MANAGEMENT CASE STUDY AUGUST 2018 EXAM ANSWERS

Variant 1

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Section 1

Pricing strategy

We need to consider the relevant business constraints that might have an impact on our pricing. The first issue is competition. MPM will be technically superior to competing cameras from Kira. That suggests that customers will pay at least as much as the current prices of top-end professional cameras. Montel should bear in mind that these cameras are intended to equip professional photographers and so buying MPM may make customers more competitive in bidding for contracts. Conversely, the selling price of MPM will have to be considered in terms of whether it will be a positive NPV investment for customers. There is little point in buying MPM if it will not result in additional commissions.

Output is restricted to 1,000 units per month and so Montel should consider the impact of pricing on demand. There is very little point in setting the price at a discount, in order to stimulate demand, if that would result in unfilled orders. It seems reasonable to aim for a price-skimming strategy, with a view to finding a point at which Montel might reasonably expect to sell all of the units that it expects to manufacture. Prices can be discounted slightly if demand starts to dry up.

The pricing decision should also consider the possible impact on revenues from current models. Any premium should reflect the fact that this model is superior to existing cameras. If the pricing is set only a little above existing cameras, then Montel could be left with unsold inventory, or be forced to discount existing cameras in order to sell them in competition with MPM. The overall pricing strategy should allow for maximisation of revenues across the whole product range.

Competitive advantage

The first thing that Montel needs to do is to ensure that the advantages of this new camera are well-documented and are well publicised. The pricing means that this will be a considered purchase even for a professional photographer and Montel must ensure that potential buyers are aware of the reasons for buying MPM. It would, for example, be worth giving an influential camera magazine the opportunity to test the new camera before its launch, so that potential buyers can be confident that it is at least worth considering the new product.

Montel should also focus on the photo editors who might commission shoots that would benefit from MPM. Montel cannot take it for granted that photographers will buy the new camera just because it is better than the cameras that they already own. It would be ideal if Montel could provide, say, advertising agencies with samples of the high quality and high definition images that MPM can create.

Montel should ensure that the camera shops that will be authorised to sell MPM will be adequately briefed and ready to support this new camera. There should be a clearly understood launch date and the sales advisers should undertake compulsory training well in advance, so that they can demonstrate MPM to full effect. Montel should ensure that all shops have sufficient inventory on hand in case there is some initial interest.

Montel should also aim to obtain the maximum benefit for the brand as a whole. It may be worth advertising MPM in order to benefit from the halo effect that being the maker of the very best camera might have for other models. A customer who is considering investing in a basic DSLR may be willing to buy from the Montel range because of the positive publicity.

Section 2

Impact on profitability

The first factor that we need to consider is whether the move to Pronto shops would have an adverse effect on demand. Professional photographers rely on their cameras to earn a living and so they will be keen to ensure that they are advised by a retailer with the necessary expertise. We need to determine whether buyers are likely to be put off by the fact that they are being directed to a different outlet that sells a different range of products.

Montel should investigate whether potential buyers of Professional cameras might be attracted by the possibility of synergies between Montel and Pronto Computers. Photographers may be attracted by the fact that Pronto's computers are used in the creative industries and so sales advisers may be able to explain how their photographs will be viewed and edited by potential clients. Overall, Montel should take time to talk to customers who own Professional range cameras and to establish how they would feel about the cameras being sold through Pronto.

The direct sales outlets are owned by Montel and so no trade discount is required. Montel must, however, bear the running costs of paying for premises and staff salaries and so closure could involve significant savings. We will have to compare the discounts that will be paid to Pronto with the running costs, taking into account any closure costs and costs of staff redundancies. The running costs of different shops will vary because of local economies and local costs.

The indirect sales outlets will be more directly comparable, assuming that we can establish the likely impact on sales. The rates of trade discount on offer could, however, affect the motivation of the managers and staff at Pronto stores. We would have to ensure that the discussion of potential demand went beyond customer attitudes and took account the interests of sales staff.

Related party

From a technical point of view, we need to consider whether Pronto Computers falls within the definition of a related party as established by IAS 24 *Related Party Disclosures*. The fact that there is a family relationship between one of Montel's non-executive directors and Pronto Computers' Marketing Director raises the possibility that there is a related party relationship between the two companies.

The definition of a related party would apply in the case that Sarah and David are members of the key management personnel of the two companies. Sarah is an executive director of Pronto Computers and David is a non-executive director of Montel, which makes both parties key management personal as defined by IAS 24.

IAS 24 would also require Sarah to be a close member of David's family. IAS 24 lists family relationships that should be considered, such as spouses, children and dependents, but that list is not necessarily exhaustive. Overall, it would appear that Pronto Computers would not be a related party in terms of the technical application of IAS 24.

From an ethical point of view, David's email disclosed the relationship with Sarah, which could be sufficient to indicate that he is sufficiently close to his niece to make this a related party relationship. David's perception is that he is sufficiently close to his niece to disclose that to his fellow directors, which could create an argument that she is a close family member.

The point of IAS 24 is that the shareholders need to be informed of the possibility that the company has entered into agreements that are not necessarily at arms' length. If they were alerted to the fact that an agreement had been reached with the niece of a director, then they would undoubtedly feel that they ought to be informed.

The reputation of Montel, and of the integrity of its directors, could be at risk if no disclosure is made and matters are subsequently made public. Arguing that the specific family relationship is not listed by IAS 24 will not reassure the shareholders that they have not given Pronto Computers an excessive discount.

Section 3

Budgetary targets

The basic issue here is that the sales managers responsible suspect that the Montel-branded shops are faced with price-competition and the convenience of online sales from the third-party retailers. In the event that these suspicions are valid, the managers will be demotivated if they are held responsible for failing to achieve sales targets. The managers will be encouraged if Montel initiates an investigation into their suspicions, before making any commitments with regard to budgetary control. Such an investigation could be justified by the fact that total sales are broadly in line with budget, but the proportion of sales made through third-party retailers significantly exceeds expectations.

Montel aims to have a fairly simple distribution channel for professional cameras, with customers making purchases from their nearest specialist shop. The shops exist in order to ensure that customers receive the very best sales advice and so the sales managers should be capable of achieving sales even in the face of competition. The sales managers should accept that they have a great deal of control over their areas of responsibility, even if they do face a degree of competition from grey imports.

There is a limit to the extent to which the third-party retailers could compete with Montel’s own shops. Montel gives its third-party retailers discounts from the retail price in order to give a margin. Any discount that the retailers are passing onto customers will reduce their profits and so the discount itself must be relatively slim. Given that these are expensive cameras, it seems unlikely that many customers would risk buying online for only a small saving.

It is unacceptable for the sales managers to make such an ultimatum. Montel has a right to set targets and to expect its managers to work towards achieving those targets. In the short term, the managers should accept the targets and should aim to achieve them to the best of their ability. Any adverse variances can then be investigated on the basis that the managers had concerns about the underlying business issues.

Sales director’s reaction

Firstly, Endo’s comment was hardly interference. If he believed that the company might be in a position to improve any aspect of its management then he has a right to ask questions of the other directors. Having raised a legitimate question, Endo should now leave it to Hans to formulate a response. At first glance, Endo’s question is reasonable. It may be that directors can bring a fresh perspective to areas that are outside of their immediate areas of responsibility.

Endo’s background does give him as understanding of distribution channels. Even if Hans is the marketing expert, Endo has skills in areas such as inventory management and budgeting. It is unacceptable for Hans to argue that he is the only director who can comment on the wider aspects of marketing.

Endo's question was informed from the analysis of internal reports that give an insight into sales. In theory, grey imports should not be possible because they do not permit customers the benefit of trained advisers. Endo's point is that the figures suggest that customers are willing to buy from other sources.

It may be that Endo's query regarding the analysis of the figures indicates that customers no longer require the sort of advice that was deemed necessary in the past. Social media and other online sources give access to reviews and opinions about products. Customers are also increasingly accustomed to buying even quite expensive goods online, which further opens up the possibility that Endo's suggestion is worth considering.

Section 4

Business risks and procedures

The most immediate risk is that Montel's customers will not receive the service that they require when they buy these expensive cameras. Buying online means that they may be disappointed when they receive the product that they have ordered. In the event that anything goes wrong, if they find any difficulty in receiving aftercare service, then they may create adverse publicity for Montel.

There are further risks arising with respect to the relationship between Montel and its third-party retailers. If the sales managers actively encourage them to breach the terms on which Montel supplies them, then they may be tempted to break other terms of the contract. That could undermine Montel's competitive position in those markets.

It is unacceptable for managers to create their own interpretation of the rules and then simply state that their behaviour reflects common practice across the company. All staff should be given explicit rules and regulations to follow and they should be expected to comply with each and every one. Montel's culture should be one in which rules are complied with and employees who breach the rules should expect to be disciplined.

Montel's approach to management should be set by the Board and permitted to trickle downwards to more junior managers and staff. That would still permit managers to make suggestions to their superiors and for sensible suggestions to be supported. If the directors receive potentially beneficial suggestions that they do not wish to endorse, then they should make their reasons clear.

Interpretation

The most immediate impact is that Montel's gross profit percentage will decrease. The policy will have the effect of pushing sales from Montel's branded shops to third-party retailers. Sales made to third party retailers are discounted, which means that the gross profit percentage will decrease.

The use of online sales may also have an impact on return on capital employed, although the direction of the movement will depend on the absolute impact of the grey imports on sales and profits. If the retailers are diverting sales away from Montel's own shops, then profits and return on capital employed may decrease. Conversely, it may be that the small discount will stimulate additional sales and that ROCE will increase because of the additional sales volume.

Sales will be recorded in one region by Montel's accounting system, even though the final sales will occur somewhere else. That means that the segmental analysis will be distorted, with shareholders being given a misleading impression of the location of sales. That could create a misleading impression of the business risks, because a larger proportion of reported sales will be occurring in relatively impoverished regions.

The fact that these retailers are selling their goods online means that the consistency of sales to different geographical regions could be distorted. Paradoxically, the poorer regions will be able to redirect their sales to the markets where there is the greatest short-term demand. The shareholders will be left with the impression that poorer regions are the most consistent markets, while more prosperous countries may show variable sales, depending on the extent to which sales from official outlets are replaced with grey imports.