MANAGEMENT CASE STUDY FEBRUARY 2016 EXAM ANSWERS

Variant 4

The February 2016 Exam can be viewed at

https://connect.cimaglobal.com/resources/management-case-study-exam/february-2016-management-case-study-exam---variant-4

SECTION 1

Explanation of benchmarking data

Based on a quick review of earnings growth and ROCE, Pizza2Go stands out as the more successful company. However, it is important to interpret these results carefully since these companies operate in slightly different markets.

Comparing earnings growth and ROCE

Pizza2Go had a much higher earnings growth in 2015 than Pizzatime (31% against 5%) which demonstrates rapid growth by Pizza2Go. However, this comparison does not reveal whether the growth was as a result of larger number of outlets or increased returns from each outlet. These figures also need to be adjusted for any one-off distortions such as the I$ 20 million reduction in provisions in Pizza2Go's financial statements between 2014 and 2015.

Pizza2Go also had a higher ROCE than Pizzatime in 2015. However, this can give a misleading result where there is a large difference between the book value and market value of equity as in this case**;** Pizzatime has a book value of equity of I$ 197 million against a market capitalisation of I$ 2,700 million, which will distort the ROCE result. Pizzatime and Pizza2Go also use quite different business models as Pizzatime offers a full restaurant experience whereas Pizza2Go only offers a takeaway service. This means that Pizzatime is likely to have a much larger capital base than Pizza2Go which will reduce its ROCE and make any comparison of ROCE results very difficult.

Assessing relative success of the two companies

Despite lower earnings growth and ROCE, Pizzatime has a much higher gross profit margin than Pizza2Go and this needs some investigation since profits margins are also an important measure of success. It is, however, important to remember that gross profit margins are before administrative costs and Pizzatime is likely to incur higher such costs than Pizza2Go because it has large premises to maintain, unlike Pizza2Go, and so it is not possible to draw any immediate conclusions on relative success based on a comparison of gross profit margins.

In terms of earnings growth, Pizza2Go has far outstripped Pizzatime's performance with a growth of 31% rather than 5% and would therefore appear to be the more successful company if growth can be sustained into the future.

Improving profitability (Porter's value chain model)

Inbound logistics

Value can be created by checking food deliveries for quality on arrival at one of Pizzatime's restaurants and returning/replacing unsuitable products.

Operations

It is important to be aware of the price that customers are prepared to pay for a meal according to the quality of the food and ensure that the menu, recipes and quality of the ingredients meet customers' expectations. The cheaper the ingredients can be acquired, the great the value created.

Outbound logistics

Customers place value on the safety of the food and so strict controls need to be in place to ensure that no out-dated food is used in food preparation and that food is stored at correct temperatures.

Sales and marketing

Marketing campaigns can help increase footfall and profitability; for example, advertising in local magazines or distributing leaflets in the neighbourhood.

Service

Customers come to restaurants for the experience as well as the quality of the food and so value can be created by investing in employees. The selection and subsequent training of employees can have a major impact on customer experience.

Customers expect fast food restaurants such as ours to provide fast service, customers are not expecting to linger over supper for several hours. Value can therefore be enhanced by taking measures to reduce the time taken to collect a customer's order and the time taken to prepare and serve the ordered meal. Staff could be monitored and set targets set to motivate and incentivise staff to improve service speeds.

Feedback from customers via questionnaires could provide important information that could be used to enhance the customer experience and hence add value..

Section 2

Competitor and customer analysis

Competitors

In respect of competitors, Pizzatime needs information on menus, trends in menu contents and any plans for developing menus in the future that are in the public domain.

The most accessible information is available by visiting competitor restaurants, observing all relevant information such as clientele, decor and service approach. Full menus may be available for download on competitor websites; websites may provide useful information on current developments and future intentions that have been made public. Newspaper articles, magazine articles and restaurant industry journals are also important to review as they may also provide valuable information on the likely future direction of the competitor restaurant groups. Market research information can also be obtained from specialist research organisations, often at a fee.

Customers

In respect of customers, Pizzatime requires information on food allergies, fads and weight loss programmes that affect their customers.

It is important to divide customers into appropriate groups for further analysis because age and income profiles are likely to have different requirements and expectations. The best source of information is likely to be from the customers themselves via a questionnaire or online feedback.

Weight loss and healthy living journals and newspaper articles would also be as good source to spot new trends.

Big data

Big data sources such as social media, twitter and photo sharing sites will all provide important data on trends in food preferences. An effective way of accessing the information would be to search on certain key words such as the names of specific weight loss programmes and certain foodstuffs. The number of 'likes' and 'views' of different food related posts could provide useful information too.

Risks

The main risk of introducing a new menu is that it is not popular with Pizzatime's regular customers and also fails to attract new customers. Moving to a high quality product is likely to require an increase in prices but this is unlikely to be a sensible strategy in this highly competitive fast food sector where many substitute products are available at lower prices.. Poor reviews and comments on social media and in popular newspapers and magazines can also have a major impact on customer numbers. Operational risks arise if new ingredients cannot be sourced as and when required and at a viable price to support the new menu items.

Even if the menu is highly successful, success could be short-lived if competitors quickly copy the new menu ideas and attract customers away.

There is also a risk that the research used to develop the menu is flawed. Both media sources and Big Data can be distorted by the action of interest groups and advertisers. The subject of healthy eating is so popular in social media that the amount of data collected could also be enormous and prove very difficult to analyse in order to extract robust results. There is also a risk that diet fads only last a certain length of time before public opinion changes, possibly even before the new menu has been launched.

There are many business risks arising from introducing a new menu but Pizzatime does not have the option to do nothing as performance is dwindling. All products have a natural lifecycle and restaurant menus are no exception and need to be renewed on a regular basis.

Section 3

Outsourcing

Key factors behind the outsourcing decision

The two key factors that should drive the outsourcing decision for Pizzatime are cost and risk. It is important for Pizzatime to compare the cost of operating the system in-house against the cost of outsourcing to O-tech, taking all relevant costs into account, even 'hidden costs' which may not be immediately apparent. Risk is also an important factor and may outweigh cost; downtime is simply not acceptable.

Comparing costs

Additional staff with specific expertise in these systems would be required if the ordering system is to be operated in-house. The full extent of staffing costs can be difficult to determine; for example, the cost of recruitment can be substantial but annual recruitment costs to maintain the team in post will depend heavily on how long each new employee remains with the company. It is also important to consider 'hidden costs' such as the cost of supervision of the IT team and the cost of setting up budgetary control and performance measurement systems.

The costs are more predictable for the outsourcing option since the greatest cost is likely to be the regular fee agreed the O-tech. Control costs should also be taken into account, including the initial negotiation and drafting of the outsourcing contract and subsequent monitoring of compliance with the contract. If problems persist, it may ultimately be necessary to find an alternative supplier or bring the operation of the ordering devices in-house, which would result in significant additional costs being incurred in lost business and in negotiating and drawing up an agreement with a different service provider.

Comparing risks

Any disruption in the operation of the ordering devices is likely to cause significant financial loss and reputational risk for Pizzatime.

There are, however, also strong arguments that risk is reduced by outsourcing the service to a company that has the specific expertise and customer technical support service that it is not possible to replicate in-house. The risk is transferred to a 3rd party which has the specialist knowledge and organisation and experience to keep the risk to a minimum. O-tech is likely to have back-up systems that can be used in the event of failure of the main system in order to help ensure and uninterrupted service.

Ethical issue re accounting for IT equipment

Overview of the ethical position

The ethical position is clear; the suggestion to deliberately use an unrealistic estimate of the useful life of the software is unacceptable. It is not sufficient defence to say that the error is an 'honest mistake'. Matt cannot hide behind the fact that he has something in writing from the hardware vendor saying that this is the correct figure and he may be safe in terms of legal position - he is supporting the use of a figure that he knows is incorrect and this is sufficient to create an ethical issue.

The CIMA code of ethics requires its members and students to show integrity, objectivity, professional competence and due care, confidentiality and professional behaviour. The three main areas under challenge here are integrity, objectivity and professional competence. The self-interest element of the impact in respect of the boost to personal reputation and management bonuses of false accounting helps create the threat to compliance with the requirement for objectivity.

Integrity

The principle of integrity imposes an obligation to be straightforward, honest and truthful. A professional accountant shall not knowingly be associated with reports where the accountant believes that the information contains a materially false or misleading statement. However, there could be an argument that this does not apply in this case if the difference in depreciation does not materially affect the reported result.

Objectivity

The principle of objectivity imposes an obligation not to compromise professional judgment because of bias, conflict of interest or the undue influence of others and the last two of these are relevant here. The financial accounting is likely to cause them to find themselves under undue influence from Matt and others to use a figure for useful life knowing it to be incorrect and they must resist this. Matt has a conflict of interest in that the higher useful life would have a positive impact on management bonuses.

Professional competence

A professional accountant has an obligation to act diligently in accordance with applicable technical and professional standards when providing professional services and Matt is clearly in breach of this principle in suggesting the use of an incorrect useful life figure.

Section 4

Pricing issues

A high price strategy is attractive in boosting profits and enabling development costs to be recovered quickly.

However, this strategy may not be appropriate in the highly competitive fast food market in which Pizzatime operates. There are many similar alternative fast food restaurants that customers could choose instead of us if we start charging higher prices than our competitors.

The only chance of success would be if customers were prepared to pay extra for our product because the health benefits of top quality food and the fun element of the hi-tech ordering devices are considered to be greater than the additional cost. The planned marketing campaign would play an important role in raising customers' awareness of the health benefits of the new menu and innovative ordering method and may be successful in convincing customers that the higher price is still good value.

It is possible that Pizzatime could charge higher prices if the new menu and hi-tech ordering devices add sufficient 'fun' to the restaurant experience that customers are prepared to pay slightly higher prices. However, our customer base largely comprises families and people on tight budgets. It is likely that our customers will be less enthusiastic about the idea of high quality ingredients and hi-tech ordering devices if it means that they have to pay a higher price.

The novelty factor is also likely to draw in new customers, potentially also young adults, extending the customer base. A new burger chain has successfully charged higher prices for a top quality product and attracted young working adults and so the same strategy could also work for Pizzatime and the new ordering devices offer an additional incentive. However, a burger chain is able to attract young working people who want a high quality meal produced quickly and Pizzatime is not able to offer the same rapid service.

Managing change

Consultation

It is important to identify all potential areas of stress that are likely to arise so that plans can be put in place to address them early on. Employees need to be consulted on the proposed changes and what they are aiming to achieve. It will be much easier to achieve cooperation if staff 'buy-into' the new venture and are excited about the business potential of the new menu and ordering concept before being asked to change working practices.

New reporting relationships will need to be set up and explained in good time for employees to understand and come to terms with the changes and what they mean for them.

Stress points

It is important to look at issues that are likely to cause problems - staff are likely to have concerns over loss of status, loss of jobs, loss of interest.

Loss of status concerns could be overcome by encouraging staff to welcome customers warmly on arrival and offer assistance with the ordering process even though they no longer take the orders themselves. Loss of interest in the job could be countered in a similar manner or by increasing rewards to reflect the higher consultative nature of the job.

Risk of loss of job is difficult to address. It is unlikely that job losses will occur immediately as customers will require a lot of assistance during the early months as they learn the new system and are given all the help they need. However, staff may expect this to follow and this could dampen morale. A statement is needed that there will be no immediate job losses, however, it would be dishonest to give any guarantees about job security in the future. This is the case whether or not the new venture goes ahead – future success is never guaranteed – but it is hoped that staff will understand that this new venture will help secure the future of the business and of their jobs.