Chartered Institute of Management Accountants

MANAGEMENT CASE STUDY AUGUST 2015 EXAM ANSWERS

Variant 5

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-5

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Section 1

Errors in assumptions

The first major assumption is that we will not make any additional sales, which may well be untrue. Our retail customers may favour our products if they are cheaper to process and so we might displaces sales made by our competitors. We may also pre-empt a decision by one or more of our customers to cut back on our products in favour of more efficient competitors'. It is unlikely that all of the customers will wish to have this service because they may well have their own inventory management process in place. In some cases, it may be easier to retain conventional difficulties because of the cost and inconvenience of tracking deliveries to separate locations.

We may not plan to make a specific charge for the enhanced delivery service, but we will recover our distribution costs through our selling prices. In time, we may gradually increase our selling prices to allow for the additional distribution costs, even though those additional charges will effectively be spread across all customers regardless of whether they take the new service.

If we are planning to conduct only a two year evaluation then it seems illogical that we would invest so heavily in infrastructure. Why are we spending so heavily on vehicles and buildings for a two year trial? The more sensible approach would have been to outsource the new service to a logistics company in the first instance, with a view to expanding capacity once the concept was proven. If we do need to invest in new vehicles then we should show the inflow from their resale when the two year evaluation has concluded.

Will it really be necessary to invest so heavily in plant for this new service? We might be able to use more flexibility and efficiency in making up packages for onward distribution. We do not, for example, have to assemble a complete order and then break it down into consignments for individual stores.

Operations department

The operations department is essentially a cost centre. Expanding the delivery options will increase the cost of running operations. The marketing department will get the credit for making the sales and so operations will simply look inefficient.

The operations department will also have a more complex task. That increases the risk of delayed and incorrect shipments. These are only downside risks. There is no upside. Also, customers may become more demanding with every increase in service, so that these problems are compounded.

There is a possibility that the operations department is correct about the need for additional staff and equipment, but there is no guarantee that they will receive everything that they have asked for, or even everything that they really need.

The best way to resolve these concerns would be to start by ensuring that the operations department had adequate resources with which to fulfil its obligations. That need not be everything that was asked for, but it should net leave the department short of resources. Resourcing needs should be kept under review and additional facilities provided when the department is under pressure.

The operations department should be evaluated on factors such as customer satisfaction ratings and the number of deliveries made on time. That would ensure that the operations department was given credit for doing a good job. It would also ensure that the head of operations was motivated to continue to provide a good service.

Section 2

Implementation targets

We need to meet with key customers to determine their interest in this service. We need to establish a deadline before which we will have met with all customers who are known to have multiple locations and to have discussed our proposed new service. We cannot plan for this exercise unless we have a clear understanding of take-up.

We need to establish a schedule of deliveries so that we can establish our own infrastructure requirements. We need to understand how many deliveries will have to be made and with what frequency. Once we have that information we can then decide how many staff will be required, what facilities they will need and so on.

We will need to set targets for the acquisition of infrastructure, the purchase of vehicles, etc.. We should aim to have a designated start date for this new service and so we need to work backwards from that in order to ensure that we are equipped and ready to start. We need to ensure that time is provided to acquire this support in an orderly and efficient manner so that we do not overpay.

Distribution staff will have to be trained in the new procedures and so we should set a deadline for the completion of training. If staff do not understand what is required of them then we may not provide customers with the service that they require. Training will be key to ensuring that we make our deliveries in a cost-effective and efficient manner.

Segmental reports

IFRS 8 requires us to determine reportable segments on the basis of the information presented to the chief operating decision maker. That suggests that we should consider expanding the information in the segmental report.

It is acceptable to aggregate potentially reportable segments and so we may not be required to provide the shareholders with the level of detail that is reported to the board. The crucial issue is that the segments have similar economic characteristics. It may be of little value to the shareholders to distinguish, say, department stores from duty free if the margins are the same and the risks of doing business are identical.

We do distinguish sales by division and by geographical region and that makes sense because the margins are different on each of those lines. We need to consider the reason for us receiving the further analysis by type of retailer to determine whether there is any value in us giving it to the board and, if so, what that value might be. If we are evaluating the performance of individual sales managers of sales departments then we are evaluating stewardship and we are not in breach of IFRS 8. If we need to distinguish supermarkets from duty free stores because there is a material difference in the factors that affect demand from those customers or because we set different selling prices for the two then our reporting is deficient.

We cannot justify failing to adhere to IFRS 8 on the grounds that a full disclosure would assist our competitors.

The responsibility for adhering to the requirements of IFRS always falls upon the directors. The external auditor’s responsibility is to form an opinion on the fair presentation of the accounts, but we cannot argue that they are responsible for alerting us to any shortcomings in our accounting.

Section 3

Commercial interests

These goods are being sold at a profit and so we do benefit from them in terms of contribution. We could be cynical and argue that we are generating significant volumes of sales through a discount reseller that we could not justify if we were to do it overtly.

We do risk tainting our brand by association with these cheap outlets, although there could be an argument for saying that they underscore the fact that our products are aspirational. It may be that our existing customer base could be replaced by the consumers who shop at the discount stores. There is very little point in buying a bottle of our perfume as a gift if the product is known to be sold cheaply.

Our official retail customers will be disturbed by the fact that they are being priced out of the market in this way and so we risk losing our traditional distribution network. The discount stores may not always wish to sell scent fragrances, particularly if the brand is dropped by more expensive outlets. The benefits of the sales through these grey imports could be very short-lived.

We do have an ethical duty not to interfere with our legitimate retailers' ability to resell our product. They will be aggrieved and feel misled if we do not agree to do something to restore their market.

Consumers may feel that we are behaving in an anticompetitive manner by interfering with their ability to buy our products at a discount. As pointed out in the press, we do leave sufficient margin in our selling prices to make it possible to re-export our goods and to resell them at a profit even after undercutting traditional outlets. We are interfering with consumer choice.

Press releases

Not preventing grey imports

Scent is concerned about the so-called practice of "grey imports", but we believe that it would be inappropriate to do anything to prevent the practice.

Attempting to stem the grey imports would create a number of legal difficulties for Scent. The companies involved are not breaking the law. It would be potentially anti-competitive for us to interfere with this market.

Scent believes that consumers will receive far better service from an accredited retailer of our products. All of our retailers have to meet our high standards with respect to knowledge of our products and the provision of informed sales advice. However, we feel that consumers have the right to choose, even though we are confident that out official retailers offer excellent value for money as well as a high standard of service.

Preventing grey imports

Scent is concerned about the so-called practice of "grey imports" and has decided to act by refusing to supply buyers who will not retail the goods themselves to their ultimate consumers. Scent is concerned that its legitimate retailers will be unable to compete against unauthorised retailers who do not provide adequate care and support to customers. All of our accredited retailers must demonstrate that their staff are trained in selling our products and can advise customers on an appropriate choice of fragrance. It would be uneconomic for them to do so in the face of competition from retailers who cannot properly assist our customers.

We also have concerns about the quality of the merchandise that may be sold by these outlets. Our accredited retailers know how to store our products safely so that they are in good condition when sold, but the discount stores do not know how their products have been stored and transported. They may also be selling counterfeit products, something that an accredited retailer would never do.

Section 4

Identifying resellers

We might use Big Data techniques to analyse national markets for Scent fragrances. We could conduct electronic searches to determine whether a prospective customer has any reported history of being a grey exporter. Similarly, some countries may have started to establish themselves as hubs for this activity and we should be highly sceptical of customers from those countries.

If we make a sale to a legitimate retailer in a new country then we would expect to see evidence of promotional activities to generate sales from their local market. We would also expect to see comments on the social media from customers commenting that they were enjoying their new fragrances.

If we look at information from our traditional markets, such as sales of other luxury goods, economic indicators, etc, then we can create a profile of countries where a buyer is likely to retail our goods legitimately. If a buyer is located in a poor country that has no existing Scent buyers then we need to be suspicious that this is a potentially abusive customer.

We should be suspicious of buyers who approach us, with whom we have had no previous contact. Our products are well known and we would normally expect most of the potential buyers who are legitimately in our market to have been identified and contacted by our sales staff. We should conduct an electronic search of our own sales contacts to establish whether the customer is known to us.

We should investigate websites carefully. We could have our IT staff study the underlying code if possible to establish how long the site has been up and running because a very new site could have been established just to mislead us. We should look for signs that the site can be used to actually buy goods, to the extent that we might even place an order.

Specific problems

The key is to ensure that all participants in such a scheme recognise that there is mutual value in cooperation. It will probably be more effective if a separate entity is created and funded by all interested parties. Otherwise, there is a risk of the free-rider problem, with everyone relying on the other participants to investigate.

This body will have investigative powers only. It is unlikely that the reseller’s host country will be interested because the law is unlikely to be broken and reselling will create net export revenues for the economy.

All participants will have to agree not to support grey imports and to refuse to make sales to suspicious customers. Equally, they should agree to share information on legitimate customers whom they have determined to be trading honestly.

It is likely that competitors will have a greater interest in the buying side of this arrangement. They may be able to share intelligence about buyers in particular countries and even in advising on countries to which sales should be regarded as suspect. Such information is likely to be shared freely because our competitors will lose sales if Scent products are being sold as grey imports and undercutting their products.

Buyers will have a greater incentive to investigate the retail side of the grey imports. Retailers study one another’s offerings closely as a matter of routine anyway, so it is a simple matter for them to gather information about discount operations in their home countries. That gives Scent the means to buy samples of suspect product so that they can check batch numbers and so on in order to identify the original buyer. Unfortunately, by that stage, all that Scent can do is to stop selling to that buyer. The goods have already entered the unofficial distribution channel.