

FINCARE LTD: Cost, Volume and Profit Analysis

Author Details: Erasmus Fabian Kipasha (PhD)
School of Business, Mzumbe University

Abstract

This teaching case study aims at providing students with real world practical application of the cost, volume and profit analysis model. It provides data for FinCare Ltd a firm operating in Dar-Es-Salaam Tanzania. The case provides situation where the firm has experienced some business failures during the startup, but then have been able to perform hence need to maintain the performance level. The case provided operating data for the company for five years and requires students to use the CVP model to analyze the trend and other variables which are necessary for firms to ensure it maintains its performance. This case study is intended for class discussion only.

Keywords: Cost, Volume and Profit Analysis, cost, financial performance, FinCare Ltd

Introduction

Among the challenges facing most of the firm's managers is how to assess and control the key variables which determine the firm performance. This is more common to small firms whose managers sometimes do not have enough required finance knowledge to perform such analysis. Among the key tool for profitability analysis is the Cost, Volume and Profit model (CVP model) which enables managers to assess and manage different performance variables of the firm. The CVP model provides a basic analysis which can provide information to managers on the level of operations, cost and revenue level that are necessary for the firm to breakeven, as well as for the profit planning.

Company Profile

FinCare Ltd is a consultancy firm registered in Tanzania for undertaking business consultancy, audits services, tax consultancy and other related business services. The establishment of the firm was basically based on individual relationships between the Managing Partner, Mr. Kasaro with several small business owners in Dar-Es-Salaam City who for some time they have been using him at individual basis to help them prepare their financial statements as well as in preparation of tax documents as per requirement of Tax Authorities. Mr. Kasaro after studying the consultancy business Environment at Dar-Es-Salaam, came to the conclusion that establishing a consultancy business firm which apart from business consultancy it will also perform audits and tax consultancy was ideal as it was profitable.

Mr. Kasaro then approached his three friends who were also experts in accounting, finance and taxation with an idea of establishing a partnership to capture the existing market opportunity. After presenting his analysis to his friends, they all agreed to form a partnership which was registered in 2006 as a FinCare Ltd after paying the registration and other costs totaling 1,200,000 Tshs, this was contributed equally among the partners.

Business Operations

FinCare Ltd started operations in September 2006 in which all the four partners engaged in individual marketing were partners would go into different business firms and individuals, and talk to the owners about their services and leave the brochures and contacts. The firm incurred a total cost of 300,000 Tshs for making this initial advertisement of their services to SMEs and individuals. It was a decided among the four partners that, the firm should first concentrate on Individuals and SMEs and once they gain experience, resource, and enough manpower, the firm will expand operations to large firms.

The first four years of operations for the firm was not good as the number of customers who turned up to acquire the services were not as anticipated, this was from both SMEs and the individual customers. As the

results of the poor performance in the first years, in 2010 the firm decided to formalize its operations by renting a modern office, employing some permanent staffs and installing furniture and fittings.

It was also agreed among the partners that Mr. Kasaro should be a managing partner and be paid monthly salary of 2,000,000 due to the fact that he uses most of his time in the firm as compared to other partners who have other primary employment obligations hence they use only their extra time for the firm. Mr. Kasaro has provided the following information regarding the firm for the period of five years.

- i. For the five years the company has been engaging in three activities which are audits services, tax consultancy and business consultancy services.
- ii. Auditing activities are conducted once a year to the companies which have contracts with the firm for the provision of auditing services. The company has categorized its audits clients into three categories, the large clients, medium clients and small clients basing on the size of their firms which has implications for the number of days and number of staff required for the work. The cost incurred during the annual audit depends on the number of days spent by the firm employees to the client, the location of the client and the number of staff required for the audit work. In the five years the average days spent per client per year are 5 days and an average of 4 staffs are required for the work regardless of the size of the client firm. The firm has 20 staffs responsible for auditing works and each staff is engaged in 5 auditing assignments in different client firms in each year, a total of 20 part-time staff are normally used for auditing work each working for at least 4 assignments per year.
- iii. Tax consultancy is open to both individuals and business firm, FinCare Ltd has been offering such services to a number of clients around the city. The firm managing partner Mr. Kasoro has provided that, the cost incurred for tax consultancy depends on the nature of the work to be performed and the number of employees to be involved in the work. For the 5 years period the average of 3 days have been used per tax consultancy work received and average of 2 employees have been used to offer the service per each work received. The firm has 10 permanent employed workers responsible for the service and each worker is engaged in 10 assignments per year. A total of 6 part-time workers are used for tax consultancy services each engaging in 3 to 8 assignments per year.
- iv. The firm has also been offering business consultancy to individuals and business firm, the services offered mainly include the business feasibility analysis, preparation of business plan and business operations and profitability analysis. The demands for such services are difficult to predict but for the 5 years period, the firm has observed the increased demand for the services for both individuals and business firms. For the period of five years the firm has used an average of 2 days to serve each customer using an average of one employee per work received. A total of 5 employees are available for such services and each is engaged in between 25 to 30 assignments in a year.
- v. The price charged by the firm to its services highly depends on the market prices offered by other firms with similar activities. For the period of five years the company has not changed its prices, which currently are as shown in the table below

Services		Price per Service (Tshs)
Audits Services	Small size business	1,000,000
	Medium Size Business	2,500,000
	Large Size Business	3,000,000
Tax Consultancy	Normal Services	1,000,000
	Specialized Services	1,200,000
Business Consultancy	Business Feasibility analysis	2,500,000
	Preparation of Business plan	1,000,000
	Operational and Profitability analysis	1,200,000

Demand for Services

According to the Managing director of the firm, Mr Kasaro, the demands for the services have been varying from year to year, although the changes in demand have been positive to the firm. The demand data for the year 2011 to 2015 are as provided in the table below.

Services		Number of Clients Served				
		2011	2012	2013	2014	2015
Audits Services	Small size business	20	20	25	25	30
	Medium Size Business	15	15	16	16	19
	Large Size Business	10	10	8	8	12
Tax Consultancy	Normal Services	38	40	45	43	50
	Specialized Services	20	22	23	24	25
Business Consultancy	Business Feasibility analysis	40	40	30	38	40
	Preparation of Business plan	40	50	60	60	70
	Operational and Profitability analysis	25	20	15	17	18

Cost

The firm’s operating costs are mainly administrative especially salaries to staffs, building rent, transport costs and other administrative costs. The following information has been provided by the managing partner regarding the costs incurred by the firm.

- i. Since 2009, a firm has a total of 35 workers who are permanently employed. On average, each permanent worker is paid an average monthly salary of 300,000 Tshs and an overtime of 60,000 Tshs per day when assigned any client work. Apart from, permanent employees, the firm also use part time employees who are paid 100,000 Tshs per day when engaged in the firm’s activities.
- ii. All permanent employees are paid transport allowance totaling 40,000 Tshs per months, regardless of their work engagement or location of work. The part-time employees are paid 10,000 Tshs per day as transportation costs for the number of days that they engage with firm’s activities.
- iii. A firm pays a commission of 10,000 Tshs to all employees permanent and part-time in a respective service category for each assignment conducted by the category regardless of whether the employee participated in that particular work or not.
- iv. All the firm’s partners received a monthly allowance of 200,000Tshs per month for communication, transport and follow ups, and an extra allowance of 100,000 per each contract of service entered by the firm with the clients.
- v. The firm rented a new building to be used as its office along the city Centre. According to the terms of the contract, a total rent of 200,000 Tshs per month is payable in a yearly basis. The rent is subject to change after every two year by an increment of 20% to reflect the changes in the market prices; the firm started paying the rent in 2010.
- vi. The firm owns two motor vehicles which were purchased between 2006-2009, the cost of the vehicles total 15,000,000 at the time of purchase. The firm incurs monthly costs of 100,000 Tshs for the running and maintenance of the motor vehicles. It is the firm policy to depreciate the vehicles at 10% reducing balance; by the end of 2009 the book value of the motor vehicles was 12,000,000 Tshs. The furniture’s and fittings purchased by the company had a book value of 3,000,000 Tshs at the end of 2009; it is the company policy to depreciate such asset at 10% reducing balance.
- vii. Since 2010, the firm has been advertising its services in a local radio and television, incurring a total costs of 800,000 Tshs per year
- viii. General administrative costs amount to 200,000 per month
- ix. Other utility costs paid by the firm include, electricity 30,000 Tshs per month, water 12,000 Tshs per month and office maintenance costs 30,000 Tshs per month.
- x. The firm also pays refreshment costs amounting to 5,000 per clients’ work, to each of the employee in a given category regardless of their involvement in the particular assignment; this is also paid to part-time workers as a way of building firm relationship with the part-time workers.
- xi. Since 2010, the firm agreed to contribute 0.1% of its annual revenue to the child development fund as a way of showing firm responsibility to the surrounding community.

Financial Performance

For the period of five years, the managing director of the firm has prepared the financial performance report showing the revenue, cost and profit earned by the firm as presented below.

	Figures in Tshs				
	2011	2012	2013	2014	2015
Revenue	319,500,000	327,900,000	314,600,000	336,200,000	385,100,000
Less Costs					
Salary to managing partner	24,000,000	24,000,000	24,000,000	24,000,000	24,000,000
Salary					
Permanent staff	126,000,000	126,000,000	126,000,000	126,000,000	126,000,000
Per diem	22,800,000	23,100,000	22,800,000	23,400,000	24,300,000
Part-time salary	12,400,000	13,600,000	17,400,000	17,100,000	25,500,000
Transport cost for permanent staff	16,800,000	16,800,000	16,800,000	16,800,000	16,800,000
Transport cost for part-time staff	1,240,000	1,360,000	1,740,000	1,710,000	2,550,000
Commission	32,530,000	33,420,000	35,730,000	36,070,000	42,800,000
Partners monthly allowance	9,600,000	9,600,000	9,600,000	9,600,000	9,600,000
Partners extra allowance	20,800,000	21,700,000	22,200,000	23,100,000	26,400,000
Building Rent	2,400,000	2,880,000	3,456,000	4,147,200	4,976,640
Motor vehicle expenses	1,200,000	1,200,000	1,200,000	1,200,000	1,200,000
Depreciation expenses	1,350,000	1,215,000	1,093,500	984,150	885,735
Advertising cost	800,000	800,000	800,000	800,000	800,000
Administrative costs	2,400,000	2,400,000	2,400,000	2,400,000	2,400,000
Electricity bills	360,000	360,000	360,000	360,000	360,000
Water bills	144,000	144,000	144,000	144,000	144,000
Office maintenance bills	360,000	360,000	360,000	360,000	360,000
Refreshment cost	16,265,000	16,710,000	17,865,000	18,035,000	21,400,000
Social Responsibility cost	292,100	297,100	279,900	301,700	346,100
Total Costs	291,741,100	295,946,100	304,228,400	306,512,050	330,822,475
Total profit	27,758,900	31,953,900	10,371,600	29,687,950	54,277,525

During the partners meeting in December 2015, all the firm partners were impressed with the firm performance for the five years period. The managing partner Mr. Kasaro started the discussion by presenting the entire report to them while explaining some issues which seem to be unclear. After the presentation, one of the partners Mr. James contributed to the firm performance as follows

Mr. James “The firm performance for the five years is really impressive, thanks very much to our friend Mr. Kasaro for making this possible. When he approached us some ten years ago with this idea we were all impressed, but when we were challenged with some failures at the start up and early years of operations, some of us, we lost our courage but he didn’t, see today the firm is growing very fast and we all have a better life. You have our full support since you have proven to us that you can take the firm that far”

The second partner, Mr Gabriel, commented on the achievement, but he wanted to know how the firm can ensure that it does not face again the previous failure. “This performance we see today is a result of hard working among the firm’s staff and us, but more thanks to our managing partners for his tireless efforts to ensure that we achieve this much. What we see today should remind us of where we come from and we should ensure that we don’t go back again to the failures. Since we have multiple services in our firm, we need to have strategies to ensure that first we cover our operating costs and then we generate profit. If we know the minimum level of activities we are supposed to undertake for the year, for the firm to cover its costs that will be very important information for making sure we don’t go where we came from. I suggest, we conduct analysis on the

business variables such as the breakeven point, margin of safety and other factors which are very important to the firm performance, especially those which are linked with the firm costs and revenue”.

The managing partner, Mr. Kasaro, agreed with the contributions and suggestions given by the other partners and promised to work out the analysis and present to them as soon as possible. He also promised the partners that, the firm will be able to achieve a profit 80, 000, 0000 Tshs by the end of the year 2016.

Required:

- i. Being an expert in cost management, analyze the cost structure of the firm and group the costs basing on cost behavior.
- ii. Basing on details provided by the managing partner regarding the operation of the firm for the five years, calculate the breakeven point in volume of each activity and value and comments on its trend.
- iii. Compute the firm’s margin of safety for the five years of operations
- iv. Basing on the managing partner strategy of attaining a profit of 80,000,000 Tshs in the next period, analyze the volume of activity of each service offered necessary for reaching the target profit.
- v. Supporting the second partners view, analyze the sensitivity of firm profits to the changes of variable costs, fixed costs, revenues and a combination of these factors. Consider a change of 10% in each of the variable in either direction.
- vi. Analyze the firm operating leverage for the period of five years
- vii. If in the next period, the firms monetary fixed cost increases by 10% and the service prices increase by 10%, recast the prepare the performance report for the 2016 and show the impact of these changes to the managing partner performance prospects for 2016.