ACCA FINAL ASSESSMENT

Business Analysis

December 2011

Paper P3

Time allowed
Reading and planning: 20 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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SECTION A

THIS QUESTION IS COMPULSORY

QUESTION 1

Introduction

Jeff Wainwright is Managing Director of Elite Plastic Packaging (EPP), part of the Print and Packaging Division, which, in turn, is part of the Sigma Group plc, a diversified company with other separate product divisions in building materials, flooring products and speciality chemicals. The group had emerged during the early 1980s as Sigma, like other companies, tried to compensate for the slowdown in internal growth by moving into different industries mainly through merger and acquisition. The grouping into product divisions was largely one of administrative convenience rather than compelling industrial logic and the Print and Packaging Division contained a number of companies, which operated largely independently of one another.

Sigma Group corporate headquarters

The Sigma Group headquarters (HQ) is dominated by accountants who Jeff regards as reacting to, rather than anticipating, rivals. Risk is to be avoided wherever possible and projects only approved if they can demonstrate a three year payback – typically a 'one solution fits all' to the companies in the group. This view of risk was reinforced by the Divisional Chief Executive of the Print and Packaging Division, Tim Sterling, also an accountant by background, with whom Jeff had a working but uneasy relationship. There was little confidence that Tim would champion the cause of the companies within the Print and Packaging Division against the wishes of the Sigma Group's domineering Chairman and Chief Executive, Archie Williams.

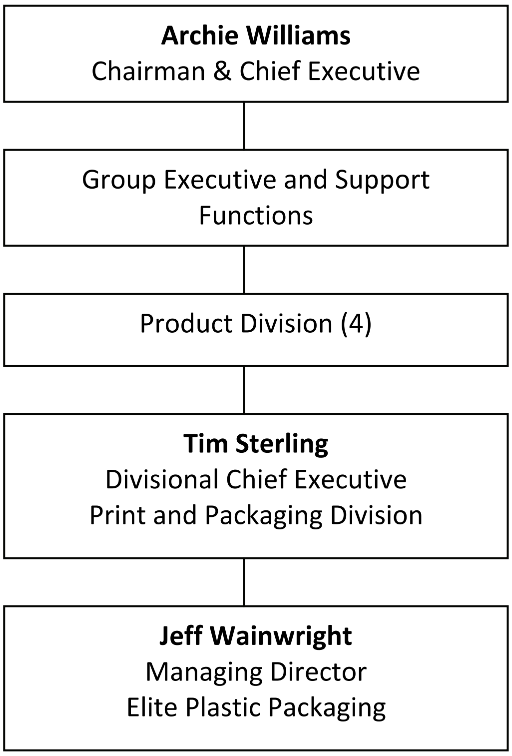
Archie is convinced that a decentralised management style is the key to maintaining profitable growth in the future. Under him corporate HQ has two key functions, firstly, an executive role carried out by a small team of four – Archie Williams and three Group Directors, collectively known as the Group Executive. Each of the Group Directors takes a special interest in, but not responsibility for, one or more of the divisions and heads up a central support function. Of prime importance are the monthly meetings reviewing, sanctioning, and monitoring each Division's budgets. The process involves the Group Executive and the Division's senior management team and takes a minimum of one week every month generating the information and holding meetings with each of the divisions.

Other Group Executive activities include the approval of divisional capital expenditure proposals, policies towards the appointing and remuneration of the top divisional management and planning and managing relationships with the financial world.

The second distinct function carried out by corporate HQ are those support activities that were carried out centrally including treasury, financial reporting, tax planning, personnel and legal activities. Fewer than 100 people work at Group HQ.

The Group Executive has a very distinctive view of the relationship between company headquarters and the operating divisions. Archie Williams had been the architect of a recovery plan in the early 1990s which had cut costs and increased profits by getting rid of a number of earlier attempts to reduce geographic dependency on UK markets by moves into Europe, the Middle East and Asia, partly through acquisition. Focus had been placed on growing product areas with the potential for a quick turnaround in results. This on occasion meant reducing sales revenue but improving profitability. The avoidance of earnings dilution was of central importance.

Sigma Group organisation chart



Strategic planning and budgeting in the Sigma Group

Elite Plastic Packaging (EPP)

EPP's main business is advanced plastic packaging where Jeff sees the greatest potential for growth. It manufactures injection moulded plastic packaging primarily for the food, drinks and confectionery markets. Jeff is encouraged by the support of large supermarket customers who have begun to insist that their major suppliers of both food and non-food goods use EPP's packaging. This means that EPP is now a supplier of plastic packaging to global manufacturers. Even more exciting is the development of 'intelligent' packaging where computer chips are built into the packaging allowing companies to 'track and trace' their products all over the world. Such a product has considerable appeal to manufacturers of expensive consumer luxury products such as perfume, alcohol and music discs where counterfeiting is a growing global problem.

EPP's global opportunities

Jeff's frustration with his Divisional Chief Executive and the Group Executive team at Sigma has been brought to a head by their reaction to a major opportunity to move the packaging business on to a global basis. EPP has had five years of fast and very profitable growth in the European market and now wants to exploit the full global market by expansion into both the USA and Asian markets. EPP's share of the European specialist plastic packaging market has reached 50%, generating some $50 million in sales revenue. The latest version of the packaging yields significant operating benefits to the manufacturers using it and as a result is generating a 15% net sales margin for EPP. The total world market is estimated at $300 million a year split evenly between the three major regional markets – Europe, the Americas and Asia. Potential competitor packaging companies exist but these have generally failed to invest sufficiently in the new technology to be effective. The issue is how best to enter the American and Asian markets and to convince the risk averse Sigma Group HQ to provide the necessary investment.

Four market entry strategies are available. Firstly, to license the technology to third parties and obtain a royalty of 5% of sales revenue. Secondly, to set up with new green field sites. Net margins would be greater than 15% as the European region would absorb most of the marketing, development and administration costs. Thirdly, subcontracting the manufacturing to a suitable partner. Profits would need to be shared 60:40 in favour of the subcontractor. Finally, by acquisition which would need to be in a related technology and provide access to the relevant sales channels to achieve growth. Each option has its own advantages and disadvantages and capital investment and budgetary consequences.

The HQ philosophy is to devolve and decentralise to the divisions all activities that affect a division's costs and revenues. They want the Divisional Chief Executives to feel that they have complete control over their division's performance. The division's senior management team and the Group Executive at the monthly board meeting critically review each division's performance. These monthly Divisional Executive Boards, in addition to reviewing the division's on-going performance against budget, also considers opportunities and threats and formal plans and budgets. It is the detailed attention and care given to budgeting and performance monitoring that determines the relationship between the Group Executive and its operating divisions. The bottom-up planning process starts with the individual companies in each division developing their own strategy. The financial consequences of this strategy are then built into a divisional budget that is stretching but achievable. This target is designed to be owned by the division and motivate the management team. Budget procedures are formally laid down and extremely comprehensive. Tim Sterling spends a day with each company's MD working on the budget to be presented to the Group Executive. Agreeing the budget is a stressful time as it is the key to Sigma's performance evaluation. Failure to achieve is unacceptable and a divisional management team unable to deliver its promises is under considerable pressure from the Group Executive.

The Group Executive does not get involved with the strategy planning process and sees the budget as the tangible evidence of division's strategic planning and in effect a contract to deliver over the coming year. Budgets are typically agreed at the November or December meeting of the Divisional Executive Board and reviewed at subsequent Board meetings, which can last up to half-a-day. The process ensures that the Group Executive is fully aware of each division's performance, where problems are occurring, and able to share thinking on solutions. The Group Executive firmly resists telling a division what to do.

Agreement to significant capital expenditure will be influenced by the previous track record of the division, the fit with their current business, a potential return above that currently being achieved and above all the commitment of the management team. Avoidance of projects with long lead times and in areas not closely connected to existing activities guides approval. Overall, therefore, the Sigma Group has no centrally determined strategy and its broad objectives are aimed at ensuring profitable growth each and every year. Acquisitions, when approved, are focused on the buying of assets rather than incumbent management. Such acquisitions are then left to the divisions to successfully integrate them. Archie Williams firmly believes that the tight budgetary control operated from the centre provides both the incentive and punishment for divisions to achieve profits today and profitable growth tomorrow.

Table 1: Information on the Sigma Group's current sales revenue and financial performance

($000) (where appropriate)

Year	*2002*	*2003*	*2004*	*2005*	*2006*
Sigma Group	$000	$000	$000	$000	$000
Group sales revenue	580.2	419.8	382.6	354.6	350.7
Group operating profit	62.9	34.7	23.6	21.9	20.1
Operating margin	10.8%	8.3%	6.2%	6.2%	5.7%
Print & Packaging Division	$000	$000	$000	$000	$000
Sales revenue	107.5	87.6	97.4	111.3	117.9
Operating profit	17.2	13.0	11.8	13.5	12.3
Operating margin	16.0%	14.9%	12.1%	12.1%	10.4%
Elite Plastic Packaging Company	$000	$000	$000	$000	$000
Sales revenue	28.1	31.5	35.2	45.1	52.3
Operating profit	9.3	10.9	13.2	17.6	21.1
Operating margin	33.1%	34.6%	37.5%	39.0%	40.3%

Required:

(a) Prepare a short report evaluating the advantages and disadvantages of each market entry strategy taking into account the Group Executive's short-term performance focus. (20 marks)

(b) Examine the value added by the Group Executive to the strategic management of the divisions and the costs and benefits of this style of involvement. (15 marks)

(c) Assuming that Jeff is successful in his plan to move EPP into a global operation, discuss which communication, control and co-ordination issues are raised by such a change.

(15 marks)

(Total: 50 marks)

SECTION B

CHOOSE TWO QUESTIONS FROM THREE

QUESTION 2

Marshall operates a business that sells advanced photocopying machines and offers on-site servicing. There is a separate department that provides servicing. The standard cost for one service is shown below along with the operating statements for the Service Department for the six months to 30 September.

Each service is very similar and involves the replacement of two sets of materials and parts. It requires specialist labour to perform the service, all of whom are employed on full time contracts by Marshall.

Marshall's budgets for 5,000 services per month.

Standard cost for one service

	$
Materials – 2 sets @ $20 per set	40
Labour – 3 hours @ $11 per hour	33
Variable overheads – 3 hours @ $5 per hour	15
Fixed overheads – 3 hours @ $8 per hour	24
	112

Outsourcing decision

Marshall has always boasted of the quality of both its product and its after sales service. The high level of service has convinced many customers to choose Marshall as their chosen photocopier supplier. But its machines are breaking down more often at present, this is often because businesses hold on to machines for longer and replace them less frequently. A lot of this can be attributed to the current economic climate experienced in Marshall's native country. One year ago the company was budgeting for 4,000 services per month but that number has now risen by 25%. This has resulted in the recruitment of more staff for the department.

The company is therefore considering outsourcing the servicing of its machines. Marshall believe that outsourcing the servicing would allow the company to focus solely on sales of photocopiers.

It has been approached by an experienced servicing company, Photoserve, who would demand a fee of $6m per annum and a 3 year contract to perform the outsourcing on Marshall's behalf. Customers would contact Marshall in the first instance when a repair is needed, and Marshall would then inform Photoserve of the need for the repair. This would ensure that customers would be less aware that the servicing has been outsourced.

Marshall's senior management team believe that this would free up the business to 'get back to its roots' and focus on its core activity of selling photocopiers.

Operating Statements for six months ending 30 September

The performance of the division over the last six months has been as follows:

Month	*1*	*2*	*3*	*4*	*5*	*6*	*Total*
Number of services per month	5,000	5,200	5,400	4,800	4,700	4,500	29,600
	$	$	$	$	$	$	$
Flexible budget costs	560,000	582,400	604,800	537,600	526,400	504,000	3,315,200
Less variances:							
Materials							
Price	5,150 F	3,090 F	1,100 F	(2,040) A	(5,700) A	(2,700) A	(1,100) A
Usage	(6,000) A	2,000 F	(4,000) A	(12,000) A	(2,000) A	0	(22,000) A
Labour							
Rate	26,100 F	25,725 F	27,331 F	18,600 F	17,400 F	15,515 F	130,671 F
Efficiency	5,500 F	9,900 F	12,100 F	(12,100) A	(4,400) A	(11,000) A	0
Variable overheads:							
Expenditure	(3,500) A	(3,500) A	(2,500) A	(4,500) A	500 F	2,500 F	(11,000) A
Efficiency	2,500 F	4,500 F	5,500 F	(5,500) A	(2,000) A	(5,000) A	0
Fixed overheads:							
Expenditure	(3,000) A	(5,000) A	(5,000) A	(15,000) A	5,000 F	5,000 F	(18,000) A
Volume	0	4,800 F	9,600 F	(4,800) A	(7,200) A	(12,000) A	(9,600) A
Actual costs	533,250	540,885	560,669	574,940	524,800	511,685	3,246,229

Required:

(a) **Prepare a summary financial statement showing the overall performance of the Service Department for the six months to 30 September 200X.** **(4 marks)**

(b) **Write a draft report to the Operations Director of Marshall commenting on the performance of the Service Department for the six months to 30 September 200X.**

Suggest possible causes for the features you have included in your report and state the further information that would be helpful in assessing the performance of the department. **(12 marks)**

(c) **Consider whether the servicing of photocopiers should be outsourced and consider the possible financial implications for the business.** **(9 marks)**

(Total: 25 marks)

QUESTION 3

John Dixon is the recently appointed Chief of Police for a major city. He has inherited a major problem in that its residents are very concerned with various forms of antisocial behaviour and minor crimes carried out by a small number of people, which makes living, working, travelling and socialising in the city centre unpleasant rather than life threatening. The city's residents have recently voted for it being one of the five worst cities in the country in which to live. There is little or no contact between the police and these residents.

The city is split into a number of police districts, each with its own senior officer in charge. Their focus is on the response to emergency calls and solving serious crimes in their district rather than the less urgent crimes affecting everyday living in the city. Response times and serious crime solution rates are the traditional measures by which their performance is measured and leave them open to criticism of simply reacting to events. There is little sense of being part of a city police force and, consequently, little sharing of information and experience between the different districts. The failure in policing antisocial behaviour in the city is seen as being largely the result of a shortage of resources.

There are also important internal and external groups varying in their support or resistance to any necessary change in policing strategy. Key players include the mayor of the city anxious to improve the reputation of the city, the city's press, traditionally used to highlighting police failures rather than successes and finally the courts of justice, which are reluctant to take on the increased workload that any moves towards reducing antisocial behaviour would produce.

John Dixon wants to encourage more sharing across police districts. Ultimately he would like to have one, unified, cross- city police force. This would allow for cross-district crimes to tie-up less resources, more efficient sharing of information and quicker processing of paperwork. This would, in turn, free up more officer time for dealing with anti-social behaviour. It would involve a large investment in technology and training, but staff costs could remain within budget. John believes that there would be an overall fall in crime rates and that police response times would shorten.

John is aware of the complexity of the problem he faces in changing the way the city is policed to improve the quality of life of its citizens. He has, however, an impressive track record as a change agent in previous appointments and is confident that he can bring about the necessary change.

Required:

(a) Consider the stakeholders affected by this planned change, the type of change that is likely to be required, and how this change could be managed. (15 marks)

(b) In order to proceed with his plan John must submit a business case to the city council officials. Explain the key ingredients of a business case document and what John should include in his arguments. (10 marks)

(Total: 25 marks)

QUESTION 4

Charm Inc is a developer of ‘casual computer games’. A casual game is a video game or online game targeted at a mass audience of consumers who come across the game and are able to play it immediately. Casual games are typically played on a personal computer online in web browsers, although they are now starting to become popular on game consoles, MP3 players and mobile phones.

Players require no long-term time commitment or special skills to play and the games involve extremely simple gameplay, like a puzzle game that can be played entirely using a one-button mouse or cellphone keypad. This limited sophistication allows gameplay to occur in short bursts, during work breaks or, in the case of portable and cell phone games, on public transportation.

Business Units

Charm Inc has several lines of business including distribution of downloadable computer games, advert-supported free online web browser games, game development studios, e-greetings, and, most recently, a social networking site for computer game players to share opinions, invite friends, and earn cash for games that their friends buy. Although the games distribution SBU is well established, the popularity of computer games means that there is likely to be significant growth in the sector going forward and many competitors exist in the market already. The e-greetings demand has been tailing off lately whereas the networking site, still in its initial introductory stages, shows potential.

Charm was founded by Tom Leanard in 2002 and has seen steady growth. As an independent company, it does not have access to the huge marketing budgets of its multinational competitors, but its reputation for developing user friendly casual games is well known. The computer game industry is however, incredibly competitive and, as well as the multinationals and smaller businesses like Charm, it is now possible for talented individuals to create games and sell them, either via a website or to a large corporation. Word of mouth, together with social networking sites like the one run by Charm, can often make a game a roaring success, or conversely an immediate failure.

Industry Customer Base

Every month, an estimated 200 million consumers play casual games online, many of whom do not normally regard themselves as gamers or fans of video games. Casual gaming demographics vary greatly from those of traditional computer games, as the typical casual gamer is older and more predominantly female, with over 74% of those purchasing casual games being women.

Distribution

Casual games are often free on-line or free to download and try (but may provide revenue by in-game advertising). Commercial studios like Charm create downloadable games, primarily available on the PC. These games are typically addictive and there are limited trials to encourage casual gamers to buy a permanent "deluxe" version for a small price (typically $25 or less). They usually have more intensive graphics and sound. Recently, 100% free "full licensed versions" of casual games have become available through advertising.

In addition to online portals, casual games are increasingly available at major retailers such as Best Buy. The success of a recent game developed by Luxis (one of Charm’s main competitors) has made retailers much more open to carrying casual games rather than the more expensive ‘strategy type’ games (which are more commonly played on a console). The game in question sold over 100,000 copies in its launch year.

Fingo

Charm has developed a new game, 'Fingo', which is ready to launch in the near future. The game has a simple bingo style format but it enables more than one player to join in.

Sales of the new game are expected to be very strong, following a favourable preview by a popular gaming website. Charm Inc has been informed that the review will give the game a 'Best Buy' recommendation. Games with good reviews and strong sales typically lead to sequels (and unfortunately copies). Charm's directors are concerned that the life of new games which they design is getting shorter and the competition is becoming more aggressive. Tom Leanard has even heard rumours that competitors are placing hoax reviews on popular websites in order to 'sabotage' new games. If this were true it could have a disastrous effect on the launch of Fingo.

Required:

(a) Comment on Charm's business units using the product life cycle (PLC) model.

(10 marks)

(b) Suggest how Charm should market the new Fingo product. (15 marks)

(Total: 25 marks)

