MANAGEMENT CASE STUDY NOVEMBER 2015 EXAM ANSWERS

Variant 4

The November 2015 Exam can be viewed at

https://connect.cimaglobal.com/resources/management-case-study-exam/november-2015-management-case-study-exam---abc-solutions-variant-number-4

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Section 1

Disregard reports

Your question raises a number of issues about the control and management of the company.

As a lead consultant, part of your responsibility is to make the best possible use of available time. Setting a target of 90% utilisation means that all managers are aware of the potential billings that are being lost because of the slack period. Your argument that a 90% utilisation rate is impossible may appear realistic, but flexing the target in the manner that you suggest will be equally demotivating. If it becomes accepted that little work will be done in the period from August to October then there will be little incentive to bid for work to be undertaken during that period. Indeed, there could be dysfunctional behaviour with some lead consultants deferring projects that might have been undertaken in the quiet period until business starts to pick up, so that the 90% rate is more easily achieved in November or December.

As a progressive consultancy, we should be thinking of ways to deal with the seasonal nature of our activities so that we can schedule staff more efficiently. If there are issues arising from annual budgetary cycles then we might consider offering discounts for work that is scheduled for the months that are traditionally quieter. If clients do not find it convenient to engage with us during those three months then there could be ways in which we might re-engineer assignments, perhaps being briefed in June or July, so that we do not need to interrupt client annual leave arrangements in August.

It is not acceptable for a manager to suggest that a budgetary report should be disregarded. The board has a responsibility to set policy and more junior managers should respect that. It is not for lead consultants to set targets for their own departments. From a governance point of view, it makes far more sense for heads of department to acknowledge any adverse variances and to discuss the reasons for those with management. Factors such as the need to permit staff to take annual leave at particular times of year are still open to discussion in any feedback relating to actual versus budget. It should be possible to show that there are months where staff are too busy to take leave and attend discretionary training programmes because their utilisation rates exceed 90%.

Lost time

ABC should aim to invest in staff, beyond paying their salaries.

Staff training is crucial if consultants are to stay up to date. IT is a fast-moving industry and so knowledge will quickly go out of date. Formal training courses will enable ABC to reassure clients that consultants are kept up to date. They can also offer certification of additional skills that have been obtained.

Participation in formal training programmes also gives consultants an opportunity to talk things over with colleagues and with course participants from other companies. Experiences can be shared and practical insights can be obtained that would be difficult to find in any other way.

Participants on formal training programmes could also include potential business contacts. Consultants could have the opportunity to meet with potential clients or potential vendors whose interests coincide with their own. These contacts could lead to sales or to insights into forthcoming new products.

Downtime also gives consultants scope for informal professional development, by reading technical publications and working with new releases of software. Time spent on such activities could broaden out consultants' perspectives and lead to greater versatility in the future.

Leisure and recreation is also important. Staff need to take time to relax and refresh themselves so that they can maintain their motivation. ABC could easily be at risk of being criticised or pressed for compensation if they force their staff to work on without taking adequate breaks. Life experiences such as participation in charity work can also help consultants to develop transferrable skills that can be of value in the workplace.

Section 2

Operational risks

This offer essentially passes the risks associated with downtime from ABC to the consultants themselves. That may actually prove counter-productive if the consultants feel badly treated.

The deal effectively asks some of the company's consultants to resign instead of being made redundant, which is effectively a sacrifice of their rights under employment law. They are receiving a loan instead of a redundancy payment, so they are losing out financially.

The consultants may not be willing to give ABC any special priority because ABC is promising only to employ them for half a week out of every month. They might restrict themselves to that 20 hours per month in the event that they are offered work from one or more of ABC's competitors because they are keen to develop other sources of fee income. ABC could struggle to obtain staff to meet commitments at busy times.

ABC's competitors will be free to contract with these consultants and to compete in terms of rates and guaranteed hours. It could prove difficult and expensive for ABC to staff some assignments. We may not have the flexibility that we had hoped for.

Clients may feel that ABC is less reliable if we are relying upon consultants and we may find it more difficult to win business. It will be more difficult for us to manage the security and confidentiality of our clients if we rely on external consultants over whom we have less control.

The only major upside, apart from not having to pay salaries during slack months, is the fact that we can also employ other external consultants, not necessarily those who were formerly employed by ABC. That may give us a little more scope in terms of expertise and experience if there are freelance consultants available who would outperform our present complement of consultants.

Reporting

As financial assets, these loans will have to be accounted for in accordance with the requirements of IFRS 9 *Financial Instruments*. This instrument will be difficult to value because it will have no observable market price.

In the first instance, we are acquiring a debt instrument at par with a zero coupon rate. Normally, financial assets are recognised at the transaction price at the date of acquisition, but this would not be appropriate in this case. There is a clear premium being paid by virtue of the fact that we are not charging anything like the normal commercial rate on such a loan.

We could determine the fair value by discounting the face value of each loan at the rate offered to business start-ups. The difference between the cash outflow and the fair value can be accounted for as either an expense or an asset. In this case, the discount could be viewed as a part-payment for future service from the consultants. In that case, there is a future economic benefit and so the difference between the initial outflow and the fair value at recognition could be viewed as a prepaid expense.

The prepaid expense can be recognised in the statement of profit or loss as the loans unwind.

We will have to take care to consider the recoverability of these loans. They will be advanced to limited companies that will have little or nothing in the way of assets. There will be little chance of repayment if the consultants decide not to continue to work independently through their companies.

Section 3

Selecting consultants

In the simplest possible case, it probably makes more sense to keep the better consultants in-house. The basic objective here is to shed capacity with a view to creating some additional flexibility in the future. It makes sense to keep the better consultants, but to be free to draw upon the rest when the need arises.

Sadly, the simplest possible case ignores some of the potential dynamics of this scheme. The consultants might see that the stronger team members are being kept in-house. In that case, they may find it more difficult to bid for work from ABC because the company will prefer to use better qualified or more experienced staff.

Other potential clients may also learn that ABC kept its stronger consultants. Indeed, ABC may publicise that fact in order to reassure clients that the standard of service will not decline. So, releasing less capable staff may be desirable, but it is less likely to result in the loss of any payroll.

It may be more productive to aim for a neutral approach to the loss of staff in terms of quality. For example, it may be worth considering encouraging workgroups to leave, with a view to setting up a small consultancy with a very specific skill set. It would then be possible for the consultants being targeted in this way to see scope for continuing to work for ABC and to bring in business from other clients.

Consolidation

Presumably, we will be keen to account for these investments as associates because we can recognise profits even if the principal shareholder chooses not to pay a dividend.

The key is that we must be able to show that we can exercise significant influence over these companies. In practical terms, it will be very difficult for us to be able to do so. The consultant will own the other 75% of the shares and so our voting rights will be essentially ineffective. It is unlikely that we will be able to exert any influence by threatening to sell some or all of our shares because doing so will have no effect on the consultant’s wealth or freedom of operation.

We might be able to exercise some influence as potential employers. There is no need for any relationship to be defined in terms of shareholdings. Any such influence would have to be visible and measurable. It would be possible to demonstrate the absence of influence if a company had a tendency to refuse work offered by ABC. In a positive sense, we would have to be able to show that we had made suggestions and that they had been acted upon. For example, if we could show that we had persuaded a consultant to reschedule assignments so that ours had priority. It might also be possible to show that we provide a significant proportion of the consultant’s fee income, although these companies would probably be too small to publish detailed financial statements and so we would find it difficult to support such a claim.

Section 4

Cost drivers and quality

The in-house staff will be paid a salary, so there is no direct incremental cost to employing them. There could be an opportunity cost if we have to forego another contract because our own staff were busy and we were unable to subcontract the work to an outside consultant in time. We need to balance cost and flexibility, using in-house staff when we know that we could find suitably qualified consultants externally if further assignments come along.

We have given the funded contractors an assurance of a small amount of work and the marginal cost of using that is effectively zero. The commitment is very limited and so it may have very little impact on planning. Given these contractors significant amounts of work will enable them to repay their loans at the end of the year and so we might actually benefit from using them in place of third parties.

The external contractors may be more expensive in terms of daily rate, but signing them up makes them unavailable to competitors. We also buy their loyalty in the event that they have specialised skills that we wish to use in the future.

There shouldn't be much difference in terms of quality as reflected in ability, but the motivation of each will differ. The external consultants have the greatest incentive to do a good job because they might never be used again. Our in-house staff may become very bored if they are not kept busy on interesting assignments, which could lead to a decline in quality.

Demotivate consultants

It may appear that ABC is setting up in opposition and that could lead to a preference to work for other companies. If ABC has funded these newly independent contractors then the existing freelance consultants might expect to obtain less business from them and start looking for alternative employers.

A more rational response would be that the number of consultants at ABC's disposal has not changed. If anything, the external consultants might rank ahead of some of the funded consultants who have been eased out of the company. It will be foolhardy to make such a statement publicly, but it might be possible to make that known, in strictest confidence, to some longer-standing freelancers whose loyalty is important.

The external consultants might take the opposite view and work harder to maintain links with ABC. Those who do so should be encouraged by giving them as much work as possible to reward their commitment to the company.

Logically, the freelance consultants are probably keen to retain their links to any employer who gives them work. It would be foolish to sever links with ABC just because ABC might give them less business. The only real question is whether ABC can expect to be first choice when a consultant is approached by both ABC and another firm at the same time.