

**ACCA INTERIM ASSESSMENT**

# **Business Analysis**

**2012**

**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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**Paper P3**

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## SECTION A

### THIS QUESTION IS COMPULSORY

#### QUESTION 1

##### Introduction

Richard Johnson, Managing Director of Polymat Industrial Tapes (PIT), was concerned that the global economic slowdown had meant some difficult years for the company. The company manufactured a range of industrial tapes for sale to a wide range of customers, from masking tape used by individual Do-It-Yourself (DIY) enthusiasts through to high performance tapes for the major automotive and aerospace companies. The origins of the company were in the late 1920s when PIT set up as a private company making tapes for use by cable manufacturers who were meeting the growing needs of the National Grid (a Government owned electricity supply network). The technology for making its products was, therefore, reasonably mature though breakthrough products did occasionally occur – as witnessed by the explosive demand for optic fibre cable and PIT's hi-tech cable jointing tapes. The tapes were mainly produced by a process that coats adhesive on to a variety of materials, including PVC, textiles and paper.

##### Product range and competitive environment

PIT had grown up in close proximity to some of its much larger cable manufacturing and automotive customers. There are currently three factories manufacturing its product range. Its original factory concentrates on cable jointing products supplied to the large domestic cable manufacturers. These manufacturers are exerting strong pressure for price reductions on their suppliers in order to prevent entry into the market by large overseas global cable manufacturers. PIT's products need to respond to any significant product developments by domestic cable manufacturers and by its overseas tape competitors. Johnson is very aware of the global brand recognition of one of its major overseas competitors, which has a strong consumer products division and a reputation for aggressive product innovation.

At its second factory PIT produces PVC tapes, mainly standardised products with a typical 30-year product life cycle. Distribution is primarily through electrical wholesalers with an extremely wide customer base. PIT's main domestic competition is of a similar size and not regarded as being particularly innovative. PIT has also had some success in meeting the particular tape needs of car makers in their new car model programmes. PIT has had to satisfy the demanding quality standards required by each car manufacturer of their suppliers. The main competition comes from low cost base manufacturers from Europe and the Far East.

At its third factory PIT produces paper masking tape. The move into paper masking tape is a more recent move aimed at the apparently ever-increasing market for masking tape with particularly heavy demands by the car industry for use in paint spraying and in the domestic market by DIY customers. The technology to produce the tape was imported from overseas under licence with a very modern factory being built to manufacture these products. Unfortunately, PIT's masking tape capacity became available just as there was a significant slow-down in global car sales. Tape manufacturers such as PIT are faced with the dual problem of excess industry capacity and sales of low priced tape in Europe by low cost North American producers. The main competitor is an American company with access to lower cost raw materials and a 35% share of the domestic market compared to PIT's 20% share. PIT's difficulties were further exacerbated by its inability to achieve efficient low cost operation,

partly due to a high level of fixed overhead cost for the company as a whole. The fixed overhead had been significantly increased by an investment in, and operation of a centralised warehouse facility. This warehouse and distribution facility had been designed to alleviate major space problems at the factories and improve service to all of the key clients, but in practice has merely added to overhead costs and working capital levels with little added value to the company's activities. Safety inventories of finished products continue to be held at the three factories. Distribution to the customers is through the company's own transport system.

### Current situation and financial performance

PIT had been acquired by one of the domestic's largest cable manufacturers during World War II. However, the recession of the early 1990s had seen the parent company look to concentrate on its core product – cable manufacture – and dispose of non-core activities including PIT's industrial tapes. Thus an opportunity was presented to the three senior directors to buy out the company. The subsequent buyout had, to use Richard Johnson's words, given them 'a company with a mature product range produced by outdated equipment'. Each of the directors has spent the majority of their careers in the industry and recognises the challenge of competing in markets that are dominated by large customers looking to drive prices down and rationalise their supplier base. The directors are committed to securing the future of the business and saving as many jobs as possible.

PIT is very much a product led as opposed to a marketing led company. The nature of its products mean that it employs a significant number of chemistry graduates at its three factories and each factory pursues a separate R & D strategy. Recognition of the changing marketplace had come with the appointment of Paul Wright, an economics graduate, as Marketing Manager. Paul soon recognised that the company lacked key information on its customers, the products they bought and which were profitable. To use Paul's words, there were some 'little gems' where the product was generating good margins from a small number of industrial customers. But identifying them is the problem. Many of its customers are small DIY retailers and information on the profitability of such orders was less than impressive. Equally worrying is the lack of any process through which the ideas for new or improved products brought back by its sales force are effectively considered in terms of PIT's ability to develop, make and then sell them at a profit. The dominance of the company by technologists means that there is a real gap between understanding market opportunities and the products developed in the company. There is also a failure to identify the key decision makers in their larger cable manufacture and automotive customers and little external recognition of the technological advances made by PIT's R & D activity.

**Table 1: Information on PIT's current sales revenue and financial performance (\$000) (where appropriate)**

Product group	20X4/05	20X5/06	20X6/07 (Forecast)
<b>Cable jointing tapes</b>	\$000	\$000	\$000
Sales revenue	4,000	4,510	5,100
Cost of sales	2,400	2,593	2,805
Gross profit	1,600	1,917	2,295
Transport costs	120	135	153
R&D	high	high	high
Market share	25%	25%	25%
Sales volume index	100	110	121
Product range	narrow	narrow	narrow

<b>Product group</b>	<i>20X4/05</i>	<i>20X5/06</i>	<i>20X6/07 (Forecast)</i>
<b>PVC industrial tapes</b>	\$000	\$000	\$000
Sales revenue	3,000	3,100	3,200
Cost of sales	1,650	1,705	1,760
Gross profit	1,350	1,395	1,440
Transport costs	150	155	160
R&D	low	low	low
Market share	10%	9%	8%
Sales volume index	100	103	106
Product range	wide	wide	wide
<b>Paper masking tapes</b>	\$000	\$000	\$000
Sales revenue	2,500	2,400	2,300
Cost of sales	1,625	1,680	1,725
Gross profit	875	720	575
Transport costs	150	192	230
R&D	moderate	moderate	moderate
Market share	20%	20%	20%
Sales volume index	100	106	112
Product range	narrow	medium	medium
<b>Company</b>	\$000	\$000	\$000
Sales revenue	9,500	10,010	10,600
Cost of sales	5,675	5,978	6,290
Gross profit	3,825	4,032	4,310
Transport costs	420	482	543
Other fixed costs	3,080	3,270	3,500
Operating profit	325	280	267
ROS	3.4%	2.8%	2.5%

**Retardon**

Indicative of the problems PIT faces, is its one and only breakthrough product 'Retardon'. This tape had been developed some five years earlier and offered significant fire resistant properties over the normal tapes supplied to cable manufacturers installing their cables in high risk environments, such as underground railway systems, airports and high rise buildings. Environmental conditions are favourable for a product with the ability to both reduce the risk of fire and the toxic fumes given off should a fire occur. However, despite significant R & D investment, the lack of adequate patent protection, a deficient product design and a failure to stimulate the market means that the threat of competition from more effectively organised competitors is increasingly likely.

**Outlook for the future**

Richard is sympathetic to Paul's concern over the lack of marketing information and the consequent failure to generate new products. Equally concerning is the speed at which many of its products are becoming commodity products in which price is the key factor influencing supplier choice. Certainly there are opportunities to work with the large automotive companies in their development of new models, but such projects were typically of five years' duration and PIT's lack of market presence is not helping it secure these long-term contracts.

Longer term, Richard is considering a change in the organisational structure of PIT. He wants to have each factory converted to a separate division with its own middle-line manager. Each division would be organised as a separate legal entity and subsidiary of an overall holding company. He hopes that this will give each division a better market focus and he intends to create a reward system for divisional managers and staff that is based upon divisional performance. The new legal structure would also make it possible to sell off a division if central management were no longer convinced of its value to the overall organisation. It would also allow the company to branch into new strategic areas that may be very different from its existing core activities.

**Required:**

- (a) **Evaluate the performance of the three product groups and their contribution to overall company results. Use appropriate models to support your analysis.**  
(20 marks)
- (b) **Assess the main strategic options open to PIT and recommend a preferred strategy.**  
(15 marks)
- (c) **Explain the changes that may be necessary to central management's parenting style if the new organisational structure is adopted in the longer term.** (15 marks)

**(Total: 50 marks)**

## SECTION B

### CHOOSE TWO QUESTIONS FROM THREE

#### QUESTION 2

Don Mac is the world's largest and best-known food service retailing group with more than 30,000 'fast-food' outlets in over 120 countries. Currently half of its restaurants are in the USA, where it first began 50 years ago, but up to 1,000 new restaurants are opened every year worldwide. Restaurants are wholly owned by the group (it has previously considered, but rejected, the idea of a franchising of operations and collaborative partnerships).

As market leader in a fiercely competitive industry, Don Mac has strategic strengths of instant global brand recognition, experienced management, site development expertise and advanced technological systems. Don Mac's basic approach works as well in Kandy or Kuala Lumpur as it does in Kansas: although the products are broadly similar, menus are modified to reflect local tastes. Analysts agree that it continues to be profitable because it is both efficient and innovative.

The group's vision is to be 'the world's favourite' through service, cleanliness and value, and it is following three main strategies:

- (1) To achieve profitable growth by building on key strengths.
- (2) To 'delight' every customer in every restaurant.
- (3) To be a good employer in each community in which it has a restaurant. (Despite this, some critics claim staff are mainly unskilled and lowly paid.)

Don Mac's future plans are to maximise global opportunities and continue to expand markets. Don Mac has long recognised that the external environment can be very uncertain and consequently does not move into new locations or countries without first undertaking a full investigation.

You are part of a strategy steering team responsible for investigating the key factors concerning Don Mac's entry for the first time into the restaurant industry in the Republic of Borderland.

**Required:**

- (a) **Justify the use of a PEST framework to assist your team's environmental analysis for the Republic of Borderland. (8 marks)**
- (b) **Discuss the main issues arising from applying this framework, and highlight what more information is needed by Don Mac on Borderland. (17 marks)**

**(Total: 25 marks)**

**QUESTION 3**

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

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

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

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

Plan:

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

Critical Success Factors:

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

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

**Required:**

- (a) Explain the different levels of planning and comment on whether Josh has fully considered each level (7 marks)
- (b) Explain the different approaches to strategic planning and consider which might be most appropriate to Josh. (9 marks)
- (c) Explain what a critical success factor is and comment on whether Josh has correctly identifies the CSF's for his new business venture. (9 marks)

**(Total: 25 marks)**

**QUESTION 4**

CCC is a specialist car manufacturer, based in Y, a country in Europe. Three ex-employees of a major car manufacturer founded CCC in 1992 as a private limited company. CCC has never required further finance to aid its expansion, and remains a private company owned by the three founders. The three, who are all engineers, decided to leave their former employer in order to establish a business producing hand-built high performance sports cars for wealthy customers. The major car manufacturers are not able to supply such vehicles, as their systems are all based on the assumption that they will produce each car model in sufficient numbers to benefit from significant economies of scale.

CCC has always been profitable, and has grown significantly in recent years. It is now the second largest specialist car manufacturer in Europe and employs 300 staff at its head office and factory near the capital city of Y.

**The specialist car industry**

The customers who buy specialist cars are very status-conscious, and want a car that is totally unique. They are prepared to pay a very high price for their new car, in comparison to 'top of the range' models from the major manufacturers, but require extremely high quality and service levels in return. At present there are fewer than twenty specialist car manufacturers in Europe, and only six of these (including CCC) produce sports cars. The others specialise in off-road vehicles, armour-plated cars or limousines. As the cars are produced to customer order, there has historically been little price competition between the various specialist sports car manufacturers.

CCC, in common with other specialist car manufacturers, has invested a significant sum in creating the design of its two car models. It also spends a large proportion of its annual budget on sales promotion and marketing. This includes placing expensive advertisements in upmarket car magazines, and attending many car shows and exhibitions. CCC also has a reputation for paying higher than average salaries to its senior designers and production staff. As a result, staff turnover at CCC is virtually non-existent.

Customers, who are often loyal to a particular manufacturer, can specify modifications to the basic design, such as minor changes to the body shape of the car, or major changes to the engine performance and driving characteristics of the car. The directors of CCC have always assumed that their customers are not particularly price-conscious, as they are often wealthy individuals with high disposable incomes. For these customers, the alternative to buying a car from CCC might be to purchase a yacht or go on a round-the-world cruise.

CCC manufactures most of the components of its cars in-house. The main exceptions are electrical and control equipment, wheels and tyres. The only major bought-in component is the car's engine, which CCC buys from a major car manufacturer and then sends to SSS (a subcontractor) for modification and performance upgrades. While the engine is relatively expensive, it is the work of SSS that represents the single most significant cost of producing each car. CCC has, on occasion, paid SSS the equivalent of 25% of the final sales price of a car.

**The board meeting**

At the most recent board meeting of CCC, the directors discussed the worsening financial position of the organisation. Having spoken to the Sales Manager they came to the conclusion that, with the economies of Y and neighbouring countries in recession, customers had recently become more aggressive in negotiating down the purchase price of their cars. This had put pressure on the profit margin of CCC for the first time in its history.

The directors therefore felt it was necessary to commission an independent review of their industry.

The Finance Director provided the following summary of CCC's performance:

€ million	2005	2004	2003	2002
Revenue	11.75	11.12	10.06	10.10
Pre-tax profit	0.88	1.43	1.55	2.01
Dividend paid	0.08	0.50	0.50	0.50

The directors were particularly alarmed that SSS, the engine modification sub-contractor, seemed to be making almost as much profit on one of the engines as CCC was on the whole car. The Purchasing Manager of CCC said that it was impossible to negotiate a lower price with SSS, as most of CCC's customers specified that their car must have its engine prepared by SSS. The Sales Manager agreed that one of the 'unique selling points' of CCC's cars was the work done by SSS. At present, SSS does not supply engine modification services to any of CCC's competitors, but there is no contractual obligation to prevent it from doing so. The Purchasing Manager reported that CCC has no long-term supply contract with SSS, and the owner-manager of SSS had declined the offer of such a contract, believing that to enter into such an agreement would not be in the best interests of himself and his seven staff.

**Required:**

- (a) Using Porter's 'five forces' model as a framework, evaluate the competitive environment in which CCC operates. (15 marks)
- (b) Advise the directors of CCC how the organisation might overcome the bargaining power of SSS. (10 marks)

**(Total: 25 marks)**