

## **CGMA FEBRUARY 2016 EXAM ANSWERS**

### **Variant 1**

**The February 2016 CGMA exam can be viewed at**

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### **SECTION 1**

#### **Proposal to open a new distribution centre in Waldania, Northern Europe**

##### **Strategic benefits of the new distribution centre proposal**

###### *Long-term cost savings*

Although the new distribution centre will cost €150 million in the next year, in the long term Rio is likely to benefit from significant cost savings. These will include savings in lease costs, staffing costs and transportation costs. This should improve the overall profitability of Rio and could allow us to pass on cost savings to our customers or invest further in infrastructure and store development to improve overall competitiveness.

###### *Reduced time to market*

The location of the new distribution centre is close to a large containerised shipping port, into which Rio's Asian outsourced products are currently shipped. The use of the latest high-technology robotic equipment and Information Systems within the new distribution centre will mean that the products are processed four times faster than currently. The location will mean products shipped from Asia can be processed more quickly and efficiently, resulting in new products reaching stores in a significantly shorter timeframe and reducing time to market, again enhancing our competitive position.

###### *Customer satisfaction and retention*

Customer retention and being able to deliver on-trend products are critical success factors in the retail fashion industry. In particular, speed to market is a significant strategic advantage in the fast fashion industry, as customers are increasingly demanding of 'fast fashion'. Customers are fickle and competition is intense. Therefore, the ability to speed up the delivery of products to the European stores is a significant benefit if this results in more satisfied and loyal customers.

###### *Reduced environmental impact*

The reduced transportation of products to and from Central Europe should also reduce Rio's carbon emissions, assisting in achieving one of our business aims of 'manufacturing and delivering fashion in a sustainable and socially responsible manner'. Rio has a strong commitment to minimising its impact upon the environment and the reduction in transportation to the Central European distribution centre will be a significant environmental benefit for Rio.

### **Strategic risks of the new distribution centre proposal**

#### *Cost of the investment*

There could be cost overruns and delays in the fitting out of the new distribution centre. If the €150 million cost is exceeded or the cost savings are lower than forecast, then the proposal will not be as financially viable. With the use of any high-technology systems, there is always the risk of delays and cost over-runs.

#### *Forecast cost savings*

Employee savings: Rio could lose many of its experienced employees who currently work in its Central European distribution centre, which is 250 kilometres away from the proposed new site in Waldania. This has 3 implications – firstly the loss of employee skills, loss of employee morale over the period from approval of the proposal to proceed with the new distribution centre and the closure of the old distribution centre and thirdly the cost of redundancy and re-location packages.

Lease costs: Lease costs will be lower than the current distribution centre as the site in Waldania is located in an 'Enterprise zone'. However, the reduced lease costs may be for a limited period, such as only 2-5 years and then the lease costs could be increased.

Transportation costs – there is a risk that the cost savings in transportation costs could be incorrect, because of the current fall in petrol and diesel costs, due to the current world over-production in the oil industry. There will be a cost saving as the proposed new distribution centre is closer to the port into which Rio's imports from its outsourced suppliers in Asia arrive. However, this accounts for only 40% of Rio's supplies.

#### *IT risks*

There is always a risk of IT failures or 'glitches' which will halt or delay the automated processes. Furthermore, when the new distribution centre is being set up, all of the IT systems will need to be linked into all of Rio's Information Systems. This could affect Rio's current logistics.

#### *Language and communication risks*

It is likely that Waldania has a different language to Sealand, where Rio's Head Office is located. This could affect Rio's employees' ability to effectively communicate with employees in Waldania.

#### *Risks of growth*

What is the size of the new distribution centre and will it be able to cope with Rio's planned growth. The 5-year plan shows revenue growing from €2,557 million in 2015 to €5,332, which is a growth rate in revenues of 109% over the next 5 years. However, this growth is not just for Europe, but for Asia as well as new geographical areas of the world.

### **How we might deal with these risks**

### *Cost of the investment*

Rio needs to establish a project management team to oversee and manage the implementation, construction and hand-over process if the new distribution centre is approved. There is a need to review the capital expenditure budget of €150 million to ensure that this covers all aspects of the fitting out, as the cost for state-of-the-art high-technology equipment can sometimes be difficult to plan. It also needs to cover the cost of all IT work.

### *Forecast cost savings*

The robustness of the budget and forecast savings need to be re-checked to ensure that the forecast savings are realistic and linked to the volumes of products moving into and out of the proposed new distribution centre from both imports from Asia and for new products from Rio's Eastern European outsourced suppliers.

The details of the reduction in lease costs due to it being located in an 'Enterprise zone' needs to be identified and for how long the reduction is applicable.

Transportation costs should be checked and monitored by the finance people on the project implementation team to ensure that they have been correctly budgeted.

### *IT risks*

The project team should include Rio's own IT specialists as well as the use of any contracted IT industry experts, to ensure the smooth implementation, testing and handover of the new systems to run the high-technology distribution centre. There will be a need to change the IT software to link the supply chain into the new distribution centre for when it goes 'live' and this needs to be exhaustively tested to try to prevent problems when the system does go live.

### *Language and communication risks*

There will be a need to recruit experienced local Waldanian managers for the new distribution centre who have multi-language skills and are also able to communicate in the same language as Rio's Head Office employees in Sealand.

### *Risks of growth*

The capacity of the new distribution centre needs to be established to ensure that it can cope with Rio's planned growth in Europe. The project team needs to plan the layout and the capacity for the new distribution centre taking account of growth.

## Section 2

**From:** Senior Finance Manager  
**To:** Sabine Roos, Finance Director  
**Date:** xx February, 2016

Dear Sabine

I have considered the issues you asked me to address in your email earlier. My responses are set out below:

### **Cultural integration problems**

Although Waldania is a neighbouring country to Sealand, it has a different language. This should not be a significant barrier, as we operate in locations all over the world and currently have another distribution centre in Eastern Europe and in Asia. However, it could create some integration issues if we are to primarily employ local Waldanian staff and management to work in the new distribution centre. Although Waldania is a neighbouring country this does not mean we operate similar cultures.

The average weekly hours worked in Waldania are 32 hours. This could cause Rio some cultural integration difficulties, if the local staff employed in Waldania are expected to work up to 40 hours per week. Staff in Waldania may feel resentful of having to work longer hours than they are used to and in the longer-term it could lead to increased levels of staff absences or staff turnover. It is clear that we have had some difficulty retaining management level staff in our Waldanian stores which may suggest some issues which we need to address in terms of improved cultural integration and expectations.

The local population of Waldania is not highly educated but has a good work ethic. In addition, Waldania is not a technologically advanced economy and the population lack technological skills. Therefore, if Rio is to employ local staff to operate and manage the new distribution centre, these factors could cause some cultural integration issues. Staff will be expected to operate in a technological and complex environment which will require a degree of knowledge and technological experience, which the Waldanian staff are unlikely to have.

Ethical and diversity issues are clearly a relatively new concept in Waldania. Therefore, this lack of appreciation of operating and acting responsibly in relation to ethics and diversity may cause cultural challenges between Rio's employees and the expectations and understanding of staff employed in Waldania.

### **Actions to overcome cultural integration problems**

Rio could consider the re-deployment of some of the management staff from the current Central European distribution centre to the new distribution centre. Incentive packages and bonuses for re-location should be offered by Rio's management in order to incentivise managers to re-locate to Waldania.

Rio should offer induction training in Rio's culture, ethos and the importance of Rio's CSR principles to new staff and also, if necessary, training in basic language skills. This should assist in improving communication with Head Office. Basic training will also be necessary in the use of the technology and sophisticated Information Systems to be used within the new distribution centre as the local employees are likely to have little experience in the use of such technology. On-going training in procedural and technological updates must also be provided. Rio must also ensure that it carries out an Ethical and Diversity training programme which must be undertaken by all staff at the new distribution centre, particularly at the senior management level.

Rio could consider offering staff at the new distribution centre flexible working hours contracts. Part-time working contracts would encourage a range of staff to work at the distribution centre. Rio must offer support and guidance from its Human Resource department. The new distribution centre staff must be given regular communication about all of Rio's activities and must feel part of the Rio team. Regular team building workshops and possible exchange programmes could be offered to integrate staff and overcome any potential cultural barriers.

### **Advantages to Rio of reporting in the GRI format and what we need to do in order to implement GRI reporting**

Reporting of Rio's business operations in the GRI format is a key platform for the company to communicate its sustainability performance and the impacts of its business behaviour.

GRI reporting encompasses 3 aspects of its business operations, which are:

1. 'People' - reporting on the people, suppliers and communities in which it operates.
2. 'Planet' - reporting of the company's sustainable environmental practices.
3. 'Profit' – this is the economic value created by the company after deducting the cost of all inputs, including the cost of the capital that the company uses. Therefore, this is different to the company's normal accounting profit.

GRI reporting is sometime called 'Triple bottom line' reporting due to these 3 aspects that are reported.

When Rio introduces GRI reporting, this will enable the Board to set goals more effectively, manage the required change to meet the goals and to report accurately its sustainability achievements.

A key advantage of Rio reporting all of its operations in the GRI format is that it will attract institutional investors who want to invest in companies who are focussed on long-term sustainability and not just short-term financial gains. Companies which undertake GRI reporting have seen a growth in their share price. Additionally, this way of reporting has enabled companies to achieve more stable and long-term focus in their business activities.

The use of GRI reporting will further enhance Rio's current code of conduct with all of its outsourced suppliers and will enable it to measure and report in the GRI format all of the ongoing sustainable work that it is undertaking to improve its supply chain.

The use of GRI reporting will benefit Rio in its approach to the environmental challenges it faces. The use of GRI reporting will also help promote the use of new initiatives to invest in greater environmental responsibility.

Whilst these activities can increase Rio's operating costs in the short-term, it encourages long-term stability of employees, suppliers, stakeholders. The long-term stability achieved through the use of GRI reporting will enhance Rio's brand reputation and could help increase sales, customer loyalty and also lead to increased long-term profitability and cash generation.

### **What Rio needs to do in order to implement GRI reporting**

Rio's management team needs to decide on the range of measures that Rio will monitor and report on, which will encompass the many aspects of Rio's business activities, across all of its supply chain in Europe and in Asia. This will require a large, committed team of employees to implement and report on all of the GRI required measures.

Therefore, for Rio to implement GRI reporting, it will need Board commitment to make the necessary changes to Rio's Information Systems in order to collect the necessary data that needs to be identified and reported on. Many companies invest in specialised 'environmental

reporting' Information Systems, although these often cover only the environmental aspects and NOT the social aspects required by GRI.

Implementation of GRI will take a commitment from Rio's management team and take some time. It would not be expected that GRI reporting could be fully implemented and operational for the start of 2017, and it is always an on-going need for improvement and enhancement of the range of measures monitored and reported on.

All aspects of Rio's supply chain and the data that is currently collected and reported on, does conform to the required format for GRI reporting. Rio will need to identify all of the new areas of GRI reporting such as social reporting, in order to meet the demands of the social aspects (human resource impact) for GRI reporting.

### Section 3

**From:** Senior Finance Manager  
**To:** Stella Erikson, Finance Director  
**Date:** xx February, 2016

Hi Stella,

Below are my thoughts on the issues you asked me to consider at our meeting earlier today.

#### **Information to communicate to Rio's employees**

##### *Employees affected in the Central European distribution centre*

There is likely to be a significant amount of concern and anxiety and it is important that communication is delivered through an appropriate medium and is timely and accurate. Employees must not hear of this proposal 'second-hand' and therefore it is imperative that we communicate this change immediately to them.

This must be done in person, either by Linda Lee, our HR Director, or by Mani Kaur, our Logistics Director. It is important that employees understand the need for this change, in terms of the improved efficiency of the business and the long-term competitive position of Rio. We must explain the relative benefits of the new location in Waldania compared to the current location in Central Europe. It will be important that a single meeting is held for all of the Central European distribution centre staff, so that all staff receive the same information at the same time.

We must inform employees of their own positions in the business and we must be completely open in terms of the timing of the closure, level of redundancies and also potential re-location opportunities. We must inform distribution centre staff of our intention to assist them as much as possible throughout this difficult period.

##### *Store employees*

Store employees will need to understand that the main benefit is to ensure that customers receive the latest products in store as quickly as possible to promote customer loyalty. Criticality of speed to market needs to be communicated to store employees, and that this will significantly be improved through the opening of the new distribution centre. Store employees should be re-assured that this is a significant development for the business and this message should encourage store staff loyalty and retention.

#### **Recommendations for three performance targets**

(Set to be compared to current performance in the existing Central European distribution centre):

1. Cycle time (measured by time of receipt in to the distribution centre to final shipment out of the distribution centre)
2. Number of products damaged in processing
3. Percentage of products picked correctly

Cycle time is a critical measure to determine service efficiency, as for Rio it is important to measure and improve upon cycle time in order to continually improve product time to market and deliver its promise to customers of fast fashion. The cycle time for the Waldania distribution centre should be compared to the cycle time achieved by the current Eastern European and Asian distribution centres to ensure that it is operating at a similar cycle time to these high tech distribution centres.

Damage measurements are a key measure of efficiency, as the lower the level of damage, the more efficiently the operations of the distribution centre are being carried out. High levels of damage are costly in terms of rectification costs and also in terms of time to market. Rio must measure and attempt to minimise the level of damage occurring at distribution centres as much as possible as lost products will result in lost sales and reduced profitability.

Accuracy measures of the percentage of products picked correctly are important measures of how efficient the distribution activities are. Inaccurate products sent to stores will reduce sales potential and also Rio's reputation.

### **Benefits of operating stretch targets**

A stretch target is one which challenges current assumptions and processes, and is designed to inspire teams to re-imagine what they previously thought possible. Stretch targets may seem impossible at the outset, but should be perceived as highly challenging but achievable.

One of the benefits to Rio of using stretch targets is that they should encourage distribution centre managers to think creatively and this may result in managers identifying new ways to improve processes and increase efficiency. Although much of the process carried out in the distribution centres is automated, there is still likely to be some potential for improvements to these processes. Also, at all distribution centres there are still a range of manual activities being carried out which could be improved. Stretch targets should encourage distribution centre managers to consider ways to improve these processes to maximise efficiency.

Stretch targets could also benefit Rio's distribution centre managers personally. When a stretch target is achieved, individuals become more self-confident and more engaged, and are thus more motivated. Stretch targets may encourage distribution centre managers to re-evaluate what they are capable of. As a company we pride ourselves on a culture of staff development and this could assist in achieving that.

### **Risks of operating stretch targets**

However, there are also some major risks that can come with stretch targets. Firstly, stretch targets that are truly impossible to reach can be hugely demotivating if managers know they will never achieve such a level of performance. Inevitably, this will lead to stress and potential staff turnover. This may be a particular risk in the Waldania distribution centre where managers are likely to be new and may not yet have the necessary skills and knowledge to achieve stretch targets. Our current distribution centre managers in Asia and Europe are highly skilled and finding replacements will not be easy if we put them under so much pressure that they leave the company.

Another risk is that stretch targets can sometimes lead to unethical behaviour. Managers may feel under pressure to do whatever it takes to achieve the target, even when their actions go against Rio's values and ethical principles. Managers might also feel pressured to take excessive risks to meet the target, for example compromising on staff safety issues or quality checks. Any breach of these could have serious reputational consequences for Rio.