Professional Level – Essentials Module

Business Analysis

March/June 2018 – Sample Questions

P3 ACCA

Paper P3

Time allowed: 3 hours 15 minutes

This question paper is divided into two sections:

Section A – This ONE question is compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Do NOT open this question paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

Think Ahead ACCA

The Association of Chartered Certified Accountants

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The question paper begins on page 3.

Section A – This ONE question is compulsory and MUST be attempted

1 Introduction

The Ancestry Book Company (ABC) publishes historical books, primarily concerned with military history, historical events, notable people and the tracing of ancestors. It was formed in 1991 by Rupert Hart when he left the army. As ABC grew, Rupert recruited people and authors who shared his background and interests and the senior management team currently consists of men who have either had a military career or who have a history degree from a well-respected university. ABC is wholly owned by Rupert Hart. It currently has about one hundred staff.

Sales channels

Up until 2015, ABC used two primary sales channels.

(1) Selling directly to customers through catalogue sales. A catalogue illustrating all the books currently in print was posted quarterly to customers on ABC's mailing list. The catalogue included an order form which the customer could complete and return, by post, to ABC. The order form includes postage and packing costs and customers paid by enclosing a cheque or their credit card details. Alternatively, the customer could telephone their order to ABC's call centre, place their order and pay by credit card over the phone.

(2) Selling through bookshops. ABC sold books at a discounted trade price to bookshops. The bookshop then sold the books at the published price to the end customer.

In 2015, ABC established a third sales channel. This is a dedicated e-commerce website where customers can place orders directly with the company.

Book buying in Oraria

ABC sell their books worldwide but the majority of its sales are in the country of Oraria where it was founded. The population of Oraria are enthusiastic buyers of books but how they buy books has changed over time. Table One illustrates this. This information is published in a trade directory.

	2007	2009	2011	2013	2015	2017
Number of bookshops	1,250	1,150	1,000	900	850	800
% of sales made through bookshops	30%	25%	20%	15%	12%	10%
% of sales made through mail order/telephone order	25%	20%	15%	12%	8%	5%
% of sales made through internet intermediaries (Note 1)	30%	40%	50%	55%	60%	63%
% of sales made through publisher's own websites	15%	15%	15%	18%	20%	22%

Table One: Bookshops and sales analysis in Oraria: 2007–2017

Note 1: Internet intermediaries are large well-known websites such as Daintree, who sell a wide range of products, often at heavily discounted prices. These websites also offer product reviews and a range of delivery options.

A similar analysis of ABC's book sales is given in Table Two.

	2007	2009	2011	2013	2015	2017
% of sales made through bookshops	40%	38%	35%	30%	25%	20%
% of sales made through mail order/telephone order	60%	62%	65%	70%	65%	55%
% of sales made through ABC's website					10%	25%

Table Two: Analysis of the source of ABC's sales: 2007–2017

There has also recently been an increase in interest in history and ancestry in Oraria encouraged in part by the success of the television series 'Who's Next?, which traces the ancestors of celebrity participants.

Financial performance and marketing initiatives

The recent financial performance of ABC is summarised in Table Three.

All figures in $millions

	2007	2009	2011	2013	2015	2017
Revenue	20	18	16	16	16	15
Cost of sales	14	13	13	13	13	13
Gross profit	6	5	3	3	3	2
Operating costs	4	4	4	4	5	3

Table Three: Financial performance at ABC: 2007–2017

The performance of ABC has been a continuing concern to the senior management team. In response to this, since 2009, the company has attempted to improve performance by:

(1) Improving customer awareness of the company by increasing display advertising which it has always placed in specialist historical magazines.

(2) Promoting special offers in its catalogue. These special offers are usually price reductions on selected books or special deals offering, for example, four books for the price of the three most expensive books placed in an order.

However, these initiatives did not stop the decline in performance and so the decision was made to develop an e-commerce website. The website development was the initiative of a newly appointed sales and marketing manager, Jon Lang, and was launched in 2015.

In appointing Jon Lang, Rupert Hart made a deliberate attempt to appoint someone from a different background to his other senior staff. Jon had worked previously for a large online retailer for five years, which he had joined after graduating with a marketing degree. Jon came to work in casual clothing, unlike the formal suits worn by his managerial colleagues, and he had no interest in military history at all. He perceived the development of the website as a 'game changer' for ABC. However, other managers at ABC were concerned that the website would negatively affect sales made through bookshops, and alienate elderly customers. Jon left ABC in 2016 to join a web analytics company. He was replaced by Edward Tern, a history graduate from the same university which Rupert had attended.

Sale of ABC to BV Ventures

In 2018, Rupert Hart decided that he wished to sell the company and retire. The company was purchased by BV Ventures, a venture capitalist with experience in turning round publishing companies. They have issued the following press release:

BV Ventures is pleased to announce the acquisition of Ancestry Book Company (ABC). We acknowledge the work of Rupert Hart and his team in developing such a well-respected brand. We see our mission at ABC 'to develop a profitable, successful company who people want to work for and customers want to buy from'.

This was the first ever mission statement for ABC. Rupert Hart had never felt that one was necessary for his company.

An internal memo from BV Ventures to staff specified its vision for ABC in more detail:

ABC needs to offer books which appeal to all its customers. We need to increase the revenue of the company, improving sales of each book which we offer. We also need to publish and deliver these books profitably, to ensure adequate returns to shareholders and to deliver profits which enable the business to grow. ABC also needs to offer a speedy delivery to customers and to deal professionally and courteously with any post-sales issue. We need to ensure that customers receive a service which exceeds their expectations. This should increase repeat orders and also encourage our customers to recommend our books to their friends. The quality of the books, both in content and presentation, must be exemplary, so that book returns are almost eliminated.

BV Ventures has a prescribed approach to turning around companies which includes:

– Producing a SWOT analysis.
– Developing a strategy for the organisation which aligns internal capabilities with environmental influences.
– Specifying clear, explicit objectives which reflect this strategy. These objectives are pursued through actions which are undertaken throughout the organisation.

BV Ventures has also introduced the principles of integrated reporting into the companies which it owns.

Required:

(a) Evaluate the overall organisational performance of ABC in the period from 2007 to 2017 with particular reference to the concept of strategic drift. (12 marks)

(b) Analyse the approaches to strategy of the past owner (Rupert Hart) and present owners (BV Ventures) of ABC within the principles of the three strategy lenses (design, experience and ideas). (12 marks)

(c) Discuss the concept of critical success factors (CSFs) and key performance indicators (KPIs) in the context of ABC, identifying and justifying appropriate CSFs and KPIs for the company under its new owners, BV Ventures. (12 marks)

(d) Discuss the meaning and value of a mission statement and evaluate BV Ventures' mission statement for ABC. Discuss how integrated reporting can be used to reinforce its mission and performance objectives. (10 marks)

Professional marks will be awarded in question 1 for the structure, coherence, style and clarity of your answer. (4 marks)

(50 marks)

Section B – TWO questions only to be attempted

2 Tailia College is a popular full-time catering college on the outskirts of the city of Tailia itself. The majority of students are 16 to 21 years old, although there are a few mature students. Approximately 80% of students live on campus, with the remainder living in the city centre. The college is approximately five kilometres from the city centre and is on a direct transport route, with buses running every 15 minutes from 07:30 until 22:00.

The college has a new head of educational development, Andrew Croft, who is responsible for the development of training courses and for the progression of students. Andrew is an innovative leader and is keen to help students progress at Tailia College. He has developed a plan to open a restaurant in the evenings, using the facilities of the college's café which serves simple snacks to the students during lunchtimes only. The restaurant will be open to the public and will be fully managed, catered and served by the students, giving them real commercial experience as a part of their studies. Andrew has asked the college's trainee business analyst to provide a cost benefit analysis for the proposal. This is shown in Table One.

Costs ($)	Year 0	Year 1	Year 2	Year 3	Year 4
Meal booking system(1)	36,000	1,000	1,000	1,000	1,000
Electricity and gas(2)		5,000	5,000	5,000	5,000
Assessment staff overtime(3)		50,000	50,000	55,000	55,000
Benefits					
Increased revenue(4)		40,000	44,000	48,400	53,240
College reputation(5)		0	150,000	300,000	350,000
Economies of scale(6)		30,000	30,000	30,000	30,000
Net cash flow	(36,000)	15,000	169,000	318,400	373,240
Cumulative net cash flow	(36,000)	(21,000)	148,000	466,400	839,640

Table One: Cost-benefit analysis for the proposed student managed restaurant

Notes:

(1) New hardware and software for the online meal booking system will be purchased. Software for the booking system requires an annual maintenance fee after initial installation.

(2) This is estimated based on the usage of the lunchtime café over the last year.

(3) It is a requirement for some staff to be present, to observe and assess students working in the restaurant. The assessment staff will receive overtime payments for this.

(4) The revenue is estimated to be the amount taken for meals over the duration of the year. This is increased by 10% each year to allow for increased prices and a growth in customers. It is expected that the food costs will be around 80% of the prices charged.

(5) The cash flow has been estimated based on the expected annual increase in the number of students enrolled by the college as a result of the enhanced student experience.

(6) Economies of scale are expected on the purchase of equipment and supplies.

The analyst suggested that the project should be accepted as it pays back the initial investment within two years. Andrew stated that whilst it is important to ensure that the college gains financially as a whole from the project, he is more concerned with the intangible educational benefits, not considered within the analysis. For example, he feels that improved grades should be forthcoming because students will experience real restaurant environments as part of their training. He is concerned that these educational benefits may not be delivered but has heard that a benefits management process would help with this.

Required:

(a) **Critically evaluate the cost-benefit analysis for the proposed restaurant. Your evaluation should include consideration of both the method of investment appraisal used and the relevance of information within it.**
(15 marks)

(b) **Explain the purpose, content and importance of a benefits management process, with reference to the proposed restaurant and the desired educational benefits.** (10 marks)

(25 marks)

3 'NICE' is a fast food restaurant which started out ten years ago as a single outlet and now has multiple outlets around the country of Lentonia. The fast food industry in Lentonia comprises four major competitors, sharing 80% of the market between them, and a large number of smaller companies. The majority of fast food companies in this market have specialised menus. 'NICE' specialises in noodle and rice meals and offers a wide range of dishes using these ingredients. An extract of the company results for the last year is shown in Table One. The gross profit margin earned by 'NICE' is roughly equal to the average for the industry.

Turnover	Gross profit	Number of stores	Market share
$758m	$232m	242	22%

Table One: Selected financial data for 'NICE' – Financial year 2016–17

The fast food market in Lentonia shows steady growth, but a recent study suggests there is a worldwide trend towards healthy, home-prepared meals which could have an effect on the market, should it continue. 'NICE' recognises that there is limited scope for growth in the current market, with its existing market share and the level of competition, but it wishes to grow to satisfy its shareholders. The company is therefore considering expanding into the neighbouring country of Beron.

The directors asked a market analyst to provide a report into the fast food industry in Beron. An extract of that report is shown at Figure One.

> The fast food industry in Beron has developed into a competitive market, with just three major national brands, holding 65% of the market between them, and a large number of smaller, regional brands. Each region tends to have its preferred variety of fast food and so the national brands offer a wide variety of menu choices to suit different regional tastes, whereas the smaller regional brands focus on their regional menu only.
>
> Market growth has recently slowed down to an average annual growth rate of 5%. The current annual market turnover is $7,000 million. The average gross profit percentage is 18%.
>
> The country has a strong farming industry and the fast food industry buys most of its supplies locally. The three major brands have diversified vertically and have acquired supplier farms and food processing plants. These food processing plants provide processed products, such as burgers, to many of the smaller regional competitors.
>
> There is evidence that the major brands tolerate the regional brands, but will act together to deter any new overseas companies from entering the market. Actions have included rather nationalistic marketing campaigns such as 'Grow your country, eat local', in addition to lobbying local authorities to refuse planning permission for more fast food restaurants. However, these actions have led to some problems for the existing companies, with the 'Grow your country, eat local' campaign being taken on by campaigners seeking to encourage healthy eating, as the nation's obesity rates increase. Local authorities have become concerned about the number of fast food restaurants and have begun refusing planning consent for regional fast food companies wishing to open further outlets.

Figure One: Extract from report into fast food industry in Beron

Coincidentally, 'NICE' has been approached by Go, one of the rapidly growing regional brands in the Beron market, with the suggestion for a joint venture in Beron. The company is looking for further expansion across Beron but does not feel it has the resources, or the market power, to do this alone. It has only 25 restaurants, but its average annual turnover per restaurant is $2·3m, compared with the industry average of $1·2m. 'NICE' is interested in this opportunity but has stated that it would prefer a full acquisition of Go rather than set up a joint venture. Go has said it might consider this, if the terms were right.

Required:

(a) Use Porter's five forces framework to assess the attractiveness, or otherwise, to 'NICE' of entering the fast food market in Beron. (18 marks)

(b) Evaluate the advantages and disadvantages to 'NICE' of acquiring Go, as compared with a joint venture with Go, as a method of entry into the fast food market in Beron. (7 marks)

(25 marks)

4 TEV is a manufacturing company based in a rapidly developing nation. It has traditionally manufactured its products using manual techniques with some automation but the chief operating officer (COO), Samuel, had sponsored a project to install a fully automated production line. The production line is now fully operational, albeit later than intended. A summary of the project timeline is shown below:

February 2015

The project was initiated by Samuel, amidst much hype. There was a factory demonstration to staff showing the space where the new production line would go and outlining the efficiency savings, and therefore the overall profitability of the company, which would arise as a result of the project. He stated that the completion date would be August 2016 and, as a result, the company would increase its market share by 20% over the following three years.

After the presentation, Samuel had called one of the factory shift managers, Da Lin, into his office and informed him that he would be taking on the role of project manager, along with his current role.

May 2015

Da Lin received the production line designs during a meeting with the contracted supplier. The contractor informed Da that the work would take approximately 12 months from the date of approval of the designs.

January 2016

Samuel resigned his role at TEV, and was replaced by Meesha as COO.

March 2016

A progress meeting was held, but Da Lin was unable to attend as he had been absent for six months due to a long-term illness. Thus, the meeting involved the contractor, Meesha and Da Lin's deputy, Byron. The contractor informed the meeting that it was still awaiting TEV approval of the new designs before it could begin the final construction and installation. The new designs would allow a greater number of different products to be manufactured using the automated production line. It stated that the project should now be completed in May 2017, as there had been delays in getting each stage approved, and the designs had changed. Meesha stated that she was unaware that the contractor was waiting for action from within TEV and said she would investigate and resolve the matter.

After the meeting, Meesha asked Byron to take over the role of project manager, and to get up to date with what had happened and what needed to happen for completion.

February 2018

The production line was opened by Meesha, and immediately put to manufacturing the product for which it was intended. The first production run took two hours to produce the same number of units which would typically be produced in a day. The first customers to receive the products commented on their superior quality. Byron, standing with his colleagues, muttered 'I'm so thankful that's over. I was so overloaded with that and my daily tasks that I didn't know whether I would ever see the end of it'. Luckily, Meesha, who was standing nearby, did not hear him above the noise of the new machinery.

Meesha is now wondering how the whole project could have been managed better, as she is considering further automation. She is concerned that the costs, which were $60,000 over budget, may make the new project financially unviable.

Required:

(a) Analyse how the production of a formal 'terms of reference' (project initiation document) and a business case would have helped address problems encountered in the project. (13 marks)

(b) Distinguish between a post-implementation review, a post-project review and a benefits realisation review and analyse the value of each of these in the context of the scenario. (12 marks)

(25 marks)

End of Question Paper