Case Study
On
Deluxe Auto Limited

By,
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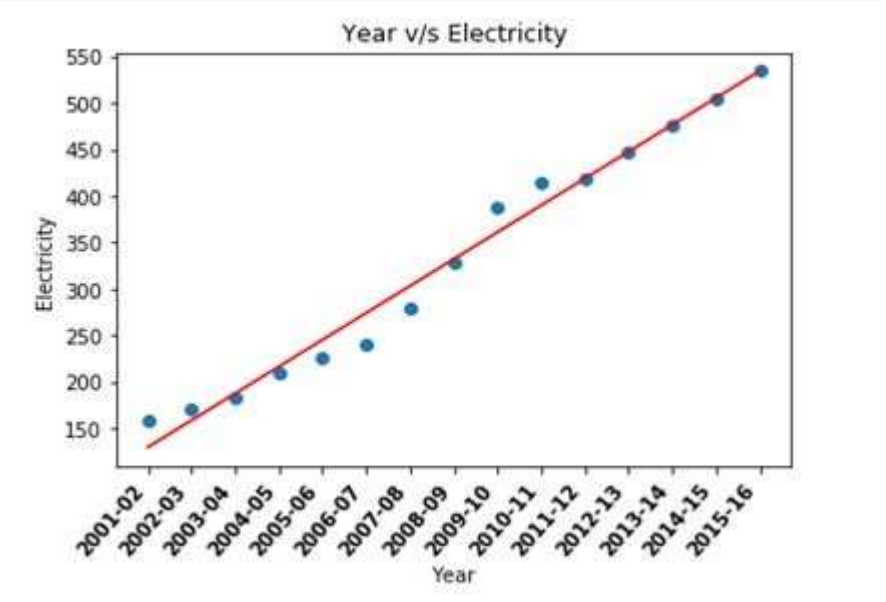
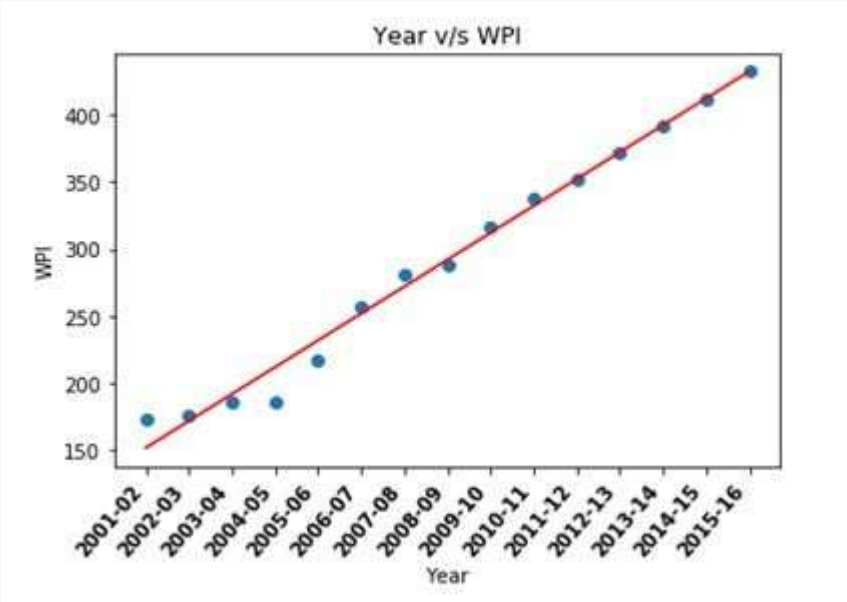
Q1) The finance manager has assumed the input and output prices to remain constant. He reasons that adjusting cash flow projections for inflation won't change results as if the cost increases this will be immediately followed by increase in sales price. Thus, the impact of inflation could be passed on to customers. Do you agree with the finance manager's argument?

Varying inflation input rates

Inflation %	2011-12	2012-13	2013-14	2014-15	2015-16
Electricity	0.011	0.069	0.065	0.061	0.057
WPI	0.041	0.057	0.054	0.051	0.049
CPI	-0.041	0.112	0.052	0.050	0.047
Wage	0.057	0.057	0.057	0.057	0.057
Salary	0.107	0.102	0.104	0.104	0.102

The prices do not remain constant due to inflation.





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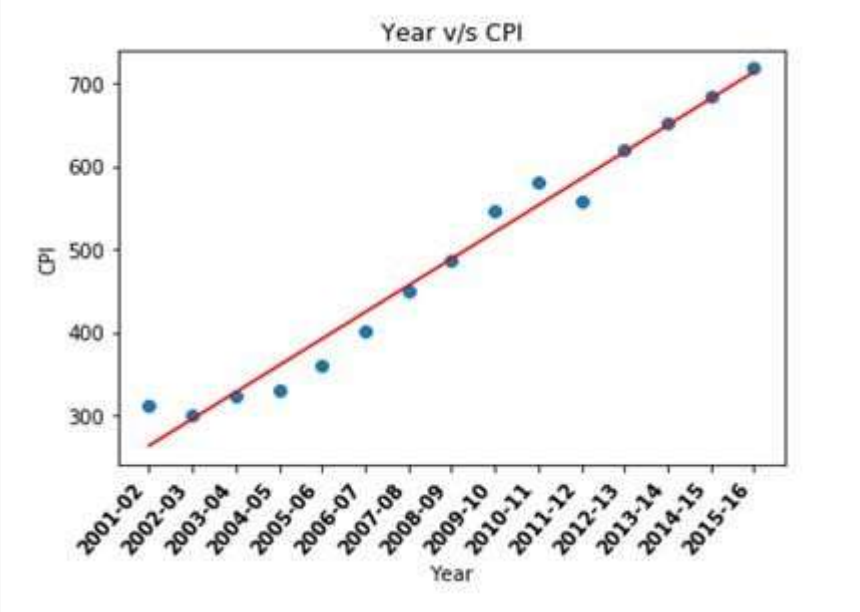

Can the increased cost due to inflation be passed on to the customer?

Elasticity and the law of demand.

- The two-wheeler market is highly competitive; It is price sensitive, especially when there are no technological innovations. Thus, making it an incredibly elastic product.

- Had DAT been an insulin selling company, some of the increased costs could have been passed onto the customer. This is possible because medicines are an essential and thus an “Inelastic product”.

Are DAT automobiles exceptions to the law of demand?

- Veblen and Giffen goods are considered the sole exceptions to the law of demand.
- DAT caters to a price sensitive segment of the automobile industry. Had it been a “Veblen good”, I.e: A high margin, low volume good;
  Then a price-rise might even have benefitted demand.
- Cars, by definition aren’t Giffen goods, especially in India. They aren’t a low income, non-luxury good. This might be the case in some demographies of countries such as USA.

So what can be done to offset the increase in prices due to inflation?

- Increasing the cost will lead to a loss of market share to other established players who engage in price wars to monopolise the industry.
- Hence, the increase in costs must be accommodated in the supply chain to keep the price competitive.

Strategies to accommodate for the impact of inflation

1. **Slashing Costs**
2. Optimizing operational and distribution supply chains
3. Leveraging market share position
4. Production profit maximisation.


Support Activities
Firm Infrastructure
Management, Finance, Legal, Planning
Human resource management
Professional development, Employee relations, Performance appraisals, Recruiting, Competitive wages, Training programs
Technology Development
Integrated supply chain system, Real-time sales information
Procurement
Real-time inventory, Communication with suppliers, Purchase supplies and materials
Margin
Primary Activities
Inbound Logistics
Real-time inbound inventory data
Location of distribution facilities
Trucks
Material Handling
Warehouse
Operations
Standardized model
Access to real-time sales & inventory system
Outbound Logistics
Order processing
Full delivery trucks
Marketing & Sales
Pricing
Communication
Promotion
Product based on community needs
Low prices
After Sales Service
Delivery
Installation
Repair
Greeters
Customer service focus
Margin

Strategies to accommodate for the impact of inflation

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2. **Optimizing operational and distribution supply chains**
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Optimizing operational and distribution supply chains.

Assess the long-run shifts in the cost position of your competitors relative to your own.

Reestablish cost competitiveness by going outside in-house operations.The company's strategic options are to negotiate with suppliers for more favorable prices, integrate backward to gain control over material costs, use lower-priced substitute inputs, etc.

When the cost disadvantage is in distribution, the company can push for more favorable terms, change to more economical distribution, or make up the difference by initiating cost savings earlier in the total value chain. It is likely, of course, that a substantial portion of any cost disadvantage a company has lies within its own in-house cost structure.

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Scenario 1: 50%+ Market Share:

Cash rich: Can afford to price and expand aggressively. (Like Amazon)

Scenario 2: It is a Vodafone in a Jio-Airtel industry.

- Be a "Price taker". Conserve Cash.
- Slowly let the better product eat away at the competitor's market share.
- Non- generic advertising.

Scenario 3: Hyperspecific player.(Just old people use it in a city.)

Identify similar markets. Organically expand.

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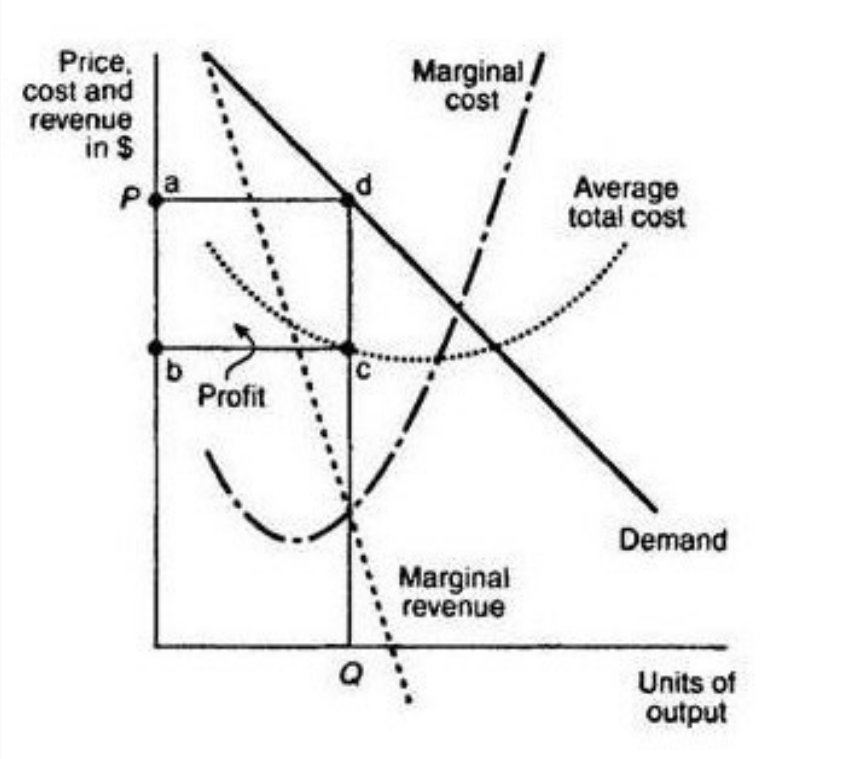

Short – run profit maximization by a monopolistically competitive firm

Q2) How would you incorporate inflation in the calculations of cash-flows as giving in Exhibit 2 of the case?

Refer to the Excel Sheet

Q3) Would you like to adjust the cost of capital of 18% for inflation? In what manner?

- No. We should not adjust cost of capital of 18% with respect to inflation.
- We need to adjust cost of capital wrt the derived inflation rates:-

Inflation %	2011-12	2012-13	2013-14	2014-15	2015-16
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