CGMA MANAGEMENT CASE STUDY FEBRUARY 2019 EXAM ANSWERS

Variant 1

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SECTION 1

Activity-Based Management system

Crowncare's present system cannot track costs incurred. That restricts the company's ability to ensure that each of the treatments that it provides generates a contribution An ABM system would give Crowncare a better understanding of its cost drivers and might enable the company to make better-informed commercial decisions. For example, should it promote cosmetic treatments more aggressively? Each dentist completes a large number of procedures every day, which suggests that any loss-making procedures could easily be offset, and so concealed, by other procedures. Crowncare could be making a loss on, say, root canal treatments and be unaware of that fact If Crowncare cannot accurately measure the contribution from different procedures then it could find itself in difficulty if there is a change in the mix of procedures being provided

The introduction of implants demonstrates the potential implications of having such a crude costing system because Morrison appears to be assuming that the opportunity cost of the chair time spent on each implant should be based on the target rate of V$390 per hour. That assumption ignores potentially significant costs, such as the V$450 in consumables, because Crowncare assumes that the V$390 hourly rate will cover all costs except for laboratory costs. The company has no real basis for assuming that implants are profitable and certainly none for arguing the revenue from an implant exceeds the opportunity costs. In the absence of a more sophisticated costing system, the only real insight into the impact of taking on more implant work will be a gradual increase or decrease in profits.

It may prove difficult for Crowncare to implement an ABM system. Firstly, dentists and dental nurses will have to spend longer during consultations on recording time and consumables used. That may be irritating if it distracts from the basic task of treating patients. The IT system would have to be adapted to

allow for time and consumables to be recorded during appointments, which could prove expensive. It may be difficult to split time and consumables objectively. For example, if a patient requires fillings on adjacent teeth then the same anesthetic may be effective for both and so it would be pointless to attempt to break the costs down Crowncare may also find it difficult to change the mix of treatments because dentists will have a professional responsibility to offer the most appropriate treatment, even if that is less profitable.

Strategic implementation

Management models, such as the Johnson, Scholes and Whittington model proposed by Frank, can be helpful in offering decision makers a logical sequence for their thoughts or some helpful criteria in which to rank options Forcing decision makers to comply with any given model is potentially dangerous because it may prove a distraction from reaching an optimal decision. A board member, such as Morrison, should be sufficiently experienced to understand the key issues associated with a business situation and so it may not always be necessary to work through every step implied by a model It could be argued that it would be unacceptable for Morrison to be on the board if he found it necessary to rely on a mechanical and inflexible thought process to guide him through every decision that he had to make in the course of his directorship.

In this case, it could be argued that the strategic analysis and choice has effectively been undertaken by Crowncare's competitors. Dental implants are a relatively new product that is offered by other dentists and is promoted to the public. Crowncare will seem old fashioned and uncompetitive if it cannot provide this procedure. Encouraging patients to go elsewhere for implants could lead to the loss of those patients altogether. That suggests that there is little or no scope for choice in deciding whether to offer implants because the decision has effectively been forced on Crowncare by market forces and so the only real question is the manner of implementation.

It would be unacceptable for Morrison, as an individual board member, to make a strategic decision independently of the board as a whole. The board has a collective responsibility for strategic analysis and for making choices and no one board member should have the authority to decide independently of the board. In this case, though, Crowncare has already evaluated the market and its competence through training 30 dental teams and conducting over 100 implants. The board is equipped with the findings of that initial investigation in order to decide whether Crowncare's capabilities should be expanded in this area.

Section 2

Benchmarking

The purpose of the internal benchmarking exercise has to be decided. For example, will it focus on metrics, processes or diagnostics? There may be little meaningful information to be had from comparing metrics if, say, failure rates are driven by relatively uncontrollable factors such as patient suitability for the procedure. It may be that the practices that have reported seven or eight failures have simply been unlucky and that they have relatively little to learn from their counterparts with none or one.

Crowncare has 30 dental teams who have been trained to carry out this procedure. That suggests that there is relatively little to benchmark in terms of comparing processes because there will be external benchmarks and protocols for fixing implants and all dentists should be adhering to that. Arguably, benchmarking should be measured against external procedures and standards for dental care and hygiene. If any of Crowncare's dentists believe that they have identified better approaches to this procedure then it might be more efficient to create a forum in which they can exchange ideas with colleagues, rather than benchmarking across the company.

The board should consider whether the benchmarking exercise might lead to dysfunctional behaviour or motivational problems. The fact that some procedures took longer than others could have little or nothing to do with the skill and care taken by the dental teams. Some patients will encounter problems with this procedure and will require more time. Benchmarking chair times could imply that Crowncare is keen for all implants to be completed within 270 minutes and that any additional time was a sign of poor clinical techniques or inefficiency.

It is worth considering whether it is too soon to get the greatest benefit from benchmarking. The dentists have averaged two procedures each over the past six months and so their individual averages could be affected quite significantly by one or two failed implants or one or two difficult patients. The dentists whose performance appears stronger could just as easily have benefitted from good luck in terms of the patients whom they have treated It may be worth considering delaying for, say, a further six months in the hope that the statistics might stabilise.

Claims

The first issue to be decided is whether the claims could result in a material loss to Crowncare. It would not be appropriate to make an entry unless there is a potential loss. The company will undoubtedly be insured against such claims and so the first thing that should be considered is whether the cost of any successful claim would be covered by the policy. We should consult with our insurer in this matter, with a view to establishing whether they will accept liability. If they will then there will be no net loss.

If the insurer cannot or will not give a clear response, or if the policy does not cover these claims then the next step is to establish whether disclosure is required under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.*

The most immediate issue is the amount claimed by the patients. If the total value sought is immaterial then there is little need to consider the accounting issues any further. If the claim is open-ended then it may be possible to obtain some guidance from Crowncare's lawyers, who will be aware of the precedents set in other cases.

If a reliable estimate can be made of the likely cost of settling these claims then Crowncare will have to create a provision. The other criteria for the recognition of a provision are that there is a present obligation from a past event and that those will require an outflow of resources. Both of these are met. The cost will appear as both an expense in the current year's statement of profit and loss and as a liability in the statement of financial position.

If a reliable estimate cannot be made then the claim should be disclosed in the notes to the accounts as a contingent liability. The disclosures should include an estimate of the financial effect of the settlement, an indication of the uncertainties and the possibility of any reimbursement. The only real accounting question is whether the likelihood of a payment is remote. If so, the disclosure would be unhelpful and so would not be required.

Section 3

Coaching

The most immediate problem is that the coaching scheme may appear to imply that the dentists with the higher historical failure rates have somehow been negligent. That may lead to resistance to the coaching exercise and could cause resentment because these are highly trained professional people.

One response to this would be to present the point of coaching as being about demonstrating support between colleagues. Dentists who have had disappointing success rates are permitted to continue with implants and their colleagues are being equipped to support their professionalism and skill.

Having another dentist in the surgery could undermine the patient's confidence if it appears that the second dentist is instructing or observing the work that is being done. The presence of a coach could also be a distraction in the limited space around the patient.

One possibility would be to temporarily reassign dental nurses, with nurses from more successful dentists changing places with those who work with less successful colleagues. That would give an experienced nurse the opportunity to observe any problems with the dentists whose success rates have been disappointing and to identify any areas where they differ.

Coaching could be relatively time consuming, especially because there is only one dentist from each practice who is trained in this procedure. Each implant involves several steps and so following a colleague all the way through an implant from beginning to end could prove a time-consuming matter.

When implants fail, it would be helpful for the dentist who fitted it to write a detailed report as to the most likely cause. Ideally, that could be supplemented with digital photographs and x-rays of the failed implant. The coach could then work through the report rather than becoming involved as a physical observer. The preparation of the report could also be a useful exercise to defend Crowncare from any claims and to encourage the dentist to reflect on the reasons for any failures.

Investment analysis

Simon's proposed system would be difficult to evaluate using NPV. Essentially, it will capture video footage that may have value in training and quality control. The potential cash inflows that will be generated from that footage will be difficult to predict with any accuracy. It is unacceptable to claim that an investment "must" have a positive NPV unless the net present value has actually been calculated, otherwise every manager could justify almost any investment by using that same argument. Simon has not even established that the system will generate any cash inflows in the future.

It would help if Simon was clearer about the criteria for evaluating this investment. It does appear to have the potential to improve key professional skills and also to create evidence that implants are being conducted carefully and skillfully. It could be argued that the immediate cost could be weighed up

against the potential intangible benefits in a subjective manner. That would not have the same theoretical validity as Simon's claim concerning NPV, but it would be a realistic and defensible basis for deciding whether to invest.

The cost of equity reflects the relationship between the company's value and the returns that it offers its shareholders in the form of dividends and capital gains. If a company's board fails to achieve an acceptable return on its equity then the value of the company will decline in response. The fact that Crowncare is unquoted means that the company's share price cannot be observed on a day-to-day basis, but that does not mean that it does not have value or that the shareholders will suffer a loss of wealth in the even that mismanagement reduces the company's value.

It may be that the shareholders would forgive Simon's enthusiasm in this case because all are actively involved in the company as dentists. They may not necessarily seek a positive return on investments that could make their working lives more fulfilling or that could protect the value of their investments. The dentists can take a long-term view of their equity because they must remain in employment with Crowncare for as long as they wish to retain their shares.

Section 4

Pricing

The most immediate strategy would be to would be to continue as before, which would mean that Crowncare chooses not to compete with Toothtravel on the basis of price. This is effectively a premium pricing strategy. Patients may be prepared to pay more for Crowncare's treatment because the increased cost implies higher quality. This is a significant surgical procedure and patients may be reluctant to entrust it to an unknown dentist, even if doing so would prove cheaper.

Other arguments in favour of a premium pricing strategy is that some patients will not have sufficient time to fly to Eastlandia for dental treatment even if it is cheaper. If they encounter any difficulties with their implant after the procedure then they may have to fly back to Eastlandia for aftercare. The alternative would be to seek assistance from Crowncare, who would be working without any direct knowledge of the procedures used by the Eastlandian dentist or the quality of the implant itself.

An alternative would be to bundle implants with some other service offered by Crowncare. Crowncare might be able to package other treatments, such as cosmetic procedures, with implants. For example, Crowncare could offer discounted tooth whitening to patients who had had an implant. That would effectively increase the volume of treatments being sold to high-spending patients. It would be more difficult for Toothtravel to bundle services because there is a limit to the amount of dental treatment that would be desirable or even advisable during the patient's visit to Eastlandia.

Crowncare could take this concept of bundling by offering regular patients who have regular checks and hygienist visits a small discount on implant procedures. That would have the effect of rewarding patient loyalty by bundling the whole package of treatment with implants. It could have the added benefit of motivating older patients, who may be more likely to require implants, to remain with Crowncare in order to benefit from the discount in future years.

Frank's assertions

The fact that Toothtravel has a good ROCE suggests that it is essentially profitable and the low gross profit percentage suggests that it is aiming to generate revenue though taking a low margin. That does not necessarily help us in this case because Crowncare is competing with Toothtravel for implant procedures only and the ratios that Frank has cited relate to Toothtravel's entire business Toothtravel could be making losses on implants as part of a penetration pricing strategy that will not be sustainable going forward.

The information in the financial statements is historical in nature and does not allow for possibilities such as the withdrawal of low-cost airline services to Coastal City. Toothtravel could also be exposed to price increases by the laboratories that make its implants. The financial statements also ignore the risk that Toothtravel's dentists could emigrate from Eastlandia in search of higher salaries.

Crowncare's management structure is rather top-heavy with dentists. Every board member is a dentist and only the CEO and Clinical Director are full-time directors. It may be that business professionals, including Frank as Senior Financial Manager, provide too little direction. The fact that Morrison is evaluating the threat from Toothtravel suggests that a more proactive finance function could relieve him of such concerns and so enable him to focus on the dental work that is his primarily role.

Crowncare could be guilty of underspending on Finance. The company has a relatively crude costing system that produces little in the way of useful information. The business model is very straightforward, with little evidence of development other than the introduction of new techniques and treatments as they become available. A stronger finance function might release Morrison's time to offer a higher-level strategic view of Crowncare's financial management.