

CGMA AUGUST 2015 EXAM ANSWERS

Variant 4

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Section 1

Counterfeit claims

Kartar's suggestion raises both reputational and ethical issues.

From a communications point of view, Kartar is in danger of damaging Glory's reputation and actually implicating the club in this scandal. At present, nobody will dispute the fact that we have subcontracted the manufacture of our shirts to a reputable manufacturer. We have agreed prices and terms of trade, but we can easily argue that we did not select the specific factories in which the shirts were made. If we assert those facts clearly, then it should be a simple matter for us to deny that we were involved in the employment of child labour and the tolerance of unsafe working practices. We can make it clear that we will be reviewing the arrangements for manufacturing these shirts and will be seeking binding assurances that manufacturing will cease immediately until we can be certain that the workers making our shirts are being treated humanely.

If we deny that the shirts were really ours then we will risk changing the direction of the press coverage. It will be a simple matter for the journalists who uncovered the story to follow these shirts through the distribution chain. It will quickly become apparent that these shirts are ours and our denial will make it appear that we were concealing our interest for some devious purpose. We may be open to accusations that we plan to tolerate the use of this factory or others like it. Our open dishonesty will, in any case, become part of the news cycle.

From an ethics perspective, the CIMA Code of Ethics is a perfectly valid basis for our purposes.

As a quoted company we should behave with integrity. We should be honest and truthful in our business dealings. If we agree to be represented on a television documentary then we should tell the truth even if that is embarrassing to us.

We aim to attract young people into a healthy sport and to teach them sound sporting values. That translates to a need to act with professional competence and due care in our treatment of other people, even if we have no direct relationship with them. This documentary represents an opportunity to address and remedy some human rights abuses and we should cooperate in any

way that we can to express our concern that we have been dragged into the mistreatment of these factory workers. We can act as a role model for our fans, particularly our young fans, by stating that we deem Morro's behaviour to be unacceptable, if only because they have been reckless.

Professional behaviour suggests that we should accept responsibility for the effects of our actions and do our best to mitigate any misbehaviour acted out on our behalf. We cannot be expected to investigate every supplier in the same way that the documentary maker did, but we can accept responsibility for resolving this problem.

Internal audit

The primary role of the Internal Audit department is to conduct compliance tests on behalf of the Board. Glory's directors can identify the matters that ought to be included in our contract with Morro (or any company that replaces Morro as our preferred supplier). The contract should, for example, specify that Morro should ensure that Glory's shirts are manufactured under safe and humane working conditions. The contract should specify the procedures that Morro agrees to undertake in order to discharge these contractual terms. The classic role of the Internal Audit department would be to test compliance with these designated procedures.

Glory's Board could make it a condition of continuing with these manufacturing arrangements that Morro's activities be open to investigation by Glory's Internal Audit department. The Board could then ask the Head of Internal Audit to identify key aspects of the contract and to observe their implementation, with a full report of the result to be delivered to the Board. Any failures could be taken up with Morro and could, perhaps, lead to the termination of the contract. The report itself would, hopefully, demonstrate that Glory has acted in good faith in its dealings with manufacturers even if a further abuse claim surfaces.

The starting point would be to check that Morro has agreements in place with specific subcontractors and that these specified Glory's expectations in the manner established by Glory's Board. For example, Morro should be permitted to subcontract the final manufacturing, but Morro should remain responsible for the standard of care and working conditions for production staff. Morro should be required to investigate these factories by conducting unannounced inspections on a regular basis. Glory's Internal Audit department should then confirm that these inspections have occurred by reviewing the reports prepared by Morro's staff and discussing their findings with the staff who conducted these reports. The purpose of this is to confirm that the inspections actually took place and so the internal auditor would be asking open-ended questions to establish the credibility of the information being provided. For example, asking about travel to the factory and the time spent on the visit will all enable Glory's internal auditor to establish whether Morro's staff have credible stories.

Glory's Internal Audit department can also conduct a small number of factory visits themselves, ideally while the club's shirts are being manufactured.

Section 2

Risks

Manufacturing shirts requires a considerable level of knowledge, even if the work is to be subcontracted. Glory has plenty of experience in the basic design of shirts, but a factory requires more detailed instructions in terms of fabric, manufacturing processes, etc. For example, should the club logo be embroidered into the shirt or attached using a transfer? There are significant cost and quality control implications to those decisions.

Glory has no experience of selecting factories and contracting manufacturing. An experienced manufacturer such as Morro knows the pitfalls associated with working in particular countries and with particular manufacturers. Glory could easily end up in the same situation as Morro was, with the unauthorised subcontracting of the work to a factory with unacceptable working conditions.

Companies such as Morro have the ability to place orders for a sensible range of sizes. If Glory is unaware of these proportions then it could end up ordering, for example, too many small shirts and too few large ones.

Morro is also experienced in the quality control issues associated with taking deliveries and with ensuring that the shirts can go into the supply chain.

Sathey has been very naïve with respect to the challenges of selling the shirts. There is no doubt that there is a market for Glory shirts, but the only relationship that we have in order to exploit that market is with the club shop. We cannot sell shirts to the wider market without retailers being willing to sell them and we may struggle to be taken seriously if we are selling only a relatively small quantity of a niche product. Some retailers may have an exclusive contract with Morro and may be unwilling to buy shirts from anyone else, including us. Alternatively, we may have to give retailers a much larger discount from the recommended retail price than would have been negotiated with a major manufacturer such as Morro. Thus, we might not obtain the full benefit of eliminating a link from the distribution chain.

Morro was also able to distribute some of our shirts overseas, which was feasible because they are a global brand. We would struggle to maintain links with foreign retailers.

Consumers may be reluctant to buy shirts from an unknown brand. Some consumers bought the shirts for leisure purposes because they had been branded as Morro products, which made them attractive. Our branding may not carry the same perceived value.

Difficulties in managing funding and working capital

The initial investment will comprise setting up costs and the initial investment in inventory.

Setting up costs may be difficult to quantify because they will consist of travel to meetings with suppliers, manufacturers and customers and for factory inspections and also the costs of recruiting a team. These costs could easily be lost in the general running activities of Glory, but they could still be significant and should be taken into account in the initial evaluation of this proposal.

There will also be opportunity costs in the form of the time that will be taken in discussion and decision making by Glory's senior management.

Working capital will require Glory to decide on the optimal inventory holdings to manage the traditional inventory issues associated with placing orders and holding inventory. There will also be complications associated with volatility in demand, which could create the risk of retailers running out of inventory and Glory losing revenue.

Purchases of inventory are unlikely to be priced in V\$ and so there could be currency issues, with payables in a foreign currency that could be open to transaction risk. The amounts involved may make it difficult to justify any form of overt hedging and the result of currency movements will probably be limited to changes in the ongoing profits from the sale of shirts.

Difficulties associated with motivation

The team will effectively constitute a cost centre. They will have little or no ability to control sales in any direct way and so they may not be credited with generating any profit. Sales may be a reflection of the club's popularity and its place in the league rather than factors under the control of the team such as product design and quality.

The team members are likely to be new to the club because Glory has no current manufacturing interests. They may find it difficult to establish themselves as part of the club because their activities will involve very little interaction with the other departments. They may be viewed as somewhat peripheral to the club's overall vision.

It is highly unlikely that Glory will offer any kind of career structure to the team members because the work is unlikely to lend itself to promotion within Glory. The team itself is unlikely to grow significantly, so the team leader is unlikely to be put in charge of additional staff.

Section 3

Sustainability

It could be argued that the club is in the leisure and entertainment industry and that none of its activities are particularly sustainable or environmentally responsible. The sport encourages tens of thousands of people to travel significant distances every week in order to watch a game being played.

With respect to the shirts, a great deal depends upon perception. It could be argued that the supporters are likely to enjoy changing fashions and designs in their soccer shirts in the same way that consumers enjoy changing fashions generally. The changing styles do seem to force the replacement of shirts, but children would tend to grow out of shirts within a year or so anyway and adults may feel that a shirt should be replaced at the end of a year's frequent wear. It is unclear whether Glory's policy does necessarily force people to buy shirts.

On the other hand, supporters may wish to wear the latest shirt in order to demonstrate their allegiance to the club and the policy of making a particular style for only one year may enable the club to charge a premium price. If shirt designs remained the same then the market could become saturated and prices might be generally lower. Social pressures do appear to be putting fans under some pressure to pay more for their club shirts.

Homewares

One approach would be to study the markets for such products, ideally in terms of sales by other clubs in Veldoun. If other clubs have thriving demand for such products then Veldoun is likely to benefit from the same level of demand.

It may be possible to evaluate initial demand because of modern production techniques that make it possible to create prototypes and even short production runs without excessive cost of complication.

It is highly unlikely that the homewares will create anything like the same level of demand as for soccer shirts. Supporters may be keen to wear the club shirt when watching a match, but they will not necessarily wish to have their homes decorated with the club logo and colours. Those who do buy a mobile phone case or a lampshade will probably regard that as a single purchase and will be unlikely to replace it with another Glory case or shade. Once initial demand for such items has been met then the sales will probably tail off to a steady state.

To an extent, the question is slightly redundant because there is no particular reason to cease the production cycle for shirts in order to manufacture other products.

Skills

The merchandising department will have to return to the basic premise that merchandising is about identifying a need and fulfilling that need. The temptation might be to launch a vast range of products in the hope that some succeed, but it would make far more sense to identify a genuine interest in a particular item.

One skill that will have to be developed is in deciding which accessories might have a viable market and which might not. The Merchandising Department could hold a series of focus groups to evaluate suggestions concerning new products and to comment on prototypes. These should be facilitated in such a way that participants feel free to express a frank opinion about products that they would not consider buying.

The Merchandising Department should learn to link products to a particular lifestyle. For example, children may be keen to have Glory lampshades in their bedrooms, whilst most adults would probably choose not to decorate using the Glory logo. Adults might be prepared to buy tasteful clothes and accessories that are attractive in themselves.

Evaluating the Merchandising Department

The revenue figures will have to be tracked, but that might not indicate the stability of income from the sale of merchandise. The department's primary goal should be to develop innovative and attractive products, so that there is always a realistic expectation that sales will continue into the foreseeable future.

The number of new products or improvements to existing products should be tracked. This demonstrates that the department is bringing new products to the market. Sales figures should be broken down to show the percentage of sales contributed to the overall total by these new products, if only to deter dysfunctional behaviour such as launching new products for the sake of enhancing this statistic.

Glory should conduct regular surveys to establish what their customers think of each of the products that it sells. For example, online customers could be asked to rate the products they buy on a Likert scale. Products that consistently score badly should be reworked to address the problems or they should be withdrawn altogether.