

MANAGEMENT CASE STUDY MAY 2017 EXAM ANSWERS

Variant 2

The May 2017 exam can be viewed at

<https://connect.cimaglobal.com/resources/may-2017-management-case-study-exam-variant-number-2>

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Task 1

Lifecycle costing

Lifecycle costing is useful as it takes into account the costs of the product throughout the life of the product, not just the purchase cost, including transportation and licensing fee.

We will incur large upfront costs in setting up supply contracts and sending a deputation to China, including Gill and Mark. There will also be significant costs associated with getting prototype products approved and paying the 25% licensing fee and there is also a high probability that we will be left with unsold goods once the fad has finished. It is important to take all these costs into account when deciding which products to purchase and when negotiating prices with suppliers.

Lifecycle costing will be difficult to apply due to the large uncertainties over product life and the number of products sold. Product life will largely be determined by how long the Princess Rose fad continues. The number of products sold will depend on the strength of the competition as well as the product life. Several different possible scenarios will need to be evaluated to determine the risk that the project proves not to be profitable.

The lifecycle of the products can be extended by minimising delay in the arrival of merchandise in stores but this is certain to result in higher costs and so a balance needs to be struck between product cost and length of lifecycle and an optimum solution found that maximises the profitability of the project as a whole.

Lifecycle issues will also impact marketing strategies – from advertising just before merchandise arrives to build initial demand to different market strategies during the mature stage when interest is waning, possibly reducing the number of products

being sold and also bundling items together (e.g. '3 for 2' offers) to maximise revenues from remaining stock and minimise write-offs.

Big data

Big data would be useful in drawing up the profile of potential customers according to their social media posts. Social media would also be useful in monitoring the growth and subsequent levelling off and fall of interest in Princess Rose in order to give advance warning of a decline in interest.

Purchase histories of potential customers may be used to identify suitable products to investigate further. Information can also be collected on competitors' intentions.

The most valuable aspect is likely to be following the levelling of interest in Princess Rose. Assuming, that is, that we can order multiple deliveries of merchandise rather than have to decide on the total delivery at the start. Being left with large quantities of surplus stock is a significant risk in this project and it is important to do all we can to minimise this risk.

However, the cost of obtaining and processing big data is likely to be very large. Large volumes of data need to be processed to obtain relevant data and this is time consuming and expensive. The time delay between obtaining the data and deriving relevant data will be critical. If too long, the value of the data obtained is significantly lower. Given the limited product lifecycle of Princess Rose products, it may not be worthwhile to rely on big data in this instance, given both the delay in processing the data and also the costs involved.

Task 2

Limitations of the decision tree analysis in providing management with guidance for decision making

Limitations of basing a decision on this analysis and hence ordering 19.2 million items include:

- Risk assumptions. Ordering 19.2 million assumes risk neutrality. Decision-makers need to consider risk appetite and acceptable possible losses.
- Subjectivity. The decision tree outcomes are based on a single set of assumptions supporting each outcome. The results are therefore subjective, being reliant on the underlying assumptions.
- Oversimplification. In practice, there would be more than three possible outcomes and more branches, dependant on competitor response and lead times etc.
- Discrete outcomes. In practice, possible outcomes would be a continuous range of outcomes rather than three possible discrete outcomes.
- Sensitivity. The decision tree should examine a number of different possible inputs in terms of, for example, different demand estimates.
- Assume perfect information. In practice, the forecast may be correct but based on imperfect information and therefore lead to an incorrect decision.

Other key risks that should be considered:

- Lifecycle. What is the risk that the fad has finished altogether by the time BES' Princess Rose merchandise finally arrives. Is there a risk that a 2nd blockbuster film is launched and customers switch interest to purchasing merchandise linked to the new film?.
- The behaviour of competitors. Will some competitors obtain products earlier and what is the impact on demand if they do?.
- The risk of large inventory write-offs if goods remain unsold.
- Poor staff morale due to delay in obtaining merchandise.
- Permanent loss of customers to competitors due to delay in receiving merchandise.

Related party and ethical issues related to dealings with Higi

Gil Morton has an ethical duty to act with integrity and avoid potential conflicts of interest. She should also avoid anything that could be regarded as a financial inducement to enter into a contract. Accepting a trip on the cousin's yacht for herself and her team straight after the end of the negotiations could be seen as just such a financial inducement, especially given the costs involved in the whole time spending time at a luxury resort. It is also a conflict of interest as the holiday might be seen by others to unduly influencing her view on which supplier(s) to deal with. It would be best to cancel the trip to avoid any such accusations. Scheduling the holiday to happen after the negotiations have been finalised is not a reasonable defence as the team clearly knew about the possibility of a holiday at the time the negotiations were being carried out..

Any contact with Higi would be classified as a related party transaction under IAS 24 as there is a close family tie between a key management person in Higi and Gil Morton (Supply Chain Director), a key management person at BES as long as it can be shown that Gil may be expected to influence, or be influenced by, the cousin employed by Higi as part of the supply contract negotiations. A cousin is not automatically regarded as a related party (unlike a spouse or child), so this additional test of degree of influence needs to be applied in order to determine whether or not this is a related party transaction.

Assuming it is regarded a related party transaction, the following disclosures would be required in BES' financial statements:

- The nature of the related party relationship.
- The nature of the transaction.
- The amount of the transaction.
- The outstanding balance relating to the transaction, including any provision for bad or doubtful debt.

These disclosures are necessary regardless of whether the price agreed was at arm's length, although this fact should be disclosed as long as it can be substantiated.

Task 3

Disciplinary procedures

Firstly, I must emphasise how important it is for you to retain objectivity and keep an open mind throughout the process. Be careful not to jump to conclusions, as you appear to be beginning to do in your email.

It is not your responsibility to investigate this matter – there needs to be someone appointed to take responsibility for acting on a complaint, as stated in the company's disciplinary code[1].

Suspension is only one of several options, others include:

- Dropping the matter (if considered unimportant – unlikely in this case).
- Arranging an informal consultation (to discuss the issue and attempt to correct the situation informally).

Suspension is only permitted under the circumstances listed in the company disciplinary procedure. For example, if there is:

- Gross misconduct (probably not in this case).
- To preserve evidence or ensure evidence is not tampered with (again, unlikely to apply in this case as evidence has already been collected).
- To avoid potential witnesses being pressured or intimidated (which may not be relevant here as there do not appear to be a witnesses).

I would therefore very much hope that this matter can be dealt with simply and quickly on an informal basis.

Rebuilding morale and building a more successful and effective team.

A strong team will have strong social links (Maslow's hierarchy of needs), that will help hold the team together in a supportive environment in difficult times. Social interaction helps reduce the risk of conflict and increase the cohesion and cooperation of group members.

A strong team will also lead to greater creativity and improved problem solving, including working together to find solutions for improving sales of slow moving Princess Rose merchandise.

The effectiveness of teams can be improved by building communication and trust. For example, problem solving exercises can encourage team members to talk and share ideas and support each other more in times of stress such as is happening now, having to handle huge numbers of customers looking for Princess Rose products.

Strong, clear leadership is essential so that staff know exactly what is expected of them. The team should be encouraged to focus on the task at hand and produce the best possible result in the circumstances faced. Both long-term and near-term objectives should be communicated in a clear and understandable manner, and desired outcomes should be measurable and rewarded when achieved.

Implications of using different pricing strategies for less popular Princess Rose products

Dropping the price of certain items comes at a risk that the already narrow profit margin is eliminated altogether. On the other hand, it is better for us to obtain some revenue for slow moving products than to have to dispose of unsold stock later on.

We could also consider product bundling, where we put a package of products together to make the products more attractive. Bundling is an efficient means of shifting slow moving merchandise; customers consider the bundled package to be a bargain and are more likely to purchase the bundled package than the original single package. This approach could work well for BES; for example, a customer may come in to buy a Princess Rose lunchbox (a best selling item) and be tempted by a repackaged set of Princess Rose cutlery and mini food containers and therefore end up buying two items rather than one. On the downside, however, some customers may be put off by bundling and, for example, are interested in the cutlery set but not in the mini-food containers and hence end up buying neither if they are packaged together..

We could also consider adding special offers in an attempt to entice customers to buy certain products.. These could be effective in making the products more attractive and also increase the 'feel good' factor associated with purchasing these products. For example, offering discounted entrance to a showing of the Princess Rose movie or a theme park that has a Princess Rose themed show.

Task 4

Accounting provisions

A provision is required under IAS 37 'Provisions, Contingent Liabilities and Contingent Assets' in respect of the goods yet to be shipped.

Reasons:

- This would be considered to be an 'onerous' contract under IAS 37. That is, it is a contract where the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.
- BES has an 'onerous contract', subject to IAS 37, since it has a contract to import goods that it no longer expects to be able to sell at a profit.
- IAS 37 covers a wide range of onerous contracts and specifically mentions contracts for the purchase of goods or services, including inventories, property, plant and equipment.

The provisions required is the least net cost of:

- Exiting from the contract (and paying any penalties due), or
- Fulfilling it (taking delivery of the goods and then attempting to sell them at a low price).

No provision is required in respect of the write-down of inventory already held. This is, instead, subject to standard IAS 2 'Inventories' requirements to value inventory at the lower of cost and net realisable value.

Should unsold Princess Rose inventory be taken into account in setting store manager bonuses?

Managers can expect any prospect of bonuses to disappear after inventory write-offs have been taken into account.

It would appear that store managers had very little, if any, choice about how many Princess Rose products to stock. The managers therefore appear to have a strong case for not being penalised for the write off of stock in this instance. It is important that managers are only held responsible and accountable for costs they can control; holding them accountable for costs they cannot control has a demotivating effect.

On the other hand, the managers would have expected to benefit from increased sales due to stocking Princess Rose products and, if the project had been highly successful, would have shared in its success by receiving higher bonuses. The system is therefore balanced – if they expect to share in company successes, managers should also expect to have bonuses reduced if a project proves to be unsuccessful.

In addition, it is important to motivate managers to optimise sales of Princess Rose products and find the most effective sales approach, despite the challenging market, and removing the write-off of stock from bonus calculations would effectively remove any motivation for managers to focus on selling these products. It is important that the bonus structure aligns with company objectives and the current policy helps achieve this.

Communicating the Princess Rose problems to the team

Good communication involves:

Thorough preparation:

- Being clear about the message to be delivered and selecting appropriate language and approach.
- Thinking about the issues from the viewpoint of the store staff – what are their concerns (e.g. job cuts) and how can these be addressed to put them at ease.
- Have a clear objective of what he wishes to achieve (e.g. build staff morale by giving a positive message).
- Anticipate likely negative feedback and plan appropriate responses.

Clear delivery:

- A convenient time, using appropriate language, clearly expressed.
- Helpful non-verbal communication (gestures, facial expressions, posture) designed to build confidence and understanding that the manager is part of the team and stands by the other team members.

Aim for a win-win outcome:

- That team members feel listened to and appreciated.
- Understand and accept the lack of bonuses this year.