# MANAGEMENT CASE STUDY MAY 2017 EXAM ANSWERS

## Variant 1

### The May 2017 exam can be viewed at

https://connect.cimaglobal.com/resources/may-2017-management-case-study-exam-variant-number-1

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**TASK 1**

**Whether to introduce a balanced scorecard framework and appropriate performance measures**

A traditional performance measure focusses on past financial results such as turnover of profit without helping to break down the elements that create the reported financial results. A balanced scorecard (BSC) is a powerful tool as it can incorporate non-financial drivers of financial performance. Non-financial drivers have been shown to often being more important than financial drivers in predicting future financial success (Kaplan and Norton, 1996). Improving non-financial drivers such as customer satisfaction levels and employee satisfaction can have a significant impact on financial results.

Barbara has identified a number of issues that could lead to poor staff morale and time wasting (chaotic storeroom), poor customer support (stressed managers) and low levels of customer satisfaction (blocked aisles). Each of these could be addressed by a BSC framework.

Performance measures should align with BES' strategic objectives of growing market share and its value statement about putting customers first.

We know that clear aisles are important in terms of customer satisfaction and attracting customers back to the store. A BSC could help by setting targets against performance measures based on the number of boxes of stock obstructing each aisle. Alternatively it could target minimum levels of items on display for each item held.

Performance measures could also be set to encourage maintaining a tidy, clean and organised stockroom, such as the percentage of boxes where labels and aisle numbers are clearly visible.

Performance measures could also be set in relation to drivers of customer satisfaction such as the friendliness of staff**.**

**Inspiring and motivating staff to take more responsibility and behavioural implications of applying the scorecard.**

Motivation takes two main forms – personal attitude and commitment and, secondly, appropriate targets and rewards for good performance.

Firstly, attitude; staff who feel they are a valued member of the store team are more likely to want to do everything possible to make the store a success. Recruitment is key – attitude and personal drive are often more important attributes to look for than previous retail experience. Social interaction is also an important element in helping staff feel part of the team and they are then more likely to want to work hard in order to help ensure the success of the team; peer pressure encourages recalcitrant members of the team to improve their performance rather than lose face to their peers.

Appropriate targets and rewards play an important part in improving motivation. The reward may simply be recognition as ‘employee of the month’ rather than financial reward, or a public ‘thank you’ at a team meeting and evidence to use in pursuing promotion. Promotion in itself is a useful motivating tool – it is better to retain our best staff by offering promotion than risk losing our best staff to competitors offering more senior positions.

A BSC framework helps facilitate the delegation of responsibility to staff members, sharing responsibility for individual targets and increasing the likelihood of meeting those targets**.**

For example, an individual could be given responsibility for a particular aisle to create a competitive environment.  It also encourages innovative behaviour, such as changing the way products are displayed in order to maximise revenue**.**

Performance measurement based on a BSC framework is, however, difficult to apply fairly across all staff**.** For example, how do you compare targets of, say, responding to mail quickly in the office with high sales per square metre in one particular sales aisle or compare the turnover of goods in one aisle with that of another that contains less popular goods in a fair and equitable manner? If poorly thought out, it could have a de-motivating effect**.**

## TASK 2

### Analysis of VES versus BES performance and strength

At first glance, BES appears to be a very successful business, reporting strong growth in revenue and profit between 2015 and 2016. However, when this information is drilled down to a 'per store' basis, the picture is quite different, showing a fall in sales per store of 4% and a fall in profit per store of 1% in the year.

VES has shown strong growth in sales per store of 8% between 2015 and 2016 at the same time as a huge fall in operating profit of 32% per store. One possible explanation is that VES has costed products incorrectly, selling them at a loss in an effort to boost sales but damaging profits at the same time. Another possible explanation is that it lowered prices below 99p in an effort to sell larger volumes of merchandise. Either way, these results are very worrying. On top of this, VES faces huge debt, with a debt/equity ratio of 101.7% based on book values. It would be more useful to be able to calculate this based on market values. The nearest direct comparison we can make based on latest values is of debt per store, which is E$681,000 for VES as opposed to E$397,000 for BES. VES also has relatively poor cash reserves of E$0.2 million compared with BES' E$11.4 million.

In conclusion, VES appears to be facing major issues, both in terms of operating profit and in terms of indebtedness and is unlikely to have sufficient financial strength to mount a sustainable price war with BES if we were to open a store in a main shopping street opposite a VES store. On the other hand, the figures also indicate VES's willingness to cut the price of goods if deemed necessary, as indicated by the low operating profit figures as compared to the revenue figures.

### Risks of expansion, how to mitigate these risks and what additional market and competitor data would be useful

There are many business risks directly linked to this expansion plan.

These include:

- Insufficient customers, for example, VES customers remaining loyal to VES rather than trying out BES stores and no new customers attracted.
- Local protests against the opening of a discount store, which might be considered to lower the standard of stores in the area and/or threaten existing stores.
- An aggressive price war started by VES to retain its customers.

Methods that can be used to mitigate these risks:

- A marketing campaign to attract customers to BES' stores, such as initial bargain offers to attract new customers.
- Differentiation in terms of customer experience or service, such as a nicer shopping environment or wider shopping aisles or shorter queues at point of sale.
- Differentiation in terms of products – by either quality or appropriateness for the local customer base.

Market and competitor data that would be useful:

- Data is useful in driving innovation – by providing the information needed to make the best decisions and drive the business forward.
- Data can also be used to create competitive advantage by choosing the best products and best store environment to stay ahead of the competition.
- Market research agencies can be used to provide data on local demographics, including on income levels and lifestyle choices/spending habits of local population/potential customers.
- Data can be collected on shopping habits in the main shopping street: for example, are there popular products purchased by customers elsewhere on the main shopping street that BES should stock?
- Market research companies can provide information on what makes the shopping experience pleasurable for customers and potential customers to grow customer numbers.
- Big data can be used to identify local interests/trends and monitor use of social media by competitors.

## TASK 3

### Pricing strategies and their likely consequences for us

Pricing strategies:

BES could consider cutting prices to, say, 88 cents in order to undercut VES and regain market share.

Instead of lowering prices, we could try other methods of differentiating our store from that of VES and attracting customers, despite our higher item price. This has the advantage of protecting our profit margin and, ultimately, the store's results, assuming we can attract sufficient customers. We could aim to differentiate stores by service levels or, even, by a special promotion such as a loyalty card or a competition with attractive prices. Alternatively, as this is an expensive neighbourhood, we could try something such as offering coffee and a small seating area to attract customers to the store.

Consequences:

Cutting prices is a high risk strategy as there is a risk of destroying BES' ability to operate at a profit. If a product has a profit margin of, say, 20%, even a 10% drop in prices would halve the profitability of that product.

In addition, cutting prices is likely to lead to VES cutting its prices further, below 88 cents, to, say, 87 cents. This could continue indefinitely until prices are cut so much that neither company can sell goods at a profit. On the positive side, however, BES has much greater financial strength to withstand such a price war on a single store than VES, given BES' lower debt burden. BES may therefore win a price war and, ultimately, succeed in pushing VES off the main shopping street.

### Communication with the store staff given the emerging rumours

Communication should be honest but also seek to address staff concerns. No promises should be made about there being no risk of closing the store and of redundancies.

It is probably best to call a meeting rather than send round an email as this gives staff members a chance to air their concerns. Individual team members should be asked to offer their own expertise and ideas on what strategies are likely to work best. All team members must be listened to with respect. It is likely that many of them live locally and will therefore have good ideas about what strategies are likely work best in this location.

Good preparation is important – make sure you know exactly what you are going to say and what questions you are going to ask in advance.

I would also suggest you arrange for someone to take minutes of the meeting so that all the good ideas from staff are recorded and also to ensure that staff are clear about what actions were agreed and see that their contributions were recorded and therefore valued**.** Provide contact details to enable staff to facilitate in providing additional feedback following the meeting. Ideas could be shared and discussed on BES' intranet.

A second meeting will be required once an action plan has been agreed with us. This will be a different type of meeting where it will be necessary to sell the new plan to the staff and obtain a commitment to see it through. It would helpful if Barbara could attend the meeting to show that the board is taking the issue seriously.

## TASK 4

### Accounting provisions

What a provision should contain:

Any provision required under IAS 37 is the best estimate of the net total cost of closing the store. The costs include:

- Any redundancy payments due.
- The cost of legal help where it is considered that the chances of success are likely.
- The cost of employing redeployment and retraining agencies to help staff find new positions.
- Any loss on the sale of the lease contract for the premises, on the basis that this would be classified as an ‘onerous lease’. The provision would be lower than the cost of fulfilling the lease obligations and the cost of early termination.

Note that IAS 37 does NOT allow a provision in respect of the costs of redeploying employees elsewhere in the business.

Timing:

A provision is only required under IAS 37 in respect of a past event. Therefore, a provision will only be required in the annual accounts up to 31 December 2017 if a public announcement about the closure of the store is made before that date. There are therefore strong arguments in delaying the announcement until 31 December in order to avoid having to make this provision.

Clearly, we cannot make a public announcement until we have informed the store staff.

However, we also have to remember our duty to disclose any price sensitive information at the earliest possible time and therefore should not delay the announcement simply to avoid making a provision in the half-year accounts.

Holding back on giving an announcement would also be unfair on staff.

### Redundancy process

Any member of staff recruited specifically to work in this new store will have been employed by the company for only a few months and we have the legal right to terminate their employment without reason; however, there may be a notice period build into their contract of employment which we will have to honour.

We have no obligation to provide any assistance to new staff in finding new positions and, indeed, this is contrary to our duty to shareholders to maximise profit. However, the board may consider it our ethical duty to help these employees. There is also a strong argument in favour of offering assistance in view of the positive image this gives of the company. This is especially important and timely in view of the adverse publicity that has so far been generated in the local area by the opening of this new store.

The redundancy programme must be fair to all and selection for redundancy must be seen to be fair. It must also be carried out according to an agreed procedure which HR can advise on and assist us every step of the way. The procedure to be followed must be documented and consistently applied. I realise that one of the staff members transferred to the new store is a cousin of Sarah Masters, our IT director, and there must be no possibility of him even being suspected of having had any influence on the final outcome.

All other possible avenues must be explored before resorting to a redundancy programme, including retraining or transferring people to other jobs or locations and cancelling overtime elsewhere if this would create a new position.

Every possible assistance should be given to people being made redundant, including retraining and counselling, to assist them in finding a new position.

Statutory redundancy payments should be made or any larger amount specified in the person’s employment contract.