

## **STRATEGIC CASE STUDY MAY 2015 EXAM ANSWERS**

### **Variant 3**

**THE MAY 2015 EXAM CAN BE VIEWED AT**

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#### **Section 1**

##### **Report by Finance Manager**

##### **The implications and risks of relocating Slide's Head Office**

#### **Strategic implications**

Slide's present home country is in Europe, but Slide does not have any exploration or production activities there. Relocating to the Middle East, where Slide has significant dealings, could simplify many of the issues associated with operating in that part of the world. Slide will no longer be viewed as a "foreign" company by stakeholders in its host country.

Politically, Slide is aligning itself with a new government. The new host country may make it easier for Slide to pursue strategic developments in the country itself and its neighbours. It may, for example, be easier for Slide to buy exploration rights in the new location.

Moving Head Office would have a significant impact on Slide's regulatory environment. The company will be subject to the laws of its host country, which may be very different from those of its original home. Presumably, Slide will only choose to relocate to countries that offer an acceptable level of freedom and any changes are likely to be to reduce the level of regulation and or supervision.

Slide's move will demonstrate that it is willing to use one of the most powerful bargaining strategies of multinational operations. Multinational companies are essentially free to relocate in the event that their host countries fail to meet their needs. Slide may find that the governments with which it deals will be keen to offer their support in case Slide moves other aspects of its operations to new locations. Such moves can cost hosts tax revenues and employment opportunities.

The move will change the corporate "neighbourhood" to which Slide belongs. Slide's Board and senior management team will move away from the bankers, business contacts, etc, with whom they have done business in the past. New business relations may be easier to develop because of the opportunity for face to face meetings. It could be argued that the loss of existing contacts will be alleviated by the ready availability of video conferencing and other communications technology.

The global nature of the oil industry may mean that Slide will lose very little in terms of existing relationships and contacts.

### **Strategic risks**

Slide may find it difficult to evaluate the culture before it takes up residence in the new host country. It may be difficult to appreciate how institutions such as the courts and the tax authorities actually operate without being subject to their authority. While Slide may be willing to relocate in response to any such disappointment, it will be costly to do so and it may be difficult to retain the company's credibility in the face of a further relocation within a few years of the first.

Most of Slide's contracts will have been negotiated in Kayland and be subject to that country's legal system. Relocating to another country may affect the confidence of both parties to any contract because Slide will not be technically subject to the authority of the courts. That could be a major distraction and source of uncertainty while Slide renegotiates its contracts.

Given that relocation can be used to reduce a regulatory burden, Slide may suffer a loss of confidence from stakeholders. It may be uncertain just how many responsibilities Slide is keen to escape. The fact that oil companies often collaborate through farming-in and farming out of projects means that Slide will have some very high-value contracts in place. Slide may also find it more difficult to negotiate new contracts because counterparties will be concerned that they will be more difficult to enforce in Slide's new host country.

Slide's move could unsettle the financial markets if the new location has implications for financial reporting. Local variations in GAAP could affect loan covenants. They could also lead to changes in earnings per share that could be viewed as a sign of weakening performance.

Shareholders may be concerned that Slide will change its listing to the stock exchange of the new host country. Many shareholders could be concerned that different regulations will leave them more exposed to weak governance and so the share price could decline.

The move could have implications for currency risks. Slide will have a new home currency that will have a different exposure to the movements in the USD compared with the K\$. This could lead to greater stability because many Middle Eastern countries tie their currencies to the USD in order to assist the oil industry.

## **Section 2**

### **Report by Finance Manager**

#### **The implications and risks of relocating Slide's Head Office**

##### **Choice of country**

The biggest decision that has to be taken is to identify the fundamental reason for the decision to relocate. There is no point in aiming to reduce regulation if the new host country has even more regulations in place.

The different countries in the region should be evaluated in order to determine which would offer Slide the most suitable terms. Slide is in a position to ask different governments about such possibilities as tax incentives, subsidies for office accommodation and so on. The cost of operating the head office of a major oil company can be significant, so any incentives could be valuable.

The networks of relationships is significant. Some countries are more accessible to major businesses than others and Slide should look at the histories of the other oil companies which are based in the different countries that are of interest.

Freedom of movement is a key factor. Geographical location will affect the accessibility by air travel. Some countries have more restrictive entry requirements in terms of visas. These issues could have implications for the ability to do business.

The security and stability of the host government is also an issue.

##### **Change management for managers**

It will be difficult to ensure the commitment of senior managers until the country has been chosen. Factors such as climate, air links, schools for their children, etc. will all play a part in deciding to stay with the company. There is a limit to the hardships that will be tolerated for the sake of making Slide more profitable.

The fact that the move could reduce costs and improve profitability could be of interest to the directors if they hold significant share options or equity. Directors with limited holdings will have less incentive to move.

Slide could insulate the directors from the financial risks of relocating. A generous housing allowance or the provision of free accommodation will mean that the directors can keep their homes in Kayland and so they would have more freedom to return in due course.

Offers need to be made to all concerned as soon as possible, otherwise any uncertainty could lead to managers and Board members applying for other jobs. The implications of any refusals to move should be made clear to remaining staff. For example, it may be possible to promote a trusted deputy in the event of a manager resigning rather than moving.

##### **Change management for other staff**

The most important thing is to minimise the inevitable uncertainty. If the redundancy package is generous then staff will be keen to stay and be made redundant rather than resigning in order to take another job.

Slide should determine which staff will benefit from the redundancy package because it is unlikely that relatively new staff will receive much and they are more likely to leave.

The workload during the transition should be evaluated with a view to avoiding overtime unless necessary. A realistic reward should be offered for extra hours. It may be helpful to have a bonus system for prompt completion of tasks to a high order.

The criteria for retaining staff should be decided and communicated, again to minimise uncertainty. The danger is that more senior staff will have the most to gain from the redundancy package and so the dilemma is to ensure that it is not made so attractive that employees refuse to stay on.

### **Main tasks for the transition team**

The logistics of the move will have to be addressed. Firstly, new premises will have to be located in the new home country. It will also be necessary to identify a suitable location for the smaller presence in the former home.

The new office will have to be furnished and equipped with all the facilities that are necessary. PCs, photocopiers, etc. will have to be purchased or leased.

Staff will have to be recruited locally for the new Head Office. A suitable employment agency will have to be appointed and briefed on Slide's needs.

The transition team will have to schedule the timings of responsibilities being handed over. Ideally, departments such as treasury, accounts, human resources, etc. should be set up in the new office and all records and functions transferred from the old. Sufficient overlap should be provided to enable the orderly transition before the departing staff leave, but too long a period will simply increase cost.

## **Section 3**

### **Report by Finance Manager on detailed issues associated with the relocation**

#### **Information system**

The relocation will mean significant changes to systems relating to HR and payroll. Slide will have to ensure that payroll deductions are calculated correctly and recorded in a manner suitable for the authorities.

There could be similar issues with accounting systems, which will have to cope with any purchase taxes or other matters. The company will also have to change the system to cope with the new country's currency and so balances will have to be translated as appropriate.

Slide will continue to operate internationally and so many of its information needs will remain constant. However, the move may create opportunities that will require additional information to evaluate. For example, it may become more desirable to retain oil wells in this region now that the Head Office is located in that country and so the directors may feel that they have greater control. The information systems may have to be changed so that the directors can predict the productivity of a well more accurately. They will also wish to have a clearer understanding of the running costs.

#### **Head Office running**

The different factors that drive costs need to be clearly understood. For example, energy consumption may be linked to such factors as the weather, the working patterns of staff and so on. Understanding such factors may make it easier to evaluate potential investments in alternative systems.

The flow of information can reduce certain costs. For example, electronic data interchange can reduce the number of employees involved in authorising and recording transactions. The use of electronic records can also impact upon stationery costs. The advent of tablet computers may mean that paperless offices are potentially viable because documents can be retrieved, read and even annotated electronically. Tracking the flow of documents would assist data managers in deciding upon whether it would be possible to replace photocopiers and printers.

Clear and accurate costing information can also help to evaluate possibilities such as outsourcing services. Many administrative functions can be outsourced, as well as services such as cleaning and catering. It can be difficult to determine what the potential savings might be.

#### **Treasury**

The first priority is to establish a good relationship with a local banker. Even if Slide retains the same bank, it will have to move to a branch in the same city and that will create the need for the treasurer to meet and clarify Slide's needs.

There could be very different rules relating to matters such as banking regulation and supervision. The treasurer will have to ensure that these are taken into account in planning Slide's exposure. It may be sensible to spread Slide's cash across different banks in order to minimise the losses from a bank failure.

There could be local laws on money laundering and similar matters that could put Slide in default. The treasurer should ask a local lawyer for a detailed briefing and possibly a visit to oversee the issues that arise in terms of Slide's operations.

The treasurer may not understand local norms with regard to credit terms, which could lead to a bad relationship with suppliers. A local banker should be able to explain the expectations, or an expatriate from Kayland.

### **Success or failure**

Many of the factors that will have to be achieved are based on timings. The team should have a detailed schedule showing the different deadlines and the amount of float attached to each. It would be desirable to meet all deadlines, with a secondary objective of staying within the float constraints to avoid knock-on effects from becoming serious.

Budgets could be developed for relocation costs. These should be applied with a light touch because it may be difficult to predict some costs accurately and it is important to avoid dysfunctional behaviour.

The headcount is another important variable. It would be vital to have all of the key posts filled by the time that the transition is completed. In the event that junior posts are unfilled, it would be possible to hire temporary staff and so that aspect could be measured in terms of the number of staff days bought in.