

CGMA NOVEMBER 2015 EXAM ANSWERS

Variant 2

These answers have been provided by CIMA for information purposes only. The answers created are indicative of a response that could be given by a good candidate. They are not to be considered exhaustive, and other appropriate relevant responses would receive credit.

CIMA will not accept challenges to these answers on the basis of academic judgement.

SECTION 1

Managing relationship with government

We should start by acknowledging that the Government will be interested in our activities in various ways and those interests may conflict. For example, our development activities may be viewed as beneficial by the Treasury because it will generate tax revenue and export trade. The Environment department may view our activities as extractive and liable to damage the country's ecology. It is unlikely that it would be possible to reconcile all of these different interests, so we have to aim to ensure that we maximise our positive contribution in order to maximise the support from those government departments that are supportive of us. At the same time, we must ensure that we minimise the negative impacts so that the other departments do not feel that they have to act against us in any way.

The most sensible approach to dealing with this would be to develop a relationship with each interested ministry, so that we are aware of the issues. We might simplify the process of developing these links by engaging a lobbying company to make the introductions that we need. Lobbyists will also understand the attitudes of key officials and politicians and will be able to advise us of how we are likely to be perceived.

The national press will have a key role to play in our political visibility. We need to develop a good relationship with the main newspapers and news broadcast media. For example, we should be very clear about our goals in the country and should publicise any positive news. If the press is supportive then politicians will be less likely to interfere with our interests.

As a foreign company, we should be conscious that our behaviour will be scrutinised and possibly criticised, even if we do not do anything that is technically illegal. We should ensure that our behaviour is above reproach in all respects. For example, we should take care in our employment practices so that there is no danger that we will be accused of discrimination or exploitation.

It might also help if we could develop local sources of funding for our subsidiary. This will mean that any action against us will be partly directed at investors or lenders in that country. Furthermore, local partners will have an incentive to assist us in developing local ties to the country and ensuring that we are perceived in a positive light.

Residual risks

There will always be risks in dealing with any government, even after we have taken every precaution.

Our business, by its very nature, will be viewed as exploitative in many quarters. We intend to fell trees, including hardwoods, that will take a great deal of time to replace through replanting. Any forestry or logging activities will be viewed as damaging to natural habitats and destructive of the environment. In the short-term, we may be regarded as bringing a net benefit to the country, but attitudes can change. If the country's economy strengthens then we may start to be regarded in a less favourable way. We will, for example, create relatively few jobs in relation to the area covered by our forest or the size of our initial investment.

It is almost inevitable that some politicians will be opposed to us, regardless of how we behave in Bravador. There could be a change of government, which could undo much of the good work that we intend to do in developing strong relationships. A party that was opposed to our activities need not even win the election; all that would be required would be for them to form part of a coalition.

One of the main ways in which multinational companies protect themselves is through the threat of relocation in the longer term. We do not have that protection to the same extent because our investment is in forestry, which clearly cannot be relocated. Even selling the forestry might prove difficult if the Government imposes restrictions on operations because the land will be difficult to sell.

Our investment is also very much for the long-term and government attitudes can change over time. For example, if the Bravadorian Government signs an international treaty to preserve natural habitats then we might find ourselves subject to restrictions. It would be difficult to lobby against such an act because the Government will be subject to more intense pressure from the international community.

Any multinational operating in a host country risks the loss of the media's support. Allegations that we have exploited the country by creating too few jobs or paying insufficient tax will leave us exposed to Government scrutiny. The Government may feel that it has to act against us because the resulting public outcry makes it unacceptable to do nothing.

The nature of our business means that we always run the risk of a major environmental or human tragedy. A major forest fire or a serious road traffic accident involving a truck hauling logs could taint our reputation in Bravador. We cannot eliminate the risk of such an event and we will always be at risk of being regarded as the reckless multinational who has brought harm to the country.

Section 2

Selling hardwood

The first thing that we have to do is to establish a cost-effective logistics system for this resource. Hardwood trees are more valuable and we may have to organise tree felling differently so that we can fell the trees without causing excessive damage to the environment. We cannot simply clear all of the trees in a particular area because the resulting soil erosion and lack of shelter would make it difficult to replant and regenerate the forest effectively. Removing hardwood trees requires some forestry skills that will require us to recruit additional staff or retain existing staff to ensure that we have that capability.

Once we have the trees, we have to be able to transport them in a cost-effective manner. If we are the only commercial forestry company in this region then there may be problems with ensuring that we can ensure economic loads. It may be possible to transport hardwood logs with our normal softwood or we may be able to stockpile the trees until we have a worthwhile load.

We will need to identify potential customers for this product. We do not deal in hardwoods at present, so we will need to develop contacts. Hardwoods tend to be used differently from softwoods and so it may be that none of our existing customers would be interested in buying hardwoods. We will have to ensure that we have sufficient hardwood available to us to make it worth developing such an infrastructure.

It may be worth looking for a joint venture partner to handle our hardwood business. If we made contact with a forestry company that has experience in handling and selling hardwoods then we might be able to draw upon its expertise in managing this resource. It may be possible to have the company come along after the softwood timber has been taken from an area and remove the hardwoods in an efficient manner.

A joint venture partner would also be able to sell the hardwood on our behalf, allowing us to make use of its knowledge of the industry. In theory, we should find it easy to sell our hardwood because it is a commodity. However, that also works against us because potential customers might be just as happy to continue to buy from their established sources because they know that they can deliver reliably.

Suspend dividend

It would appear logical to suspend the dividend because it would avoid the administrative costs and bank charges of making the dividend and also the far more significant cost of processing a rights issue.

There are a number of disadvantages to this proposal. The most significant is that dividends are often viewed as an important signal of confidence on the part of the Board. The fact that it is willing and able to make a significant cash payment demonstrates that the company is capable of making good the outflow and continue into the future. A promise to pay a higher dividend in the future is a costless signal and the shareholders and capital markets may be unwilling to accept that assurance, so the share price could fall.

The fact that Wodd is investing in a very new venture means that the capital markets may be slightly nervous of this proposal. If the shareholders do not share the Board's optimism about the investment then they may attach very little weight to the expectation of future dividends from it. In the short-term, the share price will fall because of the unexpected suspension of the dividend payment. That fall will only be reversed once the investment starts to generate profits, which could be years away. Wodd's directors could suffer a setback in their careers because of this.

The perceived risks will be heightened by the fact that the investment could not be financed in a more traditional way. One would normally expect an investment in land to be funded by borrowing because the land itself can secure the loan.

From an agency point of view, the suspension of the dividend gives the shareholders no opportunity to exercise any choice. With a rights issue, the shareholders can decide whether or not they wish to increase their stake in the company to fund this development. If they decide not to increase their stake then they can sell their rights to permit third parties to take up the offer. The danger is that the shareholders will be unable to trust the directors to maintain their stream of dividend payments in the future. There could be other investment opportunities that Wodd's Board decides to fund by suspending further dividend payments.

Shareholders may tend to gravitate towards companies whose dividend policies suit their interests. For example, tax law can make some shareholders keen to see profits reinvested in order to generate capital gains, whereas others are perfectly happy to be taxed on dividends. Some of Wodd's shareholders may be relying on the steady flow of dividends to fund their lifestyles and may sell their shares in order to avoid the inconvenience of continued cuts.

Section 3

Claims consistent?

On the face of things, our development of the forest will undoubtedly interfere with the lifestyle of the tribe to some extent.

It will be difficult to hunt game in areas close to our logging activities. The noise and activity associated with felling trees and recovering logs may cause some wildlife to move to other areas. The harvested areas will not be completely deforested, but they may be less attractive as habitats when we have moved on.

In principle, it may be possible for us to collaborate with the tribe in terms of articulating our movements around the forest with theirs. It is, admittedly, unlikely that such a policy will be entirely practical because their use of the land is unlikely to be scheduled as thoroughly as ours and so there is unlikely to be any real scope for effective liaison.

Our commitment is complicated by the reference to 'legal and customary rights'. The tribe effectively lives beyond the law and probably does not recognise the concept of legal ownership of the forest. They have been using the forest for generations, but that does not necessarily give them the right to continue to do so without some compromise. Their lifestyle effectively requires a very significant area of forest land to support it and it is debatable whether it is realistic for them to be permitted to use the land in this manner, to the exclusion of most potential alternatives.

Fair criticism?

Forestry can be unsustainable when the land is laid bare, leaving little to protect the soil from erosion by wind and rain. It is not our practice to do that to our forests and so the criticism is unfair.

Timber is a renewable resource, provided care is taken. We can replant areas that have been harvested and softwood varieties will grow to replace the felled trees very quickly. Arguably, growing timber is little different from growing other crops. The only real difference is that the growing cycle is somewhat longer for timber, but it is still in our commercial interests to avoid causing irreversible damage.

Trees that are growing benefit the environment by capturing carbon. Mature trees do not, so they do not absorb greenhouse gases.

Managed forests provide habitats for wildlife that are generally left undisturbed apart from periods when logging is occurring.

The by-products of harvested timber can be processed and used as biomass in power stations, thereby replacing fossil fuels.

We have to acknowledge a certain amount of harm to the environment because we have to use fossil fuels to power our vehicles and equipment, but that is offset by the fact that many of our products replace materials that have their own carbon footprints. For example, timber can be used in construction in place of bricks or concrete, both of which require a lot of resources to manufacture and transport.

Ethical to offer to rehouse the tribe?

Clearly, this would be the quickest and probably the cheapest means for us to resolve this conflict. Our critics will accuse us of cynicism because of that, but it does not make our behaviour unethical.

The basic question is whether we are interfering unduly in the lives of the tribe for the sake of pursuing our own interests. The tribe has maintained its lifestyle for many years by isolating itself from the rest of society and so its members have not had the opportunity to adopt a mainstream lifestyle. We are merely offering them the choice to do so. We are not compelling them to move to our village.

From a practical point of view, we are linking the offer of accommodation and social infrastructure to employment in our forestry. We are supplementing this with the opportunity to support themselves through paid employment as forestry workers.

There could be some ethical concerns. For example, the tribe members will find it difficult to make an informed choice because they will not have sufficient experience to grasp the implications of moving to the village. Once they accept our offer they may find it difficult to move back because we will already have commenced work in the forest and the supporters who have flocked to their cause may be far less sympathetic. There could be other problems, such as unforeseen medical implications of coming into contact with illnesses or adapting to a Western diet.

Should the CEO travel to Bravador?

There is no clear answer to this question.

Certainly, having the CEO visit the location will ensure that we are seen to be responding to the protest. Taking the protestors seriously and attempting to engage with them will imply that Wodd is aware of their concerns and will help us to appear open and constructive.

The danger is that this will simply degenerate into a media event and the story lends itself to the protestors. The plight of the forest, as well as that of the tribe, will offer a very visual basis for criticising Wodd. In contrast, the CEO may look out of place in the forest setting. Also, he will be put under pressure by both the protestors and the reporters to comment and he may make a slip under pressure. One careless sentence may be broadcast repeatedly and could come to be viewed as the company's perspective. This has happened frequently in dealing with public relations problems faced by many companies.

The danger is that it may be difficult for Wodd to present its care effectively if we do not send the CEO in the very short term. If he makes the same statements seated at a desk or at a news conference in our head office he will be seen as lacking commitment to the protection of the environment or of these vulnerable people.