Final Level

Management Accounting – Business Strategy

12 FLBS

23 November 2004

Tuesday morning

INSTRUCTIONS TO CANDIDATES

Read this page before you look at the questions

You are allowed three hours to answer this question paper.
Answer the ONE question in Section A. Answer TWO questions ONLY from Section B.

SECTION A – 50 MARKS

ANSWER THIS QUESTION

Question One

Background

The P Group is listed and is a manufacturer of sheet metal which it supplies to building contractors and vehicle manufacturers around the world. It has manufacturing operations in 25 countries, employing over 3,000 people in total.

The Chairman of the P Group believes that its exposure to unsystematic financial and economic risk is reduced by diversification of sales through world markets. The company has become leader in several of its markets and is regarded as a major multinational company.

Latest financial information for the Group

The following extracts are taken from the most recent set of published accounts:

Group Profit and Loss Statement for the year ended 30 September 2003

	\$m
Group turnover	320
Group profit on ordinary activities before tax	19
Earnings per share	\$0·006
Dividend per share	\$0·005

P's market capitalisation is \$110 million.

Manufacturing operations in Bigland

One of P Group's subsidiary manufacturing units (PB) is in a factory within the country of Bigland. It manufactures three sheet metal products, M1, M2 and M3 and sells these exclusively within Bigland. The market position of M1 is that a competitor is the market leader, whereas PB is itself the market leader in respect of its product M2. There is no clear market leader for product M3. The products are independent and do not complement each other. Performance data for each of products M1, M2 and M3 are given below for the two years ended September 2004 (the heading PB indicates the PB Company). For comparison purposes, performance data for the nearest competitor for each product is also given (the heading C indicates the nearest competitor).

	PRODUCT					
	M1		M2		M3	
	PB *\$m*	*C* *\$m*	*PB* *\$m*	*C* *\$m*	*PB* *\$m*	*C* *\$m*
Year to 30 September 2003						
Turnover	6·00	16·00	4·50	1·50	2·80	2·50
Operating costs	5·40	11·00	3·20	1·00	2·10	2·20
Pre-tax operating profit	0·60	5·00	1·30	0·50	0·70	0·30
Year to 30 September 2004						
Turnover	5·80	18·00	6·40	2·40	3·70	3·40
Operating costs	5·60	12·10	4·20	1·40	2·90	3·00
Pre-tax operating profit	0·20	5·90	2·20	1·00	0·80	0·40

Management of PB is very traditional and may be regarded as classical in style. It follows the principle that the company may be engineered to work perfectly. There is clear segregation of tasks and role specialisation in place. Management is exercised through a "top down" approach with staff being largely regarded as inputs into the system motivated purely by their level of earnings. In recent years, there has been increasing staff turnover at PB which has led to an increase in costs, particularly in the areas of recruitment and training. Higher than average salaries and wages have been paid to attract staff.

Strategic review of PB

Senior management of the P Group have been concerned for a few years about the overall level of market share and profitability of PB, but other than seeking an explanation regarding the unsatisfactory performance from the Managing Director, they have taken no action. The Chairman of P Group has now decided that immediate action should be taken and has proposed four alternative options.

Each of these options is set out below. The financial consequences of each option for the next financial year are also detailed:

Option		*Financial consequences*
(i)	Withdraw from the market	Impact of closure on other P Group sales in the region (due to reduction in demand for complementary products) would reduce pre tax operating profit by \$4m and the incremental cost of the closure of PB would result in a once and for all before tax cost of \$2m.
(ii)	Maintain PB	Turnover of products M2 and M3 will increase by 25% each, but M1 will continue its current rate of decline. Costs for products M2 and M3 would remain in the same proportion to sales as they were for the year ended 30 September 2004. The costs for product M1 would rise to \$5·8m.
(iii)	Export to Bigland	An incremental cost of the closure of PB will be a single before tax cost of \$2m. Turnover for products M2 and M3 will increase by 25% each, but M1 will continue its current rate of decline. The operating costs of production will be on average 5% higher than those incurred in Bigland and transport costs will be \$1m per annum to carry the products to customers in Bigland.
(iv)	Licence the products	The licence fee income will be \$2m altogether for all three products. Costs of ensuring quality of production will be \$0·5m and the incremental cost of the closure of PB will be a single before tax cost of \$2m.

The Group Managing Director now requires a review of the impact each of the four options will have on the profitability of the group as a whole in the next financial year. At this stage, he does not require an analysis which extends beyond one year, nor does he want to consider the effects on taxation or transfer pricing just yet, as he requires a speedy review to enable him to discuss the position with the Chairman very quickly.

Question One

Required:

(a) Produce a critical appraisal of the use of the Boston Consulting Group Growth Share Matrix for the purposes of evaluating PB's product portfolio.

(10 marks)

(b) Evaluate the performance of PB for the two years ended 30 September 2003 and 2004 making any comparisons you consider appropriate with the company's competitors.

(15 marks)

(c) Evaluate the financial impact of each of the four options set out by the Chairman. Recommend, with reasons, to the P Group Managing Director which option you consider to be the most appropriate ignoring the effects of discounted cash flow, inflation, taxation and the effect of exchange rate variation.

(15 marks)

(d) Discuss the effects each of the options may have on the organisational management and structure of PB and on the group as a whole.

(10 marks)

(Total = 50 marks)

SECTION B – 50 MARKS

ANSWER TWO QUESTIONS ONLY

Question Two

There are several different methods of strategy formulation. Most strategists would argue, for instance, that public sector organisations mainly favour a logical, rational approach.

The senior partners of the world famous private sector management consultancy firm SPK are presently considering both the issue of their own strategy formulation and making some changes to direction of the company. SPK only deals with traditional "blue chip" companies. SPK is renowned for networking and has access to key decision makers through the personal contacts of its partners and senior managers. These contacts are felt to be at the heart of its business success. SPK places a lot of trust in the decisions made by its relatively small core of partners and senior managers who foster close relationships with clients and identify consultancy opportunities. These individuals draw together and then lead teams of (normally) freelance consultants and academics to fulfil their consultancy briefs.

Partners and senior managers are judged on the client profile and profitability levels within their personal portfolios. Individually, they are highly skilled but tend to have definite fixed opinions and to be strong willed. In addition, they work independently when deciding which business areas to target and the nature of work undertaken.

Required:

(a) Discuss the main approaches to strategy formulation and recommend the most appropriate for SPK.

(15 marks)

(b) Analyse the reasons for public sector organisations generally adopting a logical rational approach to strategy formulation and suggest how, in the absence of profitability, they can measure performance.

(10 marks)

(Total = 25 marks)

Question Three

Parachute Fund Management (PFM) has been responsible for the investment of pension and life insurance funds for the past twenty years. It claims to be a “fund manager with a difference” by seeking to gain active involvement in under-performing or poorly managed businesses. PFM requires that companies it has invested in be run in the long-term interests of the shareholders. PFM assesses such companies in terms of communication, financial, strategic and ethical performance against certain principles it has developed. (For instance, one financial principle is that “companies should have performance evaluation and incentive systems to provide managers with an incentive to deliver long term shareholder value”).

PFM’s belief is that there is a lack of “real” accountability between boards of directors and shareholders and that too often shareholders concentrate on short-term financial gains. PFM argues that if other investors believe that a company is poorly run they merely sell their shares and invest elsewhere. Thus boards of directors are not held properly to account over poor performance. Where it believes companies it invests in are under-performing, PFM enters into dialogue with the board and seeks changes in practice. PFM is increasingly being recognised as a major driver of change in corporate life.

Required:

(a) Evaluate the stakeholder role performed by PFM including the source of its power and apparent interest.

(13 marks)

(b) Advise an under-performing company how it should put in place appropriate performance evaluation and incentive systems to provide managers with the motivation to deliver long term shareholder value.

(12 marks)

(Total = 25 marks)

Question Four

Glaspac is a manufacturer and installer of replacement plastic windows. Glaspac prides itself on its added security features. While there are some national competitors, most are regional and recently two of Glaspac's competitors have merged. Glaspac operates in a national market and has agents who display products and distribute promotional literature in some shopping malls and large stores throughout the country. These agents collect details of potential customers for sales executives to follow up and give detailed quotations. At a planning meeting two years ago, Glaspac agreed that it could realistically achieve a turnover of $400,000 per quarter within three years. At present, it only achieves a turnover of $300,000 per quarter; a fall of $50,000 from two years ago.

Required:

(a) Analyse, by reference to gap analysis, Glaspac's position and the available options implied by the technique.

(12 marks)

(b) Discuss the relationship between gap analysis and scenario planning in the strategic process. Making reference to Glaspac, advise how these techniques might be used together.

(13 marks)

(Total = 25 marks)

Question Five

For an organisation to successfully achieve its strategies it will need to give adequate consideration to both structure and support systems. Similarly, it should consider the issue of relationship management, as all organisations are reliant on relationships with others. In varying degrees, organisations explore their boundaries of responsibility with others and many have taken the decision to outsource activities, some to the extent that they operate as "networked organisations".

The term "virtual organisations" has been used to describe an extreme form of networked organisation that has minimal owned resources and activities. Here the emphasis is almost solely upon partnership and collaboration rather than permanent staff, physical sites and formal structures. Critics feel that such organisations are unable to operate beyond the short term, citing as evidence the number of so-called "dot com" companies that have gone out of business.

Required:

(a) Discuss the key strategic issues that will lead to potential strategic strengths or weaknesses for a virtual networked organisation.

(12 marks)

(b) Discuss the benefits and difficulties of conducting an environmental analysis in an organisation that is highly networked.

(13 marks)

(Total = 25 marks)

End of paper