

## **CGMA MAY 2016 EXAM ANSWERS**

### **Variant 1**

**The May 2016 CGMA exam can be viewed at**

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### **SECTION 1**

#### *Task 1*

There are arguments for and against this proposal, with the arguments in favour tending to be the stronger.

We need to start by making an explicit statement of the strategy that this investment might underpin. Essentially, Dreempark sells an escape from everyday life. Its parks provide a fantasy environment in which visitors can relax and enjoy new experiences. This ride is clearly very consistent with this strategy because it offers visitors an opportunity to “fly with dragons”, making it an extension of the present strategy.

The new ride uses significant developments in technology to offer a novel experience. It should excite the imaginations of potential visitors and so stimulate demand. It will also give previous customers an incentive to return to Dreempark in order to ride Dragon Fire as well as revisit other attractions.

Dragon Fire will generate enormous publicity around the world, building on the Dreempark legend in the process. The ride is sufficiently dramatic to attract the interest of newspaper and television news editors. Furthermore, our host governments will also find ways to incorporate the ride into their own tourism publicity. Such publicity is impossible to buy through traditional advertising.

There are potential arguments against this investment. Firstly, the technology itself appears to be unproven. It may be very difficult to translate the engineers’ intentions into a ride that actually delivers the intended experience. Any disappointment will result in negative publicity because editors will regard that as newsworthy too.

It will also be extremely difficult to quantify the returns from this investment. It may be possible to “refresh” Dreempark’s unique selling proposition in less expensive ways. Visitors may be interested in the ride, but may decide that it is not sufficiently enticing to alter their vacation plans and so we will simply offer superior entertainment to the visitors whom we would have had anyway.

Internal stakeholders are largely affected by the financial implications of any decisions. Management should evaluate investments in terms of the risks and rewards that they will bear.

Internal stakeholders include employees and shareholders.

Employees' job security may be affected by the success or failure of this investment. A successful project will stimulate growth in visitor numbers, which is likely to benefit existing employees through promotion if more junior staff are taken on and higher earnings if additional overtime is made available. There is unlikely to be a significant downside, unless the losses associated with product failure would be sufficient to require downsizing. Overall, the project is unlikely to have a serious adverse effect and so the Board can proceed without too much consideration of the employees' needs.

The shareholders are affected by the anticipated net present value of the project. The share price will move in line with market expectations concerning the project, which may differ from management's evaluation. If the projected returns are good, then the Board can proceed even if the share price is likely to fall in the short term because the actual cash flows will restore the share price as the project proceeds. Thus, the Board has a fairly objective basis for evaluating the project from the shareholders' perspective.

### *Task 2*

External stakeholders are essentially those who are outside of the business, but who have an interest in how it behaves. The interests of those stakeholders may be protected by laws and regulations. For example, emissions can harm the local community, but they will be regulated. The Board may also have a moral obligation arising from the extent to which the stakeholders are affected and their ability to manage those effects for themselves.

External stakeholders include customers and governments.

Dreempark has a responsibility to ensure that its customers enjoy the experience that it promises in its promotional materials and on its website. If Dreempark cannot meet expectations then customers may feel that they have wasted a great deal of money and also their vacation time. This does put pressure on Dreempark to maintain the quality of its offering, although it doesn't necessarily follow that the company has to invest in costly rides. In any case, customers can protect their interests simply by going elsewhere, so Dreempark can evaluate these investments in terms of maintaining revenues from the sale of entry tickets.

Governments have a number of interests in Dreempark's activities. Dreempark is responsible for providing a major boost to local economies, as an employer and customer for goods and services. Multinational corporations such as Dreempark can put host governments under pressure by threatening to relocate, although it may be difficult for Dreempark to do so in a cost-effective manner because of the nature of the assets that would have to be removed. The most appropriate way in which Dreempark should address government's needs would be by obeying the spirit of any laws. For example, by paying tax in line with profits earned rather than manipulating the tax burden through artificial schemes that are generally open to multinationals.

## **SECTION 2**

### *Task 1*

The first point to note is that there is no single criterion that can be used, other than the maximisation of net present value. We need to establish a logical sequence that can be explained to the three directors so that they can see that their concerns are being taken seriously.

### *Publicity*

Arguably, the first park to receive Dragon Fire will derive the greatest benefit from the initial publicity. The construction of the second and third Dragon Fire rides will not be nearly as newsworthy as the first.

In making the best use of the publicity, we may decide to avoid the Japanese park because the opening of that park will be a major news event in itself. Situating Dragon Fire there in time for the park opening may enhance the news value, but the message could be lost or diluted.

The Middle East park is enjoying growth and the addition of Dragon Fire might stimulate that growth further. There is often significant press interest in any innovations in that part of the world, which has a reputation for being at the forefront in terms of technology and innovation. The publicity attached to such a launch in the Middle East could make the Dragon Fire ride “aspirational” in the minds of potential visitors to the other parks. This would help create a desire to ride on the attraction that might be maintained while waiting for construction to be completed in the other parks.

The European park would undoubtedly attract significant benefit too. The downside is that Dreempark is clearly aiming to create a global brand. The company should not be seen to favour the parks in the host region, thereby risking a perception that Dreempark is a European brand.

There is also a danger that the three European parks are sufficiently close to one another that building Dragon Fire at one of them might draw visitors away from the other two European parks. If visitors to Europe gravitate towards the park with the Dragon Fire ride then we may risk overcrowding and lose much of the benefit of the publicity.

### *Cost*

The fact that Japan would be the cheapest park in terms of location could be a consideration. Given that there is a slight risk of some technological or marketing issue that would undermine the success of the launch, the construction of the first ride in Japan would give Dreempark an opportunity to evaluate the project before proceeding with the other parks. The ride was designed by a Japanese engineering consultancy and so the designers will be more readily available to give advice during the construction of the first ride.

Building in the Middle East might create particular problems. Civil engineering can be complicated because of high temperatures and sandy soil. This may mean that there would be a shallower learning curve if the first ride was built elsewhere. The knowledge gained could then be applied to the particular problems of building in the Middle East.

Overall, the costs associated with constructing the first ride in the Middle East are probably outweighed by the publicity and so the order might be Middle East, then Japan (ideally after setting aside space for the ride in a revised ground plan), then Europe.

### *Task 2*

The starting point would be to make the purpose of the mentoring scheme clear and explicit. Dreempark aims to offer visitors the same experience at any park, regardless of its location. This means that there would be value in the management teams exchanging ideas and experiences, so that a sense of shared values can be created.

One approach might be to create a management programme for junior managers. This would enable them to be seconded to another park for a short period so that they could work alongside a designated mentor. The relationship between mentors and mentees might then be maintained by email or video conferencing once the staff members return to their home parks. This approach would create a clearer sense that there is a recognised career path for Dreempark’s junior managers because selection for the programme would indicate the likelihood of promotion.

More senior managers who are appointed to Dreempark from outside might not be suitable candidates for secondment. It may be more effective to pair newly appointed managers with a more experienced counterpart at another park. The two could stay in contact electronically. This would enable mentees to seek advice on an informal basis on matters that they would be reluctant to discuss with their line managers.

The biggest problem is that designating European mentors could be viewed as creating and maintaining a sense that the managers in the Middle East and elsewhere are somehow inferior. There could, hypothetically, be more experienced managers in the Middle East and Japan who are being mentored by less experienced counterparts in Europe.

Europe is a large and diverse continent. There are four parks, including the UK park, spread across Europe. There are just as likely to be cultural differences within Europe as between Europe and other parts of the World. The implication that Europe, as a whole, is somehow superior to the rest of the World may be regarded as offensive and even racist.

The most realistic response to this threat would be to extend the mentoring scheme so that all managers could be eligible to act as mentors, regardless of their location. In the same vein, European managers would also participate as mentees. The fact that there is a two-way dialogue in any mentoring relationship means that mentors will learn from their mentees and so European experiences will still be communicated across the company even if the mentor is Japanese and the mentee is British.

It may also be sensible for Dreempark's senior management to distinguish Dreempark's European roots from the company's longer-term development. Managers may be more receptive to the idea that Dreempark has created an ethos that should be applied consistently at all parks. That ethos may be most readily observed at the European parks because they are the oldest and not because they are European.

### **SECTION 3**

#### *Task 1*

We might use the CIMA Code of Ethics as a starting point.

Objectivity would require us to determine whether there are any overt risks associated with the new ride. If we are confident that it is safe then it would be acceptable to build the first version anywhere. That depends on us being able to determine the risks for ourselves. If we have any doubts about the safety of the ride, and so the construction is effectively an experiment to establish whether the ride is safe, then it would be unacceptable to argue that we should go ahead on the basis that local laws do not prevent us from doing so.

Professional behaviour would require us to maintain the company's good name and reputation. The fact that we have built the first ride in a country that has relatively lax rules will be picked up by the press in the event that there is an incident. Our safety reputation lies at the heart of our business model, which focusses on the provision of family entertainment and so the losses could be considerable. Selecting a country that has lax regulations is highly dishonest in itself and is effectively lying to the visitors who are exposed to the risks.

#### *Task 2*

The main consideration is whether MIMC has the necessary skills to undertake this task. In the past, MIMC has relied on contractors to take charge of the actual building work. The fact that these experts are nervous about this undertaking might suggest that MIMC is unaware of just how risky or difficult this venture is.

Even if MIMC can build the ride, there is a risk that the contract will overrun or that there will be quality issues. Dreempark may be unable to make best use of the publicity opportunity because it will not wish to start advertising until shortly before the ride is opened.

If MIMC has the necessary project management skills from working with other companies on previous projects then it may be able to build the project to a higher standard. The fact that it engineered the designs means that it can sidestep the meetings to liaise with the primary contractor and explain the designs.

If MIMC's engineers are occupied on this building project then they will be unavailable for work with Dreempark's competitors. Other park operators may be keen to upstage Dragon Fire and they may wish to employ MIMC to make an even more ambitious ride.

### *Task 3*

The most obvious reassurance would be to explain how we intend to fund the project. If we are seeking a loan, for example, it would be ideal to be able to show documentary evidence that the loan had been approved. There are very few risks associated with this approach, provided we do not overstate our ability to pay.

The second possibility would be to pay in advance, on a staged basis. This would mean that MIMC would have the reassurance of payment as each stage would be paid for in advance as it got under way. This would be a drain on our cash flows and would also leave us exposed to the risk that MIMC might fail.

Finally, we could grant MIMC security over, say, some of our land. This would mean that they could simply call in the security in the event that we are unable to pay. It would also mean that we would have much less scope for negotiating a settlement in the event that we could not keep up with the payments.

### *Task 4*

The main role of the team is to ensure that all communications between Dreempark and MIMC are clear and effective. Any delays or miscommunications could be costly or could leave us disappointed with the final result.

For example, if the engineers at MIMC come up with possible improvements to the ride while construction work is under way, the liaison team will ensure that Dreempark considers the costs and other issues in time for the changes to be made if that is the preferred treatment.

The team will also ensure that any concerns addressed by either party are communicated to the appropriate people in the other company. For example, if the project's costs start to exceed budget then Dreempark will have to decide what action to take.

The team members will also be able to act on behalf of their respective employers in the event of an agreement being required. For example, the contract may specify that a payment is due when the work reaches a particular stage of completion. Dreempark's liaison team members will be ideally placed to confirm that the stage has been reached.