CGMA STRATEGIC CASE STUDY AUGUST 2019 EXAM ANSWERS

Variant 1

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

Freewheeling versus emergent approach to strategy development

I note that the news article claims that Optim has used a freewheeling approach to strategy, which could well be true, based on Mr Macon being labelled as an entrepreneur. 'Freewheeling opportunism' is an opportunistic strategy process, driven by the search for new opportunities, often with high risk decisions, being led by an entrepreneur. It is an informal and short-term approach to strategic planning which, as suggested from the article, is likely to cause concerns for potential investors in Optim.

However, a freewheeling approach does have its advantages. Mr Macon has clearly used his entrepreneurial talent for continually focusing on, and exploiting, product and market opportunities, as he did when setting up Optim in 2012. By frequently adjusting plans and strategies, freewheeling opportunists can rapidly react to the changing environment. It is very useful in a fast-changing industry such as ours, as it can result in implementing the strategy resulting from the opportunity whilst more cautious competitors are still thinking about it.

However, it also has a number of problems. Potential investors are likely to consider this approach too reactive and such a 'muddling through' style is not likely to be effective in the long term. This lack of long-term direction will make investors very nervous of their future returns in such a business. Although it can result in big gains, for being ahead of competitors, it can also result in major failures. Also, it relies heavily on the experience, flair and judgment of the founder – one single individual. Again, this is not going to sit easily with the expectations of shareholders with respect to sound corporate governance.

An emergent approach to strategy development sees strategies emerge from strategic courses of action, which are developed from both tactical and operational levels within the organisation, and these strategies are often 'unanticipated', informal and developed bottom-up. This is opposed to the formal rational planning approach, where strategy is planned for the long term by senior management using a formal and logical approach. Zoom is currently following a more emergent approach.

The advantages to us have been that it has allowed us to react to change quickly to re-position ourselves and our strategies according to market demand. Our use of tactical and operation level staff as sources of innovation have made our approach to strategic planning more dynamic and therefore emergent. This has also promoted a culture of flexibility, dynamism and learning in our business. Although not a rational approach, it is a more structured approach to strategic planning than freewheeling opportunism as, although it is not a 'rational' approach, it is still guided by the need for strategies which are responsive to the market and therefore does require a clear and detailed understanding of our business environment.

With the size of our organisation and the structured management setup that we have, as well as the fact that we have quite a sophisticated operating model, as well as some solid strategies in place at the moment, an emergent strategy would seem more appropriate for Zoom rather than one based upon freewheeling optimism.

Challenges in meeting corporate governance arrangements (and how to address these)

Firstly, we would need to comply fully with Jayland's Corporate Governance Code.

Zoom's board operations would not necessarily differ significantly from what we do now, in terms of general activities and board meetings. The board currently meet and report regularly, to satisfy the needs of the venture capitalist investors, so we should not see much change in the operational activities of the board. However, an important change is likely to be the need for a separate Chief Executive and Chairperson, roles currently undertaken by Seema. This would be necessary, but may be a challenge for Seema to report to a new Chairperson or to give up her active day to day role and become the Chairperson herself. We will need to recruit a suitable candidate for either of these roles, which may be challenging, considering the current close working relationships of the current senior team members. I would recommend that a Chairperson be recruited to allow Seema to continue with her active involvement in the management of Zoom, with the new Chairperson taking on the non-executive role. Also, more formal procedures for reporting board meetings would be required and the activities of the board would come under more scrutiny from external shareholders. Managing the expectations and communications with many external shareholders will be challenging and we would need to hold an annual general meeting so that shareholders have a forum to communicate with our directors.

We will need to implement formal procedures for the appointment of new directors and for the re-election of directors at regular intervals. As a relatively new business, this is not something we will have needed to have done before, but this will now be an expectation within the Corporate Governance code. This will need to be reported in our annual report to shareholders. Although we have a risk committee other board level committees must be set up. For example, an audit committee and a remunerations committee will need to be set up and the reports and recommendations from these committees would need to be reported to investors within our published annual results. This may be challenging, as our existing directors may not have the necessary depth of experience to play an active and effective role in such committees. Therefore we will need to consider education and training for our board members to ensure they have the necessary skills to take on these new responsibilities.

One way to address this is the recruitment of more independent Non-Executive directors (NED's). Following a listing, the board will need to consist of half independent NED's, excluding the Chairperson. Currently we employ only two NED's who are representative of the venture capitalist investors. Additional NED's will need to be independent and contain a mix of skills and experience from inside and outside the ride sharing industry. Their job is to contribute to strategy and to offer advice and direction. Again, Seema and Dev may find this challenging. It many also be challenging to find individuals with the right skills and experience to be effective

NED's. To find the right individuals to join Zoom as non-executive directors will take time and this could affect how quickly we are able to consider a listing.

A final challenge that we must take into account is the potential pressure we may face from our venture capitalists to list. We need to really understand the reasons for listing and that it is being done for the right reasons. Detailed discussions must be held with venture capitalists and potential investors to ensure that any listing is beneficial to all parties.

SECTION 2

Public listing versus current funding structure

Benefits of being a listed company

A stock market listing is likely to raise the profile of Zoom, both in Jayland and internationally. We are currently less well known in our own industry than Optim, but a stock market listing would make us more visible and raise our profile across business sectors.

With an enhanced business profile, we may achieve greater standing and credibility with suppliers and, importantly, with providers of finance. We have had a strong relationship with our current bank up to this point, but a stock market listing may allow us to seek alternative funding elsewhere. As a listed company, we are more likely to be viewed favourably and granted extended credit facilities with key lenders.

A stock market listing should assist us in raising capital for our future growth strategies through the issue of shares and expansion outside of Jayland, which is one of our corporate aims. The reputation that comes from being listed may help to attract foreign investment.

Once we are listed, the market should provide us with a far more accurate valuation of the business which has not really been possible up to this point. It will be easier to trade shares in the future, should Seema or Dev want to sell any of their shareholding and options such as rights issues also become available.

There are benefits to the staff and managers of Zoom. Improvements to our reputation as a result of being listed means that the business is more likely to succeed in the long term and, therefore, it may result in improved pay and better career prospects for Zoom's staff.

Problems of being listed

Picking up on something that Seema said during the meeting, it is important not to just see a public listing as a means of raising finance. Whilst it may raise some additional finance initially, a listing is about far more than that. A listing is likely to be costly and will take up a significant amount of time for the senior management team. We must ensure that, during this time, we do not lose focus on other key issues in the business and that we maintain our focus on continuing to grow the business. A listing may detract from this in the short term. We may require external expertise to assist in the process which is likely to be costly.

Making shares available to the wider market will inevitably lead to loss of control of Zoom for Seema and Dev. This may be difficult for them to accept, as they have such a close association with this business. It is likely that some of our current investors will buy some of the shares and also new shares will need to be offered to the public in order to generate sufficient interest in the shares. The level of ownership for Seema and Dev will be diluted. Although they will still likely want to retain some shareholding, this is unlikely to be enough to hold a controlling interest in the business that they started.

The reporting requirements will now be more onerous as a listed company. We will have to file our annual accounts with the Jayland company authority and our accounting records must be submitted in accordance with International Accounting Standards. We will be expected to follow strict listing rules, including those of Corporate Governance requirements, which are likely to be extremely detailed and onerous for the board.

Impact of listing on Zooms culture

At Zoom we have a 'community-based' culture based on a drive for continuing improvement through involvement of everybody. We need to therefore consider whether the culture will remain on track to deliver Zoom's organisational strategy following a public listing. It is likely that, to some extent, our culture has to flex and change if it is to reflect this change in our business. Gearing up to an initial public offering is likely to be energy sapping and satisfying the regulatory and legal requirements for an IPO will stretch our resources.

This may be a dangerous time for us, as the senior management team take their eyes away from the day-to-day, hoping that our culture is strong enough to sustain the business without active guidance. That danger aside, it is also a time for flexing the culture, for gearing it up to a post-IPO status.

As the business now has to take the needs and requirements of shareholders into account, it is inevitable that our culture will need to change. Even within our innovative organisation which has been looking to deliver long-term profitability together with customer excellence, the presence of shareholders will inevitably alter the balance. For example, accounts and annual reports will now have to be prepared with the 'comply or explain' principal in mind and that means a renewed emphasis on being clear on the strategy and purpose of the business.

If we look at some of the elements of the cultural web, though, we can see that there is likely to be some impact on the culture within Zoom. For instance, the power structure will certainly see some change. Up to now, even though there has been a formal board structure, it is likely that some of the staff who have been with the company since it was founded, will still have an informal relationship with Dev and Seema and will; find it very difficult to break away from this approach going forward. It is also possible that a more formal organisational structure will bring more bureaucracy into the way that staff go about delivering the service. This may initially hinder productivity as staff may find this daunting and strange at first.

Again, whilst there will be control systems in place at the moment, they are likely to need to be more formalised in order to comply with stock market regulations and the expectations of external shareholders.

With McKinsey's 7 S model in mind, the staff will have shared values about why Zoom exists. For many of them, it will have been to see the business grow and to enjoy their work, whilst earning a fair day's pay, with some aspirations of career progression. They will not have been over-concerned with the company's profitability as such, other than the need for it to remain solvent and trading. However, following a public listing, the need to make increasing profits will become more of a reason for being for the organisation as this will be the key concern for a number of the new shareholders.

So, for the CEO and leadership team the post-IPO world is one which will require a renewed and positive emphasis on strong and inclusive culture development. Unless the post-IPO culture is part of the transitional design, then we will be caught unawares. This includes planning the relationship with shareholders and working on employee engagement with the new structure.

By opening up our organisation to shareholders we are offering our culture as much as our business. Being clear about our culture is therefore as important as preparing accurate accounts or providing realistic forecasts about future prospects.

SECTION 3

Assessing internal control system effectiveness

The starting point for any assessment of our internal control systems would be to evaluate the effectiveness of the five elements of effective internal control systems set out in the COSO model. Firstly, we need to review our general control environment, by reviewing senior management's attitudes to risk and the need for internal controls. This can be reviewed by assessing our overall business ethics and behaviours and culture and through consideration of our structure and attitudes to staff (such as our commitment to training and support for both our internal staff and our self-employed drivers).

A critical element of reviewing our internal control systems is our commitment and procedures in risk assessment. Regular and thorough risk assessment must be carried out and we must evaluate Zoom's current risk register and any risk mitigating activities we undertake, to evaluate their suitability and effectiveness. This must be carried out not only by Zoom's board but also throughout the whole organisation. Following the consideration of our risk assessment procedures we must assess the control activities we have implemented to manage these risks. This might require us to assess our organisational structure, policies and procedures, contracts of employment and performance appraisal systems for staff and drivers.

In order to operate effective internal control systems, we must also assess our information systems to determine their effectiveness in providing timely, accurate and reliable control information. Finally, we must evaluate our processes of monitoring our internal control activities such as our internal audit activities and procedures.

Should we outsource internal audit

The purpose of an internal audit function is to provide us with an objective assurance of the effectiveness of our internal control system, to reassure management, external governing bodies and regulators of the effectiveness of our risk management, control and governance activities. However, we could decide to outsource internal audit if we felt it offered us better value or improved service. Before we do so, we must assess the risks that such an approach to undertaking internal audit activities could create.

1. We may find it difficult to identify an outsourced internal auditor function with a suitable level of knowledge and understanding of Zoom's objectives and culture, which may make the internal audit process more difficult. The data management systems that we use and our development of driverless technology may cause difficulties for outsourced internal auditors to fully appreciate and understand, when not directly working in this environment.

2. We must not make a decision to outsource if it is only based on cost-effectiveness. Our aim must be to ensure the same level of service and effectiveness as an internal

audit function. Unless this can be guaranteed, then the risks of outsourcing may be too great.

3. If our external auditors were to provide such assistance as internal audit activities, this may blur the roles of the two separate functions and may risk destroying the credibility of both.

4. Importantly there is a real risk that we lose control over the quality of the internal audit service provided, as it would largely be out of our control. However, we can try to minimise these risks through regular reviews of the quality of internal audit work and by setting clear guidelines ourselves for scope, reporting and reporting procedures.

Recommended performance measurement system

All of our current KPIs, including revenue growth, number of rides completed and customer membership numbers will remain relevant key business performance measures and should continue to be focused on after listing. These will continue to be key determinants of our success and will be of high importance to our key stakeholders, including our new shareholders, as they are key measures of our continued success and growth. However, new KPIs need to be considered to satisfy stakeholders. Investor performance indicators such as annual return to investors, earnings per share, dividend growth and debt to equity ratios would normally be of importance, specifically to investors concerned about returns on their investment and upon the long-term viability of the business and risks to financial stability. In the short term, some of these KPIs many not be measurable until we begin to make a stable return for investors. However, our performance will be open to a much higher level of scrutiny, so including a wide range of performance measures will be very important and we must include measures specific to our potential returns to investors.

This may be an appropriate time for Zoom to widen its performance measurement to include a range of non-financial performance measures, through the application of a Balanced Scorecard approach. This could be more useful in measuring the achievement of our critical success factors and also for driving our strategic direction. For example, customer satisfaction measures would assist in monitoring our ability to not only grow membership levels but importantly to maintain current membership. Measures such as number of staff training days would assist in evaluating our effectiveness in delivery of our core services to customers and driving strategy towards membership growth. Driver turnover measurement would help us to evaluate our internal driver management processes. Investors will expect a wider range of both financial and non-financial and quantitative and qualitative measures upon which to base a more detailed assessment of Zoom's overall performance.

Managing shareholder expectations of dividend policy

Obviously, we do not yet have an established dividend policy so shareholders should not have a pre-determined expectation of what our dividend policy will be. However, the fact that they have invested in us means that there of course will be an inherent expectation of a future dividend. Therefore, we need to manage this expectation effectively, prior to a listing within our listing prospectus. We must maintain an open and honest communication with shareholders, in order for them to make effective investment decisions. We would need to be clear about the reasons behind a zero-dividend policy by clearly stating that we are looking to reinvest as much of our profits as possible to continue to grow the organisation. There are a number of key developments that are taking place in the industry at the moment, such as the switch to electrically powered vehicles and the advent of driverless cars and these developments will need considerable investment if we are to remain competitive. By communicating this before investors purchase shares in Zoom shows that we have a clear strategy in place to exploit these developments rather than announcing at some future date that we will not be making dividend. This may be seen as poor control and lack of foresight.

There is an argument that there is little need to manage shareholder expectations as the dividend we pay out should be irrelevant to shareholders. Modigliani and Millers 'Dividend Irrelevancy Theory' argues that our decision to pay a dividend or not is really a decision of how a return is delivered to shareholders. Should our shareholders desire a return other than capital growth, then they can sell their shares.

At this critical period in the growth phase of our business, shareholders willing to invest in us must do so knowing that their returns are likely to be re-invested for future growth in the short term. Therefore, it will be critically important that we make this clear as part of the public listing communication process.