# CGMA STRATEGIC CASE STUDY AUGUST 2019 EXAM ANSWERS

## Variant 5

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### SECTION 1

**Potential financial impact of divestment**

If we decide to sell-off the bike sharing business then we could improve our cash position through the sale of the bikes and docking stations we have acquired to operate this part of our business. However, our current cash position is relatively healthy and therefore increasing cash should not be a major determinant on making such a divestment.

There is likely to be a cost involved in making a divestment in re-negotiation of contracts with equipment and payment systems suppliers and there may be potential redundancy costs relating to those staff associated with operating this part of our business. Also, some of our fixed costs, including, personnel and administrative support, will be spread across the whole business and, following divestment, the ride sharing business will have to absorb these costs. However, these costs are not significant relative to our current overall costs.

If we look to the longer term, the prospects for the bike sharing business look positive and divestment could result in us losing out on a financially beneficial future business. Revenue is predicted to increase by 68% in 2019 compared to 2018 and gross margin predicted to increase by 75% by the end of 2019. Therefore, divesting from the bike business is likely to have a severely negative impact on gross margin. However, as bike sharing is currently performing well and is expected to continue growing for the foreseeable future, if we are serious about divesting, we would be wise to do so whilst the business is an attractive proposition to potential buyers. We would be in a strong position in negotiating a good price for this business. This would bring in cash for us to invest in our driverless car strategy.

**Potential non-financial impact of divestment**

The main benefit of divesting is the increase in value that might result. As suggested by Lou Cruz, a more streamlined strategic focus will increase transparency for our shareholders, free up resources and the cash received can be invested in developing the rest of the business. Although the bike sharing business has undoubtedly got potential to increase revenue, arguably it could take the focus off Zoom's core competency – car-based ride sharing. Divestment could help us focus more on our core strategic direction. I cannot comment on Lou's accusation regarding Seema wasting her time on the bike sharing business, but he could have a point if it is to the detriment of the development and success of our ride sharing and driverless car technology strategy. However, suggesting divestment may be an extreme solution to this issue!

The bike sharing business is complementary and supportive of our ride sharing business and most certainly fits with our mission statement. Normally divestment occurs when a business unit no longer fits with a company's core business, thus helping to maintain their strategic focus. In this case, I do not agree that divestment is the correct solution, as the bike sharing business enhances and supports our strategic focus and mission and vision.

Such a short-sighted decision may have longer-term negative consequences for Zoom. If we sell the bike sharing business, we eliminate the opportunity to take advantage of the future growth potential that clearly exists. We also need to consider the impact on our stakeholders and users of this service. To withdraw it at this point would likely send out a very negative message to our customers relating to our commitment to the long-term ecological transport solutions for Jayland.

**Market Penetration and Development potential of the bike sharing business**

To date, the bike sharing business has grown rapidly in Jayland, and we are forecasting that growth to continue in 2019 with our coverage across the number of cities increasing by 51% from 2018 and the number of users increasing by 45% on 2018. This has been facilitated by demand from both the government and society for more environmentally friendly transport solutions. We are the only ride sharing business operating in Jayland which offers a bike sharing service, so we have been able to enter the market without any direct competition from our ride sharing rivals. The bike sharing market appears to be growing and therefore market penetration and market development of our bike sharing business is viable.

**Market penetration**

We need to try to stimulate increased usage of our bike sharing service by our existing customers. We could increase advertising to these customers and, through this, offer discounts for increased usage. For every ride taken, we could offer our customers either bonus points, which could be used to buy credits for more rides, or we could offer a free ride after every set amount of kilometres covered. So, for example, for every 10 kilometres completed, the rider gets 1 free kilometre on another journey made at a later date. We could also offer partnership arrangements, whereby kilometres completed are saved and converted to bonus points to be redeemed at local stores or restaurants.

We could try to attract customers from our competitors. Again, strong marketing campaigns and promotional offers which are better than those offered by our competitors will need to be considered. We will also need to investigate our price compared to competitors and, potentially, offer a lower price. However, this must only be done if we have strong evidence to suggest that price is a determinant in the customer's decision making when choosing our competitors' service over ours. They may select our competitors, based on service delivery or convenience of docking locations or payment system compared to our own offering. Offering sign up bonuses or discounts for the first 6 months of registration as a promotional offer may be a useful way of penetrating our competitors' market.

## Market development

In terms of market development, as we are proposing to merely move to new areas in Jayland, then it is unlikely that this will require us to invest in new competencies or skills (as is often required when moving to different geographical locations). However, we will need to look for ways to advertise our services in these new locations. This may mean advertising via our social media feeds or through our current car sharing app already present in those locations.

In addition, market development could mean a move to encouraging our bike usage by different demographic groups. I do not have any specific demographic data relating to who uses our current bikes but, for example, if we identify that there is a significant percentage who are male, then we need to consider introducing advertising and operational strategies to attract more female users. For example, we may need to consider advertising in gyms, shops or websites and social media sites that we know are used by women. The key will be to present our advertising message in different media and in different ways.

## SECTION 2

### Actions to improve Zoom's supply chain management

Although the relationship with Bikeeze appears to have been satisfactory in the past, this is no longer the case and we need to take positive steps at this point to manage our supply chain better and resolve the problems we have been having with deliveries of bikes.

It is most concerning that we cannot reach anyone at Bikeeze to start to fix the issues that are occurring and our first priority must be to reinstate channels of communication, as good communication is key to positively managing the supply chain. This will involve further efforts to telephone Bikeeze, and a formal letter to outline current concerns. If we continue to obtain no response whatsoever, we must stop ordering from Bikeeze for the time being. Therefore, another step we should take at this point is to start to investigate other suppliers which could fit into our supply chain if the problems with Bikeeze continue.

If we can get through to someone at Bikeeze, then it is time to start a conversation about recent experiences, explaining the problems with missing deliveries and faulty products. It is not all about telling Bikeeze we no longer want their goods. If Bikeeze lay out a plan to rectify the issues we should listen to it and assess whether we are happy it will allow for a good trading relationship in the future.

Specifically, we should raise concerns about late deliveries, asking when the currently missing bikes we have ordered will be delivered. Also, we should be very clear we do not accept the current practice of sending out faulty bikes and that quality control must be significantly improved at Bikeeze in order for this trading relationship to continue. It is clear that Bikeeze is having some major operational problems at the moment and we should be sympathetic to that and willing to work with it to help, but not to the extent that our reputation and performance is allowed to drop as a result. It is surprising to see an organisation go from being a prestigious award-winning organisation to one in such fundamental trouble in such a short time span. It is vital we establish what is going on and the future impact on Zoom.

There are several things we can take control of and do ourselves to reduce the risk in this supply chain situation. At present we do not check the quality of the bikes when they are delivered. We should be taking steps to check bikes on delivery and immediately returning bikes that don't meet our requirements. This will prevent the problems we are currently experiencing, when faulty bikes get as far as the public, creating the risk of injury, litigation and damage to our reputation.

We could also reduce our current risk levels by paying for the bikes after delivery rather than on ordering. Paying on ordering in a trading relationship like this one seems excessively generous to the supplier and is not a particularly usual relationship in this sort of context. It has, in this instance, exposed us to financial loss as we have paid for bikes we have not received and that cannot be used.

Zoom has grounds to explain to Bikeeze that it will not continue this practice and seek more standard credit terms, paying after the bikes are known to be actually delivered and of a satisfactory quality. It may be that the payment in advance option didn't cause significant issues for Zoom before now, but certainly in view of the current problems, this approach is inappropriate. Overall, the problems with Bikeeze may not be beyond repair and it is possible, currently, that the trading relationship could be saved. However, indications are not good and, unless communication channels can be reinstated quite quickly, Zoom should start to explore other options for these purchases and, perhaps, consider having more than one supplier moving forward.

**Whether the activities of Bikeeze impact us at Zoom and what we can do about it**

Although I accept your point that 'Bikeeze is just a supplier and we don't run the company' I would argue that, nonetheless, the way it behaves impacts highly on Zoom and, to some extent, our association with it reflects on our principles and ethics. Therefore, we cannot simply 'ignore what is happening at this supplier.

As you say, the newspaper article makes for uncomfortable reading and we can see evidence of poor working conditions for staff, inappropriate dumping of waste, misstatement of carbon emission data and suggestions that jobs at the organisation are precarious.

We are clearly facing a large impact on our trading relationship with Bikeeze which, as I mentioned previously, is under significant strain at present, with no sign of things improving right now. We also risk customers and the media criticising us at Zoom for doing business with a company that has so far failed to rectify some large scale ethical wrong doings.

Here at Zoom, we pride ourselves on an ethical approach to doing business with high standards of corporate social responsibility and much time and effort invested in ensuring we are carbon neutral every year. This has built up an enviable reputation that our competitors would love to enjoy. If we continue to trade with Bikeeze, and these problems are not very quickly resolved, we risk being heavily criticised for espousing a socially responsible approach but ignoring when it suits us. This could undermine all the good work we have done since we started.

Not only that, but there may be indications here that Bikeeze could be in such great trouble it will soon cease to trade. That would leave us without a bike supplier, which would significantly delay the growth of our bike-sharing operation if we don't move quickly to get other lines of supply in place.

Therefore, I think we need to take rapid action. As mentioned previously, now is the time to communicate with Bikeeze. We will need to talk not only about the problems we are having from a trading perspective but also the matters coming to light in the Daily Gazette.

One final step we may wish to take to manage the reputational damage this could cause Zoom is to make a comment about the situation ourselves through a press release and/or on our website. This should explain that we have been made aware of the problems at Bikeeze and are taking steps to deal with the situation as quickly as possible, given our ongoing commitment to an ethical and responsible trading approach.

## SECTION 3

### The currency risks of purchasing bikes from Wizz

Zoom faces new risks if it purchases its bikes from Wizz.

As Wizz is based in Zeeland, the main financial risk we are concerned with as a purchaser arises from currency risk, which can be categorised as economic, transaction and translation risks.

Economic risk could arise if there are changes in the Zeeland economy that have an impact on Zoom. This looks likely in the current scenario. We know, for example, that Zeeland has experienced some issues with a short period of high inflation. This could impact Zoom by pushing up costs at Wizz and, hence, the price it then charges to Zoom, reducing the financial performance of the bike-sharing arm of the business.

Transaction risk will also be relevant to Zoom, as it is likely to make bike purchases on credit terms and, between the time of the transaction and the date of payment exchange, rates may move. This is highly likely in Zeeland, as we know it has had historic issues with an unstable exchange rate. This movement impacts cash flows and can have a positive or negative effect, depending on the direction of the movement of the exchange rate. It is obviously any potentially negative movements that we are concerned about.

Translation risk will only arise if Zoom has an asset or liability denominated in the statement of financial position in the Zeeland currency. This is an unlikely scenario in this circumstance, so is not a risk we need to consider at present.

### Managing the currency risks identified

There are several ways to manage the risks described above.

In terms of the economic risk, we should carefully monitor economic conditions at Zeeland. If the economy is deemed to be highly unstable, we should probably seek a supplier elsewhere, but we could manage the risk of soaring prices to some extent if we can agree a medium-term pricing structure with Wizz that it must stick to even in the event of high inflation.

In terms of the transaction risk, we may wish to hedge exposure to this risk if we plan to spend a material amount and deem it worthwhile for the volume of business being conducted. Hedging may be performed using a number of different financial instruments, such as options and futures contracts, set up to to offset movements in the value of a hedged item.

A hedging program reduces the financial risk faced when exchange rates move by passing that risk to another party. This will provide certainty of cash flows and reduce risk. However, it is worth asking whether the value of the transactions undertaken are large enough to warrant the effort, as there are costs involved in arranging hedging and managing the arrangements on an ongoing basis.

It is also worth noting that, by hedging, we take away the potential for an exchange rate gain as well as removing the possibility of a loss.

**CSR objectives versus financial performance**

Faced with a broad range of stakeholders, including investors, riders, drivers, staff and the wider community, it will be difficult for us to simultaneously maximise the wealth of our investors and keep all our other stakeholders happy, and vice versa. The main aim for Zoom should be to attempt to balance our objectives with the needs of other stakeholder groups and, also, consider both short-term and long-term perspectives.

From the comments made by Anna Borosa in her email, financial objectives, including revenue growth, long term profitability and cashflow growth, will be of most importance to investors and they will have an expectation that our focus should be on these. However, Seema and Dev, from the perspective of Zoom, also have to consider the short and long-term objectives of our other stakeholders.

Our mission and vision statements demonstrate Zoom's focus on the whole transport environment (not just car sharing) and on our commitment to the transport environment. Therefore, I would challenge the statement made by Ms Borosa, particularly in relation to these being CSR objectives. Seema and Dev are not focusing on achieving CSR objectives as our CSR obligations and focus are much more than this. Indeed, the successful commitment to and achievement of our CSR objectives will likely be the foundation of our short term and long-term financial performance and growth. Although long term financial growth is ultimately a key strategic objective, achievement of this can only be supported through a focus on non-financial objectives, including our corporate social responsibilities.

**Actions to reduce potential political pressure**

We are aware that there has been increasing industry regulation in environmental and safety requirements in the car sharing business and that the regulators and local authorities are already interested in our activities. Therefore, when considering operating and developing our bike sharing business, we must maintain good and close relationships with regulators and local authorities.

Kris Muller, the local politician who has been in contact with Seema regarding us using Wizz bikes instead of Bikeeze, could be influential. Therefore, we need to make every effort to open up a dialogue with him, to put our case across as to why we are proposing to use Wizz bikes as our supplier. We need to explain our reasons carefully, setting out our long-term position in terms of our overall impact as a business, on the environment and a service provider to the wider population and economy of Jayland. We must carefully explain the environmental and social reasons for choosing Wizz bikes.

We must work closely with local authorities and explain the importance of our service to their towns and cities and the benefits that using more Wizz bikes will have on the people and economy. We could make a financial contribution to local road schemes, such as the development of dedicated bike lanes. We could work with local authorities to provide environmental awareness schemes, such as working local schools to promote more bike usage.

It is very likely that we are not the only bike sharing business to buy our bikes from overseas and we should also stress this point with regulators. We can also point out that the towns and cities may receive much needed additional revenue from tourists as a result of people using our bikes to get around on, visiting attractions that they otherwise would not visit.