

Professional Level – Essentials Module

# Business Analysis

Wednesday 15 December 2010

**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

Paper 3

**ACCA**

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The question paper begins on page 3.**

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

The following information should be used when attempting question 1

### **1 Introduction**

Shoal plc is a well-known corporate organisation in the fish industry. It owns 14 companies concerned with fishing and related industries.

This scenario focuses on three of these companies:

ShoalFish Ltd – a fishing fleet operating in the western oceans

ShoalPro Ltd – a company concerned with processing and canning fish

ShoalFarm Ltd – a company with saltwater fish farms.

Shoal plc is also finalising the purchase of the Captain Haddock chain of fish restaurants.

#### **ShoalFish**

Shoal plc formed ShoalFish in 2002 when it bought three small fishing fleets and consolidated them into one fleet. The primary objective of the acquisition was to secure supplies for ShoalPro. 40% of the fish caught by ShoalFish are currently processed in the ShoalPro factories. The rest are sold in wholesale fish markets. ShoalFish has recorded modest profits since its formation but it is operating in a challenging market-place. The western oceans where it operates have suffered from many years of over-fishing and the government has recently introduced quotas in an attempt to conserve fish stocks.

ShoalFish has 35 boats and this makes it the sixth largest fleet in the western oceans. Almost half of the total number of boats operating in the western oceans are individually owned and independently operated by the boat's captain. Recent information for ShoalFish is given in Figure 1.

#### **ShoalPro**

ShoalPro was acquired in 1992 when Shoal plc bought the assets of the Trevarez Canning and Processing Company. Just after the acquisition of the company, the government declared the area around Trevarez a 'zone of industrial assistance'. Grants were made available to develop industry in an attempt to address the economic decline and high unemployment of the area. ShoalPro benefited from these grants, developing a major fish processing and canning capability in the area. However, despite this initiative and investment, unemployment in the area still remains above the average for the country as a whole.

ShoalPro's modern facilities and relatively low costs have made it attractive to many fishing companies. The fish received from ShoalFish now accounts for a declining percentage of the total amount of fish processed and canned in its factories in the Trevarez area. Recent information for ShoalPro is given in Figure 1.

#### **ShoalFarm**

ShoalFarm was acquired in 2004 as a response by Shoal plc to the declining fish stocks in the western oceans. It owns and operates saltwater fish farms. These are in areas of the ocean close to land where fish are protected from both fishermen and natural prey, such as sea birds. Fish stocks can be built up quickly and then harvested by the fish farm owner. Shoal plc originally saw this acquisition as a way of maintaining supply to ShoalPro.

Operating costs at ShoalFarm have been higher than expected and securing areas for new fish farms has been difficult and has required greater investment than expected. Recent information for ShoalFarm is given in Figure 1.

All figures in \$m

	2007	2008	2009
<b>ShoalFish</b>			
Turnover of market sector	200·00	198·50	190·00
Turnover of ShoalFish	24·00	23·50	21·50
Gross profit	1·20	1·10	1·05
<b>ShoalPro</b>			
Turnover of market sector	40·00	40·10	40·80
Turnover of ShoalPro	16·00	16·20	16·50
Gross profit	1·60	1·65	1·75
<b>ShoalFarm</b>			
Turnover of market sector	10·00	11·00	12·00
Turnover of ShoalFarm	1·00	1·10	1·12
Gross profit	0·14	0·14	0·15

**Figure 1: Financial data on individual companies 2007–2009**

### **Captain Haddock**

The Captain Haddock chain of restaurants was founded in 1992 by John Dory. It currently operates one hundred and thirty restaurants in the country serving high quality fish meals. Much of Captain Haddock's success has been built on the quality of its food and service. Captain Haddock has a tradition of recruiting staff directly from schools and universities and providing them with excellent training in the Captain Haddock academy. The academy ensures that employees are aware of the 'Captain Haddock way' and is dedicated to the continuation of the quality service and practices developed by John Dory when he launched the first restaurant. All management posts are filled by recruiting from within the company, and all members of the Captain Haddock board originally joined the company as trainees. In 1999 the Prime Minister of the country identified Captain Haddock academy as an example of high quality in-service training. In 2000, Captain Haddock became one of the thirty best regarded brands in the country.

In the past few years, the financial performance of Captain Haddock has declined significantly (see Figure 2) and the company has had difficulty in meeting its bank covenants. This decline is partly due to economic recession in the country and partly due to a disastrous diversification into commercial real estate and currency dealing. The chairman and managing director of the company both resigned nine months ago as a result of concern over the breaking of banking covenants and shareholder criticism of the diversification policy. Some of the real estate bought during this period is still owned by the company. In the last nine months the company has been run by an interim management team, whilst looking for prospective buyers. At restaurant level, employee performance still remains relatively good and the public still highly rate the brand. However, at a recent meeting one of the employee representatives called for a management that can 'effectively lead employees who are increasingly demoralised by the decline of the company'.

Shoal plc is currently finalising their takeover of the Captain Haddock business. The company is being bought for a notional \$1 on the understanding that \$15 million is invested into the company to meet short-term cash flow problems and to improve liquidity. Shoal plc's assessment is that there is nothing fundamentally wrong with the company and that the current financial situation is caused by the failed diversification policy and the cost of financing this. The gross profit margin in the sector averages 10%.

Captain Haddock currently buys its fish and fish products from wholesalers. It is the intention of Shoal plc to look at sourcing most of the dishes and ingredients from its own companies; specifically ShoalFish, ShoalPro and ShoalFarm. Once the takeover is complete (and this should be within the next month), Shoal plc intends to implement significant strategic change at Captain Haddock so that it can return to profitability as soon as possible. Shoal plc has implemented strategic change at a number of its acquisitions. The company explicitly recognises that there is no 'one right way' to manage change. It believes that the success of any planned change programme depends on an understanding of the context in which the change is taking place.

<b>Captain Haddock</b> (all figures in \$m)	2007	2008	2009
Turnover	115·00	114·50	114·00
Gross profit (loss)	0·20	(5·10)	(6·20)

**Figure 2: Financial information for Captain Haddock 2007–2009**

**Required:**

**(a) In the context of Shoal plc's corporate-level strategy, assess the contribution and performance of ShoalFish, ShoalPro and ShoalFarm. Your assessment should include an analysis of the position of each company in the Shoal plc portfolio.** (15 marks)

**(b)** Shoal plc explicitly recognises that there is no 'one right way' to manage change. It believes that the success of any planned change programme will depend on a clear understanding of the context within which change will take place.

**(i) Identify and analyse, using an appropriate model, the contextual factors that will influence how strategic change should be managed at Captain Haddock.** (13 marks)

Professional marks will be awarded in part (b)(i) for the identification and justification of an appropriate model. (2 marks)

**(ii)** Once the acquisition is complete, Shoal plc wish to quickly turnaround Captain Haddock and return it to profitability.

**Identify and analyse the main elements of strategic change required to achieve this goal.** (8 marks)

Professional marks will be awarded in part (b)(ii) for the cogency of the analysis and for the overall relevance of the answer to the case study scenario. (2 marks)

**(c)** Portfolio managers, synergy managers and parental developers are three corporate rationales for adding value.

**Explain each of these separate rationales for adding value and their relevance to understanding the overall corporate rationale of Shoal plc.** (10 marks)

**(50 marks)**

## Section B – TWO questions ONLY to be attempted

### 2 Introduction

TMP (The Management Press) is a specialist business publisher; commissioning, printing and distributing books on financial and business management. It is based in a small town in Arcadia, a high-cost economy, where their printing works were established fifty years ago. 60% of the company's sales are made through bookshops in Arcadia. In these bookshops TMP's books are displayed in a custom-built display case specifically designed for TMP. 30% of TMP's sales are through mail order generated by full-page display advertisements in magazines and journals. Most of these sales are to customers based outside Arcadia. The final 10% of sales are made through a newly established website which offers a restricted range of books. These books are typically very specialised and are rarely featured in display advertising or stocked by general bookshops. The books available on the website are selected to avoid conflict with established supply channels. Most of the online sales are to customers based in Arcadia. High selling prices and high distribution costs makes TMP's books expensive to buy outside Arcadia.

#### Business changes

In the last decade costs have increased as the raw materials (particularly timber) used in book production have become dearer. Paper is extremely expensive in Arcadia and the trees used to produce it are becoming scarcer. Online book sellers have also emerged who are able to discount prices by exploiting economies of scale and eliminating bookshop costs. In Arcadia, it is estimated that three bookshops go out of business every week. Furthermore, the influential journal 'Management Focus', one of the journals where TMP advertised their books, also recently ceased production. TMP itself has suffered three years of declining sales and profits. Expenditure on marketing has been reduced significantly in this period and further reductions in the marketing budget are likely because of the weak financial position of the company. Overall, there is increasing pressure on the company to increase profit margins and sales.

Despite the poor financial results, the directors of TMP are keen to maintain the established supply channels. One of them, the son of the founder of the company, has stated that 'bookshops need all the help they can get and management journals are the heart of our industry'.

However, the marketing director is keen for the company to re-visit its business model. He increasingly believes that TMP's conventional approach to book production, distribution and marketing is not sustainable. He wishes to re-examine certain elements of the marketing mix in the context of the opportunities offered by e-business.

A young marketing graduate has been appointed by the marketing director to develop and maintain the website. However, further development of the website has not been sanctioned by the Board. Other directors have given two main reasons for blocking further development of this site. Firstly, they believe that the company does not have sufficient expertise to continue developing and maintaining its own website. It is solely dependent on the marketing graduate. Secondly, they feel that the website will compete with the established supply channels which they are keen to preserve.

However, the marketing director is convinced that investing in e-business is essential for the survival of TMP. 'We need to consider what unique opportunities it offers for pricing the product, promoting the product, placing the product and providing physical evidence of the quality of the product. Finally, we might even re-define the product itself'. He feels if the company fails to grasp these opportunities, then one of its competitors will, and 'that will be the end of us'.

#### Required:

- (a) **Determine the main drivers for the adoption of e-business at TMP and identify potential barriers to its adoption.** (5 marks)
- (b) **Evaluate how e-business might help TMP exploit each of the five elements of the marketing mix (price, product, promotion, place and physical evidence) identified by the marketing director.** (20 marks)

**(25 marks)**

### 3 Introduction

Frigate Limited is based in the country of Egdon. It imports electrical components from other countries and distributes them throughout the domestic market. The company was formed twenty years ago by Ron Frew, who now owns 80% of the shares. A further 10% of the company is owned by his wife and 5% each by his two daughters.

Although he has never been in the navy, Ron is obsessed by ships, sailing and naval history. He is known to everyone as 'The Commander' and this is how he expects his employees to address him. He increasingly spends time on his own boat, an expensive motor cruiser, which is moored in the local harbour twenty minutes drive away. When he is not on holiday, Ron is always at work at 8.00 am in the morning to make sure that employees arrive on time and he is also there at 5.30 pm to ensure that they do not leave early. However, he spends large parts of the working day on his boat, although he can be contacted by mobile telephone. Employees who arrive late for work have to immediately explain the circumstances to Ron. If he feels that the explanation is unacceptable then he makes an appropriate deduction from their wages. Wages, like all costs in the company, are closely monitored by Ron.

#### Employees, customers and suppliers

Frigate currently has 25 employees primarily undertaking sales, warehousing, accounts and administration. Although employees are nominally allocated to one role, they are required to work anywhere in the company as required by Ron. They are also expected to help Ron in personal tasks, such as booking holidays for his family, filling in his personal tax returns and organising social events.

Egdon has laws concerning minimum wages and holidays. All employees at Frigate Ltd are only given the minimum holiday allocation. They have to use this allocation not only for holidays but also for events such as visiting the doctor, attending funerals and dealing with domestic problems and emergencies. Ron is particularly inflexible about holidays and work hours. He has even turned down requests for unpaid leave. In contrast, Ron is often away from work for long periods, sailing in various parts of the world.

Ron is increasingly critical of suppliers ('trying to sell me inferior quality goods for higher prices'), customers ('moaning about prices and paying later and later') and society in general ('a period working in the navy would do everyone good'). He has also been in dispute with the tax authority who he accused of squandering his 'hard-earned' money. An investigation by the tax authority led to him being fined for not disclosing the fact that significant family expenditure (such as a holiday for his daughters overseas) had been declared as company expenditure.

#### Company accountant

It was this action by the tax authority that prompted Ron to appoint Ann Li as company accountant. Ann had previously worked as an accountant in a number of public sector organisations, culminating in a role as a compliance officer in the tax authority itself. Ron felt that 'recruiting someone like Ann should help keep the tax authorities happy. After all, she is one of them'.

Ann was used to working in organisations which had formal organisational hierarchies, specialised roles and formal controls and systems. She tried to install such formal arrangements within Frigate. As she said to Ron 'we cannot have everyone working as if they were just your personal assistants. We need structure, standardised processes and accountability'. Ron resisted her plans, at first through delaying tactics and then through explicit opposition, tearing up her proposed organisational chart and budget in front of other employees. 'I regret the day I ever made that appointment', he said. After six months he terminated her contract. Ann returned to the tax authority as a tax inspector.

#### Required:

The cultural web allows the business analyst to explore 'the way things are done around here'.

- (a) **Analyse Frigate Ltd using the cultural web or any other appropriate framework for understanding organisational culture.** (15 marks)
- (b) **Using appropriate organisation configuration stereotypes identified by Henry Mintzberg, explain how an understanding of organisation configuration could have helped predict the failure of Ann Li's proposed formalisation of structure, controls and processes at Frigate Ltd.** (10 marks)

**(25 marks)**

#### 4 Introduction

The Institute of Administrative Accountants (IAA) has a professional scheme of examinations leading to certification. The scheme consists of six examinations (three foundation and three advanced) all of which are currently assessed using conventional paper-based, written examinations. The majority of the candidates are at the foundation level and they currently account for 70% of the IAA's venue and invigilation costs.

There are two examination sittings per year and these sittings are held in 320 centres all over the world. Each centre is administered by a paid invigilation team who give out the examination paper, monitor the conduct of the examination and take in completed scripts at the end. Invigilators are also responsible for validating the identity of candidates who must bring along appropriate identification documents. At over half of the centres there are usually less than ten candidates taking the foundation level examination and no candidates at all at the advanced level. However, the IAA strives to be a world-wide examination body and so continues to run examinations at these centres, even though they make a financial loss at these centres by doing so.

Recent increases in invigilation costs have made the situation even worse. However, the principles of equality and access are important to the IAA and the IAA would like to increase the availability of their examinations, not reduce it. Furthermore, the IAA is under increased financial pressure. The twice-yearly examination schedule creates peaks and troughs in cash flow which the Institute finds increasingly hard to manage. The Institute uses its \$5m loan and overdraft facility for at least four months every year and incurred bank charges of \$350,000 in the last financial year.

#### Examinations

All examinations are set in English by contracted examiners who are paid for each examination they write. All examinations are three-hour, closed-book examinations marked by contracted markers at \$10 per script. Invigilators send completed scripts directly to markers by courier. Once scripts have been marked they are sent (again by courier) to a centralised IAA checking team who check the arithmetic accuracy of the marking. Any marking errors are resolved by the examiner. Once all marks have been verified, the examination results are released. This usually takes place 16 weeks after the examination date and candidates are critical of this long delay. The arithmetic checking of scripts and the production of examination results places significant demands on IAA full-time administrative staff, with many being asked to work unpaid overtime. The IAA also employs a significant number of temporary staff during the results processing period.

#### E-assessment

The new head of education at the IAA has suggested e-assessment initiatives at both the foundation and advanced levels.

He has suggested that all foundation level examinations should be assessed by multiple-choice examinations delivered over the Internet. They can be sat *anytime, anyday, anywhere*. 'Candidates can sit these examinations at home or at college. Anywhere where there is a personal computer and a reliable broadband connection.'

Advanced-level examinations will continue to be held twice-yearly at designated examination centres. However, candidates will be provided with personal computers which they will use to type in their answers. These answers will then be electronically sent to markers who will use online marking software to mark these answers on the screen. The software also has arithmetic checking facilities that mean that marks are automatically totalled for each question. '100% arithmetic accuracy of marking is guaranteed.'

He has also suggested that there is no need to make a formal business case for the adoption of the new technology. 'Its justification is so self-evident that defining a business case, managing benefits and undertaking benefits realisation would just be a pointless exercise. It would slow us down at a time when we need to speed up.'

#### Required:

- (a) **Evaluate the perceived benefits and costs of adopting e-assessment at the IAA.** (15 marks)
- (b) **Explain why establishing a business case, managing benefits and undertaking benefits realisation are essential requirements despite the claimed 'self-evident' justification of adopting e-assessment at the IAA.** (10 marks)
- (25 marks)**

End of Question Paper