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ACCA Paper P3

Business Analysis

Class Notes

June 2015

Contents

Introduction to the paper

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AIM OF THE PAPER

The aim of the paper is to apply relevant knowledge, skills, and exercise professional judgement in assessing strategic position, determining strategic choice, and implementing strategic action through beneficial business process and structural change; co-ordinating knowledge systems and information technology and by effectively managing processes, projects, and people within financial and other resource constraints.

OUTLINE OF THE SYLLABUS

A. Strategic position

B. Strategic choices

C. Strategic action

D. Business and process change

E. Information technology

F. Project management

G. Financial analysis

H. People

FORMAT OF THE EXAM PAPER

The syllabus is assessed by a three hour paper-based examination.

The examination consists of:

- one 50 mark compulsory case study.
- two from three 25 mark scenarios.

FAQS

How do I get the most from my course?

Try and be seated and pick up your handout by the start of the lecture. This will ensure we have the maximum lecture time. Your course notes will be in divided into chapters, please make sure you bring the relevant chapters with you to class.

Manage your time effectively. If you have a busy work schedule use your study planner to catch up. Do not allow yourself to fall behind.

If you have any difficulties or questions please do not hesitate to contact me either before the lecture or during the break as most students are in a desperate hurry to leave at the end of the lecture. Alternatively, you can always email me or phone me through our helpline.

In the event of an emergency you can come for the same lecture on a corresponding part-time course as all the courses run parallel to each other. It is crucially important that you attend the full course of lectures.

Try to read the business section of a decent newspaper at least once a week to get an idea of what is going on in the business world and the difficulties faced by organisations.

Look at websites such as www.pwc.com to read up on the current state of various industries. For example, from pwc's home page you can go into their reports on industry sectors. These give an overview of what is happening in various industries as well as providing case studies on particular companies.

If you have any questions, please e-mail me at dlaws@lsbf.org.uk

Chapter 1

Strategy

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PAST EXAM REQUIREMENTS

June 2013

Q1 (c) Evaluate the strategic planning project at MidShire Health through each of the three strategy lenses. 10 marks

December 2012

Q2 (a) Evaluate the strategic position of the estate with specific reference to the expectations of stakeholders, to the external environmental factors beyond the control of the estate and to the strategic capabilities of the estate itself. 15 marks

June 2012

Q1 (a) Analyse the financial position of Hammond Shoes and evaluate the proposed investment in upgrading its production facilities. 14 marks

December 2011

Q1 (a) Using appropriate models and frameworks, analyse GET's current strategic position from both an internal and external perspective. 20 marks

June 2010

Q1 (a) Undertake the assessment, required by Sheila Jenkins, of the strategic position of WET. 21 marks

Note: This question required an assessment of the environment, capability, stakeholder expectations and mission of WET.

December 2008

Q1 (c) Examine the different insights each of these lenses gives to understanding the process of strategy development at the National Museum. 10 marks

Note: Requirement (c) includes 2 professional marks.

December 2008

In the context of MMI's corporate-level strategy, explain the rationale for MMI acquiring *First Leisure* and *Boatland* and assess the subsequent performance of the two companies. 15 marks

June 2008

Q1 (b) Write a briefing paper for the CEO to submit to the strategy planning committee explaining why the retail shops division should continue to be a key part of Autofone's future strategy.
15 marks

Note: Requirement (b) includes 3 professional marks.

1.1 RECOGNISE THE FUNDAMENTAL NATURE AND VOCABULARY OF STRATEGY AND STRATEGIC DECISIONS

Strategy can be defined as:

> 'the direction and scope of an organisation over the long-term, which achieves advantage in a changing environment through its configuration of resources and competences with the aim of fulfilling stakeholder expectations'.

The above simply means that strategy is how an organisation attempts to meet its objectives.

An organisation that is responding to changes in the external environment (see chapters 3 and 4) is said to following a position-based strategy (i.e. reacting or anticipating opportunities and threats).

An organisation that concentrates on gaining an advantage because of its own strengths (see chapter 5) is said to be following a resource-based strategy.

There are two extremes when deciding on an organisation's future strategy:

- Strategic planning
- An emergent strategy.

Strategic planning involves formal analysis of each of the stages of strategic position before a final strategic choice is made.

Strategic planning is useful because:

- It forces managers to consider each stage of the strategic process
- It forces managers to justify their actions
- It forces managers to consider the effect of a strategy on all aspects of the business
- It allows managers to be proactive rather than reactive.

Emergent strategies involve no long-term strategic plan – in effect, making up the strategy as the organisation goes along.

An emergent strategy is useful because:

- It allows managers to quickly exploit changing circumstances
- It is quicker and cheaper than strategic planning.

1.2 POSITION, CHOICE AND ACTION

Under the rational planning model, there are a number of stages. Each of these will be discussed in more detail later in the notes.

A summary is:

Stage 1 – Strategic Position

1. Identify key stakeholders and their expectations.
2. Develop **long-term** objectives to satisfy these **stakeholder expectations**.
3. Calculate financial and non-financial ratios to show position of organisation.
4. Identify core **resources and competences** within the organisation.
5. Identify key factors **changing the environment** outside the organisation.
6. Use SWOT analysis (also known as a corporate appraisal) to summarise the strategic position.

Stage 2 – Strategic Choices

1. Consider possible exit from existing industries.
2. Consider diversification into new industries.
3. Consider developing new competitive advantages.
4. Consider entry into new markets.
5. Consider development of new products.

Stage 3 – Strategy into Action

1. Evaluate above options and choose strategy to be followed.
2. Implement any necessary changes in the organisation. This might involve changing processes, people etc.
    - It is unlikely that the Examiner will require you to do all the above.
    - Exam questions tend to focus on just 2 or 3 of the above.

1.3 DISCUSS HOW STRATEGY MAY BE FORMULATED AT THE CORPORATE, BUSINESS AND OPERATIONAL LEVELS

MODEL Johnson and Scholes - three levels of strategy

Corporate Strategy

This looks at the industries in which the organisation operates. This may mean deciding to leave existing areas or enter new ones. This is particularly true if the organisation has a number of divisions.

Business Strategy

This looks at how the organisation (or subsidiary / division) competes. This tends to mean either:

- The division is trying to win customers by being better than rivals in some way.
- The subsidiary is trying to win customers by being cheaper than rivals.

Operational Strategy

This looks at how resources are used to carry out the strategies noted above.

In addition it looks at how areas like processes can be improved to help make the strategy more likely to succeed.

In a large company, corporate strategy will be carried out at Head Office. Business Strategy will usually be done by each division. In a small company, corporate and business strategy all tend to be the same.

1.4 STRATEGIC LENSES

Model Johnson and Scholes – three lenses

This model argues that strategy can be set in different ways:

- Strategy as experience. Here the strategy is basically repeating what has been done in the past.
- Strategy as ideas. Here the strategy aims to encourage innovation. Culture will be very important here.
- Strategy as design. Here the strategy is driven from the top in order to meet the objectives of the organisation. The process is very similar to that given earlier in this chapter.

1.5 HOW STRATEGIC MANAGEMENT IS AFFECTED BY CONTEXT

Since this is an accountancy exam there will obviously be some numbers for you to analyse.

There are two main things to look at:

- the financial performance; and
- the financial position of the organisation.

What is meant by financial performance?

Financial performance looks at the profit / loss of an organisation. In the exam the performance is usually getting better or worse.

Look at the earliest and latest years and calculate:

- The change in revenue
- The change in profit
- The gross / net profit margin (the net may be given).

If the performance is getting better this is usually because of the strengths of the organisation (see later notes).

If the performance is getting worse it usually because the external environment has got worse (see later notes).

If you are given a number of product groups or divisions, also calculate what percentage of the total revenue / profit is being made by each group / division.

What is meant by financial position?

Financial position looks at the balance sheet side of the organisation. In the exam there will usually be some problems arising.

Look at the earliest and latest years and calculate:

- The change in liquidity ratios
- The change in gearing / borrowings.

Note that you will be given data to calculate the financial performance but you might NOT be given data to calculate its position.

What type of organisation do we have?

Not all exam questions are about companies. You may also get public sector organisations or charities. For these kinds of organisations, the key stakeholders will be very important.

Chapter 2

Stakeholders, ethics and culture

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PAST EXAM REQUIREMENTS

June 2012

Q1 (c) Advise the Hammond family on the importance of mission, values and objectives in defining and communicating the strategy of Hammond Shoes. 12 marks

December 2011

Q2 (a) Analyse the culture of iCompute, and assess the implications of your analysis for the company's future performance. 13 marks

December 2010

Q3 (a) Analyse Frigate Ltd using the cultural web or any other appropriate framework for understanding organisational culture. 15 marks

December 2009

Q1 (c) Identify the stakeholders in Ecoba Ltd and analyse how ABCL could successfully manage them during the ownership transition. 10 marks

December 2008

Q1 (b) Assess the underlying organisational cultural issues that would explain the failure of the Director General's strategy at the National Museum. 20 marks

Note: Requirement (b) includes 2 professional marks.

June 2006 (Paper 3.5 previous syllabus)

Q1 (b) Using relevant evaluation criteria, assess how achievable and compatible these three strategic goals are over the next five years. 15 marks

December 2003 (Paper 3.5 previous syllabus)

Q1 (c) Explain how PIT might change from a technology driven culture to a marketing led one. 10 marks

2.1 EVALUATE THE RELATIVE INFLUENCE OF STAKEHOLDERS ON STRATEGY

Stakeholders are those parties interested in the decisions made by an organisation.

Stakeholders can be:

- Internal – employees and managers
- External – shareholders
- Connected – customers and suppliers.

MODEL – Mendelow - stakeholder mapping

There will always be a conflict of interest between what different groups want. For example giving employees better pay levels reduces the profit available for shareholders.

Stakeholders can be divided into:

- High Interest with High Power = Key players
- Low Interest with High Power = Keep satisfied
- High Interest with Low Power = Keep informed
- Low Interest with Low Power = Minimal effort.

Stakeholders matter because objectives should be geared towards the needs of those with high power.

Stakeholders matter because any strategy followed will need to be acceptable to the key players and keep satisfied.

2.2 CORPORATE GOVERNANCE AND ETHICAL INFLUENCES

Johnson and Scholes suggest that corporate governance is about answering two questions:

1. Who is the organisation there to serve (ie who are the key stakeholders?)?
2. How should the priorities of the organisation be decided (ie should strategy e planned or should the organisation be opportunistic?)?

Johnson and Scholes define the main ethical position for a company as:

> The extent to which an organisation will exceed its minimum obligations to shareholders.

The four main ethical positions are:

1. Short-term shareholder interest.
2. Longer-term shareholder interest.
3. Multiple stakeholder obligations.
4. Shaper of society.

Although corporate governance is not a main theme in P3 it is important to remember that poor corporate governance will probably lead to a business under-performing so you may still be examined on elements of good governance.

As a reminder these are that the board should;

- Should lead strategy;
- Should contain a balance between executive/non-executive directors;
- Should meet regularly;
- Should separate the roles of chairman and CEO;
- Have rigorous/transparent nomination: nomination committee consisting of non-executive directors;
- Hold performance reviews annually;
- Require directors to submit for re-election;
- Have a remuneration committee consisting of non-executive directors;
- Should establish a sound system of internal control;
- Should establish an audit committee and be composed of non-executive directors;
- Should consider the need for internal audit;
- Should encourage good relations and communication with shareholders.

2.3 THE SCOPE OF CORPORATE SOCIAL RESPONSIBILITY

To a large extent, corporate social responsibility is just an extension of the ethical stances noted above. The areas covered include:

- Sponsorship of the arts and charitable donations.
- Employee welfare programmes.

There are a number of different viewpoints on what companies should do. For example, companies:

- Exist to make profits for shareholders (who can then use their dividends to help good causes).
- Exist to make long-term profits for shareholders and the way they are perceived by those outside will affect this.
- Exist to try and meet the needs of a variety of stakeholders (many of whom might not be powerful).

2.4 CORE VALUES AND MISSION STATEMENTS

Core values are the principles that guide the behaviour of an organisation.

A mission statement explains to the external world and to those managers making strategic decisions inside the organisation, the basic principles the organisation should be following.

A mission statement will commonly contain the following:

- Purpose of the organisation.
- Overall strategy of the organisation.
- The core values of the organisation.

Supporters of mission statements claim they help:

- Resolve stakeholder conflict.
- To guide managers when setting strategy.
- Communicate the values of the organisation to employees.
- Help with marketing the organisation.

2.5 INTEGRATED REPORTING

Integrated reporting aims to move beyond the traditional annual report aimed solely at shareholders and provide information for a range of stakeholders.

The main idea looks at all the different types of resources (known as capitals) that an organisation has access to. These are;

- financial
- manufactured
- intellectual
- human
- social and relationship
- natural

2.6 THE CULTURAL WEB

MODEL – Johnson and Scholes - the cultural web

Culture is made up of seven elements:

- Rituals and routines – Which procedures are emphasised?
- Symbols – Are status symbols used within the organisation as rewards?
- Control systems – What is most closely monitored?
- Organisational structures – How tall / flat is the organisation?
- Power structures – How much centralisation is there?
- Stories – Does news within the organisation focus on successes or failures?
- The paradigm – What assumptions are taken for granted?

2.7 THE IMPACT OF CULTURE

Organisational culture consists of the beliefs, attitudes, practices and customs to which people are exposed during their interaction with the organisation.

MODEL – Charles Handy - types of culture

- Power – Heavily centralised with few decision-makers. Allows quick responses to changes in the environment.
- Role – Lots of formalised procedures. Can be very useful in an environment that is stable.
- Task – Emphasis on getting the job done rather than following rules. Works well in complex, unstable environments.
- Person – Purpose is purely to look after the individuals (found where self-employed people are the norm).

This may impact on whether a strategy chosen by the directors is likely to be accepted by the employees.

MODEL – Miles and Snow – Strategic cultures

- Defenders – like strategic options that have worked in the past / low risks / secure markets.
- Prospectors – like options that could deliver results even if they entail high risk.
- Analysers – will move into new areas but only after someone else has proved they work.
- Reactors – do not plan ahead.

The above may impact on the type of decisions made by the organisation.

Chapter 3

Environmental issues

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PAST EXAM REQUIREMENTS

December 2013

Q1 (c) Explain the principles of Porter's "diamond" and use it to assess the relative attractiveness of Ceeland and Arboria in providing an environment in which MachineShop's growth ambitions could be achieved. 10 marks

June 2013

Q2 (b) Discuss the potential use of scenarios by NESTA's managers as part of their analysis of NESTA's possible entry into the discount fixed-price retail market in Eurobia. 10 marks

June 2011

Q1 (a) Analyse the external macro-environment and industry environment at EcoCar. 16 marks

June 2010

Q2 (b) Examine, using Porter's Diamond (or an appropriate alternative model/framework), the factors which could influence Swift's decision to move a large a large part of its logistics business to Ecuria. 10 marks

December 2008

Q1 (a) Analyse the macro-environment of the National Museum using a PESTEL analysis. 20 marks

June 2008

Q1 (a) Using an appropriate model or models, analyse the competitive environment of Autofone's retail division. 20 marks

Note: Requirement (a) includes 2 professional marks.

Pilot paper

Q1 (a) Assess the macro-environment of NMS by undertaking a PESTEL analysis. 20 marks

(b) Using appropriate models and financial and quantitative data from the scenario, provide an environmental and financial analysis of NMS, highlighting problem areas. 25 marks

3.1 THE MACRO BUSINESS ENVIRONMENT

In earlier chapters we saw that organisations need to satisfy their key stakeholders. Organisations do this by setting objectives. If these objectives are achieved the stakeholders will be kept happy.

Once these objectives are set, the organisation then needs to decide how to meet the objectives. It is important that the organisation considers what is going on in the outside world.

The business environment is the world in which the organisation operates. There will be factors which might make some strategies more or less likely to succeed.

There are a number of factors which will affect all organisations in the same industry in similar ways. For example most accountancy colleges in the UK would be affected in similar ways by:

- A downturn in the economy.
- Changing laws making it easier for overseas students to obtain visas.
- A trend towards more demand for accountants within the UK public sector.

These general factors are known as the macro-environment.

3.2 WHAT ARE THE KEY DRIVERS OF CHANGE?

In any environment there will be some of the external factors that are more important than others. These are likely to be mentioned in the exam scenario.

If these are not mentioned then the following list is useful.

Model – Johnson and Scholes - Key drivers of change

- Market globalisation
- Cost globalisation
- Global competition.

In addition to the above, if you have a UK company, use:

- Economic – conditions as they are at the time of the exam.
- Environmental – the move towards more environmentally friendly products (this includes things like materials and packaging).
- Legal – minimum wage for unskilled labour.

3.3 HOW CAN THE MACRO ENVIRONMENT BE ANALYSED?

MODEL – PESTEL

- Political – includes government policies on education and infrastructure.
- Economic – includes the state of the economy, interest rates and tax levels.
- Social – includes attitudes, demographics and household structure.
- Technological – includes new technologies making current products obsolete.
- Environmental – includes the move towards environmentally cleaner products.
- Legal – includes changes in law making it, eg, harder / more expensive to operate.

With PESTEL the key things to consider are:

- Is the current environment making it easier or harder for the organisation?
- In the exam things are usually getting harder, look for the financial performance to be getting worse because of this.
- If the environment is making conditions harder, what can the organisation do about it?
- Remember that the macro – environment will effect an entire industry the same way. This means all the organisation's rivals will also be affected.
- If the company is going to move into a new industry what will the conditions be like (different industries will be affected in different ways).

3.4 USING SCENARIO PLANNING TO PREDICT THE FUTURE ENVIRONMENT

It is important that organisations *try* to make some projections of what might happen as their strategy will need to take account of this.

Scenario planning

These methods look at what might happen (scenarios) and then decide what the organisation should do if they occur. They are particularly useful when two possibilities cannot both occur.

For example – there is a possibility that a law could be passed which will make trading conditions more difficult for a company.

Three scenarios could be prepared. What to do if:

- The law is passed
- The law is not passed
- A compromise law is passed.

Note that only one of the above three can happen.

Scenario planning is useful as it forces managers to consider what might happen.

Scenarios can then be drawn up for those situations which would have the most effect on the organisation.

The problems with this approach are:

- The time and cost of preparing scenarios and most of the scenarios will not actually occur.
- There may still be unexpected major environmental influences.

3.5 USING QUANTITATIVE METHODS TO PREDICT THE FUTURE ENVIRONMENT

The main two techniques are:

1. Time Series Analysis.
2. Regression Analysis.

Note it is unlikely you will have to carry out these calculations in the exam but you may have to interpret them.

Time Series Analysis is used when sales tend to be seasonal. The time series is made up of two parts:

- The long-term trend (calculated using moving averages).
- The seasonal variation (calculated as the average of actual figures against the trend).

Regression Analysis is used when sales tend to be steady throughout the year.

The analysis can take a number of external influences on sales (the economy, number of competitors, number of customers etc) and build a mathematical model to predict the future.

Both these models suffer from a number of problems:

- They assume that future performance will reflect what has happened in the past
- They ignore the fact that recent events have more influence than older ones
- They assume that everything which affects the company can be quantified
- They deal poorly with sudden changes in the environment.

You may also have to prepare a basic flexed budget in order to compare actual and budgeted performance. This might also include some basic variances i.e. total materials variance.

These are dealt with in more detail elsewhere in the notes.

3.6 THE COMPETITIVE ADVANTAGE OF NATIONS

MODEL – Porter's national diamond

Companies based in certain countries seem to be more competitive than companies from other countries. Porter's diamond looks at why.

Porter comes up with 4 reasons for this:

- Factor conditions
- Firm strategy, structure and rivalry
- Demand conditions
- Related and supporting industries.

Factor conditions

These include:

- Natural resources
- Climate
- Communications infrastructure
- Knowledge bases and logistics systems.

Firm strategy, structure and rivalry

These include:

- Attitude to short-term profit
- National culture
- Level of domestic rivalry.

Demand conditions

These include:

- Market segmentation of home market
- Sophistication of buyers
- Position within product life-cycle in home market
- Anticipation of buyer needs.

Related and supporting industries

These include:

- Strength of suppliers
- Quality of suppliers.

Chapter 4

Competitors and markets

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CHAPTER CONTENTS

PAST EXAM REQUIREMENTS

June 2013

Q2 (a) Use Porter's five forces framework to assess the attractiveness, to NESTA, of entering the discount fixed price retail market in Eurobia. 15 marks

December 2009

Q1 (a) Using Porter's framework, analyse the business analysis certification industry (BACTI) in Erewhon and assess whether it is an attractive market for ABCL to enter. 20 marks

(b) Write the requested short report evaluating Ecoba Ltd and analysing whether it was the most appropriate and attractive of the three possible acquisition targets for ABCL. 16 marks

Pilot paper

Q1 (a) Assess the macro-environment of NMS by undertaking a PESTEL analysis. 20 marks

(b) Using appropriate models and financial and quantitative data from the scenario, provide an environmental and financial analysis of NMS, highlighting problem areas. 25 marks

June 2006 (Paper 3.5 previous syllabus)

Q2 (a) Using models where appropriate, provide John with an environmental analysis of the conditions affecting the low cost air travel industry. 15 marks

(b) Explain how the process of developing scenarios might help John better understand the macro-environmental factors influencing Airtite's future strategy. 10 marks

June 2003 (Paper 3.5 previous syllabus)

Q1 (b) Assuming the role of Sam's accountant, prepare a report for Sam, evaluating the current position of Hair Care Ltd and highlighting any financial and strategic issues concerning future developments which you feel should be bought to his attention. 20 marks

4.1 INDUSTRY, SECTOR AND CONVERGENCE

An industry is a group of firms selling the same products or close substitutes.

A sector is similar but includes public sector organisations (for example public and private schools are both in the education sector).

Convergence is where industries that were previously been separate become substitutes for each other (this will have an effect on Porter's five forces).

Convergence is of two main types:

1. Supplier-led is where a company decides to offer a wider range of products to its customers. An example would be a supermarket offering insurance services.
2. Market-led is where customers expect a supplier to offer a wider range of products. An example would be a fast food chain offering healthier eating options.

4.2 STRATEGIC GROUPS

A strategic group refers to organisations in the same sector which are competing using similar strategies.

There may be a number of strategic groups within the same industry. For example, there are many shops that sell coffee; however they are not all competing with each other directly. Within this industry there are at least three strategic groups;

- Multi-National corporations, eg Starbucks
- Country specific chains, eg that only operate in one country
- Small independent companies.

It is very unlikely that Starbucks will worry about a new small independent coffee shop opening up in London, but they would worry about McDonalds starting to sell coffee in its restaurants.

Using strategic groups means that the number of rivals to be analysed can be reduced dramatically.

4.3 THE INDUSTRY LIFECYCLE

Industries grow and then shrink over time. It is important for a company to consider which industries it is involved in so that it can deliver profits to shareholders over the long-term.

The stages the industry goes through are:

Introduction

- The industry is only just being established.
- The industry may be seen as a niche.
- At this point there may be only a few competitors (or maybe only one).
- Customers may not be entirely sure why they need the product.

Growth

- An increasing number of customers start to buy the product and reasonable profits can be made.
- The industry becomes more attractive and new competitors attempt to join.

Maturity

- The industry typically goes through a period of consolidation.
- Weaker companies might leave.

Decline

- Customers are buying different products and so total sales are falling.
- The industry may again become a niche.

As part of its corporate strategy, a company should regularly review the industries it is in to decide whether to:

- Exit from existing industries.
- Enter into new ones.

4.4 PORTER'S FIVE FORCES

Porter's 5 forces

Porter's 5 forces model looks at why some industries might be more profitable than others. In general the more of the forces that are favourable within an industry the more profits will be earned. Unfortunately as the industry becomes more attractive then more rivals will want to enter it.

The 5 forces are:

- Competitors (new)
- Competitors (existing)
- Customers
- Suppliers
- Substitutes.

Competitors (new)

New entrants always drive down profit margins (as companies have to spend more on marketing or lower prices to keep customers). New competitors are only kept out by barriers to entry. These barriers include:

- High fixed costs
- High capital requirements.

Competitors (existing)

If there is a lot of rivalry in an industry then profit margins will be lower as companies constantly fight to retain their customers.

There will tend to be higher rivalry (and lower profits) when:

- Market growth is slow.

Customers

Powerful customers prevent companies from putting prices up or implementing other changes.

Customers will be powerful if:

- There is standardisation within the industry (making it easier to switch to another supplier).

Suppliers

Powerful suppliers might put their prices up or impose other changes on the company.

Suppliers will be powerful if:

- There are high switching costs
- There are a limited number of suppliers.

Substitutes

If there are many substitutes for a product then it becomes harder to raise prices.

There are three main kinds of substitute:

- Direct – where the customer buys the same product from a different manufacturer.
- Indirect – where the customer buys a product from a different industry to meet the same need.
- Monetary – where different industries are competing for the same part of a customer’s income.

Note that an organisation might collaborate with another one to reduce some of these threats. For example:

- Organisations could collaborate with their purchases to reduce the power of their suppliers.
- Organisations could collaborate to put up barriers to entry into a market (by co-ordinating a price–cutting campaign).

Based on the external analysis carried out using PESTEL, lifecycle and Porter’s five forces, a company can identify:

- Opportunities to be exploited, eg rising incomes within a particular group of customers.
- Threats to be reduced, eg the possible entry into an industry of a multi-national corporation.

Note that opportunities will potentially make it easier for the organisation to meet its objectives, just as threats will potentially make it harder.

A position-based strategy is one that tries to respond to changes within the external environment.

Chapter 5

Strategic capability

CHAPTER CONTENTS

PAST EXAM REQUIREMENTS

June 2014

Q1 (a) Undertake a SWOT analysis of Reink Co. 20 marks

December 2012

Q4 (c) Discuss how EACH of the above risks (supplier business failure and employee travel) might be avoided or mitigated. 10 marks

June 2012

Q4 (a) Analyse the existing value chain, using it to highlight areas of weakness at Jayne Cox Direct. 12 marks

(b) Evaluate how technology could be used in both the upstream and the downstream supply chain to address the problems identified at Jayne Cox Direct. 13 marks

June 2011

Q1 (c) Analyse how each of these three weaknesses might be addressed at EcoCar. 15 marks

June 2010

Q3 (b) Analyse what new or enhanced competencies the business analysts will require to undertake their proposed new role in the city authority. 7 marks

December 2009

Q2 (a) Analyse the primary activities of the value chain for the product range at IL. 10 marks

(b) Evaluate what changes IL might consider to the primary activities in the value chain to improve their competitiveness, whilst continuing to meet their charitable objectives. 15 marks

June 2009

Q1 (a) Evaluate the current strategic position of *greenTech* using a SWOT analysis. 12 marks

Dec 2007

Q1 (a) Using the information provided in the scenario, evaluate the strengths and weaknesses of ONA and their impact on its performance. Please note that opportunities and threats are NOT required in your evaluation. 20 marks

5.1 RESOURCES AND COMPETENCES

In earlier chapters we have looked at the external environment. This analysis will identify opportunities and threats. In the exam there are often threats to the existing business (or reasons why the business has been performing poorly).

In the exam, there will also be opportunities for the business to grow in different directions. These opportunities will need to be discussed using models (SFA and Ansoff) we will come to later in the notes.

The problem with only looking at the external environment is that it does not consider what the organisation is good or bad at. This section examines the strengths and weaknesses of an organisation.

According to Johnson and Scholes, strategic capability is 'the adequacy and suitability of the **resources and competences** of an organisation for it to survive and prosper'.

Resources are things an organisation has, such as:

- Machinery (tangible)
- Labour skills (intangible)
- Finance (tangible)
- Reputation (intangible)
- Knowledge (intangible).

Competences are the things an organisation does.

MODEL – the nine M's model

This model gives nine possible areas an organisation might be strong in

- Machinery
- Money
- Materials
- Men and Women
- Makeup (culture)
- Markets (products)
- Management information
- Management
- Methods (processes).

Note that the second half of the course deals with areas where an organisation may be upsetting customers by failing to deliver what the customer expects.

An example of a threshold resource would be a supermarket owning enough space to be able to provide a selection of products to its customers.

An example of a threshold competence would be an electronics store being able to train its staff to give advice on the latest products.

In the exam, look at the numbers that the Examiner gives you (particularly ones that do not fit into Financial Accounting areas). These often indicate weaknesses. Examples could include:

- Sales per employee
- Age of machinery
- Time taken to process orders.

5.2 COST CONTROL

One common threshold competence in the exam is cost control.

This is important to public sector organisations as they may have a fixed income.

This is important to companies as they are trying to make a profit. If costs increase then either they have to accept lower profits or attempt to pass this on to customers through higher prices.

The likelihood of costs rising will be affected by the power of the organisation's suppliers.

The possibility of raising sales prices will be affected by the power of customers.

Costs could be reduced through:

- Economies of scale
- Low supply costs
- Sensible design
- Experience.

5.3 SUSTAINING COMPETITIVE ADVANTAGE

Sustainable competitive advantage is about the reasons a customer buys from one firm rather than another.

The key word here is "sustainable", a resource may give an organisation an advantage in the short-term but this will not be sustainable if it is easy for competitors to acquire as well.

Similarly a competence that can easily be copied by others will only give a short-term advantage.

Sustainable competitive advantage will need to focus on resources and capabilities which are:

- Rare (this could include patents or a skill).
- Robust (things that are difficult to imitate). Examples include:
  - Complex procedures
  - Uncertainty to outsiders.
- Difficult for a customer to substitute with something else.

A final thing to remember is that the customer must be willing to pay for this unique resource or core competence.

MODEL – Porter's value chain

Porter divides a business into nine different areas.

The five primary activities are:

- Inbound logistics
- Operations
- Outbound logistics
- Marketing and sales
- Service.

The four secondary activities are:

- Firm infrastructure
- Human Resource Management
- Technology Development
- Procurement.

Porter argues that each cost in the business is one of two types.

- Value-adding – the extra cost is outweighed by the extra the customer is willing to pay
- Non value-adding – the extra cost is not valued by the customer.

The company should be willing to spend money on value-adding costs but should reduce non value-adding costs to a minimum.

There is obviously a link between value-adding costs and the core competences of the organisation. Porter also suggests than non value-adding activities could be outsourced.

MODEL – Porter's value network

This extends the idea of a value chain to include customers and suppliers. For example:

Customer – retailer selling low priced basic products.

The customer value chain will place heavy emphasis on low cost inbound logistics

Means that ↓

The manufacturer's value chain should emphasise low cost production

Means that ↓

The manufacturer will choose suppliers whose value chain emphasises low cost materials.

5.4 THE PRODUCT LIFECYCLE

MODEL – The product life-cycle

One of the most important areas inside the company is the products that it offers. The life-cycle model looks at the market for the product from its first development until sales fall to zero. The stages the life-cycle goes through are:

- Introduction – may be low sales and problems attracting customers
- Growth – product grows in popularity which means new entrants might enter market
- Maturity – profits at their highest but many rivals
- Decline – if exit barriers are high then rivals chasing falling number of customers
- Senility – sales fall to zero.

There are a number of important areas to consider for the exam:

- At the introduction stage – can a company put up barriers to entry to prevent rivals entering as the product becomes popular?
- At the decline stage – can the company modify the product or sell into a new market to take it back to the growth stage?
- Unless the company only has one product it will need to have a balanced portfolio. This means taking profits from mature products to invest in new ones.

Services can differentiated from products since they are:

- Intangible
- Heterogeneous
- Perishable
- Simultaneous.

These make it difficult to make sure that services are delivered in a way that differentiates them from competitors.

5.5 HOW CAN KNOWLEDGE MANAGEMENT BE USED STRATEGICALLY?

The knowledge that an organisation has is a resource that may be difficult for other organisations to acquire and so can be a source of competitive advantage. For this to happen the organisation must record the knowledge of its employees and make it available to others.

Knowledge management is the collective and shared experience accumulated through systems, routines and activities of sharing across the organisation.

MODEL – Nonaka and Takeuchi on tacit and explicit knowledge

Tacit knowledge is knowledge that staff possess. They are often unaware of how important this knowledge is.

Explicit knowledge is knowledge that has been recorded by the organisation.

Nonaka and Takeuchi say knowledge can be transferred by:

- Socialisation
- Externalisation
- Internalisation
- Combination.

Ways that an organisation can try to make knowledge available to all include:

- Office automation systems;
- Groupware
- Intranets
- Expert systems
- Data warehouses
- Data mining software.

Note this will become important again when we look at Harmon's process strategy matrix.

5.6 HOW CAN STRATEGIC CAPABILITY BE IMPROVED?

Once the organisation has analysed the external and internal environments it should be able to identify:

- Strengths
- Weaknesses
- Opportunities
- Threats.

It is important to remember that strengths and weaknesses are in the eye of the customer not the company.

It is important to remember in the exam that opportunities and strengths need to match up. If there is an opportunity for which the organisation does not have a matching strength – then the organisation will not be able to exploit the opportunity.

Strategic capability can be improved by:

- Extending competences
- Ceasing non-essential activities
- Extending best practices
- Adding or improving activities
- Remedying weaknesses.

It is important in the exam to remember that a SWOT analysis is a summary of other models. So if you have used PESTEL to identify threats in the environment, then using SWOT will simply repeat the same threats (and waste your time in the exam).

5.7 HOW CAN AN ORGANISATION DEAL WITH RISK?

All organisations face risks. A risk simply means something happening that is different to what was expected.

MODEL – The TARA Framework

Risks can be:

Transferred – letting someone else worry about them, eg by insuring against them.

Accepted – the organisation takes no further action in relation to the risk.

Reduced – this takes two forms:

- Reducing the impact of the risk by having contingency plans in place.

- Reducing the likelihood of the risk occurring through internal controls.

Avoidance – the organisation stops doing whatever is leading to the potential risk occurring.

Chapter 6

Strategic options

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PAST EXAM REQUIREMENTS

December 2012

Q1 (a) Analyse the performance of each of the four companies described in the scenario and assess each company's potential future contribution to the EA Group portfolio of businesses.
24 marks

June 2012

Q1 (b) Using an appropriate framework (or frameworks) examine the alternative strategic options that Hammond Shoes could consider to secure its future position. 20 marks

December 2010

Q1 (a) In the context of Shoal plc's corporate level strategy, assess the contribution and performance of Shoalfish, ShoalPro and ShoalFarm. Your analysis should include an analysis of the position of each company in the Shoal plc portfolio. 15 marks

December 2007

(c) Identify and evaluate other strategic options ONA could consider to address the airline's current financial and operational weaknesses.
10 marks

Note: requirement (c) includes 2 professional marks.

6.1 HOW CAN ANSOFF'S MATRIX BE USED TO GENERATE STRATEGIC OPTIONS?

MODEL – Ansoff's growth vector matrix

Igor Ansoff came up with a simple method of identifying strategic options. The areas for a business to consider are:

- Should they carry on selling their existing products?
- Should they carry on selling to their existing market (this means the types of customer they already target)?

Note that this can be a business strategy decision (if they continue with the same products to the same market). Perhaps they need to consider improving the quality of their existing products or lowering their prices (and costs).

It could also be a corporate strategy decision (if they decide to move into new areas).

Ansoff comes up with four possibilities:

- Market penetration – existing products and existing markets
- Market development – existing products and a new market
- Product development – new products and an existing market
- Diversification – new products to a new market.

We will look at all of these in turn in this section.

Whichever of these is chosen there is an additional decision to be made. Should the organisation:

- Grow organically – should the organisation launch a new product / go into a new market themselves?
- Grow by acquisition – should the organisation buy another company that sells a new product / operates in a different market?

The company then has to decide how each separate business will be run. Will managers be allowed to make their own decisions or will all decisions be made by Head Office?

The above will all give possibilities in the exam. The most important area to consider is to look at every option and ask three questions:

- Is the strategy suitable – will it help the organisation to achieve its objectives?
- Is the strategy feasible – has the organisation got the resources in order to be successful?
- Is the strategy acceptable – will the key stakeholders support it?

This builds on the strategic analysis discussed in earlier chapters. Because of this the first part of a question usually asks you to carry out the strategic analysis and then the final section asks you to discuss the choices.

Because this is such a large area Ansoff is dealt with in this chapter. The remaining areas are covered in the next chapter.

6.2 WHAT OPTIONS ARE THERE FOR MARKET PENETRATION?

Market penetration means maintaining or building up market share. This could be done through marketing, pricing policies etc. This can also involve trying to get customers to buy the products more often. An alternative would be to buy market share by acquiring a rival offering the same products. Since the business already knows the market and has products this option is usually seen as being low risk.

Another possibility would be to use Porter's value chain / system. This might mean cutting out non-value adding costs, seeking alternative suppliers etc. The idea is that even if market share does not change – profitability could be increased.

MODEL – Porter's generic strategies

A further possibility would be to change HOW the company competes (the business strategy). This means changing the reason why customers should buy the product. Porter comes up with three possibilities:

- Cost leadership
- Product differentiation
- Focussing on a particular type of customer.

Cost leadership means becoming the cheapest supplier of that type of product in the industry as a whole. Note this means if the company has a range of products then they ALL need to be the cheapest of their type. This could be achieved through:

- Changing suppliers
- Economies of scale
- Use of technology etc.

Porter argues that the problem with this strategy is that only one company can be the cheapest.

Product differentiation means becoming better in some way than all the rivals in an industry. Again, if the company has a range of products they ALL need to be better in the same way. This could be achieved through:

- Building up a brand image
- Having special features (a unique resource or core competence) of the product.

Porter argues that the problem with this strategy is that other companies may become even better.

A focus strategy means the company focuses on one particular group of customers. The idea is that the company can concentrate on keeping those customers happy and become the natural provider that customers think of (this puts up a barrier to entry). The problem with this strategy is that eventually the organisation will outgrow the market it has chosen.

Porter's generic strategies are very important for the exam, often the company's current strategy is not working and you will have to advise a change. Be careful to make sure that whatever you advise fits in with the external environment.

MODEL – Johnson and Scholes' strategic clock

Strategies can be placed on a clock

1	No frills	Low price	Low added value

Use for market entry – needs a great deal of customers who are price conscious

2	Low price	Low price	Medium added value

Use cost leadership to provide a better value product than rivals

3	Hybrid	Low price	High added value

Needs low cost base (economies of scale). Can be used short-term to for market entry or to build up market share.

4	Differentiation	Medium price	High added value

Aim is to build up market share by charging reasonable price

5	Focussed differentiation	High price	High added value

Looks for high premium for high degree of differentiation

6	Failing strategy	High price	Medium added value
7	Failing strategy	High price	Low added value
8	Failing strategy	Medium price	Low added value

According to Johnson and Scholes the added value must be at least the same as the price for the strategy to work. This model is very useful for analysing the current position of the company in the exam.

The strategic clock can be particularly useful in times of hyper-competition. This occurs when the external environment is constantly changing in radical ways. One approach would be to take a product that is in sector 4 (differentiation) and reduce its price to move it into sector 3. This might allow the company to introduce a new product into sector 4. A variation would be to keep the existing product in sector 4, but to introduce a cheaper version with less features into sector 3. The main reason being to demonstrate why the higher priced one justifies the extra price.

6.3 WHAT OPTIONS ARE THERE FOR MARKET DEVELOPMENT?

Market development can be of two types:

- Selling to a different type of customer in the same country
- Selling to a different country.

The second option is more common in the exam.

Before expanding abroad – the target country should be analysed using the same methods discussed in earlier chapters (PESTEL, Porter's five forces) to see if it is an attractive place to expand to. The company should also think about whether its current generic strategy is likely to be successful.

A company can attempt to enter a foreign market in a number of ways. The main ones for a manufacturer are:

Direct exporting – selling directly to overseas customers.

- Advantages – the company gets to know the needs of the final customer
- Disadvantages – it may be costly to build up customer awareness.

Indirect exporting – selling to intermediaries such as retailers who then sell to final consumer.

- Advantages – the company gets access to the local company's knowledge
- Disadvantages – the company will not see all of the profits.

Overseas production – the company manufactures and sells the products in the target country.

- Advantages – distribution costs will be reduced
- Disadvantages – may require a large capital investment.

Contract manufacture (licensing) – the product is made abroad by another company.

- Advantages – lower risk since no need to build manufacturing plant
- Disadvantages – may lose control over areas such as quality.

Joint ventures – the company goes into partnership with a local company.

- Advantages – lower risk since local knowledge gained and costs shared
- Disadvantages – lower returns since profits shared.

If an organisation expands abroad by setting up local divisions it also needs to decide how much to adapt products to local markets (independence) and how much it will attempt to co-ordinate activities across the globe.

Low independence / low co-ordination – International divisions

These will use the same products as the home company. The basis for advantage is the products themselves. The main problem is that the products might not meet the needs of local customers.

High independence / low co-ordination – International subsidiaries

Here the subsidiary makes its own decisions to respond to local conditions. This should bring the advantage that products will be more in line with demand. The difficulty is that the lack of co-ordination might lead to additional costs and different strategies being adopted in different countries.

Low independence / high co-ordination – Global product companies

Here the emphasis is on developing products which will meet the needs of customers in many different countries, an example would be large car manufacturers who develop cars to be sold across large groups of customers. This should give economies of scale in production. This approach may not be good for growth.

High independence / high co-ordination – Transnational corporations

The idea here is to attempt to transfer knowledge and capabilities to different countries. This should allow for a global strategy to be pursued but with local variations. An example would be the big accountancy firms. The main disadvantage is the difficulty of meeting local needs and still fitting into the global strategy.

6.4 WHAT OPTIONS ARE THERE FOR PRODUCT DEVELOPMENT?

MODEL – The BCG matrix

The BCG matrix attempts to analyse the products that a company currently offers. The matrix can then be used to suggest what to do with each product. The model looks at two measurements – market share and market growth and divides products into four categories. Because the model uses market growth it can be combined with the life cycle models seen earlier. The categories are:

- Cash cows Low market growth High market share
- Stars High market growth High market share
- Question marks High market growth Low market share
- Dogs Low market growth Low market share.

In the exam you may have to calculate the market share of a product. If the information is available it would also be useful to calculate profit margins for each product.

- Cash cows are in the mature or decline stage of the life cycle:
  - The threat of new competitors is low and the high market share makes the threats from substitutes and existing competitors low as well.
  - This product should be earning reasonable profits.
  - The product cannot grow any further (since the market is already mature).
- Stars also have a high market share:
  - The market is growing (introduction or growth stage of the life-cycle) so new competitors will be attracted into the market
  - Prices may need to be kept low to maintain market share
  - Marketing costs might also need to be high to keep sales up
  - Profits may not be high.
- Question marks have a lot of potential due to the high growth. Decision is whether to:
  - Spend money to build up market share
  - Spend money to hold market share
  - Leave market.
- Dogs have low market share and low growth. They should be closed unless needed by one of the other products.

The company should aim to have a balanced portfolio, with cash cows funding the growth of stars and question marks.

The BCG model (and the life-cycle model) can also be used to look at the industries a company operates in. Again, the company should aim to have a balanced portfolio. This might lead to corporate strategy decisions, for example whether to gradually withdraw from an industry and whether to enter new ones.

6.5 WHAT OPTIONS ARE THERE FOR DIVERSIFICATION?

Related diversification (also known as concentric diversification) means moving into areas that are similar to those the business already operates in.

The idea is use the current strengths of the company to exploit new opportunities. In the exam look for examples of:

- Horizontal integration – eg a shirt manufacturer that starts manufacturing shoes
- Backwards integration – eg a shirt manufacture that starts manufacturing cloth
- Forwards integration – eg a shirt manufacturer that starts retailing clothes.

Backwards and forwards integration:

- Guarantees a supply of raw materials (good if power of suppliers is high in the industry)
- Can build stronger relationships with customers (good if power of customers is high)
- Forward integration works well as part of a differentiation strategy
- Backward integration works well as part of a cost leader strategy
- Makes the company heavily dependent on similar industries
- May make the company unable to exploit economies of scale.

Unrelated diversification (also known as conglomerate diversification) means moving into areas different to those the company is presently in. The idea is simply to exploit new opportunities. Unrelated diversification:

- Spreads risk (if current industries are threatened)
- Allows new profits to be made
- Allow brand stretching
- May lead to a lack of purpose
- Will involve areas the management know little about
- Will require decisions about resources to be made.

Chapter 7

Strategic choice

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CHAPTER CONTENTS

PAST EXAM REQUIREMENTS

June 2014

Q1 (a) Recommend possible strategic options for each quadrant of a TOWS matrix of Reink Co.

12 marks

December 2013

Q1 (a) Internal growth, acquisition and strategic alliances are three methods of pursuing growth.

Explain and evaluate each of these three methods of pursuing growth in the context of MachineShop's development to date and its ambitions for future growth and development. 18 marks

(b) Write a report, using the criteria of suitability, acceptability and feasibility, which evaluates the potential acquisition of FRG, concluding with whether you would recommend MachineShop to acquire FRG. 7 marks

December 2012

Q3 (a) Evaluate the franchising option being considered by Graffoff, highlighting the advantages and disadvantages of this approach from Emile's perspective. 10 marks

(b) Johnson, Scholes and Whittington have identified franchising as a form of strategic alliance.

Evaluate how other forms of strategic alliance might be appropriate approaches to strategy development at Graffoff.

7 marks

(c) A consultant has suggested that Graffoff should be able to completely fund its proposed organic expansion (at a cost of $500,000) through internally generated sources of finance.

Evaluate this claim. 8 marks

June 2012

Q1 (a) Analyse the financial position of Hammond Shoes and evaluate the proposed investment in upgrading its production facilities.

14 marks

December 2011

Q1 (b) Write a report evaluating GET's proposed strategy. 16 marks

June 2011

Q1 (b) Evaluate the financial and non-financial case for and against the outsourcing option. 15 marks

December 2010

Q1 (c) Portfolio managers, synergy managers and parental developers are three corporate rationales for adding value.

Explain each of these separate rationales and their relevance to understanding the overall corporate rationale of Shoal plc.
10 marks

June 2010

Q2 (a) Assess, using both financial and non-financial measures, the attractiveness, from Swift's perspective, of EVM as an acquisition target. 15 marks

June 2009

Q1 (b) Write a briefing paper evaluating the three proposals and justifying the selection of Professor Ag Wang as the best strategic option for *greenTech* to pursue. 20 marks

June 2009

Q3 (b) Explain the key factors that would have made franchising Rock Bottom feasible in 1988, but would have made it unlikely to be successful in 2007. 7 marks

December 2008

Q2 (b) Assess the extent to which the proposed acquisition of *InfoTech* represents an appropriate addition to the MMI portfolio. 10 marks

December 2007

Q2 (a) The CEO of Oceania National Airlines (ONA) has already strongly rejected the re-positioning of ONA as a 'no-frills' low-cost budget airline.

(i) Explain the key features of a 'no frills' low-cost strategy.
4 marks

(ii) Analyse why moving to a no-frills low-cost strategy would be inappropriate for ONA. 16 marks

Note: requirement includes 3 professional marks.

7.1 WHAT IS THE ROLE OF THE PARENT COMPANY?

A small company will consist of a single business. As the company grows (through product development / diversification etc) it becomes harder for a single business to do everything. At this point it is common to split the company into a number of Strategic Business Units (SBUs) with a corporate parent.

Each SBU sells its own products in a particular market using its own knowledge and experience. There will also need to be a Head Office that oversees the operations of the entire company. There may be various functions that are performed by Head Office on behalf of the entire company to gain economies of scale (for example, Human Resources or IT).

Model - Johnson and Scholes strategic rationale

Johnson and Scholes suggest there are three main ways that Head Office (parent, corporate parent etc) can create value in the business:

- **Portfolio Managers** – These businesses find undervalued companies, acquire them and then aim to improve profitability. This might be done by using the functions that already exist, such as a marketing department, to lower costs. These organisations tend to follow a path of unrelated diversification.

The role of the parent is to keep Head Office costs low and will typically provide few centralised services to the SBUs.

- **Synergy** managers – These businesses look for synergies between existing and future SBUs. For example, a company might start providing ACCA courses and then use much of that knowledge to start an SBU delivering CIMA, then another doing AAT etc. This will typically mean attempting to find resources and competences that can be shared between SBUs.

The role of the parent is to know the operations of the SBUs in great detail, so that they can identify potential synergies.

- **Parental developers** – These companies look to use the competencies based at Head Office, such as tight financial control, to improve the performance of all the SBUs. Other possible competences could include marketing ability or Research and Development.

The role of the parent in this situation is that the managers at Head Office should be very clear about what they cannot do cheaply and outsource this.

Whichever approach head office adopts it must be careful to add value to the business. The main ways to do this are through:

- Providing access to resources the individual SBUs could not access on their own (eg financing).
- Achieving economies of scale and synergies that an SBU would not be able to achieve on their own (eg a co-ordinated IT system).
- Giving a strategic direction the SBUs and to co-ordinate their activities.

Head office can also destroy value through:

- High costs outweighing synergies achieved elsewhere.
- Slower response times to changes in the external environment.

7.2 THE ASHRIDGE PORTFOLIO MODEL

This model links with the previous one (particularly the idea of a parental developer) to see which divisions are the most useful to keep and which should be closed or sold off. The idea is that the parent should:

- Build a portfolio of business which can be developed effectively.
- Build skills which will allow them to run the portfolio more effectively.

They classify business into four groups depending on:

- How much overlap there is between the CSFs of the division and of the parent (Feel).
- How much overlap there is between the opportunities for the division and the skills of the head office (Benefit).

The four groups are:

- High Feel / High Benefit

Heartland businesses which gain most benefit from the attention of the parent (concentrate on these).

- High Feel / Low Benefit

Ballast businesses which would be just as viable if they were independent businesses (so leave these ones alone to run themselves).

- Low Feel / High Benefit

Value Trap businesses which do not have much overlap with the skills of the parent (these may have been acquired as a method of unrelated diversification). Unless the parent can develop these skills the business may not be of much benefit.

- Low / Feel / Low Benefit

Alien businesses which should be sold off.

From this follows the idea that the amount of cost being spent by the parent should reflect the value it adds to the divisions.

7.3 THE PUBLIC SECTOR PORTFOLIO MATRIX

This model looks at state owned companies

One axis measures support from the public (taxpayers) and fund holders, for example, government departments.

The other measures how good the service being delivered is.

The interpretation of the four quadrants is:

- Political hot box

- Public sector star

- Golden fleece

- Back drawer

7.4 HOW SHOULD THE COMPANY GROW?

Most companies look to grow. Putting together some of the ideas we have already seen, a company may decide to diversify into an unrelated area because:

- Social changes mean that the new industry is in the growth stage of its life-cycle
- The organisation's existing industries are mature
- The organisation believes its existing competences may assist in the new industry.

Once the company has decided on a suitable method of growing (market development etc), it then has to decide what method to use. Should the company start its own SBU (organic growth), should it acquire a company already operating in the industry or should it use a more flexible approach such as a joint venture?

Reasons for choosing to grow organically include:

- The time spent developing a new product allow the company to understand the market.
- There may be no companies to acquire (if the industry is brand new).
- There are no suitable acquisition targets.
- It may be possible to fund entirely from existing cash flows.
- The same management style and culture can be maintained.
- The company will not have to pay for functions (eg payroll) which it ultimately does not need.
- Acquisitions usually benefit the shareholders of the company being acquired not those of the acquiring company.

Reasons for choosing to grow through acquisition and mergers include:

- They are a relatively quick route into a growing market
- It may be difficult to enter a new market (due to barriers to entry)
- Provides access to resources (eg machinery etc)
- The company may be able to buy a brand name /reputation.

Reasons for choosing to grow through a joint venture include:

- The joint venture partners share the costs (and the risk of failure)
- Close control over operations
- Quick access to knowledge
- It may be the only way to enter a market (because of government policy)
- Synergistic benefits between the partners.

However the problems include:

- Differing objectives between the partners
- Disagreements over operations.

Reasons why two companies may enter into an alliance include:

- The risk is shared between the partners (this is particularly true in technology industries).
- An alliance offers the benefits of working together but it is easier for the partners to leave.
- It allows companies to work together on a specific project but keep their other operations separate.
- It allows for separate cultures to be maintained in each company.

Reasons for expanding through franchising include:

- The franchisor (the company) can expand quickly since much of the capital is being put in by the franchisee (the person who will operate the franchise).
- Since the franchisor co-ordinates the activities of each franchise it allows for synergies.
- The franchisee can attempt to meet local needs.

Note that none of the above is perfect and will work in every situation.

Other types of alliances could include;

- Becoming a boundary-less organisation
    - Hollow
    - Modular
    - Virtual
- Offshoring (or nearshoring)
- Using shared services

7.5 HOW SHOULD A STRATEGY BE CHOSEN?

Model – TOWS Analysis

TOWS analysis simply looks to link up areas from Strategic Analysis.

	Strengths	Weaknesses
Opportunities	Do we have any current strengths that we could use to exploit opportunities	Could we fix some of our weaknesses and use our improved position to exploit opportunities
Threats	Do we have any current strengths that we could use to reduce the impact of threats	Could we fix some of our weaknesses and use our improved position to reduce the impact of threats

7.6 HOW SHOULD A STRATEGY BE EVALUATED?

Model – Johnson and Scholes SFA test

Remember that models such as the BCG matrix and Ansoff can be used to generate strategic options. Once the organisation has come up with these ideas, they need to decide on the best option.

Johnson and Scholes suggest that for any option to be considered seriously it must pass three tests. The option must be:

- Suitable
- Feasible
- Acceptable.

A strategic option is suitable if:

- It builds on strengths/ reduces weaknesses / exploits opportunities / avoids threats.
- Gives a new competitive advantage / maintains an existing one.
- Suits the organisation's culture.
- It fits with the current strategies already being adopted.

A strategic option is feasible if:

- The organisation has enough finance to pursue it.
- The organisation has the rights skills / knowledge / experience to pursue it.
- The company will be able to deal with any responses from competitors.
- The company has enough time to follow the strategy.

A strategic option is acceptable if:

- The additional reward if the strategy is successful is greater than the risk if it is unsuccessful.
- The additional risk is acceptable to shareholders / banks etc.
- It helps the company to meet its financial objectives (ROCE etc) – shareholders.
- Any interest payments will be maintained – banks.
- It does not break any regulations – government.
- It does not adversely affect connected stakeholders – customers / suppliers.

Note that the above means the company needs to have carried out stakeholder analysis and some kind of SWOT analysis.

Chapter 8

Finance Pt 1

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CHAPTER CONTENTS

PAST EXAM REQUIREMENTS

December 2013

Q2 (b) Analyse how introducing a formal budgeting process would address the issues of inaccurate forecasting, low morale and indiscriminate cost cutting at ATD. 10 marks

December 2013

Q3 (b) Using the data provided, show why HGT is losing money and recommend immediate and other short-term changes for HGT, quantifying the increased income or cost savings that these changes should bring. 15 marks

June 2011

Q2 (a) Critically evaluate Barry's comments on the investment appraisal approach used at 8-Hats to evaluate internal jobs. 15 marks

June 2009

Q3 (a) Assess, using the financial information available, the validity of W and P's conclusion. 13 marks

8.1 WHAT IS MANAGING FOR VALUE?

Managers in a company are responsible for generating value for shareholders. In the public sector they need to provide value for money from the resources they are allocated.

In the exam look for ways in which the company could reduce non-value adding costs or increase revenues. This is a fairly quick way to improve performance (remember that cost-cutting will still need to be suitable, feasible and acceptable).

The text may give some clues as to:

- What costs could be cut.
- The power of customers (if it is low then sales prices could be raised).
- The power of suppliers (if it is low then the company could negotiate lower purchase prices).
- The level of rivalry (if it is low then sales prices could be raised).
- The generic strategy being used (if it is differentiation or focus then sales prices could be raised).
- The level of funding.

8.2 STANDARD COSTING

Standard costing is used to make pricing decisions easier. By assuming the same cost for all units, a single price can be set for all of them (otherwise each would cost a slightly different amount).

Notice that standard costing only works if the products are homogenous.

At the end of a period, the actual costs are compared with the standard costs. Based on the results the organisation might need to:

- Change something in the production process.
- Change the prices.

The following are common causes for ADVERSE variances;

• Materials price	Powerful supplier Change of supplier
• Materials usage	Poor quality material
• Labour rate	Powerful supplier
• Labour usage	Poor quality labour
• Overhead efficiency	Poor levels of maintenance
• Sales price	Powerful customers Many substitutes
• Sales volume	Sales lost to new entrants Many competitors

In addition, there may be other external factors (changes in the law, tax etc) which have led to variances.

There is also the possibility that the company just got the standards wrong.

Example (Pilot Paper)

CoolFreeze constructs refrigeration systems for supermarkets, food processing plants, warehouses and other industrial premises. It has a sales forecasting committee consisting of the company's sales manager, procurement manager, production manager and the head of administration. The committee produces annual sales forecasts for the company which they review quarterly. Historically, these forecasts have been reasonably accurate.

In the second quarter of 2009 they revised/produced their estimates for the next four quarters. The predicted unit sales volume and prices are given in figure one.

Figure one: Sales forecast 2009–2010

Year	Quarter	Predicted sales	Predicted sales price	Revenue
2009	3	81	$1,000	$81,000
	4	69	$1,000	$69,000
2010	1	62	$1,000	$62,000
	2	83	$1,000	$83,000

At the meeting that agreed this forecast the sales manager expressed some doubts about the figures. "My team are telling me that it is very tough out there. Companies are not replacing old equipment or constructing new plants. Furthermore, cheaper foreign products are becoming available – undercutting our prices by 10%". Despite these reservations, the sales manager agreed the sales forecasts produced by the committee.

Actual sales performance

The actual sales for the four projected quarters were as follows (figure two).

Figure two: Actual sales 2009 – 2010

Year	Quarter	Predicted sales	Actual sales
2009	3	81	82
	4	69	68
2010	1	62	61
	2	83	50

The sudden drop in quarter 2 sales caused consternation in the boardroom, particularly as it was a quarter when high demand and profits were anticipated. An analysis of the quarter 2 trading is shown in figure three.

The managing director recognises that the actual quarter 2 performance has to be analysed against the budgeted one. "I think everyone here has made mistakes – the sales manager, procurement manager, production manager, administration manager. They all have to take responsibility. We are in this together and now we must pull together to get out of this mess".

Figure three: Analysis of quarter 2 trading; budget and actual

Quarter 2 – 2010	Budget	Actual
Units	83	50
Revenue	$83,000.00	$45,000.00
Raw materials	($29,050.00)	($15,000.00)
Labour	($26,975.00)	($15,750.00)
Fixed overheads	($18,000.00)	($18,000.00)
Operating profit	$8,975.00	($3,750.00)

Required:

Write a briefing paper for the managing director that:

Analyses the quarter 2 – 2010 performance of CoolFreeze. (13 marks)

(25 marks)

8.3 HOW CAN BUDGETS HELP?

A budget is a short-term plan that aims to help the organisation achieve its strategy.

Organisations often begin with a sales budget which is then used to generate production, raw material usage etc. budgets.

If demand is not steady during the year, this might identify various points of the year when limiting factors such as warehouse space, production capacity etc. will appear.

Flexed budgets and variance analysis can be used to compare actual with expected performance. This is particularly important if sales levels are below the original budgeted ones. Managers can see which part of the business have been able to reduce their costs in line with the fall in sales.

Budgets are also useful for analysing the impact of various measures. For example, in an attempt to reduce costs a manager might reduce expenditure on Research and Development. The impact of this can be seen in the sales figures for future periods.

Another issue is whether to involve managers in the budget-setting process.

A top-down budget (set by senior managers) has the advantage that it focuses on the strategic objectives of the organisation.

Involving more junior managers should result in a budget that is more realistic and therefore is more likely to motivate staff (since it is more likely to be achieved).

The fact that junior managers are being included in the budget process should also motivate them.

8.3 MARGINAL COSTING TECHNIQUES

Marginal costing techniques are used a great deal in decision-making. The emphasis is unlikely to be on HOW to do the calculations (although the notes will remind you). Instead the emphasis will probably be to DISCUSS the method used and the DISCUSS the result.

Example (from Pilot Paper)

In response to poor internal investment decisions, Ray has introduced a more formal approach to quantifying costs and benefits in an attempt to prioritise projects that compete for his limited funds and time. His first formal cost-benefit analysis helped him select a new machine for producing certain components in his factory. The results of his analysis are shown in figure one. The cost of the machine was $90,000, with annual maintenance fees of $5,000. Ray has seen the machine working and he believes that he can save the cost of one technician straight away. These savings are shown as reduced staff costs. The manufacturer of the machine claims that the accuracy of the machine leads to reduced wastage of "up to 10%". NMS have detailed measures of the wastage of the current machine and Ray has used this to estimate wastage savings. The increased accuracy of the machine over time is reflected in his estimates. Finally, the manufacturer claims 'energy savings'. NMS currently know the energy costs of the whole factory – but not of individual machines. However, Ray thinks that his estimates for energy savings are realistic. He concludes that "over five years the machine breaks even, so this seems a reasonable business case to me". Overall summary financial data for NMS is presented in figure two.

Figure one: Business case for new machine

Year	0	1	2	3	4
All figures in $000					
Cost of the machine	90				
Maintenance costs	5	5	5	5	5
Reduced staff costs	15	15	15	15	15
Reduced wastage	2	4	6	8	10
Energy savings	2	2	2	2	2

Required:

Discuss the method used by Ray in his decision to purchase the new machine and also the data that the decision is based upon. 10 marks

Limiting factor decisions

This looks at the situation where an organisation has insufficient resources to carry out its strategy in full. This is likely to be as a result of external factors.

Example

Two products, Abel and Baker, are given a final finish by passing them through a spraying process. The product details are as follows:

	Abel	Baker
	$	$
Selling Price	11.00	20.00
Variable Cost	7.00	12.50
Contribution	4.00	7.50
Finishing time in spraying process	1 hour	3 hours

The company can sell all the Abels and Bakers that it can make, but there is a restriction on the capacity of the spraying process. There are 50,000 hours available per month.

Required:

(a) What is the maximum total contribution the company can earn in a month?

(b) If the actions of competitors reduce demand for Abels to a maximum of 20,000 per month, what is the maximum contribution?

Method

- Calculate the contribution per unit of product.
- Calculate contribution per unit of scarce resource.
- Rank products.
- Allocate the scarce resource to the best product.
- Once the demand for that product is satisfied, move on to the next best product and so on until the scarce resource is used up.

What assumptions has the company made?

From a strategic perspective, what should the company do?

Make or buy decisions

A company has to make a decision about whether to purchase from an external supplier or carry out the work itself.

Note this could be purchasing a component or could be referring to an area such as outsourcing.

Example

A firm manufactures 20,000 units of component Abel per annum. The cost of the component is as follows:

	Cost/unit
	$
Direct Materials	1.50
Direct Labour	1.75
Variable Overheads	2.25
Fixed Overheads	4.00
TOTAL COST	9.50

Required:

This component could be bought in for $6.00 and if so, the production capacity utilised at present would be unused. Assuming that there are no overriding technical considerations, assess whether the component should be bought in or manufactured?

Method

- Calculate the relevant cost of making - usually only variable cost.
- Calculate relevant cost of buying - usually the purchase price.
- Choose the cheaper option.

What assumptions has the company made?

From a strategic perspective, what should the company do?

Closure or continuance decisions

This looks at whether a product, division etc should be discontinued / closed down or whether to continue with them.

Example

KL Ltd makes 3 products. KL treats all fixed overheads as general. Next year's forecasted trading results are shown below:

	Product A	Product B	Product C
	$	$	$
Sales	130,000	150,000	170,000
Variable Costs	121,000	135,000	149,000
Share of general Fixed overheads	12,000	12,000	12,000
Profit/Loss	(3,000)	3,000	9,000

Required:

Explain how the company's forecasted profits would be affected if product A were discontinued.

Method

- Focus on the relevant costs and revenues.
- Ignore fixed costs unless *avoidable*.

What assumptions has the company made?

From a strategic perspective, what should the company do?

Special contracts

One off contracts could be used to break into new markets (Ansoff) and as such the pricing is crucial.

Example

JB Ltd is a small specialist manufacturer of electronic components and much of its output is used by the makers of aircraft for both civil and military purposes. A new civil aircraft manufacturer (REL Ltd) has recently entered the industry and is building a prototype plane to demonstrate to various airlines.

REL has offered a contract to JB Ltd for the supply in six months time of a sophisticated electronic warning system to be used in the prototype plane.

If the airlines order the plane, REL expect to be producing 120 planes a month for the next five years and would expect JB to sign a long-term contract to supply the electronic warning system.

The data relating to the production of is as follows:

(1) Material requirements

4,000 kg material M1 – see note (i) below
3,000 kg material P2 – see note (ii) below
1 part no. 678 – see note (iii) below

Notes:

(i) Material M1 is in continuous use by the company. 1,000 kg are currently held in stock at a book value of $3.80/kg but it is known that future purchases will cost $6.50/kg.

(ii) 5,000 kg of material P2 are held in stock. The original cost of this material was $3.50/kg but, as the material has not been required for the last two years, it has been written down to $1.50/kg scrap value. The only foreseeable alternative use is as a substitute for material P4 (in current use) but this would involve further processing costs of $1.60/kg. The current cost of material P4 is $4.60/kg.

(iii) It is estimated that the part no. 678 could be bought for $80,000.

(2) Labour requirements

The component would require 3,000 hours of skilled labour and 4,000 hours of semi-skilled. Employees possessing the necessary skills can be hired for $8/hour. The semi-skilled workers are at present idle through lack of work and there is an agreement with the union that in such circumstances they be paid their normal rate of $5/hr.

(3) Overhead

JB Ltd absorbs overhead by a machine hour rate, currently $20/hour, of which $7 is for variable overhead and $13 for fixed overhead. If this contract is undertaken, it is estimated that fixed costs will increase for the duration of the contract by $300,000. Spare machine capacity is available and the component would require 40,000 machine hours.

A price of $720,000 has been suggested by the customer.

Required:

State whether or not the contract should be accepted and support your conclusion with appropriate figures for presentation to management.

What assumptions has the company made?

From a strategic perspective, what should the company do?

8.4 HOW CAN RATIO ANALYSIS BE USED TO ANALYSE THE STRATEGIC POSITION?

Ratio analysis is used as part of the strategic analysis of an organisation (usually in part a) of a question).

The aim is to identify any financial issues that the company currently faces or might face. The emphasis in the exam will be on calculating simple ratios and interpreting them. The bulk of the marks will be for the interpretation.

Your ratios should support what the text in the question tells you. For example if profit margins are falling, the text will give you a reason why this is happening (new competitors, suppliers increasing costs etc.).

In the exam you have two main approaches:

- Calculate the ratios first and then find the text that tells you why they are changing.
- Read the text and consider which ratios might be affected.

Remember to calculate as few ratios as you need to give an idea of the organisation's position. Calculating too many leaves no time to interpret them and will score few marks.

Remember your interpretation has to explain WHY a ratio has changed. It is not acceptable to say 'the margin has gone up' without saying why!

There are two common themes in exam questions:

- A company is doing poorly (the ratios will indicate this).
- A company is doing well now, but the text will indicate problems in the future (particularly if the last set of figures is a forecast).

If the text gives you separate figures for different products/divisions then calculate ratios for each one as well as an overall position. If this is the case you will probably find one division is doing badly already and another is doing well at the moment but will get worse.

You may have to calculate some non-financial ratios as well. Look particularly for things that effect customers and new products.

Simple percentages

Start with simple numbers such as percentage change in turnover, profit etc.

Profitability ratios

Look at ratios such as:

- Profit margin
- Asset turnover
- Return on capital employed
- Return on investment
- Operating gearing.

These are particularly useful for corporate strategy decisions (whether to close down a division).

Liquidity ratios

Look at ratios such as:

- Current ratio
- Quick ratio
- Receivables days
- Payables days
- Inventory days.

These are useful to identify if the organisation is poor at managing its working capital.

Gearing ratios

Look at ratios such as:

- Capital Gearing (state which one you are using)
- Interest cover.

These are useful to see how feasible it will be to raise more debt.

Stock market ratios

Look at ratios such as:

- Dividend yield
- Earnings per share
- P/E ratio
- Dividend cover.

These are useful to know whether the company's present situation will be acceptable to shareholders.

8.5 WHAT TYPES OF FUNDING ARE AVAILABLE?

There are two main reasons why a company in the exam wants to raise finance:

- It is in trouble and needs to re-finance to carry on in business.
- It wants to expand but does not have the resources to fund the expansion.

The main sources of funding in the exam will be:

- **Share issues**

Will current shareholders be able to put more money into the company or will they accept their shareholding will decrease as new shareholders are involved?

- **Overdrafts**

Will the shareholders accept the added level of risk and the reduction in profits?

- **Fixed term loans**

Will the bank accept the added level of risk and is it feasible to borrow the money?

Remember that if you recommend a strategy which requires financing you will need to check that both the project and the funding are:

- **Suitable**

If the extra revenue is lower than the extra finance costs then the funding is not suitable.

- **Feasible**

If the shareholders cannot raise extra money or the bank will not lend it then the funding is not feasible.

- **Acceptable**

If the company raises debt finance then the added level of risk for the shareholders may not be acceptable.

In other words, an acquisition might be a good idea, but if it cannot be afforded then it is unfeasible.

Chapter 9

Finance Pt 2

CHAPTER CONTENTS

PAST EXAM REQUIREMENTS

December 2013

Q2 (a) Explain and analyse the data in the least squares regression and time series analysis spreadsheets left by the business analyst and evaluate the appropriateness of both techniques to sales forecasting at ATD. 15 marks

December 2012

Q4 (a) Develop a decision tree from the information given in the scenario and discuss its implications and shortcomings. 9 marks

(b) The divisional director suggests that the procurement decision could have been taken on the evidence of the decision tree.

Discuss what other factors (not considered by the decision tree analysis) should also be taken into account when deciding which option to select. 6 marks

December 2011

Q4 (b) Evaluate the potential of each set of statistical data for use in the pricing decision for the e-learning product, particularly highlighting any limitations in using such data. 10 marks

Pilot Paper

Q3 Write a briefing paper for the Managing Director that:

(a) Explains and evaluates the spreadsheet used by the sales forecasting team. 12 marks

9.1 REGRESSION ANALYSIS

In other parts of the course we looked at the impact external factors can have on sales. Organisations need to have some method of predicting what sales levels might be so they can include this as part of their strategic planning.

One quantitative method is to use regression analysis.

Linear regression analysis can be used to make forecast or estimate wherever a linear relation is assumed between two variables, and historical data is available for the analysis.

Linear regression analysis is a statistical technique for identifying a "line of best fit" from a set of data.

If it is assumed that there is a linear relationship between two variables, the technique can be used to quantify this relationship using historical data. The relationship is expressed as:

$$Y = a + bX$$

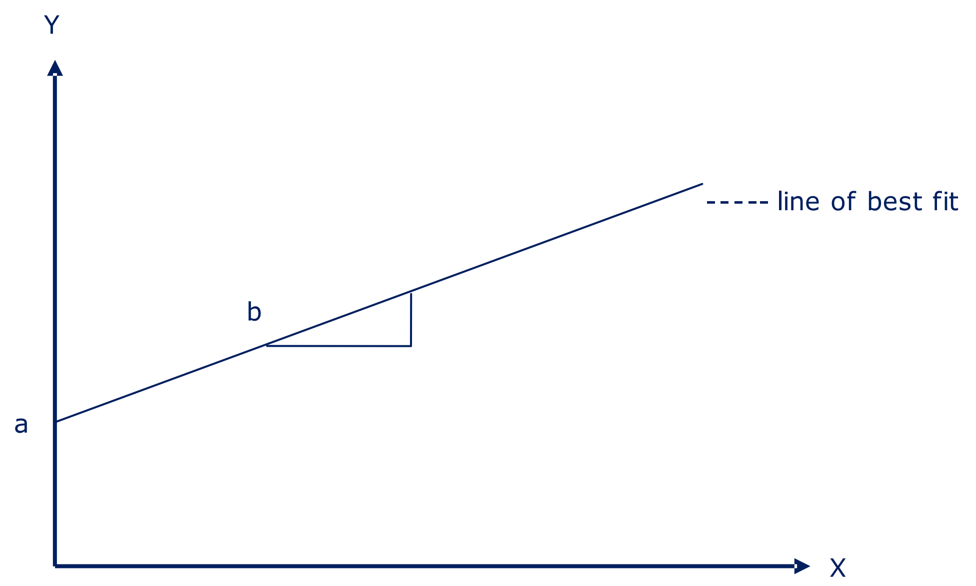
This is the same as equation of a line.

Where:

Y = the value of the dependent variable (its value depends on X)
X = the value of the independent variable (its value can be chosen by the company)
A = intercept
B = gradient

A and B are values obtained from a statistical analysis of historical data for values of X and Y.

This can be deduced from a scatter diagram as follows:



The coefficient of determination (known as "r^2") measures how much of the change in Y is being caused by changes in the value of X.

Example 1

A company has recorded expenditure on advertising and resulting sales for 6 months as follows:

Month	**Marketing spend ($000)**	**Sales ($000)**
	x	*y*
July	40	680
August	80	960
September	100	1,040
October	120	1,200
November	60	880
December	80	1,000

Required:

The line of best fit can be calculated to give b as 6 and a as 480.

The coefficient of determination can be calculated as 0.978492

(a) Interpret the above figures

(b) Forecast sales when advertising expenditure is:

(i) $100,000

(ii) $250,000

and comment on your answers.

Weaknesses of linear regression analysis

The analysis is based on the following assumptions

1. there is a linear relationship between the two variables represented by X and Y.

2. the relationship in the future can be predicted from the relationship in the past.

9.2 TIME SERIES ANALYSIS

Time series is used when demand is seasonal. The idea is to identify any underlying patterns in order to predict the future.

Example 2 (Pilot Paper)

CoolFreeze constructs refrigeration systems for supermarkets, food processing plants, warehouses and other industrial premises. It has a sales forecasting committee consisting of the company's sales manager, procurement manager, production manager and the head of administration. The committee produces annual sales forecasts for the company which they review quarterly. Historically, these forecasts have been reasonably accurate.

In the second quarter of 2009 they revised/produced their estimates for the next four quarters. The predicted unit sales volume and prices are given in figure one.

Figure one: Sales forecast 2009 – 2010

Year	Quarter	Predicted sales	Predicted sales price	Revenue
2009	3	81	$1,000	$81,000
	4	69	$1,000	$69,000
2010	1	62	$1,000	$62,000
	2	83	$1,000	$83,000

At the meeting that agreed this forecast the sales manager expressed some doubts about the figures. "My team are telling me that it is very tough out there. Companies are not replacing old equipment or constructing new plants. Furthermore, cheaper foreign products are becoming available – undercutting our prices by 10%". Despite these reservations, the sales manager agreed the sales forecasts produced by the committee.

Actual sales performance

The actual sales for the four projected quarters were as follows (figure two).

Figure two: Actual sales 2009–2010

Year	Quarter	Predicted sales	Actual sales
2009	3	81	82
	4	69	68
2010	1	62	61
	2	83	50

The sudden drop in quarter 2 sales caused consternation in the boardroom, particularly as it was a quarter when high demand and profits were anticipated. An analysis of the quarter 2 trading is shown in figure three.

The managing director of CoolFreeze has called you in to review the forecasting model used by the sales forecasting team. "It must be very flawed to go so badly wrong. I have the feeling that the model is not based on a well-accepted approach". He has obtained a copy of the spreadsheet used by the sales forecasting team (see figure four) to help you in your analysis.

Figure four: Forecasting spreadsheet

A	B	C	D	E	F	G	H
Part 1							
Year	Quarter	Units		Trend	Variation	Seasonal	Residual
2006	1	56					
	2	70					
	3	74	524	65.50	8.50	7.35	1.15
	4	60	538	67.25	-7.25	-4.73	-2.52
2007	1	60	554	69.25	-9.25	-11.65	2.40
	2	80	570	71.25	8.75	9.02	-0.27
	3	80	582	72.75	7.25	7.35	-0.10
	4	70	586	73.25	-3.25	-4.73	1.48
2008	1	62	588	73.50	-11.50	-11.65	0.15
	2	82	588	73.50	8.50	9.02	-0.52
	3	80	586	73.25	6.75	7.35	-0.60
	4	70	586	73.25	-3.25	-4.73	1.48
2009	1	60	590	73.75	-13.75	-11.65	-2.10
	2	84	590	73.75	10.25	9.02	1.23
	3	82					
	4	68					
Part 2							
	1	2	3	4			
2006			8.50	-7.25			
2007	-9.25	8.75	7.25	-3.25			
2008	-11.50	8.50	6.75	-3.25			
2009	-13.75	10.25					
Total	-34.50	27.50	22.50	-13.75			
Average	-11.50	9.17	7.50	-4.58	0.58		
Adjust	0.15	0.15	0.15	0.15			
NewAvg	-11.65	9.02	7.35	-4.73	0.00		
Forecast							
2009	3	73.50	7.35	81			
	4	73.50	-4.73	69			
2010	1	73.65	-11.65	62			
	2	74.00	9.02	83			

Required:

Write a briefing paper for the managing director that:

Explains and evaluates the spreadsheet used by the sales forecasting team. (12 marks)

9.3 EXPECTED VALUES

Expected values are one technique that can be used when future outcomes are uncertain.

Example

A company is considering launching a new product. The company will have to make an initial investment of $30,000 to buy some special equipment.

It is expected that the project will last 4 years and at the end of the project the equipment can be sold for $2,000.

They have carried out some market research and discovered that the inflows may be either high or low each year with a probability of 0.75 and 0.25 respectively. The actual income figures are given below:

Year	Income with high demand	Income with low demand
1	$12,000	$10,000
2	$13,000	$10,000
3	$13,000	$9,000
4	$14,000	$8,000

Required:

Calculate the expected income each year, and use these figures to calculate the expected NPV, assuming a discount rate of 14%.

Note discount rates are:

Yr 1 = 0.877

Yr 2 = 0.769

Yr 3 = 0.675

Yr 4 = 0.592

What assumptions has the company made?

From a strategic perspective, what should the company do?

Advantages of expected values

1. EV considers all the different possible outcomes and the probability that each will occur.
2. It recognises risk in decision, based on the probabilities of different possible results or outcomes.
3. It expresses risk as a single figure.

Limitations of expected values

1. The EV shows a long term average, so that the EV will not be reached in the short term and is therefore not very suitable for one-off decisions.
2. The accuracy of the results depends on the accuracy of the probability distribution used.
3. EV takes no account of the risk associated with a decision.

9.4 DECISION TREES

A decision tree is another quantitative method for looking at uncertainty.

A decision tree is a diagrammatic approach to solving problems involving probabilities and decision making.

Method

Step 1: Draw the tree from left to right showing appropriate decisions and events/outcomes.

Use □ for a decision point,

and ○ for an outcome point.

Label the tree and cash inflows/outflows and probabilities associated with outcomes.

Step 2: Evaluate the tree from right to left.

* Calculate an expected value at each *outcome* point.

* Select the option to maximise expected payoff at each *decision* point.

Step 3: Recommend a course of action to management.

Example

The Brownhill Manufacturing Company is considering the production of a new consumer item with a five-year product lifetime. In order to manufacture this item it would be necessary to build a new plant. After having considered several alternative strategies, management are left with the following two possibilities.

Strategy A: build a large plant at an estimated cost of £600,000

This strategy faces two types of market conditions: high demand with a probability of 0.7 or low demand with a probability of 0.3. If the demand is high the company can expect to receive an annual cash flow of £250,000 for each of the next five years. If the demand is low the cash flow would consist of a loss of £50,000 each year because of large fixed costs and inefficiencies.

Strategy B: build a small plant at an estimated cost of £350,000

This strategy also faces two types of market conditions: high demand with a probability of 0.7 or low demand with a probability of 0.3. The annual cash flow over the five year period for the small plant is £25,000 if the demand is low and is £150,000 if the demand is high.

All costs and revenues are given in present value terms and should not be discounted.

(a) Draw a decision tree to represent the alternative courses of action open to the company. (5 marks)

(b) Determine the expected return for each possible course of action and hence decide the best course of action for the management of the Brownhill Manufacturing Company. (5 marks)

Chapter 10

Marketing

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CHAPTER CONTENTS

PAST EXAM REQUIREMENTS

June 2014

Q2 (a) Suggest a pricing strategy for iTrain, including an evaluation of the initial price of $750 per delegate suggested by Marco. Your strategy should include both financial and non-financial considerations. 16 marks

(b) Analyse the contribution that physical evidence, people and processes could make to the success of iTrain's entry into the IT certification market 9 marks

December 2013

Q3 (a) Recommend, with justifications, longer-term marketing strategies for HGT. 10 marks

June 2013

Q3 (b) Evaluate how CT could use a CRM system to acquire and retain customers. 10 marks

December 2012

Q1 (c) Discuss the principles, together with the advantages and the disadvantages, of benchmarking in the context of Steeltown Information Technology. 10 marks

December 2011

Q1 (c) Explain and discuss the concepts of Critical success factors and Key performance Indicators in the context of GET and the rail industry. 10 marks

December 2011

Q4 (a) Identify and discuss the factors that need to be taken into consideration when pricing the e-learning product.

15 marks

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June 2011

Q4 (a) Evaluate how the principles of interactivity, intelligence, individualisation and independence of location might be applied in the e-marketing of the products and services of CAR. 16 marks

December 2010

Q2 (b) Evaluate how e-business might help TMP exploit each of the five elements of the marketing mix identified by the marketing director. 20 marks

June 2008

Q3 (b) Evaluate how the marketing manager might use electronic marketing (including the internet) to vary the marketing mix at AEC. 15 marks

10.1 WHAT IS MARKET SEGMENTATION?

Customers do not all want the same things from products. For example there are many things that different customers might want from a car.

A company could have a single product that it markets to all customers regardless of what the customer actually wants. In a large number of cases this will probably be unsuccessful. This is known as undifferentiated marketing.

Alternatively a company could manufacture unique products and services to meet individual requirements. This is common in industries such as kitchen design.

Many industries do not fit either of the above and so a company has to try and group together customers who have similar needs and design products aimed at that group. This is known as market segmentation.

Note that for a small company concentrating on one market segment is very similar to following Porter's niche strategy. This is also known as concentrated marketing.

A company can attempt to sell its products in as many segments as it likes. The key thing is that the company will need to design different products to meet the different needs of different customers (see marketing mix below).

Model – Value based marketing

One area often ignored by companies is that not all customers cost the same amount to look after or generate the same revenue. Some customers may expect to pay discounted rates, others cost more to attract in the first place, in other words the company does not make the same amount of money on all of them. Using Activity Based Costing, the company can identify the true cost of each customer. The idea behind VBM is to identify these low-margin customers/ segments and charge them more (or even encourage them to leave).

The above might also be used to identify key customers. These can then be assessed to consider what they are likely to do in the future. For example, a key customer is powerful, so what happens if:

- They were to move to another supplier (how can we reduce the chance of this happening?).
- They were to go out of business (is it in our long-term interest to help them survive?).

10.2 HOW CAN MARKETS BE SEGMENTED?

There are a number of different ways that markets can be segmented. These include:

- Business to business (B2B) v Business to consumer (B2C)
- Government v Non government
- Geographic segmentation
- Lifestyle
- Behaviour
- Social
- Use of product (this fits in with Porter's value system seen earlier)
- Frequency of demand
- Volume of demand
- Size of customer.

This leads to the idea of differentiated marketing, where different products are developed to meet the needs of customers in different segments.

Once the segments have been identified the company will need to decide whether it is worth pursuing the customers in that segment. Amongst the questions the business should ask are:

- Is the segment large enough to be profitable?
- Can the product / service be delivered to the customers?
- Can the product / service be priced to make a profit?
- Is the segment sustainable (i.e. where in the life-cycle is it)?
- Are there barriers to entry which might prevent the business reaching the segment?

Note the link here with Ansoff:

- Attempting to sell more items to the same segment (e.g. lowering prices) is similar to market penetration
- Moving into a new geographical segment is similar to Ansoff's market development strategy.
- Moving into a new segment might result in related diversification.

10.3 WHAT IS THE MARKETING MIX?

MODEL – The marketing mix

The marketing mix states that once a market segment has been identified then the following needs to be decided.

Product (what the Customer receives)

Customers are placed into segments because they have similar needs. The product must satisfy these needs. This is sometimes refined to include:

- Actual product e.g. a flight from the UK to the US
- Augmented product e.g. being able to check in online.

Note that companies use the ways the product is augmented to differentiate themselves (this is also known as product positioning)

Price (the Cost to the customer)

There are a number of things which might influence the price that can be charged including:

- External factors such as:
  - Competitors
  - Economy.

These can be identified through PEST, Porter's five forces and life-cycle analysis.

- Internal factors such as:
  - Required return
  - Cost of manufacture.

The key idea is to charge a price that fits in with the product being offered. It is possible to charge too low a price as well as one which is too high.

Place (the Convenience to the customer)

The customer must be able to purchase the product. This could be directly from the manufacturer or indirectly through an intermediary. Sometimes this will mean the customer going to the seller (e.g. going to a department store to buy clothes). On other occasions the seller will deliver the product to the customer.

The idea again is that this should fit with what the customer wants from the product.

Promotion (how does the company Communicate with the customer)

There are many ways companies can attempt to increase sales but most come back to either:

- Pull promotions – these are aimed at the customer to attract them to purchase the product.
- Push promotions – these are aimed at retailers to encourage them to purchase the product (and so promote it to their own customers).

The company also needs to consider who it is trying to communicate with. Possibilities include:

- The user (also known as the consumer)
- A gatekeeper
- An influencer
- The buyer (also known as the customer).

The above four elements are for any product or service offered. There are three other elements that may also be important for services:

- People
- Processes (particularly if a service can be augmented or delivered more easily)
- Physical evidence.

10.4 STRATEGIC ASPECTS OF PRICING

Earlier we gave a definition of strategy as;

> 'the direction and scope of an organisation over the long-term, which achieves advantage in a changing environment through its configuration of resources and competences with the aim of fulfilling stakeholder expectations'.

Most of the organisations in the exam will be companies. One of the key stakeholder groups will be shareholders who will expect profits.

A company does this through obtaining an advantage over other companies. Porter identified two of the generic strategies as;

1. **Cost leadership** – becoming the cheapest supplier of that type of product in the industry as a whole. The implication here is that prices will need to be lower than rivals. This could be through the use of penetration pricing – setting a low price in the short-term to:
   - enter an existing market
   - build market share in an existing market
   - build up a new market.
2. **Product differentiation** – becoming better in some way than all the rivals in an industry. The implication here is that prices will be higher than competitors because the product is adding value to customers in some way. This could be though the use of price skimming. Note the links here with:
   - Porter's value chain – identifying what activities add value to the customer.
   - Strategic clock – identifying the relationship between the added value and the price.

10.5 COSTING METHODS AND THEIR IMPACT ON PRICING

Many of the factors that impact on pricing are external:

Customers – how much can / are they willing to pay?

Competitors – how much are they charging?

One of the major factors affecting prices will be the costs involved in delivering the product.

Most companies make a number of products and the way that costs are calculated will have a large impact.

For example, which costs are direct and which are indirect? It may be difficult to calculate this for service industries.

In addition, the method that is used to absorb overheads into products will affect their cost and therefore the selling price.

The company may even consider moving to an Activity Based Costing system which will again change the costs of each product.

The above could be used as part of a closure / continuance question. As an example:

- if the price cannot be changed (due to external factors), and
- the costs have now changed (the overheads are being absorbed in a different way)

Should one of the products be closed or continued?

It is important in P3 to remember that the total overheads will not change whatever method is used to absorb them, there may be other reasons to keep selling a product even if it appears to be loss-making.

For example, changing from a labour hour rate to a machine hour rate may have a large impact on the cost of a product.

Example 1

	Product A	Product B
No of units	10,000	10,000
Labour hours per unit	10	1
Machine hours per unit	3	8

Total overheads are $550,000, calculate the overhead cost per unit of each product if overheads are absorbed using:

- Labour hours
- Machine hours

10.6 CRITICAL SUCCESS FACTORS AND KEY PERFORMANCE INDICATORS

Critical success factors are those elements that an organisation must perform properly in order to succeed. These often link with competences.

- Threshold competences – it is critical that the organisation meets or exceeds the minimum standards expected by customers. For example, if a company sells products to a supermarket, then the supermarket will expect deliveries to be on-time.
- Core competences – these are what gives the company its competitive advantage and so it is critical that they are meeting the expectations of the customer (who will be paying a premium for the products / services).

In the example of the supermarket, a key performance indicator would be the percentage of deliveries that were late. The company should monitor this constantly, if this figure starts to rise, corrective action will need to be taken immediately or the company will risk losing the contract.

A common way of thinking about KPI's is to group them into various categories. One common approach is to use:

- Economy – the amount spent on inputs (materials, labour, marketing etc).
- Effectiveness – whether customers are satisfied with the products / services provided (customer satisfaction, repeat customers etc).
- Efficiency – how good the organisation is at turning inputs into outputs (wastage, idle time etc).

10.7 BENCHMARKING

KPIs need to be compared with something; on their own they are meaningless. In the supermarket example, if the company discovers that 1.46% of deliveries are late, this does not tell them whether there is a problem to be resolved. Instead they will need to be benchmarked, i.e. compared, with something.

There are various types of benchmarking:

- Historical - comparisons are made between actual and past figure to see if the organisation is improving / deteriorating.
- Strategic– comparisons are made between actual and budget (note that the budget should be set at a level so that meeting the budget should mean the critical success factor is achieved).
- Industry – comparisons are made between actual and performance of others to see if we are performing better or worse than our rivals (this will identify strengths and weaknesses).

Benchmarking has a number of potential problems:

- Obtaining the information (particularly for industry benchmarking).
- It does not say why the organisation is performing worse than rivals.
- Managers may focus on what is being measured.
- Managers may feel that benchmarking will be used to punish their performance rather than identifying areas to improve.

Chapter 11

Improving business processes

CHAPTER CONTENTS

PAST EXAM REQUIREMENTS

June 2014

Q3 (a) Suggest a process for evaluating, selecting and implementing a software package solution and explain how this process would have prevented the problems experienced at Bridge Co in the Custcare CRM application. 15 marks

(b) Explain, with reference to the CRM project at Bridge Co., the advantages of adopting a software package approach to fulfilling business system requirements compared with a bespoke software solution. 10 marks

June 2013

Q3 (a) Use Harmon's process-strategy matrix to analyse the characteristics of each of the three process areas defined above and suggest how each should be sourced an implemented at CT. 15 marks

June 2012

Q2 (a) Critically evaluate the decision made by the CEO to use a software package approach to automating the production process at Flexipipe, and explain why this approach was unlikely to succeed. 12 marks

(b) Analyse how a formal process for software package procurement, evaluation and implementation would have addressed the problems experienced in the production process project. 13 marks

December 2011

Q2 (b) Evaluate using an appropriate framework or model, the suitability of iCompute's current approach to each of the high level business processes. 12 marks

June 2011

Q3 (a) Identify a range of re-design options the IAA could consider for improving their question handling process.
of each option.

Evaluate the benefits 15 marks

Q3 (b) Explain the advantage of fulfilling users' requirements using a software package solution and discuss the implications of this solution for process re-design at IAA. 10 marks

June 2010

Q1 (b) Analyse faults in the current membership renewal process that cause the problems identified above. Suggest solutions which would remedy these faults. 15 marks

June 2010

Q3 (a) Evaluate the potential benefits to the city authority and its IT employees, of outsourcing IT to ProTech-Public. 12 marks

December 2009

Q3 (b) (i) Explain, using Harmon's process-strategy matrix, how the complexity and strategic importance of process initiatives can be classified. 4 marks

(ii) Recommend and justify a solution option for each of the three process initiatives. 9 marks

June 2009

Q1 (c) (i) Identify deficiencies in the current internet-based process for ordering and configuring fully assembled green computers. Recommend a new process, together with its implications, for remedying these deficiencies. 10 marks

(ii) Analyse the relationship between process design and strategic planning using the context of *greenTech* to illustrate your answer. 8 marks

June 2009

Q4 (b) Examine FOUR ways in which OneEnergy failed to follow a proper evaluation procedure in the selection of the RitePay software package. Include in your examination a discussion of the implications of each failing. 12 marks

June 2008

Q2 (a) Suggest and justify recommendations to the BAC for each of the following major process areas:

(i) Attendance of repair staff at breakdowns

(ii) Membership renewal

(iii) Vehicle insurance services

(iv) Membership queries

(v) Vehicle history checks. 15 marks

(b) Analyse the advantages that 3C will gain from the decision to outsource the purchase and maintenance of their own vehicles. 10 marks

11.1 WHAT ARE BUSINESS PROCESSES?

Businesses deliver products through processes, many of which are hidden from the customer. For example you are studying with us. From your point of view the process has been simple (we hope!).

You:

- Booked the class.
- Turned up at the lectures.
- Received the material.

That's it.

From our point of view the process is quite complicated. Look at the process for getting notes to you.

We:

- Checked any changes to the syllabus.
- Reviewed the previous exam sitting.
- Checked any new articles by the Examiner.
- Wrote / updated the notes.
- Decided on a suitable format for the notes.
- Sent the notes to a typist to be put into the new format.
- Had the new version formatted.
- Had the notes returned from the typist.
- Checked the new version.
- Sent any changes back to the typist.
- Received a final version back from the typist.
- Did a forecast of how many copies would be needed.
- Delivered the master copy to the printers.
- Received the notes back from the printers.
- Stored the notes until needed.
- Delivered the notes to the correct classroom on the correct day.

Etc.

All these stages take time and cost money. Some are aimed at external customers and some are aimed at internal customers. In addition, someone has to be responsible for making sure each stage happens and that any problems are solved.

Also notice that a process can be thought of as a competence (something an organisation does). This could be giving the organisation a competitive advantage.

Also notice that for any strategy to succeed, the business processes must support that strategy. In other words, if the organisation is trying to be a:

- cost leader – all the processes will need to be efficient
- product differentiator – all the processes will have to help the differentiation.

All processes must be as efficient and effective as possible in order to support the strategy.

This means the organisation will need some method of measuring performance.

One common method is to use the balanced scorecard. Processes can be measured to see if they are helping the following perspectives:

- Financial
- Customers
- Internal business
- Innovation and learning.

11.2 HOW CAN BUSINESS PROCESSES BE IMPROVED?

Business processes become outdated and need to be updated just like products.

Some processes are relatively straightforward and do not need to be changed often (eg payroll). Process improvement is used to gradually make these better. This often means making the process simpler.

Some processes could be changed dramatically to exploit an opportunity, minimise a threat or remedy a weakness (eg delivering classes over the internet. Changing the fundamental processes is known as process re-engineering.

Anything between the two is known as process re-design. Porter's value chain could be used to see if they add any value. If not they should be streamlined to save money.

Model Hammer and Champy – business process re-engineering (BPR)

The ideas behind BPR are:

- Managers try to see how processes affect each other.
- Try to think of one continuous process from when the customer makes contact with the company until payment is received.
- This long process can then be broken down into a number of smaller processes.
- IT can be used to make processes more efficient /effective.
- Look at the processes from the customer's point of view.

Model Rummler and Brache – gaps and disconnects

The emphasis in this model is on the problems involved when different department need to communicate. This identifies three levels where problems occur:

- The organisation as a whole.
- The process.
- The job.

They also divide the types of problem into three kinds:

- Those to do with departments trying to pursue different goals (possible because their performance is being measured in different ways).
- Those to do with processes being poorly designed or being implemented poorly.
- Those to do with processes being managed poorly.

Model - Swim Lane diagrams

These are simply diagrams that show a business process as it passes through various departments within an organisation.

The Examiner usually gives a description of the process as well.

The idea will be to make the process more efficient and / or more effective.

Process improvement would mean changing the way one task is done or who performs it.

Process redesign would mean removing an entire department from the process or moving when a task is carried out.

Process re-engineering would mean removing two or three departments and replacing them with some form of IT solution.

Model Harmon's process-strategy matrix

There are four approaches to change depending on:

- Is the process strategically important? (does it tie up with SWOT?); and
- Is the process complex?

This leads to:

- High importance / complex Improve processes focusing on staff
- High importance / simple Use an automated ERP solution
- Low importance / complex Outsource
- Low importance / simple Automate.

11.3 BUSINESS PROCESS OUTSOURCING

Some textbooks refer to the "commoditisation" of processes. This means they can be thought of as items to be purchased, just like labour or materials.

Should a company manufacture a product or purchase it? Obviously if it is cheaper to purchase the product then that is what the company should do.

Companies can look at doing exactly the same with processes. Common examples are to outsource:

- Cleaning
- Invoice processing
- Receivables collection
- Payroll
- Machine maintenance
- Distribution.

It will often be more efficient to outsource these since the outsourcing company can obtain economies of scale.

Similarly the outsourcing company may be a specialist leading to the process being performed more effectively. Example of this kind of outsourcing could include:

- IT development
- Marketing
- Publishing
- Training.

Problems with outsourcing processes include:

- Fragmentation of complex processes (outsourcers can only do part of the process).
- Concerns with relying on others for key business processes.
- Concerns about quality.
- Unwillingness to be locked into long-term contracts.

11.4 EVALUATING BUSINESS PROCESSES

In the exam, processes are likely to be inefficient or ineffective. Look for steps in the process that are likely to:

- Take a long time
- Be overly complicated
- Rely on others to do something important
- Not be user-friendly
- Upset customers.

There are a number of different approaches to improving the processes depending on how serious the problems are.

Process improvement methods

- Lean processes – eliminate non-value adding activities or time between activities.
- Human performance analysis – re-design incentives, improve training.

Process redesign methods

- Automate activities.
- Integrate processes – to reduce gaps and disconnects.
- Process Measurement schemes – develop or redesign the way performance is measured.

Process re-engineering methods

- Use a BPR approach.

Whichever of the above approaches is used, the new process must be

- Suitable
- Feasible
- Acceptable.

11.5 HOW CAN WE ASSESS AND SELECT SOFTWARE PACKAGES?

There are a number of software packages available to assist with redesigning processes. The most basic of them are known as Enterprise Resource Planning systems.

These packages tend to provide standard solutions, for example, to carry out the work of the sales ledger (this may not be ideal for a particular company). These might then be adapted to meet the particular needs of the company. The advantage of using these generic packages is that they:

- are relatively cheap
- are readily available.
- should not contain errors
- be easy to train staff on.

ERPs can be assessed by looking at:

- Functional requirements – these should come from the end-users
- Non-functional requirements
- Technical requirements
- Design requirements
- Supplier stability requirements
- Supplier citizenship requirements
- Initial implementation requirements
- Operability requirements
- Cost constraints
- Time constraints.

Model – Skidmore and Eva – stages in selecting software package

The company may decide to have a software package written especially (known as a bespoke package). There are five stages the company goes through:

- Obtain tenders
- First pass selection
- Second pass selection
- Implementation
- Managing long-term relationship.

Chapter 12

E-business

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CHAPTER CONTENTS

PAST EXAM REQUIREMENTS

December 2013

Q4 (a) Analyse how the principles of interactivity, individualisation, intelligence and independence of location offered by the internet and other new media could be exploited by Victor in his development of a new business model for the BA Times. 15 marks

(b) Write a short report which addresses the specific concerns Victor has about the effect of any potential technology or media change on his subscribers, on his advertisers and on the financial viability of his company. 10 marks

December 2012

Q2 (b) Discuss how the website could be further developed to address some of the issues highlighted in the survey. 10 marks

December 2011

Q3 (c) Identify and discuss the potential benefits to HomeDeliver of the new ordering system. 7 marks

June 2011

Q4 (b) Explain the principles of e-procurement and evaluate its potential application at CAR. 9 marks

December 2010

Q2 (a) Determine the main drivers for the adoption of e-business at TMP and identify potential barriers to its adoption. 5 marks

December 2010

Q4 (b) Evaluate the perceived benefits and costs of adopting e-assessment at the IAA. 15 marks

June 2010

Q1 (c) Evaluate how email and website technology might facilitate the acquisition and retention of WET's customers and support WET's aim to gain increased revenues from members and donors.

10 marks

June 2008

Q3 (a) Explain, in the context of AEC, how the marketing characteristics of electronic media (such as the internet) differ from those of traditional marketing media such as advertising and direct mail.

10 marks

12.1 WHAT IS E-BUSINESS?

We saw earlier in the notes that companies need to re-design business processes to make them:

- Faster
- Cheaper.

E-business can be defined as 'the transformation of key business processes through the use of internet technologies'. Note in this definition:

- Transformation – changing radically.
- Key – the most important ones.

The above definition does NOT mean that goods / services have to be sold to customers over the internet – this is referred to as e-commerce.

Benefits of adopting e-business include:

- Cost reduction
- Capability
- Communication
- Control
- Customer service
- Competitive.

The major forms of e-commerce are:

- Business to Business – B2B
- Business to Consumer – B2C
- Consumer to Business – C2B
- Consumer to Consumer – C2C

All of these allow:

- Access to more customers
- Lowering of costs
- Faster response times.

A company may also be forced to adopt e-commerce because their rivals are i.e. fitting in with the external environment.

There may also be barriers within an organisation that prevent the adoption of e-business. These might include;

- Setup and maintenance costs
- Lack of knowledge / skills
- Fear of upsetting existing customers (in a B2B situation).

It is important to remember that e-business or e-commerce will only give a company an advantage if:

- They are better at it than others
- Their name/brand is associated with a particular type of transaction (egg Amazon or Google).

Model – McFarlan's grid

McFarlan's grid looks at how important IT is to the organisation, in particular, how it can help with the organisation's strategy.

The grid looks at:

- The impact of current IT systems on gaining an advantage.
- The potential impact of future IT systems on gaining an advantage.

This gives four boxes:

1. Current Low / Future low Support

IT is useful but no advantage is being achieved (e.g. payroll).

2. Current High / Future low Factory

IT is crucial to the current operations but it is unlikely that it can be developed further to give an advantage in the future(e.g. a JIT system).

3. Current Low / Future High Turnaround

IT can be used to develop new advantages over the long-term (e.g. Amazon's Kindle e-reader and store).

4. Current High / Future High Strategic

IT will be fundamental to the ongoing success of the business.

12.2 WHAT ARE E-COMMERCE STRATEGIES?

There are various social trends that are increasing the influence of the internet. These include:

- New distribution channels
- Power moving to the consumer
- Growing international competition
- Increased dynamism
- Growth of knowledge as a strategic asset.

Revenue can be generated from e-commerce through:

- Sales
- Transaction fees (eg eBay)
- Advertising
- Subscription (eg The Times)
- Affiliate links (eg payments for links clicked through).

E-business and e-commerce will be aided by:

- Intranets
- The internet
- Extranets
- Amazon or Google.

12.3 E-BUSINESS AND THE UPSTREAM SUPPLY CHAIN

The supply chain is the intermediate stages that a product goes through before ending up with the consumer.

The most basic type of supply chain would be:

- Raw materials manufacturer
- Finished Goods manufacturer
- Retailer
- Consumer.

This is very similar to the value system, the only difference is the supply chain does not look at how value is being added.

The analogy used here is that the supply chain is like a river running downstream to the consumer. Upstream therefore means moving away from the consumer.

The up-stream supply chain is mainly concerned with procurement and inbound logistics. A company using e-procurement in these areas could:

- Reduce purchasing costs
- Reduce stock levels
- Have greater control over stock levels
- Source worldwide
- Speed up manufacturing cycle.
- Acceptable.

The risks associated with e-procurement include:

- Loss of control over purchases being made by the company.
- There is a risk that the software does not work or that it is not used properly.
- Security of data.
- Difficulty of controlling finance.

As an example of e-procurement, many car companies basically design a car, outsource the production of all the components and then carry out final assembly.

This use of IT is known as virtual integration (as opposed to Ansoff's vertical integration).

12.4 E-BUSINESS AND THE DOWNSTREAM SUPPLY CHAIN

The down-stream supply chain is mainly concerned with outbound logistics and marketing. A company using e-business in these areas could:

- Reduce selling costs
- Have access to more customers
- Have access to global markets
- Have better information about customer needs.

The supply chain has traditionally revolved around what is known as "push" marketing. In this, a company makes a product and then "pushes" it towards the consumer hoping the consumer will buy it.

Using e-business can transform this into "pull" marketing. Under this approach, the company only makes something when the consumer orders it.

This might lead to customers dealing directly with the company and bypassing a traditional retailer. This process is known as disintermediation.

12.5 E-MARKETING

The internet an assist companies with their marketing. The main areas the internet can help are:

- Creating awareness
- Branding
- Incentives
- Generating customer leads
- Customer services
- Performing transactions online.

This can be done through:

- Websites
- Customer loyalty cards
- Use of search engines and social network sites.

The internet can assist with each of the seven marketing areas:

- Product – this can be done individually for different customers.
- Price – can be different for different customers, eg locations.
- Promotion – can be more focussed on areas the customer is likely to see.
- Place – products can potentially be made available anywhere.
- People – can be highlighted (eg through video technology).
- Process – can be made faster.
- Physical evidence. – may disappear for some services.

Many companies use exactly the same brand on the internet as they do in physical stores, eg Tesco.

Other companies use a very similar brand name, eg ING Direct.

Alternatives are to link with a well-known company, eg Occado sells Waitrose products.

Model – 6Is for e-marketing

1. **Interactivity** – Customers can be asked for contact details.
2. **Integration** – Adverts on the web can be clicked to go straight to purchasing.
3. **Intelligence** – websites can record how many visitors they have and what they do on the website.
4. **Industry** structure – Websites can change distribution channels (by cutting out intermediaries and selling direct).
5. **Independence** of location.
6. **Individualisation** – if a customer regularly visits a website it can be tailored to that individual.

12.6 CUSTOMER RELATIONSHIP MANAGEMENT

CRM is the establishment, development, maintenance and optimisation of long-term mutually valuable relationships between consumers and organisations.

CRM has many benefits including:

- Improved retention
- Improved cross-selling
- Improved profitability.

Model – Adcock's guide to CRM

In order to build relationships with customers, businesses need to:

- Build a customer database
- Develop customer oriented service systems
- Have more direct contacts with customers.

As part of this process, businesses should think about their long-term relationship with customers and what that is likely to be worth over the customer's lifetime.

Model – The customer life-cycle

The relationship with customers goes through four stages.

- Customer selection – What types of customer do we want?
- Customer acquisition – Persuading the customer to buy from us for the first time.
- Customer retention – Keeping existing customers by continually meeting their needs.
- Customer extension – Persuading existing customers to buy more through:
  - Upgrading to newer versions
  - Upgrading to more expensive versions
  - Cross-selling.

12.7 IT INFRASTRUCTURE AND CONTROLS

A company looking to use e-business needs to consider infrastructure using

- The internet
- Intranets
- Extranets

With the move towards e-business the company also needs to develop controls over use and access

General Controls

- Where an organisation develops its own applications, or has to invest time and money configuring those applications, controls are needed to protect the integrity of the application
- Controls over access to systems, programs and data
- Controls designed to rectify errors in transaction processing (e.g. authorisation of refunds), and to investigate what caused them.
- Controls over installation and use of hardware, software and so on, installation, testing, management standards, policies and procedures.
- Business resilience procedures, e.g. controls over disaster recovery and back up.
- Controls to ensure the physical security of information technology from individuals and from environmental risks

Application controls

- Input controls: are transactions captured, accurately recorded, and properly authorised?
- Processing controls: have transactions been processed as intended
- Storage controls: are data items stored appropriately and correctly (for legal and other reasons relating to reporting, for example, credit card data is stored under certain conditions)
- Output controls (how accurate are the results)
- Audit trail: controls to ensure the transaction can be traced from its origination to any reports.
- Authorization - controls that ensure only approved business users have access to the application system.
- Input controls - controls that ensure data integrity fed from upstream sources into the application system.
- Forensic controls - control that ensure data is scientifically correct and mathematically correct based on inputs and outputs

Chapter 13

People in organisations

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CHAPTER CONTENTS

PAST EXAM REQUIREMENTS

June 2013

Q4 (a) Analyse Sully Truin's leadership style before and immediately after the training course and explain why the change of leadership style at ARC was unsuccessful. 15 marks

(b) Describe the principles of job enrichment and evaluate its potential application in the Contracts Office at ARC. 10 marks

June 2013

Q1 (a) (ii) Explain how an understanding of organisational culture and organisational configuration would have helped the CEO anticipate the problems encountered in his attempt to introducing a strategic planning system, and an associated information system, at Midshire Health. 18 marks

June 2011

Q2 (b) Discuss the principles, benefits and problems of introducing a matrix management structure at 8-Hats. 10 marks

December 2010

Q3 (b) Using the stereotypes developed by Mintzberg, explain how an understanding of organisational configuration could have helped predict the failure of Ann Li's proposed formalisation of structure, controls and processes at Frigate Ltd. 10 marks

June 2010

Q4 (a) Based on Judy's appraisal, evaluate the appropriateness of the appraisal process and performance measures at the National College, from both an employee and an organisational perspective. 15 marks

(b) Explain the concept and purpose of competency frameworks for organisations, assessing their potential use at the National College and the Institute of Managerial Finance.

10 marks

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June 2009

Q2 (a) Analyse the reasons for Rock Bottom's success or failure in each of the three phases identified in the scenario. Evaluate how Rick Hein's leadership style contributed to the success or failure of each phase. 18 marks

June 2008

Q1 (c) Evaluate what changes the Autofone retail sales division should consider making to both its business idea and its reward system. 15 marks

13.1 WHAT IS HUMAN RESOURCE PLANNING?

HRP is the idea that human resources are fundamental to the success of the organisation. This means that whatever strategy is adopted will have human resource implications.

One possible approach is to look inside the organisation at the resources and competences that are already available (we saw this when looking at strengths and weaknesses). This would mean looking at areas such as:

- Knowledge
- Experience
- Skills.

In particular we would look to use these to:

- Extend an existing competitive advantage
- Exploit new opportunities using our skills etc

ie our strategy fits in with what we are already good at.

An alternative is to look for opportunities and then obtain the necessary knowledge, experience and skills in order to exploit them.

i.e. we change what we are good at to fit in with the outside world.

Whichever one of the above is followed the HR implications may make the strategy unfeasible (or unacceptable) unless they addressed early enough.

13.2 WHAT IS MEANT BY ORGANISATIONAL STRUCTURE?

In earlier papers you will have looked at the way that an organisation is structured. This simply means the way an organisation is split into departments and how those departments interact.

For example, you may remember three common types of structure are:

- **Functional**
  - Good for efficiency (gains economies of scale)
  - Poor at effectiveness (loses customer focus).
- **Divisional**
  - Poor for efficiency (loses economies of scale)
  - Good at effectiveness (gains customer focus)
- **Matrix**
  - Good for combining efficiency and effectiveness
  - Poor at sending a consistent message to managers

A further possibility is a **virtual** structure, where the organisation outsources various functions.

Whichever structure is chosen, senior management will need to control what is happening. There are a number of approaches:

Centralisation

Senior management instruct others in decisions to be made.

This links with the head office role of being a parental developer or synergy manager.

The main advantage of this approach is it should lead to goal congruence.

Decentralisation

Senior managers leave junior managers to make their own decisions.

This links with the head office role of portfolio manager.

The main advantages are that:

- Junior managers should have a better understanding of the local situation.
- Decisions should be made more quickly.

If this approach is used, senior management will need to have some way of knowing if the correct decisions have been made, this may be through:

- Performance Measures
- Use of service level agreements
- Instilling a strong corporate culture.

Model – Mintzberg's structural configurations

Mintzberg divides the organisation into six areas:

- Ideology – the culture of the organisation
- Strategic Apex – senior management
- Middle line – middle managers
- Operating core – employees directly involved in producing goods and services
- Technostructure – providing technical support
- Support staff – providing general support.

Mintzberg then classifies organisations based on which of the areas is the most important.

- Machine bureaucracy – technostructure is the most important
- Professional bureaucracy – operating core is the most important
- Simple structure – strategic apex is the most important.

13.3 LEADERSHIP

All organisations need someone in charge. The role of a leader is likely to be particularly important in times of change or crisis.

Leadership has been studied by many different writers. The following are some of the main classical approaches to the subject:

- Trait theories – assume that good leaders all share similar characteristics.
- Style theories, eg Blake and Mouton – assume that workers respond better to certain styles of leader.
- Contingency theories, eg Fiedler – assume that leaders need to adapt their management style depending on tasks and power.
- Situational theories, eg Adair – assume that leaders need to adapt their style depending on tasks, the groups they are interacting with and the personality of the manager.

You also need to know about modern theories of leadership.

- Transactional leaders – use systems and processes to control behaviour.

These types of leader are particularly effective when the external environment is static.

- Transformational leaders – provide a vision of the organisation's direction and inspire employees to follow them.

These types of leader are particularly effective in times of change. In addition to vision, a transformational leader needs:

- Good communication skills.
- A passion for their beliefs.
- Flexibility to adapt their leadership style.

13.4 JOB DESIGN

Job design refers to how managers decide what tasks need to be carried out be employees. The approaches are:

- **Scientific Management**

  - There is one best way to carry out a task.
  - Managers should identify this method and train the workers how to carry it out.
  - The worker then just repeats what they have been instructed to do.

- **Job enrichment**

As workers gain more knowledge, skills and experience they are delegated more interesting tasks.

Model - Hackman characteristics of job enrichment

- Range of skills and talents
- Task closure
- Task significance
- Autonomy
- Feedback.

Japanese management

This includes a number of techniques:

- Total Quality Management.
- Cellular manufacturing where multi-skilled teams of workers are responsible for the complete assembly of something.
- Just in time manufacturing.

Job re-engineering

- This is simply the change in the tasks of an individual after the business processes have been re-engineered.
- This is likely to be significant if IT is being used to radically alter the process.

There is obviously an ethical dimension to all of the above, particularly scientific management and job re-engineering.

13.5 WHAT IS KNOWLEDGE WORK?

Knowledge work is work that is mainly concerned with skills and experience (as opposed to manual labour).

The implications for HRM will be:

- Selection needs to be based on general competencies rather than directed at a particular task.
- Staff will need to be able to access data from remote locations.
- Team and project based work becomes more common.

The transfer of knowledge inside an organisation can be a competence that gives an organisation a competitive advantage.

The idea of knowledge management is becoming increasingly important. The main tasks of the organisation will be:

- To establish a culture where sharing of ideas is encouraged.
- A programme to move individuals to different parts of the organisation to share knowledge and to make contacts.
- A flat structure so that decisions can be made by those with the appropriate knowledge.
- Development of intranets (perhaps with remote access).
- Development of data warehousing.

13.6 WHAT IS THE LINK BETWEEN STAFF DEVELOPMENT AND STRATEGY?

The main idea behind all of HRM is that staff are potentially one of the biggest competitive advantages an organisation has.

As part of this, employees will need to constantly learn new skills and will eventually replace those higher up.

HRM development has traditionally been carried out through:

- Identifying future training needs.
- Training staff.
- Evaluating the method used to train the staff.

This is often done on an annual cycle and so may not work particularly well if the external environment is changing rapidly.

In many organisations, this has now been replaced by the idea of the learning organisation. In this:

- There is a culture of continuously learning new skills.
- Workers are encouraged to find solutions to problems and to learn how to come up with better solutions to future problems.

Competency frameworks are used to:

- Provide an analysis of the core competencies required for the strategy to succeed.
- Help during the selection process.
- Identify training needs.
- Develop appraisal schemes.

Succession planning refers to developing a system to ensure important staff are replaced. Key features will include:

- Early identification of potential candidates for senior management.
- Training linked to career development.
- Development of contingency plans in case a post becomes vacant sooner than expected.

Chapter 14

Project management

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CHAPTER CONTENTS

PAST EXAM REQUIREMENTS

June 2014

Q4 (a) Critically evaluate the financial case (cost/benefit) of the computer-based assessment project. 15 marks

(b) Explain the concepts of benefit owners, benefit maps and benefits realisation and their potential application to the computer-based assessment project. 10 marks

June 2013

Q1 (a) (i) Identify and analyse mistakes made by the CEO in the project management process (initiation, conduct and termination) in his attempt to introduce strategic planning, and an associated information system, at Midshire Health. 18 marks

June 2012

Q3 (a) Analyse how a formal project initiation document would have helped address problems encountered in the project to construct the community centre and lead to improved project management in future projects. 13 marks

(b) Draft an analysis for the PAA that formally categorises and critically evaluates each of the four sets of proposed benefits in the original business case. 12 marks

December 2011

Q3 (a) Explain the purpose of each of the following; a post-project review, a post-implementation review and a benefits realisation review. 6 marks

(b) Evaluate the problems and the lessons that should be learned from a post-project review and a post-implementation review of the electronic ordering system at HomeDeliver. 12 marks

December 2010

Q4 (b) Explain why establishing a business case, managing benefits and undertaking benefits realisation are essential requirements despite the claimed "self-evident" justification of adopting e-assessment at the IAA. 10 marks

December 2009

Q3 **(a)** The branch rationalisation was a successful project.

Identify and analyse the elements of good project management that helped make the branch rationalisation project successful.

12 marks

December 2008

Q3 **(b)** **Evaluate the alternative strategies available to ASW's project manager to address the slippage problem in the CaetInsure project.** 10 marks

(c) **As a result of your evaluation, recommend and justify your preferred solution to the slippage problem in the CaetInsure project.** 6 marks

December 2007

Q2 **(a)** **Explain how a business case and a project initiation document would have helped prevent some of the problems that emerged during the conduct of the website re-design project.** 15 marks

(b) **Analyse how effective project management could have further improved both the process and the outcomes of the website re-design project.** 10 marks

14.1 WHAT IS PROJECT MANAGEMENT?

A project is an undertaking that has a beginning and an end and is carried out to meet established goals within cost, schedule and quality objectives. This will need to be organised by someone.

Project management is the integration of all aspects of a project, ensuring that the proper knowledge and resources are available when and where needed, and above all to ensure that the expected outcome is produced in a timely, cost-effective manner. The primary function of the project manager is to manage the trade-offs between performance, timeliness and cost.

In earlier sections we looked at the strategic planning model. This consisted of:

- Strategic analysis
- Strategic choice
- Strategic implementation.

Each of these stages can be viewed as a project.

Many of the areas we have looked at in the second half of the course (implementing a new business process, introducing a new product etc) are also projects and must be carried out properly for the project (and the strategy) to succeed.

If a strategy is changed it might force projects to be carried out, eg changing the marketing mix.

One method of looking at the way to run a project is through the use of project gateways. These are basically stages in a project at which point the project can be stopped or continued. The five gates are following the:

- Initial screening
- Risk assessment
- Business case
- Project plan
- Project milestones.

Finally at the end of the project it is common to carry out a post implementation review.

An alternative way at looking at projects is that most projects go through four stages:

- Project definition
- Project design
- Project delivery
- Project development.

14.2 INITIAL SCREENING

The initial screening stage looks at how the project will assist the organisation to meet its objectives.

Project definition takes place at this stage. This is looking at:

- What strengths is the project trying to build on?
- What weaknesses is the project trying to fix?
- What is wrong with the current approach?
- What opportunities is the project trying to exploit?
- What threats is the project trying to reduce?
- What is the objective of the project?
- What are the potential costs?
- Who are the key stakeholders who will be affected?

Note that even at this early stage, this should be done in as much detail as possible.

It might be that the project never progresses beyond this stage.

14.3 RISK ASSESSMENT

This is looking at identifying and managing the risks involved with the project.

Any project has constraints. They are:

- Scope
- Time
- Quality
- Budget.

These will need to be identified at an early stage.

There is a risk associated with all of these. There is also a risk associated with the whole project since the organisation still has to carry on its day to day activities while the project is taking place.

Risk assessment looks at:

- What might go wrong?
- What warning signs are there that things might be about to go wrong?

All risks have:

- A level of impact on the success of the project.
- A likelihood of occurring.

Risks can then be dealt with in different ways:

- Ignored.
- Transferred.
- Reduced through prevention.
- Reduced through contingency planning.

14.4 PREPARING THE BUSINESS CASE

Still in the project development stage, it is sensible for a detailed business case to be prepared.

This will be an analysis of the financial and non-financial benefits and costs that can be expected from the project.

As such, many techniques from earlier papers are appropriate here. Amongst these techniques are:

- Cost / benefit analysis
- Net present value
- Payback period
- Sensitivity analysis.

This will often be carried out by the finance department, often working with the project sponsor. The project sponsor is usually a senior person whose department will benefit if the project is successful.

One of the most important areas will be to try and include analysis of non-financial issues and to quantify intangible ones.

The analysis might include assumptions about how long the project will take or how much it will cost (to go in the NPV calculation). It is common at this stage for the constraints to become detailed.

Organisations may have many potential projects they COULD undertake. Preparing business plans for each allows the organisation to choose the most appropriate ones (capital allocation).

Model Ward and Daniels types of benefits

Although there may be difficulties with accurately predicting future costs, it is probably even more difficult to predict future benefits accurately.

Ward and Daniels categorise benefits into four types:

1. **Observable**. Benefits that may arise but are impossible to measure accurately, eg how do you measure accurately how much customer satisfaction will increase if a company's website is improved?

2. **Measurable**. It will be possible to measure these benefits but very difficult to predict how much the project will improve them, eg it might be known that improving the lighting in a factory **will** improve productivity and this increase can be measured. The problem is that it is hard to predict in advance how much the productivity will go up by.

3. **Quantifiable**. It will be possible to measure and predict how these benefits will be affected by the project, eg if a new machine is installed output will go up by 10%

4. **Financial**. These are quantifiable benefits that can be converted into financial benefits (there is obviously an overlap with quantifiable benefits), eg the financial benefit of installing a new machine will be $200,000 per year.

Ward and Daniels would argue that only financial benefits should be included in the business case.

14.5 PREPARING THE PROJECT PLAN

The project plan is developed as part of the project design stage. From the point of view of the exam, this is one of the most important parts of the entire project. The tasks include:

- Preparing a project initiation document.
- Selecting a project manager.
- Selecting a project team.

The project initiation document

The project initiation document is a formal document which sets out:

- The purpose of the project.
- A formal statement of the scope of the project (including any required standards).
- A list of stakeholders in the project.
- A list of the written documentation which will be delivered to stakeholders in the project (eg how often they will receive updates).
- A formal budget.
- A list of deadlines.
- A diagram of the project team structure (reporting lines etc).

The project manager

The project manager is the person who is responsible for ensuring the project meets the scope, quality, time and budget constraints.

The project manager is responsible for:

- Ensuring that sufficient resources are available
- Efficient use of those resources
- Providing information on the progress of the project
- Ensuring the project will meet customer needs
- Helping team members to integrate
- Supporting team members.

The skills required by the project manager include:

- Leadership and team building
- Organisational
- Communication and negotiation
- Technical
- Personal qualities
- Problem solving

- Change management.

The project team

A team is a small group of people with complementary skills who are committed to a common purpose, performance goals and approach for which they hold themselves mutually accountable.

Teams will perform better when they are:

- Small
- Cohesive
- Have a mix of personalities.

Model – Tuckman's stages of group formation

- Forming
- Storming
- Norming
- Performing.

Model – Belbin's personality mix

The various personalities that should be included within the group are:

- Co-ordinator
- Shaper
- Plant
- Monitor-evaluator
- Resource-investigator
- Implementer
- Team worker
- Finisher.

Project members will often have their own work to do in addition to the work being done on the project. This results in most project teams following a matrix structure (covered in earlier papers).

The matrix structure means project members having two managers:

- One specifically to do with the project.
- One specifically for their day to day work.

The advantages of this approach are:

- Project members get to learn new skills.
- They can see what role they are filling in the overall project.
- The structure is very flexible, team members can be added / removed as necessary during the project.

The disadvantages of this approach are:

- Team members have two managers who may not agree on priorities.
- Appraisal becomes more difficult.

The first of these can be resolved by having regular meetings between the relevant managers.

An even better approach might be to have team members working on the project full-time.

14.6 PROJECT MILESTONES

At the project delivery stage, the project commences. There will need to be some kind of detailed project plan of:

- What should be carried out.
- Who should carry it out.
- When it should be carried out by.

There are various techniques, software that could be used here such as GANTT charts and critical path analysis.

At some point there will be conflict between the constraints and the manager will need to decide how to resolve the issues.

The most common problem is that the project runs late. The consequences of this should have been identified in the risk assessment already carried out.

The most common responses will be:

- To try and get an extension of time.
- To reduce the scope of the project (not doing as much as originally planned).
- To reduce the quality of the project (not doing the project as well as originally planned).
- To increase the amount of resources above what was originally planned.

There may be unforeseen problems such as issues that need clarification. The most important thing for the project manager is to make a decision quickly and then move on (again, hopefully, many of these have already been identified in the risk assessment).

Benefits realisation

The reason that organisations carry out projects is because they expect to receive some benefit at the end of the project (lower costs, better service etc.). These should have been set out very clearly as part of the project plan.

However, projects change over time, sometimes deliberately, sometimes not. The second one is known as project creep and this can result in the expected benefits not happening.

During the project delivery, someone must regularly monitor the project to make sure that these benefits are realised. This is known as the benefit owner.

Benefit maps show what has to happen for the benefits to occur. The project may change over time and these maps help the benefit owner to make sure the benefits still occur.

Benefits realisation happens at the end of the project when the benefits in the business case are compared to what actually happened.

This might result in action being taken to ensure a benefit occurs or to identify what needs to happen in future projects to make sure benefits are delivered.

14.7 PROJECT COMPLETION

One of the most important stages in project management happens once the project has finished.

The completion report

There should be a completion report produced by the project manager. This should include:

- The original objectives and the objectives actually achieved.
- The original and budget and actual expenditure.
- The original timescale and the actual timescale.

This should be signed off by the project sponsor.

The post-implementation review

This review allows end users to report back any problems with using the product or service the project has delivered.

This might then form the basis for a new project to fix those errors (if there are a large number of faults).

This phase is designed to learn lessons to improve the product / service.

The post-project review

The post implementation review analyses the completed project to identify:

- Problems with the process used to decide whether to even carry out the project.
- Problems that occurred due to poor planning (unrealistic budgets etc).
- Problems that occurred due to poor management (cost overruns etc).
- Areas that were carried out well and can be repeated on other projects.

This phase is designed to learn lessons for future projects.

Chapter 15

Change and development

CHAPTER CONTENTS

PAST EXAM REQUIREMENTS

June 2014

Q1 (b) Evaluate the effect of contextual features on the introduction of strategic change at Reink Co. 14 marks

December 2012

Q1 (b) Time, scope, capability and readiness for change are four contextual factors that affect strategic change.

Evaluate the potential influence of these four factors at Steeltown Information Technology on any strategic change proposed by the EA Group. 12 marks

December 2010

Q1 (b) (i) Identify and analyse, using an appropriate model, the contextual features that will influence how strategic change should be managed at Captain Haddock. 13 marks

(ii) Identify and analyse the main elements of strategic change required to achieve this goal. 8 marks

June 2008

Q4 (a) Analyse the nature, scope and type of this proposed strategic change for PSI. 10 marks

(b) Identify and analyse, using an appropriate model, the internal contextual features that could influence the success or failure of the Chief Executive's proposed strategic change for PSI. 15 marks

Dec 2003 (Paper 3.5 previous syllabus)

Q1 (c) Explain how PIT might change from a technology driven culture to a marketing led one. 10 marks

15.1 TYPES OF STRATEGIC CHANGE

In P3, all the Section A case studies and most of the Section B scenarios will involve some kind of change, since there will be problems that need fixing.

The process of change needs to be managed properly, otherwise the company's strategy will fail.

Model Johnson and Scholes types of change

There are two aspects to change:

- The scope of the change – whether the changes are minor or fundamental
- The nature of the change – whether the change will be gradual or sudden.

Johnson and Scholes then classify changes as:

- Adaptation – minor and gradual
- Reconstruction – minor and sudden
- Evolution – fundamental and gradual
- Revolution – fundamental and sudden.

Fundamental changes might be needed for the organisation (because of changes in the environment).

Fundamental changes might be harder to implement (because they will clash with the existing culture).

15.2 ACCEPTANCE OF STRATEGIC CHANGE

Model – Balogun and Hope Hailey

Fundamental change is likely to be resisted unless there are good reasons for stakeholders to accept it.

Balogun and Hope Hailey list the contextual features which stakeholders will consider (in other words the context of the change as to whether it is necessary or not).

Using an example of an acquisition, some of these factors relate to the purchasing company – some to the target company.

Those factors related to the purchaser:

- Time – Is the organisation in the middle of a crisis or do they have time to change things gradually?
- Capability – Do senior managers have the knowledge and experience to deal with the change?
- Power – Can senior managers force changes through even if it is against the wishes of other stakeholders?
- Capacity – Does the organisation have the resources (particularly finance) required to undertake the change?

Those factors related to the target company:

- Scope – Will a lot of people / divisions / departments be affected or only a few?
- Preservation – Are there processes, competences and staff that will need to be retained?
- Diversity – Different parts of the business may have their own cultures and interests, will the proposed change impact on these.
- Readiness – Are the key stakeholders aware of why change is needed and are they likely to accept it?

Similarly, if a change is internal, for example changing the culture, the top four factors would represent senior managers, the bottom four would represent the other employees.

Balogun and Hope Hailey argue that it is necessary to answer all the above questions before change is implemented.

As part of this, managers need to get the organisation ready to change.

Analysis of the strategic position should indicate reasons why the organisation needs to change.

Analysis of the contextual features will indicate why there might be resistance to any proposed changes.

Model Lewin's force field analysis

Lewin identifies that there are always two forces at work whenever change is being considered:

- Driving forces
- Restraining forces.

He argues that change will not take place unless the driving forces outweigh the restraining ones. To do this:

- Build up the driving forces
- Reduce the restraining forces.

15.3 MANAGEMENT OF STRATEGIC CHANGE

One of the key elements that will effect whether change is successful or not concern the managers at the top of the organisation.

If the organisation is about to go through revolutionary change, then stakeholders will be more willing to accept changes if lead by a transformational leader.

Model - Maurik – Qualities of the transformational leader

Leaders in a dynamic environment need to:

- Change from within.
- Empower others.
- Work with teams.
- Provide clarity of direction.
- To be visionary.

As well as the leader, managers are also important to the change process since they:

- May have to change their own role.
- Help others to change their roles.
- Ensure the business continues to operate during the change process.

It may be difficult for managers to carry out the 2nd and 3rd points at the same time; so many organisations will appoint a person known as a change agent. This might be an internal manager who is asked to work full time on managing the change or may be an external manager employed for the duration of the change. The change agent should:

- Help clarify what the organisation is trying to achieve.
- Help employees understand their new roles.
- Help resolve any disputes.
- Be able to keep sight of the overall objective of the change.

The more radical the change, the more senior the change agent needs to be.

Part of the change agent's role will be in preparing stakeholders for change and planning the necessary steps to take.

Model Lewin's 3 step process

Lewin identifies that three stages are necessary for something to change:

- Unfreeze – It must be accepted that change is needed.
- Change – The change takes place.
- Refreeze – It should be made difficult to go back to the earlier position.

It is argued that the last step is the most important. Without it, any change will be temporary.

15.4 HOW CAN CHANGE BE MANAGED?

Model – Johnson and Scholes approaches to change management

The approaches to change management are:

- Participation – Involving employees directly in decision-making.
- Coercion – Forcing employees to accept change.
- Negotiation – Employees and employees bargain over approach and goals.

In addition:

- Education – Management explain what is happening and why – this could be used alongside any of the above.
- Support – Management provide counselling and other services to help individuals worried about how change will affect them. Again, this could be used alongside any of the above.

Finally:

- Manipulation – Management only tell employees information which supports change, not telling them information which would build resistance.

Model - Johnson and Scholes management of turnaround

The seven elements to successfully turnaround a company are:

- Crisis stabilisation
- Changes to management
- Communication with stakeholders
- Attention to target markets
- Concentration of effort
- Financial restructuring
- Prioritisation.

15.5 THE BUSINESS CHANGE LIFECYCLE

Organisations should go through a number of stages to constantly keep their business operating efficiently and effectively

Model – The business change lifecycle

- Alignment – this may involve internal or external drivers
- Define the business improvement using POPIT (see below)
- Design the change including changing business processes
- Implement the change including dealing with key stakeholders
- Benefits realisation

Model – The POPIT approach to change definition

This identifies the areas that must be considered when making a change.

- People
- Organisation structure
- Processes
- Information Technology

15.6 INTENDED AND EMERGING STRATEGIES

The strategic planning model states that managers:

- Analyse the strategic position (external, internal, stakeholders etc).
- Consider various strategic options and choose one (Ansoff, SFA etc).
- Implement the required changes (Lewin etc).

The idea is that the organisation has a strategy that:

- It intends to follow.
- It deliberately tries to make the strategy occur.
- The strategy is realised.

However, this is not necessarily the way that things work in real life.

Alternatives are:

- Unrealised strategy – a strategy which was planned but did not take place or failed.
- Opportunistic strategy – an opportunity in the external environment is exploited.
- Imposed strategy – a change in the external environment might force an organisation to follow a particular strategy.
- Strategic drift – where the organisation does not review the external environment frequently enough – this leads to the strategy being inappropriate.
- Emergent strategy – a strategy develops over time even though it was never specifically planned.

Note the link here with Johnson and Scholes lenses:

- Strategy as design ties up with the planned approach.
- Strategy as ideas can lead to the opportunistic approach.
- Strategy as experience often results in the emergent approach.

Also note that many of the ideas from other parts of the course are affected here.

- Strategic change impacts on marketing, processes and staff (the planned approach).
- The changing skills of the staff and refinement of processes can lead to new competitive advantages and strategies (emergent).

Suggested solutions

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CHAPTER 8

CoolFreeze Part 1

Examiner's Answer

The budgeted sales volume for the second quarter of 2010 was 83 units. Except for warnings from the sales manager, there was no evidence that this would not be achieved. The actual sales for the previous three quarters had been in-line with the forecast and so there was no clear case for the budgeting committee to change its sales forecast.

Flexing the budget allows us to look at the consequences if the planned level of output had been 50 (actual sales) rather than 83 (planned sales).

This flexed budget is presented below.

Output (sales)	50 units
Sales revenue	$45,000
Raw materials	($17,500)
Labour	($16,250)
Fixed overheads	($18,000)
Operating profit (loss)	($6,750)

The table below compares budget, actual and the flexed budget.

	Budget	**Actual**	**Flexed Budget**
Units	83	50	50
Price	$1,000.00	$900.00	$900.00
Revenue	$83,000.00	$45,000.00	$45,000.00
Raw materials	($29,050.00)	($15,000.00)	($17,500.00)
Labour	($26,975.00)	($15,750.00)	($16,250.00)
Fixed overheads	($18,000.00)	($18,000.00)	($18,000.00)
Operating profit	$8,975.00	($3,750.00)	($6,750.00)

A number of conclusions can be drawn.

Sales volume

The sales volume variance for quarter 2 is an adverse variance. The sales manager should be held accountable for this. However, in fairness to him, he had warned of weakening demand at the meeting of the planning committee that set the targets for the four quarters. The reasons appear to be associated with changes in the external environment. Customers are reluctant to invest in new machines or replace old machinery in times of difficult trading conditions. Cheaper foreign imports have also been identified.

Sales price variance

The sales price variance for quarter 2 is also an adverse variance. This is due to lower prices being charged. The sales manager is again accountable for this. He has probably discounted prices to compete with cheaper foreign imports. He warned in the scenario of cheaper foreign imports undercutting prices by about 10%. It appears that the sales manager has had to match these prices, as the sales unit price fell to $900 in this quarter.

Materials variance

The materials variance is a favourable variance because actual costs ($15,000) are less than the flexed budget $17,500. There may be at least two reasons for this. On the one hand the production manager may have been able to reduce the amount of raw material used in the manufacture of the equipment. This may be possible, although with such a well-established product this seems unlikely. It is more likely that the procurement manger has been able to negotiate lower prices for raw materials. CoolFreeze has had to reduce its prices (reflected in the sales price variance) but this has been partly offset by obtaining lower prices from suppliers.

Labour variance

The labour variance is again favourable because actual labour costs were less than the flexed budget. The variance is relatively small; $500. There may, again, be two possible reasons for this. Firstly, that labour costs have been reduced by paying lower rates. This would be the responsibility of the personnel department. This may be possible; perhaps some employees have left and have been replaced by cheaper employees. Alternatively, perhaps the number of hours required to produce each unit has been reduced. This would be the responsibility of the production manager. Further information is needed to come to a firm conclusion.

Overhead costs

Fixed overheads have remained as per the original budget.

Summary

Your assertion that "we have all made mistakes" seems rather sweeping. The main problems to be addressed appear to be in sales volume and sales price. These are the responsibility of the sales manager. In contrast, raw materials and labour costs have been well controlled with positive variances achieved by the production and procurement managers. Similarly, overheads have been maintained at their budgeted value.

NMS

Examiner's answer

Ray Edwards has effectively undertaken an informal time to payback calculation. His assertion that the machine will pay for itself after five years is correct. A more formal representation of the approach is given below.

All figures in $000s

Year	**0**	**1**	**2**	**3**	**4**
Brought forward		76	60	42	22
Cost of the machine	90				
Maintenance costs	5	5	5	5	5
Reduced staff costs	15	15	15	15	15
Reduced wastage	2	4	6	8	10
Energy savings	2	2	2	2	2
Carried forward	76	60	42	22	0

There are two issues that need further consideration. The first concerns the approach to investment appraisal. Time to payback is a legitimate approach, but Ray has to be sure that it is a reasonable way of evaluating project investment in the context of NMS. It does not take into account the time value of money and so future cash flows are not discounted, unlike the Net Present Value (NPV) approach. This is significant here, because most of the cash outflows of the project are almost immediate (half of the costs are incurred in year zero), whilst significant benefits do not accrue until years three and four. If time to payback is acceptable, then Ray has to consider whether the payback time (five years) is acceptable and, more importantly, whether there other investments within the company which might pay back sooner, given that projects will be competing for limited resources.

Secondly, the costs of buying the new machine are very tangible. However, Ray's classification of benefits requires further consideration. Although all three categories of benefit have been given a financial value, these values are not of the same degree of reliability.

Ray has already calculated that less labour is needed to use this machine and has estimated a reduction of $15,000 per annum based on observed performance. This appears to be a relatively tangible financial benefit. In Ward and Daniel's term this is a quantifiable benefit, because sufficient evidence exists to forecast how much benefit should result from the change.

Wastage is currently being measured in NMS, but there is a risk of transferring the manufacturer's claims of savings of 'up to 10%' directly to the NMS environment. It is impossible to predict how much will be saved in advance in the specific context of NMS. It will be possible to measure reduced wastage once the machine has entered into service, but it is difficult to predict accurately in advance. In Ward and Daniel's terms this is a measurable benefit for which a reliable measure currently exists and the improvement can be measured once the machine is working.

The manufacturer claims lower energy costs, but no data is provided. At present, energy costs are measured for the company as a whole, but not for individual machines. It should be possible to do this (and measure it again afterwards) to see if the claimed benefits have been achieved. However, at present the data is at the wrong level of granularity and so the claimed benefits must be an "educated guess" and it will be impossible to reliably allocate any savings to the new machine after implementation. Other elements of energy policy might have had a greater effect.

Limiting factor decision

(a)

	Abel	**Baker**
Contribution per unit ($)	4.00	7.50
Finishing time in spraying process	1 hour	3 hours
Contribution per hour	$4	$2.50
Rank	1	2

Make all Abels. Maximum that can be made is 50,000. Maximum contribution is $200,000

(b) Production Schedule:

Product	**Units**	**Hours used**	**Hours left**	**Contribution per unit ($)**	**Total contribution ($)**
Abel	20,000	20,000	30,000	$4.00	80,000
Baker	10,000	30,000	0	$7.50	75,000
					157,500

Make or buy decisions

Calculate the relevant cost per unit. Assume fixed costs are not avoidable, and therefore not relevant.

	$
Direct Materials	1.50
Direct Labour	1.75
Variable Overheads	2.25
TOTAL COST	5.50

As the cost of purchase is $6.00, it would be better to manufacture the component.

The company can see that buying the component would be unacceptable on financial grounds.

It should also investigate whether it will be suitable, for example is the supplier reliable, will the quality be high enough (does this component add value to the finished product or not?)

Close or continuance

With product A:

	Product A **$**	**Product B** **$**	**Product C** **$**	**Total** **$**
Sales	130,000	150,000	170,000	450,000
Variable Cost of sales	(121,000)	(135,000)	(149,000)	(405,000)
Contribution	9,000	15,000	21,000	45,000
General Fixed overheads	(12,000)	(12,000)	(12,000)	(36,000)
Profit/Loss				9,000

Without product A:

	Product B **$**	**Product C** **$**	
Sales	150,000	170,000	320,000
Variable Cost of sales	(135,000)	(149,000)	(284,000)
Contribution	15,000	21,000	36,000
General Fixed overheads			(36,000)
Profit/Loss			Nil

Assuming that the fixed costs are unchanged whether or not product A is discontinued.

Since A is making a contribution towards fixed overheads, dropping A will cause profit to decrease by the amount of A's contribution. Consequently, A should not be dropped.

In addition, the company might want to look at:

- The BCG matrix, should they continue to invest (A might be in the growth stage of the life-cycle).
- External factors, has the environment changed so that it will be less likely for A to be profitable in the future?

JB Ltd

Relevant Cost per unit of the Contract:

	Note	$
Materials:		
M1: $6.50 × 4,000	1	26,000
P1: $3.00 × 3,000	2	9,000
Part 678		80,000
Labour:		
Skilled: $8.00 × 3,000	3	24,000
Semi Skilled: Nil	4	Nil
Overheads:		
Variable: $7 × 40,000	5	280,000
Fixed	6	300,000
Total Cost per Component		719,000

Notes:

1 As material is in regular use, the relevant cost is the replacement cost.

2. There are three choices:

- Scrap P2 and receive $1.60.
- Use as a substitute for P4. This would cost an additional $1.60 to save $4.60 (the original cost is irrelevant as it already in the warehouse). A net benefit of $3.00.
- Use for the contract, this means JB cannot do EITHER of the above (since they will use the material). The relevant cost is the best alternative, ie $3.00.

3. Skilled labour can be hired for $8 per hour

4. The semi-skilled labour will be paid whether or not they work on this contract. The relevant cost is zero.

5. The variable cost per hour is relevant, since this would be avoidable if the contract were not undertaken. Relevant cost is $7.

6. The fixed cost per hour is an absorption rate. Actual fixed costs would not increase by $13 per hour for any component made. Actual fixed costs would increase by $3,200 in total, which is 3,200/400 = $8 per component.

Based on the above JB should accept the contract since it will generate $1000 per component.

However it should be noted that if the contract is accepted:

- The semi-skilled labourers may not have idle time in the future, so JB may have to turn away other work (with the resulting lost contribution).
- It is unclear whether the $300,000 will be a one-off cost or a continuing one.

Strategic issues to consider include:

- The profit is positive, but only $1,000 (margin 0f $1,000 / $720,000) = 0.139%. Would JB be better off looking for other customers (is it acceptable?).
- JB currently have idle time, presumably through a lack of customers. If this likely to continue, having a steady source of revenue would be very sensible (is it suitable?).
- JB is a small firm, will it be able to meet REL's demand for 120 x 12 x 5 = 7,200 components over five years (is it feasible?).
- REL are likely to become JB's main (maybe only) customer. This gives REL power to negotiate prices down and wipe out JB's already small margin. In addition, there would be the danger that REL could go bankrupt and take JB with it (is it suitable?).
- REL is designing a prototype plane, it is not certain they will be able to sell it (is it suitable?).
- The work they do for REL might bring them to the attention of other customers (is it suitable?).

CHAPTER 9

Regression analysis

(a) b = 6. For every extra $1 spent on marketing, sales revenue increases by $6.

a = 480. Even if there was no marketing spend, revenue would be expected to be $480,000.

Correlation coefficient = 0.978492. The revenue is very dependent on the marketing spend.

(b) (i) When X = 100, Y = 480 + 6 x 100 = $1,080 = $1,080,000

(ii) When X = 250, Y = 480 + 6 x 250 = $1,980 = $1,980,000

It should be noted that the highest marketing spend so far is $120,000 and so the estimate for what happens when $250,000 is spent might be very inaccurate as it has been extrapolated from the data.

Time series analysis

Examiner's answer

I have had the opportunity to analyse the spreadsheet that you provided. My analysis suggests that the forecasting team used moving averages to help them analyse past sales and forecast the future. This is a well-established technique of analysing a time series and you are incorrect in your assumption that it is "not based on a well-accepted approach".

Explanation of the spreadsheet construction

The technique is based on averaging figures in the time series. For example, column D is calculated by adding up the first four figures (56,70,74,60) and then adding this total to the total moved on by one quarter (70, 74,60,60). This value is than divided by 8 (the number of values in the total calculation) to give the average value in column E. This represents the trend of the time series.

The figures in column F are the variation of the trend from the actual sales figures. These variations are analysed in part 2 where a seasonal variation is calculated.

This seasonal variation is then subtracted from the total variation of each quarter to determine the random or residual variation (column H).

The author of the spreadsheet has checked that the total of the trend plus seasonal plus random variation comes to the original sales figure (column I).

It is difficult to identify where the forecast figures come from. They are roughly in line with the observed trends and represent a very modest increase on the previous year (less than 1% growth). The forecasting group probably thought they were being very realistic.

Analysis

Time series analysis is based on past data. It cannot be used to predict sudden changes in the marketplace. The sales manager had expressed reservations when the forecasts were agreed. His sales staff had already reported that customers were less optimistic about the future because of a weakening economy and the availability of cheap foreign imports. In retrospect, a greater consideration of the external environment should have been included in the overall forecasting approach. Perhaps a number of scenarios should have been considered that took into account changes in the external marketplace.

However, even without such consideration it is clear from the trend figures that growth had been weakening. The growth from 2006 to 2007 (based on the quarter 3 trend figure) was about 11%. In contrast the growth from quarter 2 of 2008 to quarter 2 of 2009 (again based on the trend values) was less than 1%. The final two actual sales figures for 2009 were, in total, exactly the same as the previous year (150 units). This weakening was reflected in the cautious forecasts put forward by the forecasting team. However, there appears very little in the statistical data that suggests that the rapid decline in sales experienced in quarter 2 of 2010 could have been anticipated from the data alone.

The forecasting team might have given further consideration to the sudden increase in random variations in the last three analysed quarters. These might have suggested that the external environment was changing and that other factors were beginning to influence the marketplace. The absolute random variation reported in the last three quarters is greater than that reported in total in the preceding six quarters.

One of the weaknesses of the approach used by the forecasting team is that data from four years ago is given as much weight as much more recent data. This could have been addressed by using exponential smoothing that uses a smoothing constant to reduce the influence of early data considered in the time series. This method uses a series of weights with higher weights given to the most recent data

Overall, time series analysis is a well-documented way of analysing past data and using it to forecast the future. However, it is suited to a relatively stable situation where historical data is representative. The concerns of the sales manager should have been taken into consideration. Changes in the external environment meant that a technique that had worked well in the past produced optimistic forecasts that could not be achieved.

Tutor Note – in the spreadsheet, the Examiner has used regression analysis to predict the future trend. This illustrates a problem with regression analysis, since the predicted trend is up, even though the Examiner has pointed out in his analysis that the trend is weakening!

Expected values

Year 1 expected income = \$12,000 × 0.75 + \$10,000 × 0.25 = \$11,500

Year 2 expected income = \$13,000 × 0.75 + \$10,000 × 0.25 = \$12,250

Year 3 expected income = \$13,000 × 0.75 + \$9,000 × 0.25 = \$12,000

Year 4 expected income = \$14,000 × 0.75 + \$8,000 × 0.25 = \$12,500

NPV calculation:

Year	Cash Flow ($)	Discount Factor (14%)	Present Value ($)
0	(30,000)	1.000	(30,000)
1	11,500	0.877	10,086
2	12,250	0.769	9,420
3	12,000	0.675	8,100
4	12,500 + 2,000	0.592	8,584
		NPV	*36,190*

Note that the expected NPV will never occur, since demand is always high or always low.

If demand is high throughout the project the NPV is $8,768.

If demand is low throughout the project (which has a probability of 0.25 of occurring) the project has a negative NPV of $-1,545.

Note that 8,768 *0.75 + (-1,545*0.25) = 6,190 ie the same result.

Decision trees

1 Start with decision – build large or small plant – put building cost next to each.

2 If building a large plant, put in the possibilities and their likelihood. Demand could be high in which case we have 5 years of $250,000 profits – the probability of this is 0.7.

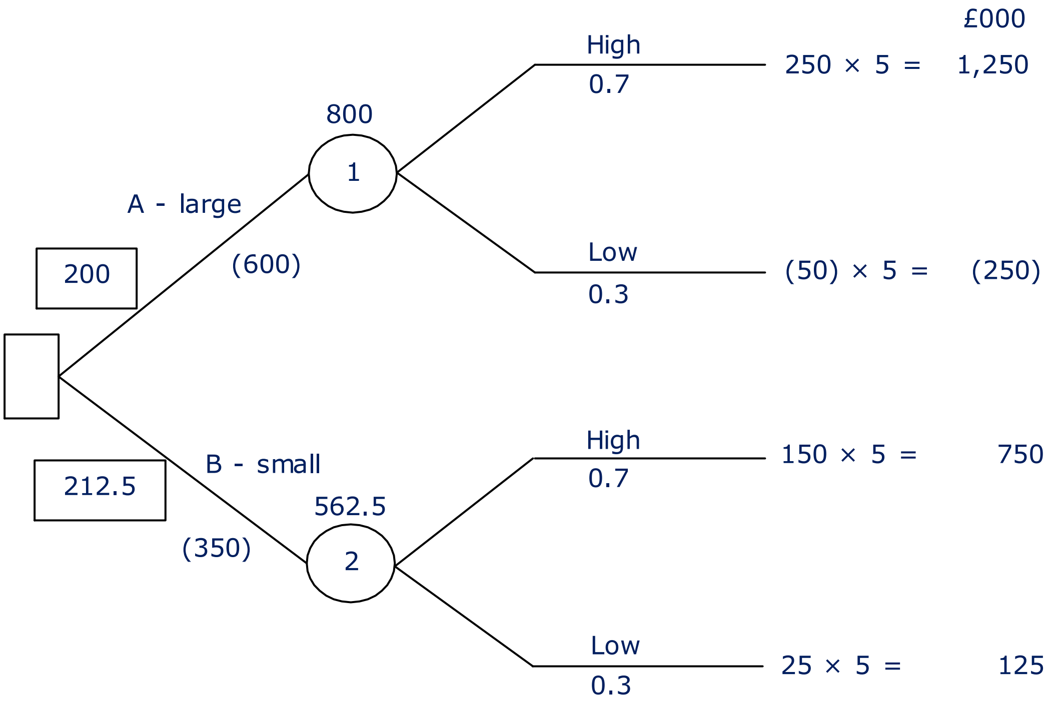
3 Repeat for the other possible decision (build small plant).

4 Work out the expected value if large plant is built (working 1 below).

5 Subtract building cost of large plant to leave net benefit.

6 Repeat steps 4 and 5 for small plant.

7 Decide which is best.



Decision: Build a small plant

WORKINGS

①

x	**P**	**P*x***
1,250	0.7	875
(250)	0.3	(75)
	800	

②

x	**P**	**P*x***
750	0.7	525.0
125	0.3	37.5
	562.5	

CHAPTER 10

Example 1

Using Labour hours to absorb overheads

Total labour hours = (10,000 x 10) + (10,000 x 1) = 110,000

Absorption rate = $550,000 / 110,000 = $5 per labour hour

Each Product A absorbs overheads of 10 x $5 = $50
Each Product B absorbs overheads of 1 x $5 = $5

Using Machine hours to absorb overheads

Total machine hours = (10,000 x 10) + (10,000 x 1) = 110,000

Absorption rate = $550,000 / 110,000 = $5 per machine hour

Each Product A absorbs overheads of 3 x $5 = $15
Each Product B absorbs overheads of 8 x $5 = $40