

CGMA FEBRUARY 2017 EXAM ANSWERS

Variant 1

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

Part 1

The various formal codes that deal with governance generally state that it is undesirable for one individual to hold this dual role. Putting the Chairman in charge of managing the Board and the CEO in charge of managing strategy creates scope for mutual oversight at the very highest level. There have been major scandals that have been attributed to the fact that there was a single person acting as both Chairman and CEO. The very fact that Evestar's Board must report non-compliance with Teeland's Code is undoubtedly an argument that it is undesirable for Denny to hold this dual role.

The fact that Denny founded Evestar adds to the concerns about his dual appointment. In the early stages of the company's development, he would have undoubtedly regarded it as "his", and with good reason because it would not have come into existence without his support. This attitude may well have been healthy and a factor that motivated him in driving the company's early development, but it may also mean that he takes an unduly possessive attitude. This attitude is no longer appropriate now that the company is quoted and it is in a mature state. The shareholders will be looking for steady and responsible management that is accountable to them. Denny may have an unacceptable sense of entitlement because of his early role in the company and he may make unacceptable demands in terms of remuneration and other benefits.

Denny's association with How Music creates the threat of a conflict of interest. For example, Evestar may lose the opportunity to develop the musical careers of acts discovered on various programmes because Denny uses his position to sign them with How Music instead. There could be other forms of abuse, such as unknown acts which sign up with How Music being promoted on shows such as Teeland Variety or Starmaker. The lack of any formal link between Evestar and How Music could actually deepen this concern because accountability will be more difficult to establish.

There could be an argument in Denny's defence. It is unusual, but not unknown, for quoted companies to have this dual appointment when they believe that the individual can manage the business effectively. Denny is clearly a creative individual who has a strong track record in show business. His skill set may make him almost unique when it comes to developing successful television programmes that present musical talents. His role as the face of

Teeland Variety, Evestar's most popular and longest running programme, could also be at risk if he is asked to step down from either of his Board positions.

Part 2

From a strategic point of view, it would appear that Evestar has developed three successful programmes that are still being broadcast and one that has enjoyed some success, but whose popularity is dwindling (The Cavern). This may seem like a rather limited output from a company that prides itself on its creativity. If there have been any other programmes then they have not stood the test of time because none of them are currently being broadcast. The most recent development appears to be running into difficulty, with declining viewing figures, which is particularly worrying because it is a clear departure from the basic formula of viewers watching competing entertainers and voting on a favourite. The fact that the show under development to replace The Cavern is essentially the same format that has been translated to a ship instead of a cave does little to inspire confidence in Evestar's ability to develop new programmes.

The complaints about programme formats may ignore the fact that Evestar's revenues have been growing steadily year by year since 2012. The most significant measure of a successful strategy is that it can deliver sustainable growth in revenues and profits. Evestar has developed at least three successful programmes and appears to be focussing on promoting the success of each. It could, for example, be argued that the hands-on nature of the CEO's involvement in the 15 week annual production cycle for Teeland Variety is evidence that Evestar is prepared to invest heavily in maintaining the success of its programmes.

It is debatable whether it is logical to measure the success of Evestar's strategy in terms of the creativity implied by the range of programmes on offer. The company's success is measured in terms of profitability and the creation of shareholder wealth. The fact that three of the programmes that are on offer follow a successful model suggests that Evestar has a strong grasp of its strengths and capabilities and has used these to create synergies, such as maintaining viewers' willingness to pay for their participation in voting for winning contestants. In a sense, basing the basic programme on entertainment introduces an implicit updating of the show because music and other styles of entertainment are constantly changing and so the programmes will evolve alongside the styles of entertainment.

Looking at the reality television industry more generally, there is relatively little to suggest that Evestar is lagging behind its competitors. Bonchant has only three programmes, of which Hear My Song could be said to be similar in nature to Evestar's shows. The other shows are relatively short-lived and may be in danger of losing viewer interest because they seem rather slight. Bonchant's revenues lag significantly behind Evestar's, which suggests that the shows that it has developed are no more successful. The other forms of reality television would not appear to offer direct replacements for major "events" such as Teeland Variety. There appears to be very little to recommend a move into documentary-style programmes such as Capital City Canal because those shows do not attract significant advertising revenue.

SECTION 2

Part 1

The dividend policy appears to be to pay out most, if not all, of the profit for the year as dividend. The dividend payments themselves appear to be closely aligned to profits, with no attempt to offer a steady growth or other clearly observable pattern. It appears that Evestar is simply paying as much as it can every year. There was a reasonable level of retained earnings at 31 December 2012, which suggests that the company retained profits for at least part of the first six years. Perhaps Evestar's profits were significantly higher before 2012 and so it was possible to pay a dividend and retain earnings.

Evestar's share price was relatively steady until the end of 2012, thereafter it grew rapidly until the end of 2015, before slumping. If dividends have driven the share price then it might be argued that the market did not believe that the level of payments being made was sustainable. The comparison with Bonchant suggests that a steady growth in share price is possible, although Bonchant's dividend policy appears to be a little more conservative, with retained earnings being allowed to increase by just over 10% in the past year. The markets may be concerned that Evestar is going to get itself into financial difficulties through the overpayment of excessive dividends.

The dividends could appear to be motivated by personal greed. Denny owns 7% of the equity, so he will enjoy 7% of any payment. The 2016 dividend of 72-(124-121) = T\$69m would have given him a personal reward of T\$4.83m. Evestar's bank balance has been declining steadily from year to year and gearing remains high at $250/(174+250) = 59\%$. There could be serious concerns about governance matters arising from Denny's financial strategy and the possibility that his self-interest is harming the company.

Having said all of that, Evestar's business model generally does not require a significant level of funding for maintenance or even growth. The programmes require the use of rented accommodation and require little else in terms of initial investment. The gearing ratio has been high, but consistently so. That suggests that the levels in place are tolerable. The bank balance has declined, but it still remains in credit. The dividend policy may have created a number of risks, but it is debatable whether Evestar has been harmed.

Part 2

The starting point is to recognise that the CEO is expected to deliver sound strategic management. The most valid reflection of this would be the maximisation of shareholder wealth. To an extent, the share price could be used as a basis for measuring Denny's performance because any value that he can add to the market capitalisation will benefit the shareholders. Share prices can be manipulated to some extent, for example the reduction of dividends might help maintain share prices, so we could use the rate of return offered by investing in Evestar, measured by combining dividends and capital gains. We could further improve that by taking risk into account by linking Evestar's returns to the company's beta coefficient.

Denny's obvious contribution to strategy is the maintenance and development of the product portfolio, which could form the basis of a further KPI. Evestar produces a small number of programmes that must all be managed if they are to remain successful. Denny could demonstrate his performance by referring to viewing figures and satisfaction ratings for his various shows. There could be further measures of success by referring to the number of newspaper comments or social media references that indicate that the public is taking an interest.

Another measure of Denny's success is the relationship between Evestar and the broadcasters. The company has two programmes being broadcast on IndTV and one each

on NTV1 and Peeps. The renewal of contracts for new series would be one sign that Denny has managed this aspect of strategy well. The level of fee may also be a useful KPI because it would indicate that Denny is working to maintain both programme quality and the value perceived by the broadcasters. If factors such as advertising rates are publicly available from IndTV and Peeps then the maintenance of the rates paid by advertisers would be a further measure of Denny's success.

Audience satisfaction scores are also a vital element of Denny's performance because they reflect the long-term viability of the programmes. Healthy viewing figures for, say, Teeland Variety could be due to the fact that none of the other channels has anything more attractive to watch and so the programme could be vulnerable in the event that another channel puts out a more attractive programme at the same time. There could also be a tendency for viewers to watch a popular programme as it is broadcast, in order to see it as soon as possible. If they are less keen then they may record it, which would be less attractive to advertisers because viewers could then fast forward through the commercial breaks. High satisfaction scores will also put broadcasters under pressure to continue to show the programme because viewers will be unhappy if they threaten to replace a popular programme.

SECTION 3

Part 1

If Evestar has a report to hand then that would suggest that the company had conducted a full environmental assessment before implementation. That would demonstrate good faith with regard to the environmental issues being raised. If the report has yet to be commissioned then it may well do more harm than good to offer to publish it because it will appear that Evestar did not know what the environmental issues were before getting under way. The publication of the report may be presented as an act of transparency, although there will undoubtedly be counter-claims by the environmentalists, who will have reports of their own that underpin the concerns being raised by the protestors. On balance, Evestar probably has little choice but to publish an environmental report because it will be expected that the company has invested time and money in ensuring that its behaviour is environmentally responsible.

The protestors are unlikely to be persuaded by a report because their position is essentially about the more generic issue of whether business and leisure activities harm the environment. Politically, protestors cannot really afford to back down in the face of a positive report, even if it is provided by independent experts. It is unlikely that the publication of the report will help in any way. Public opinion may be swayed by the fact that this has the potential to become newsworthy because of the association with the popular television programme and because the setting is very picturesque. The report could possibly help persuade the government of Paradis to support Evestar against the protestors and environmentalists, so it might lead to any objections being overruled.

Part 2

The impact on the fishing industry could be addressed by consultation with local fishermen and possibly marine biologists on the reasons why the show might affect fishing. The first question is whether anchoring the submarine in the lagoon will interfere with fish stocks or fishing operations in any way and whether any changes to our proposal would help. For example, we might discuss the implications for fishing of different sites for the anchorage or the routing and timing of supply runs by motor boats. We should also ensure that there are no externalities or emissions that could harm local fish stocks. For example, the dumping of garbage or sewage at sea should be expressly forbidden.

We may be able to persuade the fishermen that they could profit from our activities. The submarine will require to be maintained and serviced and the cast and production crew will require transportation. We could offer fishermen the opportunity to use their boats to support the programme in return for a fee. Any lost revenues from fishing will, hopefully, be more than offset by earnings from business that we will generate for the fishermen and that should address the minister's concerns, at least in part. The other advantage is that the fishermen are familiar with navigating these waters in a manner that does not disrupt fishing, so we might also minimise the impact of our activities.

Calm Island is uninhabited, so the proposal will not affect hotels or other tourist accommodation. Our first priority is to establish why the minister believes that tourism might be adversely affected. We should consider whether the submarine will be visible from other islands and whether any visual impact might be minimised. For example, locating the submarine in a lagoon suggests that it will be at least partly surrounded by land and so there could be some concealment. There may be issues arising from, say, game fishing or wildlife tours that visit Calm Island. We should consider whether our activities would adversely affect these. For example, we might tow the submarine to a more remote location between production activities on different series.

The minister should be encouraged by the possibility that the submarine will attract visitors and stimulate tourism. Visitors may be attracted by the opportunity to see the set of what will hopefully become a popular television programme. It may also be possible to use the submarine as a tourist attraction in itself when it is not being used for production purposes. Finally, the contestants and production crew will require accommodation and will spend money in the local economy, so they will effectively be adding to the tourist revenues.

Part 3

The traditional focus of a post implementation audit would be on the costs of implementing the project. For example, the costs associated with buying, transporting and anchoring the submarine. These should be examined and a variance report prepared, allowing for any remaining costs that are still to be incurred. There may have been unbudgeted costs associated with managing the legal and public relations issues arising from the protests and these will have to be explained in the audit report. The audit should cover the suitability of the submarine as a programme set and the practicality of the location.

The post implementation audit should also consider whether the project has been compromised in any way as a result of the political issues encountered. The audit should document the discussions with local politicians and other stakeholders and should summarise any concessions made by Evestar in order to reach final agreement. The focus should be on lessons that can be learned and might be applied in future projects of this nature. It would also be useful to have a clear and comprehensive summary of any restriction on operations in order to assist with developing operational plans for this programme.

Part 4

Share prices reflect market expectations of future cash flows. The markets will not care that Denny is being criticised in the press unless there are associated concerns that his leadership is holding Evestar back in some way. We might start by gathering as much data as we can concerning capital market sentiments, possibly using Big Data. For example, there are capital market and shareholders blogs that could be searched for comments concerning Denny's leadership. Share price movements could be tracked alongside these to see whether complaints about Denny, or suggestions that he might vacate office, move the market. We might attempt to track reasons for changes in the share price and link these to Denny's strategy, much as the newspaper coverage did when it linked a drop in shares to alleged disappointment with the new show.

Another approach might be to hold meetings with key investment analysts who take an interest in our industry. The analysts are generally responsible for buying and selling quite large quantities of shares and so their opinions can influence the markets. The analysts would probably wish any briefing to cover Denny's likely replacement and the changes that would be associated with his departure, so they might not feel that they can comment on Denny's departure in isolation. One possibility would be to analyse the share price immediately after these informal discussions with the analysts. The very fact that they suspect Denny might leave could affect their view of the future and so a fall in the share price would suggest that they would prefer him to stay while a rise would suggest that he should go. We could obtain virtually the same effect by feeding rumours that Denny might leave to the business press, to see whether the share price rises.