

## **CGMA AUGUST 2015 EXAM ANSWERS**

### **Variant 3**

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### **Section 1**

**From:** Finance Manager  
**To:** Manjiri Kamat, Director of Finance  
**Subject:** Investment Decision

#### **Expanding the stadium**

From a purely financial point of view, the expansion of the stadium would increase capacity by 25%. Ticket sales have actually declined slightly in revenue terms since last year. Average attendance leaves significant excess capacity at the stadium as it is at present, so no additional revenue would be generated most weeks. Average attendance means that the stadium is  $26,000/36,000 = 72\%$  full for home fans and  $7,000/12,000 = 58\%$  for visitors. Increasing capacity could mean that the stadium feels 'empty' and lacking in atmosphere, which could actually depress demand for tickets.

The only time that capacity is an issue at present is when Glory plays against Walleen, which happens only twice per season at home. Crucial matches are also better attended, but those are likely to be the matches against Walleen because many supporters will expect Glory to win against other clubs. If we assume that all ticket sales come from Glory's home games then the average ticket sales per match will be  $V\$163,642,000/18 = V\$9,091,222$ . If we increase capacity by 25% and use that excess capacity twice per season then the additional revenue will be  $V\$4,545,611$ . Even overstating the additional revenue, this appears to be a poor return on a  $V\$50$  million investment.

Against that, if the national team catches the public's imagination, it may be that all home tickets will be sold if the side plays at Glory's stadium. Presumably, Glory will receive a share of ticket sales in return for the use of the stadium and the extra capacity may yield further value because of that.

The expansion may distract the Board from the more pressing matters of running the club and managing its success in soccer terms. The building work will also divert cash from investment in the team, which is arguably a more secure investment in terms of generating additional revenues.

Scenario planning may assist Glory's Board in reaching a sensible decision. The additional capacity will give the club new scope in future years. Firstly, if Glory is successful in stimulating demand for tickets then it will be able to exploit that demand if the capacity is already in place. If the expansion is delayed until the demand materialises then the club may struggle to accommodate the additional supporters while parts of the stadium are closed for expansion. There is a fairly long lead-time from committing to the expansion and the capacity being available for occupation. That lead-time could be reduced, though, by the Board commissioning the plans from an architect and seeking the necessary permission from the Government. The paperwork could then be filed until it was needed.

The use of the stadium for other purposes should also be considered in the scenario planning. For example, rock concerts frequently sell to full capacity and so the extra seats could make the stadium more attractive as a venue. It may be that some opportunities will be lost altogether as major bands are unwilling to appear at a 48,000 seat stadium.

### **Rights issue**

The rights issue would amount to V\$50 million/V\$120 million = 42% of share capital and premium. This will be a very substantial rights issue in relation to issued share capital, which suggests that it may be unlikely to succeed.

Given the doubts about the financial viability of expanding the stadium, the shareholders may be unlikely to perceive this as a positive NPV project and so the issue may be unattractive. The shares will probably have to be issued at a substantial discount from the current market value in order to deal with negative perceptions. This discount could further discourage shareholders from investing. Alternatively, they may be unwilling to see their holdings diluted by the large discount and so may feel obliged to invest.

Kartar will almost certainly feel obliged to take up all of his rights. The proposal would not be going forward without his express support and so he must be seen to buy up his rights. That more or less guarantees one third of the issue.

The other shareholders are generally fans with small blocks of shares. The absolute cost of taking up the rights in that case may not be particularly expensive and so many fans may be willing to support their club. The investment could be presented as a matter of club loyalty rather than financial return and so the supporters may be willing to invest. Having said that, the fans may like the stadium as it is and may not be keen to encourage the Board to change the stadium.

The fact that many of the shareholders may be unsophisticated investors may mean that they do not sell their rights if they do not intend to exercise them. If a large proportion of the rights lapse then the issue will fail to generate the expected amount.

The prospect of the national team playing at the stadium could provide a soccer-based incentive to buy the additional shares. The fans may be motivated by the prospect of having international matches at the Glory stadium rather than at a rival club's. Apart from team pride, most fans live in Praree and it will be easier for them to attend international matches played in their own city.

## **Section 2**

### **Lessons in handling the shareholder**

Kartar should be aware of the very obvious role that he plays in both Glory and Glorious Energy. Both entities are firmly linked to him. Whenever there is any form of relationship between the two then stakeholders on both sides are likely to suspect a conflict or the abuse of power.

Kartar should have been more transparent about the advertising banner, perhaps referring to it in the governance section of Glorious Energy Group's annual report. The V\$400,000 annual payment is unlikely to be material in monetary terms, but the Group's shareholders may regard it as material because of Kartar's involvement in the club. The same disclosure should also have indicated any other relationship between the entities and whether those dealings were at normal arm's length prices.

Kartar should not have announced the decision to rename the stadium in response to the question because it simply adds weight to the sense that there are underhand dealings between the club and the Group. A clear statement to the effect that the Group benefitted from the prominent advertising would have been sufficient. It would have been better if he could have truthfully stated that the Group had similar advertising at other stadiums.

Given the prominent advertising that is obvious to anybody attending a match or watching television coverage, Kartar should have had an answer ready for this question.

### **Lessons in handling the media**

The club should have been ahead of this story and should have taken care to have all interested parties briefed and ready to respond. As indicated above, Kartar should have been warned not to make the name change public in advance of a formal announcement from the club.

Kartar has only announced that the stadium's name will be changed, but he has not stated what it will be changed to. That leaves scope for conjecture and both fans and the media have decided on the worst possible case, where the King's Yard title will be lost altogether. It may be that Glory's intention is to rename a stand or an entrance in honour of Glorious Energy or that the stadium will incorporate elements of the old name such as 'Glorious Energy King's Yard' stadium.

As soon as Kartar's revelation occurred, the club should have drafted a press release in order to contain the damage. The club's supporters could have been informed of the new stadium name using social media or other means. There should have been a senior spokesperson ready to comment on the club's intentions and he or she should have been fully briefed.

### **Business consequences of upsetting fans**

Generally, soccer fans support the same club for the whole of their lives. In that sense, Glory is unlikely to lose any fans in the long term because of this controversy.

In the short term, alienating the fans could cost Glory revenue from ticket sales, particularly if they decide to boycott home matches because they are upset at the change in name. If fans decide not to renew their season tickets then that could lead to a serious decline in annual revenues. Even though ticket sales are only a small proportion of total revenue, it will still have an impact on the bottom line.

Similarly, sales of merchandise will be affected by disgruntled fans, who may not wish to associate themselves with the club by wearing its colours.

Sponsors and advertisers may be unwilling to continue their association with the club if it has alienated its fans because they may decide not to buy the sponsored or advertised products. Those funds will be committed in the short to medium term and it is unlikely that any protest will continue for long enough for Glory to lose sponsorship contracts altogether, but it will be a distraction at the very least.

### **Ethical consequences of upsetting fans**

The fact that soccer fans do not generally change their allegiance creates a sense of responsibility for Glory. In many respects, soccer fans make an even greater commitment than the shareholders. They make continuing sacrifices through the purchase of tickets and merchandise. Unlike the shareholders, they cannot unwind this financial commitment through the sale of their investment.

Kartar appears to be manipulating his relationship with Glory to satisfy his own ego. Other fans are unable to enjoy the same privileges that he has, such as him keeping offices at the stadium and discussing team tactics with the Director of Soccer. The team's name is already based on the name of his other major creation, the Glorious Energy Group, and he should not rob the supporters of the few traditions that they enjoy, such as the stadium name.

It would appear that there is a lack of objectivity in this whole story. It is unlikely that any other advertiser would have the stadium name changed simply because of the regular purchase of advertising space beside the pitch.

## **Section 3**

### **Risks**

Kartar appears to be an enthusiastic fan of Glory, but that does not necessarily make him an expert in managing a soccer team. His involvement may be well intentioned, but that does not prevent him from harming the club by interfering in decisions that he is not necessarily competent to make.

Good governance requires that the Board be collectively responsible for strategic decision-making. The implementation of that strategy should be left to the expert and specialist managers who are in that role.

If Kartar meddles in the implementation then nobody will be in control of the team's management. Decisions made by the Team Manager may conflict with changes made by Kartar. Kartar should really either take full responsibility for such decisions or leave them all to the Team Manager.

Apart from anything else, the Team Manager's position may become untenable if Kartar continues to interfere. His only realistic course of action may be to resign from the club.

### **Managing the signing**

There is nothing to prevent any member of Glory's management from passing information to the Team Manager if they feel that it would improve the team's performance. Kartar should have contacted Simon to explain that he had seen a potential new signing for the club and explained why he felt that the player would be valuable to the team. Ideally, Kartar should have obtained some video footage or other sources to assist Simon in deciding whether to pursue matters.

In general, new players should be signed because they are needed to complete the team or to make it more effective. It will be potentially wasteful to sign players just because they play well if that ties up cash in signing fees and wages that are needed to fund a different position.

Ideally, Simon should have had the opportunity to see the player in action before a decision was made. The player could then have been considered against alternatives who might have been signed instead, in order to decide who would make the greatest contribution or offer the greatest value for money.

Even if the commitment was to be limited to a loan of the player, Glory's doctor should have had the opportunity to assess the player's health and fitness.

### **Should Simon be held accountable?**

It is probably unfair to hold Simon accountable for the team's performance if he has been unable to contribute to major decisions on signing players. If he is forced to select players on the basis of decisions made by Kartar then that is even more unfair because it may prove difficult to develop suitable tactics that suit both the new signing and the other available players.

Nevertheless, Simon must be held accountable. As a manager he has been given a set of resources and a set of objectives and constraints in their utilisation. As with any manager, he must ensure that he makes the best use of those resources. If he is not held accountable then nobody will be responsible for the overall performance of the team and so there is a risk that results will slide. Simon must be told that his job is to build a set of tactics around the new signing and deliver goals and wins in the process. Otherwise, he will simply be able to excuse losses on the grounds of Kartar's interference.

Simon may be demotivated by the decision to sign the player without consulting him and by the order to play the signing in every match, but he will feel that his authority has been further undermined if he is not made accountable for the team's performance. Making him responsible will not only boost his morale, it will equip him better to stand up to Kartar because he may feel that it is necessary for him to assert himself for the sake of his own career as well as the good of the club. Kartar has a number of supporters on the Board, if only because a number of them have been recruited from Glorious Energy Group, and it may be difficult for the Board to support Simon unless he forces a confrontation with Karter.

### **Viktor and Simon**

The Director of Soccer is in a complementary role to that of Team Manager and there is likely to be some overlap. It is desirable for the two to develop a good working relationship so that they both work together effectively. One of the challenges is that Viktor's management experience was at the highest level in terms of club management in the European leagues, while Simon has less experience and much of his management career was with second division clubs.

Simon's management experience in the lower divisions in Europe could mean that he has better experience of training and managing players who are not at the very top of the sport. Viktor's experience may be more forward looking and could come into its own as soccer develops and emerges in Veldoun.

It may be appropriate to create a distinction between working with the players themselves, which could be left entirely to Simon and setting wider strategy for sporting success, which could be Viktor's role. For example, Simon could be responsible for team selection on a match by match basis and for setting tactics against specific opposition teams. Viktor could concentrate on issues such as Glory's standing in the league and the need to finance the signing of new players in order to maintain success.