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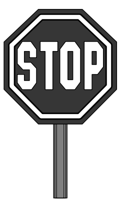
ACCA

Paper P5

Advanced Performance Management 2012

Interim Assessment – Answers



To gain maximum benefit, do not refer to these answers until you have completed the revision mock questions and submitted them for marking.

Key answer tips

1 Reading time

– The 15 minutes reading time can be used to read the paper, make notes and plan the answer. This can only be done on the question paper and not the answer booklet.

– Start by skim reading the paper, making brief notes about the questions and choosing which section B questions to complete.

– Then decide which order to tackle the questions in. Complete your best question first and worse question last.

– The remainder of the time should be spent reading the questions in detail and making answer plans.

2 Questions

– Split your time between the four questions. It may sound obvious but few candidates will do this. One of the key reasons for failing is that candidates do not get to the end of the paper.

– Attempt all parts of the question. Again, this may sound obvious but you may be tempted to spend ages on the bits that you like and live in denial of the bits that you don't like! There will always be easy marks available and you may just pick up the vital one or two marks needed to pass.

– The questions will be based around a scenario. You must refer back to this scenario in your answer.

– The questions will be drawn from a wide range of syllabus areas.

3 Approach to answers

– The examiner has so far set very fair exams. There have been no tricks and requirements have been clear.

– The low pass rates seem to indicate that many candidates are ignoring his objectives. Do not spend all your time on the calculations. Plenty of question practise means that you should be able to work through the calculations to time. Remember that your answers don't have to be perfect. If you are not sure, you should take a guess, put a number in and move on. Any workings should be clearly referenced.

– You must complete the written parts. You should plan your answer to ensure you have enough relevant points and an appropriate structure. A brief intro, use of sub-headings with concise points and a quick conclusion seems to do the trick. There is no indicative marking scheme but one mark per point seems to be the norm. Students must make use of the scenario in their answer and may be expected to have some knowledge are real world issues.

– There may be a small number of presentation marks available, e.g. if the question asks for a report structure. Make sure that your answer is structured appropriately – these are easy marks to pick up.

SECTION A

ANSWER 1

(a) Setting corporate objectives can help a company in various ways.

- Corporate objectives provide a framework within which plans can be made and decisions can be taken. Managers can formulate plans and make decisions on the basis of whether they will contribute towards the achievement of those objectives.
- In a larger organisation, formally announced objectives provide a method of communicating the intentions of senior management to others in the organisation, so that everyone knows what the organisation is trying to achieve.
- Honestly stated objectives can also act as an incentive to staff. Employees often like to have the reassurance that the organisation they work for has worthwhile objective and that they can help to contribute towards achieving them.
- In a large organisation, formally announced objectives provide a basis on which different departments and groups can co-ordinate their activities. It is more likely that different parts of the organisation will all 'pull in the same direction'.
- Corporate objectives, formally announced, provide a benchmark by which management can monitor and assess actual performance and shareholders can assess the performance of management. Rewards for top executives often include a bonus for achieving results in line with or in excess of company targets.

Setting corporate objectives can, however, be obstructive and prevent the satisfaction of shareholder demands. It is assumed that shareholders seek to maximise their wealth, or to maximise returns on their investment consistent with the risks undertaken by the company. In the IT industry, the market is changing continuously and the industry is dynamic. Already in the case of ICS, its initial business of providing computer software to local firms has grown rapidly, but the rate of growth has now declined. Similarly, the diversification into emergency computer data retrieval services has provided some growth, which is now declining. For the company to continue to grow, or possibly even to survive, it will possibly have to continue diversifying. Its decisions about what to do, as in the case of the contract under review, might have to be opportunistic. In other words, the company might need to take opportunities as they arise, without regard to formally established objectives. If the company's objectives are too restrictive, the company might forgo opportunities to develop because they are inconsistent with objectives that might no longer be appropriate for the company.

The company should therefore be advised that corporate objectives can be beneficial, but should not be allowed to become restrictive in a volatile business environment. Objectives should therefore be reviewed regularly and often, and amended as changing situations demand.

(b) Although managers can sometimes make excellent decisions on a hunch or 'by instinct', in the long run their decision-making will be more rational and soundly based when they are properly informed. The quality of management decisions is always likely to be better when managers are well-informed about the different options available, and the likely outcome of pursuing each different course of action.

When the future is uncertain, management information helps to reduce the uncertainty and analyse the risks involved.

When the business environment is changing rapidly, organisations must adapt to survive and grow. Information systems can help managers to recognise the nature of the changes that are happening, and their potential significance. They can then formulate new strategies to adapt to the changing circumstances.

However, the type of information required by management differs between a rapidly changing business environment and a stable environment. In a stable environment, most information needs can be obtained from within the organisation and derived from historical results. The past is a useful guide to the future. In a rapidly changing environment, in contrast, information has to be more forward-looking, taking account of risk and uncertainty. Information sources are also likely to be sourced more from outside the organisation than from within. For example, environmental data relating to the actions of competitors, to changing technology or to changes in consumer tastes and habits.

The functions of management include the requirement to formulate and implement plans and to monitor and control actual performance. Planning and control systems, at an operational and a strategic level, depend on information. Feedback and feedforward systems of control are based on the provision of information for management to make their control decisions.

The best information systems are well-planned and structured. Given the developments that have occurred in information systems, ICS might well benefit from extensive integrated databases and executive information systems.

On the other hand, in a continually changing environment, it is also likely that much data and information reporting will become obsolete and unnecessary. Information is only worth having if the benefits from its use exceed the cost of collecting and storing it. It is therefore advisable for ICS to carry out regular reviews of their information systems, and remove unwanted data and eliminate unwanted routine reports.

In summary, managers need information to do their job properly. In a rapidly changing business environment, there will be a greater need for external environmental information. There will also be a continuing need for internally generated information, such as performance reports and statutory reports and statements. However, even if the nature of the information required changes rapidly as circumstances change, management information is essential.

(c)

	20X5	20X6	20X7
RETAIL	$000	$000	$000
Sales	4,290	3,575	3,150
Variable costs	3,003	2,502	2,205
Contribution	1,287	1,073	945
Fixed costs	1,070	890	790
Profit before interest and tax	217	183	155

	20X5	20X6	20X7
INDUSTRIAL	$000	$000	$000
Sales	1,716	1,950	2,079
Variable costs	1,373	1,560	1,663
Contribution	343	390	416
Fixed costs	470	590	800
Loss before interest and tax	(127)	(200)	(384)

	20X5	20X6	20X7
OTHER	$000	$000	$000
Sales	594	975	1,071
Variable costs	505	829	910
Contribution	89	146	161
Fixed costs	190	270	310
Loss before interest and tax	(101)	(124)	(149)

TOTAL	$000	$000	$000
Sales	6,600	6,500	6,300
Variable costs	4,881	4,891	4,778
Contribution	1,719	1,609	1,522
Fixed costs	1,730	1,750	1,900
Loss before interest and tax	(11)	(141)	(378)

The information in this analysis indicates the following:

- The company has been making a loss for the past three years, and the loss has been increasing each year.
- The retail sector is profitable, but profits have been declining and a substantial fall in sales turnover would, at first sight, appear to be the main cause.
- The industrial and other sectors have been growing in terms of sales turnover but, in each case, the growth in fixed costs has exceeded the growth in contribution.
- The situation cannot be rectified by closing down the loss-making industrial and other sectors, because each of these sectors makes a contribution towards fixed overheads.

We are also aware that ICS has a cash flow problem, although the information set out here does not provide an analysis of the cash position, nor of operational cash flows each year.

The information here would seem to suggest that Z is not aware of the financial position of the company and the severe difficulties it is in. On its own, the information is also insufficient to assist Z in making decisions about what needs to be done.

In the short-term, it is recommended that a basic management accounting system should be introduced. This should include:

- a system for preparing a budgeted profit and loss account, cash flow budget and budgeted balance sheet
- a system for regular reviews of cash flow
- a budgetary control system, in which actual results are compared regularly with the budget, and variances reported.

The company also needs to establish what needs to be done to turn the company round and back into profitability. Management information will probably be needed about:

- costs, with a view to identifying unnecessary sending and cutting costs
- revenues and the nature of sales demand
- whether additional sales are being achieved by offering products at a loss.

A simple management accounting system based on budgets and control reports with variances can be set up on a spreadsheet, and advanced IT knowledge is therefore not required.

ACCA marking scheme

		Marks
(a)	1 mark for each well explained point, up to a maximum of:	7
(b)	1 mark for each well explained point, up to a maximum of:	6
(c)	½ mark for sales for each sector	1.5
	½ mark for variable costs for each sector	1.5
	½ mark for fixed costs for each sector	1.5
	½ mark for PBIT for each sector	1.5
	Total loss before interest and tax	1
	1 mark for each comment on the results, up to a maximum of:	5
	1–2 marks for the discussion of types of management information which should be provided, up to a maximum of:	5
		17
Total		**30**

ANSWER 2

(a) *Container type:*

	Uno	*Due*	*Tre*
	$	$	$
Product unit cost and price information:			
Direct material cost (note 1)	36.00	24.00	72.00
Production conversion cost (note 2)	27.69	18.46	55.38
Distribution cost (note 3)	9.33	9.33	9.33
Total product specific cost	73.02	51.79	136.71
Profit mark-up at 35% (note 4)	**25.56**	**18.13**	**47.85**
Selling price	98.58	69.92	184.56

Note 1: Direct material **=** sqm × price per sqm e.g. Uno = 1.2 × $30 = $36

Note 2: Production conversion cost = $6,000,000

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

Direct material cost = $7,800,000

Absorption rate (as % on direct material cost)

$6,000,000/$7,800,000 = 76.92%

e.g. Due = $24 × 76.92% = $18.46

Note 3: Distribution cost = $1,400,000

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

Average cost per container = $1,400,000/150,000 = $9.33

Note 4: Mark-up on cost to include administration cost, selling/marketing cost and ROCE.

	$000
Administration cost	1,800
Selling/marketing cost	1,000
ROCE = 15% × $16,800	2,520
Total mark-up required	5,320

Total product specific cost:

	$000
Direct material (per note 2)	7,800
Production conversion	6,000
Distribution	1,400
Total	15,200

Profit mark-up required = $5,320,000/$15,200,000 = 35%

(b) (i) Original vs. ABC Unit cost comparison

	Product – Uno		*Product – Due*		*Product – Tre*	
	Original	*ABC*	*Original*	*ABC*	*Original*	*ABC*
	$	$	$	$	$	$
Direct material cost	36.00	36.00	24.00	24.00	72.00	72.00
Production labour and overhead	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 product specific cost	73.02	81.21	51.79	62.69	136.71	127.63
Product specific selling/market		1.20		6.00		1.20
Amended product specific cost	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

(ii) **Container type – Uno:** 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.
- Interdivisional 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 containers from external suppliers?
- Possibly a dual system of pricing could be put in place. Cinque 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 recognised. 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 Uno at $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.

Container type – Due: Relevant points are:

- ABC cost is 21% higher than the original cost (even before adding product specific selling/marketing cost). This must be investigated and cost savings sought.
- The product specific selling/marketing cost of $6 is much higher than for Uno or Tre ($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 programme?

Container type – Tre: It is known that Cinque division is having difficulty retaining its budgeted level of sales. Points of note are:

- 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.

(c) (i) A summary of the range of unit cost outcomes is as follows:

Direct Material Sqm	*Probability*	*Number of cuts*	*Probability*	*Combined probability*	*Unit cost* $
1.6	0.3	40	0.3	0.09	97.10
		35	0.2	0.06	96.30
		25	0.5	0.15	94.31
1.2	0.4	40	0.3	0.12	82.41
		35	0.2	0.08	81.61
		25	0.5	0.20	79.62
0.8	0.3	40	0.3	0.09	67.35
		35	0.2	0.06	66.55
		25	0.5	0.15	64.56
				1.00	

(ii) For each row in the above table multiply the combined probability by the unit cost and sum the answers to calculate the expected value unit cost. The answer is $80.74.

Management may be risk neutral, risk seeking or risk averse. They may view the likely change from the existing ABC cost of $82.41 as the basis for their views. Note that the existing ABC cost was calculated in (b) (i) OR may be read from the Appendix.

- A risk neutral manager may take the view that since the EV unit cost of $80.74 is less than the existing ABC cost, the redesign strategy is worth pursuing.
- There is a 21% likelihood of a unit cost of $66.55 or less which is approximately a 20% reduction from the current value. A risk seeking manager might see this as an attractive possibility.
- There is a 30% likelihood of a unit cost greater than the existing level of $82.41. This might be enough to lead a risk averse manager to reject the redesign strategy.

ACCA marking scheme

			Marks
(a)		Direct material cost	1
		Production conversion cost	2
		Distribution cost	1
		Profit mark-up	3
		Selling price	1
			—
			8
			—
(b)	(i)	Direct material cost	½
		Production labour and overhead	½
		Distribution cost	½
		Total product specific cost	1
		Product specific selling/ marketing cost	1
		Profit mark-up	½
		Selling price	1
			—
			5
			—
	(ii)	1–3 marks for possible actions for each type of container, up to a maximum of:	6
(c)	(i)	½ mark for each column (excluding combined probabilities)	4.5
		Combined probabilities	1.5
			—
			6
			—
(d)	1 mark for each comment, up to a maximum of:		5
			—
Total			**30**
			—

ANSWER 3

(a)

	Workings	$000
Volume (m)	7% × 100m = 7m units	
Revenue	7m × 0.90/1.25	5,040
Total cost of ingredients	7m × 0.25	1,750
Packaging	7m × 0.12	840
Distribution	6% × 5,040	302
Fixed costs		1,250
Profit		898
Profit/sales		17.8%
Target		15%
Target profit		757

Based on the information provided the expected return on sales amounts to 17.8%. This exceeds the target of 15%.

(b) **Product quality**

The fact that the production staff had no previous experience in a food production environment is likely to prove problematic.

It is vital that a comprehensive training programme is put in place at the earliest opportunity. SPC need to reach and maintain the highest level of product quality as soon as possible.

Supply quality

Delivery to the Universities is of critical significance. It is important that deliveries can be made at short notice. Hence supply chain management must be extremely robust as there is very little scope for error.

Technical quality

Compliance with existing regulations regarding food production including all relevant factory health and safety requirements is vital in order to establish and maintain the reputation of HSC as a supplier of quality products.

External credibility

Accreditation by relevant trade associations/regulators will be essential if nationwide acceptance of SPC as a major producer of snack pots is to be established.

New product development

Whilst SPC have developed a range of healthy snack pots it must be recognised that taste change and that in the face of competition there will always be a need for a continuous focus on new product development.

Margin

Whilst SPC need to recognise all other critical success factors they should always be mindful that the need to obtain the desired levels of gross and net margin remain of the utmost importance.

Notes:

(i) Only five critical success factors were required.

(ii) Alternative relevant discussion and examples would be acceptable.

(c) More integrated supply chains through the use of electronic ordering; tracking and inventory management will lead to reduced costs.

With timely and accurate information SPC can instantly change, edit, and update sensitive information such as price lists or inventory information. Compared to typical paper-based publishing processes, an extranet offers a unique opportunity to get up to date information.

By linking the University/Vending inventory system directly to SPC, they can process orders as soon as the system knows replacement is needed, thus reducing the inventory the University keeps on hand and making the procurement process more efficient.

Extranets make business relationships better. If SPC proves they can replace inventory as soon as required they are more likely it is to keep the Universities business.

Alternative answers may consider any of the following:

Benefits to University	**Benefit to SPC**
Fewer phone and fax enquiries	Faster order-to-cash cycle
Less mismatching of orders and invoices	Insight into own performance
Accurate information on stock ability	Increased inventory turns
Reduced risk of supply and delays	Increased revenue
Improved order fill rates	Lowered costs
Reduced inventory levels	Improved asset utilisation
Reduced downtime and overtime	Increased order fill rates
Lowered procurement/inventory costs	Better capacity utilisation
Improved asset utilisation	Fewer phone and fax enquiries

ACCA marking scheme

		Marks
(a)	Revenue	½
	Ingredients cost	½
	Packaging	½
	Distribution	½
	Fixed costs	½
	Profit	½
	Profit to sales margin and conclusion	2
		5
(b)	Up to 2 marks for each critical success factor	10
(c)	1 mark for each well explained point, up to a maximum of:	5
Total		**20**

ANSWER 4

(a) **Using a PEST analysis to assist the environmental analysis**

PEST analysis examines the broad environment in which the organisation is operating. 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 organisation understand the factors specific to that market so that the specific opportunities and threats posed can be assessed and appropriate action taken.

It is a useful tool for the following reasons:

1 *It ensures completeness*

The majority of issues relevant to an organisation will be covered under one of the four areas of PEST analysis. By reviewing all four areas, Speedy Eat can be sure that it has done a full and complete analysis of the broad environment.

2 *All four elements are relevant to examining new markets*

Political/legal

Each new country entered will have different political systems and laws. Speedy Eat will need to understand these differences to ensure that they operate within the law in Borderland. They will also want to ensure that there is 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 the local economy in Borderland and how it is expected to develop enables Speedy Eat to assess the potential within that market as well as any economic issues which they need to consider.

Social

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

Technological

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

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

PEST analysis is a very simple tool that does not require detailed understanding. This means that it is easy to use by the team and simple for Directors to analyse and understand.

(b) **Main issues arising from applying the framework**

Various issues which Speedy Eat will need to consider include:

Political/legal factors

(i) *Government grants*

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

(ii) *Political stability*

Given Speedy Eat's worldwide penetration (over 120 countries) it is likely that Borderland 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.

(iii) *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.

(iv) *Employment legislation*

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

(v) *Tax legislation*

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

(vi) *Tariffs and other barriers to trade*

Tariffs may be imposed on imports into Borderland. This may put Speedy Eat at a significant disadvantage compared with local competitors if they aim to import a significant number of items (unlikely on food items, more likely on clothing, fittings etc).

Economic factors

Things to consider include:

(i) *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 organisation to understand the potential of this market and the likely future investment required.

(ii) *Interest rates*

This affects the cost of borrowing within Borderland. If high it may mean overseas funding is necessary. A big differential between interest rates in Borderland and the US is also likely to cause instability in the exchange rate (see below).

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 Speedy Eat.

(iii) *Exchange rates*

Speedy Eat will be affected by exchange rates for items they export to Borderland (clothing, fittings). An unfavourable movement in exchange rates could make exporting to Borderland expensive and reduce profitability. It can also affect the value of profits when converted back to US dollars.

(iv) *Position in economic cycle*

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

(v) *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:

(i) *Brand reputation/anti-Americanism*

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

This is particularly relevant given the anti-Americanism which is prevalent currently in some countries. Speedy Eat may have a significant hurdle to climb to convince people to eat there if this is the case in Borderland.

(ii) *Cultural differences*

Each country has its own values, beliefs, attitudes and norms of behaviours which means that people of that country may like different foods, architecture, music and so on, in comparison with US restaurants. By adapting to local needs Speedy 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 Speedy Eat of employee relations. People might have different religious needs to be met or may dislike being given autonomy so the management style needs changing.

(iii) *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 the local language. General Motor's Nova suggested that ‘it won't go' in Spanish, for example.

Technological factors

Speedy Eat may need to train people in the use of their technologies if the local population are 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.

ACCA marking scheme		
		Marks
(a)	1–2 marks for each reason given for its usefulness, up to a maximum of:	8
(b)	1–2 marks for examples of political, economic, social and technological issues	12
Total		**20**

ANSWER 5

(a) **Role of gap analysis in the strategic planning model**

The rational strategic planning approach provides a step-by-step model to consciously and formally plan and implement a business's strategy. It provides a clear, justifiable strategy based on the information available about the company's current position, environment and competencies ensuring a well thought through and effective strategy is followed.

The rational planning approach consists of a number of distinct stages:

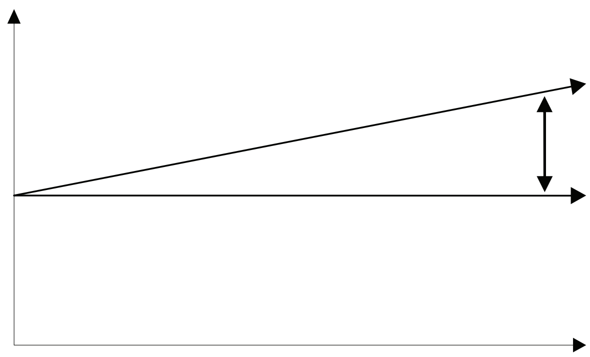
(i) **Strategic analysis**: defining the direction (mission and objectives), analysing the environment, doing an internal analysis of the firm and summarising this in a corporate appraisal.

(ii) **Strategic choice**: selecting strategic options and choosing options the firm is going to follow.

(iii) **Strategic implementation**: putting the strategies into practice including polices and strategies for marketing, finance, R&D, structure and so on.

(iv) **Strategy evaluation and control**: evaluating the success of the strategy by measuring actual performance against objectives and taking control action by amending future strategies and objectives.

Gap analysis fulfils a vital role in the strategic analysis and choice stage of the rational model.



Based on the strategic analysis, gap analysis starts by estimating the expected performance over time if the company were to continue with its current approach and strategy. During the analysis stage, objectives will have been set outlining what the business aims to achieve in the future. During gap analysis these objectives are estimated over time. A comparison between objectives and current position can then be taken.

Usefulness of gap analysis as part of the corporate appraisal

This is a useful part of the corporate appraisal process since it:

- Brings together the objective setting, environmental analysis and position appraisal into a model where a direct comparison can be made
- Takes the current position and estimates what this means for the future – something that may not have been undertaken in previous analysis
- Forces the general analysis to be converted into expectations based on clear measures of performance (e.g. profit, market share, numbers of customers, etc) which enables a more suitable comparison. It can also be useful in the review and control stage when comparing actual results.

Usefulness of gap analysis as part of strategic choice

Gap analysis is useful to help decide upon the extent of change required by the business. The bigger the gap found between the expected performance and objectives, the bigger the change required and the more strategies which will be needed.

It is also useful when evaluating strategies. An assessment of the extent to which each will close the gap can be made to evaluate whether they are suitable.

Criticisms of a rational planning approach

The criticisms of a rational approach to planning include:

(i) *Time taken*

The approach can involve significant investment of time from staff to undertake the analysis, thus using this valuable resource. It may also delay decisions being taken since they first need to be agreed as part of the planning process. Opportunities may therefore be missed.

(ii) *Cost*

The analysis will use people's time (as discussed above), involve investment in collecting information (e.g. market research) and could involve employing external parties to assist in the process (e.g. strategy consultants). The process can therefore be expensive.

(iii) *Inflexibility*

Once the plans are set down, the organisation is constrained by them. This means that it is hard for new opportunities to be taken at short notice or for changes to be made when there is environmental uncertainty.

(iv) *Reliant on information obtained*

If the information obtained and/or analysis undertaken is incorrect the new strategy will be poor. For instance, in gap analysis, the prediction of future performance might be difficult due to uncertainties in the environment.

(b) **Reasons why gap analysis might have declined in popularity in the private sector**

Gap analysis might have declined in popularity for the following reasons:

(i) *Uncertain environment*

The business environment has become a highly dynamic and fast changing place. Globalisation has heightened what was already significant competition in the marketplace. With increased competition comes a need to change more often and respond to changes. This has meant that a gap analysis which focuses on the effects of strategies on the business in the long term has become a less useful tool.

(ii) *Inaccurate forecasts*

The uncertain environment can also make it hard to make accurate forecasts. Since gap analysis relies on this the analysis becomes less useful.

(iii) *Defensiveness during the recent world recession*

During recessionary times companies become more conservative in their expectations. This means they are less likely to set significant growth targets and more likely to focus on maintaining existing operations. This may cause the gap to naturally reduce and gap analysis to become less useful.

(iv) *Short-termist approach*

Many companies in the UK and US have been accused of taking a short-termist approach to their businesses mostly because of the focus of investors on short-term financial performance. In this environment the benefit obtained from looking at long-term strategies reduces.

(v) *Time consuming to undertake*

Forecasting future results can be a time-consuming process to do accurately, and may take longer in the current uncertain marketplace.

Gap analysis in the public sector

Gap analysis could be particularly helpful in the public sector for the following reasons:

(i) *Stable environment*

Public sector companies work in a more stable environment than the private sector. They do not usually have competition so do not have to respond to competitors' changes as private sector companies do. They are also largely based within national borders so are less effected by globalisation.

The NHS for example operates within the UK with only minor competition from the private sector. There is little benefit for overseas competitors to enter the UK market since they are unlikely to secure public funding and hence find it difficult to compete against the free service offered by the NHS.

(ii) *Long-term budgeting (four years)*

Public sector organisations usually have a long-term budget. The MoD for example agrees budgets every two years for a four-year period. This means that they can plan for the long term with relative certainty about their income levels in that period. Gap analysis is a useful tool to support such long-term planning.

(iii) *Considering demographic factors*

Long-term changes in demographics can be predicted accurately and hence make gap analysis a useful tool. Requirement for schools in an area can be predicted using birth rates and compared against current position if no changes are made.

(iv) *Demonstrating a need for more funding*

Following on from point (iii) it is a useful tool to demonstrate the need for additional funding – an important part of ensuring the continued success of any public sector organisation.

(v) *Can be used across a wide range of measures*

Since they do not have a profit motive, public sector organisations usually use a range of performance measures, often set by government and based around the three areas of economy, efficiency and effectiveness. Gap analysis can be used for any of these measures.

ACCA marking scheme		
		Marks
(a)	Explanation of the role of gap analysis – 1 mark for each well explained point, up to a maximum of:	4
	Evaluation of the usefulness of gap analysis – 1 mark for each well explained point, up to a maximum of:	4
	Explanation of the main criticisms of a rational approach – 1 mark for each well explained point, up to a maximum of:	4
	maximum	10
(b)	Reasons for the decline in the popularity of gap analysis in the private sector – 1 mark for each well explained point, up to a maximum of:	5
	Reasons why gap analysis is useful in the public sector – 1 mark for each well explained point, up to a maximum of:	5
		10
Total		**20**