ACCA INTERIM 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

BMH Industries plc is a multinational conglomerate organisation with its headquarters based in the UK, with an annual turnover in 20X6 of £3.3 billion (1 billion = 1,000 million). The company has concentrated mainly in the mature industries and has grown by means of acquisition. The origins of BMH were in the construction industry based within the UK. Successful growth in construction and office building 20–30 years ago brought significant profits and these were reinvested by acquiring companies within the UK and overseas.

The BMH strategy was to identify asset-rich organisations with negative market value (i.e. market value compared with balance sheet value). This has tended to occur in mature industries where management had become complacent and where sales were static. Target acquisitions were expected to provide potential synergies when combined with BMH and they were generally acquired with cash rather than an issue of BMH shares. The acquisitions were financed by temporary borrowing which was subsequently repaid by disposing of the surplus and undervalued assets of the acquired company. The intention was to retain a valued core business which in fact had cost the company very little. This strategy proved to be successful for BMH. In the 25 years to 20X6 the company's turnover had grown from £120 million to £3.3 billion. Assets value had increased from £95 million to £3.2 billion.

This rapid expansion had coincided with a degree of steady growth prevalent within the geographical markets covered by the company. BMH's businesses now operated throughout the world, but mainly in Northern Europe, the USA and in India. Apart from construction, BMH had integrated backwards into brick manufacturing, and had also moved into forestry development and management so as to guarantee raw materials for the timber-based products required in the construction industry. It also had interests in textile manufacturing based in India and Bangladesh. As the standard of living of the European countries improved, BMH spread its interests into the leisure and entertainment fields. Furthermore, in the early 1990s when share prices were relatively low BMH bought companies with interests ranging from the manufacture of safety equipment and office furnishings to agricultural equipment distribution. It also acquired three motor vehicle franchises with outlets in the UK, Germany, France and Italy. There was nothing in common between many of the acquisitions except for the following aspects.

- The acquired firms were relatively cheap to purchase.
- The assets of the acquired companies were generally undervalued.
- Little, if any, capital injection was needed by BMH to stimulate growth and profits.
- Asset turnover tended to be rather low.

A conventional turnaround strategy involving cost cutting, reduced capital investment, redundancies and tight financial controls ensured that these once tired and neglected companies soon returned to profit. The markets in which they operated were stable, providing steady but unexciting growth. There were very few competitors within these markets who had the resources to fight off aggressive predators such as BMH.

The culture of the company seemed to be clearly portrayed when in 20X5 the late chairman and chief executive officer (CEO) of BMH had an interview with a leading group of fund managers. He was quoted as saying, 'The mission of BMH is to enhance the shareholder value of the company. Whilst we may wish to grow at our current rate of 8 per cent per annum, and whilst we may wish to spread our products and market coverage ever wider, our sole responsibility is to our shareholders. We are not in business for the sake of business but to add value for our owners, whoever they may be. We have been criticised for being an asset stripping company. We strongly disagree with this. We see our role as asset management. Indeed if a competitor company made a bid for us, and if we felt that this was in the interests of our shareholders, then we would welcome the approach.' The views of the chairman were significant, because as the founder of the company he had been dominant in the development of BMH over the years. Even when BMH become a public company with a full Stock Exchange listing 26 years ago he still considered it to be his own property and he controlled and directed it in the way he thought best. He was rarely prepared to accept opposition to his ideas.

However, as a result of the untimely death, in early 20X6, of the chairman of BMH, the board decided to separate the roles of chairman and CEO. The new chairman had previously been managing director of a leading commercial bank and the CEO had previously been the finance director of BMH.

Within six months of their appointments to the board the new directors planned to make their first move in the acquisition business. This focused upon a major foreign corporation which was heavily involved in aeronautics and in satellite design and manufacturing technology. The company, StarLink Technologies, had been created as a result of mergers between a number of medium sized Japanese high technology companies. They had amalgamated to create an organisation of sufficient critical size to operate competitively in the new space-oriented industries. The BMH board announced that the acquisition would move the company into a fast moving, high value-added sector of industry. The sales potential was large, with the international scope of the business being enormous. Developing countries are now increasingly able to access high technology telecommunications without having need of the traditional infrastructure existing in the more developed countries, by leapfrogging technology and using satellite systems. Consequently demand for satellite capacity was growing at a rapid rate. Additionally, many customers, such as the telecommunication companies and the defence contractors who needed to use satellites to carry their research instruments, were interested in encouraging another supplier into the market. This enabled them to reduce the supplier power of the existing satellite manufacturers.

The acquisition was regarded by BMH as the first stage of a corporate renewal – the solid, unexciting mature industry liaising with a leading edge technology sector with short-term versus long-term criteria being part of the mix.

The following figures give financial details of BMH, an example of a typical prior acquisition of BMH and the comparable data for StarLink Technologies.

Table 1: £m

	Typical acquisition	*BMH 20X7*	*StarLink Technologies*
Sales	250	3,300	390
Cost of sales	185	2,300	220
Gross profit	65	1,000	170
Sales and administration	(35)	(370)	(65)
Research and development	(10)	(130)	(80)
Operating profit	20	500	25
Net assets	280	3,200	250
Debt	100	800	100
Equity	180	2,400	150
Price earnings ratio	8	11	20
Market value	220	3,600	820

Required:

(a) **Evaluate the growth strategies which BMH had pursued prior to the new board appointments in 20X6.** **(15 marks)**

(b) **Acting as a consultant, prepare a briefing paper to present to the board of directors of BMH, evaluating the implications of the proposed acquisition of StarLink Technologies. In support of your analysis, use strategic planning tools of your choice, as well as an assessment of the financial consequences of the move.** **(25 marks)**

(c) **Identify and evaluate the critical areas which will need to be addressed if the new acquisition is to be successfully integrated within BMH's portfolio of businesses.**

(10 marks)

(Total: 50 marks)

SECTION B

CHOOSE TWO QUESTIONS FROM THREE

QUESTION 2

Your 18 year old cousin, Josh Sprite, has decided against attending university and instead would like to pursue an entrepreneurial career. He has inherited a sum of money from his grandmother that he aims to invest in his first business venture. In order to be better prepared for the business world he has enrolled in a Business Studies night course at a local college. However, on the first night of the course the lecturer done an overview of the syllabus and Josh was so inspired that he believes that he now has it cracked. He doesn't intend attending any more evening classes and want to focus his energy on his first business venture.

The key element that Josh picked up on during his first visit to the Business Studies course was that the key to any business success was planning. The lecturer explained that there are different levels of planning (from strategic down to operational) and different types of planning. Josh didn't pay attention to all the detail, but he came away with a clear understanding that planning was important.

The lecturer also underlined the importance of critical success factors. He said that he'd go into them in detail at a later date but Josh believes he understand the principle anyway.

So Josh is ready for his first business venture – he intends to set up a computer games development company. He has always had a key interest in computer games and believes he knows what gamers are after – more adult content. After his attendance at the computer course he has come up with a plan and some associated critical success factors:

Plan:

- Buy a top level gaming computer
- Set aside one month to create the game
- Approach local games stores directly and convince them to sell the game
- Also use word of mouth and the internet to promote the game

Critical Success Factors:

- Great graphics
- Having a good computer
- Being technically adept at using the software needed to create the computer game (Josh believes that he has some ability in this area)

Josh knows that you are about to qualify as an accountant. He has a lot of belief in himself and his ability but asks you for a quick second opinion to ensure he's not missed anything vital.

Required:

(a) Explain the different levels of planning and comment on whether Josh has fully considered each level (7 marks)

(b) Explain the different approaches to strategic planning and consider which might be most appropriate to Josh. (9 marks)

(c) Explain what a critical success factor is and comment on whether Josh has correctly identifies the CSF's for his new business venture. (9 marks)

(Total: 25 marks)

QUESTION 3

Astoria is a small country which, until recently, operated a centralised economy. This meant that most industries were nationalised, including the provision of internet services.

Citizens had no choice of internet service provider (ISP) and had to get services from the state. The service provided was a slow, dial-up service that had variable results. Connections would regularly be lost and service provided by the state was very poor. The service had been in operation for five years and there had been little investment in infrastructure or improved technology. A poor economy meant that only 50% of private households had a internet services. Even amongst private businesses, which were almost all based in the capital, Astor, internet services were provided on a dial-up basis and were slow and unresponsive.

But a recent social and cultural revolution has brought change to the country. A new democratic government have been elected who want to spark a more open economy, greater international links, and a growth in entrepreneurial growth. Entrepreneurial attitudes are most apparent in Astor where it is planned to establish an international stock exchange. Many foreign banks and other financial institutions have set up offices.

The new government, committed to market economies, has recently announced that the state-provided internet system is to be privatised and will be known as Astoria Telecom (or 'AT'). So that an element of competition is introduced, permission is to be given to a new company to offer internet services.

This company, Interspeed, is about to start operating its own network. Regulations allow Interspeed to make use of Astoria Telecom's local lines. Interspeed and Astoria Telecom will both be subject to state regulation of prices. In five years' time the government intends to open up the telecommunications market much more and will invite other businesses to set up internet services in the country. Established foreign businesses will also be able to apply for licences. Once the ISP sector appears to be sufficiently competitive, state regulation will cease.

Required:

(a) Using appropriate strategic models, analyse the external, environmental market that is likely to develop for ISP's in Astoria. (13 marks)

(b) Assess the strategic position of both Interspeed and AT and briefly recommend a strategy for each company to follow in the market. (12 marks)

(Total: 25 marks)

QUESTION 4

Background

Lindleys plc (the Bank) is a large clearing bank. It has 2,000 retail branches. It categorises its business as retail and corporate. Each category currently accounts for half of the Bank's turnover. The Bank defines retail business as "banking for customers in their own right and small businesses where lending would not exceed £1,000,000 in any one year". Corporate business is defined as "....where lending would exceed £1,000,000 in any one year". Corporate lending includes international lending.

Retail banking

The number of retail and small business customers at each branch has ranged from 1,000 to 10,000, although 5,000 is typical. The bank has employed the following Mission statement for its retail banking:

"Our Mission is to deliver a high-quality service to customers based on our managers' personal knowledge of customers' affairs."

The Bank recognised that retail banking was relatively unprofitable. It was willing to operate a policy of cross-subsidisation between corporate and retail as it hoped that some retail customers would become corporate ones. It saw its branch managers as assisting in this process because of their financing expertise and deep knowledge of their customers.

The Bank has operated each branch as a cost centre. Managers have been provided with a three-monthly expenditure report which compared committed expenditure to budgeted expenditure. The managers' remit was to operate within their expenditure budgets. In addition to this, they were set targets, for example, number of new accounts opened, amount of holiday insurance sold, level of bad debts. The managers were not consulted about the size of their budgets or their targets. These were imposed by head office.

Proposals for change

The Bank is reappraising its corporate posture. The Bank has become concerned about the attitudes which it believes have become dominant in retail banking. Most of its managers have found their targets relatively easy to achieve – which has resulted in large bonuses being paid out which are unpopular with shareholders. Managers have been criticised for a lack of entrepreneurial awareness and for being too inward-looking. The managers have retorted that "as soon as a customer gets to be interesting we lose them to corporate, so why bother?" Because of these factors, the Bank has decided upon the following changes:

- Retail banking must, in future, earn 50% of the Bank's profit before taxation.
- There will be a programme of branch rationalisation in which half the branches will close.-
- New "superbranches" will be established. These will be at the centre of a network of 6 to 8 existing branches. The superbranch will contain the manager, who will make all the major decisions for the network of branches. He will be assisted in this by two assistant managers who will probably be drawn from the existing managers in the network.

  Each superbranch has been given an expenditure budget which equates to that of the cumulative total spent by its network branches in the previous year. No extra funds have been allocated for the establishment of the superbranches. The manager of the superbranch has discretion as to where the superbranch will be located. This could be inside an existing branch or in a new premises.

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- The manager of the superbranch will be responsible for the design and operation of all of the network's information systems. These will be capable of being interrogated by head office, which will continue to draw up the statutory accounts.
- The manager of the superbranch has discretion as to the number of employees working in the network. If there are to be any redundancies, head office will negotiate nationally to determine the terms for redundant staff. The superbranch will be charged with the costs, if any, of redundancies in its network.

The managing director of the Bank has described the new philosophy for retail banking thus: "We are operating in a very competitive environment and in order to survive, we must change. We must never forget that we are a profit-seeking organisation. Retail banking has been subsidised in the past and had become inefficient. Our proposals will enable us to deliver an efficient, low-cost service. However, I am afraid the days of the bank manager being a personal friend and adviser are over."

Required:

(a) Johnson, Scholes and Whittington suggest that valid strategies should fulfil a number of criteria. Consider whether the new bank strategy would be 'acceptable' to stakeholders such as staff, customers and shareholders. (13 marks)

(b) Suggest, and fully justify, THREE qualitative performance indicators you consider would be of assistance to a superbranch manager. (12 marks)

(Total: 25 marks)

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