CGMAX MANAGEMENT CASE STUDY MAY 2019 EXAM ANSWERS

Variant 5

Section 1

Importance of understanding the competitive environment in Ustaria
Competitor analysis would be useful to help management understand Jord's competitive advantages and disadvantages, relative to its potential competitors in Ustaria, to generate insights into competitors' past, present and potential strategies. If we are considering investing in developing the Ustarian market then competitor analysis will assist us in developing appropriate future strategies in that market to sustain or establish advantages over the competitors that exist there.

One aspect of competitor analysis would be to develop an understanding of market size and market growth. This is usually based on the annual sales of competitors and the predicted increase of sales. As we can see from the presentation slide, in 2018 there were 95,000 prefabricated house sales and this is predicted to rise to 112,000 by 2020 (a predicted growth of 18%). 80% of this output (76,000 in 2018) was produced by 120 prefabricated house manufacturers and the remaining 20% was produced by over 150 smaller prefabricated house manufacturers. Therefore, it would seem that the competitive market is fragmented.

Analysis of the market growth that has been achieved by our prospective competitors would also be useful to us. As stated above, there appears to be definite growth potential in the prefabricated housing market. Importantly, growth in the higher end of the prefabricated market, which is likely to be our area of focus in the Ustarian market, is growing rapidly, with a predicted growth of 61% between 2018 and 2020 for homes priced at +C$1.25 million. In fact, this is what appears to be the 'luxury-end' of the Ustarian prefabricated market is growing more rapidly than any other segment of the market. The numbers of houses being built at the top end of the market is still relatively low, which could be a double-edged sword. On the positive side, it may indicate that there is space for a niche player like Jord to enter into the market. However, on the negative side, it may mean that the appetite amongst homeowners for luxury prefabricated houses in Ustaria is not great.

It may also be useful to understand the market share of the competitors, particularly those in the higher-end price bracket. If we identify any particular competitor with a large market share this may be strategically beneficial to them as they may be able to influence prices and reduce costs through economies of scale.

We also need to have an understanding of the wider competitive environment and determine the levels of potential competition we may face. In particular we need to understand our main brand competitors who will offer similar products to the same customer group. However, we must not ignore the wider industry competitors (i.e. all of the prefabricated house manufacturers in Ustaria), even though they may be offering products to a different customer segment, we need to know how they operate. It may also be useful for us to even look further, at the wider housing industry to understand the wider competitive housing market. Understanding the level of competitors will help us to understand the basis on which we must try to compete within the Ustarian market and will assist us in defining our competitive strategy.

Potential business risks

If we look firstly at the strategic risk, our success to date has been building on our brand, which is heavily associated with being environmentally conscious, using only locally sourced timber, etc. Building a portfolio of homes in an overseas country like Ustaria will make it much more difficult for us to remain true to this strategy. The upside risk here, of course, is that, if the showroom is successful in bringing in sales in Ustaria, this could open up an opportunity in a growing market and provide Jord with the chance to sow that we are truly global in our operations.

There is operational risk relating to capacity. We are currently operating at maximum capacity and therefore if we increase sales in the Ustarian market we will inevitably have to reduce sales elsewhere, either in Corvola or in other European countries (assuming we are not going to attempt to increase our capacity). This could be a serious risk to our operations in these countries and may bring with it, negative publicity and also damage to our reputation in our home market. If we pursue more house sales in Ustaria at the expense of the home customers, then these customers will go elsewhere and we will in fact be assisting our own home-based competitors. Indeed, our own home-based competitors could use this against us as a marketing tactic to provide evidence of our lack of loyalty to home customers. This could have negative consequences on future home sales.

There is also a risk that our products will not be popular in the Ustarian market. In 2018 we only sold 5 houses in North America, which could of course be due to lack of awareness in our products, but equally could be due to there being little demand for the type of house we produce. The average sale price for a prefabricated house in 2018 in Ustaria was C$888,000, significantly less that the average sales price of our houses at C$1.5 million. This could suggest that our products may not suit the pricing needs of the Ustarian customers.

There is also an operational risk that sales in the Ustarian market could negatively impact on sales in other regions. If we pursue sales in Ustaria without further increasing our current production capacity, then sales in other regions will need to forgone. This could mean reduced margins overall as the cost of transportation and logistics would inevitably be higher for the Ustarian market.

Also, until we have undertaken a detailed analysis of competitors, we need to seriously consider the risk of competitive retaliation. There are many prefabricated house manufacturers who are not likely to welcome our arrival in the Ustarian market. With excellent growth predicted across the whole of the prefabricated housing market, we may face severe pressure from the incumbent prefabricated house manufacturers who may collaborate to ensure customers but from home producers or who may be able to reduce costs to a level that we cannot match. We are likely to have to reduce our profit margins for the Ustarian homes, based on the additional costs we will need to incur on transportation and import costs and the need to not over-price our products in order to enter the market. This will be more seriously affected if competitors force us to reduce prices further due to their own competitive prices.

Section 2

Rights issues are generally a popular means by which quoted companies issue shares. They are less common for unquoted companies, such as Jord, but they could offer some advantages.

A rights issue gives existing shareholders the right to subscribe to new shares in proportion to their current shareholding. The benefit of a rights issue for a shareholder is that they have the right to buy shares if they want to, thus maintaining their relative holding in the organisation and preventing dilution in the value of their shares. There are only nine shareholders and they may be reluctant to upset the company's stability by introducing new shareholders, who may wish to push the company in a different direction. Collectively, the members of the Larsson family control 60% of the company and so they may be nervous about diluting their control.

However, there are potential disadvantages with a rights issue in our scenario. Jord is unlisted and it seems unlikely that the shareholders will be able to invest a further C$10 million between them. The Larsson family members would have to find C$6 million between them. It is already clear that only some of the shareholders are interested and so the issue may be a failure. The fact that this is an unquoted company may mean that it will be difficult to sell the rights. Indeed, it may not be permissible to do so under the company's constitution.

Debt may be a sensible option given Jord's financial history. There is no debt currently held by Jord and given its historic profitability there would be ample opportunity to borrow from a bank. This would also give the benefit of a 'tax shield' as our interest payments will be tax deductible. You should note however that this borrowing will cost interest charges and will need to be repaid out of operating cash flows over the next few years.

Alternatively, we could use our cash balance to fund this project, although this may require sacrificing dividends payable. In 2018 there is a cash balance of C$26 million but dividends payable are C$17 million and these are due to be paid in July which will reduce the cash balance significantly. These dividends are still, however, unpaid and could be used to fund the project effectively achieving the same result as a fully subscribed rights issue.

Pricing in the Ustaria market

There are many different theoretical approaches we could take to setting prices in the Ustaria market including premium pricing (our current approach), cost-plus pricing, and penetration pricing but not all these approaches would be relevant in our circumstances.

Our normal approach to pricing is premium pricing. We charge a higher price than most of our competitors because Jord houses are superior, high quality luxury builds. We have been able to charge this because the demand for our houses is very high and we like to charge a premium price to support the notion that a Jord house is a premium product.

The appropriate question to ask is whether we should continue to use premium pricing if we want to break into the Ustaria market. We might consider as an alternative, a lower pricing strategy such as penetration pricing to attract interest and gain business. However, given our current long customer waiting lists, all we would achieve, if we expanded sales to the Ustaria market at a lower margin, is lower profit overall given that we currently operate at full capacity. We would simply be replacing the high margin sales we can make here in Corvola and in other countries in the world with lower margin sales to Ustaria which would make no commercial sense.

The issue is one of opportunity cost. We may be generating new sales in Ustaria, but at full capacity we would otherwise have been generating sales at a premium elsewhere. An aggressive attempt at penetration pricing may also provoke the competition in this market to compete against us with a view to eliminating whatever threat we may pose. They will not be subject to the same transportation costs and have an established reputation, so they may be able to match our prices in the short term and still win any available business from us.

Therefore, I recommend that we retain our premium pricing structure in the short term even in Ustaria. It is consistent with our brand image and that is not due to change just because we are entering a new market. Indeed, changing to almost any other basis for pricing whilst we are at full capacity would lead to a worsening of overall results rather than improvement.

If, however, we decide in the longer term to expand production to take advantage of potential demand in the Ustaria market and find that at an expanded level of production our premium pricing strategy no longer generates the required profit levels, we could revisit the pricing decision again, perhaps offering a discount in the Ustaria market to generate growth. However, we would need to be very careful that this didn't simply displace higher margin work and didn't reduce customers' perceptions of our brand.

Section 3

Need for additional disclosures and types of disclosures recommended
You might consider the application of IAS 24 *Related Party Disclosures* to this case. If your brother is classed as a related person under IAS 24 then this arrangement will have to be disclosed in the notes to the financial statements.

As CIO, you are a member of key management personnel. A close member of your family would count as being a related party. The definition of "close member of the family" does not actually include sibling relationships, focusing on children and spouses. Your brother is probably not a related party under a narrow interpretation of IAS 24, although if it could be argued that he could be expected to influence you then he might be included in terms of the spirit of the standard.

It might be argued that the lack of a specific accounting regulation that requires disclosure does not constitute grounds for omitting disclosures. From a purely ethical perspective, the shareholders might be concerned by any lack of transparency in this arrangement. The fact that your brother may have obtained an unfair advantage without disclosure would probably constitute a material breach.

This matter is complicated still further by the fact that several family members hold shares in the company. They will undoubtedly be aware of their brother's ownership of the showroom and so they would not require any disclosure. That may not be deemed an acceptable excuse by the investment companies who have made major investments in equity. They may feel that they have a right to know everything that the family members do about the business.

Cultural differences

Culture, which is aptly defined by Hardy as 'the way we do things around here' is an important part of the way in which an organisation works. Culture will influence strategy formation and performance on an ongoing basis, therefore it is an important part of success or failure and when an organisation begins to operate in a new culture it is certainly worth taking time to understand that culture and how differences may influence existing together.

In this scenario we are considering opening a showroom in Ustaria, where the culture is relaxed, flexible and casual. This seems, superficially, to contrast with the culture at Jord where work is performed on an efficient, formal, lean, well controlled 'just-in-time' basis. This could lead to frustrations for Jord if the staff working in the Ustaria showroom don't function in the style Jord is used to and depends upon to deliver its high standards. For example, if a casual approach was to lead to delays in ordering, Jord is likely to find this unacceptable, jeopardising high standards of customer service and potentially affecting Jord's reputation.

Worse still, if a casual approach leads to a reduced understanding of customer requirements or mistakes in the order, Jord's premium reputation may again suffer.

Managing the cultural differences

It seems unlikely that it would be acceptable to operate a showroom in Ustaria that has a different culture to the rest of Jord's global operations. Therefore, Jord will need to attempt to influence the culture of those people working in its Ustaria showroom to be more consistent with the culture at Jord.

It may be that Jord has to allow some element of difference in the way its Ustaria showroom works to ensure the operation fits in satisfactorily in that country, but this is more likely to be in the way of some small compromises rather than accepting a vastly different operating culture.

Staff at the Ustaria showroom are likely to be used to working in certain ways, consistent with the norms of Ustaria. Therefore, they will need to understand that the way Jord likes to work is culturally different and receive good quality communication about those differences and how Jord proposes the culture to operate in the Ustaria Jord showroom.

Once staff in Ustaria understand why Jord operates in certain ways, and why it is beneficial for the organisation overall, then there is a higher chance that they will be receptive to work in that style themselves. Training will be required to ensure this is fully understood and an open approach to communication with a two-way flow is fundamental to setting this showroom up well.

Technology may be effectively utilised to communicate across national borders and across different time zones. For example, a computer-based conference call may allow people to talk in a virtually face-to-face manner regardless of the time difference.

Section 4

Evaluation of first quarter performance report of the Ustarian showroom

To some extent, I can understand why Theo has concerns about the performance of the Ustarian showroom after its first quarter of activity. However, there may be some reasoning behind these results. Whilst having the equivalent Corvola showroom figures may offer some insight as to the targets that the Ustarian showroom could be aiming for in the future, it is unrealistic to expect a new showroom to be performing at the levels of a well-established one, especially given the fact that it is in a completely different country.

There appears to be some significant variances on the expected number of sales enquiries, both in the showroom and online. Both measures are almost 50% below expected levels. Before we make any judgement on this it would be useful to know on what these targets were based. If they are based on the Corvolan showroom and website enquiries then this may not be the best target level. The Corvolan showroom and website are well established and therefore it will take time for such target levels to be achieved.

In terms of house sales agreed, the variance of 1 is not significant. When we compare house sales signed to the number of enquiries (i.e. a sales conversion rate), in fact the showroom staff appear to be doing well. Two house sales signed based on 38 customer enquiries is a conversion rate of 5%. This can be compared to a target conversion rate of 4%. Therefore, the sales staff are in fact doing well based on the enquiries they have received. However, compared to Corvola, these are both very low, as the Corvolan showroom has a target sales conversion rate of 20%. Again, we should not be over harsh in judging the Ustarian sales team as the Corvolan sales team have significantly more experience, hence the target is higher. However, the Ustarian sales team have certainly performed well in terms of sales price agreed, with a positive variance of C$0.2 million. This is indeed very encouraging as it suggests that the customers in Ustaria are willing to pay a premium price for a Jord home which could have a very positive impact on our revenues.

Customer satisfaction ratings are lower than we would have hoped, particularly as we have built our competitive advantage on high levels of customer service and customer satisfaction. Again, it is early days and we need to assess why out customer ratings are lower than expected. This indicator may indeed be related to the staff satisfaction rating which is also lower than expected. If staff are not happy with either conditions of work or pay, this may lead to a potential knock on effect on our customers. Again, this could also be linked to both the staff absentee indicator and the days training indicator both of which indicate worse than expected performance. If staff are receiving less training than expected this may impact on morale and levels of performance, thus impacting on customer satisfaction. The staff satisfaction result may also be causing the increased days of staff absence. Therefore, I think that our primary area of concern is to look at how we are training and managing the Ustarian sales staff in order to optimise their satisfaction and performance.

Improvements in the value chain

The first area of the value chain we could address is operations, as we can see that target conversion rate is only 4%, compared to a target conversion rate of 20% for the Corvola showroom. Improvements to the products that we are offering or the lead times on the houses may in fact increase this conversion rate, if we can identify if it is these issues which are causing them not to order a Jord house. A further area of the value chain that we could address is our marketing and sales activities, (within the primary activities of our value chain). It would appear from the performance indicators that we are not reaching the targeted levels of sales enquiries expected and therefore we must look at how we are marketing and advertising our homes in the Ustarian market. We need to consider if our showroom is using the correct means of advertising, and in particular whether our website is appropriately targeted and advertised. We may need to consider improving our internet search profile to try to gain more customer awareness. We need to consider how our Ustarian sales staff are handling sales enquiries and if they are responding to these effectively.

In terms of the secondary activities in our value chain, we could consider enhancing the technological support we offer to the Ustarian showroom. This may mean giving them electronic real-time access to production schedules and architectural and design models in order to communicate effectively with potential customers. We must have excellent technological communication facilities which allow the Ustarian showroom staff immediate and uninterrupted connection with Head Office. Poor technological support could have serious implications on our conversion rate.

A further secondary activity which we need to focus on to improve the performance of the Ustarian showroom is human resource management which will entail the selection, retention and promotion of staff, the appraisal of staff and implementation of performance rewards.

From our analysis of the quarterly performance of report of the Ustarian showroom, it would appear that staff motivation may be an issue. Therefore, there are a number of specific HRM activities we could implement to improve staff motivation.

1. Clearly training levels did not meet expected targets and therefore appropriate job- related training must be carried out. It may be useful to ask Corvolan sales staff to carry this out at the Ustarian showroom, face-to-face, to explain all of the technical and product knowledge and to deliver sales technique training, which will be specific to our products. If the sales team feel confident about the products they are selling, they will be more motivated.

2. Provide sales staff with the opportunity to feedback to the Corvolan head office with any concerns and queries. The sales staff must not feel isolated as this will lead to demotivation

3. Implement a staff sales bonus system. Staff should be rewarded for hitting sales targets, based on either number of houses sold per month or the revenue

generated per month. However, we will need to carefully manage this activity as we do not want to cause dysfunctional behaviour.

4. Regular staff appraisals on performance so that sales staff can understand their performance in the overall organisation context and can also have a forum to air their own concerns at management level.