ACCA

Paper P3

Business Analysis
June 2012

Final Assessment – Answers

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

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ANSWER 1

Key answer tips

Read the question very carefully, noting that asset disposals or acquisitions are excluded by the requirements of part (a). A resource audit is asked for (often referred to as the 'M's model' and it will be important to cover as many elements of the model as possible. It will also be important to include quantitative analysis in part (a) as the examiner sees this as a key skill that is needed for passing P3.

For part (b) a model such as the Ashbridge portfolio display would have been an excellent way of assessing possible acquisitions and disposals.

In part (c) notice that the answer brings in some brought forward knowledge from Paper F1 when it references Peters and Waterman and Handy. It would not be necessary to do this in the question in order to pass this part of the question, but the examiner has stated that he will give credit for students who use their brought forward knowledge.

Part (d) requires the possible segmentation of the industrial market and recommendations for the appropriate segments.

(a) The resource audit assesses the internal position of a business by analysing strengths and weaknesses into a number of categories and the name of these categories means that it is often refered to as the 'M Model'.

Make up – Structure and systems

Metalcraft Industries Group plc appears to be a collection of loosely associated companies without any strong central direction. The Chairman, Simon Lewis, has suggested that the individual companies are better able to operate as individual entities. However it is obvious that the fragmentation of the Group is disadvantaging them in that none of the individual units appears to be able to acquire critical mass so as to develop a strong position within a market. The Group headquarters also appears to interfere with the companies' operations by imposing constraints from the centre.

There is a dichotomy within management between centralisation and decentralisation. Unfortunately instead of balancing these opposing concepts so as to gain optimum advantage for Metalcraft, the outcome appears to have resulted in a worst-case scenario. The Group has acquired the disadvantages of both centralisation and decentralisation.

The disadvantages of decentralisation are summarised by the concept of fragmentation and a lack of economies of scale and operations. Most of the functional activities are company-focused. Given the small size of many of the units – £5 million turnover or less – there is an unacceptable level of duplication. This is unnecessarily costly, because many of the companies operate in similar product or market areas. The sales forces, both domestically and overseas, must be under pressure. They will inevitably be small and under-funded, and will find it difficult to obtain a significant market share when facing larger and better-organised competitors.

Markets

This is made worse by the fact that the product range is limited and lacks an innovatory image. Evidence of some of these problems is apparent:

- firstly, with the attendance at a foreign trade fair of a number of executives from the Group, so duplicating their activities, and
- secondly, with the reliance on second-rate overseas agents because the larger, competitor firms had the financial strength and reputation to attract the better agents.

Allowing the individual companies to maintain their own company name is acceptable if the name is a powerful selling point. Again, the fragmentation of the market suggests that this is now not the case. This is particularly so in the foreign markets where the company has the majority of its sales. The existence of many brands and company names, all operating within the Metalcraft portfolio, is inevitably confusing to the consumer. There is no opportunity for a corporate identity to be developed. Promotional expenditure is being spread too widely and too thinly and the consumer is not aware of the related nature of these products. Consequently a corporate image is not being developed. This may, of course, be advantageous to the group if the quality of the products is poor.

Make up – Brand

With a corporate and integrated brand poor product performance could affect the associated products' reputation. Nevertheless in the long-term the advantages of a strong unified brand would be beneficial to all the companies and their products.

Although marketing is an obvious area where fragmentation could be damaging, there are also problems with research and development and manufacturing. It would appear that there is no transference of knowledge or expertise within the group. **Successful R&D** needs a critical mass of expenditure. It is probable that most of the firms are spending small amounts on research and are probably duplicating work done by sister companies. It would be beneficial if the companies could complement the work and expertise of each other, rather than compete with each other. Whilst internal competition can stimulate efficiency, there is also a danger that it can result in wasted resources.

Machines/ manufacturing

The existence of **companies producing similar products** could mean that capital utilisation is not optimally achieved with some machines being under-utilised.

Materials

Purchasing is also likely to be carried out on a smaller scale preventing the group as a whole from being able to take advantage of economic purchase orders.

Sales have been rising, but not as fast as the cost of sales. This is probably the result of heavy distribution costs servicing the many markets that Metalcraft is involved in. Consequently, despite the increase in sales, gross profit has fallen in recent years.

Expenses have also risen, reducing the margins being obtained. Marketing costs have risen by 50% over the past five years, resulting from poorly focused promotional and sales activity. Sales have not risen to the same degree. Nevertheless the company has attempted to save on expenditure by cutting back on R & D expenditure. However this has been a short-sighted strategy because sales have been hindered by poor product innovation and quality.

Money

The decentralisation of both marketing and manufacturing operations has resulted in inefficient operations. However this philosophy of decentralisation has been ignored in certain areas and in finance and manpower development, in particular, there has been a move towards **centralisation**. It is not unusual for group headquarters to control, to a certain extent, finance and expenditure. However it appears here that the subsidiary companies have little say in their **capital allocation**. Dividends have taken precedence over internal investment for future growth. It would appear to be short-sighted to allow individual companies the notion of independence whilst denying them the finance to pursue their goals. If companies are to be encouraged to grow and act in their own interest, there should be some mechanism to allow them to bid for funds. Allocation of capital should be dependent upon realistic and well-argued business plans, and not solely on shareholders' expectations of higher dividends. The current strategy concentrates on the short-term.

Analysis of the company's data also suggests:

- With the resultant substantial reduction in operating profits investors have lost confidence in the Group and this has been reflected in the worsening price/earnings ratio.
- In order to placate these shareholders, the Group has starved the companies of cash by maintaining the dividends per share. This will only make the situation worse, because without productive expenditure and investment, there will be no improvement in the key functional areas of production and marketing, and the situation will only deteriorate.

Manpower

It is also apparent that the demands imposed by the centre on the companies are damaging. Small companies do not have the resources to plan for and implement programmes on quality and on training, without some support from the centre. Key managers are being sidelined from their major duties by working on the introduction of these programmes. They often have to 're-invent the wheel'. Much of this work should be organised by specialists from the centre who understand the problems and the solutions, having carried out the programmes with the sister companies. This will then leave the company managers to focus on the big issues such as developing both profitable products and markets.

Improvements

There are a number of areas where Lewis could improve the performance of the Group without having to resort to asset disposals or acquisitions. Firstly the companies could be re-structured into a more logical format. This could require a surrender of some independence by the companies, but this independence has actually been more notional than real. The companies with overlapping product lines could be divisionalised. In this way resources and experiences could be pooled, so creating a critical mass that would enable the combined units to compete more effectively with the larger competitor companies in the world's markets. The sales forces could be consolidated, enabling them to obtain greater depth of coverage and at the same time saving on expenditure. Costs of overseas representation would be reduced, and larger sales potential would attract more proficient agents to the Group. The development of a corporate or divisional brand for products operating in similar markets or with similar product ranges would also be helpful.

Research and Development could be funded and shared throughout the group, avoiding duplication of effort and encouraging economies of scale. This should help eliminate the problem of poor product innovation and development that has been experienced by the Group as a result of the currently-fragmented and poorly focused R & D. Consolidation, which divisionalisation might bring about, would afford the potential for larger purchase orders which should make supplies cheaper. In addition there may be an opportunity for inter-group transfers, whereby components or materials supplied by one company could be sold at favourable prices to another member of the group. This would only be acceptable if the overall profit to the group was increased. Inter-firm trading must not be used to foster inefficiencies or to stifle initiative.

Apart from the consolidation of the disparate groups, the centre should provide a central resource to provide assistance in administrative functions, particularly in the areas of implementing training standards and quality. This will enable the smaller companies to concentrate on what they are good at – knowing their products and understanding their customers. This provision of service should be paid for with a levy on each company, according to a formula based on utilisation or sales. This should prevent the companies wasting resources and adding unduly to overheads.

Finally, more attention should be paid to the choice of overseas markets. The companies seem to have operated in a wide and indiscriminate range of markets. By focusing on a more select range it will be possible for the divisions to operate where the potential is promising and to concentrate their resources where they will be most effectively utilised. Currently it would appear that the philosophy is sales-driven and not profit-driven. It is probable that in a number of the markets the returns are negligible.

(b) **To:** Members of the Board of Metalcraft Group plc

From: Ruth McGeorge

Date: XX/XX/XX

Criteria to be considered before an acquisition is undertaken

Introduction

There have been a number of acquisitions within the Group which have not always been successfully developed. It is important that, in future, before other purchases are actioned there should be a satisfactory evaluation of the proposed company. There are a number of models which can be used to assess acquisitions.

The BCG matrix

This can be used to assess existing and potential strategic business units (SBUs) by assessing them against two criteria – the growth that they have in their market, and the market share within that market. The aim would be to target businesses that have both a high market growth and a high market share. These 'stars' are likely to give the best long-term prospects for an acquisition.

However, acquisitions with current low market shares should not be discounted. These may have the ability to be transformed into future stars if a strong competitive advantage can be developed. Metalcraft should assess acquisitions in terms of its ability to add this competitive advantage (this is explored more later).

Targets with low growth and a low market share should be avoided as they are unlikely to add much value to the business. For those with a high market share but low market growth (known as 'cash cows'), the key decision is likely to come down to valuation

These cash cows are likely to generate large cash surpluses that can be used to support other areas of the business. But Metalcraft is likely to pay a high premium for such targets and therefore they should only be acquired if there is evidence that they have been significantly undervalued.

The BCG matrix has been extended by other companies such as General Electric and Shell into other models such as the market attractiveness matrix. This matrix extends the analysis to also cover the size of the industry and the competitive strengths of the target. These criteria should also be considered by Metalcraft when targeting acquisitions – it should seek out businesses with a competitive advantage such as cost leadership or brand image, and look for industries that have a high value.

The Ashbridge portfolio display

This model considers corporate parenting more closely and examines the possible link up between the parent (Metalcraft) and any potential target. The model has two criteria:

- it assesses the parent's ability to add value to the target (e.g. by adding skills or finding synergies or reducing risk), and
- it also assesses the opportunities that might exist within the target for the parent to do this.

Metalcraft should focus its attention on acquisitions where the above assessments give high values. These 'heartland business units' give a high degree of match between Metalcraft and its target and shows that Metalcraft have the opportunity to add value to the target through its capabilities and experience. 'Alien businesses', where the above assessments give low values should definitely be avoided.

Metalcraft would appear to have a number of 'value trap' businesses. These are businesses that need a lot of help and have lots of opportunities to add value, but, unfortunately due to the lack of strategic fit with Metalcraft, they take up too much time and effort and Metalcraft lack the ability to solve their problems. These are the type of targets that should be avoided in the future.

Overall

It can be seen that there are a number of criteria that should be used to assess potential acquisitions and it is important that these assessments are carried out in the future in order to avoid some of the problems that have SBU's to determine whether any of these should be considered for divestment by the board.

(c) There is confusion within the Group because officially the companies are to operate as independent units and yet there is substantial evidence that the Chairman is interfering in some operational areas and yet appears not to be providing the leadership such a group requires. The nature of Metalcraft is such that a degree of control from the centre is not incompatible with allowing individual companies a certain level of freedom to operate.

There are a number of models which could be used to help identify a management style which might be suitable to balance the potentially conflicting messages emanating from trying to achieve a degree of central direction whilst, at the same time, allowing subsidiaries a certain amount of freedom of action. It is possible to use **Mintzberg's divisionalised structure**, permitting a **concentration on markets or technology**. In this situation companies or divisions are allowed operational freedom, but are generally constrained from the centre by having strong financial guidelines. There is a danger here that short-term decisions may be taken by the subsidiaries who are now obsessed by bottom-line outcomes.

Mintzberg maintains that by developing a missionary culture all parts of the organisation will subordinate themselves to the corporate will. This, however, will require the senior managers and the Chairman, in particular, to provide inspirational leadership which all parties can support.

Peters and Waterman identified key characteristics that could help companies manage complexity and change. Many of these attributes could be easily applied to this new organisational development. Attributes such as autonomy and entrepreneurship, being close to the customer, a bias for action, hands-on and value-driven all suggest the need to allow operational managers to be near to the point of decision making. The concepts of simple form and lean staff, along with simultaneous loose-tight properties suggest the need for a simplified centre providing a degree of direction and support to the subsidiaries, without incurring costly overheads and generating conflict and confusion amongst the subsidiary units.

Goold and Campbell suggest three styles of managing relationships between the centre and the subsidiary companies. The **'strategic planning' style** emphasises the greater input of the centre, whereas the **'financial control' style** provides for greater delegation of decision making. The **'strategic control' concept** attempts to balance between these two extremes. In this particular scenario there is no specific 'best' model. Although there is a willingness to decentralise to provide motivation, there is no strong case for this with reference to both markets and technology. Many of the products are of a similar nature and the markets are so fragmented that it is unlikely that any single company has a dominant knowledge of the market place to the detriment of the others. The company has much to gain from further centralisation and any culture or structure that encourages this without adversely affecting motivation should be closely examined.

Handy's development of the four cultures could also be considered here. It is apparent that Lewis is leaning strongly towards the **power culture**. He interferes in many areas of activity and occasionally acts in an imperial manner. Power appears to emanate from him. This fits in badly with his supposed strategy of decentralisation. It is possible that a **role culture** might be more appropriate here, whereby objectives and strategies are clearly laid out by the strategic apex, and the management style is to delegate clearly and appropriately the actions and activities to be carried out by the subordinate staff, who might even be the general managers of the subsidiary companies. This bureaucratic procedure should ensure that there is consistency between different layers of management and that they each know and understand his/her position within the group. It is also possible to argue for a **task culture** to be used. By developing teams and cross-divisional responsibilities it is possible to focus on performance and successful outcomes. At the present time optimisation of sales or profits appears to be neglected. Results are being ignored. A task culture might correct this problem.

(d) By effectively segmenting markets into specific sub-groups, it is possible to develop and implement marketing strategies to appeal specifically to those groups and devise a marketing mix programme to meet their needs more precisely.

With a company operating on an international scale, the most obvious mode of **segmentation** is **geographic**. Although customer needs are unlikely to vary as much as with consumer goods there is still potential here for refining promotional and distribution strategies. Companies can also be **classified according to purchasing characteristics –** frequency and size of orders. This type of segmentation is particularly useful when designing sales force visits.

Industrial customers can be segmented according to what products they manufacture. Metalcraft could identify a number of customer groups – aircraft furniture manufacturing, vehicle manufacture and users of electric motors. Each group would be driven by different considerations. The size of the customer companies should also be considered. Whereas smaller companies would possibly need fewer deliveries, bigger companies could be expecting just-in-time deliveries. It is also possible to segment markets according to benefit expectations. Some companies are price-sensitive, whereas others may be more concerned with guarantee of supply, quality or innovative design. Metalcraft should target those companies who are expecting the performance, service or price that the Group can provide.

When segmenting the market, it is important to consider the following criteria:

- **Measurability**. Is there sufficient published data to enable the Group to identify and select accurately companies to include within the segment?
- **Accessibility**. Can these segments be effectively reached by either a sales force or by promotional media?
- **Substantiality**. Is the segment of sufficient size to be financially viable and attractive?
- **Appropriateness**. Is the segment compatible with the objectives and resources of the company?
- **Stability**. Is the segment sufficiently constant so that it can be predicted in the future?

If a segment fails on a number of these tests then it will be difficult to develop and maintain a successful segmentation strategy.

ACCA marking scheme

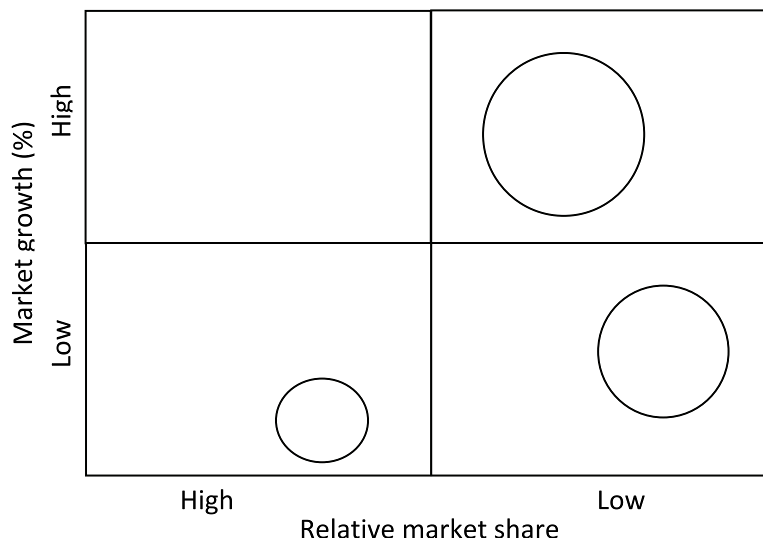
		Marks
(a)	Award up to 3 marks for each area of the resource audit that has been discussed. Maximum of 9 marks. Award up to 6 marks for analysis of the data Award up to 8 marks for the recommendations for improvements.	17
(b)	Up to 2 marks for each valid point that is made Award three marks for the report format and sign off by Ruth George	15
(c)	Up to 2 marks for each academic model used and three marks for it's application to the scenario	10
(d)	Marketing segmentation concept – max 4 marks Application to Metalcraft – max 4 marks	8
Total		**10**

ANSWER 2

(a) **Product portfolio evaluation**

The product portfolio can be assessed using the BCG matrix framework as follows:

BCG matrix (see working 1 for details)



Commentary

According to the BCG matrix, Office furniture would be classified as a problem child, having a relatively low share of a high growth (and hence attractive) market. This would normally imply that it is receiving investment in excess of any cash flows generated by itself and hence requires cash subsidization by other SBUs. This seems unlikely in this case as Office furniture provides the largest share of contribution and has the highest C/S ratio (working 2).

Bedroom furniture would be classified as a cash cow, having a relatively high share of a low growth (and hence unattractive) market. Conventional BCG analysis would suggest that this SBU should be cash rich and able to provide funds for financing other SBUs. With AFR it appears that bedroom furniture generates the lowest contribution, so again does not fit with the BCG "wisdom".

Lounge furniture would be classified as a dog product, having a relatively low share of a low growth (and hence unattractive) market. This would normally imply a product with few prospects and cash neutral or even cash negative position. The relatively low C/S ratio of 12.4% (W2) would indicate the lack of a clear competitive advantage, but lounge furniture does provide 37.5% of the firm's contribution suggesting a cash positive position.

Summary

AFR has three major SBUs, each of which generates a positive contribution to fixed costs. Lounge and bedroom furniture have the lowest C/S ratios, due to competitive pressure and/or cost efficiency.

The fact that AFR's profitability has been higher than average for the sector would reinforce the view that it has a healthy, balanced portfolio.

BCG matrix analysis, however, would suggest that the portfolio is not balanced due to the lack of star products.

Working 1:

SBU	*Market growth*	*Relative market share*	*Contribution (gives circle size)*
Office furniture (OF)	+15%	4.23/6.35 = 0.67	0.81
Bedroom furniture (BF)	–5%	3.20/2.85 = 1.12	0.44
Lounge furniture (LF)	+2%	6.04/14.25 = 0.42	0.75

Working 2: C/S ratios

Office furniture:	C/S ratio	= 0.81/4.23	= 19.1%
Bedroom furniture:	C/S ratio	= 0.44/3.20	= 13.8%
Lounge furniture:	C/S ratio	= 0.75/6.04	= 12.4%
Overall:	C/S ratio	= 2.00/13.47	= 14.8%

(b) **Office furniture**

According to BCG, office furniture is a "problem child" and hence the choice is to "double or quit". Given it has the highest growth prospects and C/S ratio within the portfolio, the best approach is to "double" or invest.

The BCG remedy assumes a competitive strategy of cost-leadership and relies on gaining market share to achieve economies of scale. However, DS appears to be following a cost-leadership approach so it would make more sense for AFR to pursue a strategy of differentiation.

This will involve a process of value analysis to determine which aspects of furniture design and manufacture could be the source of a quality advantage. Investment should also be targeted at marketing and branding to enhance a quality reputation/image.

Bedroom furniture

According to BCG, bedroom furniture is a "cash cow", so the prescribed strategy is to cut back on investment and harvest cash for reinvestment in other SBUs.

However, bedroom furniture produces the lowest contribution in the portfolio. It may also be a mistake to cut back all investment as AFR is currently the market leader with a good reputation.

Some investment will be required to defend this position from NKO and MK. As with office furniture, a strategy of differentiation would be recommended.

Lounge furniture

Lounge furniture is a "dog" and so should be phased out according to BCG.

This is clearly wrong in this case as lounge furniture generates 45% of AFR's revenue and 37.5% of its contribution.

However, BCG are correct is their assumption that a dog product like this lacks the economies of scale to compete on a cost basis. AFR should look to develop a differentiation with focus strategy for tailor made furniture.

ACCA marking scheme		
		Marks
(a)	Up to 1 mark for each calculation (max 7 marks) 1 mark for using a recognised model such as the BCG 1 mark for placing SBUs in the matrix 1 ½ marks for the justification of each position Up to 4 marks for the overall opinion	16
(b)	3 marks for justifying a strategy for each SBU	9
Total		**25**

ANSWER 3

(a) The investment manager has analysed three mutually-exclusive investment opportunities A, B and C.

Reasons for differences between NPV and IRR rankings

There are two main reasons that NPV and IRR rankings differ:

- The magnitude of the cash flows.
- The timing of the cash flows.

Magnitude of cash flows

Imagine we were faced with a choice between the following two projects:

Year	*Project A1* *Cash flow* £	*Project A2* *Cash flow* £
0	(105,000)	(105)
1	48,000	49
2	48,000	49
3	48,000	49

The cash flows in Project A1 are approximately 1,000 times bigger than those in Project A2. Hence the NPV of Project A1 will be approximately 1,000 times bigger than the NPV of Project A2. The NPV of Project A1 is £14,376, but the NPV of A2 will be just over £16.86. NPV would therefore suggest that Project A1 should be preferred – despite the fact that the cashflows are actually providing a slighter higher percentage return (49/105 = 46.7%, 48,000/105,000 = 45.7%).

Consider the IRRs of A1 and A2. In project A2 the return is £48,000 p.a., whereas project A2 yields £49 p.a. The relative percentage return from Project A2 is thus higher than that of Project A1. Hence A2 has a greater IRR than A1.

The inconsistency in ranking has been caused by the magnitude of the figures.

Timing of cash flows

The actual time periods when the cash is generated can produce conflicting results.

Again consider two projects.

Year	Project A1 *Cash flow* £	Project A2 *Cash flow* £
0	(105,000)	(105,000)
1	48,000	130,000
2	48,000	0
3	48,000	0

The NPV of Project A2 is £13,170 (130 × 0.909 – 105). This NPV is lower than the NPV of Project A1.

The magnitude of the cash sums is very similar in both projects.

If we consider how the NPVs of the two projects reduce as the discount rate rises. The NPV of A1 will fall rapidly as the cash flows in the years 2 and 3 very quickly reduce in present value terms. The NPV of this project becomes zero at a 17.5% discount rate. The cash in Project A2 is all received in the first year. This cash sum is only £130,000, compared to cash in flows of £144,000 in Project A1. However the value of the year 1 cash flow remains strong even as the discount rate rises. Indeed, at a discount rate of 17.5% the NPV of A2 is still positive at £5,630 (130 × 1/1.175 – 105).

Hence the IRR of Project A2 MUST be greater than 17.5%.

Again there has been a conflict in the rankings, this time because of the timing of the cash flows. These examples should illustrate that it is just as important to consider WHEN the cash flows arise as to consider HOW MUCH the cash flows are. It is very important to obtain cash in the early years of a project whilst it holds a high present value.

Comparison of opportunities A, B and C

The capital outlay in Project C is much greater than the other two projects. Cash inflows are generated for 9 years. At a low cost of capital this project is worth the most to the company. The cash in years 6-9 maintains a high value when discount rates are low. However, this project is very sensitive to increases in discount rates. As the cost of capital rises the NPV of Project C declines rapidly. This is illustrated in the graph at the beginning of the report. Project A is less sensitive to increases in discount rates. All its cash is received in years 1 to 3. These maintain a strong value as the discount rate increases. Project A could be said to be the least risky of the three choices if interest rates are volatile.

Which project should be selected?

The company has a cost of capital of 10%. At this rate Project C produces an NPV of £31,432. This is of higher benefit to MN plc than either project A or B. Hence this project should be selected.

Assumptions: cash flows are known and certain. The cost of capital is known. Taxation and inflationary aspects have been ignored. If MN plc is very risk averse, Project A may be considered as its NPV is more robust to increases in the cost of capital than projects B or C.

(b) **Post Project Review**

The post-project appraisal of projects provides a mechanism whereby experience gained from current and past projects can be fed into the organisation's decision-making process to aid decisions on future projects. In other words, it aids organisational learning. A post-project appraisal reviews all aspects of an ongoing project in order to assess whether it has fulfilled its initial expectations. It is a forward-looking rather than a backward-looking technique. The task is often carried out by the Capital Expenditure Committee, or an appointed sub-committee. The committee would meet either annually, bi-annually, or if necessary, quarterly.

Benefits of post-project review

- If managers know in advance that projects are going to be subject to a post-completion appraisal they ensure that assumptions and plans for the project are more accurate and realistic.
- If an appraisal is carried out before the project life ends, and it is found that the benefits have been less than expected because of management inefficiency, then steps can be taken to improve efficiency.
- It might identify weaknesses in the forecasting techniques and the estimating techniques used to evaluate the project. The discipline and quality of forecasting for future investments can be improved.
- Managers may be motivated to achieve the forecast results if they are aware of a pending post-completion appraisal.
- The appraisal reveals the reliability and quality of contractors and suppliers involved in the project.
- The appraisal may highlight the reasons for success or failure in previous projects – thereby providing a learning experience for managers to aid better decision making in the future.

Problems with post-project reviews

- It may not be possible to identify separately the costs and benefits of any particular project.
- It can be a time-consuming and costly exercise.
- Applied punitively, post-completion appraisal may lead managers to becoming over-cautious and risk averse.
- The strategic effects of a capital investment project may take years to materialise and it may never be possible to identify and quantify them correctly.
- There are many uncontrollable factors in long-term investments. A post-completion appraisal will not help managers change these factors in the future.

ACCA marking scheme			
			Marks
(a)	(i)	Reasons for conflict between NPV and IRR	7
	(ii)	Comparison of the projects	7
		Maximum	**13**
(b)		Explanation of PPR	2
		Benefits of PPR	5
		Problems of PPR	5
Total			**25**

ANSWER 4

(a) Risks might include:

First outsourcing arrangement. This project is to be the hospital's first outsourcing assignment. Previous systems have been developed by the internal Information Systems (IS) department and so the hospital management does not have any experience in contractually dealing with an external supplier. Risks of this sort can be reduced by drawing up formal supply contracts which include arrangements for dealing with changes, extensions, conflicts and finance. The contract must clearly establish what is to be supplied under its terms. Arrangements must also be made for such possibilities as the supplier going out of business.

Using relatively unproven software. This software is likely to be unproven and so it may still have errors and problems. It is also unlikely that there are many developers with experience of this development language and so contract developers may be difficult to find and expensive to employ. This risk can be reduced by an incremental approach to development so that facilities can be experimented with and parts of the system developed to allow 'proof of concept' and to demonstrate progress to the user. Risk can also be reduced by asking the software house to undertake parallel development with a more conventional software package.

Becoming a supplier of software to other organisations. There are a number of risks associated with supplying a product that does not perform acceptably. The customer may enter into a legal dispute, demanding consequential damages for business losses caused by the non-performance of the software. These risks can be reduced by:

- legal disclaimers in the supply of the software
- insuring against claims for damages
- careful specification, development and testing to reduce the possibility of software failure
- setting up the software supply side as a separate company which can be liquidated in the face of an award for considerable damages.

Internal staff dissatisfaction. Staff dissatisfaction appears likely given the fact that the internal Information Systems staff will not be able to develop bespoke systems in the future. This dissatisfaction may lead to efforts to undermine or discredit the external supplier. This is a difficult risk to reduce given the policy adopted by the management committee. One possibility may be to outsource the work of the IS department, perhaps to the same supplier.

(b) Knowledge worker tasks include:

- keeping the organisation up-to-date with new medical knowledge as it develops outside the hospital – medical equipment and technology, new treatments being developed by other hospitals, and new drugs being developed by pharmaceutical companies
- providing advice inside the hospital on the use of such new medical knowledge
- acting as change agents by actually recommending and implementing change within the hospital to existing treatments for patients.

(c) **'Competencies'**

Competencies are the critical skills, knowledge and attitudes that job-holders such as doctors and nurses in the hospital must have to perform effectively. Competent doctors and nurses can perform work roles in a wide range of settings within the hospital over a long period of time. They are expressed in visible, behavioural terms and must be demonstrated to be contributing to the aims of the hospital to an agreed standard.

'Competency frameworks'

Organisations such as the hospital are increasingly making use of competency frameworks in linking human resource management skills to the skills and behaviour required to meet the objectives of the hospital. The recruitment and HRM system being developed by the hospital might include many components:

- to provide an analysis of the behaviour needed to achieve a given strategy
- for benchmarking purposes
- for recruitment, so as to provide a basis for person specifications and candidate comparison
- to identify training needs
- to help manage performance, and to integrate with staff appraisal systems.

ACCA marking scheme		
		Marks
(a)	3 risks required:	
	2 marks for the risk identified	
	2 marks for measures to deal with each risk	12
(b)	2 marks per task	6
(c)	Up to 3 marks for the meaning of 'competencies'	
	Up to 4 marks for uses	7
Total		**25**