

## **TOPCIMA - November 2007 - Post Exam Guidance report**

### **1.0 General Overview**

The purpose of this report is to give help and advice to candidates who were not successful in the November 2007 sitting of the Merbatty TOPCIMA exam. This report explains what the examiner was looking for in candidates' answers and details the most common mistakes made by candidates sitting this exam.

This report will also be useful to candidates planning to sit a future TOPCIMA exam, as the advice given is not necessarily specific to the November 2007 TOPCIMA case, but can be taken and used to improve candidates' understanding of the higher level analysis skills required to pass this final CIMA exam. As always in CIMA exams, it is quality, not quantity, which is important. It is often the recommendations at the end of your report and the judgement displayed throughout the report that will determine whether your report will pass or fail. So good time management is crucial in order to allow adequate time to prepare detailed, fully justified recommendations.

TOPCIMA is a case study based exam, with the pre-seen material to set the scene, being published over 8 weeks before the exam sitting. This case was about a luxury boat building company called Merbatty. The requirement was similar to previous TOPCIMA exams. Candidates were asked to write a report to the Board of Merbatty, which:

- Prioritises the issues facing Merbatty
- Analyses and evaluates the issues and provides a choice of alternative actions to address them
- Makes appropriate recommendations on what actions should be taken, together with the rationale for why each particular course of action has been selected (from the choices provided earlier in your report).

The assessment matrix has 9 criteria, each of which carries between 5 and 20 marks. It is stressed that it is important to earn high marks in Judgement (for analysis of the issues) and Logic (for recommendations), as each carries 20 marks.

Merbatty, the luxury boat building company featured in the case, has been a listed company for less than one year and has an ambitious 5 year plan, which investors will want to see achieved as this is why they invested in Merbatty in 2006. The 2 main issues in the unseen material concerned:

- A hostile take-over bid by CCL, at a bid price equivalent to €4.20 per share
- A gap in the planned profit for 2008, which was planned at €51 million, but is currently only forecast to be €39 million.

The unseen material also included 5 issues of secondary importance:

- Currency fluctuations which are having an adverse effect on profits
- Sales Director had resigned (and moved to CCL, who have announced the take-over bid against Merbatty)
- A sales agent in the USA has resigned and a possible new agent is requesting substantially increased agent's commission.
- The locations of Merbatty's boat building facilities and whether the plans to expand in Asia should be brought forward, or whether land in Europe should be acquired for future expansion there.

- Test results on boats in production showing possible faults. These faults could lead to delays in a market where there is commercial pressure to deliver boats on time.

Prioritisation is very important, with the need to identify and subsequently analyse around 5 issues. Therefore it is NOT necessary to discuss ALL 7 issues in this case. However, the 2 main issues, which are inter-related, are the take-over bid and the need to achieve the planned level of profits. Without discussing either of these 2 important issues, it would be difficult to earn sufficient marks to pass. However, almost every candidate did discuss one or both of these 2 important issues.

Many candidates who failed this sitting of TOPCIMA did so because they did not recognise the future potential value of Merbatty or the importance of achieving the planned profit level and did not recognise the inter-relationship between these two key issues. Only about a third of candidates prepared relevant calculations to identify that the bid undervalued the company's future earnings potential. Even without any calculations, many candidates who identified that Merbatty was growing fast, did not understand that the Merbatty Board did not have the power to reject the bid, and that the rejection of the bid would be dependent on a few key shareholders including JKL, who own 28%. The unseen material even included a sentence reminding candidates that "JKL need to be convinced". However, many candidates did not discuss JKL at all or even how JKL could be convinced to stay loyal. This demonstrated a poor understanding of this very fundamental strategic issue.

The second issue in the case concerned how Merbatty could achieve its planned profit target of €51 million in 2008. The unseen material stated that 2007 planned profits had been achieved but that plans had identified a profit gap of €12 million in 2008. As in real life this issue is inter-related to the hostile take-over bid. If the Merbatty Board are to be able to convince JKL to stay loyal and that a higher share price will be achieved in the future if Merbatty achieves the 5 year plan (which they invested in Merbatty on the basis of), then it is extremely important that the 5 year plan is achieved. Therefore it was extremely naïve for some candidates to recommend that the bid should be rejected and that JKL must be convinced to stay loyal, and then to state that they could not make any recommendations as to how Merbatty could ensure that the planned profits are achieved.

Many candidates discussed all of the individual ways to reduce costs (change engines, cut down specifications, cut sponsorship, manage currency differently) but then did not recommend any changes. If the profit gap of €12 million was not closed, and a substantially lower profit subsequently achieved in 2008, then Merbatty would lose the confidence of its investors and any future hostile take-over bid (probably at a lower bid price) would no doubt be successful. It is unrealistic that candidates should recommend JKL to "stay loyal and Merbatty will achieve plan – but, sorry Merbatty will not achieve plan in 2008" as they failed to recommend any changes so that the planned profit can be achieved.

There is a need for more consideration of the impact of the key issues on the company in the case, rather than repeating theoretical strategies, with little understanding of their relevance to the strategic decision making process. Candidates are reminded that all of the analysis given in the appendices should be relevant to the case and should be referred to and discussed in the body of their report. They should not be simply used as "stand alone" appendices which are then not used to analyse the issues in the main body of the report.

## **2.0 Areas that were well attempted by candidates**

The format of candidates' reports remains very good. Technical knowledge was also good. Around 90% of candidates earned pass marks in prioritisation. The examiner considered that the hostile take-over bid by CCL should be within the top 2 priorities and that the issue of achieving the planned profit for 2008 should appear anywhere within the top 5 priorities.

Recommendations were good in some candidates' reports, as they showed clear reasoning as to how they had reached each recommendation. It is this justification behind the recommendation that earns higher marks rather than the recommendation itself. Also, many candidates correctly prepared recommendations for all of the issues they had identified, prioritised and discussed earlier in their report.

Ethical issues were generally well answered, although advice tended to be weak.

### **3.0 Areas that were not well attempted by candidates**

There are 20 marks for Judgement and 20 marks for Logic. Therefore these two criteria have a significant impact on the total marks awarded. It is in these two criteria that unsuccessful candidates often did not achieve high marks, resulting in marginal fail marks overall. Therefore it is important to learn the skills required in order to earn pass marks in these two criteria in particular.

Within these two criteria there were 5 main areas of weakness:

1. Many candidates simply stated that the takeover bid price at €4.20 was "very attractive" as it was 24% higher than the share price before the take-over was announced. This did not recognise what future potential value of Merbatty or its stated growth plans. For example if the 2008 profits are delivered at €51 million, this would result in a higher price of €4.25 ( $\text{€51 million} / 180 \text{ million shares} \times \text{P/E of } 15$ ). Furthermore, if the planned profit of €80 million were to be achieved in 2011, the share price could be €6.67, based on a P/E ratio of 15.
2. Many candidates did not recognise that the Board of Merbatty cannot reject the bid as they do not own overall control of the shares. They can make a recommendation to shareholders not to accept the bid, but ultimately it is the shareholders decision. JKL, with a 28% shareholding, is a crucial shareholder to convince. Therefore recommendations that stated "the bid should be rejected" earned lower marks than a more detailed recommendation such as "the Merbatty Board should try to convince JKL of its ability to deliver the planned level of profits, which will see the Merbatty share price rise far beyond the bid price to around €6.67 by 2011".
3. The need to achieve planned profits was clearly not recognised by many candidates. The unseen material gave a few ideas as to where costs could be saved but most candidates simply stated that none of these costs should be cut, as the cuts could affect Merbatty brand reputation. Neither did candidates suggest any other ways to achieve the planned profit of €51 million. Many candidates simply recommended rejecting each of the suggested cost reduction methods. The candidates did not recognise the important link between the need to convince JKL to reject the bid – which it would only do if it could be assured of the 2008 planned profit being delivered. It was rather commercially naïve to expect JKL (who have a seat on the Board) to reject €4.20 per share now and then to only achieve 2008 profits of €39 million, which represents only €3.25 per share. It is the role of a management accountant to identify profit gaps as part of the planning process and to work with management to identify ways of closing the profit gap.
4. Currency. This was an area that many candidates chose not to discuss, despite the currency movement that was forecast to cause an adverse variance of €6 million, half of the profit gap in 2008. Many candidates earned no marks for simply stating that Merbatty should hedge its currency exposure, which the case material stated it already undertook. What was required here was a discussion on whether Merbatty should try to procure more supplies in US Dollars to match revenues or to change its price list to be denominated in only Euros. A better understanding of currency management is recommended.

5. Agent's fees. A disappointing large number of candidates did not recognise that if Merbatty appointed a new sales agent at 8% commission (double what Merbatty is paying to all other agents), this could result in far larger fees being demanded by other agents and that this could have a significant impact on Merbatty's profits. It was expected that candidates would identify that an alternative agent should be found and paid the same 4% fee. Alternatively, existing agents in another part of the USA could be asked if they wanted to expand their sales territory. Another option is that Merbatty could open its own sales office.

Furthermore, many candidates earned low marks in Application. High marks were often awarded in the criterion of Technical for a wide display of technical knowledge, but unfortunately much had not been "applied" to the case material, resulting in lower marks in Application. Also many candidates prepared very few relevant calculations, such as valuations for Merbatty or how costs could be saved to close the forecast profit gap.

#### **4.0 Assessment matrix and areas for improvement**

##### **4.1 Overview of the TOPCIMA Assessment matrix**

The examiner was pleased with the format of candidates' reports although the discussion was often "thin" and lacked depth of analysis and many of the supporting theoretical frameworks were not referred to in the reports.

The analysis of alternative strategies and the recommendations (marked in Judgement and Logic respectively) were generally weak. In addition to the top 2 priorities of the take-over and the need to achieve the 2008 profits, there were 5 other issues in this case. The other 5 issues in the case included the choice of location for Merbatty's boat building locations, the need to appoint a new Sales Director, how to manage the loss of a key sales agent, currency fluctuations and the test results. These issues gave candidates ample opportunity for analysis and to make a range of commercially sensible recommendation to earn marks. It was NOT necessary to discuss all of these 5 additional issues but perhaps just 3 of them (in addition to the take-over and the need to reduce costs).

Therefore, whilst reasonable marks were awarded in the other 7 criteria, the criteria of Judgement and Logic (which carry 40% of the total marks) were often poorly answered. It is important to display a good degree of professional and commercial judgement throughout the report and to make sensible, commercially realistic recommendations.

##### **4.2 Technical**

5 marks are available for Technical. Many candidates earned very high marks for a good display of relevant technical knowledge. Indeed many candidates produced at least 3 or 4 relevant theories or analyses, including a SWOT, a PEST analysis, references to Porter, Ansoff, Mendelow etc. as well as financial ratios and valuation techniques.

There was ample opportunity to earn marks in this criterion for the display of any of the following techniques:

- SWOT analysis
- PEST analysis for the proposed move to Asia
- The Johnson and Scholes model to structure the answer by using the suitability, acceptability and feasibility framework for the proposals to cut costs or for evaluating the take-over bid

- Porter's Generic Strategies to demonstrate that Merbatty differentiates itself on quality and excellence in design and customer satisfaction
- Porters five forces to demonstrate that barriers to entry in the industry are high and that suppliers' power is also high.
- Mendelow's stakeholder analysis which should analyse Merbatty's many stakeholders, including its shareholders. This was particularly relevant in terms of sales agents for delivering sales and JKL as a key shareholder in respect of the take-over bid.
- Motivational theories put forward by Herzberg and Maslow.
- Other applied models such as Ansoff's growth matrix , the BCG matrix and the Balanced Scorecard
- Valuation techniques such as Dividend Valuation Model (DVM) or valuations based on P/E ratios
- Relevant ratios

However, many candidates spend too much time preparing detailed appendices that are then not referred to or discussed within the body of the report. It is a fine balance on how to spend the 3 hour exam time. The 2 criteria of Technical and Application are together worth 20 marks – and therefore should not have more that 20% of exam time spent on them. This equates to 36 minutes maximum. However, it is suggested that with exam planning time and time spent prioritising issues, no more than 30 minutes should be spend on appendices. Exam time would be better used prepare a more in depth analysis to earn higher marks in Judgement and Logic.

The recommended study text is Elsevier's TOPCIMA Learning System, which has a whole chapter on techniques that should be revised for use in this exam.

### **4.3 Application**

The Application criterion carries 15 marks and is used to reward candidates for applying technical knowledge (both theories and calculations) to the case material. In order to earn high marks for the SWOT, candidates should have identified the CCL take-over bid as a Threat and also the threat of reduced share price if the planned profit is not achieved. It is necessary to incorporate all of the new information given in the unseen material in order to earn high marks. A pre-prepared SWOT based on the pre-seen is insufficient. Candidates are also reminded that all of the issues prioritised should be included in the relevant section of the SWOT. It is surprising how many candidates omitted the top priority of the take-over as a Threat. There is no greater threat to any company than a take-over, which will cause the company to not exist in its current form. Additionally, many candidates listed the take-over as an Opportunity for Merbatty. Whilst this is partially correct (as it may enjoy economies of scale etc), Merbatty would cease to exist in its current form – therefore it really is an Opportunity for CCL and a Threat for Merbatty.

A good range of theoretical knowledge was prepared and applied to the case material and many candidates earned high marks for the theories applied. However, within the available 15 marks, roughly half of the marks were available for applying theoretical knowledge and the other half for relevant accurate supporting calculations.

TOPCIMA is not a "numbers" exam and there are limited marks in the assessment criteria of "Application" for relevant calculations. Therefore it is recommended that candidates do not spend too much time (perhaps 20 minutes maximum) on preparing supporting calculations. However, in this November 2007 exam concerning a hostile take-over bid, it was particularly relevant for candidates to prepare some calculations to value Merbatty, both now and its future value (based on profits in the 5 year plan) as this would support their analysis of the bid.

Unfortunately in this case the accuracy and range of supporting calculations was not very good. Only about a third of candidates prepared any valuations for Merbatty at all. Those who did usually

calculated the correct 2011 share price projection of €6.67 per share. This helped them to identify that the bid significantly under-valued the future earnings potential of Merbatty.

Calculations that could have been prepared, to earn marks include:

- Merbatty's market capitalisation and the bid premium
- Valuations for Merbatty based on 2007 profits and the 5 year plan profits for 2008 to 2011 using P/E ratio method or DVM method
- Calculation of ways in which the profit gap of €12 million could be closed, by saving costs such as changing engine supplier, increasing prices and reducing the currency losses
- Calculations concerning the possible impact of higher agents fees
- Calculations for providing the enhanced Marinatron navigation systems
- Relevant ratios for Merbatty on gearing and profitability

#### **4.4 Diversity**

Diversity carries 5 marks. Many candidates earned good marks for industry awareness and relevant comments on international boat building companies and other companies that have been taken-over. Many candidates appeared to have some understanding of the boating industry and had obviously undertaken research or been taught about the sector prior to the examination. Relevant companies included Sunseeker (location in Poole, UK), Riviera (strong brand and established reputation in the Australian market), Ferretti (innovation, level of expenditure on research and development activities, and development of products with companies such as Mitsubishi), Ferretti (currency issues), Sunseeker (Alliances with other companies), Ferretti and Azimut-Benetti (growth by acquisition), Princess and Riviera (sales agents), and Sunseeker (use of own sales teams). There were also references to boat shows, the development of marinas in China and other countries, and the increasing number of high wealth individuals around the world. Many candidates also commented on the American economy and the recent 'credit crunch', and made reference to how this might effect Merbatty's operations in the USA.

In summary, high marks were awarded in Diversity to many candidates. However, the information about the real life companies was often not considered when preparing the rest of the report.

#### **4.5 Focus**

There are 5 marks available for the Focus criterion. These are awarded for discussing the issues raised in the case. There was the opportunity to earn marks in Focus for the discussion of any of the 7 issues. These included the take-over bid, the need to achieve the planned profit in 2008, the currency issue, the need for a new Sales Director, the need to replace the USA sales agent, the choice of location for Merbatty's boat building facilities and the problem with the test results for some boats in production.

Most candidates earned the full 5 marks available for their discussion of 5 relevant issues.

#### **4.6 Prioritisation**

Almost all candidates clearly prioritised 5 issues at the start of their reports, and did attempt to justify the rationale behind their ranking. This resulted in high marks for prioritisation for many candidates in the important criteria.

The most crucial of all issues affecting a company is maintaining its very existence. A hostile take-over threatens Merbatty's very existence and no other decisions affecting Merbatty's future could be decided before this issue. Therefore the examiner considers that the CCL proposed take-over bid should be ranked as the top priority. However, given exam conditions and all of the other

important issues in the unseen material, the examiner awarded high marks (8 to 10 marks) if the take-over bid was placed either as the top, or the second priority.

If the take-over was placed as a lower priority, marginal fail marks in the criterion of Prioritisation were awarded. Therefore, whilst a candidate could still pass, low marks would be awarded if the take-over was not recognised as one of the 2 highest priorities. Furthermore, the related issue concerning the need to achieve the planned level of profit for 2008 was considered by the examiner as being important. This issue needed to be placed anywhere within the top 5 priorities. The title and discussion concerning achieving the planned profit could take various formats, as it was unimportant whether it was described as 'reducing costs', or 'achieving plan' or whether 'the engines and other cost savings' were given separate priorities. However, what was important here was recognition of the need to take action to ensure that a higher profit than the latest forecast of €39 million must be achieved.

There continues to be a lack of understanding by some candidates of the nature of prioritisation. It is not about urgency but about impact on the company. A minor issue that requires a decision next week is less important than a major strategic issue that will affect the future success or very existence of the company.

To summarise, in order to earn the full 10 marks available, it was necessary to identify and place within the top 2 priority issues the take-over bid and also to prioritise the need to achieve the planned level of profits for 2008 anywhere within the top 5 priorities.

#### **4.7 Judgement**

This is a very important criterion, which carries 20 marks. Marks are awarded for analysing each of the issues and for discussing a variety of alternative solutions. The Judgement criterion is a clear discriminator between well prepared candidates and weaker candidates. Where low marks are awarded in Judgement, it is unlikely that the candidate will have earned enough marks in other criteria in order to pass TOPCIMA. Therefore it was this criterion that often determined the difference between pass and fail in a script and is an important criterion which future candidates should concentrate on, to ensure that their analysis skills have been developed and practiced. Candidates who analysed and discussed several of the issues well and showed good commercial judgement on several issues earned pass marks of over 10. However, candidates who demonstrated poor commercial and professional judgement earned between 3 to 8 marks.

Therefore it must be stressed that this criterion is an area that unsuccessful candidates need to improve in. Marks are only awarded in Judgement for comments and choices of action that are commercially viable, realistic and sensible. Common sense and general business awareness were often not displayed. For example, many candidates stated that it is important that Merbatty do not lose any further sales in the USA and that the proposed new sales agent SFBS should be appointed, even though the requested sales commission is double the existing sales commission. Some candidates even stated that a confidentially agreement should be signed. Furthermore, there was no recognition that if Merbatty's other sales agents worldwide were to hear of the 8% commission arrangements, this could have a material effect on Merbatty's profits. Agents costs at 4% of revenues equate to around €22 million (2007 revenues of €555 million x 4%). If all sales agents were to insist on 8% this would result in operating costs increasing by a further €22 million – which is half of the post tax profits for 2007. This would be a significant impact on profitability. The alternatives would be to find other sales agents who would accept the 4% commission fee, or to ask Merbatty's existing sales agents in the USA to expand by opening further sales offices. Alternatively Merbatty could open its own sales office staffed by employees and incentivise them for achieving sales.

In the November 2007 case, there were 7 issues for which marks were available in Judgement. Marks were awarded for reasoned analysis of the following 7 issues:

1. The CCL take-over bid

The CCL bid at €4.20 represents a 24% premium on Merbatty's pre-bid share price of €3.40. Usually a bid premium exceeds 25% and is often around 30%. So the bid price was not generous. Some candidates incorrectly stated that the bid price was "attractive as it exceeded the share price". This was incorrect as a hostile take-over bid would always be at a price higher than the current share price – otherwise it would not be attractive to the shareholders! What many candidates did not recognise was the value Merbatty as a company could be worth. This should have included valuations of what Merbatty is worth now and what could be its worth in a few years if it were able to deliver the planned profits. Merbatty was only listed a year before, in November 2006. When shareholders invested in Merbatty (at €2.80 per share) they invested on the basis of the published 5 year plan. They are not investing to make a "quick profit" – they are investing for the medium to longer term. While the Merbatty Board continues to deliver the planned level of profits, they will be content.

The unseen material stated that the 2007 planned profit of €45 is likely to be achieved. On the basis of this profit, at a P/E of 15, the company is worth €3.75 per share ( $\text{€45 million} \times \text{P/E } 15 / 180 \text{ million shares}$ ). Therefore the current market price reflects Merbatty's current earnings, despite the loss of market confidence in this market sector.

Candidates could also have prepared an analysis of who could vote for and against the bid and this should have identified that JKL are a key player (Mendelow's matrix) with 28% of the shares – so much would depend on whether JKL considered the future value of Merbatty would be greater under the current Merbatty's Board control or under CCL. Given CCL's track record of lower EPS and lower net profit margin, there is evidence available to persuade JKL that CCL would not deliver Merbatty's current 5 year plan. The key to gaining high marks in Judgement in respect of the take-over bid was the recognition of the importance of JKL and the need for the Merbatty Board to come up with reasons as to why the bid should be rejected and also the recognition of Merbatty's much higher future value. If the planned level of profits were to be achieved, the Merbatty share price would be over €6.67 in 2011.

Many candidates earned low marks as they did not recognise that the Merbatty Board do not have the ability to reject the bid – this is for the Board to advise its shareholders – i.e. JKL in particular. Also few candidates recognised Merbatty's future potential higher value or prepared calculations to substantiate its future share values. A further disappointing theme in some weaker candidate's answers was that the takeover (which was a share exchange) would result in cash flowing into Merbatty. This was totally incorrect.

2. The need to achieve the planned profit of €51 million in 2008.

If JKL are to be persuaded to reject the bid then it is important that plans are made so that the 2008 planned profit of €51 million is achieved. It would not be acceptable to ask JKL to stay loyal and then to state, 'sorry, but we are going to issue a profits warning as 2008 profits will be €12 million lower at €39 million, and we are taking no action to close this profit gap!' This is unrealistic. Commercially, it is important that Merbatty continues to hit planned profit targets. It is the role of a management accountant to identify profit gaps and to work with management to develop ways in which the profit gap could be closed. It is never easy and some tough decisions will have to be made.



In the case material on exam day, some suggestions as to how costs could be saved were included. It is the role of the consultant to advise on some of these suggestions and to explain the consequences of the cost cutting. However, it is not acceptable to state that Merbatty should not change engines, should not reduce specs, should not increase prices, and should not cancel sponsorship etc, as some of these decisions will need to be made – unless other more innovative ways can be found to save the €12 million profit gap. It was surprising, and disappointing, that so few candidates produced any summary of how the 2008 profits could be improved, as this was fundamental to the case.

It was expected that candidates would recognise that the dual sourcing of engines made good commercial sense, particularly at the bottom end of Merbatty's range of boats. Merbatty boats are pleasure boats not speedboats. The customer could be given the choice. Therefore, Merbatty could have a price list with an extra charge if the more powerful MNE engines were requested by a customer. Additionally, ENG engines procured in the USA would provide a good match for US Dollar revenues, therefore reducing Merbatty's currency exposure as this would provide a natural hedge.

The proposal to increase the price of the P3000 model was generally rejected by candidates, despite the fact that Merbatty plans to sell only 15 in 2008. Many candidates stated that any price increase could affect volumes of sales without recognising the small number of boat sales. Sales volumes may be reduced, but enhanced specifications, possibly incorporating the new Marinatron navigation system could justify a price increase in this one model. This proposal was generally rejected. With TOPCIMA it is not the answer that is right or wrong generally, but the arguments put forward to justify the suggested courses of action. Generally this was not well handled.

In respect of the other cost savings suggested, it was expected that candidates would reject the suggestion to install cheaper, lower technology equipment as this was totally contrary to Merbatty's policy of differentiation on quality and could damage the brand image. Similarly, it was expected that candidates would reject the proposals to reduce development expenditure and to cancel the sponsorship contracts. There were 2 reasons for not cutting sponsorship: firstly, both of the sponsorship contracts have several years to run and probably could not be cancelled without a penalty. Secondly, the cancellation would generate adverse publicity and cause potential customers to lose confidence in Merbatty if such a visible sponsorship contract were cancelled. It would be better to suggest that Merbatty should consider not renewing one or both when the contracts came up for renewal in 2009 and 2011.

Many candidates suggested that Merbatty should install the new Marinatron navigation software in all boats, but were often unclear as to whether they were suggesting that Merbatty bear the cost or whether customers would pay for this additional extra. If Merbatty were to bear the cost, this would increase the 2008 profit gap. It could be suggested that Merbatty should offer this enhanced navigation system as an extra, or as a way to justify a higher sales price.

Merbatty was only listed in November 2006 – only 1 year before, and it is important that Merbatty tries its best to deliver to the plan that was promised its investors. At this first hurdle, ways need to be found, such as JIT, lean manufacturing techniques, TQM etc, to enable Merbatty to achieve its financial plans. What earned marks here was not just a discussion of ways to cut costs, but the recognition of the need to deliver its planned profits to keep its investors content. If Merbatty were to fail to achieve the planned profit of €51 million in 2008, CCL or another bidder would come along with another hostile take-over bid and perhaps Merbatty's investors would not be loyal if Merbatty had failed to deliver the planned profit. In the business section of national newspapers, there are usually reports on take-overs and on whether shareholders will accept or reject the bid and about historical and future profit

projections. These would help candidates to understand what the examiner wishes to elicit in their answers in TOPCIMA.

### 3. Currency fluctuations

It was expected that candidates would recognise that what was being described here was exactly what has happened in real life. The US Dollar was very weak and was around \$2 to £1 in November 2007 when this exam was sat. Candidates at this level of their studies should be aware of the importance of currency movements in today's global markets. This goes deeper than treasury management and external hedging techniques. Many candidates earned no marks for simply stating that Merbatty should hedge its currency exposure. A discussion on natural hedging methods such as procuring more supplies in US Dollars to match revenues or to change its price list to be denominated in only Euros was required. An alternative would be to change Merbatty's reporting currency to US Dollars. This is typical of the challenges facing many international companies today, and this issue was noticeably either avoided by candidates or handled badly. It is important that candidates should gain a good understanding of currency management.

It was expected that candidates would discuss a range of ways to ensure that the potential €6 million currency loss (half of the total profit gap of €12 million) does not occur by pricing in Euros only or Euros only for non-USA sales and by ensuring costs are matched against revenues.

Some candidates incorrectly recommended closing the USA facility so that the "problem would go away". This would, in fact, make the situation worse, as it is Merbatty's revenues that are in US Dollars which are now worth fewer Euros. By taking away the ability to offset some of its US Dollar operating costs, the situation would worsen. This type of comment demonstrated to the examiner a lack of understanding of this important issue.

### 4. Need to appoint a Sales Director following Stefan Gil's resignation.

Although Jesper Blanc (Marketing Director) has been given this role temporarily in addition to his other role, most candidates did recognise that he was the wrong person for such an important role as he was very inexperienced. Many candidates earned good marks for recognising this and for recommending that another, more senior Board member should take this role on until an external person can be recruited into this role.

Some candidates earned low marks for stating that all efforts should be made to get Stefan Gil to return. Stefan Gil left Merbatty on 9 November and has joined a rival (the same rival who has made the take-over bid for Merbatty). It is commercially unrealistic for someone of this level to return to the company he has already left. No doubt at the time of his resignation, Board colleagues would have tried to persuade him to stay. However, he has now left and candidates should have prepared more realistic comments on how the position should be filled rather than suggesting that he be enticed back. Many candidates also did not discuss the importance of recruiting a capable Sales Director, who will be able to deliver the 5 year plan.

### 5. Sales agents in the USA.

Following the notice given by Merbatty's agent LABS, Jesper Blanc (the new temporary Sales Director) approached a prospective new agent, SFBS, which requested substantially increased agents commission of 8%.

Marks were awarded for the recognition that it was commercially unrealistic to appoint a new agent at double the commission and that this could have far reaching implications for all of

Merbatty's sales agents' word wide and could potentially impact the profits by over €20 million if all agents insisted on 8%. Alternative available have been shown earlier in this report.

Some candidates made an incorrect suggestion that a higher commission percentage should be given for the sale of larger boats to encourage these to be sold, rather than the same commission as a smaller boat. As the commission is a percentage of the revenue generated, agents already get a far higher fee for the sale of larger boats.

#### 6. Location of Merbatty's global boat building facilities

Marks were available for the discussion on Merbatty's facilities and whether Merbatty should bring forward its planned expansion of facilities and whether it should be in Asia or Europe. There were also marks available for discussion on whether the USA facility should close due to a recent fall in sales. This issue was not intended to trick candidates but too many simply suggested that the USA facility be shut with no recognition of the impact that this could have on sales in the important target market of the USA or indeed the impact this would have on Merbatty's capacity to build the planned number of boats.

Some candidates also muddled the building of boats in the USA with sales to customers in the USA and did not appreciate the significance of this important target market, which generates around 24% of sales. If the USA facility were to be closed, this could have an adverse impact on Merbatty's ability to sell boats to the important USA market.

High marks were available for noting that expansion in Europe would not contribute to Merbatty's need to cut operating costs and that it should not purchase land speculatively, as there was nothing in the agreed 5 year plan about extending operations in Europe. Overall, the planned move to Asia should still be considered. This, however, was an issue of lesser importance, as Merbatty will cease to exist if it is acquired. Therefore all management efforts should be spent on managing shareholders expectations and achieving agreed profits and not on additional capital expenditure until additional boat building capacity is required.

#### 7. Computer test results

The discussion required here was to balance commercial pressure against the need to maintain high operating standards. The boats concerned should not be delivered to customers despite commercial pressures. If faults that had been ignored during test procedures were found, these would be expensive and time consuming to fix after delivery. Furthermore, there may be an adverse effect on Merbatty's brand image.

It was disappointing that some candidates gave brief unsubstantiated comments on many of these issues and did not discuss commercially sensible alternative approaches to address them. Business is all about managing risks and ensuring that threats to business goals are mitigated.

### 4.8 Integration

This criterion rewards candidates for their ability to write a cohesive, comprehensive report that "flows" well and reaches well justified recommendations on each of the issues discussed. This criterion rewards a report which is realistic in that it contains commercially viable comments that would help advise the Board of Directors of Merbatty. On the other hand, if it is considered that a company, in receipt of a report of this standard would be dissatisfied due to a lack of sensible recommendations, then low marks are awarded.

A report that contained recommendations which the examiner considered could cause the company problems was awarded low (fail) marks in this criterion. The recommendation that Merbatty should

accept the CCL bid was considered to be incorrect (as Merbatty could be worth substantially more than the CCL bid price of €4.20) and therefore low marks were awarded for candidates who recommended accepting it. However, if other issues in the case were well discussed and culminated in commercially sensible recommendations, the candidate could pass overall. Therefore accepting the bid resulted in low marks in Integration and Logic but did not directly result in the candidate failing.

#### 4.9 Logic

The criterion of Logic carries 20 marks in the assessment matrix and rewards clear, justified, well argued recommendations. It was a criterion in which fail candidates earned low marks.

It is recommended that candidates allocate at least 40 minutes of their examination time to preparing detailed and justified recommendations. Some candidates apparently did not manage their time adequately and prepared rushed recommendations. This is one of the most important areas of the report and will often determine a pass or a fail when the script is marginal, so it is important to ensure that recommendations are clear and the rationale for the recommended course of action is given.

It is of paramount importance that the report makes appropriate recommendations and does not leave any of the issues undecided. It is for the consultant (i.e. the candidate) to present all the arguments for and against and to weigh them up in order to make recommendations. There are few right or wrong answers with TOPCIMA – it is the depth of discussion and the strength of the candidates' arguments and the justification behind the recommendations that earns marks. Ill-thought through analysis and poor recommendations are not rewarded.

In this case, no marks were awarded for a recommendation to accept the CCL bid. Additionally, low marks were awarded if the candidate stated that none of the cost saving suggestions should be accepted. It was necessary to recognise in the recommendations that Merbatty has to take some actions and find ways to achieve the agreed 5 year plan.

In respect of all of the other issues, there were no right or wrong answers, although the recommendations that were commercially realistic earned higher marks than poorly thought through recommendations. Candidates are referred to the case writer's answers for detail of what actions were recommended and the rationale for the recommendations. These are available from [www.cimapublishing.com](http://www.cimapublishing.com) (through Elsevier).

A summary of the recommended actions for the 7 issues in this case are as follows:

1. The CCL take-over bid – it was recommended that the Merbatty Board should persuade JKL to reject the bid as the future potential value of Merbatty is over €6.67 if Merbatty achieves the agreed 5 year plan in 2011.
2. The need to achieve the planned profit of €51 million in 2008. If Merbatty are to be able to keep its investors loyal and not be the target of a further take-over bid, it must find ways to cut costs and achieve the agreed 5 year plan, including the €51 million profits in 2008. Recommended actions included:
  - accept ENG engines for some smaller Merbatty boats and have MNE engines available at an additional cost if customer requires a better engine
  - Increase price of P3000 boat and moderately enhance the specification to help this justify price rise, possibly with new Marinatron navigation system.
  - reject low specifications as they would damage brand image and Merbatty's differentiation policy

- reject cutting developments costs as these are necessary in this industry to remain competitive
  - reject the suggestion to cut sponsorship contracts as the cancellation would generate adverse publicity and could damage brand reputation
  - reduce losses from currency (see below).
3. Currency fluctuations. It is recommended that Merbatty should only allow USA based customers to sign contracts for Merbatty boats in US Dollars and all other customers around the world should pay in Euros. It is expected that around 74% of sales (i.e. all non USA sales) should be contracted for in Euros which could save €4.3 million of the forecast €6.0 million currency losses.
  4. Need to appoint a Sales Director following Stefan Gil's resignation. It is recommended that Merbatty recruit and appoint a new Sales Director, once the CCL bid period had ended.
  5. Sales agents in the USA. It is not recommended that Merbatty appoint SFBS. It is recommended that Merbatty should try to locate another agent in this area at the usual fee of 4% of revenues. Alternatively, Merbatty could open its own sales office.
  6. Location of Merbatty's boat building facilities. There is no convincing reason to close the USA boat building facility and to construct a new facility in Asia at this point simply to achieve operational cost savings. Merbatty does not need extra capacity until 2011 and therefore this proposal should be rejected at this time. The upheaval and potential problems this could cause could detract from the Merbatty management's need to manage the business during this growth period and to achieve the agreed 5 year planned level of profitability. The proposal to purchase land in Europe should also be rejected.
  7. Computer test results. It is recommended that the Board stop the delivery of boats to customers until it is satisfied that the faults have been rectified, or found out whether there really are software faults in the test programme.

As a reminder, it is generally better for all recommendations to appear together at the end of the report, rather than at the end of each section concerning each issue, as actions impact on each other. Additionally, recommendations are sometime on related issues. For example, as explained earlier, it was unrealistic to recommend that the CCL bid should be rejected and to persuade JKL to stay loyal, and then to recommend that no actions are taken to bring the forecast 2008 profits back to planned levels. Some candidates even recommended a profits warning – however, it would be more sensible to suggest ways to achieve the profit. If a profits warning were to be issued, it is likely that investors would take the €4.20 now and sell their shares to CCL.

Recommendations must be realistic and be consistent for related issues. In real life many decisions made are inter-related.

#### **4.10 Ethics**

Most candidates attempted to address 2 or 3 ethical issues and earned pass marks. In order to earn a pass mark, it is necessary to identify the ethical issues, justify why you consider them to be ethical issues and to advise on how to resolve several of the ethical dilemmas identified. The full 10 marks are awarded for a good discussion and advice concerning two or more ethical dilemmas. The problem is that many candidates discuss a number of ethical issues but do not:

- justify why the issue is an ethical dilemma or
- give clear, fully justified advice on how the ethical issue could be addressed and the cost implications for the company

Candidates are reminded to ensure they justify why an issue is deemed to be an ethical issue. For example, the problem with the test results showing faults is an ethical issue because Merbatty is suggesting that customers' safety is compromised in order to ensure that boats are delivered on time.

A maximum of 4 marks, i.e. marginal fail, was awarded for the discussion of ethical issues alone. It is the advice and recommendations on how the ethical issues could be overcome that earns up to the maximum 10 marks.

There were a range of ethical issues in this case including:

- Alberto Blanc's (Chairman) promise of a "loyalty" bonus of €3 million to his son Jesper Blanc to entice him not to sell his shares to CCL
- Merbatty has not given its customers a choice as to whether they would like the newly enhanced navigation software to be installed on new boats
- Proposed termination of agreed sponsorship with immediate effect, in order to cut costs
- Potential faults showing on the specialised software test programme that Alain Mina (Technical Director – Systems and IT) is choosing to ignore.
- Merbatty's ethical position on greenhouse gases and emissions and sources of renewable materials.

Generally the advice given on ethical issues was weak and earned low marks. For example, many candidates correctly identified the "loyalty" payment to Jesper Blanc as unethical but offered weak advice such as additional training for the Board on corporate governance whilst failing to recommend that the payment should not be made.

Many candidates treated the test results only as an ethical issue. However, as in the real world, this problem is a business issue as well. Candidates earned marks in Judgement as well as Ethics if both aspects of this problem were addressed.

## **5.0 Recommendations to improve your chance of passing TOPCIMA in the future**

Candidates are referred to the TOPCIMA Learning System, ([www.cimapublishing.com](http://www.cimapublishing.com)) which is the recommended reading text for this exam. This CIMA Learning System takes candidates through past TOPCIMA cases and demonstrates how to analyse the pre-seen and also what to do on the exam day with the unseen material and how to prepare answers on the exam day. It also contains a chapter on Technical issues, including revision of a range of business and financial techniques that candidates should understand and incorporate in their answers. This CIMA Learning System also contains past TOPCIMA cases and the case writer's answers.

Candidates sitting TOPCIMA for the first time are referred to previous Post Exam Guidance reports or the general TOPCIMA guidance notes (on the CIMA website) for advice on the suggested report format.

It is recommended that all candidates should read the financial pages of a good newspaper at least once a week, in order to gain an appreciation of the business world that this CIMA exam is set in. This will enable you to gain a far greater understanding of how companies operate and hopefully will reduce the number of non-sensible comments appearing in reports.

In summary, the eight key tasks that will put you in a better position to pass TOPCIMA are:

1. Work (not simply read) through at least 2 TOPCIMA past cases (on [www.cimaglobal.com](http://www.cimaglobal.com))

2. Read thoroughly 2 past TOPCIMA Post Exam Guidance reports (on [www.cimaglobal.com](http://www.cimaglobal.com) )
3. Research the business setting for the case thoroughly and totally familiarise yourself with the pre-seen material (read newspapers, research using the Internet, use Internet search engines such as Google to identify companies in the industry etc.)
4. Revise business strategies and suitable techniques and be able to apply them to the case material. The examiner would also like to stress the importance of cash management in any organisation, large or small, listed or unlisted, profit making or not for profit – cash is key.
5. Practice writing answers to previous TOPCIMA cases in a 3 hour session and see how comprehensive an answer you can produce. Check your answer to the case writer's answer (in the CIMA Learning System or available from [www.cimapublishing.com](http://www.cimapublishing.com) )
6. Read the two articles on the CIMA website ([www.cimaglobal.com](http://www.cimaglobal.com) ) about the case you are planning to sit. CIMA commissions independent writers to analyse the pre-seen material and these articles give a good insight into the industry setting and the problems and opportunities the company is facing. The articles for the September and November 2007 exams on Merbatty are "Plain Sailing" by Adrian Sims of BPP and "Navigating uncertain waters" by Shuaib Masters of Kaplan Financial. There will be other articles for the next TOPCIMA exams on the CIMA website early in 2008.
7. Ensure that the report clearly prioritises the top 5 key issues raised in the unseen material and consider carefully whether the priorities are in an appropriate order given the circumstances of the case. The order in which issues are placed must be justified.
8. Ensure that the answer covers all nine assessment criteria

Remember – do your research and prepare for the exam – but on the day, ensure that you write a thorough, well reasoned answer that covers the relevant key issues raised in the unseen material and ensure that your answer covers all aspects of the requirement, particularly clear well justified recommendations.

The examiner cannot stress enough the importance of practicing writing an answer using past TOPCIMA cases. You really must practice your exam technique, as this exam is different to all other CIMA exams. There is no way to prepare for the TOPCIMA exam without investing in hours of work using past TOPCIMA papers and to work on them. Remember it is good preparation that will help you to pass this final test of professional competence.

The skills you learn from preparing for your TOPCIMA are the same skills that you will use in the real world when you are a qualified CIMA accountant – so learn them now as you will use them in your future career. Now you have read this report – go and prepare for the TOPCIMA exam that you are planning to sit, but learn from the advice given in this document.