in the past 3 years, many times PTPL has delayed the delivery of orders to these distributors. When distributors run out of "A1 Tea" packages, they place an order with the company for stocking up their inventory. Meanwhile, orders from retail outlets and smaller distributors keep coming in, which need to be met by the distributors on time. Hence, if the packages of "A1 Tea" are not replenished in time, distributors instead sell packages of another rival company to meet the order demand on time. The retail outlets and smaller distributors (who are customers of the distributors) are largely indifferent to which brand of tea. As mentioned in the paragraph above, this is because there is not much to differentiate "A1 Tea" from the rest of the brands of similar variety.

A further investigation for the reason for delays in meeting restocking requests of distributors was undertaken. The delayed sales delivery is costing the company in the form of lost opportunity sales. The study of this problem reveals that PTPL has been following Just in Time (JIT) production in its production facilities. This was implemented around 3 years back by the production manager who had wanted a lean production system. Accordingly, the tea blending process happens only when a distributor places an order for tea packages with PTPL. A typical order size would be 50,000 packages a month from each distributor. In a month at least 200 distributors place orders with PTPL.

The raw material in the form of tea leaves is stocked in advance by buying tea from various auctions. Since "A1 Tea" is a blend of popular tea flavours, it requires a mix of tea leaves providing those different flavours. It was found that these different types of tea leaves had different growing, cultivation cycle and were grown in different plantations spread across India. Hence, while stocking up for raw materials, it does happen many times that a particular type of tea leaf is unavailable at that auction centre. In such cases, the tea leaf has to be sourced from some other auction centre or sometimes directly from the plantation. These delays increase the lead time for procurement for tea leaves. The purchase manager at PTPL has not taken any initiative to resolve the problem and reduce the lead time for procurement. Hence, because the entire raw material of the required varieties of tea leaves are always not readily available, it has many times happened that there have been delays in the production of the blended tea. Since the production is JIT system based, PTPL does not have buffer stock of blended tea (finished product) from which it could try to meet the order requirements at least partially. This is the primary reason for delays in sales delivery, which has resulted in the distributors preferring to sell rival tea brands.

Mr. Kumar, son of Bhushan Triboovandas is the CEO of PTPL. Last month, he called the senior management of the company to understand the reason for stagnating sales. This month, there was a follow up meeting where the findings of the investigations detailed above, were presented to him. On presentation of the findings, an argument ensued between the sales, production and procurement managers defending their department and function.

Sally, the sales manager: "*I am facing the brunt of this problem. It is already very difficult to sell "A1 Tea" as it does not enjoy very high visibility due to which the end user customer is indifferent to the brand and its quality. Distributors also do not get any additional incentive to sell "A1 Tea" since the profit margin they derive is just the same from any other brand. While I am trying my best to promote and sell our tea, I am not given sufficient support by Pam from our production department. Others too need to do their job well in order to sustain sales. Is that not the least I can expect?*"

Pam, the production manager: "*My hands are tied, we have best in class blending machines that can blend tea in huge quantities on very short notice. The short turnaround time for sales delivery was considered while implementing the JIT production system 3 years back. This is the reason why we had these high-performance machines installed in the first place. I just need a phone call from Sally and my machines are ready to do the job. My department cannot be blamed for delays if the requisite raw materials are not available. Procurement is Sam's responsibility; she should be made accountable for this.*"

Sam, the procurement manager: "*It is unfair to lay the entire blame on me. I have no information about what the production is going to be during the month. I need at least 1-month advance notice if not more, to ensure that raw material supply is uninterrupted. Perhaps my colleagues here have forgotten that tea leaves are agricultural produce that cannot be grown on the drop of a hat. I need time to get the varieties of leaves from different auction locations across India to our storage facility here in our plant. Certain varieties are available only for few seasons, hence procuring them during off seasonal months is very difficult. While JIT production may work fine for blending, JIT procurement is impossible for tea leaves. I need advance notice of raw material requirements. Without this information, I cannot ensure their supply.*"

Mr. Kumar says "*Right from my father's days, all departments had complete understanding of each other's requirements. We have never felt the need to have information systems in place. All that was required was a phone call between the managers for the business to be done. Of-course, over the years we have grown in scale. However, this has led to gaps in passing on information. How can we resolve this*?"

Scenario-1

Anticipating heated arguments, Mr. Kumar on behalf of PTPL, has hired you as a management consultant to guide the company on ways to improve its sales and increase its market share. Your priority is to resolve the issue of delayed sales delivery to the tea distributors. Reduction in instances of lost sales opportunities will dramatically improve the sales for PTPL and grow its market share.

Required

Write a brief note addressed to the senior management, ADVISE critical points that need to be attended to in order to resolve this issue.

Answer

Let me begin with Mr. Kumar's observation that there are no information systems in place despite the company growing in scale over the years. As correctly pointed out, there are gaps in passing on information which has resulted in delays and thereby lost sales opportunities.

JIT production system works will work well only when PTPL can *anticipate the demand patterns* of distributors for "A1 Tea". It is of paramount importance therefore, that the sales forecast be as accurate as possible. This role will primarily be driven by Sally, the sales manager. She has to study the demand patterns, interact with distributors to understand the market and customer needs. Once, the sales order trend is understood, Sally has to prepare a monthly plan for expected sales. This can be drawn in anticipation for the entire year. This plan will then give the company an idea about the output required to be produced to meet the distributor's demand in its entirely and on time.

The production manager, Pam has implemented the JIT production system 3 years back. The problem of delays in meeting sales orders also began around that same period. This provides a reasonable ground to conclude that the lost sales opportunities could be linked to the type of production system followed at the production centre. If production has to happen seamlessly, the raw material should be available on demand. Hence, *there is a requirement for information to flow from sales to production and to procurement departments*. Sally has to share the sales plan with both Pam and Sam, the production and procurement managers respectively. When the expected annual output needed is known, production and purchasing can align their functions accordingly.

Pam, the production manager has to then co-ordinate with Sam the procurement manager and discuss the production schedule. Any specific requirements have to be discussed, for example the requisite grade of tea leaves, any other technical aspect that needs attention. If a JIT production system is to be followed, there may not be much time for quality check of the raw material input or to look into certain technical specifications at the last moment. Any misunderstanding or lack of information will lead to delays in production and the system will not be Just in Time at all.

Coming to raw material procurement, the raw material tea leaves have to be adequately stocked up. Being an agricultural produce, a JIT procurement system may not always be feasible. Moreover, different varieties of tea have to be procured from different auctions in different geographical locations. All this *increases the lead time for procurement of tea leaves* (the raw material for blended tea). However, the sales, production and purchase manager have to co-ordinate to ensure that there are no delays in availability of raw material for immediate production. Tea leaves are procured at auctions from across India. Sam has to ensure that there is always adequate stock of the required varieties of tea leaves based on the likely production schedule shared by Pam. Sam *can even consider the possibility of having buffer stock* in order to meet any rush requirements. These off-course would be *subject to the available storage space, cost of storage and any resultant loss or waste on storage.*

Further the production manager can consider the possibility of **"making to stock"** instead of using "JIT which is making to order". It is mentioned that packaged tea has a *long shelf life*, if stored in appropriate conditions. Also, procurement of tea leaves requires lead time and co-ordination between the company and brokers at auctions or sometimes even with tea plantations when the variety in unavailable. Company can explore the possibility of having *long term contracts with brokers or plantations* for its tea leaf requirements. Due to long lead times required for procurement, it *makes sense to stock up the raw material.* At the same time, since the finished product has a long shelf life, it may make sense to stock up the finished product as well. This can give company a buffer to provide for any rush orders from distributors or even provide for errors in its sales forecasting. This can be the support that Sally is looking from both Pam and Sam.

As a final remark, there must have been a rationale for implementing the JIT production system 3 years back. It is definitely useful as cost savings can be achieved from lower storage space requirements, improving labour efficiency, reduction of wastage etc. Hence, before management take a decision on whether to continue JIT production or revert back to "make to stock" production system, it is necessary to understand why the production system was changed to the current JIT system in the first place. Depending on the nature of business, the cost effectiveness, management may choose the system that will have least disruptions in order to meet demand within the tea industry.

Scenario-2

PTPL extends a "net 30" day credit to its distributors (customers). The 30-day credit period begins from the time of dispatch of goods from PTPL's warehouse. Invoices are generated and posted to the distributors. On an average it takes 3 days after dispatch to generate the invoice and a further 3 days for the post to reach the distributors. So, totally the distributor gets the invoice 6 days after dispatch. There have also been instances of the invoice being misplaced or not being received at all. In such cases, PTPL resends the invoice, which again requires few more days to reach the distributor.

Only 30% of the accounts receivable is collected within 30 days. On an average, the accounts receivable collection period is 50 days. PTPL does not charge any interest for this delay since it wanted to maintain good relations with the distributors. Bad debts account for almost 10% of the accounts receivable.

Required

You have been requested to ADVISE ways to reduce the collection period from the current average of 50 days to 30 days without creating any acrimony with distributors.

Answer

PTPL is using a manual method for dispatching invoices to its distributors (customers). The distributor is made aware of the amount payable 6 days after dispatch of goods. This is almost 20% of the credit period (6 days out of 30 days). So, the distributor gets 24 days to arrange for the payment on the due date. The following steps can help to improve the collection of accounts receivable on due date and help to reduce bad debts:

(i) Revisit the credit period extended: If only 30% of the accounts receivable is collected within 30 days, it implies that the balance 70% delay the payment / settlement. PTPL has to assess whether the credit period of 30 days is reasonable and *in line with industry standards.* If the credit period is longer than 30 days, then PTPL may need to at least temporarily adjust to the industry norm for settlement with distributors. If the credit period is 30 days or lesser, then PTPL should develop an understanding with the distributors that emphasises that the payment has to be made within due date of 30 days.

(ii) Better distributor relations: For PTPL to be able to dictate terms to distributors, it must *first ensure that the distributor's requirements are met on time.* Hence, PTPL has to ensure that it delivers the goods on time, it has the capability of restocking whenever requested by the distributor. The other improvement can be by *automating the invoicing*, it can be generated and sent electronically as soon as the goods are dispatched to the distributor. This way there is sufficient information about the amount to be settled, giving distributor ample time to arrange for funds.

(iii) Credit analysis of distributors: PTPL has to analyze which distributors cause delay in payments or default in payments. Credit should be extended only to *credit worthy distributors.*

(iv) Ensure multiple channels of settlement: PTPL should *provide various channels through which settlements can be conducted*, including electronic transfers, and other banking channels such as cheques or drafts. Electronic mode of settlement ensures that the funds are received instantaneously. At times when the distributor is constrained by one method, PTPL should be in a position to offer alternate settlement methods.

(v) Offer discounts on early settlements: To encourage early receipt of funds, PTPL can offer a small discount if the funds are remitted before due date. For example, PTPL can offer 1/10 net 30 deal. If a distributor settles the entire amount due within 10 days, a discount of 1% can be availed. Beyond 10 days until 30 days, no discount can be availed but there will be no penalty or interest either. Beyond 30 days, there can be an interest or penalty charged.

Scenario-3

'If we recoup the entire accounts receivable, that is there are no bad debts, it also means that we are profitable. It also means that each and every customer contributes towards this profit'.
– Mr. Kumar

Required

Critically ANALYZE this statement and ILLUSTRATE whether it is always true.

Answer

Recouping entire accounts receivable, with zero bad debts is indeed an ideal situation. Simply put, the company has managed to recover the entire sales that it has made to its distributors. However, it does not imply that the company is profitable. A quick example would be a case where 1 kg. tea package costs ₹300 to manufacture while due to intense competition, the company is forced to sell it at ₹250. The net loss incurred in this sale is ₹50, this would be so despite the entire amount outstanding of ₹250 is received. This refutes the first statement that '*If we recoup the entire accounts receivable, that is there are no bad debts, it also means that we are profitable*.' The above example shows that this need not always be true.

Coming to the second assertion that '*if the bad debts are nil, it also means that each and every customer contributes towards profitability*'. Again, this need not always be true.

Note: Let us take the example below for the purpose of better understanding.

Let us say PTPL has only 2 customers (here distributors). Details of sales and cost of generating these sales are given below –

Particulars	Distributor A (₹)	Distributor B (₹)	Total (₹)
Sales	10,000	30,000	40,000
Less: Cost of Goods Sold	5,000	15,000	20,000
Cost of sales visits (specifically traced to customer based on actual sales visits) A: 1 visit × ₹500 per visit B: 10 visits × ₹500 per visit	500	5,000	5,500
Sales order processing cost (allocated based on number of orders) A: 1 order × ₹500 per order B: 10 orders × ₹500 per order	500	5,000	5,500
General administrative cost (based on number of hours of support lent to each customer)	1,000	2,000	3,000
Profitability	3,000	3,000	6,000

From the above example, it can be seen that each distributor contributes the same profit of ₹3,000 each to PTPL. However, Distributor A is lot more profitable (profit margin is 30% of sales) as compared to Distributor B (profit margin is 10% of sales). Hence, the profitability of each customer is not the same. It could very well be that there may be loss making customers, the loss is absorbed by the profits generated from other customers. Hence, even if the entire outstanding amount is recouped, it does not mean that each and every customer contributes towards profitability.

The type of detailed customer wise profit analysis done above is called Customer Account Profitability. By attributing revenue and costs to each of the customers, their individual contribution towards the profit margin of the company can be calculated. Costs will vary since the amount of support each customer needs from the company may be different. In the above example, Distributor B needed more sales visits as compared to Distributor A. The number of sales visits were 10 times more, but that yielded revenue only 3 times more than Distributor A. Reasons for this have to be understood. There may be underlying problems with the sales arrangement with the customer or PTPL can perhaps improve some business process that can reduce the number of sale visits.

PTPL should analyze its customer base and identify the profitable customers and the unprofitable ones. Expand business with profitable ones. Either turn around the unprofitable ones by reducing costs or increasing sales else cease to do business with them.

MCQ- 1

Giving the case study scenario, which pricing strategy do you think that PTPL is following for its "A1 Tea" brand?

(a) Cost plus markup pricing

(b) Target rate of return

(c) Perceived value pricing

(d) Going rate pricing

Answer

The correct answer is (d) going rate pricing.

Reason

Going rate pricing is a competition-based pricing where the company sets the price based on the market price for the product. The market is highly competitive. Hence, it is given that customers are more price sensitive and indifferent between different brands. So, going rate price would be the best pricing for PTPL to follow.

MCQ- 2

Below is the cost structure for producing of 1 kg of "A1 Tea":

Direct material cost	₹200
Direct labour cost (20 minutes, costing ₹300 per hour)	₹100
Overhead cost	₹50
Total cost	₹350

In addition, 1 kg of "A1 Tea" also requires 0.6 kg of other material which costs ₹80 per kg, with 4% substandard quality which cannot be used in production of tea.

PTPL sells 1 kg of "A1 Tea" for ₹400. PTPL wishes to earn 10% profit margin on the same. Is the target cost being met?

(a) No, the total estimated cost is ₹400 per kg while target cost is ₹360 per kg.

(b) Yes, the total estimated cost is ₹350 per kg while target cost is ₹400 per kg.

(c) Yes, the total estimated cost is ₹350 per kg while target cost is ₹360 per kg.

(d) Yes, the total estimated cost is ₹400 per kg while target cost is also ₹400 per kg.

Answer

The correct answer is (a) No, the total estimated cost is ₹400 per kg while target cost is ₹360 per kg.

Reason

The total estimated cost is:

Direct material cost	₹200
Direct labour cost (20 minutes, costing ₹300 per hour)	₹100
Overhead cost	₹50
Other material (0.6 kg. / 96% × ₹80 per kg.)	₹50
Total estimated cost (per kg.)	₹400

The target cost if the company wishes to earn 10% of revenue as profit is ₹360 per kg. Selling price ₹400 per kg less profit margin ₹40 per kg = ₹360 per kg.

MCQ- 3

Rani is a tea sommelier who has recently graduated from university and holds a professional certified tea sommelier degree. Few months back, she started 2 outlets by the name "Queen Tea" in Kolkata which serves gourmet tea specially crafted by her. Business has been profitable and has gained traction in terms of revenue and customers. Rani envisions that she can revolutionize the tea industry by influencing the taste preference of tea consumers.

Her specially crafted tea is authentic, unique in flavour that can be appreciated by real tea enthusiasts. India's economy has space even for niche tea enthusiast who are willing to pay a premium for a good cup of tea beverage. However, Rani is facing many issues running the business-like access to extra finance, networking, how to market her product etc. Whom should she approach to find proper guidance, finance, and support?

(a) An incubator

(b) An accelerator

(c) A start up

(d) An intrapreneur

Answer

The correct answer is (b) an accelerator.

Reason

Accelerators can accelerate growth by removing some of the risk and uncertainty involved; through a short-term program usually for start-ups that already have a Market Viable Product (MVP), which in Rani's case is her specially crafted gourmet tea. She can get guidance on how to scale up business, have access to business mentorship and guidance that can improve profitability, get industry connections etc. An accelerator generally gets an equity stake in the startup that joins its program. This gives proper motivation to provide proper guidance to the startup founder.

MCQ- 4

In order to drive up sales, PTPL started offering a teacup free for every 1 kg of "A1 Tea" bought per order. This would be an example of:

(a) Awareness

(b) Promotion

(c) Subscription

(d) Cross subsidization

Answer

The correct answer is (b) Promotion.

Reason

A low-cost product, teacup in this case, is offered for free in for the purchase of 1 kg of "A1 Tea".

MCQ-5

An employee of PTPL visited Guwahati to purchase tea leaves from an auction at Guwahati Tea Auction Centre and had stayed in the hotel located in Guwahati, Assam. At the time of checkout from hotel, the invoice was issued for an amount equivalent to ₹1,00,000. The hotel issued invoice in the name of PTPL and GST was charged at the rate of 14% CGST and 14% SGST on total invoice amount of ₹1,00,000. Out of such amount, the amount recoverable from the employee towards non-official stay by PTPL was ₹50,000.

Whether input tax credit is available on the GST paid by PTPL on the invoice amounting to ₹1,00,000 to the hotel located in Guwahati, Assam, for stay of the employee? If yes, please specify the amount of input tax credit available.

(a) Yes, ₹14,000 as CGST and ₹14,000 as SGST

(b) Yes, ₹28,000 as IGST

(c) No input tax credit is available

(d) Yes, ₹7,000 as CGST and ₹7,000 as SGST

Answer

The correct answer is (c), no input tax credit is available.

Reason

ITC of GST paid on hotel accommodation is not available as CGST/SGST of one State cannot be utilized for discharging of CGST/SGST liability of another State.

MCQ-6

PTPL entered into a contract with Nayan Distributors, Siliguri for supply of 1 tonne of "A1 Tea". It sent the said consignment to the distributor and paid loading and unloading charges of ₹20,000.

Which of the following statements is correct under the GST law?

(a) "A1 Tea" is an agricultural produce. Loading and unloading of "A1 Tea" is exempt from GST.

(b) "A1 Tea" is an agricultural produce. Loading and unloading of "A1 Tea" is liable to GST.

(c) "A1 Tea" is not an agricultural produce. Loading and unloading of "A1 Tea" is liable to GST.

(d) "A1 Tea" is not an agricultural produce. Loading and unloading of "A1 Tea" is exempt from GST.

Answer

The correct answer is (c) – "A1 Tea" is not an agricultural produce. Loading and unloading of "A1 Tea" is liable to GST.

Reason

Item (e) of Entry 54 of *Notification No. 12/2017 CT(R) dated 28.06.2017* exempts loading, unloading, packing, storage or warehousing of agricultural produce. In this regard, it may be noted that "A1 Tea" is a blended tea prepared by mixing popular tea flavours into one. Different tea flavours are processed products - dried, fermented, and cut tea leaves. Thus, "A1 Tea" is not an "agricultural produce" and thus, loading of the same is not eligible for exemption under entry 54.

MCQ-7

PTPL recently came across a new export opportunity, involving the export of tea to Country 'N' via the Rupee State Credit Route. However, the person who will execute the trade is based out of Country 'N' and would charge a commission of 20%. The CFO informed the CEO that we cannot enter into this trade as the remittance of commission on the Rupee State Credit Route is not allowed.

Considering the given legal position of the execution of the trade through the payment of commission on export under Rupee State Credit Route, comment on correctness of advice of CFO on such remittance of commission in the light of the Foreign Exchange Management Act, 1999.

(a) Yes, the CFO is correct. No commission can be paid on exports through the Rupee State Credit Route. Hence, we cannot export the tea.

(b) No, the CFO is incorrect. Commission up to 20% can be paid on exports through the Rupee State Credit Route. Hence, we can export the tea and remit the commission to the agent.

(c) No, the CFO is incorrect. Although commission cannot be paid on exports through the Rupee State Credit Route, however commission up to 10% of invoice value of export can be paid on tea and tobacco. Here, still cannot export the tea because commission only up to 10% is allowed.

(d) No, the CFO is incorrect. Although commission cannot be paid on exports through the Rupee State Credit Route, up to 20% commission can be paid on tea and tobacco. Hence, we can export the tea and remit the commission to the agent.

Answer

Correct Answer is (c).

Reason

In accordance with Foreign Exchange Management Act, 1999, Schedule 1, transactions for which drawal of foreign exchange is prohibited includes payment of commission on exports under Rupee State Credit Route, except commission up to 10% of invoice value of exports of tea and tobacco.

MCQ-8

The management of PTPL has developed a strong internal control in its accounting system in such a way that the work of one person is reviewed by another. Since no individual employee is allowed to handle a task alone from the beginning to the end, the chances of early detection of frauds and errors are high. To facilitate the accumulation of the information necessary for the proper review and evaluation of internal controls, PTPL's auditor framed an internal control questionnaire to obtain an understanding of internal financial control relevant to the audit in order to design audit procedures that are appropriate. Which of the following questions relates to the procurement of tea leaves.

i. Is there a procedure in place to match received tea leaves with corresponding invoices?

ii. Is there a procedure of monitoring broad customer preferences worldwide?

iii. Are provisions for bad debts made based on a systematic assessment of the collectability of outstanding receivables?

iv. Is there a designated authority responsible for approving tea leaf procurements?

v. Is there a confirmation process, such as signed delivery receipts, to validate successful deliveries?

Options

(a) Only (i)

(b) (i) and (iv)

(c) (i), (ii) and (iv)

(d) (ii), (iii) and (v)

Answer

Correct Answer is (b)- (i) and (iv).

Reason

In the internal control questionnaire developed by PTPL's auditor, it is noted that question (ii) is primarily focused on study of consumer behaviour or demand pattern rather than directly addressing internal control measures. Meanwhile, question (iii) pertains to internal controls associated with receivables, and question (v) specifically addresses internal control aspects related to the dispatch of tea.

Note: The Prime Tea 2 Case Study will be hosted on the website separately.