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

Question one (compulsory)

Anfal Supermarkets (Anfal) is a multi-national listed business operating in several developing countries. The business is divided into two divisions: division one, which runs smaller stores in the densely populated centres of cities and division two, which runs the large supermarkets situated on the edges of cities. Anfal sells food, clothing and some other household goods.

Competition between supermarkets is intense in all of Anfal's markets and so there is a constant need to review and improve their management and operations. The board has asked for a review of their performance report to see if it is fit for the purpose of achieving the company's mission of being:

'…the first choice for customers by providing the right balance of quality and service at a competitive price. We will achieve this through acting in the long-term interests of our stakeholders: earning customer loyalty, utilizing all our resources and serving our shareholders' interests.'

This report is used at Anfal's board level for their annual review. The divisional boards have their own reports. Also, there has been criticism of the board of Anfal in the financial press that they are 'short-termist' and so the board wants your evaluation of the performance report to include comments on this. A copy of the most recent report is provided as an example at Appendix1and Appendix2.

The board is considering introducing two new performance measures to address the objective of 'utilizing all our resources'. These are revenue and operating profit per square metre. The CEO also wants an evaluation of these two measures explaining how they might address this aspect of the mission, what those ratios currently are and how they could be used to manage business performance. There is information in Appendix 3 to assist in this work.

There have been disagreements between Anfal's divisional management about capital allocation. The divisions have had capital made available to them. Both sets of divisional managers always seem to want more capital in order to open more stores but historically have been reluctant to invest in refurbishing existing stores. The board is unsure of capital spending priorities given that the press comments about Anfal included criticism of the 'run-down' look of a number of their stores. The board wants your comments on the effectiveness of the current divisional performance measure of divisional operating profit and the possibility of replacing this with residual income in the light of these problems.

As the company is opening many new stores, the board also wants an assessment of the use of expected return on capital employed (ROCE) as a tool for deciding on new store openings, illustrating this using the data in Appendix3 on one new store proposal. The focus of comments should be on the use of an expected value not on the use of return on capital employed, as this is widely used and understood in the retail industry.

Finally, the CEO has proposed to the board that a new information system be introduced. She wishes to spend $100m on creating a loyalty card programme with a data warehouse collecting information from customers' cards regarding their purchases. Her plan is to use this information to target advertising, product range choices and price offers more efficiently than at present.

Required:

Write a report to the board of Anfal to:

a) Evaluate the performance report of Anfal, using the example provided in Appendix 1 and Appendix 2, as requested by the board.

(14 marks)

b) Evaluate the introduction of the two measures of revenue and operating profit per square metre, as requested by the CEO.

(8 marks)

c) Assess the proposal to change the divisional performance measure.

Note: No calculations of the current values are required.

(8 marks)

d) Calculate the expected return on capital employed for the new store and assess the use of this tool for decision-making at Anfal.

(8 marks)

e) Explain how the proposed new information system can help to improve business performance at Anfal.

(8 marks)

Professional marks will be awarded for the format, style and structure of the discussion of your answer.

(4 marks)

(Total: 50 marks)

Board’s performance report
Year to 31 March
Appendix 1: Division one and Division two

Particular	Division one		Division two	
	Budget 2016 $ Millions	Actual 2016 $ Millions	Budget 2016 $ Millions	Actual 2016 $ Millions
Revenue:				
Food	1,094	1,105	5,431	5,542
Clothes	765	773	3,802	3,879
Other goods	328	331	1,629	1,663
Total	0	0	0	0
Cost of sales	1,995	2,015	10,200	10,408
Gross profit	192	194	662	676
Gross margins		8.78%		6.09%
Operating costs	35	35	174	177
Operating profit	157	159	488	499
Operating margin		7.19%		4.50%
Return on capital employed	13.20%	13.30%	13.20%	13.50%
Number of stores		525		200
Total square metres		140,220		820,960

Appendix 2: Anfal

Particular	Budget 2016 $ Millions	Actual 2016 $ Millions	Actual 2015 $ Millions	Change on previous year
Revenue:				
Food	6,525	6,647	6,514	2.04%
Clothes	4,567	4,653	4,536	2.57%
Other goods	1,958	1,994	1,964	1.52%
Total	0	0	0	2.15%
Cost of sales	12,195	12,423	12,187	1.93%
Gross profit	855	871	827	5.32%
Gross margins		6.55%		
Operating costs	209	213	208	
Operating profit	646	658	619	6.30%
Operating margin		4.94%		
Finance cost	77	80	75	
Group profit before tax	569	578	544	6.25%
Tax	142	145	135	
Group profit after tax	427	433	408	6.12%
Total shareholder return		3.1%	2.7%	
Return on capital employed	13.2%	13.4%	13.2%	

Appendix 3: New store

The following data has been forecast by the marketing department for the new store based on Anfal's existing experience.

There are three possible scenarios:

Demand scenarios	Low	Medium	High
Revenue ($m)	12.5	13	13.5
Probability (%)	20	50	30
Forecast operating margin (%)	4.1	4.3	4.4

The new store is expected to cost $4·2m to buy, fit out and stock.

The target ROCE for Anfal has been set at 13%.

<u>Section B-TWO questions ONLY to be attempted</u>

<u>Question two</u>

RelaxConfort is a small family run hotel chain based in Newland, a major region in Zeeland. The hotel has been in existence for 15 years and build up a core of loyal customers seeking mid quality range accommodation.

In recent years trade has started to slacken off and so the family decided to analyze why this might be? Their main findings were:

- The introduction of new local competitors has taken trade from RelaxConfort. These competitors have been what might be described as cost leaders offering relatively cheap but clean accommodation with joint venture partners providing a coffee shop and food on the premises. Although technically cost leaders, the standards are viewed to be quite good with new beds, a choice of pillows to suite customer needs and celebrity based marketing.
- RelaxConfort themselves received some criticism for failing to invest in the accommodation and the view was that the hotel chain did not provide a good value proposition.
- The legacy KPI system used had not been changed many years and needed upgrading. a consultant offered to help design a new system and the old and new proposal are shown below.

RelaxConfort responded to these findings by deciding to upgrade rooms which all now include free WIFI, music dock and a better grade TV. The hotel management needs advice about the KPI system, as they are not convinced that this needs changing. They feel that with upgrades that they have made and the marketing of those then the loyal customers will return and that will inevitably reflect in better results.

Old KPI system:

The hotel has used net profit percentage, occupancy rates and small number of cost control measures for many years. These cost control measures include: maximum total wage spend increases and repairs must not exceed 2% of turnover in one year.

New proposal:

The consultant has suggested the adoption of a quality focus and using a balanced scorecard approach, the following KPIs should be used instead:

1. Overall customer experience score, based on a scale of 1-5 with information gathered by the use of a very brief questionnaire to be left in each room each day.
2. The online processing system is to be monitored by measuring the proportion of online booking compared to total bookings.
3. Staff turnover rate will measure the learning aspect.

Required:

a) Explain why the existing system of KPIs might be contributing towards the financial decline of RelaxConfort. (8 marks)

b) Evaluate the use of the balanced scorecard approach to this quality based problem (you are not expected to suggest alternative approach). (5 marks)

c) Evaluate the suggested KPIs and suggest three other with justifications. (12 marks).

(Total: 25 marks)

Question three

Laziz Eat is the world's largest and best known food service retailing group with more than 20 thousands fast food outlets in over 90 countries. Currently half of its restaurants are in UK, where it first began 30 years ago, but up to 700 new restaurants are opened every year worldwide. Restaurants are wholly owned by the group (it has previously considered, but rejected the idea of franchising of operations and collaborative partnerships).

As market leader in a fiercely competitive industry, Laziz Eat has strategic strengths of instant global brand recognition, experienced management, site development expertise and advanced technological system. Laziz Eat basic approach works as well in Singapore as it does in Australia: although the products are broadly similar, menus are modified to reflect local tastes. Analysts agree that it continues to be profitable because it is both efficient and innovative.

The group's mission statement is to be ' the world's favorite' through service, cleanliness and value, with following three main strategies:

1. To achieve profitable growth by building on key strengths.
2. To delight every customer in every restaurant.
3. To be a good employer in each community in which it has a restaurant (despite this, some critics claim staff are mainly unskilled and lowly paid).

Laziz Eat future plans are to maximize global opportunities and continue to expand markets. Laziz Eat has long recognized that the external environment can be very uncertain and consequently does not move into new locations or countries without first undertaking a full investigation.

You are part of a strategy steering team responsible for investigating the key factors concerning Laziz East's entry for the first time into the restaurant industry in republic of Russia.

Required:

a) Justify the use of PEST framework to assist your team's environmental analysis for the republic of Russia.

(8 marks)

b) Discuss the main issues arising from applying this framework.

(12marks)

c) Discuss the purpose, potential benefits and potential problems of mission statements.

(5 marks)

(Total: 25 marks)

Question four

Manufacturing division produces three types of products which it sells to external customers and transfers to other divisions within its own group of companies.
Relevant budget information for the period ended 31 December 2017 on which the unit costs per product are as follows:

Product type	Product 1	Product 2	Product 3
Total production/sales(units)	50,000	25,000	75,000
Direct material per unit(square metre)	1.2	0.8	2.4

- Material cost per square metre $30.
- Overhead costs for the division are:
  - Production conversion cost $6 million.
  - Administration cost $1.8 million.
  - Selling/marketing cost $1 million.
  - Distribution cost $1.4 million.

The current policy of the Manufacturing division is to compile unit cost per product on the basis of production cost plus distribution cost. Administration and selling/marketing costs are considered general divisional costs which are not product specific.
The budgeted unit costs per product are calculated as the sum of:

- Direct material cost.
- Production conversion cost absorbed on the basis of an overall percentage on direct material cost.
- Distribution cost as an overall average cost per product unit.

Product pricing is based on the achievement of overall return on capital employed of 15% (ignore taxation). A single mark up percentage applicable to all product types is applied to product specific unit cost in order to achieve this ROCE level. The resulting selling prices form the basis of selling and marketing strategy. Capital employed is taken as $ 16.8 million.

Required:

a) ***Prepare calculations which show the detailed unit cost and selling price calculations for each product type.*** (8 marks)

b) The directors of manufacturing division are considering switching to an activity based costing system. As part of their review of the system, activity unit costs have been prepared for the period ended 31 December 2017. These differ from the original unit costs in a number of cost areas. The relevant amended elements of product specific unit costs are:

Product type	Product 1	Product 2	Product 3
Product conversion cost($)	42.81	30.69	41.23
Distribution cost($)	2.40	8.00	14.40
Selling/marketing cost($)-see note 1	1.20	6.00	1.20

Note 1: 30% of the budgeted selling and marketing cost has been identified as product specific. This has been charged to product types after taking into account relevant activities. The balance of selling and marketing cost is still considered a divisional cost.

A substantial proportion of sales of product1 are transfers to other divisions within the group. This business is obtained in competition with potential external suppliers. In addition, manufacturing division is experiencing problems in retaining the level of market which it has budgeted for product3.

Prepare a summary which compares original and activity based information per product for cost, profit and selling price for each type of product, where selling prices remain as calculated in (a) above. Suggest possible actions that could be taken by management for EACH of the three types of products in order to improve divisional and group profitability. (10 marks)

c) Critically discuss the adoption of activity based management (ABM) in the manufacturing division. (7 marks)

(Total: 25 marks)

-End of the question paper-

Question one:
Report
To: Board of Anfal
From: A. Accountant
Date: June 2016
Subject: Performance reporting and management issues at Anfal
Introduction
This report evaluates the current performance report for Anfal and the introduction of two new performance measures. Then, the effect of a proposed change in divisional performance measure is assessed. Next, the use of expected ROCE for new store proposals is evaluated. Finally, the report explains how the proposed new information system can help to improve business performance at Anfal.

(a) Performance reporting at Anfal

The current report has a number of strengths and weaknesses. These will be discussed according to whether the report:
– addresses the mission,
– contains appropriate information for decision-making,
– shows signs of being short term and
– is well presented.
The current mission can be broken down into two parts:
– To be the first choice for customers and
– To provide the right balance of quality, service and price.
There are three strategies for achieving this mission, reflecting stakeholder concerns:
– earning customer loyalty,
– utilising all resources and
– serving shareholders' interests.

The report does not address the first part of the mission. This can only be measured using external data but the report is utilising only Anfal's internal data. This part of the mission relates to the first strategy to gain customer loyalty. Customer loyalty could be gauged through repeat purchases or market share information but neither is supplied. This is clearly important to a retailer and may be more easily gathered once the data from the new information system are available for inclusion in this report.
The report provides no measures of the balance of quality, service and price other than through the historic growth in revenue.
It would only be through comparison with competitors or customer survey data that a picture of the mix of these qualities could be gained.

The second strategy of utilising resources requires that the key resources be identified. Clearly, the stores themselves (and thus the capital invested) are an important resource and the introduction of the revenue and profit per square metre and comparison with competitors will indicate the efficiency of their use. However, there are likely to be other important resources such as staff and no measure of their performance is offered. Staff costs are not shown in the trading account although a more sophisticated measure such as revenue per employee is a commonly used metric and would address this.

The report is much better on the third strategy of serving shareholder interests as it supplies two helpful measures: total shareholder return and return on capital employed. However, most shareholders will want comparison with benchmark returns within the retail sector and the market more widely, since these represent their alternatives.

The criticism of the company's management as being short term is reflected in the performance reporting. The report only contains for comparison budget information and the previous year's figures. There are no longer term forecasts or information on future capital investment. Also, there are few indicators which would be described as determinants of performance. These are often non-financial and focused on the external business environment (behaviour of customers and competitors).

As already noted, there is a significant gap in the information in the report as it contains no external information. Also, although revenue is broken down into broad product categories, no further information about growth within these categories nor the margins being earned is supplied. As a result, it could be questioned whether this break-down is worthwhile.

In terms of presentation, the data is clear and in a form which would be easily recognisable to those used to reading accounts.

However, no narrative commentary is provided which would highlight the key features in the report such as major deviations from the budget or performance well outside industry norms. There should be a comment on each of the five areas within the mission and strategies as well as comments about specific, material issues arising in the period covered. The report could be made easier to read by reducing the volume of numbers present both by cutting out unnecessary measures (see earlier discussion of product categories) and also by rounding all figures to millions.

(b) New asset utilization indicators

Revenue and operating profit per square metre reflect the utilization of the key capital asset used in their generation (the store).

Therefore, they are directly addressing a major part of the aim of utilising all resources; however, they do not address *all* resources which the business uses.

There are likely to be significant staff costs and so similar measures of revenue and operating profit per employee could also be introduced in order to reflect these human resources.

	Division one	Division two
Revenue per sq. metre ($)	15,754	13,501
Operating profit ($m)	159	499
Operating profit per sq. metre	1,114	608

These measures reflect the importance of the use of the store's space which is an area which the business does not give sufficient attention as is reflected in the problems with divisional performance measures. Focus on these measures will require addressing issues of volume of sales and the profitability of those sales. The two types of store at Anfal will have different impacts on these measures. For example, the smaller Division one stores may be capable of earning higher margins as they are convenient to customers while selling lower volumes. The Division two stores may concentrate on selling in volume to customers who come to buy in bulk. However, in terms of the overall performance of the business it is essential that Anfal sells in high volumes as it is a low margin business but it must not sacrifice profitability, in effect buying customers' revenue by selling at or near a loss.

(c) Divisional performance assessment

The current measure of divisional operating profit reflects the trading in the period under consideration. Profit will link to the whole business's operating profit which is the correct level to reflect the efforts of the divisional managers. However, this measure only indirectly addresses the capital being used by the divisions (depreciation charged to operating profit). This is distorting the behavior of the divisional managers.

The managers are not investing in refurbishing their stores which is causing the press (and presumably customers) to notice their run-down appearance. This may reduce the depreciation charge against operating profit. They are prioritizing new store capital expenditure over the refurbishment since they are not being charged for the use of that capital (financing charges are deducted after operating profit is calculated). This may not be optimal since small spending on existing capital assets often yields higher returns than new spending (which may be subject to greater risks).

The proposal to change the divisional performance measure addresses the issue of not reflecting the capital used since residual income (RI) deducts an imputed interest charge. Divisions can then be set targets in terms of their RI. The difficulties in calculating RI lie in correctly setting the imputed interest rate and calculating the capital being employed by the division.

However, since both divisions are types of stores they will have similar assets and so the same rules can be applied to each to fairly calculate the capital used. An advantage of RI is that the imputed interest rate can be changed to reflect the different risks of the divisions. The two divisions here do not seem to have significant risk differences unless the geographical locations introduce these (city centres and city edges). However, it is worth noting that using RI can discourage investment. As net book values of assets fall over time, RI automatically increases and 'do not invest' could become an attractive option to the managers. Overall, the proposed change addresses existing problems and would be considered a normal solution to measuring divisional performance in this industry.

<u>(d) Use of expected ROCE in new store appraisal</u>

The expected ROCE is calculated as:

Demand scenarios	Low	Medium	High
Revenue ($m)	12·5	13	13·5
Probability (%)	20	50	30
Forecast operating margin (%)	4·1	4·3	4·4
Forecast operating profit ($m)	0·5125	0·559	0·594
Expected operating profit ($m)	0·5602		
Expected ROCE	13·34%		

The expected ROCE is above 13% which is Anfal's required ROCE, so this should be an acceptable investment.

The use of expected values in the calculation of ROCE is appropriate if the probabilities used can be reasonably estimated and the decision is likely to be one which is made a number of times. Since Anfal has opened many stores, it is likely to be able to predict volumes and margins with reasonable accuracy. Since Anfal is going to continue to open stores, this decision will occur a number of times which makes using a probabilistic approach viable. In general, ROCE is neither considered as accurate nor as a direct measure of shareholder wealth as, for example, net present value (NPV).

<u>(e) New information system- Loyalty card system</u>

The proposed new information system will collect data from customers' purchases and store it for data mining purposes in a data warehouse. The capital required will be significant at $100m (the equivalent of about 24 new stores at $4·2m each).

There will also be considerable annual running costs. However, the benefits could be significant although quantifying them will be difficult as they depend on influencing customer behavior and so are not simply cutting costs.

The new system will help to address the mission of Anfal as it will help the board to understand customers better and so improve their loyalty to the business. By

focusing offers on those things which customers enjoy Anfal can enhance the brand and also take the opportunity to sell greater volumes alongside the offered products.
The data warehouse will allow data mining for relationships, for example, geographical preferences for products; links between price offers and volumes sold; products which are often bought together; seasonality of product purchases. These relationships can then be used to address the CEO's three target areas of advertising, product range choices and price offers.
Potentially, there will be cost savings by more efficient advertising. The data on each individual customer can be searched to profile customers and identify their individual preferences. Marketing can then be targeted to groups of customers using products which they commonly buy. Data mining will also identify associated products (those often bought together) so that offers can be grouped, for example, with a price reduction on buying a linked pair of products.
A problem in most retail businesses is the size of the product portfolio which they offer since more products (and potentially more suppliers) require more effort to manage. The new system may allow a Pareto-style analysis where the least profitable non-essential products are identified and can be cut from the product range.

Question two:

f) Existing KPIs

In general, legacy KPIs can often not be in line with needs of the market or business. Things change, as has been the case here. So-called cost leaders in the hotel industry are no longer offering very poor accommodation and so RelaxConfort needs to raise its game.
The existing KPIs do not have any quality aspect at all which is inconsistent with needs of the business. Specifically:
Measuring net profit %(of turnover presumably) is not a driver of performance and so lacks the aspect. Equally net profit is the end result of a lot of factors and so its decline could not easily be traced back to a causal factor. In this regard it could be accused of contributing to financial decline in that it doesn't provide any answers.
Occupancy rates are an industry norm and so are difficult to criticize in themselves. However they are again an indicator of performance not a driver. RelaxConfort would want to know why occupancy rates are down not merely that they are.

Maximum wage spend limits could lead to de-motivation (where pay rises are refused) or under staffing. In both cases this could damage quality and experience of customers. Hotels provide a service and well motivated staff could be seen a critical success factor (CSF) in this case. Maintenance of hotel buildings is important (another CSF probably) in this case an essential repair might have to wait if the limit is exceeded. Some repairs could involve value added services and their failure felt by customers (no heating in the winter for example). Artificially limiting repair spending could easily damage RelaxConfort's reputation and destroy loyalty.

g) The balanced scorecard was intended as a quality model. It was however applicable to many business types and could include a differentiation aspect when defining the business mission (which is normally at the centre of the model).

By definition the balance scorecard considered a balance of perspectives for a business if the vision had been defined as a quality based differentiator then each of the perspectives could be tailored towards quality. For example in customer perspective RelaxConfort could focus on high levels of satisfaction or in the internal business perspective high quality booking systems could be targeted.

The model is fairly easy to understand and so the RelaxConfort management team should be able to grasp it.

h) Custom experience score. This seems very general to be of much use to RelaxConfort. What action would be taken if a customer gave a low score? The question needs to be much more specific- for example- was the room clean enough? Questionnaire left in hotel rooms suffer from poor response rates and RelaxConfort may find so in this case. Some hotels offer prize based incentives to improve response rates.

On- line proportion. This appears to have the wrong focus. What about the quality of the on- line system? Admittedly if more booking are being taken on-line it might be fair to assume that the system is liked by customers however there are many other factors. Just because a customer books in person doesn't mean that they do not like the on-line system at all. The measure should be more about the efficiency of the process and the ease of use. This could be captured by the system at the time of booking. RelaxConfort could measure the time taken to book or ask specific questions of the customer at the end of the booking process about its ease of use.

Staff turnover. This is a better measure than the previous ones. The presumption must be that experienced staff will know their job better and the workings of the hotel. Hence they should be able to provide better service to customers. It is odd however that the new room technology was not chosen for a measure given the investment made here. Questions could be asked of customers about the new TV and music systems or monitoring of their use could be built in (perhaps anonymously).

Question three:

1. ***Using a PEST analysis to assist the environmental analysis:***

   PEST analysis examines the broad environment in which the organization operates. PEST is a mnemonic which stands for political/legal, economic, social and technological factors. These are simply four key areas in which to consider how current and future changes affect the business. Strategies can then be developed which address any potential opportunities and threats identified.

   In entering a new overseas market, an environmental analysis is important to help the organization understands the factors specific to that market so that the specific opportunities and threats posed can be assessed and appropriate action taken.

   It's a useful tool for the following reasons:

- *It ensures completeness*

  The majority of issues relevant to an organization will be covered under one of the four areas of PEST analysis. By reviewing all four areas, Laziz Eat can be sure that it has done a full and complete analysis of the broad environment.
- *All four elements are relevant to examining new markets*

Political/legal:

Each country entered will have different political systems and laws. Laziz Eat will need to understand these differences to ensure that they operate within the law in Russia. They will also want ensure there is a political stability within the country which will ensure long term viability of the new operations.

Economic:

Economies are different in different parts of the world. Understanding local economy in Russia and how it's expected to develop enables Laziz Eat to assess the potential within the market as well as any economic issues which they need to consider.

Social:

Each country will have its own cultural differences, and Laziz Eat can change how they operate depending on Russia's culture. Laziz Eat has already shown its willingness to change for each country's different tastes and will want to do so in Russia too.

Technological:

Each country has a different technological expertise and experience. Laziz Eat might need to change processes to accommodate local systems, or implement training programs for staff unfamiliar with their technology.

- *It's a well-known tool which is easy to understand and use*

  PEST analysis is a very simple tool that doesn't require detailed understanding. This means that it is easy to use by the team and simple for directors to analyze and understand.

2. ***<u>Main issues arising from applying the framework:</u>***

   Various issues which Laziz Eat will need to consider include:

   Political/legal factors

   4. Government grants

      Some countries may have grants available for investment in the country. Considering the requirements to gain such grants may enable Laziz Eat to make use of these.

   5. Political stability

Given Laziz Eat worldwide penetration it's likely that the Russia is in a developing region which may be more politically unstable than many countries in which they currently operate. This may affect the long term potential in the market.

6. Regulation on overseas companies:

   There may be regulation on how overseas companies can operate in the market. In China for instance, it is common for joint ventures with local companies to be a prerequisite for western companies entering the market.

7. Employment legislation:

   Each country will have different employment legislation e.g. health and safety, minimum wages, employment rights. Laziz Eat may have to change internal processes from the original country to stay within the Russia. Being a good employer is also one of Laziz East's specific strategies.

8. Tax legislation:

   Tax laws will impact the profits available for distribution to the group. High tax levels may discourage Laziz Eat from entering the market.

9. Tariffs and other barriers to trade:

   Tariffs may be imposed on imports into the Russia. This may put Laziz Eat at a significant disadvantage compared with local companies if they aim to import a significant number of items.

Economic factors:

Things to consider include:

d) Economic prosperity:

   The more prosperous the nation the more money people will have to invest in fast food. Examining the current and likely future prosperity enables the organization to understand the potential of this market and the likely future investment required.

e) Interest rates:

   This affects the cost of borrowing within the Russia. If high it may mean overseas funding is necessary. A big differential between interest rates in

Russia and the U.K is also likely to cause instability in the exchange rate.

Interest rates also affect the availability of money for the people of the country. Low interest rates mean more disposable income to spend increasing the potential for Laziz Eat.

f) Exchange rates:

   Laziz Eat will be affected by exchange rates for items they export to Russia. An unfavorable movement in exchange rates could make exporting to Russia expensive and reduce profitability. It can also affect the value of profits when converted back to U.K sterling.

g) Position in economic cycle:

   Different countries are often at different positions in the economic cycle of growth recession. The current position of Russia will affect the current prosperity of the nation and the potential for business development for Laziz Eat.

h) Inflation rates:

   High inflation rates create instability in the economy which can affect future growth prospects. They also mean that prices for supplies and prices charged will regularly change and this difficulty would need to be considered and processes implemented to account for this.

Social factors:

Things to consider include:

4. Brand reputation

   As a global brand the reputation of Laziz Eat might be expected to have reached Russia. If not, more marketing will be required. If it has, the reputation will need to be understood and the marketing campaign set up accordingly.

5. Cultural differences:

   Each country has its own values, beliefs, attitudes and norms of behaviors which mean that people of that country may like different foods, architecture, music and so on, in comparison with U.K restaurants. By adapting to local needs Laziz Eat can ensure it wins local custom and improve its reputation.

Different cultures also need to be considered when employing people, especially given the importance to Laziz Eat of employee relations. People may have different religious needs to be met or may dislike being given autonomy so the management style needs changing.

6. Language problems:
   Different local languages can create problems, firstly in communication with staff. Secondly product names need to be considered to ensure they are acceptable in local language. General Motor's Nova suggested that it won't go in Spanish, for example.

Technological factors

Laziz Eat may need to train people in the use of their technologies if the local population is unfamiliar with them e.g. accounting systems or tills. In addition, technology might have to be adapted to work in local environments, such as different electrical systems.

- ***A mission*** is the purpose of an entity and its reason for existence, i.e. what is it attempting to accomplish? Henry Mintzberg has stated that ' a mission describes the organization's main function in society in terms of products and services it produces for its customers. A large number of organizations provide a formal statement of their mission in a mission statement. Even though an entity might not have a clearly defined mission it may nevertheless have a mission statement.
  A mission statement should be both memorable and succinct. It should also be 'enduring', i.e. the statement should not change unless an entity's mission changes otherwise the mission statement would serve to confuse the business community.
  The mission statement should guide all employees throughout an organization to work collectively towards the accomplishment of the corporate mission and may contain references to many stakeholder groups such as, for example, shareholders, customers, employees and general public.
  Potential benefits of mission statement include:

a) Providing strategic direction to the organization thereby assisting in the formulation of acceptable strategies.
b) Assisting in the resolution of potential conflict among different stakeholder groups.
c) Providing a framework within which managerial decisions can be made.
d) Assisting in the communication of key cultural values to employees.
e) Assisting in the presentation of a clear image of the organization for the benefit of customers and other interested parties.
f) Helping to prevent potential misinterpretations of the organization's 'reason for being'.

Potential problems of mission statements include:

a) They may be unclear.
b) They may be vague and therefore valueless.
c) They may be unrealistic and not reflect realty.
d) They may be inconsistency between different elements.
e) They may be inconsistent with management action.
f) They may lack sufficient external focus.

Question four:

d) ***<u>Unit costs and selling prices calculations:</u>***

Product unit cost and price information:	***Product1***	***Product2***	***Product3***
	$	$	$
Direct material cost (note1)	36.00	24.00	72.00
Product conversion cost (note2)	27.69	18.46	55.38
Distribution cost (note3)	<u>9.33</u>	<u>9.33</u>	<u>9.33</u>
Total product specific cost	73.02	51.79	136.71
Profit mark-up at 35% (note4)	<u>25.56</u>	<u>18.13</u>	<u>47.85</u>

Selling price	98.58	69.92	184.56

Note 1:

Direct material =sqm*price per sqm e.g. procuct1 1.2*$30=$36.

Note 2:

Production conversion cost=$6m.

Direct material cost= (50,000*1.2)+(25,000*0.8)+(75,000*2.4)*$30=$7.8m

Absorption rate(as% of direct material cost) $6m/$7.8m=76.92%.

e.g. product 2 = $24*76.92%= $18.46.

Note 3:

Distribution cost= $1.4m.

Total product units= 50,000+25,000+75,000= 150,000

Average cost per container= $1.4m/150,000= $9.33

Note 4:

Mark up on cost required to achieve 15% ROCE:

Firstly, calculate the profit required to achieve 15% ROCE.

ROCE of 15%=profit/capital employed of $16.8m*100

Profit =$16.8m*15%= $2.52m.

Therefore, the mark up on costs must cover this profit figure and the administration cost and selling and distribution cost (these are included in product specific cost).

	$millions
Administration cost	1.80
Selling/* marketing cost	1.00
ROCE= 15%*$16.8m	2.52

Total mark up required 5.32

Now calculate the profit mark up as a%

Total product specific cost:

Direct material(note2)	7.80
Production conversion cost	6.00
Distribution	1.40
Total	15.20

Profit mark up required =$5.32m/$15.20m= 35%.

e) ***Original vs. ABC unit cost comparison- all figure in $:***

	Product1		**Product2**		**Product3**	
	Original	ABC	Original	ABC	Original	ABC
Direct material	36.00	36.00	24.00	24.00	72.00	72.00
Conversion cost	27.69	42.81	18.46	30.69	55.38	41.23
Distribution cost	9.33	2.40	9.33	8.00	9.33	14.40
Total specific cost	73.02	81.21	51.79	62.69	136.71	127.63
Specific selling/m	0.00	12.0	0.00	6.00	0.00	1.20
Amended specific	73.02	82.41	51.79	68.69	136.71	128.83
Profit mark up	25.56	16.17	18.13	1.23	47.85	55.73
Selling price	98.58	98.58	69.92	69.92	184.56	184.56

Possible management actions:

Product 1: a major factor is that a substantial proportion of the units are transferred to other divisions within the group. Points which may require management action are:

- From a group viewpoint there is a need to focus on cost reduction. The ABC system indicates that overall unit cost is up by 11% even before the product specific selling and marketing cost is taken into account.
- Inter divisional profit on group transfers should be examined. Could such units be sold to external customers? If not, should

transfers to other group divisions be offered at marginal cost in order to avoid more external purchases of similar products from external suppliers?

- Possibly a dual system of pricing could be put in place. Manufacturing division may be allowed to report a profit based on the estimated selling price but should offer to transfer at marginal cost.
- It is important that the ABC costs are recognized. The marginal cost is not known. However, using total cost the problem may be examined. Under the existing system the total cost per unit ($73.02) is low. ABC cost is $81.21 (before selling/marketing cost). If an external supplier offered a product similar to product1at $75 it would be rejected where the existing cost was used as the basis for decisions. The ABC cost of $81.21 shows that the external offer of $75 should be accepted on financial grounds.

Product 2:

- ABC cost is 21% higher than the original cost (even before adding product specific selling/marketing cost). This must be investigated and cost saving sought.
- The product specific selling/marketing cost of $6 is much higher than for product1 or product3 ($1.20). The reasons for this should be investigated.
- At the existing selling price of $69.92 we are almost in a nil profit situation. Can a price increase be obtained without affecting demand?
- Can cost reduction be achieved in conjunction with a quality improvement program?

Product 3: it is known that manufacturing division is having difficulty retaining its budgeted level of sales. Points of note are:

- The ABC cost is approximately 6.7% below the original cost (approximately 6% after allowing for product specific selling/marketing cost).

- A price reduction of $8 could be allowed in an attempt to retain demand without affecting product profitability (as represented by a 35% mark up) or
- An increased amount could be spent on marketing effort to sell the merits of the product and company record on delivery, quality, etc.

f) ***Activity based management (ABM):***

ABM is the use of ABC information for management purposes to improve operational and strategic decisions.

By identifying the underlying drivers of manufacturing division 's activities, ABM will provide an understanding of the resource implications of various courses of action and therefore ensures that unfeasible courses of action are not taken.

Manufacturing division may use ABM to:

- Reprice its products, e.g. a decision may be taken to increase the unit selling price of product3 (as discussed in part b) and optimize product design through the understanding of what drives cost.
- Reduce cost. Managers may be able to reduce the cost of , say, the product1 or the product2 by decreasing the cost of an activity or the number of activities per unit.
- Influence operational and strategic decisions. Implications for action from the ABM study include target costing, performance measures for continuous improvement and resource allocation based on projected demand. ABM can also assist manufacturing division in considering new opportunities. However, there are risks associated with the adoption of ABM. Some activities have an implicit value which is not reflected in the financial value of the product. For example:
  - ✓ A pleasant workplace at manufacturing division will attract/retain staff. A risk of ABM is that this activity is eliminated.
  - ✓ A low value customer may open up new leads in the market. If manufacturing division uses ABM they may eliminate this customer.

Marking Scheme

Question One:

a) Performance report
   - ✓ Breaking down the mission – up to 3 marks: two main aims, 3 CSFs/Strategies, noting how these are logically connected.
   - ✓ Comments on how report addresses mission and strategies – up to 6 marks.
   - ✓ Missing information – up to 3 marks: Lack of external information, margins by product category.
   - ✓ Report is short termist – up to 3 marks.
   - ✓ Comments on presentation – up to 3 marks: lack of narrative, data overload, rounding.

   Maximum 14 marks.

- New asset utilization indicators
   - ✓ Addressing the mission – up to 3 marks.
   - ✓ Calculations – up to 3 marks.
   - ✓ Use in managing business performance – up to 5 marks.

  Maximum 8 marks.

- Divisional performance
   - ✓ Discussion of existing behavior and measure – up to 5 marks.
   - ✓ Discussion of new measures – up to 5 marks.

  Maximum 8 marks.

- Decision making under risk
   - ✓ Calculations:
      - 1 mark for method.

- 1 mark for correct profit under each scenario.
- 1 mark for expected operating profit.
- 1 mark for expected ROCE.

✓ Comments – 1 mark per point – up to 4 marks.

Maximum 8 marks.

- New information system
  - ✓ Description and costs – up to 2 marks.
  - ✓ Benefits – 1 mark per point – up to 8 marks.

Maximum 8 marks.

Professional 4 marks.

Total 50 marks.

Question Two:

a) Marking as follows:
   - ✓ 2 marks for general comments.
   - ✓ 6 marks for considered KPIs.

   Maximum 8 marks.

b) Marking as follows:
   - ✓ 2 marks for NOT a quality model.
   - ✓ 2 marks for can be applied though.
   - ✓ 1 mark for example.

   Maximum 5 marks.

c) Marking as follows:
   - ✓ 2 marks for each KPI evaluated.
   - ✓ 2 marks for each suggestion justified.

Maximum 12 marks.

Total 25 marks.

Question Three:

a) Marking as follows:
   - ✓ 1-2 marks for each reason given for its usefulness, up to maximum of 8 marks.

b) Marking as follows:
   - ✓ 2 marks for examples of PEST issues, up to maximum of 12 marks.

c) Marking as follows:
   - ✓ Purpose- 1 mark per point, maximum of 2 marks.
   - ✓ Benefits, 0.5-1 mark per point, maximum 2 marks.
   - ✓ Potential problems, 0.5-1 mark per point, maximum 2 marks.

   Total 25 marks.

Question Four:

a) Marking as follows:
   - ✓ 1 mark for direct material cost.
   - ✓ 2 marks for product conversion cost.
   - ✓ 1 marks for distribution cost.
   - ✓ 3 marks for profit mark-up.
   - ✓ 1 mark for selling price.

   Maximum 8 marks.

b) Marking as follows:
   - ✓ 1 mark for product specific and marketing cost.
   - ✓ 1 mark for profit mark-up.
   - ✓ 1 mark for other lines in the summary table.
   - ✓ 1 mark for presentation.
   - ✓ Up to 2 marks for possible actions for each type of product, up to maximum of 6 marks.

   Maximum 10 marks.

c) Marking as follows:
   - ✓ 1 mark for definition.
   - ✓ 1 mark for resource implications of actions.
   - ✓ 1 mark for reprice products/optimize new product design.
   - ✓ 1 mark for cost reduction.

- ✓ 1 mark for influence strategic and operational planning.
- ✓ 2 marks for risks of ABM.

Maximum 7 marks.

Total 25 marks.

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Examiner of P5

July 27th 2018