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# ACCA – Paper P3 Business Analysis June 2015 Final Assessment

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## Marking Report

### Notice to Markers

- 1 When commenting about the script performance, please ensure on individual questions and on overall assessment your comments cover areas of examination technique including:

• Time management	• Handwriting	• Presentation and layout	• Use of English
• Points clearly and concisely made	• Relevance of answers to question	• Coverage and depth of answer	• Accuracy of calculations
• Calculations cross-referenced to workings	• All parts of the requirement attempted	• Length of answers equates to marks available	• Read the question carefully

- 2 For each question, please provide suitable constructive comments

Question Number	General Comments	Exam Technique Comments

**ACCA FINAL ASSESSMENT**

# **Business Analysis**

**June 2015**

**Time allowed**

Reading and planning: 15 minutes  
Writing: 3 hours

**This paper is divided into two sections**

**Section A** This question is compulsory

**Section B** Choose two questions from three

**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.**

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**Paper P3**

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## SECTION A

### THIS QUESTION IS COMPULSORY

- 1 Film Tech (hereafter FT) is a film production company based in Arcadia. The company was formed in April 20X1 by three individuals who had previously worked in various aspects of the film and DVD/video industry and who came together to set up the business. Between them they have a wealth of broadcast and creative experience having previously worked for the country's major television network, the Arcadian Broadcasting Company (ABC) – as well as time spent abroad working for major film companies and broadcasters.

FT has extensive experience in production work across all aspects of broadcasting. It has a state-of-the-art digital media facility tailored towards broadcast production and corporate DVD services including editing services and post-production. When the company is busy, it requires extra teams of freelance animators to create the images.

The company owns a modernised warehouse in the country's capital where it has the space for administration and film production, together with some storage space. The company also rents a second warehouse nearby which is used for inventory purposes and as a second studio for film production and post-production editing when needed.

#### **Competition**

FT operates in a crowded market where competition is constant and where being well-known and well-connected is often as important as being technically skilled. That, coupled with the fact that at the lower end of the market almost anyone with a digital camera can attempt to make their own film, means that the technical barriers to entry in this industry can appear very low.

The whole film and DVD industry is suffering during this recession, and FT, along with all other commercial enterprises in this sector, has been adversely affected.

#### **Advertising work**

FT began by working on the creation of advertisements for corporate clients to be broadcast on television and in cinemas. FT's corporate film output includes high-impact promotional films and educational DVDs, as well as the filming and production of training presentations. FT has established a reputation for high-quality work and has frequently bid for and won contracts to produce films and DVDs against strong competition in what is seen to be a highly competitive market. FT has attracted some top quality brands as corporate clients, but increasingly, many companies are simply re-running old campaigns and have not been commissioning new work.

This work combines the special talents of the creative teams within FT, together with an observant eye and ear for the message which the client wants to deliver. More recently work has included online advertising with short films and animations produced for websites or search engines, which catch the eye of web-browsing customers. Commercially FT has had to develop the skill to deliver a succinct visual and audio corporate message to capture the attention of a viewer in the very short time-span during which a web user scans for items on the web.

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### **Animation output**

Initially performed as an in-house experiment, FT became the creator of a number of thin wire-based characters (called 'Cluckoos'), which were used in an educational campaign for the country's road safety department. Children seemed to like these strange looking characters, which attracted positive reactions, especially from younger viewers. Because of their clean, positive image parents accepted them as well. Gradually a whole happy Cluckoos community was created – with a distinctive cheerful logo to go with it.

Because of the Cluckoos safety series, FT established an excellent reputation for creativity and technology as well as a growing fan-base amongst younger viewers. Apart from sales of the Cluckoos safety series to Arcadian schools, FT retained the rights to the profits on all subsequent sales to other customers in the Arcadian and abroad, of both the safety DVDs and all other Cluckoos output.

### **Sales of merchandise and DVDs**

FT have also developed a wide range of Cluckoos merchandise. FT did not realise the full potential of this aspect of the business until audience demand, from its younger viewers, forced it to become more aware. FT retains the rights on all aspects of Cluckoos merchandising, and those rights are very clearly established in all of its contracts. FT is heavily dependent on the success of the Cluckoos output, because most of the merchandise sold is associated with the Cluckoos animation series – whilst it remains popular, so will the merchandise.

The company also sells DVDs of Cluckoos episodes. FT have found the business to be rather seasonal – with over half of all sales coming in the two months leading up to Christmas last year. FT are unsure about how successful this revenue stream might become as buyers move towards digital downloads and parents become more inclined to store recordings on their set-top boxes rather than buy new DVDs.

### **Commissions of films**

Twelve months ago, FT was commissioned by ABC to create a series of four short films, based on the Cluckoos – that ran over a period of four weeks. The series proved fantastically popular and has led to ABC requesting the production of 22 more episodes for next year.

The Cluckoos product has become a great success for the company and FT is determined to protect its success and also to avoid any over-exposure which may shorten the characters' useful life. It will be vital to remain appealing to children and to retain the trust of parents in order to continue to win new commissions and the revenue from merchandising that is likely to follow from that.

**Figure 1: Extracts from the statements of profit or loss (20X6–20X8) (all figures in \$000)**

	20X8	20X7	20X6
Revenue			
Corporate work (including advertising production)	14,357	15,348	16,555
Commission work (for ABC)	1,000	0	0
Merchandising and DVD	8,742	2,657	487
Cost of sales	8,619	5,124	4,144
Gross profit	15,480	12,881	12,898
Administration expenses	6,142	5,887	5,664
Other expenses	245	665	212
Finance costs	612	458	314
Profit before tax	8,481	5,871	6,708
Income tax expense	2,120	1,514	1,622
Profit for the year	6,361	4,357	5,086

**Figure 2: Extracts from statements of financial position (all figures in \$000)**

	20X8	20X7	20X6
Non-current assets	25,472	21,316	18,874
Work-in-progress	2,869	2,379	2,731
Retained earnings	24,283	19,512	16,244
Long term borrowings	6,455	6,120	5,263

### **New commercial opportunity**

FT has received an approach from The Arcadian Cereal Company (TACO) with a proposal regarding the use of Cluckoos characters in an advertising programme, scheduled for the first quarter of 20X9. TACO are a popular children's cereal brand and are the country's second largest cereal supplier. TACO want to launch a new chocolate breakfast cereal for children. It will be supported by new television adverts featuring the Cluckoo characters as well as having free Cluckoo themed gifts inside each box of cereal purchased.

The production of the adverts would be carried out by FT and would be worth \$250,000 of contribution to FT. Merchandising would be performed by FT's existing supply chain and TACO would pay a fee (based on a 25% mark-up) for each one.

The work would have to be carried out within the next few months and, if the launch was successful, TACO would then want to extend the campaign beyond Arcadia and into the international market. FT are a little concerned as work on the TACO contract will coincide with planned work on the ABC commissions – though they hope to be able to fit both projects into their schedules.

### **Recent issues**

A recent road safety film featuring the Cluckoos characters has been mildly criticised in the media and on social networks for its inappropriate storyline (in one scene a character was thought to have exhibited an element of sexism). FT's managing director ordered a thorough investigation of the production of this episode and her over-riding conclusion was that many of the problems were caused by a decision taken two years ago by the company to outsource many elements of its activities.

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A decision had been taken to outsource storyline production. This reduced the workload on existing writers who could concentrate on corporate adverts. There are many experienced, freelance writers available who offer writing services. It is a specialist skill and these staff can be quite expensive.

FT had also outsourced the scheduling of staff, cameras, and facilities etc. to a specialist operational planning business. Although scheduling had never been a difficult task for the business, the offered services were seen to be quite cheap. But it led to many issues with staff turning up on the wrong days, cameras not being available at appropriate times and facilities bookings clashing with other programmes.

The managing director is now concerned that outsourcing of activities should be abandoned completely. She has even started to question decision to outsource the production of merchandising as merchandising is becoming a core area of revenue for the business.

**Required:**

- (a) Using a suitable model or models, analyse FT's strategic position from both an internal and external environment perspective. (20 marks)**
- (b) Evaluate the potential link up with TACO and explain why this opportunity would be inappropriate for FT. (14 marks)**  
**Professional marks will be awarded in part (b) for the clarity, structure and style of the answer. (4 marks)**
- (c) Evaluate, using a suitable framework or model, the suitability of FT's decision to outsource the activities of story writing, staff scheduling and merchandising production. (12 marks)**

**(Total: 50 marks)**



## SECTION B

### CHOOSE TWO QUESTIONS FROM THREE

- 2 Xie is a medium-sized specialist retailer of children's sports shoes. It was established in 1997, and currently operates from three retail shops in town centre locations. It has recently faced some fierce competition from rival shoe store chains who often have a national presence which gives them economies of scale and therefore the ability to provide branded goods at low prices. These chains also have high advertising budgets which are employed to create television adverts, billboards and product placement opportunities. On the other hand, Xie relies primarily on word of mouth and leaflets distributed to local schools and children's clubs in order to promote its products. Rivals' stores are not specialists in children's sports shoes but instead add the product to their existing offerings. But the chains aim to take advantage of a market that is starting to grow rapidly as parents become more aware and concerned about children's health and fitness.

The management team of Xie is very careful about how it recruits staff. In addition to the specific skills required to do the job, any applicant must also have a 'passion' for working with children and families. This has resulted in Xie gaining a reputation for excellent customer service and enthusiastic staff. A large proportion of staff time is also devoted to training, both on the product range and customer service techniques. According to a recent survey conducted by the store managers, the customers believe that Xie employees are 'helpful and knowledgeable'. The customers also praised the Xie shops for being 'well designed' and child friendly, unlike some large national chains who focus on maximising the use of the limited space available to them by having narrow aisles and no children's waiting or play areas. Also, within these large national chains, children's sports shoes are often located in a remote corner as it continues at present to be a small part of the stores overall sales.

Another feature of Xie that is appreciated by the customers is the range of goods stocked. By focusing solely on children's sports shoes, Xie is able to stock a far wider range of items than its rivals. Control of this stock was made easier, last year, by the development of a sophisticated computerised stock control system. Using the system, any member of staff can locate any item of stock in any of the shops or the warehouse. If the required item is not 'in stock' at Xie, it is also possible to automatically check the availability of stock with the manufacturer. This means that if an item required by a buyer is not in stock at a particular store, the buyer can use a "reserve and collect" service and pick the item up at an alternative store or wait for the item to come to the store that they prefer.

#### **Website development**

At a recent management meeting, one of the store managers suggested that Xie could consider developing its very basic website into one capable of e-retailing. At present, the website only gives the location of stores and some very basic details of the range of stock carried. Although the development of the website would be expensive, the managers have decided to give the suggestion serious consideration.

The company's marketing director has performed some initial market research into this area and discovered that the critical success factors are likely to be very different for any online addition to the business. A survey of sportswear customers was carried out and their opinions sought on their reasons for buying.

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The following table gives information on the percentage of shoppers who mentioned particular needs when determining which retailer to choose when buying sports goods:

Reason for choosing a particular retailer	For 'offline' sales	For 'online sales
Price	61%	87%
Choice	75%	46%
Service	80%	22%
Returns	42%	54%
Payment methods	12%	42%
Delivery times/availability	13%	65%
Independent reviews	16%	49%

**Required:**

(a) Using the value chain model, explain those activities that add value in the Xie organisation, BEFORE the e-retail investment. (12 marks)

(b) Identify those activities in the value chain of Xie that may be affected by the e-retail investment, explaining whether the value added by each of them may increase or decrease as a result of the e-retail investment. (13 marks)

**(Total: 25 marks)**

**3** Reason Tech is a new business start up which is 100% owned by Lucy Chen. The company has been created to develop and sell a new accessory for a home games console based on a patent owned by Lucy Chen. This small, light accessory can be placed in front of most television screens to convert 2D images into 3D images. As many more games are being released with 3D capabilities the company have very high expectations about the potential success of the product.

**Product cost**

Lucy has had some poor business experiences in the past and is determined that this time around her new company will not launch into the market without fully understanding the product cost and margin and having a clear marketing plan. For this reason the launch of the new product has been delayed by three months whilst Reason Tech has constructed a standard cost card for the product. After making 1,000 units (Reason Tech expect the total production of the product to be around 100,000 units over its four year life) the standard cost card was constructed as follows:

Cost	Activity driver	\$/unit
Direct materials		8.50
Overheads:		
Design	Design hours	50.00
Engineering	Machine hours	8.50
Research	Research hours	46.50
Reworking	100% of material cost	8.50
Inspection	Number of inspections	1.00
Delivery	Number of deliveries	1.00
		124.00

Reason Tech have been encouraged to use activity based costing in the production of the standard cost card as this is seen as giving more accurate overhead costs. The company has spent time analysing each activity, determining activity drivers and allocating costs between activities in order to create the most accurate cost card.

Costs per unit have been determined based on the costs incurred to date. For example, total design costs to date have been \$50,000. This has involved 5,000 design hours which has resulted in activity charge out rate of \$10 per design hour. Each product has had an average of 5 hours of design time which translates to a cost per unit of \$50.

### **Pricing**

This standard cost card has put the entire venture in jeopardy. Lucy Chen knows the industry well, having been a director in a console accessory manufacturing previously. She knows that typical industry margins are around 20% and had planned for Reason Tech to make that level of return. This would mean that the new product would have to sell for \$155 in order to make an acceptable return. Reason Tech plan to sell their product through retailers and this would mean that retailers would be selling to the public at around \$180 to \$200.

This may give the company a problem when trying to compete with rivals. Reason Tech's product is of high quality and the company would aim for a high selling price. However, initial market research has indicated that consumers would only be willing to pay between \$100 and \$150 for the product. Lucy Chen does not believe that the company would be able to attract many buyers at a price to retailers of \$155.

### **Current position**

Despite the fact that Lucy Chen has put hundreds of thousands of dollars into Reason Tech in order to make the company a success, she is now unsure as to how to proceed. She believes that the standard cost card needs further examination and that the product should only continue in production if the final selling price comes within a range that consumers would find acceptable.

She also believes that in order to reduce end selling price further that the company should look to sell the product themselves through a newly developed website rather than sell through high street retailers. She is aware that more gamers are making their purchases online and that high street retailers are struggling to compete with the lower prices available online for many products.

### **Required:**

- (a) Evaluate the use of activity based costing in constructing the standard cost card for Reason Tech's new product. In particular, your answer should cover the use of ABC, problems with the existing standard cost card and the setting of the selling price.**  
(13 marks)
- (b) Consider how the marketing mix could be applied to the new product website of Reason Tech.**  
(12 marks)

**(Total: 25 marks)**

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**4** Hazeldine is a well-established manufacturer of camping equipment. It has a large national distribution chain and 4 retail premises spread throughout the country. It manufactures a wide range of equipment as well as buying in and re-badging other equipment with the Hazeldine logo and branding. It sells its products through its retail sites as well as a through an online e-commerce store.

Six months ago Hazeldines undertook a project to build a specialist display area close to its head office site. The plan was to build a mini camp site that could be used to display equipment manufactured by the company in a camping environment. This would be used to illustrate the equipment to potential overseas buyers who represent large international retailers. The sales team at Hazeldine believe that selling to these buyers will greatly increase the company's international presence, branding awareness and overall volumes.

A detailed project plan process was followed and the board reviewed the project plan and gave approval for project initiation. The plan was to build the facility within three months and a total budget of \$500,000 was set for the project. Steve Mexes, the director of product design, was placed in charge of the project and created this initial cost plan:

	\$
Materials	100,000
Equipment costs	40,000
Labour	90,000
Machinery hire	90,000
Project salaries	90,000
Project planning costs	5,000
Specialist project software	20,000
Miscellaneous	15,000
Contingencies	50,000
	<hr/>
Total budgeted cost	500,000
Expected extra contribution from international sales	600,000
	<hr/>
Net project benefit	100,000
	<hr/>

Two months into the project and Steve Mexes now believes that, not only will the project not be finished on time, but also that it is likely to be so far over budget that it is no longer viable (even taking a best case scenario). The latest reviews show that the project is around 50% complete and has incurred the following costs to date:

		<i>Costs to date</i>	<i>Expected cost to completion</i>
		\$	\$
Materials	(50%)	50,000	50,000
Equipment costs		0	40,000
Labour		90,000	90,000
Machinery hire		60,000	60,000
Project salaries		60,000	60,000
Project planning costs		5,000	0
Specialist project software		18,000	0
Miscellaneous		12,000	0
Contingencies		120,000	0
		<hr/>	<hr/>
Total costs at end of month 2		415,000	300,000
		<hr/>	<hr/>

Materials include items such as fencing, building materials, turf etc. This was purchased in full at the start of the project and is charged to the project at full. Equipment costs refer to the production cost of Hazeldine camping equipment which will be transferred from production at the end of the project.

Labour costs are expected to be low as the plan was to use idle time from factory production staff to perform the building work. When idle time was not available then these staff would be paid at their normal overtime rate of \$20 per hour. The project specific salaries are incurred for specialist staff recruited to the project management team. They are employed on a fixed monthly contract with one month's notice period for termination available to either party.

Specialist software was purchased at the start of the project to help with project planning etc. and no further project planning costs are expected. Contingencies have increased due mainly to the unexpected need to build a drainage system to the camp and provide water access for those items of equipment that require it.

Steve Mexes believes that the best way forward would be to abandon the project completely. Machine hire could be stopped, project staff given their one month's notice and the area set aside for the new camp could be converted to product storage space at a cost of \$10,000. Unfortunately, the remaining materials and the project software are unlikely to have any sell on value, but the project software could at least be used on future business projects.

**Required:**

- (a) On the basis that the project is likely to take another two months to complete, consider whether, from a financial perspective, the project should be abandoned at its current stage. (5 marks)**
- (b) Explain the other responses that the project manager could take to resolve the project problems. (10 marks)**
- (c) The project benefits have not yet been derived and are likely to be long term in nature. Explain the process for establishing responsibility for the delivery of these benefits. (10 marks)**

**(Total: 25 marks)**

