MANAGEMENT CASE STUDY FEBRUARY 2016 EXAM ANSWERS

Variant 2

The February 2016 Exam can be viewed at

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SECTION 1

Current strategy

Pizzatime's basic strategy appears to be to generate revenues from the sale of fast food. It could be argued that the addition of a home delivery service is simply an extension of that basic strategy. Customers are familiar with the brand and Pizzatime is simply adding a new distribution channel.

There are a number of issues that will have to be resolved before this can be viewed as wholly consistent.

Firstly, Pizzatime's restaurants are generally located in places that do not lend themselves to supporting home deliveries. Restaurants are presently located on sites that may be too far from residential areas to offer a realistic potential market. Only the motorway service stations are likely to have convenient parking for delivery vehicles. Orders for evening meals are likely to require drivers to deal with the evening rush hour from those locations to outlying residential areas. In other words, there is limited synergy.

Secondly, Pizzatime is selling a high quality product. All pizzas are baked to order. Customers are used to their food being taken straight from the oven to the table. A home delivery service will involve a delay in serving, which can only impair the quality, even if a heated container is used. Customers may be disappointed with the service and it could deter further visits to Pizzatime restaurants.

Finally, Pizzatime may be displacing some sales. Many restaurants are located in town centres, which can be visited in lunch hours by office workers or by shoppers. Some of those customers may decide to place a delivery order online rather than take time to eat in a restaurant. From Pizzatime's perspective, it will be cheaper and more efficient to serve customers in restaurants rather than deliver pizzas, so any displacement of sales is unfortunate.

Identifying profitability

This is a new venture for Pizzatime so we have no historical data to base our forecast of sales on. The customers may be the same as before but using the convenience of deliveries. So Pizzatime may lose some of the present customers to home deliveries so the shop may not be so busy.The charge for delivery must cover the cost plus make a profit or the home delivery will make lower profits. Customers must be encouraged to but drinks as extras in the same way they do in the shop or they will make less profits not more.

Profits from the new service may be less predictable than from the shop and may be led by what is on tv. It may take a few months for the trade to become more predictable.

A major decision will be whether to buy or lease the vans or motor bikes.Perhaps leasing would be good initially until profits are clearer. Bikes may be cheaper and would encourage younger staff who may also be cheaper to hire.

A decision will also have to be made about where to make the pizzas and where to deliver from. A unit may have to be leased to give more capacity. A unit which is not on the main streets will be cheaper than a high street shop.

Section 2

Learning curve issues

There will be two main aspects to the learning curve. Firstly, staff in participating restaurants will have to adapt to dealing with electronic orders. The biggest change could be due to dealing with peaks in demand. The limited number of seats in the restaurant will have provided a natural limit to the number of orders even at busy times.

Delivery staff will have learn how best to navigate their delivery areas. Presumably, satnav systems will handle the detailed navigation, but drivers will have to work out which streets are most likely to be congested or where best to park. This may be an ongoing process if the job is regarded as unattractive, having to be out in all weathers in the dark and staff turnover may be high.

Establishing rate

It will take some time to establish the learning rate because there are likely to be complex interactions that make the rate of learning difficult to observe. For example, the previous cycle of peaks and troughs in demand for sit-in dining may not match those for home delivery. It may take several weeks to identify the times of the week where the total demand for sit-in and home delivery pizza is sufficient to tax staff.

We also need to take care over potential time savings that may not be identified if staff are not monitored closely. For example, as drivers become more familiar with their routes they may not take the shortest route back to the restaurant in order to delay leaving on their next delivery. They may be concerned that working to 100% efficiency will risk tighter targets or reduced staffing.

Implementation

The first step will be the design of the web page and the associated software. There may be standard commercial packages that can be adapted to our needs. We will have to determine what is available and decide whether it is more cost-effective to buy off the shelf or have something purpose written. The software will have to be tested extensively to ensure that it rejects orders from customers who are not within the areas that we serve and that it allocates every order to the most appropriate restaurant. We will also have to identify features that should be built into this system, such as tracking customers to offer rewards and discounts for loyalty or feedback to enable the system to determine whether a restaurant can fulfil an order within a reasonable period. The need for those features may not be identified until we start testing, although the software will be cheaper to develop if we identify all requirements at the outset.

The launch strategy will have to be decided. Will the service be rolled out across store, or will we launch across all stores? There are advantages and disadvantages to both. A concerted launch will offer economies of scale in terms of promotion and maximising impact. A more gradual roll-out will enable us to learn from the initial experiences.

Advertising and other promotional activities will have to be developed. There may be relatively inexpensive opportunities such as posters and leaflets in restaurants. We may be able to stimulate comments on social media concerning the launch. We will have to decide whether to have these matters developed in-house or whether we will go to one or more agencies.

The drivers will have to be recruited and trained. We may delegate this task to a recruitment agency or we may make restaurant managers responsible for advertising locally and interviewing their own drivers. We will need to take legal advice concerning our liability to both drivers and third parties in the event of an accident involving one of our vehicles. We will have to identify suitable levels of insurance and buy appropriate cover.

Section 3

Related party

This matter needs to be decided in terms of IAS 24 *Related Party Transactions*.

Our marketing director would be deemed a member of “key management personnel” by virtue of being on the board. It doesn’t matter whether he has participated in the decision to hire Town Logistics of whether he even has the authority to sign a major contract without seeking approval.

The question of control over Town Logistics is complicated because IAS 24 focusses on control, whereas the director’s wife has been said to “own” Town Logistics. It seems unlikely that we could argue that she does not have the ability to control Town Logistics, even if she chooses to take no active role in the company’s management. The two companies ae only related parties if the director’s wife has control over Town Logistics.

A joint directorship between the two companies would not be sufficient to create a related party, so the real question is whether the marketing director’s wife as control over Town Logistics.

There are two main factors that should be taken into account in deciding whether to volunteer this information. The first is the question of transparency. From an ethical point of view, the company should volunteer this information if there is reason to believe that the shareholders would be interested in it. It is immaterial whether there is a rule compelling this disclosure.

The counter-argument to this is that IAS 24 exists to clarify disclosure requirements. Reporting transactions that are otherwise not reportable could confuse the shareholders. The relationship between the two companies could be exaggerated by a voluntary disclosure and could distract from the real issues that should be considered.

Conflict between restaurant and delivery drivers

The most obvious response would be for us to permit restaurant staff to apply for jobs with Town Logistics. If the jobs are attractive then the present delivery employees will be fairly settled and will not have a rapid turnover. We should not expect to see a significant loss of staff unless we extend the delivery service to other branches, thereby creating new jobs at Town Logistics. The numbers would be further restricted to those who are willing and able to drive a motorbike.

The staff who move to Town Logistics will be able to compare the two jobs and will be able to share their observations with their colleagues. Presumably the additional pay is to compensate for the nature of the work. Delivery work may be regarded as unsociable because the drivers will be working alone and will be forced out in all weathers. There will be stresses involved in locating delivery addresses and finding suitable parking. There may even be an element of danger if deliveries are being made to rough neighbourhoods. Also, motorbikes are a relatively dangerous form of transport.

Pizzatime should communicate with all staff to stress that delivery drivers work for a different company, which is responsible for setting its own rates of pay. Pizzatime values the efforts of its staff, but raising pay rates to match those of Town Logistics would be both inappropriate and unsustainable.

Section 4

Is the board excelling?

Revenue and operating profit have both increased dramatically, with revenue rising by 50% and operating profit more than doubling.

Return on capital employed has increased from 30% to 64%.

These results reflect an impressive improvement, although we need to be careful to compare like with like. The new delivery service appears to have generated a spurt in sales. The marginal costs of making additional pizzas appears to be relatively small and there appears to be a healthy contribution from these sales after taking account of delivery costs.

We have contracted the delivery service out and so we have not had to invest in additional assets. The increase in ROCE is driven by the additional contribution and not from any particular increase in the efficiency of the utilisation of assets.

The improvement is all the more remarkable given that the new delivery service has only been operational for six months.

In terms of evaluating management's performance, these results could be misleading. The initiative has undoubtedly been successful, but it is basically one really good idea that has been implemented effectively. Hopefully, Pizzatime will continue to deliver this high return on capital employed, but that will not necessarily indicate that management has "excelled".

In order to demonstrate excellence, management will have to ensure this improvement in performance is sustainable. The initial surge in sales could be due to the novelty of the service and the heavy initial promotion. Customers who have tried home delivery must now be converted to repeat customers and management will have to ensure that this initial success does not prove counterproductive because competitors are encouraged to offer their own home delivery service.

Directors' bonuses

An element of performance-related remuneration is regarded as good corporate governance. Sales revenue is important to the company and so encouraging the board to look for ways to further improve sales is potentially in te shareholders' interests.

The structure of the bonus is relevant here. If the bonus is paid as a straight percentage of sales then the increase in the bonus could be disproportionate to the efforts of the directors. The additional payment may not represent good vaue for money to the shareholders.

The other question is whether the bonus could encourage dysfunctional behaviour. The directors may focus their efforts on increasing either restaurant or delivery sales, whichever is easier, rather than maximising sales and profits overall. There could also be a risk of discounts and promotions being offered to stimulate sales at the cost of contribution.

Restaurant managers

The restaurant managers do have some indirect control over restaurant sales because they have control over the ambience in their restaurants. Motivated staff under effective supervision can make customers feel welcome and can encourage them to buy side dishes, desserts and so on. Customers will return to restaurants where they have had good experiences.

The restaurant managers do have very little control over demand for home deliveries because they are promoted and sold online. They also have relatively little control over the delivery process because the drivers are employed by a different company and because deliveries happen away from the restaurants. They can, however, ensure that the pizzas are properly cooked and prepared for delivery.

Overall, it is fair to say that the restaurant managers have very little control over delivery sales. It might be more relevant to manage their involvement by tracking customer complaints concerning food quality.