Professional Level – Essentials Module

Business Analysis

September/December 2017 – Sample Questions

Time allowed: 3 hours 15 minutes

This question 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 question paper until instructed by the supervisor.

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

Paper P3

Think Ahead ACCA

The Association of Chartered Certified Accountants

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

1 The company

The Fidelity Model Corporation (FMC) produces high quality model kits of locomotives, ships and aircraft. These kits contain plastic, metal and glass parts and are bought and constructed by enthusiastic hobby modellers. Many of these modellers customise the kits during construction to ensure that the final model accurately reflects the real prototype which they wish to represent. The model kits are relatively expensive and the price reflects the accuracy, detail, quality and size of the kits. The average price for an FMC kit is $500 and it is estimated that, on average, an FMC customer buys and constructs two FMC models a year.

The dealer network

FMC does not sell its model kits directly to the public. It sells them through appointed dealers who are independent, specialist model shops, often owned and managed by enthusiastic modellers. These shops sell a range of kits, including the kits produced by FMC's main competitor, Barnhoff. FMC mandates a minimum price which dealers must charge for its kits. This is designed to prevent dealers from undercutting each other. This minimum price reflects a dealer margin of approximately a third of the price. So, for example, a product with a minimum price to the customer of $520 would be sold to the dealer, by FMC, for $390.

The model shops are important social hubs for the modelling community. Often modellers visit the shops to discuss issues and view product releases with other modellers. It is the model shops which demonstrate the products to prospective customers, provide assistance in construction, trouble shoot any problems with the finished model and liaise with FMC to resolve any outstanding issues which they cannot address.

Pete Waterless, a high profile celebrity modeller, put it succinctly in a recent television documentary.

'We modellers are a solitary lot. We sit alone in our workshops constructing complex models. Sometimes we just have to go down the local model shop to see some fellow humans and seek advice and solace. Often we need a little bit of help to build the model. We sit for hours in the shop looking at models and talking about models. Most normal people think we are very boring and, in truth, we are!'

FMC customer profile

In an attempt to better understand its end customers, the people who actually buy its kits from the dealers, FMC recently commissioned a customer survey. For two weeks in May, selected dealers were asked to record the age of customers buying FMC products in their shops. Table 1 shows the results of this survey. For example, 45% of customers were males aged 60 to 79.

Age	<20	20–39	40–59	60–79	80>
Male	5%	10%	20%	45%	5%
Female	1%	4%	5%	5%	0%

Table 1: Age and gender distribution of customers buying FMC products

The structure of the company

The board of FMC consists of the chief executive officer (CEO), the production director, the sales and marketing director and the finance director. The current CEO was appointed in 2005. He has considerable experience of the model kit market place.

The production director heads up the production department where components for the model kits are fabricated and packaged. There are four teams of ten people in this department, with each team led by a team leader who reports to the production director. There is also a quality control department of three people with a quality supervisor who reports to the production director. This quality team was established in 2007 by the previous production director to address product quality issues which were affecting the profitability and reputation of the company at that time. The production director responsible for this initiative has recently retired and a former team leader has been promoted to replace him. The logistics manager is also located in this department. He has a team of 12 drivers and six vehicles which are used to deliver the kits to the dealer network.

The sales and marketing director leads a sales team of nine people who are responsible for servicing the dealer network. Each sales person in this team liaises with between 10 and 15 dealers, depending upon the size of the geographical area they support. The sales team regularly visits every dealer to promote the company, explain changes

in the model range and to deliver promotional brochures and display advertising. They also provide the dealers with completed kits of selected models so that these can be shown to customers. They are responsible for taking orders from dealers and liaising with production to fulfil these orders. All of the sales team have built up close relationships with the dealers who they are responsible for and many regard the dealers as personal friends. A small marketing team of three people also reports to the sales and marketing director. One of these people is responsible for national brand promotion, one is concerned with the production of brochures and display advertising and one is responsible for information technology in the company, including the maintenance of the website. The current website provides information about the company's products and a list of dealers where these products can be bought. The sales and marketing director who led a review of the product range in 2007 has recently left the company. A new sales and marketing director has been promoted from within. She was previously responsible for national brand promotion.

The finance director heads a small team of four people. Two are responsible for accounts payable and two for accounts receivable. Dealers pay for the inventory they have ordered a month in arrears. For example, they pay for all products delivered in March at the end of April. So, only one sales invoice is raised per month for each dealer. The current finance director has been in post since 2011.

Most FMC employees have been with the company a long time. They are aware of a recent fall in revenue but believe that this is a temporary problem and little cause for long-term alarm. 'After all', said one, 'we had similar problems in 2007. However, improvements in quality and a revamp of the product range soon improved things.'

The Change Agents (TCA)

The Change Agents (TCA) is a small management consultancy aimed at delivering 'real, sustainable change in organisations'. The board of FMC is concerned about the decline in sales revenue and net profit (see Appendix A) and has commissioned TCA to submit a proposal for addressing this decline.

The management summary of TCA's proposal is included as Appendix B. In brief, it suggests a radical change in the business model of FMC. It proposes that FMC should sell directly to the end customer via the internet and abandon the dealer network completely.

Some of the recommendations of this proposal are based on an interpretation of financial information for FMC for selected years since 2007 (Appendix A).

Appropriate industry averages for financial performance for FMC's industry classification (light engineering – specialist) are shown in Table 2.

Performance measure	2016 industry average
Return on capital employed (ROCE)	24·5%
Net profit margin	5%
Current ratio	2·10
Acid test ratio	0·92
Gearing	20%

Table 2 Selected industry averages for FMC's industry sector (light engineering – specialist)

A balanced response

When TCA's proposal was presented to the board, most of the directors were shocked and rejected it immediately as impractical. The sales and marketing director cited the recent customer survey, saying 'most of our customers are elderly, retired men. I don't see them using the internet to buy things.' The production director added that he had read that older people were particularly worried about the security and fraud aspects of internet use.

However, the CEO wanted a more balanced view and has asked you, as an independent business analyst, to write a report which:

– Analyses the context of strategic change from the perspective of selected features of the Balogun and Hope Hailey contextual features model. He notes that TCA makes some reference to this model in its proposal and so he is keen to use it as a basis for analysing the implications of the proposed strategic change.

– Evaluates the implications of the POPIT four view model for understanding how the business will be changed by the TCA proposal. He is concerned that the company takes a holistic approach to business change.

– Identifies and assesses likely barriers to moving to the proposed business model from the perspective of the customer. He wishes to understand what factors may prevent or deter current customers from becoming direct internet customers of FCA.

Required:

Write the report required by the CEO. This report should:

(a) **Analyse the context of strategic change at FMC applying five elements of the Balogun and Hope Hailey model: time, scope and nature, readiness, capability and preservation. Use performance data to support your analysis where appropriate.** (20 marks)

(b) **Use the POPIT four view model to analyse the implications of implementing TCA's proposed strategic change at FMC.** (14 marks)

(c) **Identify and assess the barriers to moving established customers to the e-commerce model proposed by TCA.** (12 marks)

Professional marks will be awarded in question 1 for the structure, tone, coherence and clarity of your report. (4 marks)

(50 marks)

Appendix A

Financial performance for FMC for selected years in the period 2007 to 2016

Extract from financial statements

All figures in $000s

	2007	2009	2011	2013	2014	2015	2016
Assets							
Non-current assets							
Property, plant, equipment	450	500	550	525	500	495	475
Total non-current assets	450	500	550	525	500	495	475
Current assets							
Inventory	500	500	505	510	505	500	490
Trade receivables	295	280	250	245	250	240	235
Cash and cash equivalents	200	190	175	170	175	165	150
Total current assets	995	970	930	925	930	905	875
Total assets	1,445	1,470	1,480	1,450	1,430	1,400	1,350
Equity and liabilities							
Share capital	610	610	625	625	625	625	625
Retained earnings	330	350	345	340	325	315	275
Non-current liabilities							
Long-term borrowings	80	80	60	60	55	45	40
Current liabilities							
Trade payables	375	390	410	390	390	385	380
Current tax payable	50	40	40	35	35	30	30
Total current liabilities	425	430	450	425	425	415	410
Total liabilities	505	510	510	485	480	460	450
Total equity and liabilities	1,445	1,470	1,480	1,450	1,430	1,400	1,350
Revenue	4,950	5,000	5,150	5,250	4,900	4,750	4,650
Profit before tax and interest	250	300	325	275	250	225	195

Appendix B

Management summary provided by TCA

We were asked by the board of FMC to review its business model, particularly in the light of declining revenues and profit. This appendix summarises the main points of our response to the board of FMC.

1. Our analysis of the financial data of the company (Appendix A) suggests that *urgent change is required at FMC to address the financial performance of the company*.
2. We suggest that selling products through a dealer network is no longer viable. It represents a buying process which is rapidly declining in the commercial market place. We suggest that FMC sells its products directly to end customers and, to avoid competing with itself, no longer provides products through a dealer network.
3. FMC has to recognise that 90% of the country now has broadband coverage and that purchases made over the internet are increasing, whilst off-line purchasing remains static.
4. Selling products directly to end customers will increase customer reach, increase profit margins and improve cash flow. Eliminating the dealer margin allows FMC to consider cutting prices whilst at the same time increasing margin.
5. Strategic change will be technology-led. The company will require a fully functional e-commerce system allowing customers to browse, order and pay for products and track their orders. Payment will be made on ordering using credit and debit cards.
6. TCA has considerable experience in technology-led change and also capabilities in change management. *Our view is that revolutionary change, in terms of the Balogun and Hope Hailey model, is required at FMC*. We would be delighted to assist FMC in this revolutionary change, moving FMC from its present traditional business model to a contemporary e-business model.

Section B – TWO questions ONLY to be attempted

2 NCBT plc is a diversified business formed through a merger of Nairo Consumer Electronics and Birit Technology in 1990. NCBT is the holding company for many subsidiaries in a variety of industry sectors including insurance, financial services, clothing manufacture, farming and fertilisers.

The company is undertaking a strategic review of three of its subsidiaries: Swiftdale Farms, CCB Insurance and Pait Technology. Data for the three companies has been provided for this review, as shown in Figure 1.

	2014	2015	2016
	$m	$m	$m
Swiftdale Farms			
Turnover	102	97	90
Gross profit	12	7	4
Market turnover	550	530	512
CCB Insurance			
Turnover	70	84	93
Gross profit	20	25	22
Market turnover	810	850	890
Pait Technology			
Turnover	50	58	69
Gross profit	20	23	28
Market turnover	330	360	400

Figure 1 – Financial data for three subsidiaries 2014–2016

Swiftdale Farms – this was NCBT's first acquisition in 1994. NCBT had been a success story in the 1990s technology boom and had a surplus of cash and a number of shareholders looking for growth in the value of their shareholding. In 1994, the farming industry was faced with a number of threats and Swiftdale Farms was opportunistically acquired for what was considered to be a low price.

At the time of the acquisition, the board of NCBT was aware that they had little knowledge of the farming industry but it felt that the managers of Swiftdale Farms were capable and just needed some encouragement. They offered financial incentives for good performance, and provided financial resources to assist in the growth of the subsidiary. This initially worked well, but the company performance started to decline in 2010 and NCBT stopped providing financial resources, as they felt they were not being used to add value.

In 2016, Swiftdale Farms' nearest competitor held 15·4% market share.

CCB Insurance – this was acquired in 2011 as NCBT recognised the rapid development of the insurance industry in its home market and also the high margins being earned. CCB Insurance was a relatively new listing on the stock market and the board of NCBT commissioned a broker to buy shares aggressively on its behalf, so that it acquired a controlling stake. NCBT felt justified in its actions as the share price rose rapidly after acquisition.

CCB Insurance has continued to grow with little involvement from NCBT but is now struggling to manage its growth, failing to recruit sufficient new staff or to provide enough office space to cope with its growing operations. It operates in an industry where there are relatively few larger firms and hundreds of smaller companies and where the market leader holds 12% of the market. The economy in which CCB Insurance operates is growing at a rate of approximately 2% every year.

Pait Technology – this is the most recent acquisition, having taken place in 2014. The company manufactures consumer electronics, similar to both of the founding companies of NCBT. It operates in a different country where the industry is just starting to develop and grow, the way it did for NCBT in the 1990s. NCBT has other subsidiaries situated in this country. The management of Pait Technology are highly knowledgeable about their customers and industry and the company has a good brand name with high recognition. Its nearest competitor has an 8% market share.

Required:

(a) Analyse the financial position of each company (Swiftdale Farms, CCB Insurance and Pait Technology) in the NCBT portfolio. Your analysis should include consideration of the position of each company within the BCG and Ashridge matrices and should suggest an appropriate strategy for each subsidiary as a result of your analysis. (18 marks)

Portfolio managers, synergy managers and parental developers are three corporate rationales, developed by Johnson, Scholes and Whittington, for adding value to their business units by the corporate parent.

Required:

(b) Explain each of these separate rationales for adding value and suggest which is most likely to be the corporate rationale of NCBT. (7 marks)

(25 marks)

3 A newspaper publishing enterprise, Deal International Group, is undergoing a review of its business processes with the aim of improving its competitiveness and financial performance.

It has already decided to outsource its internal legal department, which is used, as required, on a case-by-case basis, either to defend the company when someone brings an action against it, or to check whether it breaches any laws when publishing an article. The company believes that outsourcing this process is the correct decision, as the requirement for the work is infrequent and unpredictable. It currently has to maintain the necessary legal skills within the company, together with funding the continuous professional training needed to keep those skills up-to-date. It believes that outsourcing will be cheaper and will allow the appropriate legal expertise to be utilised as and when required.

The company has identified three further processes which it feels are in need of a review:

Publication of the *Daily Finance* newspaper

This is one of the key brands within the Deal Group. The company prides itself on providing detailed financial news items from all over the world. The paper is well known amongst finance professionals and company leaders. However, the popularity of the paper has been declining, with complaints from its readers that it lacks sufficient high level editorial analysis and comment, instead simply reporting the facts. Readers have suggested that most of this information can now be found online, so the paper needs to provide something more.

The newspaper publication process uses many reporters, who work from numerous locations worldwide. When a story breaks, the editor of the newspaper commissions an article from the nearest reporter geographically. These reporters work for all the newspapers within the Deal Group as required and so are not specialist finance professionals. The reporters submit articles by email. The deadlines for submission are tight, as the articles still have to be typeset for the final production. The tight deadlines mean that editorial members of staff, responsible for the final article, often do not have time to check the quality of the article or to add high level commentary.

Subscriber management

Although the Deal Group has a wide distribution network, selling the *Daily Finance* and its other newspapers through supermarkets and newspaper sellers, the majority of its income comes from regular subscribers to whom the newspapers are delivered directly. The subscribers are managed by a client relationship team who operate from a central office. Each member of the team is responsible for a number of subscribers. If the appropriate team member is unavailable when a subscriber calls with a query, the subscriber is asked to call back later. As a result of this policy, a number of subscribers have recently been lost and the revenue from this stream is falling. The subscriber queries tend to be fairly simple, such as incorrect billing, or delivery issues.

Payroll

The Deal Group has an internal payroll department, which is struggling to deal with the variety of payment terms for its different employees. Some reporters get paid on a per article basis, whereas others are paid a regular monthly salary. Additionally, there are bonus payments to staff if weekly sales surpass stated target figures. There are regular errors in these payments and staff, including reporters, are increasingly spending time trying to sort out these errors with the payroll department.

The Deal Group has identified three process areas for improvement: publication of the *Daily Finance* newspaper, subscriber management and payroll.

Required:

(a) Evaluate each of the three process areas identified above using Harmon's process-strategy matrix. Recommend and justify an improvement strategy, for each of the three processes, which addresses the problems each face. (15 marks)

The Deal Group has already decided that its legal processes would be improved through outsourcing.

Required:

(b) Explain the disadvantages and risks associated with outsourcing the legal department and discuss how these risks could be managed. (10 marks)

(25 marks)

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Question 4 begins on page 10.

4 Tramor, a manufacturer of sweets and chocolates in the country of Bayland, hired a group of consultants (BTM) to carry out a strategic review of the company. Tramor requested that BTM should focus on suggesting alternative strategies for achieving growth. Following the review, Tramor plans to make its own decision about which strategy to follow. The board of directors explained to BTM why they were commissioning this review, with the reasons summarised as follows:

1. The company has failed to increase its market share in Bayland over the last four years, with its share fluctuating by less than 1% each year.
2. Profits have been falling gradually, as it has been necessary to keep prices fairly constant to maintain demand. However, both direct and indirect costs have been increasing.
3. The shareholders are getting restless as dividends have fallen and the share price is gradually declining. They want to see both dividends and share price improved by significant growth in the future.

As part of the review, BTM carried out a SWOT analysis, with the key findings being shown in Table 1.

Strengths	Weaknesses
– Tramor owns patents for many recipes, valid in Bayland – Wide product range of over 300 products – Tramor is the market leader with a market share of 46% of the confectionery market in Bayland – Previous experience of acquisition – Strong marketing; 98% of Bayland residents age 11+ are aware of the Tramor brand – Experienced management team, averaging 16 years employment with Tramor – Good supply chain, with products sold in all major supermarkets in addition to small stores and newsagents	– Less than 3% of revenue is from new products each year – Small product design team, with the majority of members nearing retirement – Poor succession planning – Highly inflexible manufacturing processes, with dedicated production lines – No previous experience of overseas expansion
Opportunities	**Threats**
– One growing segment of the market is overseas tourists, who see confectionery as a key Baylandian product – Tourists from the United Federation of Torra (UFT) have developed a website showing where every Tramor product can be purchased – Lean manufacturing is becoming more commonplace and accessible to companies *Further opportunities are presented in Table 2*	– The Tramor confectionery market declined 1·5% last year, the first year a decline has been recorded – There is a trend towards healthy eating, with a particular focus on natural, non-processed, sugar-free foods – Brands from overseas have become more popular in Bayland and are growing their market-share at the expense of some smaller domestic companies

Table 1 – SWOT analysis for Tramor

In addition to producing a SWOT matrix, BTM also drew up its version of Ansoff's growth matrix, displaying the potential growth strategies it is suggesting for Tramor. The strategies presented are shown in Table 2.

	Existing product	New product
Existing market	A. Use intensive advertising to target the existing market. Key television adverts around children's programmes used to target families, with luxury chocolates being advertised in cinemas and magazines.	B. Develop a new range of products for the home market, designed to resemble and replace the increasingly popular overseas imports.
New market	C. Sell the existing products in overseas markets, with a suggestion that the Torra (UFT) market be targeted initially.	D. Manufacture and sell healthy goods and snacks, such as dried fruit snacks, for health-conscious customers and those with special dietary needs. This would involve using a new distribution channel of health food stores.

Table 2 – Ansoff's Matrix showing potential growth strategies for Tramor

Although only asked to present the findings of the review, rather than make a decision, BTM has recommended to Tramor that it is in favour of option C, entering a new market with existing products.

Required:

(a) Critically evaluate the four strategies (A, B, C and D) for achieving growth, given the findings of the SWOT analysis. Your answer should include a justification for BTM's recommendation of adopting strategy C.
(15 marks)

(b) Evaluate the different methods (organic growth, mergers, acquisitions and strategic alliances) for implementing strategy C and explain which method would be the most appropriate to Tramor. (10 marks)

(25 marks)

End of Question Paper