



Final Level

Management Accounting – Business Strategy

12

FLBS

20 May 2003

Tuesday morning

INSTRUCTIONS TO CANDIDATES

Read this page before you look at the questions

You are allowed three hours to answer this question paper.
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Answer the ONE question in section A.

Answer TWO questions ONLY from section B.

Maths Tables and Formulae were provided at the end of the questions and are available elsewhere on the website.

Write your examination number in the boxes provided on the front of the answer book.
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Write FLBS on the line marked "Subject" on the front of the answer book.
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Do NOT write your name or your student registration number anywhere on your answer book.
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Tick the appropriate boxes on the front of the answer book to indicate which questions you have answered.

SECTION A – 50 MARKS

ANSWER THIS QUESTION – the scenario is given below, opposite and continues on page 5. The question requirements are also on page 5, which is detachable.

Question One

The Worldair Alliance

Introduction

PC Airlines was founded nearly 60 years ago by two pilots. The airline began flying from its home base in Asia to local destinations. It soon grew and now has acquired routes to many worldwide locations. The company was listed on its home stock exchange 15 years ago. Now, a conglomerate group holds 45% of the airline's shares while a further 25% are held by an Investment Corporation.

Four years ago, PC Airlines entered an alliance with other airline companies. The alliance took the name "Worldair" as this reflects its composition, which is made up of airlines based in the USA and Europe, as well as Asia. The three airlines in the alliance are PC, AB and US. They operate out of the following geographic regions of the world:

PC	Asia
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AB	Europe
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US	USA
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Aims of Worldair

The Worldair Alliance was formed in response to increasing competition from other airline alliances. These competing alliances threatened to attract customers (passengers) from the Worldair members. The Worldair Alliance members have agreed to co-operate with each other on route destinations. The members also enjoy economies of scale in satisfying their customers' demand by reducing the overall number of flights and increasing the seat occupancy of member airlines. This means that a customer may book a seat with one member of the Alliance and be allocated to another member's flight which is travelling to the same destination. Senior managers of the members of the Alliance claim that by rationalising the number of flights, they are able to pass on economies to customers in terms of seat prices and also reduce aircraft traffic congestion and pollution emissions.

The financial aim of Alliance members is to increase their shareholders' wealth by providing a better service than their competitors. To achieve this aim, it is essential that all members improve profitability by increasing their popularity with customers. All senior managers of the Alliance have agreed that it is very important for the members to establish consistent policies and that each must not deviate from these in any way. In order to co-ordinate the activities of the Alliance, a Worldair management team, drawn from senior managers of the members, has been appointed.

Recent bad publicity

Much publicity has recently been given to lack of passenger space associated with travelling in economy-class seats on long-distance (known as "long-haul") flights. (Short distance flights are known as "short-haul".) The publicity has centred on the fact that many economy-class passengers feel discomfort on long-haul flights because the seats are too close to each other.

An expected level of growth of 5% in passenger numbers for Alliance members next year was anticipated by senior managers of the Alliance airlines. However, as a result of the recent bad publicity, they do **not** now think there will be any growth next year in long-haul economy-class passenger numbers. Turnover levels from long-haul economy-class passengers of Alliance members are expected to remain at the current year's level. There is also expected to be a depressing effect on the rate of growth of short-haul passenger numbers for next year, but this is not thought by the senior managers to be as severe as for long-haul passenger forecasts.

In a measure to counter the potential threat resulting from the bad publicity, all members of the Alliance have established a programme to increase the amount of space available for each economy-class customer. This will be achieved by reducing the number of this type of seat in its aircraft which undertake long-haul flights. AB favoured delaying this and waiting to see whether the bad publicity actually resulted in reduced customer numbers. The other Alliance members, however, were not willing to wait. They wanted to assure customers of their serious concern for customer safety and comfort while on a long-haul flight. Additionally, it was felt prudent to take some positive action on restricted leg room to calm possible fears among customers and before legislation was passed forcing airlines to comply with minimum space requirements between economy-class seats on long-haul aircraft.

Financial and customer information relating to the Alliance
(Last year actuals and current year forecasts)

	<i>PC</i>	<i>AB</i>	<i>US</i>	<i>Total</i>
Last year:				
Passengers carried	2 million	5.5 million	7 million	14.5 million
	<i>\$ million</i>	<i>\$ million</i>	<i>\$ million</i>	<i>\$ million</i>
Turnover	1,000	2,500	3,000	6,500
Gross profit	200	350	450	1,000
Net profit	25	30	50	105
Current year:				
Passengers carried	2.3 million	5.4 million	7.5 million	15.2 million
	<i>\$ million</i>	<i>\$ million</i>	<i>\$ million</i>	<i>\$ million</i>
Turnover	1,200	2,540	3,300	7,040
Gross profit	250	330	500	1,080
Net profit	30	15	56	101

Other information for current year:

	<i>PC</i>	<i>AB</i>	<i>US</i>
	<i>%</i>	<i>%</i>	<i>%</i>
Gross contribution to sales ratios:			
Economy class	25	10	17.5
Other classes	70	85	80
Proportion of total turnover from economy-class seats	75	50	80
Proportion of economy-class turnover coming from long-haul passengers	70	80	60

All aircraft within the Alliance currently fly on average at 95% of passenger capacity.

Impact of bad publicity

For each Alliance member, the net contribution levels for next year which were expected to result if the effects of the bad publicity had **not** been felt by the airlines are as follows:

<i>PC</i>	<i>AB</i>	<i>US</i>	<i>Total</i>
<i>\$ million</i>	<i>\$ million</i>	<i>\$ million</i>	<i>\$ million</i>
456.75	1,266.8	1,039.5	2,763.05

Scenario continued from page 3

Information for next year

- A marketing forecast for the Alliance has predicted that customer numbers will grow on average by 5% for each Alliance member next year for all classes **except** long-haul economy-class.
- Turnover from long-haul economy-class passengers for Alliance members next year is expected to be at the current year's level.
- It may be assumed that customer growth will be the sole cause of a change in turnover next year.
- The possible effect of the bad publicity has also been estimated as having a depressing effect on short-haul economy-class marketing growth forecasts for next year, as follows:
 - 10% reduction on growth forecast – probability of 0·3
 - 20% reduction on growth forecast – probability of 0·4
 - 30% reduction on growth forecast – probability of 0·3
- Senior managers of the Alliance estimate that it will be necessary to reduce the number of economy-class seats in long-haul aircraft operated by all Alliance members by 5% from the current average of 400. Next year the cost of this refit will be:

PC	\$30 million	AB	\$50 million	US	\$80 million
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In other classes, seating will be unchanged.
- Research and development (R&D) and publicity costs into customer preferences on long-haul flights are estimated to be \$50 million and \$20 million respectively next year. This will be charged to each Alliance member in proportion to current year turnover.

Required:

- (a) Discuss the benefits and disadvantages of Worldair Alliance membership to PC Airlines in determining its future aims and objectives. (10 marks)
- (b) Discuss what action the Worldair Alliance management team should take regarding the potential threat from the bad publicity. Explain the possible implications for members of the Alliance of **not** taking any action. In answering this question, you should consider the availability and quality of data provided in the scenario on space between seats in economy class on long-haul flights. (10 marks)
- (c) Produce an analysis of the net contribution for **next year** for each of the Worldair Alliance member airlines. The net contribution should be calculated after the deduction from total gross contribution of costs relating to seat conversion, R&D and publicity. Explain the value of such an analysis for strategic decision making by the Worldair senior management team. (20 marks)
- (d) Discuss the different attitudes of Worldair Alliance members towards the implementation of an operational policy to address the bad publicity and discuss how disagreements between Alliance members on operational policy issues may be reconciled. (10 marks)
- (Total = 50 marks)**
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SECTION B – 50 MARKS

ANSWER TWO QUESTIONS ONLY

Question Two

Eastborough is a large region with a rugged, beautiful coastline where rare birds have recently settled on undisturbed cliffs. Since mining ceased 150 years ago, its main industries have been agriculture and fishing. However, today, many communities in Eastborough suffer high unemployment. Government initiatives for regeneration through tourism have met with little success as the area has poor road networks, unsightly derelict buildings and dirty beaches.

Digwell Explorations, a listed company, has a reputation for maximising shareholder returns and has discovered substantial tin reserves in Eastborough. With new technology, mining could be profitable, provide jobs and boost the economy. A number of interest and pressure groups have, however, been vocal in opposing the scheme.

Digwell Explorations, after much lobbying, has just received government permission to undertake mining. It could face difficulties in proceeding because of the likely activity of a group called the Eastborough Protection Alliance. This group includes wildlife protection representatives, villagers worried about the potential increase in traffic congestion and noise, environmentalists, and anti-capitalism groups.

Required:

- (a) Discuss the ethical issues that should have been considered by the government when granting permission for mining to go ahead. Explain the conflicts between the main stakeholder groups.

(12 marks)

- (b) By use of some (mapping) framework, analyse how the interest and power of pressure and stakeholder groups can be understood. Based on this analysis, identify how *Digwell Explorations* might respond to these groups.

(13 marks)

(Total = 25 marks)

Question Three

PAL is a banking group specialising in loans for home purchase. It has a network of shops, cash machines and other outlets in and around the capital city (where it has its headquarters) with all outlets within 70 miles. It monitors interest rates offered by competitors and strives to match or better the lowest rates. This strategy has been successful, but in order to compete more fully, it has introduced a range of additional customer services, including home insurance. A dedicated unit was established to extend existing benchmarking of price to other aspects of customer requirements. Following a survey, the following factors in addition to price have emerged as being relevant to customers:

- delivery;
- technical content of literature;
- customer service and correspondence.

Required:

- (a) Discuss the use of appropriate performance measures which home insurance could use as part of the proposed competitor benchmarking exercise. For each measure, advise on ways in which subjectivity might be dealt with.
- (b) Analyse the strategies followed by *PAL* so far and evaluate the possible effects of actions arising from benchmarking in supporting these strategies.

(12 marks)

(13 marks)

(Total = 25 marks)

Question Four

Most organisations recognise that continuing as at present, sometimes referred to as the "do nothing" option, is rarely advisable as it is likely to lead to a performance shortfall against objectives. Even new policies may not guarantee meeting organisational objectives.

The planning technique "gap analysis" is a means by which an organisation can assess whether proposed policies are likely to achieve their objectives or the degree to which they might fall short.

Required:

- (a) Typically, an organisation might construct and then respond to a gap analysis as part of an overall (rational) approach to strategic management. Evaluate the usefulness of the "gap analysis" technique as part of such a system and the main criticisms of this rational approach.
- (b) Some people feel that gap analysis has declined in popularity particularly within the private sector. Discuss why this should be the case, and, using examples, explain how gap analysis could be particularly helpful to public sector organisations.

(10 marks)

(15 marks)

(Total = 25 marks)

Question Five

Qualispecs has a reputation for quality, traditional products. It has a group of optician shops, both rented and owned, from which it sells its spectacles. Recently, it has suffered intense competition and eroding customer loyalty, but a new chief executive has joined from one of its major rivals *Fastglass*.

Fastglass is capturing *Qualispecs*' market through partnership with a high-street shopping group. These shops install mini-labs in which prescriptions for spectacles are dispensed within an hour. Some competitors have successfully experimented with designer frames and sunglasses. Others have reduced costs through new computer-aided production methods.

Qualispecs has continued to operate as it always has, letting the product "speak for itself" and failing to utilise advances in technology. Although production costs remain high, *Qualispecs* is financially secure and has large cash reserves. Fortunately, the country's most popular sports star recently received a prestigious international award wearing a pair of *Qualispecs*' spectacles.

The new Chief Executive has established as a priority the need for improved financial performance. Following a review she discovers that:

- (i) targets are set centrally and shops report monthly. Site profitability varies enormously, and fixed costs are high in shopping malls;
- (ii) shops exercise no control over job roles, working conditions, and pay rates;
- (iii) individual staff pay is increased annually according to a pre-determined pay scale. Everyone also receives a small one-off payment based on group financial performance.

Market analysts predict a slowdown in the national economy but feel that consumer spending will continue to increase, particularly among 18-30 year olds.

Required:

- (a) Produce a corporate appraisal of *Qualispecs*, taking account of internal and external factors, and discuss the key strategic challenges facing the company.
(16 marks)
 - (b) Corporate appraisal offers a "snapshot" of the present. In order to focus on the future, there is a need to develop realistic policies and programmes. Recommend, with reasons, strategies from your appraisal that would enable *Qualispecs* to build on its past success.
(9 marks)
- (Total = 25 marks)

End of paper