PROFESSIONAL LEVEL EXAMINATION

WEDNESDAY 18 MARCH 2015

(2½ hours)

BUSINESS STRATEGY

This paper consists of **THREE** questions (100 marks).

1. Ensure your candidate details are on the front of your answer booklet. You will be given time to sign, date and print your name on the answer booklet, and to enter your candidate number on this question paper. You may not write anything else until the exam starts.

2. Answer each question in black ballpoint pen only.

3. Answers to each question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.

4. The examiner will take account of the way in which answers are presented.

5. When the assessment is declared closed, you must stop writing immediately. If you continue to write (even completing your candidate details on a continuation booklet), it will be classed as misconduct.

The questions in this paper have been prepared on the assumption that candidates do not have a detailed knowledge of the types of organisation included in the paper. No additional credit will be given to candidates displaying such knowledge.

IMPORTANT Question papers contain confidential information and must NOT be removed from the examination hall. **DO NOT TURN OVER UNTIL YOU ARE INSTRUCTED TO BEGIN WORK**	You MUST enter your candidate number in this box.

1. Rocket Co (Rocket) is an accountancy practice with four partners. It operates from a single office in a European country that is not part of the EU and whose currency is the franc.

Information about Rocket

Rocket employs 17 professional staff, both qualified and part-qualified accountants, and five support staff. It specialises in accounting and tax advisory work in the sports and leisure sector. Rocket's clients are typically wealthy self-employed sportsmen and sportswomen. It competes with a number of big regional and national accountancy practices which service sports and leisure clients as part of a more general client portfolio.

Rocket has experienced impressive growth rates but the partners are concerned that growth appears to be slowing. An extract from Rocket's balanced scorecard for the years ended 31 December 2013 and 2014 is provided in the **Exhibit**, showing both financial and non-financial information. The partners' financial returns in 2014 were affected by a number of factors, including a fall in billable hours, a rent review and increased professional indemnity insurance (PII) premiums. Most significantly, Rocket had to pay higher salaries to its employees. Professional staff working on sports and leisure clients normally command a premium of around 10% on market salaries. During the recent economic recession, Rocket had been paying its 17 professional staff just below the market rates for general accountancy staff. This was accepted by staff while they had few other employment options available, however the market is now improving and external job opportunities are growing. As a result, during 2014, Rocket was forced to give professional staff a substantial pay rise.

Change in strategy: creation of a multi-disciplinary practice

A new regulatory framework for the legal services market was recently introduced in Rocket's country, to increase competition and encourage efficiency. This removed the previous restrictions on lawyers forming partnerships with other professions and created a new type of professional services firm, known as a multi-disciplinary practice (MDP). An MDP is a professional firm consisting of professionally qualified lawyers and accountants working together in client-facing roles. To operate as an MDP, a licence is required from the newly-created regulatory authority which is responsible for monitoring quality and compliance.

In February 2015, Rocket's four partners decided to take steps to become an MDP. Clients in the sports and leisure sector often need more than one professional service to deal with matters such as contract negotiations, sponsorship deals and personal injury claims. Rocket's intention is to capitalise on this by offering legal, tax and accounting advice to its existing clients. This should also allow it to attract new clients. Typically both legal and accounting firms face high fixed costs for salaries, premises and PII. The synergies involved in becoming an MDP will allow Rocket to provide a greater volume of client services more efficiently and cost-effectively, thereby increasing both revenue and margins.

Rocket estimates it initially needs six fully-qualified lawyers, with a view to increasing this to a team of ten once demand is established. Two possible ways of resourcing the change to an MDP are being considered:

(i) recruit qualified lawyers on an individual basis
(ii) acquire a specialist team of qualified lawyers from a law firm to which Rocket has previously referred work.

Announcement of the change in strategy

On 1 March 2015, Rocket issued the following email to its professional staff and support staff, in order to announce the firm's change of strategy and to set out the partners' expectations. There had been no prior consultation with the recipients of the email and it has caused considerable anxiety among all staff.

CONFIDENTIAL EMAIL

To: allstaff@Rocket.com
From: Rocket partners
Date: 1 March 2015

Re: New business structure and strategy

The partners have decided to take advantage of recent changes in legislation so, with effect from 1 June 2015, Rocket will become a multi-disciplinary practice (MDP) offering both legal and accounting/tax services. As you are aware, our high-profile sporting clients frequently also need legal services and this change in strategy will allow us to attract a greater share of their expenditure on professional advice, and to improve our competitive position. We are in the process of recruiting the necessary qualified lawyers.

We will be spending heavily on marketing the new services and to fund this over the next month we will be examining the potential for cost savings and efficiencies across the firm. This may have some impact on our staffing and management structure.

We estimate that 75% of a fully-qualified staff member's total workload is dependent on having completed their professional qualification. The remaining workload could be carried out by a combination of part-qualified professional staff and support staff. Therefore, we require all fully-qualified staff to identify immediately which parts of their work they can begin to pass on to other staff. This will result in financial benefits to clients as we can reduce certain fees, and it will allow our fully-qualified staff to focus on more value-added advisory work, which will enhance revenues.

From 1 June 2015, each client will be serviced by a multi-disciplinary account management team headed up by a partner, with at least one qualified lawyer and one fully-qualified accountant. There will be a single central support team providing administrative assistance to both legal and accounting/tax professional staff, so that clients receive a co-ordinated service. We need to improve the productivity of our support function with a view to maintaining a ratio of one member of support staff for every six professional staff (including partners).

We expect all staff to be as co-operative as possible and ask you to do everything you can to make our new legal colleagues welcome. Please give them open access to your clients and all relevant client information.

Ethical issue

Alina Jay, an ICAEW Chartered Accountant with Rocket, has recently been involved in preparing a statement of personal assets and liabilities for a long-standing client of the firm, who is currently seeking loan finance. The final statement which was submitted to the client's bank was very different from the initial draft which Alina prepared and submitted to her manager at Rocket. She suspects that the Rocket manager, who is a personal friend of the client, may have agreed to a misstatement of the client's personal affairs. Alina is unsure whether she should report the client and/or the manager to her superiors, and is concerned about the impact on her job and career if she were to do so.

Requirements

(a) Using the balanced scorecard in the Exhibit and the other information available, analyse and evaluate the performance of Rocket between 2013 and 2014. **(18 marks)**

(b) Analyse the impact of the following factors that may influence Rocket's ability to create a multi-disciplinary practice:

- Human resource capabilities
- Legal and regulatory issues
- Competitors and market structure. **(10 marks)**

(c) In relation to the email announcing Rocket's proposed change in strategy, discuss the extent to which Rocket's approach meets best practice in change management. Refer to an appropriate change model such as Gemini 4Rs. **(10 marks)**

(d) Discuss the ethical issues associated with Alina's concerns and advise her on appropriate actions to take. **(8 marks)**

Total: 46 marks

Exhibit: Extract from Balanced Scorecard for Rocket

	Year ended 31 December 2014	2013
Financial		
Note: all monetary amounts are expressed in francs (F)		
Total fee income (F'000)	7,091	6,653
Growth in fee income	+6.6%	+9.2%
Mix of fee income - Accounting:Tax	47:53	45:55
Average fee charged per billable hour (F):		
Accounting services	335	300
Taxation services	415	360
Fee income per partner (F'000)	1,773	1,663
Net profit as a % of fee income	20.8%	23.1%
Clients		
Market share (sports and leisure sector)	12%	14%
% of satisfied clients (based on annual survey)	75%	85%
Innovation and learning		
Average training hours per qualified employee	14	14
Total staff turnover	23.5%	17.6%
Internal business processes		
Error rates (% of client assignments undertaken where mistakes by Rocket employees are detected)	10%	8%
Utilisation rate (% of total professional staff hours spent on chargeable client work)	70.5%	66.5%
Staff ratio: Number of support staff : number of professional staff and partners	5:21	5:21

2. The Scottish Woodlands Commission (SWC) is a government department. It is responsible for all state-owned forests in Scotland.

SWC's mission and activities

SWC's mission is to "manage, protect and expand the public woodlands in Scotland and to increase their value to society and the environment". It is authorised to carry out woodland management, nature conservation and the provision of facilities for public recreation.

Woodland management requires a long-term planning process, typically involving a timescale of more than 20 years. Activities include:

- Maintenance of existing trees and removal of deadwood
- Felling of trees and extraction of timber
- Planting of new trees
- Identification and management of threats to woodland (eg, fire, pests, disease, impact of wildlife, soil erosion).

In addition to woodland management, SWC's secondary aims are:

- to protect and maintain habitats for wildlife and to manage wildlife populations
- to provide the general public with widespread access to the natural woodland environment and to promote the woodlands as a location for sports and leisure activities.

SWC is governed by a board of trustees whose role is to make strategic decisions, monitor performance and liaise with stakeholders including the general public and other government departments. SWC is allocated a share of central government funds annually, but it is prohibited from borrowing money in its own right. Money is spent on replanting, making grants to private organisations and individuals engaged in woodland creation and improvement, providing education, and research. SWC is able to generate some revenue from the harvesting and sale of timber for use in house-building, paper, fencing and bio-fuels.

Holiday village

SWC has been approached by CabinCo Ltd (CabinCo), a private company, which operates a number of up-market, self-catering holiday villages in England and Wales. CabinCo has a database of around 400,000 customers. Its mission is "to be one of the UK's leading providers of luxury short-breaks in natural surroundings". CabinCo has been highly successful because of the high occupancy rates it achieves in its holiday villages. It wants to take advantage of the rapid growth in the short-break market (holidays of 3-5 days) and the increased demand for "sustainable tourism" to create a new, high-quality holiday village in Campbell Forest, one of SWC's woodlands in Scotland. Customers will be able to rent a luxury self-catering log cabin and participate in a variety of activities in woodland surroundings. Due to Campbell Forest's location, on the edge of a lake surrounded by mountains, it is envisaged that there will be demand all year round and cabins will be available 365 days a year.

Structure of venture

A limited liability public/private partnership will be set up specifically for the new venture. The LLP will have two members: CabinCo and SWC. CabinCo will provide capital in the form of £2 million cash for building the cabins and developing the site, and will provide holiday management experience.

SWC will make its capital contribution by making available Campbell Forest (current market value £2 million) for use in the venture. It will also provide expertise in woodland management and woodland activities. The LLP will be operated as a commercial venture, with the members sharing profits and losses equally. The new venture will be known as Woodsaway LLP (Woodsaway). CabinCo and SWC will each be entitled to appoint three representatives on Woodsaway's senior management committee.

Campbell Forest will continue to be owned by SWC, which will grant a long lease to Woodsaway in exchange for an annual rent of £30,000. Woodsaway will have day-to-day management responsibility for operating the holiday village and the surrounding woodland. The village will consist of 100 high-quality two bedroom log cabins, built to a unique, eco-friendly design. Construction of the village will take approximately 12 months at an expected cost of £2 million, to be funded by CabinCo's contribution to the LLP.

The government has granted preliminary approval for creation of the public/private partnership, as it believes this is the most appropriate format for the management of risk and the exploitation of benefits from the village. The financial projections for Woodsaway make it clear that cabin occupancy levels will be critical to the venture breaking even:

Cabin occupancy	40%	65%	90%
	£'000	**£'000**	**£'000**
Cabin revenue	1,752	2,847	3,942
Variable costs	(526)	(854)	(1,183)
Contribution	1,226	1,993	2,759
Fixed costs	(1,502)	(1,727)	(1,985)
Rent to SWC	(30)	(30)	(30)
Operating (loss)/profit	(306)	236	744

If the initial venture proves successful then the concept may be expanded to other SWC woodland locations and Woodsaway will be given first right of access for the development of any new holiday villages in these locations.

Governance

At a meeting of SWC's trustees, one trustee expressed concern: "Given SWC is a public sector body and we have a responsibility as trustees to deliver public benefit, by demonstrating selflessness and objectivity among other things, won't our involvement in Woodsaway give rise to possible corporate governance issues?"

Another trustee disagreed: "Surely corporate governance isn't relevant. As the term 'corporate' suggests, it is a matter for companies and their directors only, not a public sector body like SWC".

Requirements

You are a strategic business adviser engaged by the government. Write a report for SWC's trustees, evaluating the proposed venture using the following headings:

- Strategic fit
- Financial benefits
- Risks
- Governance issues.

Total: 34 marks

PLEASE TURN OVER

3. WeDive Ltd (WeDive) is a company which produces and sells high-performance drysuits for divers. It was set up some years ago, by a group of friends, after they experienced severe discomfort whilst scuba diving in cold waters because of leaks in their hired drysuits, which are supposed to work by keeping water out. The friends sourced a single supplier that was able to provide a special thermal fabric and designed a very tight-fitting durable suit with a unique neck seal, to offer maximum protection.

WeDive's drysuits are very expensive (up to £2,000 each) and are typically bought by professional divers (police, armed forces, oil companies, rescue organisations and salvage businesses). To achieve optimum fit the company produces a wide range of different sizes for both men and women. Each drysuit has a three year warranty and any repairs are undertaken at WeDive's production facility, located in the UK.

WeDive has grown successfully. It now has a number of major contracts with professional divers, but also distributes its drysuits to diving retailers for recreational users who want a high quality product. Total sales last year were approximately £13 million, comprising 65% professional divers and 35% recreational users. All sales were in the UK.

Drysuit production is very labour intensive. The market for recreational drysuits is dominated by several large manufacturers in China and South East Asia which benefit from economies of scale, although there are a significant number of smaller producers, like WeDive, which sell in niche markets.

WeDive's directors are keen to expand the business and are considering the following two mutually exclusive strategies:

<u>Option 1: Expand the range of products for the UK market</u>

WeDive would source supplies of lifestyle clothing (t-shirts, jackets and accessories) and sell them under its own brand. The products would be aimed at consumers in the UK market and distributed and sold through existing channels (diving retailers). This option would require marketing but, because of limited funds, WeDive primarily intends to use social media.

<u>Option 2: Produce drysuits for export markets</u>

Entering export markets would involve finding and partnering with new distributors, which WeDive hopes would promote the product on its behalf. A key aspect of WeDive's high-performance drysuit is the fit, so the product may need some redesigning or additional tailoring depending on the height and weight of the local population in each export market.

If Option 2 is pursued, a possible key market is New Zealand. If WeDive enters this market, there is a 90% chance that New Zealand market conditions will be favourable and it will generate a profit of £300,000. However, if market conditions are unfavourable, a loss of £100,000 is expected. Alternatively WeDive could delay its decision until it has undertaken market research, at a cost of £15,000, which would accurately predict the expected market conditions in New Zealand.

Requirements

(a) So far as the information permits, evaluate the two strategic options being considered by WeDive's directors. Refer to models where appropriate. Ignore the specific information about the New Zealand market for this requirement. **(14 marks)**

(b) Using a decision tree, calculate whether it would be worth WeDive paying for market research on the New Zealand market. Discuss your findings. **(6 marks)**

Total: 20 marks