

CGMA MAY 2017 EXAM ANSWERS

Variant 1

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SECTION 1

Part 1

Stakeholders

Medical profession

The medical profession will have a high interest in anything that relates to enhancing health, but a low to medium level of power over anything that relates to taxation because that is a matter for government policy. The profession will probably be in favour of the tax because it will discourage the consumption of an unhealthy product.

We might be able to persuade the medical profession to speak out against the tax on the grounds that it will confuse the public. Perhaps consumers will cut down on high-calorie drinks but will continue to eat and drink other unhealthy products. One response might be for us to agree to fund at least some of the education and other health initiatives and to work closely with the medical profession in order to use those to good effect if the proposed sugar tax is withdrawn.

Press

The press will have little or no active interest in the sugar tax itself, but a significant interest in any controversial matter that could attract readers. The press has significant power, if it chooses to exercise it, in terms of mobilising public opinion on any matter.

We might aim to attract the press' interest by issuing controversial press releases that are intended to stir up a public debate over the sugar tax. If we make our side of the case interesting then it might be more likely to be published. The other approach we might take would be to advertise heavily, thereby creating a financial incentive for the press to support our side in order to enjoy the advertising revenues.

Supermarkets

The supermarkets will have relatively low interest because the sugar tax may discourage sales of some drinks but boost sales of others. They will also have relatively little power over legislation. The supermarket industry is likely to be against any proposal that disrupts revenues, even if there is a degree of compensation from consumers switching to alternative products.

We might persuade the supermarket industry to support our case by changing our pricing of traditional and sugar-free drinks. A slightly higher profit on traditional drinks might be sufficient to persuade supermarkets to promote our case. We might also argue that the sugar tax is an initial step to encourage a more healthy diet, which could involve people eating less in addition to eating healthy alternatives.

Consumers

Consumers will have a high interest because they enjoy drinking high calorie drinks and they will be unhappy about the implications of having to pay more for their favourite product. Individually, consumers will have very little power over the Minister for Health's behaviour.

Fizz could create a focal point for this campaign, perhaps turning it from a health issue to one of retaining freedom of choice. It may even be possible to recruit an opposition party to speak out on the basis that high calorie drinks are only harmful if consumed to excess and that consumers have the right to choose whether to drink them.

Part 2

Risk register

The whole point of the risk register is to ensure that risks are kept under observation and are managed appropriately. We need to be realistic about both the risk and the severity in order to do so. If we rate every risk as high then we will waste resources on observing and managing risks that are unlikely to occur. Every risk that is listed must, by definition, have a chance of occurring, otherwise it should not be on the register. Thus, every risk classed as a likelihood of 1 or 2 could occur, even though such an event would effectively be unexpected.

The fact that we rated the likelihood at 2/5 could have been an accurate reflection of the information that was available to us at the time. We can only determine why the tax was given such a low probability if we revisit the information that was available to us at the time with regard to the government's intentions during the period leading up to the announcement. We might reassure Hong by explaining where the evaluation of the probability came from. We might also show that the risks had been reviewed reasonably recently in order to reassure Hong that risks are kept under constant review.

It is worth pointing out that the nature of both the food industry and of politics means that there will be a constant threat of adverse legislation. The government may wish to demonstrate its concern about public health and may target almost any sector of the food industry in order to do so. The proposals from the Health Minister would cost nothing for the government to implement and could even yield net revenues so it could easily be a policy that is kept in reserve by the government in order to distract attention from bad news elsewhere. In other words, it would be impossible to determine when such a policy would be proposed, if ever. In that event, we could easily waste resources in planning for such a contingency because there would be little or no warning as to when it would be put into effect.

The final point we might make is that the legislation is only a proposal and so there is no immediate threat. The proposal could prove so unpopular with the public that the government could withdraw it in order to avoid damaging its popularity. The Minister for Health may not

even wish to enact this legislation because it could be a political move to propose an unpopular tax and then withdraw it. The government may simply wish to create an argument that public health is difficult to manage because whenever the government tried to curb consumption of high-calorie drinks there was an outcry.

SECTION 2

Part 1

Ethics

The first issue is whether it would be unethical to suppress the report. We might consider this in terms of the CIMA Code of Ethics.

The concept of integrity suggests that we should be straightforward, honest and truthful in our business dealings. That creates a dilemma that does not have a straight answer. The Professor's report is based on facts and results that are freely available in the public domain. He has not actually done anything to prove or disprove the health and safety issues associated with sugar-free drinks and so we are not really suppressing findings. Any consumer, or consumer protection group, could easily study existing research in the manner that the Professor did and could draw their own conclusion. The Professor's opinion is inconclusive, at best, and so there is little to support the argument that it would be dishonest to suppress the report.

There could be an alternative argument, again based on the concept of integrity. We paid the Professor to prepare a report that would enable us to argue that low-calorie drinks are safe. Our own expert came back with a recommendation that the drinks are best avoided, despite it being clear that we wished the opposite conclusion. If it ever becomes general knowledge that we had suppressed this report then we might find ourselves facing a hostile reaction from the public, who would undoubtedly feel that we had suppressed material information. We might at least publish an edited version of the report that tells the truth about the evidence being inconclusive, but also states that these drinks are one way to reduce sugar intake.

We might argue that the issues associated with the manufacture and sale of low-calorie drinks is also open-ended from an ethical point of view.

The concept of professional competence and due care suggests that we should not act in a reckless manner that may harm an interested party. This suggests that we should not sell a product that is likely to harm a consumer. We have a report prepared by an expert that casts doubt on the safety of our drinks, so perhaps we should withdraw them until further work can be undertaken. It is our responsibility to avoid the manufacture of potentially dangerous products. At the very least, we should warn consumers of the potential risks so that they can make an informed choice.

Again, the ethical argument is unclear. Firstly, it is almost impossible to prove a negative proposition, such as it being safe to drink artificial sweeteners. If the food industry insists on testing to prove that a product is safe then it will never be able to use any new ingredients or products. We could argue that the NFDA's inspectors are experts who had the ability to test sweeteners to their satisfaction and that they felt that there was no reason to declare them unfit for consumption. It is also likely that withdrawing from the manufacture of low-calorie drinks will simply lead to consumers buying other brands and so there will be no impact on consumer safety.

Part 2

Sustainability

A sustainability report should reflect long-term profitability, social responsibility and environmental care. Long-term profitability is dependent upon the manufacture and sale of a safe product, otherwise future revenues will decline because consumers are concerned about their health. The sale of unsafe products is unsustainable and may be curtailed through legislation because of safety concerns, and so comment on consumer safety is a logical extension of the sustainability report. The fact that soft drinks are associated largely

with children makes it all the more important to ensure that their safety is managed and reported.

Safety is also a key aspect of social responsibility, particularly because soft drinks can be unhealthy when consumed to excess. Fizz's products are sold because they are enjoyable. Consumers could keep themselves hydrated just as easily by drinking water and so they do not really need to buy soft drinks. Fizz should recognise that it has a responsibility to ensure that consumers are free to enjoy drinking its products without suffering undue risk of harm. Including consumer safety in the sustainability report will recognise that it is aware of that responsibility and that it is discharging it effectively.

The most immediate issue is the question of the steps that Fizz is taking to ensure that its products are safe and are being consumed responsibly. For example, the provision of clear and helpful information on drink cans would alert consumers to the fact that a high-calorie soft drink should be regarded as an occasional treat within a balanced diet. Ideally, Fizz should exceed the statutory minimum for any such disclosures and should reflect that it does so in its sustainability report. The report should indicate any other steps that Fizz is taking, such as reducing the sugar content of its traditional drinks or developing safer and better tasting artificial sweeteners.

Fizz might also disclose any steps that it is taking in the wider community to ensure the wellbeing of its consumers. For example, if Fizz sponsored school sports then it could be seen to be encouraging physical exercise, which would go some way to offsetting the effects of the sugar contained in its drinks. It would also enable Fizz to demonstrate that its products could have a role to play in a healthy diet because soft drinks may help to replace electrolytes and to hydrate participants in sporting activities. Such activities would even be commercially defensible because they would develop brand awareness in a key consumer demographic.

SECTION 3

Part 1

Share price movements

According to the efficient markets hypothesis, share price movement will be rational in an economic sense if it is triggered by new information that has implications for future cash flows. If the market was taken unaware by the Minister's announcement of the sugar tax that could threaten Fizz's tax burden then a fall in share price makes perfect economic sense.

The gradual recovery in the share price could also reflect the fact that the market participants will actively look for new information. Even if nothing was announced, there could be leaks and rumours that could enable the market to infer that the sugar tax was unlikely to be enacted.

If the combination of the passage of time and other information enabled the market to establish that the sugar tax would not be imposed then it would be logical for there to be little or no response to the announcement that the proposal had been shelved. The announcement itself may be newsworthy, but it is not "news" if the market had been able to determine the outcome by itself.

Finally, the price could remain depressed because the whole episode could have had a significant and pervasive impact on revenues. For example, the debate over sugar tax could have led to greater consumer awareness that might reduce future demand for high-calorie drinks.

Part 2

Maximise shareholders' wealth

The 10% reduction will concern the shareholders because it means that their wealth has declined. That is not necessarily the same as stating that Fizz's Board has failed to maximise shareholder wealth.

Maximising wealth involves using the resources that are available to the Board to generate the highest expectations possible of future cash flows. Both the management process and the market's expectations will be driven by assumptions concerning the economic and legal environment in which the entity will operate.

Recent events may have changed long-term expectations concerning the demand for soft drinks or for the threat of a new tax regime, not necessarily a sugar tax. In that case, the decline in share price reflects a new understanding of future prospects and does not reflect mismanagement.

The market will anticipate a response to the new environment, and that will have been factored into the fall in share price. If Fizz's management is able to exceed expectations concerning these issues then the share price will rise.

Part 3

Delphi method

The essence of the Delphi method would be to discuss the possibilities with as many informed sources as possible. Ideally, these would be the decision-makers themselves, but they would be unlikely to make themselves available to a corporate interest such as Fizz.

As an alternative, Fizz might contact politicians who are not directly involved in the process because they might be a little more open. For example, retired ministers and/or members of the main opposition parties could be helpful. Their views might be worth having because

their experience of politics helps them to understand what is possible and what is likely to happen.

It could also be worth talking to political reporters, and certainly worth reading as much political news as possible. These reporters will generally be well informed about ministers' intentions and will also be used to leak ideas to make them less of a shock when they are formally announced.

Another indirect approach to gathering the thoughts of politicians would be to engage a lobbying company. Lobbyists will have private contacts with confidence assured, so they may be able to obtain insights that would not be available to Fizz.

Part 4

Strategic options

The starting point would be to identify possible scenarios which ought to be addressed in terms of forward planning. The sugar tax case suggests that Fizz ought to be prepared, in a general sense, for the possibility that there will be a decline in interest in high-calorie drinks or some external threat that could increase costs. Fizz might then develop a range of strategies that could be put into effect in the event that these threats were to emerge. For example, if high-calorie drinks were to become uneconomic, Fizz might switch the emphasis to other products in its portfolio. For example, sugar-free drinks might become more attractive to regulators and consumers. Fizz would adopt Porter's Generic Strategy of differentiation to sell its already popular drink in a low-calorie form.

Fizz might also adopt one or more of Ansoff's strategies, possibly market development. The company has a number of product ranges that are presumably classed differently in the minds of both regulators and consumers and it might be possible to develop new markets for existing products. For example, Joocy Fruit might be regarded as healthier and so it might be possible to present it as a more acceptable drink for young consumers. It is likely to be exempt from the sugar tax and so it would be possible for Fizz to plan ahead to consider ways in which it might exploit this product to best effect in the event that it could not sell its traditional drinks without restriction.