ACCA FINAL ASSESSMENT

Business Analysis

June 2012

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

Metalcraft Industries Group plc is a UK company, operating mainly in the metal goods manufacturing sector and currently has an annual turnover of £170 million. The company originally concentrated on manufacturing high precision machine tools for use in a wide range of industries, particularly in the transportation sectors – automobiles, lorries and military vehicles.

The market

The market for Metalcraft's products is international, with half the total sales destined for markets overseas. Thirty years ago the company met increasing competition from more efficient and cheaper suppliers from Europe and the Far East and consequently it decided to operate in a more diversified range of products and markets. It initially bought a company which manufactured electric motors for power transmission and then acquired a range of companies which manufactured a variety of products including wheelchairs for the disabled, wheel rims and nuts and bolts for the motor industry and metal partitioning for the kitchens and toilets used in civil aircraft. In total the company has, within its portfolio, about 20 subsidiary companies, some of them producing an over-lapping range of products whilst others manufacture components that could be utilised by other companies within the Group. Many of these subsidiaries have a turnover of less than £5 million and only five of the companies have individually sales in excess of £15 million.

Management

Simon Lewis is currently the Chairman of Metalcraft Industries and has held that position for 25 years. His father had founded the original company 50 years ago and it became a public company, quoted on the Stock Exchange 30 years ago. Currently the Chairman owns 30% of the issued shares, with another 15% being owned by the managers of the subsidiaries. Many of the acquisitions were made over 15 years ago. Generally they had been under-performing family-owned companies and had been purchased relatively cheaply. The smaller companies were acquired for cash, without resort to loan finance. However two or three of the larger acquisitions had involved a share exchange.

Having acquired the companies Lewis has then allowed them to operate as if they were still independent companies. When asked why he has not encouraged a greater integration of the companies he replied that his policy has been to delegate authority and control to the local managers as they know the industries and their customers better, and that a strategy of decentralisation improves motivation. Each of the companies promotes itself as if it were independent, using the original company name and not the Metalcraft name. Marketing activities are the responsibility of the individual companies. Each company has its own sales force and its own research and development facility. There are few occasions when a corporate-wide activity is initiated. One company's marketing manager had exhibited at an overseas trade show and had been surprised to see five other of the Group's subsidiary companies represented there.

Competitiveness

There has been little evidence that the acquisition of these companies has improved their competitiveness. Sales volume in most of the subsidiaries has remained static. This has been primarily because of increased competition despite there being a healthy world-wide market demand for similar products.

The Group's companies are selling to a wide range of geographic markets, which helps to explain the relatively high ratio of foreign to domestic sales. Unfortunately no individual company has a strong presence in any of these overseas markets, so inhibiting a greater penetration of these areas. It is difficult to state who the competition are because of the wide spectrum of the products and markets covered. As none of the subsidiary companies has developed a strong position within any of the markets it is almost impossible to build up any brand loyalty and consequently most of the sales have been price-led, which inevitably has had an adverse effect on profits.

Because of the lack of co-ordination and co-operation between the subsidiary companies overseas sales often are of a haphazard nature. Overseas agents frequently provide inferior service mainly because the better agents are already under contract to bigger or more focused competitors.

Constraints

Despite the corporate philosophy of decentralisation the Chairman has often contradicted himself by imposing highly centralised constraints on the subsidiary companies. He has insisted that each company should acquire the latest international quality standards approval. He argues that this is sensible for companies operating in the highly competitive manufacturing sectors. He also has required them to seek the Investors in People award (a national award for training), so demonstrating the corporate commitment to manpower development. Whilst these initiatives are encouraged there has been no centralised direction or assistance given to the companies, some of which might have as few as 50 employees. Possibly the most constraining issue of all is that of capital expenditure. The parent company considers itself as the shareholder of the subsidiaries, and as such, requires a given profit from each company. It is very inflexible with regard to its attitude to finance. Any capital investment by a subsidiary has to be approved by the main Board. Because of the lack of a strong portfolio of products and the failure to market them in an effective manner, the profits in the group have fallen during the last 10 years. In order to keep shareholders happy with a satisfactory dividend payout the main Board has rejected many applications by the subsidiaries for capital investment. This naturally has exacerbated the problem of low profits because product innovation, development and quality have now suffered and have affected sales adversely.

Performance

By early 2008 the poor performance of the Group was being reflected in its share value that had gradually deteriorated, against a background of a buoyant stock market. External shareholders were becoming hostile. Lewis had considered a share buy-back so as to reduce this pressure but the poor profit performance over recent years prevented him from doing so, despite the current low value of the shares. He has belatedly realised that his strategy has been unsuccessful. He has decided that he must re-structure the holdings of the Group. In Lewis's opinion there appears to be little scope for internal efficiencies and internal development to provide the growth in profits that the shareholders are expecting. The best hope appears to be in selective asset disposals and in new acquisitions. Currently the group is an amalgamation of disparate companies with little or no synergy being evident.

The Chairman has brought in a new Finance Director. In addition two new non-executive directors have been appointed to the main Board, one being Ruth McGeorge, a specialist on mergers and acquisitions, to advise the company on its future strategies.

The future

Lewis is conscious of the fact that his previous record of company acquisitions has been rather haphazard and now he is looking for a more logical strategy. Consequently the influence of Ruth McGeorge has grown. She has convinced Lewis that if any acquisitions are to be made in the future they must be more rationally undertaken.

Looking at the current portfolio, some of the acquired companies do not fit easily into the group and others are competing against each other. There is a need for some organisational re-structuring. Lewis has asked McGeorge if she will produce a paper for him and the rest of the Board identifying the main sources of synergy that can be utilised in a group of companies such as Metalcraft. He is also keen to know if there are any cultural factors within companies that might lead to the successful integration of acquisitions. He believes that with her experience of acquisitions McGeorge must have noticed whether there are any critical success factors or distinctive competences that might be common in successful acquisitions.

Details of the financial status of Metalcraft Industries Group plc are given in Table 1 below.

Table 1	*2006*	*2007*	*2008*	*2009*	*2010(forecast)*
	£m	£m	£m	£m	£m
SALES	160.0	165.0	170.0	175.0	181.0
Cost of sales	96.0	100.0	106.0	112.0	120.0
Gross profit	64.0	65.0	64.0	63.0	61.0
EXPENSES	48.0	50.4	51.5	52.0	54.0
Marketing	10.0	11.0	12.0	13.0	15.0
R & D	6.0	5.5	5.0	4.5	4.0
OPERATING PROFIT	16.0	14.6	12.5	11.0	7.0
P/E ratio	12	10	9	8	5
Earnings per share (pence)	12	10	8	7.5	6
Dividend per share (pence)	4	4	4	4	4

Required:

Acting in the role of Ruth McGeorge:

(a) **Using a resource audit or similar tool, analyse the internal position of Metalcraft Industries Group plc, and suggest actions that the management could take to improve the situation other than with asset disposals or acquisitions. (17 marks)**

(b) **Prepare the briefing paper for the Board, requested by Lewis, outlining the main criteria you think would be important in evaluating a company prior to its proposed acquisition.**

(*This requirement includes three professional marks)* (15 marks)

(c) **Comment on the existing management style and suggest how Lewis might provide leadership and direction to the Group in order to effect the necessary changes. Support your arguments with appropriate academic theories or models. (10 marks)**

(d) **Explain, with reference to Metalcraft Industries Group plc, the concept and use of market segmentation. (8 marks)**

(Total: 50 marks)

SECTION B

CHOOSE TWO QUESTIONS FROM THREE

QUESTION 2

AFR is a large retailer of furniture, based in Armasia. It has three strategic business units (SBUs) which specialise in office, bedroom and lounge furniture. Each SBU is responsible for the design, procurement and retailing of its own range of furniture. AFR sells all its product ranges through a chain of large 'furniture superstores' throughout its own country. Each store sells all three furniture ranges.

AFR has been in existence for over twenty years, and has always been profitable. Recently, the organisation's profitability has been slightly higher than average for the furniture retail sector.

All the furniture that AFR sells is designed 'in house'. Design staff from each of the three SBUs work in a centralised research and development (R&D) department, where all designs are developed. Production of the designs is outsourced to a number of small local manufacturers. This ensures that AFR can keep close control of product features, style and quality, while negotiating down the unit cost of production.

Market conditions

The market for office furniture is estimated to be growing at a rate of about 15% each year. The market leader is DS with a reported sales revenue from this sector of $6.35 million. DS sells a much narrower range of 'basic' office furniture than AFR, through a chain of specialised office furniture stores. Most of its products are mass produced in large factories elsewhere in Armasia, and it is therefore able to sell at much lower prices than AFR.

The market for bedroom furniture is considered to be declining by about 5% each year. AFR is market leader in this segment, ahead of NKO (with sales revenue of $2.85 million) and MK ($2.14 million). AFR has a good reputation for the style and quality of its bedroom furniture, and customers report very high satisfaction levels.

The market for lounge furniture, such as sofas and easy chairs, is growing at a rate of about 2% each year. AFR is a relatively small player in this market which is dominated by MK with its sales revenue of $14.25 million. The second placed competitor is TSC ($11.96 million), closely followed by NKO ($8.94 million). Despite having tried to increase its market share in this segment, AFR has had little success. Much of AFR's lounge furniture is made to order, with customers allowed to choose from a wide range of styles and fabrics.

The following information has been provided by the Government bureau of economic statistics:

		$ *million*
Market volumes	Office furniture	23.60
(2006)	Bedroom furniture	12.80
	Lounge furniture	70.00

Segmental analysis

The following figures are extracts from the report and accounts of AFR for 2009. AFR reports its performance in the local currency, the dollar.

		$ *million*
Sales revenue	Office furniture	4.23
	Bedroom furniture	3.20
	Lounge furniture	6.04
	TOTAL	13.47
		$ *million*
Contribution	Office furniture	0.81
	Bedroom furniture	0.44
	Lounge furniture	0.75
	TOTAL	2.00

Required:

(a) Evaluate the existing product portfolio of AFR.

Note: There are up to 7 marks available for calculations in this requirement.

(16 marks)

(b) Recommend an appropriate strategy for each existing product range. (9 marks)

(Total: 25 marks)

QUESTION 3

MicroNews plc has a rolling programme of investment decisions. One of these investment decisions is to consider mutually-exclusive investments A, B and C. The following information has been produced by the investment manager.

	Investment decision A £	*Investment decision B* £	*Investment decision C* £
Initial investment	105,000	187,000	245,000
Cash inflow for A: years 1 to 3	48,000		
Cash inflow for B: years 1 to 6		48,000	
Cash inflow for C: years 1 to 9			48,000
Net present value (NPV) at 10% each year	14,376	22,040	31,432
Ranking	3rd	2nd	1st
Internal rate of return (IRR)	17.5%	14%	13%
Ranking	1st	2nd	3rd

Each project includes a cash cost throughout its life for performing a post project review. The managing director of MicroNews is a strong believer in the value of such audits given the number of project investments that are carried out by the company.

Required:

(a) For the management of MN plc prepare:

(i) a statement of the reasons for differences between NPV and IRR rankings – use investment A to illustrate the points you make;

(ii) a brief summary which gives MN plc's management advice on which project should be selected from a financial point of view. (13 marks)

(b) Explain the meaning of a post project review and its potential benefits and problems for an organisation. (12 marks)

(Total: 25 marks)

QUESTION 4

A large teaching hospital is considering the computerisation of its recruitment and HRM system.

The hospital has a small in-house IS (Information Systems) department that administers the internal systems and has written bespoke software for the hospital in the past. However, the hospital management committee has decided that all future developments will be outsourced. The internal department will be restricted to supporting current systems and will eventually be phased out altogether.

The first outsourcing project is the recruitment and HRM system. In the first phase of this project the software house has produced a functional specification defining the requirements of the system. The software company has also put in a bid to write a bespoke system to fulfil the requirements. The hospital administrator has surveyed a number of packages but believes that none of them completely fulfil the functional specification. In his formal report responding to the functional specification, he has proposed that the hospital should jointly build the software with the software house and, after successful implementation, sell it to other hospitals. The hospital management committee has agreed in principle with his suggestion and has given the go-ahead to proceed with the bespoke development.

Several members of the hospital management committee are worried about the manner in which this project is being set up and conducted. They believe that it is exposing the hospital to considerable business risk.

Required:

(a) Identify three risks associated with the project and, for each risk provide measures that might be taken to overcome or reduce it. (12 marks)

As part of the new recruitment and HRM system project, the software house has expressed doubt about the meaning of some of the phrases used by the hospital administrator in his formal report. Particular phrases causing confusion include the description of some of the doctors in the hospital as 'knowledge workers', 'competencies' and 'competency frameworks'.

(b) Identify the tasks that may be completed by a 'knowledge worker' within the teaching hospital. (6 marks)

(c) Explain what is meant by the phrase 'competencies' in the context of competency frameworks, and provide examples of possible uses for such 'competency frameworks'. (7 marks)

(Total: 25 marks)