

A Module

Diploma in Financial Management

PROJECT DA2, INCORPORATING SUBJECT AREAS
– INTERPRETATION OF FINANCIAL STATEMENTS
– PERFORMANCE MANAGEMENT

All questions are compulsory and **MUST** be answered

The project **MUST** be written in English.

The maximum word count (including appendices and tables but excluding references and bibliography) is 5,000.

The project **MUST** be **TYPED** in black ink, one-sided, double-spaced, using a minimum 12-point font size and a 1-inch margin at each side. **HANDWRITTEN SUBMISSIONS WILL NOT BE ACCEPTED.** The project must be submitted by post, electronic submissions are not acceptable.

The project should be submitted on A4 paper with your student number, project name, date and page number at the top of each page.

A project submission form **MUST** be completed for each project submitted and attached to the front of the project.

The Association of Chartered Certified Accountants



Section 1 – incorporating subject areas – Interpretation of Financial Statements and Performance Management.

This ONE question is compulsory and MUST be attempted

Motorsayles plc

- 1 You have recently been appointed to the post of Chief Executive with Motorsayles plc, a retail motor sales group which operates a number of outlets throughout England and Wales. You were appointed when the founder, Malcolm Sayles, retired. The company has achieved strong growth which has been achieved both organically and through acquisitions. The board is continuing to seek opportunities to acquire additional dealerships as well as growing existing outlets.

Malcolm Sayles had often been quoted as saying that the company's strategy was:

'To grow the business through the acquisition of high quality dealerships, and the development of a range of franchises across all market sectors.'

It had always been Malcolm's intention to retire once he had achieved his long held ambition to take the company public, and a UK Stock Exchange listing was achieved two years ago. Your appointment was part of his vision that the company would require different leadership as a public company.

It was made clear to you during the recruitment process that while the board believed that the company's strategy should be reviewed and refreshed, it was felt that the outcome of this review should acknowledge the existing values which had been instilled by Malcolm Sayles.

Prior to joining Motorsayles you had several years' experience as Chief Operating Officer of a distributor of electronic components. Before taking up that position your experience was mainly in product development and marketing.

Following your appointment with Motorsayles, as discussed during the recruitment process, you undertook a strategic review of the company. The purpose of this review was to allow you to become familiar with the specific issues affecting the retail motor trade, and to develop the company's strategy. It had been agreed with the Board of Directors that the findings from this review, and the existing values, would provide the basis for the development of the company's strategic plan for the next five years. You are due to meet with the Board of Directors in the near future, and you are now preparing a briefing paper with your analysis and proposals. This is due to be circulated to the board members for their consideration two weeks before the meeting. You have formed the view that an important part of the development process is to confirm that the directors, all of whom have been with the company for more than five years, clearly understand how their roles have changed due to the company's listing. Although they were fully briefed as part of the listing process, you took the view that it would be valuable to confirm that the change in role continues to be recognised.

Prior to presenting your recommendations to the board you plan to assess the company's performance since it achieved a listing. You have decided that this will be done most effectively by focusing on a small number of key measures (you have decided to focus on six measures), and ensuring that the significance of these is clearly understood by the board members.

Current Lines of Business

The company has two core business activities:

- the sale of new and used cars; and
- the provision of after-sales service.

Within the new and used car sales business, franchises are held for a range of manufacturers and these are managed in two business areas – volume manufacturers and specialist manufacturers. The company's portfolio of franchises includes all the main volume manufacturers, and a number of high quality marques. Because of the wide range of manufacturers which the company represents, it is possible to meet customers' requirements for a range of vehicle types. It has been Malcolm Sayles' proud boast that 'we can provide all the vehicles a customer will need, from the sales rep's motor to the chairman's Rolls'.

The after-sales business is also managed on the basis of two activities:

- servicing and repairs; and
- sales of parts and accessories.

You have noted that the ability to generate profit from the after-sales activities is directly dependent on the volume of vehicle sales.

Servicing has a high level of fixed costs, and the key operating objective is to achieve a high level of activity from routine servicing, repairs and warranty work. While customers are obliged to ensure that their vehicle is routinely serviced according to the manufacturer's schedule, they are not required to have this work carried out by the supplying dealer.

Parts and accessories sales provide opportunities for additional profit to be earned on the sale of vehicles. Due to the low profit per unit on vehicle sales, it can often be the case that more profit is generated from the sale of parts and accessories (for example, an upgrade in the in-car entertainment system or satellite navigation system) than is generated by the sale of the vehicle.

The core business is supported by two complementary activities: contract hire and vehicle finance.

The company's contract hire business offers a comprehensive package to customers, and also contributes to overall company performance by generating sales which are included in the overall calculation for volume bonuses.

The contract hire business offers customers a combination of certainty and flexibility. The certainty comes from a fixed price for the supply, routine maintenance and disposal of the vehicle, while the flexibility comes from the company's ability to change vehicles during the contract period, due to the range of manufacturers represented and the ability to dispose of the contract vehicle through the dealer network.

Most customers use some form of finance for their vehicle purchase. Such finance is provided by a number of companies. Most of these are subsidiaries of either the major banks or vehicle manufacturers.

As a registered financial intermediary, the company earns commission by arranging both finance and insurance for customers. The level of activity and profits from this line of business have reduced in recent years due to the impact of direct marketing by banks and building societies and the increasing use of the internet by customers. Nevertheless, it remains profitable and is seen as an important element in offering a complete service to customers.

Volume bonuses

The profit on the sale of an individual vehicle is very low for both volume manufacturers and specialist manufacturers. The overall profitability of vehicle sales is dependent on achieving the sales volume targets set by the manufacturer in order to earn volume bonuses. Such bonuses can be significant, and failure to achieve volume targets would have a detrimental effect on the company.

Staff

The company has low labour turnover, and staff are highly motivated. This is regarded as a key element in achieving the high levels of customer satisfaction which in turn lead to customer retention, and profitability.

Staff are encouraged to undertake structured training and each employee is appraised on an annual basis. During this appraisal, staff agree targets for the next six, twelve and eighteen months with their line manager.

Employee incentive scheme

One of the directors has suggested that the company should consider setting up an employee share ownership trust as an incentive to staff. He has commented that his understanding is that any investment in such a trust would be reported on the balance sheet under 'Fixed asset investments'. He went on to say that although this would have the short term effect of reducing the key ratio of return on capital employed, the long term benefit, in terms of employee motivation, would be far greater.

On checking the accounting treatment of such a trust, you have been advised that the correct treatment is to deduct any investment in the company's own shares from shareholders' funds.

Market outlook

While there has been strong demand for several years, there is evidence that market growth will not continue at the current level. The growth to date has been due, in large part, to strong consumer confidence, as a result of relatively low interest rates. The trade is also characterised by over-supply and it is expected that competition between manufacturers, particularly in the volume sector, will intensify.

Strategic choice

As noted above, the board continues to seek opportunities to acquire additional dealerships as well as growing existing outlets. Your view is that, while this may be possible, it is important to consider alternative strategies. You have also noted that the focus to date on growth has meant that little attention has been paid to ensuring that the company's structure is appropriate, and you have indicated to the board that as a listed company, this must be considered if the company is to meet the objectives of shareholders.

Financial and industry data

You have obtained the following data to assist your review:

Motorsayles plc

Profit and Loss Account for the year ended 31 March

		2006 £m	2005 £m
Turnover	Continuing operations	1,199.64	1,009.24
	Acquired operations	98.72	51.11
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		1,298.36	1,060.35
Cost of sales	Continuing operations	1,038.73	866.98
	Acquired operations	85.90	46.26
		<hr/>	<hr/>
		1,124.63	913.24
Gross profit	Continuing operations	160.91	140.26
	Acquired operations	12.82	6.85
		<hr/>	<hr/>
		173.73	147.11
Operating expenses (excl. goodwill amortisation)		136.31	115.62
Goodwill amortisation		0.62	0.75
Operating profit	Continuing operations	35.86	30.35
	Acquired operations	0.94	0.39
		<hr/>	<hr/>
		36.80	30.74
Net interest charges		3.74	2.81
Profit on ordinary activities before tax		33.06	27.93
Tax		9.80	8.38
Profit on ordinary activities after tax		23.26	19.55
Dividends		7.36	6.62
Retained Profit for year		15.90	12.93
Earnings per share – basic (pence)		12.45	11.40
– diluted (pence)		11.90	10.95

Balance Sheet as at 31 March:

		2006	2005
		£m	£m
Fixed Assets	Intangible	2.56	1.06
	Tangible	144.29	123.84
		<hr/>	<hr/>
		146.85	124.90
		<hr/>	<hr/>
Current Assets	Stocks	198.02	127.86
	Debtors	62.87	57.25
	Cash and Bank	19.41	36.42
		<hr/>	<hr/>
		280.30	221.53
		<hr/>	<hr/>
Creditors falling due within one year		217.04	187.76
		<hr/>	<hr/>
Net Current Assets		63.26	33.77
Creditors falling due in more than one year		48.41	15.19
Provisions for liabilities and charges		4.96	4.67
		<hr/>	<hr/>
Net Assets		156.74	138.81
		<hr/>	<hr/>
Capital and reserves			
Called up share capital (5p shares)		9.70	8.98
Share premium		38.86	37.55
Revaluation reserve		0.13	0.13
Profit and loss account		108.05	92.15
		<hr/>	<hr/>
Equity shareholders' funds		156.74	138.81
		<hr/>	<hr/>

Analysis of Turnover, Profit before Tax and Net Assets

	Turnover		Profit before tax		Net assets	
	2006	2005	2006	2005	2006	2005
	£m	£m	£m	£m	£m	£m
Vehicle sales and after-sales	1,275.28	1,044.63	31.12	26.63	153.23	136.12
Contract hire and finance	23.08	15.72	1.94	1.30	2.82	2.69
	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	1,298.36	1,060.35	33.06	27.93	156.05	138.81
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Number of vehicles sold

	Volume		Specialist	
	2006	2005	2006	2005
New	51,260	40,210	4,963	3,380
Used	48,750	44,990	4,875	2,510

Share price		
Company	2006	2005
Start of year	140p	152p
Mid year	180p	145p
End of year	223p	140p
Average for a group of similar companies		
	2006	2005
Start of year	89p	124p
Mid year	105p	102p
End of year	128p	89p
Analysis of stock		
	2006	2005
	£m	£m
Vehicles for resale	160.83	99.52
Vehicles on consignment	14.61	11.67
Repurchase commitments	16.91	11.29
Parts and sundry stock	5.67	5.38
	<u>198.02</u>	<u>127.86</u>
Debtors		
	2006	2005
	£m	£m
Trade debtors	53.94	48.94
Prepayments	8.93	8.31
	<u>62.87</u>	<u>57.25</u>
Creditors falling due within one year		
	2006	2005
	£m	£m
Trade creditors	152.43	113.48
Finance lease obligations	16.38	12.78
Bank overdraft	–	22.62
Consignment stock loans	14.62	11.65
Repurchase commitments	8.24	6.09
Tax and VAT	9.63	6.84
Accruals and deferred income	15.74	14.30
	<u>217.04</u>	<u>187.76</u>
Creditors falling due in more than one year		
	2006	2005
	£m	£m
Finance lease obligations	6.96	10.15
Bank loans	32.76	–
Repurchase commitments	8.69	5.04
	<u>48.41</u>	<u>15.19</u>
Provisions for liabilities and charges		
	2006	2005
	£m	£m
Deferred tax	4.07	3.74
Warranty provision	0.89	0.93
	<u>4.96</u>	<u>4.67</u>

Industry averages for 2006

Growth in sales (based on 2005 sales)	14.72%
Return on capital employed	16.87%
Profit margin	2.80%
Gearing (Debt/Equity)%	48.2%
Interest cover	6.22 times
Asset utilisation	6.57 times
Profit per unit	£329
Current ratio	0.96
Quick assets ratio	0.42
Debtors collection period	11.2 days
Creditors payment period	37.2 days
Stock turnover period	41.5 days

Required:

Prepare the briefing paper for circulation to the board members. Your paper should:

(a) Discuss:

- (i) the information needs of the company's shareholders now that it is a listed company as compared to the period when it was a private company with the majority of shares held by Malcolm Sayles and members of his family; and (4 marks)
- (ii) the implications of shareholders' information needs for the company's managers. (4 marks)

- (b) Based on Malcolm Sayles' expression of the company's strategy, the published financial statements and the industry averages.

Required:

Assess the company's performance in the two years since it achieved a listing. (34 marks)

(As noted in the introductory information on page 10, this assessment should be based on a maximum of six measures with the significance of each measure being clearly explained.)

- (c) Discuss the accuracy of the director's assessment of the impact of establishing an employee share ownership trust on the financial results, and indicate how the measures you have used to assess the company's performance would have been affected if such a trust had been in place in the past. (8 marks)
- (d) Propose an updated statement of strategic intent and an appropriate mission statement. (8 marks)
- (e) Discuss the factors which will influence the type of responsibility centres which the company should use, and propose a suitable organisational structure. (12 marks)
- (f) Identify and justify six appropriate critical success factors for internal use in managing the company's performance. (30 marks)

(100 marks)

End of Project