THE INSTITUTE OF CHARTERED ACCOUNTANTS OF PAKISTAN

Final Examination Summer 2003

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BUSINESS MANAGEMENT **(MARKS 100)**
Module 'E' Paper E-17 **(3 hours)**

Q.1 The Board of Directors of Synergy Leasing Company Limited, a medium sized public listed company are concerned about the decline in the profitability of the company during the past five years. The situation has been specially worsened during the years ended December 31, 2001 and 2002 in view of declining mark-up rates and resultant decline in spreads witnessed by the leasing industry.

The Company was formed in 1985 and had flourished during the period 1985 to 1995. Although the Leasing Industry had also grown rapidly over that period, but the profitability of the company remained above the industry average.

Current Chief Executive of the Company was appointed on July 1, 1996. He had vast experience of successfully leading Resource Leasing Company Limited, a major leasing company of the country from 1988 to 1996. Soon after his appointment he made an in-depth analysis of the company's operating procedures. He realized that their were serious flaws in the system of evaluating and approving leasing proposals. The company had formed policies, which gave many discretionary powers to various levels of Managers. Leasing proposals above Rs. 100 million were approved by the Board of Directors, whereas proposals above Rs. 25 million were approved by the Chief Executive. The General Manager Marketing and the Marketing Managers were authorized to carry out leasing below these limits subject to their assessments of each case based on specific parameters. The minimum rate of mark-up was fixed at 16%. The senior field staff including six Assistant Managers and two Managers were authorised to quote the Mark-up rates to the clients. He noticed that cases of default have increased over the last five years and the amount of Provision for Bad Debts had risen from Rs. 9.0 million in 1991 to Rs. 21.0 million in 1995. Moreover since there was no control over the rates of mark-up, the weighted average IRR had declined from 22% in 1991 to 20.5% in 1996 as against the decline in industry average from 22.5% in 1991 to 21.5% in 1996.

He therefore decided to implement the following procedures immediately:

- The leasing proposals would have to be approved as under:
  - Upto Rs 0.5 million by Marketing Managers
  - From 0.5 million to 2.0 million by General Manager Marketing
  - Above Rs. 2.0 million by the Managing Director.

- Mark-up rate will be decided by the Chief Executive himself, based on his discussion with General Manager Marketing.

Within a short period of time it became evident that the policy has succeed[illegible]port to the Board of Directors he highlighted his successes as under:

- Bad Debts for the year 1996 have been reduced by 7% as compared to 1995.
- Weighted average IRR has increased from 20.5% on June 30, 1996 to 20.8[illegible] December 31, 1996 and will be increased further as new leases are written.
- Net profit of the company in the second half of 1996 has increased by 6% as compared to the first half of the year.

However, the staff of the Marketing department was not happy with the change as they felt that their authority has been diluted. They also objected to the increase in processing time of lease evaluation and approval, as a result of the above measures.

During 1997, the General Manager Marketing resigned. The company had a policy of promotion from within the organization as it helped in improving employee motivation. In line with this policy, the senior of the two Marketing Managers was promoted as head of the department. However, in view of his relatively limited experience, he was designated as Chief Manager Marketing. It also resulted in cost saving as the salary of the newly promoted Chief Manager was far less than that of his predecessor. During the same year, the Human Resource Manager retired as he reached the age of 60. It was decided that the post of Human Resource Manager would be abolished. The Chief Executive will himself control the Human Resource Function as even now most of the policy decisions were being taken after his approval. In 1997, the company's profitability improved slightly i.e. by one percent.

During 1998, the over due lease rentals increased by 16% as one major lessee went bankrupt. The performance of recovery department was also found to have deteriorated. It was decided that a legal manager shall be appointed to deal with the increased number of defaulting lessees. The Legal Manager was appointed on July 1, 1999. On the recommendation of the Legal Manager, six recovery assistants were sacked as they were making little contribution towards recovery. The measure was strongly resisted by the Marketing Manager who was of the opinion that the visits by these recovery assistants made an invisible but significant contribution towards restraining the lessees from defaulting.

In the year 2000 the company diversified its operations and entered into the business of Money Market operations. An Assistant Manager – Trading was hired to carry out the routine matters, however, in view of the risks involved in this segment of the business, it was decided that that the Chief Executive will himself supervise the operations. The spreads in this segment were relatively smaller, however the Chief Executive in one of his periodic report, supported it in the following words, "Although the spreads are somewhat lower, the investments are much more secured".

The year 2001 witnessed a decline in the net profit of the company for the third consecutive year. In the Annual General Meeting the shareholders were very critical of the company's performance. However, their criticism was brushed aside by the Chairman of the Board, who claimed that it was on account of the declining trend being witnessed in the leasing industry.

The year 2002 witnessed a drastic decline in the mark-up rates of all finan[illegible]s as the State Bank of Pakistan reduced the discount rate substantially. The com[illegible]ts plunged to their lowest levels. The Chief Executive, in his report to the Board o[illegible] made the following remarks "The declining profitability of the company is the [illegible] emerging trends in the financial sector including leasing. The enormous decline in ma[illegible] rates, increased competition and rate war among lenders, excessive liquidity and [illegible] emergence of banks in the leasing business have all contributed to this state of affairs. The Board of Directors was not satisfied with this response.

They have decided to hire you to carry out a critical evaluation and review of the company's operations and policies.

Besides the information given above you have been provided the following additional information.

	1998	1999	2000	2001	2002
Weighted average cost of borrowings (%)	18.0	17.5	16.5	16.0	13.0
Weighted average IRR at the time of leasing	21.0	20.5	20.0	19.5	15.0
Weighted average return on investments	19.5	19.5	18.5	18.0	13.8
Overdue lease rentals (Rs. In millions)	175	183	310	465	600
No. of employees	56	52	54	52	53
New appointments	13	11	13	12	12

On investigation, you were able to ascertain that

- Many good lessees with high IRR had resorted to premature termination of their leases.
- The company could not avail the full benefit of reduction of borrowing rate, as it was mostly committed for a period of three to five years.
- Most of the company's long-term loans have been obtained from three main banks with whom the company has a long and cordial relationship since last 15 years.

Required:

(a) As a consultant you are required to write a report in the form of a letter addressed to the Board of directors, evaluating the key factors responsible for the decline in company's profitability in the recent years with specific reference to its policies on

(i) Human Resource Management **(05)**

(ii) Marketing **(06)**

(iii) Borrowings **(04)**

(iv) Diversification Strategy **(04)**

(b) Describe briefly why, in your opinion, the Chief Executive was unable to repeat the success story of his previous assignment with Resource Leasing Company Limited. **(08)**

Q.2 You have been appointed as a nominee director of a large and profitable company. You find that while the company has been making enormous profits and paying excellent return to its share holders, it has not made any contributions to any welfare or charitable projects. You find this very discomforting and decide to raise the matter of social responsibility of the company in the next board meeting. You are required to develop your arguments to convince the board to adopt a policy of making significant contributions to some welfare or charitable institutions, in future. **(08)**

Q.3 (a) Manpower planning is an integral part of corporate strategy. Discuss the and concept of manpower planning as a part of strategic planning proce 7)

(b) Why is succession planning considered a critical part of effective c governance? Discuss.

Q.4 Strategy evaluation can be achieved through measuring organizational performance.

(a) What quantitative criteria would you use to evaluate strategies? **(05)**
(b) What qualitative aspects would you look at? **(05)**

Q.5 Pricing decisions are a function of various elements. What are those factors and influences? **(07)**

Q.6 Conflict at individual and group level is considered to be inevitable in every organization. Under what circumstances would you accept conflict and why would you want to avoid it? Discuss. **(07)**

Q.7 Describe different stages of Product Life Cycle. Does product life cycle always have an ‘S’ curve? Discuss. **(08)**

Q.8 What are the strategic planning issues an organization must address before it decides to do business internationally? **(09)**

Q.9 Multinational organizations typically compete in domestic and foreign markets on the basis of competitive advantages. What are these advantages? Give a list briefly explaining each one of them. **(09)**

(THE END)