Professional Level – Essentials Module

Business Analysis

Monday 9 June 2014

Paper P3

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

This paper is divided into two sections:

Section A – This ONE question is compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

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Section A –This ONE question is compulsory and MUST be attempted

The following information should be used when answering question 1

1 Eland – the country

Eland is an industrial country with a relatively high standard of living. Most commercial and domestic consumers have computers and printers. However, the economic performance of the country has declined for the last seven years and there are large areas of unemployment and poverty. The economic problems of the country have led to a significant decline in tax revenues and so the government has asked its own departments (and the public sector as a whole) to demonstrate value-for-money in their purchases. The government is also considering privatising some of its departments to save money. The Department of Revenue Collections (DoRC), which is responsible for collecting tax payments in the country, has been identified as a possible candidate for future privatisation.

The people of Eland are enthusiastic about the principles of reuse and recycling. There has been a notable rise in the number of green consumers. Mindful of this, and aware of the economic benefits it delivers, the government is also encouraging its departments (and the economy as a whole) to recycle and reuse products.

The printer consumables market

There is a significant computer printer market in Eland, dominated by Original Equipment Manufacturers (OEMs). Many of these are household names such as Landy, IPD and Bell-Tech. OEMs also dominate the printer consumables market, which is worth about $200m per year. However, there are also independent companies who only supply the printer consumables (printer cartridges and toner cartridges) market, offering prices which significantly undercut the OEMs. The printer and printer consumables markets are both technology driven, with companies constantly looking for innovations which make printing better and cheaper.

The emergence of independent printer consumables suppliers has not been welcomed by the OEMs. They have brought legal actions against the independents in an attempt to make refilling their branded products illegal. However, they have not succeeded. The government in Eland has ruled this to be anti-competitive. However, the OEMs continue to promote their case with political parties, claiming that they need the revenues from printer consumables to fund innovations and advances in printer technology. They also regularly issue statements which worry consumers, claiming that printers may be harmed by using ink which is not from the OEM. Landy has been particularly aggressive in this regard. It continues to pursue legal claims against the independents and has also issued a statement which makes clear that if one of their printers is found to be faulty whilst using non-Landy ink, then the printer's warranty will be void.

It is relatively easy to enter the independent printer consumables market and so companies tend to compete on price. There is little brand loyalty amongst consumers, who regularly change their choice of brand. The independent companies constantly focus on finding technologies which make the print cartridges cheaper to buy and are of better quality. Used print cartridges can be reused for their material alone (recycled), or reused by being refilled with ink. However, there are still printing products on the market which can only be used once, or are expensive to recycle.

ReInk Co

ReInk Co (ReInk) was formed five years ago by Dexter Black, a technology entrepreneur with expertise in printer technologies. He still remains the only shareholder. He set up ReInk to produce and market his designs for reusable ink systems. ReInk is focused primarily on the reuse of printer cartridges by using a process to refill them with ink. Key technical elements of ReInk's innovative process for refilling cartridges have been patented, but in Eland, such patents only last for eight years. The current patent has a further six years to run.

The company was established in a declining industrial town in Eland with high unemployment. Government grants were available for two years to help support hi-tech industry and purpose built factories were cheap, readily available and, initially, rent free. Although the company now pays rent for its factory and offices, the annual rent is relatively low. The area has a good supply of people suitable for administrative and factory jobs in the company. ReInk's location is also close to an attractive area of countryside, which Dexter felt would appeal to the technology experts needed to help him exploit and develop his printer technology ideas. It would help provide a good standard of living and relatively cheap property and so he could attract good staff for modest salaries. His assumption proved correct. He has been able to attract an expert team of technologists who have helped him develop a unique approach to printer cartridge reuse. As one of them commented, 'I took a pay cut to come here. But now I can afford a bigger house and my children can breathe fresh country air.'

ReInk is an attractive company to work for and the team of technologists are enthusiastic about working with such an acknowledged industry expert, where technical innovation is recognised and rewarded. Both his staff and competitors acknowledge Dexter's technical expertise, but his commercial expertise is less well regarded. Dexter recognised this as a weakness and it was the prime driver behind his decision to recruit two new directors to the company.

To fund the development of the printer refilling technology, ReInk has needed significant bank loans and a substantial overdraft. Although the company has made a small operating profit for the last three years, interest repayments have meant that it has recorded a loss every year. It currently has revenues of $6m per year, 20% of which are derived from a long-term contract with the DoRC. ReInk is not one of the independent companies currently being sued by Landy.

To help him address these continuing financial losses, Dexter recently recruited a sales director to attempt to increase revenue through improved sales and marketing and a human resources (HR) director to review and improve staffing practices. Together with the financial director and Dexter himself, they make up the board of ReInk.

Although both of these recently appointed directors had the commercial expertise which Dexter lacked, neither has been a success. The technologists within the company are particularly scathing about the two new appointments. They claim that the sales director has never really made the effort to understand the market and that 'he does not really understand the product we are selling'. There has been no evidence so far that he has been able to generate more sales revenue. The HR director upset the whole company by introducing indiscriminate cost cutting and attempting to regrade staff to reduce staff costs. The technologists believe that the HR director 'clearly has no experience of dealing with professional staff'.

Despite the appointment of the new sales director, ReInk is still not recognised by the majority of the consumers who were surveyed in a recent brand awareness survey. No significant marketing is undertaken outside of the development and promotion of ReInk's website. In search results, it often appears alongside companies which appear to offer similar services and usually have very similar trading names.

ReInk continues to struggle financially, and its bank, Firmsure, in response to its own financial difficulties, has recently reduced ReInk's overdraft facility, creating a cash flow crisis which threatens the company's very existence. At present, it does not have enough cash to meet next month's payroll payments.

The employees of the company are well aware of the company's financial position and although they are proud of the company's technical achievements, they believe that the company may soon go into administration and so many are actively looking for other jobs in the industry or in the area. A combination of poor management (particularly from the new directors) and the company's uncertain financial position has demotivated many of the employees, particularly the technologists who have created the company's vital technical edge over its competitors.

Vi Ventures (VV)

Vi Ventures are venture capitalists who inject money and management expertise into struggling companies, in exchange for a certain degree of control, ownership and dividend reward. They have acknowledged financial and management competencies which they have used in a variety of commercial environments. They are experienced change managers.

VV have been introduced to ReInk by Firmsure and they are considering some form of involvement. Actual arrangements are still under consideration and will only be discussed after they have made their standard assessment of ReInk's strategic position. This standard assessment report contains three elements:

– A SWOT analysis
– An assessment of the contextual factors of strategic change. They need to understand what factors will affect the change which they may need to bring to the company. The framework they use is shown in Figure 1 and is derived from the work of Balogun and Hope Hailey.
– A TOWS matrix analysis to identify strategic options which might be pursued if VV invest in the company.

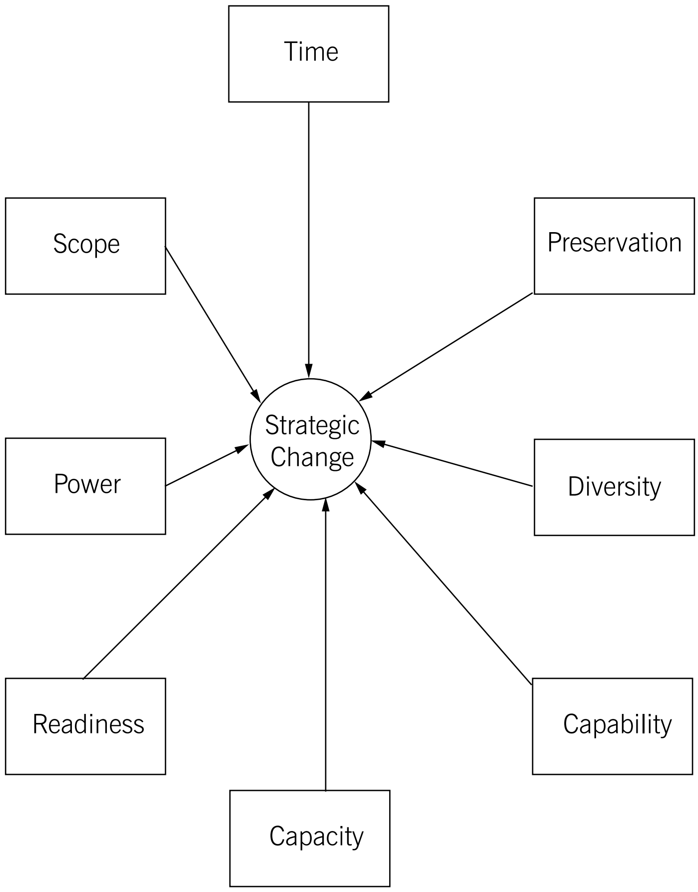

Figure 1: Contextual features in strategic change

Required:

You have been asked to write the standard assessment report of the strategic position of ReInk required by Vi Ventures. Write a report for Vi Ventures which:

(a) Undertakes a SWOT analysis of ReInk Co. (20 marks)

(b) Evaluates the effect of contextual features on the introduction of strategic change at ReInk Co. (14 marks)

(c) And, in the light of your analysis above, recommends possible strategic options for each quadrant of a TOWS matrix of ReInk Co. (12 marks)

Professional marks will be awarded in question 1 for the overall quality, construction, fluency and professionalism of the complete standard assessment report required by Vi Ventures. (4 marks)

(50 marks)

Section B – TWO questions ONLY to be attempted

2 For 11 years, Marco was a senior salesman at AQT, a company specialising in IT certification courses. During that time, AQT became the most successful and dominant training provider in the market.

Marco has now left AQT and established his own training company, iTTrain, aimed at the same IT certification market as his former employers. He wishes to offer premium quality courses in a high quality environment with high quality teaching. He has selected a number of self-employed lecturers and he has agreed a daily lecturing fee of $450 per day with them. He has also selected the prestigious CityCentre training centre as his course venue. It has a number of training rooms which hold up to nine delegates. Each training room costs $250 per day to hire. There is also a $10 per day per delegate charge for lunch and other refreshments. Although not a lecturer, Marco is an IT expert and he has already produced the relevant documentation for the courses iTTrain will run. He sees this as a sunk cost and is not concerned about recovering it. However, printing costs mean that there is also a $20 cost for the course manual which is given to every course delegate.

Marco has scheduled 40 courses next year, as he is limited by the availability of lecturers. Each course will have a maximum of nine delegates (determined by the room size) and a minimum of three delegates. Each course is three days long.

iTTrain has been set up with $70,000 of Marco's own money. He currently estimates that fixed annual costs will be $65,000 (which includes his own salary) and he would like the company to return a modest profit in its first year of operation as it establishes itself in the market.

Marco is currently considering the price he wishes to charge for his courses. AQT charges $900 per delegate for a three-day course, but he knows that it discounts this by up to 10% and a similar discount is also offered to training brokers or intermediaries who advertise AQT courses on their own websites. Some of these intermediaries have already been in touch with Marco to ask if he would be prepared to offer them similar discounts in return for iTTrain courses being advertised on their websites. There are also a number of cheaper training providers who offer the same courses for as little as $550 per delegate. However, these tend to focus on self-financing candidates for whom price is an issue. These courses are often given in poor quality training premises by poorly motivated lecturers. Marco is not really interested in this market. He wants to target the corporate business market, where quality is as important as price and the course fee is paid by the delegate's employer. He is currently considering a price of $750 per delegate.

During his employment at AQT, Marco collected statistics about courses and delegates. Figure 1 shows the data he collected showing the attendance pattern over 1,000 courses.

Number of delegates attending the course	Number of courses
3	150
4	210
5	250
6	190
7	70
8	80
9	50
Total	**1,000**

Figure 1: Analysis of attendance at 1,000 AQT courses

Required:

(a) **Suggest a pricing strategy for iTTrain, including an evaluation of the initial price of $750 per delegate suggested by Marco. Your strategy should include both financial and non-financial considerations.** (16 marks)

(b) Physical evidence, people and process are three important elements of the marketing mix for services.

Analyse the contribution each of these three elements could make to the success of iTTrain's entry into the IT certification market. (9 marks)

(25 marks)

3 **Introduction**

The following is an interview with Mick Kazinski, a senior marketing executive with Bridge Co, a Deeland-based construction company. It concerns their purchase of Custcare, a Customer Relationship Management (CRM) software package written by the Custcare Corporation, a software company based in Solland, a country some 4,000 km away from Deeland. The interview was originally published in the *Management Experiences* magazine.

Interviewer: Thanks for talking to us today Mick. Can you tell us how Bridge Co came to choose the Custcare software package?

Mick: Well, we didn't choose it really. Teri Porter had just joined the company as sales and marketing director. She had recently implemented the Custcare package at her previous company and she was very enthusiastic about it. When she found out that we did not have a CRM package at Bridge Co, she suggested that we should also buy the Custcare package as she felt that our requirements were very similar to those of her previous company. We told her that any purchase would have to go through our capex (capital expenditure) system as the package cost over $20,000. Here at Bridge Co, all capex applications have to be accompanied by a formal business case and an Invitation to Tender (ITT) has to be sent out to at least three potential suppliers. However, Teri is a very clever lady. She managed to do a deal with Custcare and they agreed to supply the package at a cost of $19,995, just under the capex threshold. Teri had to cut a few things out. For example, we declined the training courses (Teri said the package was an easy one to use and she would show us how to use it) and also we opted for the lowest level of support, something we later came to regret. Overall, we were happy. We knew that Custcare was a popular and successful CRM package.

Interviewer: So, did you have a demonstration of the software before you bought it?

Mick: Oh yes, and everyone was very impressed. It seemed to do all the things we would ever want it to do and, in fact, it gave us some ideas about possibilities that we would never have thought of. Also, by then, it was clear that our internal IT department could not provide us with a bespoke solution. Teri had spoken to them informally and she was told that they could not even look at our requirements for 18 months. In contrast, we could be up and running with the Custcare package within three months. Also, IT quoted an internal transfer cost of $18,000 for just defining our requirements. This was almost as much as we were paying for the whole software solution!

Interviewer: When did things begin to go wrong?

Mick: Well, the implementation was not straightforward. We needed to migrate some data from our current established systems and we had no-one who could do it. We tried to recruit some local technical experts, but Custcare pointed out that we had signed their standard contract which only permitted Custcare consultants to work on such tasks. We had not realised this, as nobody had read the contract carefully. In the end, we had to give in and it cost us $10,000 in fees to migrate the data from some of our internal systems to the new package. Teri managed to get the money out of the operational budget, but we weren't happy.

We then tried to share data between the Custcare software and our existing order processing system. We thought this would be easy, but apparently the file formats are incompatible. Thus we have to enter customer information into two systems and we are unable to exploit the customer order analysis facility of the Custcare CRM.

Finally, although we were happy with the functionality and reliability of the Custcare software, it works very slowly. This is really very disappointing. Some reports and queries have to be aborted because the software appears to have hung. The software worked very quickly in the demonstration, but it is painfully slow now that it is installed on our IT platform.

Interviewer: What is the current situation?

Mick: Well, we are all a bit deflated and disappointed in the package. The software seems reasonable enough, but its poor performance and our inability to interface it to the order processing system have reduced users' confidence in the system. Because users have not been adequately trained, we have had to phone Custcare's support desk more than we should. However, as I said before, we took the cheapest option. This is for a help line to be available from 8.00 hrs to 17.00 hrs Solland time. As you know, Solland is in a completely different time zone and so we have had to stay behind at work and contact them in the late evening. Again, nobody had closely read the terms of the contract. We have taken legal advice, but we have also found that, for dispute resolution, the contract uses the commercial contract laws of Solland. Nobody in Bridge Co knows what these are! Our solicitor said that we should have asked for this specification to be changed when the contract was drawn up. I just wish we had chosen a product produced by a company here in Deeland. It would have made it much easier to resolve issues and disputes.

Interviewer: What does Teri think?

Mick: Not a lot! She has left us to rejoin her old company in a more senior position. The board did ask her to justify her purchase of the Custcare CRM package, but I don't think she ever did. I am not sure that she could!

Required:

(a) **Suggest a process for evaluating, selecting and implementing a software package solution and explain how this process would have prevented the problems experienced at Bridge Co in the Custcare CRM application.**
(15 marks)

(b) The CEO of Bridge Co now questions whether buying a software package was the wrong approach to meeting the CRM requirements at Bridge Co. He wonders whether they should have commissioned a bespoke software system instead.

Explain, with reference to the CRM project at Bridge Co, the advantages of adopting a software package approach to fulfilling business system requirements compared with a bespoke software solution.
(10 marks)

(25 marks)

4 The Institute of Independent Analysts (IIA), an examining body, is considering replacing its conventional assessment process with computer-based assessment which produces instant results to the candidate. A business case has been developed for the computer-based assessment project. Figure 1, extracted from the business case, shows the financial appraisal of the project. It uses a discount rate of 8%. The NPV of the project is $10,925.

All figures in $000s				**Year**				
	0	**1**	**2**	**3**	**4**	**5**	**6**	**7**
Costs								
Initial software	200	200						
Software maintenance			40	40	40	40	40	40
Question bank	50	50	5	5	5	5	5	5
Security			20	20	20	20	20	20
Disruption		15	15					
Total costs	250	265	80	65	65	65	65	65
Income/Savings								
Marker fees			125	125	125	125	125	125
Admin saving		20	30	30	30	30	30	30
Extra income			10	20	30	30	40	40
Total benefits		20	165	175	185	185	195	195
Benefits – costs	(250)	(245)	85	110	120	120	130	130
Discount factor	1	0·926	0·857	0·794	0·735	0·681	0·630	0·583
Present value	(250)	(226·870)	72·845	87·340	88·200	81·720	81·900	75·790
							NPV	10·925

Figure 1: Financial cost/benefit of the computer-based assessment project

An explanation of the costs and benefits is given below.

Initial software – refers to the cost of buying the computer-based assessment software package from the vendor. The software actually costs $375,000, but a further $25,000 has been added to reflect bespoke changes which the IIA requires. These changes are not yet agreed, or defined in detail. Indeed, there have been some problems in actually specifying these requirements and understanding how they will affect the administrative processes of the IIA.

Software maintenance – This will be priced at 10% of the final cost of the delivered software. This is currently estimated at $400,000; hence a cost of $40,000 per annum.

Question bank – refers to the cost of developing a question bank for the project. This is a set of questions which the software package stores and selects from when producing an examination for an individual candidate. Questions will be set by external consultants at $50 for each question they successfully deliver to the question bank. It is expected that further questions will need to be added (and current ones amended) in subsequent years.

Security – refers to security provided at computer-based assessment centres. This price has already been agreed with an established security firm who have guaranteed it for the duration of the project.

Disruption – refers to an expected temporary decline in IIA examinations staff productivity and staff morale during the implementation of the computer-based assessment solution.

Marker fees – manual marking is undertaken in the current conventional assessment process. There will no longer be any requirement for markers to undertake this manual marking. All examinations will be automatically marked.

Admin saving – concerns reduction in examinations staff at IIA headquarters. The actual savings will partly depend on the detailed requirements currently being discussed with the software package provider. It is still unclear how this will affect the administrative process.

Extra income – the IIA expects candidates to be attracted by the convenience of computer-based assessment. Other competing institutions do not offer this service. The extra income is the IIA's best guess at the amount of income which will result from this new assessment initiative.

The IIA is also putting in place a benefits management process for all projects. The IIA director is concerned that project managers are just moving on to other projects and not taking responsibility for the benefits initially established in the business case.

Required:

(a) **Critically evaluate the financial case (cost/benefit) of the computer-based assessment project.** (15 marks)

(b) Benefit owners, benefits maps and benefits realisation are important concepts in benefits management process.

Explain each of these concepts and their potential application to the computer-based assessment project. (10 marks)

(25 marks)

End of Question Paper