

MANAGEMENT CASE STUDY AUGUST 2015 EXAM ANSWERS

Variant 3

The August 2015 Exam can be viewed at

<https://connect.cimaglobal.com/resources/management-case-study-exam/august-2015-management-level-case-study-exam---scent-variant-number-3>

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Section 1

Target costing

Consumers buy celebrity fragrances because they like the smell and they carry an association to a celebrity lifestyle. They are highly unlikely to pay a premium for a fragrance just because it is costly to manufacture because that will not necessarily make the product any more desirable to wear. In the case of the Sarah Leabody fragrance the flowers themselves have no real bearing on the aroma of the fragrance, the actor has simply insisted that they be used.

At the lower end of the market, consumers will have a price point in mind when they are shopping for a fragrance. Scent must be able to supply its products to retailers at a price at which everybody earns a profit while keeping the overall price to what the market will pay. If the product is too expensive then it may be difficult to have retailers stock it because they are reluctant to waste shelf space on a product they perceive as overpriced and unprofitable.

Celebrity fragrances carry the additional cost of rights to use particular celebrity names. The charge for amortisation of intangibles in 2015 was \$Z 35 million, which is 6% of revenue for celebrity fragrances. These are additional costs that are specific to that segment of our product range and so we have the combined pressures on profit of a fickle market and a higher cost base.

Fine Fragrance products are slightly different because many of those products are well known and they have a, loyal base of consumers who use them. While selling price does matter, Scent knows that it has a reasonably steady demand for those products and so it is well known that we can make a profit. We also have the advantage that retailers have already demonstrated their willingness to support those products at their current price point.

Ethical implications

We could analyse the ethical issues in a number of ways. The CIMA Guide is a good starting point.

This case creates a complicated ethical dilemma because the most obvious breach is being committed by LK's employee. Scent has no particular responsibility to protect LK's confidence. Indeed, in order to maximise shareholder wealth, Scent has a duty to study competitors' behaviour and to develop plans and course of action that will enable Scent to compete against any likely developments.

We could start with the basic requirement that the principle of integrity requires us to be straightforward and honest in all business relationships and measure the facts against that criterion.

Firstly, we advertised a job despite the fact that we did not have a particular vacancy needing filled. That does not lack integrity because the perfumery department employs skilled artists who are difficult to recruit and a speculative advertisement could have enabled us to extend our capabilities in that area at relatively little cost or risk.

We asked the applicant in question some very leading questions, although we did not offer any inducement to breach LK's confidence. The applicant could have answered our questions with a little more discretion and the decision not to do so is really a matter for the employee. Perhaps we should have asked the interviewee not to divulge any confidential information about LK, although we were under no specific duty to do so.

We have offered the perfumer a significant pay rise for coming to work for us, and there is nothing to suggest that this offer is due to any specific skills. Alice Fairbanks is arguing that the perfumer's initial role would be to steal the proposed product that LK has under development. That appears rather underhand. We would clearly have no right to complain if LK, or any other perfume house, decided to use the same tactic against us.

Our reputation is likely to be damaged by this if we proceed. Consumers will feel that we have competed unfairly and that we do not have sufficient imagination to develop our own products. We may be portrayed in the press as treating a young actor as a commodity in attempting to prevent her from signing a contract with LK.

Section 2

Cost structures

LK focusses more on the bottom range of the market. That may mean that they have to focus more on cost because they have less scope for charging premium prices. They have a narrower range, which may mean that they can focus on fragrances that can be manufactured using readily available organic products. Our wider range of products will force us to use a greater range of ingredients if only because we have to provide more variety.

LK operates only a single factory, which means that they have the greater efficiency associated with working from a single site. We will have a certain degree of duplication because there will be fixed costs associated with, say, factory security that we will have to incur three times over.

LK has a narrower product range, which means that their promotional and advertising activities can be far more focussed. We may enjoy some synergy from advertising because we will promote the brand whenever we advertise any one of our products, but we still have to ensure that the market remains aware of our whole product range.

LK's factory is in a site that has high unemployment and so they may find it cheaper and easier to recruit and retain production staff. If there are fewer employers competing for staff then LK will not have to incur the cost of paying recruitment agencies to advertise jobs and interview candidates.

The flexible working conditions that are being offered will lead to a greater cost because the programme will have to be administered and managed. LK will also have to ensure that it avoids accusations of underpaying and exploiting vulnerable employees, so it will have to pay a fair hourly rate.

If staff turnover is reduced then there will be less of a learning curve, with wastage of materials not being wasted and other efficiencies associated with an experienced manufacturing team.

Comparability

On the basis of return on capital employed, LK does appear to be far more successful than we are.

We did suffer a significant loss this year because of impairment. If we excluded that cost then our operating profit would have increased by Z\$ 54 million, to give us a return on capital employed of $(69+54)/(546+347+54) = 13\%$, which remains less attractive than LK, but is still a marked improvement.

Our business models differ to a large extent. A significant proportion of our revenue and net profit come from the Fine Fragrance division. Our founders created a business on the basis of popular fragrances that consumers wish to buy for their own sake. LK has had the rather artificial benefit of its association with successful actors. That publicity may have considerable value in the short to medium term, but it may not be sustainable indefinitely.

Scent sells a range of Fine Fragrance products that may be going through a difficult period given that many countries are in recession. In the longer term, Scent may benefit from a resurgent demand when the global economy strengthens and disposable incomes increase.

LK's emphasis on organic and natural ingredients may enable them to be a little more profitable within our market segment because we tend to use more synthetic materials. We are selling slightly different products, which makes it harder to compare our relative success.

LK has a major advantage when it comes to the whole area of publicity and public relations.

The company's founders include two Hollywood celebrities, whose association with the brand will generate publicity at little or no cost. These actors will also find it easier to persuade other celebrities to lend their names at a cost that could be lower than the amount that we would have to pay for the same deal. Their inside knowledge may also give them the means to identify potential prospects for a contract before they reach the public's attention. It will be cheaper to sign up an actor who has not yet released a major film in a starring role.

Section 3

Big data

The most effective way in which big data might be used would be to track the number of references to particular actors in the press and on social media sites. There is a reasonable likelihood that the key supporting actors in popular films will be given more prominent roles in future releases and so could be working their way towards stardom.

Having found films, the next step would be to evaluate the number of references to actors in those films.

Big data could also be used to identify new forms of celebrity who may or may not have long term publicity value. For example, some contestants in talent competitions or participants in reality television events have a degree of prominence that can prove long-lasting. There is an associated risk that some celebrities become extremely famous for only a very brief period of time and so there may be no value in signing them up for Scent.

One problem is that the analysis could be distorted by the publicity being planted by film studios and even by actors' agents. Presumably, the film companies will expect to see some return from their efforts, but artificial "hype" is less likely to indicate a future star than a genuine response by the public.

It may be difficult to tell whether the comments made on a particular actor or other celebrity are positive. If an actor or singer receives a lot of negative comments then it may be counter-productive to sign them and risk alienating at least a proportion of the potential market for a fragrance product.

In the same vein, it may be difficult to measure the response by gender. If Scent is using a lifestyle statement to promote a perfume then it may not be helpful to name it after a female actor whose fan base is largely male.

Maximising Brian's potential

The first step would be to consider using Brian for more than just the development of celebrity-inspired fragrances. If Brian can evoke a particular personality then he can almost certainly evoke an emotion or a feeling, such as "calm and relaxed" for a home fragrance or a bath oil. In that case, Brian could make a contribution across all of Scent's divisions, which might maximise the number of products that he might develop.

Brian should be motivated and encouraged because we are using his ideas and enabling him to make a major contribution on the creative side.

We should bear in mind that Brian left LK because he was asked to participate in a project that was doomed because of a difficult personality. We should take care to insulate Brian from such demands. Indeed, there is very little point in granting the celebrity any real input into creative decisions over the fragrance and Scent should learn from LK's mistake by refusing to involve celebrities in that side of the business.

It is important that Brian's salary should remain competitive so that he cannot be tempted away for a further pay rise. We should take care to make him aware that we will match any serious offer if he is approached by any of our competitors, particularly LK. We need to make it clear that his rewards should not be discussed with other perfumers because that could cause ill feelings.

To avoid alienating other perfumers, we should avoid making it obvious that Brian has a senior role within the design function. Scent should create project teams and involve Brian in those to which it is felt that he could make a contribution. If his gift is in the basic formulation of the fragrances then perhaps he should be moved on to other projects once the initial design work is under way so that the other perfumers can then be left feeling that they are in charge of completion and implementation.

Section 4

Negotiation

We have a very strong bargaining position.

Firstly, we could simply change Brian's contract so that his job starts at the end of the six month period. We could make this attractive to Brian by making him an interest-free loan to fund a six month break, which could be repayable only when he leaves Scent's employment. In any case, we have very little to lose because it is unlikely that Brian's contract will contain significant penalties for his failure to refrain from working for a competing company. We could simply permit LK to apply that penalty and we could recompense him.

The threatened loss of intellectual property is possibly more of an issue, although it would be very difficult for LK to quantify the loss and so any legal proceedings against us could easily fail. Our fragrance is not the same as LK's because we will not be using mountain daisies as an ingredient and the worst that they can say is that our fragrance may smell similar to ours, although many fragrance products will have similar smells. The proposal to use a particular actor as a namesake is not really intellectual property, unless there are contracts in place that guarantee exclusive use of that celebrity's name. LK had no such contractual right and there is nothing to prevent us from making a more attractive offer to that celebrity while discussions with LK are ongoing.

The one thing that LK could do is take this story to the press. The press response could be to view the story as being about LK's failure to develop a fragrance that suited the celebrity namesake. The fact that LK is partly owned by high profile actors and that it has a policy of ethical behaviour suggests that the press reaction might be against Scent. We may be portrayed as the company that threatened the livelihoods of the factory workers in deprived areas or who harmed the company created by favourite actors.

Brian's future with Scent

We should be clear about the extent to which Brian is capable of contributing to Scent's future. He is clearly a talented perfumer, but we already have a variety of talented perfumers in our employment and so Brian's contribution may be marginal. The initial motivation behind the decision to employ him was to disrupt a project that LK had underway. We did not make him an offer because he was regarded as more gifted than our present perfumers.

We have to consider the likelihood that Brian will fit into the company. He applied for a job with us because he was unhappy at his previous employer. He may leave if we upset him in any way. He also seriously breached his previous employer's trust by divulging commercial secrets and by breaching his contract. We may regret keeping him.

We need to consider whether the dispute with LK could have any serious repercussions. We will incur legal costs and will have to engage public relations consultants no matter what we do. There will also be the distraction of having to plan and manage this dispute.

Finally, could there be a risk that LK will retaliate in other ways? Ideally, we wish to compete openly and freely. However, if we avoid any overt hostility then we can coexist and we both serve a function in promoting celebrity-inspired fragrances. If we provoke them into poaching our employees or steal our ideas then we will suffer a serious loss.