

## **CGMA MAY 2016 EXAM ANSWERS**

### **Variant 4**

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

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### **SECTION 1**

#### **Task 1**

There is little to be gained in direct strategic terms for Dreempark. The merger would create an entity that was probably too strong in the UK and possibly elsewhere in Europe. Dreempark is working towards global expansion and so the attraction of additional parks in the region where it is already strongest may not appeal. The merger may prove a distraction from Dreempark's strategic growth overseas, where the potential rewards are likely to be far greater. Any merger will require a great deal of management time. Furthermore, it may be decided to close some of Happyworld's parks in order to avoid clashes with Dreempark locations.

This might not be a conclusive observation, but the two companies' statements of financial position imply that Dreempark is the larger of the two entities. This suggests that Dreempark would be the larger partner in any merger and that its Board would have more influence over the future strategy of the business than Happyworld's management. If that is true then future changes to Happyworld's former business might favour Dreempark's strategic position. That might offset some of the concern about possible distractions for Dreempark's management.

There might be an opportunity for Dreempark to create some options for itself through this merger. For example, the former Happyworld parks might be suitable for redevelopment as a complementary leisure business. Their location would preclude them being Dreempark sites, but Dreempark could consider an alternative concept. For example, they might be reconfigured as amusement parks that attract visitors from a nearby tourist resort, so they are less ambitious as investments and would not draw business away from Dreempark's existing facilities. The merged entity could then cater for the "annual holiday" market alongside the "short break" business.

One major strategic issue is the question of blocking potential competition. If Happyworld is taken over by a travel company, an airline or a hotel chain then we could find ourselves facing a serious challenge in the form of an operator which provides holiday packages that are linked to visits to Happyworld parks. For example, an airline could invest heavily on improving Happyworld's parks to the point where they might compete with our own. Foreign visitors will then be able to fly from their local airport, be collected by coach and taken to the Happyworld location. We might find it difficult to establish that level of infrastructure in order to remain competitive.

## *Task 2*

The two businesses operate in the same basic business, so there will undoubtedly be operational synergies. For example, online ticket sales can be consolidated into a single system that will sell tickets to both Happyworld and Dreempark locations. Marketing activities can also be consolidated, with valuable synergies to be had. For example, a single website will mean that visitors looking for Happyworld will also find Dreempark and vice versa. We will also need only a single marketing department to design promotional campaigns and other activities.

The merger may create synergies in the form of economies of scale in purchasing and manufacturing. For example, food to be sold through park outlets can be rationalised so that larger bulk can be created and larger discounts negotiated. This might create an opportunity for savings in the UK and in Continental Europe because the various parks can all be served by the same suppliers. Branded souvenirs can easily be purchased from the same suppliers for the whole of the merged group and shipped around the world to all locations, so the potential savings there might be even greater.

Theme parks require large numbers of employees and a single HR function may make it possible to rationalise aspects of recruitment and training. We could, for example, advertise jointly for both Dreemparks and Happyworld and we may interview for both at joint facilities. Most training programmes can be common to both parks. For example, basic first aid training can be to a common syllabus and training teams can cover both locations. There may be even more scope for synergies in specialised training on topics such as staff management for newly promoted supervisors.

The parks themselves will not offer scope for combination because Happyworld parks will not be immediately beside Dreempark's. There is unlikely to be sufficient free space alongside any of the Dreempark sites to make it possible to construct a Happyworld as a further attraction. If there are any that are reasonably nearby then it may be possible to sell a combined entry ticket to both Dreempark and Happyworld. Apart from possibly stimulating demand, such arrangements will also mean that visitors might spend an additional day of their holiday buying food and merchandise from both parks.

## **SECTION 2**

### *Task 1*

Presumably, Dreempark will wish to retain the matrix structure because this appears to have been successful in the past. Happyworld has a more straightforward functional approach to managing, which may reflect the fact that Happyworld has a tighter geographical spread. Continuing with a matrix structure will lead to a steeper learning curve for Happyworld's managers once the merger goes ahead. We may increase the number of operations directors to have one for the UK and another for the rest of Europe to reflect the fact that the UK will have a total of three parks.

Apart from the control benefits, a matrix structure will normally require more Board members and so there will be less need to lose directors from the merged entity. The more Board positions there are, the less pronounced the competition will be and so the inevitable conflict will be minimised. Retaining experienced Board members will also ensure that expertise remains within the company so that the benefits and opportunities from the merger can be maximised. The retention of the structure applied by Dreempark may also help to stamp our position as the more dominant party.

The chairmen of both Happyworld and Dreempark should meet in order to establish a joint Nomination Committee. Majorpark's Board should include a mixture of directors from both of

the former companies in order to avoid the impression of a takeover. Selection should clearly be on merit rather than former employment. If necessary, the Nomination Committee should consider making an outside appointment in the event that neither Board has a suitable contender for a particular role in Majorpark's Board.

The Nomination Committee should invite the current complement of directors to indicate whether they are willing to be considered for Majorpark's Board. Those who are should be given the opportunity to make a presentation on the direction that they would like Majorpark to make. These presentations should be evaluated both on their commercial merits and on their consistency with the direction that Majorpark is likely to take. The Nomination Committee should then discuss the overall composition of the Board and make an announcement concerning the successful candidates. If individual directors are identified on a piecemeal basis then there may be more scope for internal politics to apply, with those who know that they have a place on the Board working to appoint their preferred colleagues.

## *Task 2*

It will be difficult to change a culture of rigid compliance to one that allows a degree of flexibility and discretion because Happyworld's managers may find the prospect of change daunting. There is a degree of security to be had in applying the rules in a rigid manner. There is little point in aiming for a middle ground, with reduced discretion applying to former Dreempark management teams, because that would be demoralising. It might also be difficult to communicate the revised limits for discretion at Dreempark.

The most immediate priority is to train Happyworld managers to change their leadership styles to allow for greater flexibility in their management of junior managers and staff. If they cannot demonstrate the necessary tolerance and confidence in their staff then the changes will be cosmetic and the opportunity will be lost. It may be helpful to organise staff exchanges so that Happyworld managers can spend time gaining experience at Dreempark while their Dreempark counterparts spend time socialising junior staff at Happyworld. Managers will have to be clear on when they should assert themselves and when they should step back and delegate, which is a delicate balance.

Procedures manuals and other documentation will have to be developed so that Happyworld staff know the limits of their authority. There should be realistic limits on discretion, otherwise there will be anarchy and inconsistency. Additional training will have to be provided to ensure that employees appreciate and understand the new regime. Care should be taken when the inevitable complaints arise that staff are not sent mixed messages. Errors should be dealt with by counselling and encouragement unless gross misconduct is involved.

Happyworld may have to look towards the new culture in staff recruitment. If staff are expected to work with a little more discretion then they may have to be a little better qualified and a little more experienced when they are recruited for any given role. They may require more flexible and adaptable personalities. It may be necessary for Happyworld to adjust pay rates to attract such staff.

## **SECTION 3**

### *Task 1*

We should start by looking back at recent actions by the competition authorities. We need to appreciate the factors that are likely to trigger an investigation. For example, is it simply market share or could it require, say, an unjustified price increase? It may be possible to pre-empt such action by disposing of some parks or by reassuring the authorities in some other way. In that case we will be retaining greater control over the outcome.

It may be helpful to meet with the competition authorities in order to explore the possibilities. For example, it might be argued that theme parks are a tiny part of the overall market for leisure and tourism. The merger between Dreempark and Happyworld might not be viewed as an issue by the competition authorities. This is an area where we might benefit from seeking legal advice.

### *Task 2*

We have a duty to maximise shareholder wealth. The ethical principle of professional competence and due care suggests that we should act decisively in pursuing this duty. If a constraint limits us then we should attempt to eliminate any constraint that prevents us from earning profits. We might argue that it would be unethical of us to permit the government to break up our business for no good reason.

The concept of integrity requires us to be straightforward and honest. The law exists to protect society and Majorpark will benefit from operating in a society that is well managed by the rule of law. It would be hypocritical to threaten to circumvent the law by abusing our freedom to move capital. In this case, closing the parks in one of our host countries would cause significant harm to the stakeholders whom we would be leaving without jobs and businesses. Given that we would have to find buyers for the parks, which could prove difficult, we could be lying if we said that we intended to pull out, which is hardly acting with integrity.

### *Task 3*

The merger terms have to be settled by negotiation.

The market capitalisation is affected by market expectations, which may affect the fairness of any weightings as suggested. For example, if the market believed that Happyworld's directors would negotiate a better settlement then Happyworld's share price would increase and Dreempark's would decrease. In other words, Dreempark's shareholders would receive fewer shares because of the short term views of the market. The directors of both companies could abuse this approach by attempting to manipulate share prices up until the cut-off date.

A clear negotiation can take past share prices into effect in the settlement. The negotiators can also allow for long term trends and averages in the share prices, which is more likely to offer a fair settlement to both sets of shareholders. A negotiated share price can also allow for the contribution that each company will make to Majorpark. For example, the Happyworld parks are in need of major reorganisation, while Dreempark sites are thriving.

### *Task 4*

There are potential problems when remuneration schemes focus on any single factor. This tends to encourage dysfunctional behaviour.

The shareholders are always keen to see profits maximised because they generate wealth. Dividends are paid out of profits. The problem is that the profit figures can be increased in

artificial ways, such as through creative accounting. There is also the risk that management will take a very short term view that boost short term profits and leads to a net decline in business.

The danger with share price is that management cannot necessarily do much to maintain it. In an efficient capital market, the stock market evaluates the Board's ability to deliver a strong share price performance. The Board cannot consistently outperform this expectation because any unexpected improvement will be factored into the market's expectation. The Board can only "beat" the market by manipulating the share price, which is hardly behaviour that the shareholders will wish to encourage.