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# Solution a

## Part (i) Computation of Coffee Shack Revenue and Variances for January 2024



Figure 1 Flexible Budget Variances

The company is deriving unfavorable revenue variances in January 2024 indicating, that the sales value of the product has declined by £20,000. Further, the excessive amount has been spent on raw materials (£107360), wages and salaries (£50450), utilities (£24840), repair and maintenance (£4540) and fuel (£1680). The expense incurred becomes high and, hence the income arrived is not optimum. According to the budget data, the company should generate a net income of £452680. However, as the expense has been highly incurred, the net margin has minimized to £243810 and decreased by £208870 (Liyanage, and Gooneratne, 2021).

The stated scenario is unfavorable as the company is not generating profits per the budgeted data.

## Part (ii) Objectives of budgeting:

* Cost Control and Revenue improvement: Budgeting serves as an important tool for controlling and managing costs while simultaneously identifying opportunities to increase revenue. This focuses on controlling costs and increasing revenue is essential for maximizing profit (Drucker, 2019).
* Profit assessment at various production levels: To know profit at different levels of production and identify the optimal production level.
* Efficient production management: Budgeting facilitates the smooth operation of production activities.
* Monitoring budget variances: To incorporate a measure of calculation of deviation from the budgeted result and analysis of same.
* Interdepartmental coordination: Budgeting fosters collaboration among different functions, which is crucial for success.
* Alignment with Targeted actions: To ensure that the actions taken align with a set of objectives. This alignment helps in improving accountability and maintaining focus towards its desired Outcomes (Aranda, Arellano, and Davila, 2019).
* Predicting Financial position: Budgeting assists in forecasting both short-term and long-term financial health, leading to improved working capital management.

# Solution b

## Computation of total Contribution

Total Contribution = Sales – Direct materials – direct wages- variable overheads

= 780000 – 284000- 140000-88000 = £268000

## Importance of Breakeven Point

The breakeven point is necessary for estimating the sales value that has to cover undertaking all types of expenses either variable or fixed.  The expansion of the business is dependent on the analysis of the breakeven point.     This process would allow an organization to interpret the profit from the given scenario.

## Profitability Ratios

Gross profit = Sales – direct material- direct wages

=£ 780000 – 284000- 140000 = £356000

Net Profit = Gross Profit – Variable overheads – Fixed overheads-admin overheads – Selling & distribution overhead

= £356000 – 88000-40000-105000-70000

= £53000

Gross profit Ratio = Gross Profit x 100/ Total sales

= 356000 x 100/780000 = 45.64%

In the given scenario, the company is deriving 45.64%of gross profit from the effective operations.

Net Profit Ratio = Net Profit x 100/ Total Sales

= 53000 x 100/780000 = 6.79%

The derived net margin is very low which is 6.79% indicating that the company is spending excessively leading to which the net profit is very low. The situation is not favourable for the business and hence should be improved by implementing executive strategy (Nariswari, and Nugraha, 2020).

## Evaluation of new proposal

40% of sales contain meals deals = £780000 x 40% = £312000

Material cost is 40% = £284000 x 40% = £113600

Increase in meal deal by 10% =£312000 + 312000x 10% = £343200

Direct materials cost would increase by 15% which would be £113600 x115%= £130640

Selling distribution overhead costs = £5000

Net profit = 343200 – 130640 – 5000 = £207560

## Evaluation of result

The company would derive a profit of £207560 from the change in product mix and hence the new proposal should be accepted.

## Benefits of Cost Volume Profit Analysis:

Cost volume profit analysis is an important tool in the process of managerial decision, and it is extremely helpful to management in a variety of problems involving planning and control (Tin, 2023).

* Cost Volume analysis helps in setting up a flexible budget that can adjust to different levels of business activity.
* CVP analysis is determining the break-even point, the level of sales a which total revenue equals total costs.
* Profit planning by showing how changes in sales volume, and cost affect and pricing profits (Okpala, and Osanebi, 2020).
* By comparing actual performance with CVP analysis projections, businesses can evaluate their performance. This helps in identifying areas where costs can be controlled, or efficiencies can be improved.

# Solution c

## Evaluation of NPV technique for both proposals

Proposal 1



In the given scenario, the proposal is delivering a positive outcome and hence the proposal should be accepted.

Proposal 2



In the given scenario, the proposal is delivering a positive outcome and hence the proposal should be accepted.

## Merits of NPV Technique

* The cash flows are discounted at the inflated rate leads to the determination of the proper outcome which is very effective for crucial decision making.
* The outcome generated positive or negative cash flows thereby enabling an investor to understand the nature of the proposal.
* The process adopted in the determination of the NPV is simple and easy which is very helpful for an investor to interpret the outcome (Agung, and Zuhri, 2023).

## Evaluation of Payback Period for both proposals

Proposal 1



Payback Period = 4+ 145000/640000 = 4.23 years

In the given scenario, the company would be taking 4.23 years to recoup the investment amount.

Proposal 2



Payback Period = 4+45000/390000 = 4.11 years

In the given scenario, the company would take 4.11 years to recoup the investment amount.

## Merits of Payback Period

* The period is determined that a proposal would take in recouping an investment amount.
* An investor can short short-term projects if they are not willing to deploy the investment amount for a longer period.
* The steps followed are easy to understand and a similar pattern is followed for every project (Zhang, 2021).

## Evaluation of IRR for both proposals

Proposal 1

For computing IRR, Let’s take two discounting rate. The first discounting rate is 10% and second discounting rate is 15%.



IRR= Ra + [NPVa (Rb-Ra)/ (NPVa-NPVb)]

= 10% + 124430.15 (15-10)/ (124430 – (-3876)

= 10% + 124430.15 x 5/ 128306

= 10% + 622150 / 128306

= 10% +4.85%

= 14.85%

Therefore, for proposal 1, the company is deriving 14.85% IRR.

Proposal 2

The two discounting rate has been considered for the evaluation of IRR which include 10% and 15%.



IRR= Ra + [NPVa (Rb-Ra)/ (NPVa-NPVb)]

= 10% + 28214 (15-10)/ 28214- (-84150)

= 10% + 141071/112364

= 10% + 1.26%

= 11.26%

In the current scenario, the company would be deriving 11.26% of IRR.

## Merits of IRR

* This process is most useful in ranking the projects which is available at the same time.
* The outcome is delivered in percentage and hence if an investment is delivering a higher percentage then such a proposal is accepted (Miletić, and Latinac, 2020).
* The time value of money is considered in the very crucial investment evaluation.

## Evaluation of Accounting Rate of Return for both proposals

Proposal 1

Average investment = total investment/ number of years = 800000/5 = £160000

Average net profit = Total net profit/ number of years= (190000+175000+170000+120000+640000)

= 1295000/5= 259000

Accounting rate of return = Average net Profit/ Average investment

= 259000/160000 = 1.618

As accounting rate of return is above 1, hence the proposal should be accepted.

Proposal 2

Average investment = 870000/5 = £174000

Average net profit = Total net profit/ number of years= (230000+190000+195000+210000+390000)

= 1215000/5= 243000

Accounting rate of return = 243000/174000 = 1.396

As accounting rate of return is above 1, hence the proposal should be accepted.

## Merits of Accounting rate of return

* The net income is considered in the evaluation process thereby undertaking all types of expenses which is very beneficial for effective decision making.
* The steps adopted are simple and hence there is no confusion for making any types of mistakes.
* If the outcome is higher than 1, then the proposal is accepted or else rejected.

# Solution d

## Profitability

The term profitability evaluates the financial performance of an entity after undertaking all direct and indirect expenses. This process enables an organization to determine the net result that arises from smooth effective operations. Further, in the expansion of the business, the term profitability plays a crucial role as large chunks of retained profits have been deployed in the investment process (Le, and Ngo, 2020). Also, the company would function for a longer time if the financial performance is in positive figures. Various ratios interpret profit margin at each stage including gross margin, operating margin and net margin.

## Sustainability

In every organization, the consideration of sustainability issues is the most important factor nowadays. The scope of the business is not limited to earnings profits but also extends to the preservation of the environment. This process enables an organization to adopt measures which is useful for the longer run such as minimum usage of paper items to reduce pollution. The adoption of this process ensures that an entity has to consider the requirements of future as well as present generations thereby efficiently utilizing the economic resources (Soltanian et al., 2022).

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