

CGMA MAY 2016 EXAM ANSWERS

Variant 5

The May 2016 CGMA exam can be viewed at

These answers have been provided by CIMA for information purposes only. The answers created are indicative of a response that could be given by a good candidate. They are not to be considered exhaustive, and other appropriate relevant responses would receive credit.

CIMA will not accept challenges to these answers on the basis of academic judgement.

SECTION 1

Task 1

It would help to clarify what it is that we actually sell.

From a strategic point of view, we aim to be a major holiday destination. We have a relatively small number of very large parks and our visitors must travel significant distances in order to spend time with us. A visit to one of our parks requires a whole day and there is the possibility that visitors will wish to visit two or even three parks. The majority of our visitors will require hotel accommodation.

From a strategic point of view, there could be synergies associated with operating hotels. For example, the availability of an adjacent hotel might make a visit to a Dreempark complex more attractive and the parks would attract hotel guests. We could further promote the hotels by offering benefits that would cost us very little. For example, the hotel guests might be offered priority for park entry. It would cost very little to promote the hotels because we could integrate the hotel promotion with that of the parks. Hotel guests will have to rely on either the park catering or the hotel dining room for their meals and drinks.

From a strategic point of view, we might threaten alliances with other stakeholders. Any relationships with major hotel chains could be threatened by the fact that we are now competing with them. Local communities will not benefit to the same extent from being close to a Dreempark site because visitors will not be as likely to come into local towns for accommodation, food or shopping. The loss of goodwill could lead to problems with local government agencies, which will have less incentive to treat Dreempark as a valued neighbour.

The hotel business would possibly divert resources, such as management attention. We know and understand the theme park business and we have no experience of building and managing hotels. We will have to sacrifice land that might otherwise be used to extend the parks, for hotels. At present, there are plenty of hotel operators who are happy to run hotels in proximity to our parks and so we could simply let them continue to offer this service.

Task 2

The hotels will require a dedicated management team, which will be motivated by the fact that they have direct representation at Board level. The operation of the hotels will be different from that of the parks and the challenges will be different. This makes it useful to have a Board member who is tasked with the hotel venture. Managers may find it frustrating to have to explain the basics of hotel management to the Board, with no representation to speak on their behalf. The Board might set targets that are unrealistic, or apply performance measures that are suited to theme parks and not to hotels, if they do not have a colleague who can guide them.

This will be a major investment that will require leadership. It will be easier to recruit someone of the necessary calibre to head this venture if there is a seat on the Board for the right candidate. This person will be a major asset to the Board in terms of taking charge of the construction and development of the hotels, leaving the rest of the Board free to manage the parks. A Board member will have greater credibility in dealing with contractors and government agencies when negotiating matters relating to the hotels. The appointment of a director will be reported in the business press and so the markets will be more confident that this venture will succeed.

The matrix structure may become complicated by the appointment of a director for hotels. The Board has functional directors, who are responsible for areas like HR, and regional directors. A director in charge of hotels would not fit well within this structure. There is a danger that the new appointment will confuse the lines of reporting and responsibility for the Board. For example, who will be responsible for HR issues in the hotels? This problem might be overcome by having "hotels" as a geographical region, so that there would be a Director of Operations, Hotels.

Having a director for hotels might diminish the sense that the hotels are intended to bring additional revenue to the parks. The newly appointed director might, for example, be motivated to maximise hotel profits even if that is at the expense of the group as a whole. Issues such as the recognition of revenue from a visitor booking that covered both accommodation and park entry might cause friction within the Board. The new director may be tempted to push for additional investment and facilities that are unlikely to assist in operating the hotels as an adjunct to the parks, but which might help the hotel chain itself to grow.

SECTION 2

Task 1

The key to successful environmental reporting is transparency. If we provide stakeholders with clear and meaningful information about our sustainability then we will be able to demonstrate our willingness to take responsibility for our actions. We need to determine the key benchmarks that are appropriate to the hotel industry so that our figures are comparable with other hotel chains. We should aim to publish targets in the first instance, so that we can address the immediate concerns of environmentalists.

We should recognise that this will be a sensitive issue. As a company, we contribute to global air travel by attempting to attract foreign visitors to our various parks. The leisure industry may improve the overall quality of peoples' lives, but we cannot argue that our product meets a pressing need. At best, we might argue that we are aiming to minimise the damage that we do to the environment, while providing enjoyable life experiences. We might also point out that some of the environmental impact is not directly attributable to our activities. People will bathe and flush toilets regardless of whether they are at home or staying at one of our hotels.

During the construction phase, we should report the benchmarks that we are aiming for and compare these to industry averages. The fact that we are building from scratch means that we can design the buildings to be environmentally friendly. For example, we might use higher than normal levels of insulation to minimise the need for heating or air conditioning. We might demonstrate our commitment to sustainability by publishing examples of expenditure on measures to save energy or water. For example, we may decide to invest in solar energy to generate electricity or to heat water, even though such additional investments are not necessarily financially attractive.

Once the hotels are open and operational, we should publish our actual performance against targets. We should be careful to include factors that might easily be overlooked, such as the proximity of the hotels to the parks meaning that visitors do not need to drive between their hotels and the main gate, as they would if they stayed in a local hotel. We should also be careful to ensure that our performance is understood in context. For example, holiday hotels may have guests who stay for seven or fourteen nights, while visitors to a theme park may stay for only a few days. This may mean that we have to launder bedding more frequently than a traditional vacation hotel. We should offer stakeholders both qualitative and quantitative analysis so that we can explain our approach while offering “hard” information.

Task 2

The most immediate problem is that this is a new venture. We have no direct history to draw upon. If we do not have targets in the first instance then staff may not be fully motivated and initial performance may flag. We should make use of the experience of the managers whom we recruit to develop an understanding of a set of credible and meaningful targets. These factors should be measured on a regular basis and early feedback should be used to determine whether the initial targets should be modified.

The performance of the hotels may be difficult to separate from that of the parks. If the numbers of park visitors decline then there will probably be less demand for hotel accommodation, regardless of how well the management team is performing. There may also be cross subsidies if, for example, the Board decides to give hotel guests a discount on park entry then we will need to decide whether it will be charged to the hotels or the parks. The Board should ensure that all profit figures are reported in the context of the business as a whole, with both park and hotel management being recognised as providing a contribution.

Guests may have unrealistic expectations of the hotels because of their association with the parks. The promotion for the parks stresses fun, excitement and novelty. Getting back to a Dreempark hotel after a day in the park may seem like an anti-climax and guest feedback may reflect that. The Board should be realistic about the satisfaction levels that they are likely to receive from the hotels and should ensure that hotel managers are not demoralised by moderate satisfaction scores.

A related issue arises because hotel guests may be unlikely to complete feedback forms unless they are dissatisfied. Happy guests may be too busy enjoying themselves to provide feedback, while dissatisfied guests may use the feedback forms as a means of retaliation. There is also a risk that dissatisfied guests will feed back via social media sites that are visible to the public and so the hotels’ reputation may be damaged. Dreempark should ensure that hotel guests have a helpful point of contact for dealing with problems, so that negative feedback can be pre-empted by resolving the guests’ complaints before they leave.

SECTION 3

Task 1

The Flinders business model appears to view the hotel as a destination in itself. Our interest is in facilitating visits to our theme parks. The risk is that the Flinders hotels will aim for an adult clientele that will not be interested in visiting Dreemparks. That, in turn, may deter families from staying at Flinders Dreempark Resort Hotels. Flinders' guests may take up parking spaces, making it more difficult for Dreempark visitors to park and possibly costing park revenues. Some Dreempark visitors might find it distasteful to have a casino in the grounds of a theme park that offers family entertainment.

The Flinders management team has much greater experience than we do in managing destination hotels and so customer service may be enhanced, thereby boosting revenues. The more adult setting may create demand for services such as conferences and wedding receptions and so Dreempark could have a more diverse income. The Flinders model may be less affected by seasonal demand, such as school holidays. We would be exposed to revenues, but not costs, and income from leases is fixed so we may be at less risk in the volatility of future cash flows.

Task 2

Integrity requires us to be straightforward and honest. Claiming that we are not polluting or understating our carbon footprint by leasing our land to a third party is arguably misleading. We need to be clear about our motives. If we agree to Flinders' proposal in order to avoid the responsibility for reporting our environmental impact then we are clearly in breach of this principle. If we have a clear business justification for using Flinders then we can make that explicit in our reporting, so that we are at least admitting some culpability. Even so, we will not be fully transparent unless the terms of our contract force Flinders to disclose their sustainability performance to us and permit us to publish the results.

Objectivity requires us to avoid having our judgement overridden by self-interest. We should not distort our reporting of environmental performance because there is a cost associated with doing so. Our actions have implications for our stakeholders and we should be honest about that. We should not use any form of creative accounting to manipulate these results. We should explicitly take responsibility for Flinders' actions while operating our hotel franchise.

Task 3

This will be difficult because it is unlikely that Flinders will grant us the ability to conduct our own investigation of their records.

As a start, we should set budgets for the royalties and should investigate any variances. During the planning stage of this venture we should agree targets for occupancy rates and room prices and so we should be able to estimate our royalties. Flinders should explain any and all factors that affect our payments and we should check these explanations for credibility.

We might permit customers to book hotel rooms through the Dreempark website. We could deduct our royalties at source and pay Flinders the balance. We could also compare the trends in internet bookings against the trends in demand as reported by Flinders.

As part of the agreement, we could ask Flinders to commission its external auditors to report to us on the revenues recorded by the Flinders Dreempark Resort Hotels. This would give us independent confirmation of the completeness of this figure.

Task 4

Firstly, we might look at the factors that indicate Flinders' rating by the markets. If Flinders has a strong share price or a high P/E ratio then we might benefit from any association with them.

We might brief the analysts who specialise in our industry and seek their comments. If they are generally enthusiastic then we will probably receive buy recommendations which will boost our share price.

We should allow for the fact that the market knows that we have this free land and there will be speculation on what we will eventually do with it. If there is public comment to the effect that we will or should expand our theme park business on this land then releasing it for some other purpose may create a degree of uncertainty which could cause the share price to decline.

If the Board is confident that this is a positive NPV project then that confidence should be visible to the capital markets. We will not release the detailed business plan, but we will be interviewed by the business press and we will have to answer some searching questions and our responses could inform the share price movement.