MARK PLAN AND EXAMINER'S COMMENTARY

The marking plan set out below was that used to mark these questions. Markers were encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks were available than could be awarded for each requirement. This allowed credit to be given for a variety of valid points that were made by candidates.

Question 1

General comments

This is the mini case at 46 marks and also the data analysis question. It was the highest scoring question on the paper.

The scenario relates to a four partner accountancy practice - Rocket - which operates in a European country and specialises in accounting and tax advisory work in the sports and leisure sector. Rocket has experienced impressive growth rates but the partners are concerned that growth appears to be slowing. Candidates were presented with a balanced scorecard for Rocket for 2013 and 2014, showing financial and non-financial performance indicators.

A new regulatory framework for the legal services market has recently been introduced in Rocket's country, allowing the creation of a multi-disciplinary practice (MDP) - a professional firm consisting of professionally qualified lawyers and accountants working together in client-facing roles. Rocket has decided to begin operating as an MDP, and needs to obtain the necessary licence and recruit staff to resource the change in strategy. It will either recruit qualified lawyers on an individual basis or acquire a specialist team of qualified lawyers from a law firm to which it has previously referred work. On 1 March 2015, Rocket issued an email (provided in the scenario) to all staff, announcing the firm's change of strategy and the partners' expectations. There had been no prior consultation with the recipients of the email and it has caused considerable anxiety.

Rocket is also facing an ethical issue - Alina Jay, an ICAEW Chartered Accountant, suspects that her manager may have agreed to the misstatement of a client's personal affairs on a loan application because he is a personal friend of the client. 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.

(a) Performance analysis

Appendix: Further analysis

Examiner note: a wide range of possible calculations have been given here for marking purposes and to illustrate the scope for additional numerical analysis

Figures in red are given in the balanced scorecard in the question

Analysis of income

	2014	**2013**
Fee income F'000 (given)	7,091	6,653
Mix of fee income: Accounting:Tax	 47:53	 45:55
Absolute fee income: Accounting F'000 Tax F'000	 3,333 (increase 11.3%) 3,758 (increase 2.7%)	 2,994 3,659
Average fee charged Accounting Tax	 F335 (increase 11.7%) F415 (increase 15.3%)	 F300 F360
Premium charged for tax (tax rate/accountancy rate)	23.9%	20%
Hours billed Accounting Tax	 9,949 9,055 Total 19,004	 9,980 10,164 Total 20,144
Change in total hours: Accounting Tax	-5.7% -0.3% -10.9%	

Market information

	2014	2013
Fee income F'000 (given)	7,091	6,653
Market share (given)	12%	14%
Hence market size F'000	59,092 (increase 24.3%)	47,521

Profitability

	2014	2013
Fee income F'000 (given)	7,091	6,653
Net profit margin	20.8%	23.1%
Net profit F'000	1,475 (decrease 4.0%)	1,537
Total costs F'000	5,616 (increase 9.8%)	5,116
Fee income per partner F'000 (given)	1,773	1,663
No. of partners	4	4
Average profit per partner	368.75 (4% decrease)	384.25

Variances on non-financial indicators

	2014	2013	Variance
Market share	12%	14%	2% decrease
%Satisfied clients	75%	85%	10% decrease
Total staff turnover	23.5%	17.6%	5.9% increase
Error rates	10%	8%	2% increase
Utilisation rate	70.5%	66.5%	4% increase

Rocket uses a balanced scorecard approach to performance measurement which combines financial and non-financial information. Some of the non-financial factors in the scorecard can be used to help explain the financial performance of and the prospects for the business and give much greater insight into key operational issues within the business.

Income and market share

Fee income is up by 6.6% compared to an increase of 9.2% the previous year which suggests that growth is slowing and may explain Rocket's desire to consider new products.
However referring to the market share information (customer perspective), it is clear that Rocket has underperformed the market, losing 2% of its share at a time when the market for services (measured by revenue) has increased by 24.3%. It would be helpful to have the market share information analysed between tax and accounting to consider both lines of service separately and assess whether one is out-performing the other. The sales mix has altered with the more lucrative tax work representing only 53% of income (F3.758million), compared to 55% in 2013 (F3.659million), so it maybe that Rocket is falling behind in this market. Since tax services command a premium rate compared to accounting, the change in sales mix will have an adverse effect on income.

The cause of the growth in fee income needs to be analysed between price and volume:
Rocket increased the fees charged for both services – accounting by 11.7% and tax by 15.3%. As a result the hours billed have fallen by 5.6% in total, from 20,144 to 19,004. This is consistent with a drop in market share. One possible reason for the increase in price would be to cover the pay rise that Rocket has had to offer staff to keep its salaries more in line with competitors.

It can be seen from the analysis that the tax services seem to have been more sensitive to the change in price, with chargeable tax hours reducing by 10.9% and thus only a 2.7% increase in overall tax revenue (compared to 11.3% for accounting). It would be useful to know to what extent the level of WIP (work done not yet billed) is comparable across the years and to try to ascertain whether the loss of chargeable hours is a timing issue or symptomatic of a loss of clients. It would also be useful to obtain competitor charge-out rates for the sports and leisure sector to see whether Rocket's fees are reasonable, although as discussed above the fact that Rocket has lost market share may be in part due to over-pricing.

Another reason for the drop in hours billed may be to do with loss of clients due to client dissatisfaction. The 2014 customer survey has revealed that only 75% of clients are satisfied, compared to 85% in 2013 – a 10% adverse variance. The cause of the dissatisfaction needs to be investigated. It may be linked to an increase in error rates from 8% to 10% of jobs (internal business) or to staffing issues – see below. Certainly if clients are being asked to pay higher fees they are likely to expect standards and quality of service to be at least maintained, so a 25% increase in the error rate is unlikely to be acceptable. It would be useful to know the reasons for the dissatisfaction and to ascertain whether one service has been affected more than the other.

Rocket has not been paying staff the appropriate market premium and this has probably led to demotivation and dissatisfaction, as evidenced by the increase in staff turnover (17.6% to 23.5% - innovation and learning). This represents one more fee-earner (5.9% x 17 fee earners) leaving and needing to be replaced. The pay rise offered may have come too late for some staff and more may choose to leave given the increasing employment opportunities in the marketplace. Continuity of staff is important as clients may resent revealing personal financial details to a variety of different people each year. Recruiting replacement staff costs the business money and there is then a learning curve period, during which perhaps errors may be made. In addition the business does not appear to be investing much in training, with qualified staff only receiving two days per year. In a specialist sector this may not be sufficient to keep abreast of developments and may be an additional cause of the error rates.

Profitability

Despite the 6.6% increase in fee income, Rocket's net profit for 2014 of F1.475million is 4% lower than in 2013.

The net profit margin has fallen from 23.1% to 20.8% as a result of the total cost increase (9.8%) exceeding that of the revenue increase. A number of factors have caused Rocket's costs to increase in 2014:

- Rent review
- Increased PII premiums
- Pay rise for staff (it would be useful to know how much this was and at what point in the year it was made as it does not yet appear to have stemmed the staff turnover)

One factor which will be adversely affecting profitability is the poor staff utilisation rate. Although this has improved from 66.5% to 70.5% it still means that staff are spending a considerable amount of time engaged in activities that are not billed to clients. This may be due to having to incur write-offs of time e.g. on fixed fee jobs or because staff are spending time on business development, or too much time on administrative issues. Assuming staff work 7 hours a day, 5 days a week for 48 weeks, there are 1,680 hours available per fee earner. Assuming utilisation rates were between 85% and 90%, Rocket would only need 13 staff to achieve the 2014 billed hours. In the change management memo the partners identify the need for qualified staff to consider delegating more tasks to concentrate on higher value activities which would increase profitability.

Summary

In conclusion, although the revenue has grown and margins are still reasonable, the financial results do not show the full picture. Rocket appears to have some fundamental weaknesses in its core business that need to be addressed, if it is to continue to grow into the future. The success of the MDP proposal will be dependent on existing clients' willingness to buy additional legal services from Rocket, which they will not do if they are dissatisfied with the existing services and perceive staff to be inadequately trained.

Requirement (a)
Candidates were asked to analyse and evaluate the performance of Rocket between 2013 and 2014, using the balanced scorecard.

The data analysis requirement was reasonably attempted but certainly not as well answered as in recent sittings. The fact that a balanced scorecard of performance indicators was provided in the Exhibit seemed to discourage a surprising number of candidates from undertaking any further numerical analysis. Better candidates provided some additional up-front calculations in a reasonably well structured table to help explain some of the changes in the scorecard (fee income per service stream, billable hours, market size, profit per partner). Weaker candidates were very poor in this regard, merely reiterating the KPIs that had been given or at most providing occasional calculations of changes in figures, within their narrative.

Most candidates structured their narrative explanation using the four headings from the scorecard and made good links between the different sections, successfully drawing conclusions from the non-financial information to explain the reasons behind the financial performance.

Only the stronger candidates suggested additional information that would assist their analysis and concluded that Rocket would need to address some of its internal issues relating to client and staff dissatisfaction before becoming an MDP.

Total possible marks	20
Maximum full marks	18

(b) Factors affecting ability to create MDP

Human resource capabilities

Rocket's existing partners and staff are all experienced in accountancy and taxation, not law, so it does not currently have the HR capability to implement this strategy. It would appear that it intends to use its existing support staff but will need to employ new "fee-earners".

It is critical to the venture's success that the legal staff have appropriate specialist expertise, otherwise there will be no incentive for existing clients to switch their legal services to Rocket. The MDP will take longer to set up if Rocket recruits piecemeal rather than acquires an existing team. However the advantage of the former is that Rocket may be more likely to integrate individuals into its own culture and may experience less resistance from staff.

From a cost point of view, Rocket may have to offer higher pay/rewards to induce staff to move, particularly if it has a reputation for poor pay and high staff turnover. The upside of recruiting an existing team however is that they may bring some clients with them.

Increasingly law firms are employing para-legal/non-lawyers to do routine work such as document processing, so Rocket will need to consider how many staff are required and what the appropriate mix is. This will depend on the expected demand for its legal services.

Legal and regulatory issues
These forces may relate to/be affected by government policies and be politically driven. They are largely outside Rocket's control.

Changes in the regulations affecting the legal services market appear to be an attempt by government to increase competition in the market. However this could change.

The new MDP will need a licence to operate and will be monitored by the new regulatory authority. It is not clear how easy it will be for Rocket to acquire the licence, the time and cost involved, what terms and conditions will apply eg in relation to the mix of partners, governance requirements etc. and what the costs of compliance are likely to be. Rocket is presumably used to being accountable to the relevant accountancy and tax regulators so it has some experience in this area.

It will also need to consider the prospect of further regulations affecting MDPs/law/accountancy firms and also in relation to the sports sector where there are likely to be rules and regulations of different sports governing bodies, disciplinary matters etc.

Competitors and market structure

The reduction of barriers to entry is likely to increase competition and give rise to a number of alternative professional services providers.

Other accountancy firms may also decide to create MDPs.

Alternatively legal firms could develop their own accountancy and tax businesses so Rocket may lose referrals that it is currently getting from these firms.

Possible consolidation in the market place is likely to increase the size of the various players and if they are able to reduce costs, this may result in lower prices for services which will affect margins.

Rocket's advantage is that it specialises in sports and leisure, so it may face less competition in this niche than if it were targeting the whole market.

Requirement (b)

Candidates were required to analyse various factors that might influence Rocket's ability to create an MDP.
Requirement (b) was very well answered on the whole. The majority of candidates identified that Rocket does not currently have any legal expertise and that recruiting the necessary staff and obtaining the licence would be critical success factors for the creation of an MDP. Better candidates discussed the two different approaches to resourcing suggested in the question, in light of Rocket's current staffing issues. They also highlighted the uncertainty surrounding the MDP licence and rules given that the regulatory framework is new and designed to increase competition. Weaker candidates typically found it more difficult to discuss competition and market structure, although candidates who used their knowledge of rivalry and barriers to entry from the Porter's 5 forces model had more to say.

Total possible marks	12
Maximum full marks	10

(c) Change management

The change to an MDP is a major transformational change for Rocket, which is being made in response to changes in the external environment. As the internal memo points out, it may have a significant effect on the staffing and management structure of the firm.

The Gemini 4Rs framework to change involves reframing, restructuring, revitalising and renewal. To an extent, in advance of the memo, Rocket's partners have already addressed the first three of these:

- Reframing – Rocket has asked fundamental questions about what the organisation is about, decided to become an MDP and created a vision of what it will stand for: a mid-market professional services practice offering one-stop legal, tax and accounting advice for its existing wealthy sporting clients.
- Restructuring – the alignment of the physical organisation with the plan. Again the partners have addressed this by identifying the need to recruit resources, creating a central administration function and setting up appropriate account teams.
- Revitalising – this is the process of securing a good fit with the environment and explains the motivation for the change – here the partners of Rocket have quickly decided to adopt a new business model in response to the deregulation of the legal services market and are one of the early adopters in the hope of gaining competitive advantage.

This leaves the critical element – renewal - which is ensuring that people in the organisation support the change process and have the necessary skills to contribute to it.

Here the partners appear to have left the major change of culture and structure to be announced to staff in a memo. This is a coercive change approach, with little attempt at participation. As a result they have possibly underestimated the forces of resistance to change and do not appear to have attempted to harness support in favour of the new structure.

The problem with this is that change affects individuals in different ways and that the way change is introduced can influence the degree of resistance to it. Staff are likely to have lots of questions about the MDP and there will be a great deal of uncertainty surrounding the impact that the new legal staff will have on the firm's culture, structure and systems. The fact that the partners state they will "be examining the potential for cost savings and efficiencies across the firm" is likely to cause staff to worry about earnings and job security.

Existing staff may see the change as a threat for a variety of reasons: administrative staff in particular are being told to increase efficiency and informed that there will be target staffing ratios. Qualified staff may fear that in delegating work to juniors they lose their power base or may become redundant. Junior staff may feel ill-prepared to take on the additional work that is expected of them and worry about their lack of appropriate skills and training.

Such an approach can lead to low staff morale, which may already be a problem given that Rocket is not paying the market premium for specialist staff and has experienced an increase in staff turnover.

Instead of presenting staff with a fait accompli, Rocket would have been better undertaking some consultation process in advance of the announcement, allowing discussion about individual needs and creating opportunities for staff to contribute to the changes. This would have given staff time to get used to the idea and reduced the resentment and feelings of helplessness.

Thus whilst Rocket is taking a proactive approach to changes in its environment, its chosen method of communicating the change falls short of best practice. In the aftermath of the email, Rocket would be well advised to hold meetings to address any concerns and offer staff the chance to become involved in the implementation phase of the change process.

Requirement (c)

Candidates were asked to discuss, in light of the partners' email, the extent to which Rocket's approach meets best practice in change management, referring to an appropriate change model such as Gemini 4Rs.

The main difference in the answers to this requirement related to whether candidates were familiar with the specific model suggested for use. Candidates are normally well versed in the technical knowledge for the change management requirement but the Gemini 4Rs model proved to be an exception. A significant number of candidates, clearly unable to recall the Gemini model, made comments along the lines of "whilst Gemini 4Rs is useful, so is Lewin Schein's iceberg model" and then went on to use that as an alternative.

Candidates are advised that if the examiner recommends an approach, there is usually a good reason for doing so. Whilst credit was awarded to candidates who used an alternative model, the use of the recommended Gemini model would have created scope to make a wider variety of points. Faced with changes in the external environment, Rocket appears to have *reframed* what the practice should stand for, is *restructuring* (recruiting lawyers and creating a central admin team) and attempting to *revitalise* by being an early adopter of the MDP model. However this is a major transformational change and staff are already unhappy, yet Rocket appears to have adopted a coercive change approach with little consultation. Thus the critical element of *renewal*, ensuring people in the organisation support the change, is lacking. Better answers were produced by the very few candidates who understood the model and recognised this.

As usual, weaker candidates failed to apply their knowledge to the question, simply discussing the type of change and the likely barriers rather than evaluating Rocket's decision to announce the change via email.

Total possible marks Maximum full marks	11 10

(d) Ethics issue

This situation gives rise to a number of different potential ethical issues:

- facilitation by the manager of unethical behaviour or even possibly illegal actions by the client
- conflict between Alina's obligations as an ICAEW professional accountant and her obligations to Rocket, her employer
- possible issues with the tone at the top within Rocket.

Every employee has a duty of loyalty to their employer and in this case Alina owes a duty to Rocket Co. As a result Alina must not just turn blind eye to suspected wrongful behaviour because saying something might put her in an uncomfortable position with colleagues or because of self-interest in relation to her job or career. Thus if there is evidence of wrongdoing then keeping quiet should not be an option. Instead she needs to consider morally and ethically what the right thing to do is in relation to her suspicions.

A longstanding personal relationship with a client may have given rise to a familiarity threat to the manager's fundamental principles of objectivity. However it is important that Alina does not automatically assume that the manager has done something wrong. She needs to try and ascertain the facts. An effective relationship with superiors needs to be open, honest and trusting – the culture of Rocket should be such that Alina feels able to go to the managers and partners she works for and discuss opinions/ask questions/even challenge. It is not clear to what extent Alina has already done this with the manager concerned in relation to the statement of wealth and what evidence she has that the client's personal wealth has been misstated. If Alina has felt unable to raise her concerns then there may be a cultural issue to be addressed here by Rocket (the manner in which the change management was handled may suggest that this is the case).

Alina also needs to consider whether there is any statutory duty here and what legislation applies. Professional accountants need to be mindful of their responsibilities to their clients and employers to keep any information they learn confidential. Certainly Alina needs to avoid spreading news of the potentially dishonest activity by discussing it with colleagues or others who do not have responsibility over the matter. However there may be anti-fraud and/or anti-money laundering legislation that might govern reporting requirements. Whistle-blower protection provisions are common in most of Europe so she also needs to consider what legislation exists in the country to protect whistle-blowers, particularly for example in relation to the disclosure of confidential information about the client concerned.

In determining the appropriate action, Alina should consider whether there is any guidance in her employment contract, staff handbook, Rocket's code of conduct, or any internal guidance on whistleblowing. She also needs to consider her professional responsibility as a qualified accountant and the IESBA code of ethics (which is likely to apply to her manager and Rocket's partners to the extent that they are qualified accountants). Alina may be able to contact the firm's HR representative for assistance and/or seek legal advice

Discussing her concerns with superiors in Rocket may be key as a means of preventing/detecting possible fraud. It would also highlight the inadequacies in Rocket's systems and culture which have allowed this to happen. Were Alina not to take any action, this would be allowed to perpetuate.

Requirement (d)

Candidates were requested to discuss the ethical issues associated with Alina's concerns and advise her on appropriate actions to take.

This requirement was well answered, presumably because the ethical issues (the suspected provision of misleading information to the bank and the need for internal/external disclosure) were reasonably easy for most candidates to identify. The vast majority of candidates recognised that there is likely to be a legal issue here - possibly fraud or money laundering. Most candidates made good use of ICAEW ethical principles and ethical language to assist their discussion and were able to identify the potential actions open to Alina. Some weaker candidates did apply the transparency, fairness and effect decision-making approach, although this is often more relevant in relation to a business dilemma and was much less useful here

Total possible marks	9
Maximum full marks	8

Question 2

General comments
Overall this question was also well attempted, although it contained both the highest and lowest scoring sections on the paper.

The scenario concerns a government department - the Scottish Woodlands Commission (SWC) **-** that is governed by a board of trustees. Its mission is "to manage, protect and expand public woodlands in Scotland and to increase their value to society and the environment". SWC is allocated a share of government funds but is prohibited from borrowing money in its own right. It also generates revenue from the harvesting and sale of timber. Money is spent on replanting, making grants for woodland improvement, providing education, and research.

SWC has been approached by a private holiday company, CabinCo, which wants to create self-catering holiday cabins in one of SWC's forests. A limited liability public/private partnership would be set up for the new venture, Woodsaway LLP, with profits and losses shared equally. CabinCo would supply £2m investment capital for the construction of the cabins and site and provide holiday management experience. SWC would make available Campbell Forest (current market value £2 million) for use in the venture. Campbell Forest would continue to be owned by SWC, which would grant a long lease to Woodsaway in exchange for an annual rent of £30,000. Financial projections for Woodsaway are provided which make it clear that cabin occupancy levels will be critical to the venture breaking even.

One of the trustees is concerned that their involvement in Woodsaway may give rise to certain conflicts with some of the principles of public sector governance that apply to them as trustees of SWC. Another believes that there is no issue, as corporate governance only applies to companies and their directors.

Candidates were required to act as a strategic business adviser engaged by the government and to write a report for SWC's trustees, evaluating the proposed venture using given headings For ease of reference, the four sub-headings provided have been referred to as requirements (a) – (d) in the commentary below.

(a) Strategic fit

To: SWC's Trustees
From: Business adviser
Date: March 2015
Re: Woodsaway LLP

Strategic fit

SWC's mission is to "manage, protect and expand the public woodlands in Scotland and to increase their value to society and the environment". In order to achieve this, it is authorised to undertake woodland management, nature conservation and provide facilities for public recreation

The Woodsaway venture is likely to increase the number of people who are able to enjoy Campbell Forest and assist SWC in fulfilling one of its subsidiary objectives, of providing the general public with widespread access to the natural woodlands environment, and to promote woodlands as a location for sports and leisure activities.

It would not appear to directly assist with woodland management or nature conservation. Indeed construction of the log cabins may have a negative impact on the habitat for local wildlife, the maintenance of which is the other of SWC's subsidiary objectives.

However if the LLP generates additional income for SWC (see financial benefits below), then it may indirectly allow it to better achieve its primary and secondary objectives by providing more financial resources. Also woodland activities undertaken by Woodsaway's customers may have educational benefits by raising awareness and, if paid for, could also generate funds for conservation.

For the venture to be a success the two members of the LLP need to have complementary and aligned objectives.

CabinCo's mission is "to be one of the UK's leading providers of luxury short breaks in natural surroundings". It has created a strong brand and is seeking competitive advantage from having access to Campbell forest to develop a holiday village, and first option on the development of future villages on SWC woodlands in Scotland. As a private commercial company, CabinCo's aims are likely to involve growth and profits. Its primary objectives are more likely to be financial rather than non-financial, with a probable focus on cost control and margins. However the sustainable tourism market it is targeting may be more in line with SWC's environmental aims. Also the benefit to SWC is that CabinCo brings commercial experience to the venture, which may help increase profits and hence SWC's share.

There may be possible conflicts of interest about the strategy and activities of Woodsaway, between CabinCo as a private entity and SWC as a public body, since they have very different stakeholders and different planning horizons. CabinCo as a company accountable to its shareholders is likely to have a shorter term focus than the 20 year planning horizon that woodland management entails. A balance will need to be struck between financial return and delivering a service to customers and the general public.

Also conflicts may arise between the interests of the LLP and the separate interests of the two participating members. For instance CabinCo's desire to increase the profitability of the Woodsaway venture may conflict with SWC's mission to protect the woodlands and increase their value to society.

This is further discussed under the governance heading below.

Requirement (a)
In the first section of the report, candidates had to assess the strategic fit of the proposed venture. It was well answered. Most candidates were comfortable discussing the extent to which the venture is aligned with SWC's mission and secondary aims, recognising that construction of the log cabins might be inconsistent with the achievement of some of these aims (e.g. protection of the woodland and nature conservation) but might facilitate others (increasing access and education). The better candidates also highlighted the very different nature of the two organisations involved in the LLP and questioned the conflict that may arise as a result. Most, but surprisingly not all candidates, scored an easy format mark for setting out their answer in the report format required. Some candidates created a time management issue for themselves by using all three headings from the suitability, feasibility, acceptability model when in fact "suitability" is sufficient to assess strategic fit.

Total possible marks	10
Maximum full marks	9

(b) Financial benefits

The public/private partnership reduces the need for investment from SWC which would have to come from central government and SWC's limited commercial funds.

CabinCo (and possibly Woodsaway) will be able to raise funds privately from banks etc as it is not under the same restrictions regarding borrowing as SWC. The access to finance could provide opportunities for SWC, which would be unlikely to be able to find the £2m building costs. In the future it would also allow extension of the concept to other sites.

The venture provides SWC as landlord with a guaranteed income stream in the form of the lease rentals of £30,000pa. Depending on the occupancy levels, SWC, as a member of the LLP, will also receive a 50% share of the profits. Provided Woodsaway does not make a loss of more than £60,000 then SWC will avoid any financial loss.

Looking at the figures in the exhibit, the financial returns to SWC are highly sensitive to occupancy, which is likely to be lower in the early years:

Occupancy rate	40%	65%	90%
	£000	**£000**	**£000**
Rental	30	30	30
Share of Woodsaway (loss)/profit	(153)	118	372
Net return to SWC	(123)	148	402
Annual return on £2m land value invested	-6.15%	7.4%	20.1%

Occupancy rate	40%	65%	90%
	£000	**£000**	**£000**
Cabin revenue	1,752	2,847	3,942
Contribution	1,226	1,993	2,759
Fixed costs incl rent	(1,532)	(1,757)	(2,015)
Loss/Profit	(306)	236	744

The cabins are projected to generate a gross profit of £84 per night (eg £1,226,000/(365 x 40)). There are 36,500 available cabin nights (365 x 100 cabins). If operating costs were £1,532,000 including rent then for the Woodsaway venture to break-even it needs to sell £1,532,000/84 = 18,238 cabin nights which equates to 50% occupancy.

Were operating costs to be £1,757,000 including rent then it would need 20,917 cabin nights or 57% occupancy. In reality it appears that some operating costs are stepped (14.7% increase in operating costs for 25% increase in occupancy), so break-even occupancy is somewhere between 50% and 57%.

It would be useful to know what occupancy CabinCo currently achieves in its other holiday villages, which is said to be “high”, but if Woodsaway achieves anything over 65%, it would appear to be providing SWC with a decent return.

It is not clear who has supplied the figures and how these compare to other CabinCo ventures. More detail on the breakdown of operating costs would be useful and the assumption of 365 days availability may be over-optimistic.

As discussed above, money from Woodsaway can be used to fulfil SWC’s other objectives and is a useful source of income given its reliance on government funds.

Requirement (b)

Answers to this section on financial benefits were varied and there were a considerable number of poor answers, resulting in this section having the lowest overall mark. Once again a surprising number of candidates made no reference to the numbers provided in the question, despite the fact that this was the obvious place to do so. Weaker candidates simply discussed the fact that SWC is limited in its ability to raise finance and that the venture may help with this, without considering the financial returns.

The key to evaluating the financial benefits was to identify the two separate roles of SWC in relation to the Woodsaway venture:

(i) as landlord in receipt of annual rental
(ii) as a member of the LLP, sharing in 50% of the profits or losses

Better candidates recognised this and used the various projections to calculate SWC’s profit share for the different occupancy levels. The best candidates used the financial projections provided to give some indication of the likely return on SWC’s £2m land investment and examined the sensitivity of the venture (eg by calculating a break-even occupancy).

Total possible marks	10
Maximum full marks	10

(c) Risks

A key issue for SWC is risk and who will take responsibility for managing those risks.

Compared to SWC operating a holiday village on its own, the risk of the Woodsaway venture is reduced because it is structured as an LLP and risk is shared with CabinCo, an experienced partner in the holiday sector. The public/private partnership integrates the complementary resources of the two parties. However as discussed in (a) above, a conflict of interest may arise between the interests of the LLP and the separate interests of the two participating members.

The Woodsaway venture brings its own additional risks:

Economic risk– financial events that would affect the management of the holiday village and/or the forest. This might include the volatility of revenue streams and profit share due to the state of the economy. Also any impact that operating the holiday site may have on revenues from the sale of timber. The construction of the cabins may require tree felling which could generate revenue initially but may then reduce the areas available for replanting, adversely impacting SWC's future revenue.

Reputational risk – the possible negative impact of the LLP and the holiday site on the image of SWC in the minds of other organisations it deals with, the general public and the government. If Woodsaway is very profitable it may not be appropriate for SWC to be seen to be associated with this, conversely the same may be true with a financially unsuccessful venture. There may also be reputational issues if Woodsaway is seen to pay high salaries/bonuses or alternatively if it treats staff poorly or causes environmental damage (see below).

Environmental risk – the creation of a holiday site exposes the woodland estate to possible additional threats in relation to damage and disease. There is a possible risk of urbanisation of forest through construction of cabins, which might destroy natural habitats, and there may be ongoing issues relating to damage due to footfall, more vehicles, creation of waste etc.

Hazard risk - similar to the environmental risk above, there is an increased risk of fire damage from the use of the forest as a holiday site.

Social risk – the holiday site may open the woodland up to more people but if CabinCo's customers are largely in England and Wales, these may not necessarily be from the community which SWC serves. Also the luxury cabins may only be affordable by a small minority and could be seen to be elitist.

SWC will need to ensure that appropriate risk management processes are put in place to address the additional risks that arise as a result of the Woodsaway venture. It needs to insist on controls in relation to woodland management, protection of habitat and leisure.

Requirement (c)

The majority of candidates were clearly well prepared to discuss the risks associated with the proposed venture and scored very highly on this section of the report. Most candidates identified a range of risks and discussed their potential impact. Better candidates also discussed their likelihood and suggested how they might be mitigated/managed if SWC is to go ahead with the proposal, pointing out that the risks are reduced by the creation of the LLP to operate the venture.

Total possible marks	8
Maximum full marks	7

(d) Governance issues

Applicability of corporate governance

Corporate governance generally refers to the system by which companies are directed and controlled. The aim of corporate governance is to facilitate effective, prudent management in order to deliver long term success. It is underpinned by the principles of accountability, transparency, probity (honesty) and focus on long term sustainable success.

Whilst the second SWC trustee is correct that the UK Corporate Governance Code applies to listed companies only, good governance is essential not just for companies but to any organisation, irrespective of whether it is private or public, if that organisation is to be well led and high performing.

It could be argued that good governance is even more important in the context of a public sector body, like SWC, which needs to ensure that public funds are wisely spent and that resources such as Scotland's woodlands are properly safeguarded and are used economically, efficiently, and effectively. This is the view expressed by the first trustee.

More generally therefore, governance relates to the framework of accountability to users, stakeholders and the wider community, within which organisations take decisions, and lead and control their functions, to achieve their objectives. As such it would apply to both SWC and Woodsaway. Without effective governance, the proposed public/private partnership is unlikely to be successful.

Nolan principles

Governance in the public sector has much in common with corporate governance for companies. As a publicly funded body, SWC's management board needs to act in accordance with the Nolan principles, which include the principles of integrity, accountability, openness (transparency) and honesty (probity). These are very similar to the core corporate governance principles. In addition, holders of public office are expected to comply with the additional principles of selflessness, objectivity and leadership.

Of particular relevance in the context of the Woodsaway venture are:

Selflessness: Holders of public office should take decisions solely in terms of the public interest. They should not do so in order to gain financial or other materials benefits for themselves, their family, or other friends. Thus SWC needs to balance its different responsibilities and ensure that its involvement in Woodsaway does not give rise to the risk of appearing to act in a manner contrary to public interest.

Objectivity: In carrying out public business, including making public appointments, awarding contracts, or recommending individuals for rewards and benefits, holders of public office should make choices on merit. The trustees need to be seen to have considered alternative partners as well as CabinCo, which has been selected because it is the best option
Public sector organisations operate in complex legislative, political and local contexts, in which they have to make difficult decisions. Well-governed organisations balance their different responsibilities and use information to decide where to allocate effort and resources to meet competing demands.

Governance of Woodsaway

The principles of governance will apply to Woodsaway, as an LLP. A key part of good governance is risk management and this will be particularly important to SWC given the additional risks that arise as a result of the Woodsaway venture (discussed in (c) above).

CabinCo and SWC will each be entitled to appoint three representatives on Woodsaway's senior management committee so neither party would appear able to dictate decisions.
SWC needs to insist on controls to ensure Woodsaway LLP does not undermine SWC's objectives in relation to woodland management and the protection of habitat and nature. It will also need to agree on the methods for resolving any disputes and the exit arrangements should either party want to terminate the venture.

Conclusion
Overall the project appears likely to generate financial returns and would appear to help SWC further some of its aims. It seems to have the support of government, which has granted preliminary approval for the formation of the LLP. More work should be done on the financial projections and SWC could engage in stakeholder consultations to assess the public perception of the proposals. The LLP will need to be set up carefully to ensure that the risks and governance issues identified are properly addressed.

Requirement (d)
Answers to the governance section were very variable in quality. There were really two issues here: addressing the trustees' comments in relation to governance and considering the governance of the proposed LLP. A significant minority failed to appreciate the distinction between the UK Corporate Governance Code that applies only to listed companies and corporate governance, which is the system by which companies are directed and controlled. The better candidates recognised that the principles of good governance (accountability, transparency etc) are very similar to those enshrined in the Nolan principles and are best practice for the prudent and effective management of any organisation. Thus governance may be more, rather than less, relevant for a public sector organisation such as SWC with a wider group of stakeholders to account to and a need to act in the public interest.

Having discussed this in the light of the trustees' comments, better candidates also went on to consider governance in relation to the LLP as a critical factor in the likely success of the venture, and discussed the proposals for the structure of Woodsaway's senior management committee.

Recognising that the overall purpose of the report was to evaluate the proposed venture, most candidates provided reasoned advice at the end as to whether SWC should go ahead with the Woodsaway venture. This was pleasing to see.

Total possible marks	10
Maximum full marks	8

Question 3

General comments
The third question, worth only 20 marks, was also well attempted overall, with good scores on requirement (a) making up for poorer answers to requirement (b).

The scenario relates to a company which produces high-performance thermal drysuits for scuba diving. The drysuits are very expensive and are typically bought by professional divers, although WeDive also distributes its drysuits to diving retailers for recreational users who want a high quality product. The directors are keen to expand and are considering two mutually exclusive strategies:

Option 1: Expand the range of products for the UK market by sourcing lifestyle clothing and selling it under WeDive's own brand, through existing distribution channels (diving retailers). Due to limited funds, WeDive intends to use social media to market this option.

Option 2: Produce drysuits for export markets. This would involve finding and partnering with new distributors. Since a key aspect of WeDive's high-performance drysuit is the fit, the product may need some redesigning to fit the local population in each export market. Some basic financial information is provided in the form of possible outcomes, and their probabilities, for one possible market being considered - New Zealand.

(a) Evaluation of options

Option 1: expand the range of products for the UK market

Option 1 in terms of the Ansoff matrix constitutes product development.

Advantages

- It may be less risky than targeting overseas markets as there are no language/cultural barriers
- WeDive's brand name is already known to the UK market and seen as high-quality, so it can easily capitalise on it
- Casual lifestyle clothing is related to the existing product range so there is some strategic fit and it may appeal to existing recreational dive customers.
- These products can probably sell through the existing distribution channels which facilitates implementation of the strategy.
- The new products may also appeal to other market segments, so this strategy could involve an element of market development too.
- The marketing of the product via social media may fit with the appeal of lifestyle clothing to a younger market.

Disadvantages

- From a generic strategy point of view, WeDive's existing product is very differentiated and it protects itself from competition by operating in a market niche. There are high levels of competition in the lifestyle clothing market already and the products are more homogeneous.
- Margins on casual clothing may be lower than on existing drysuit products and will be affected by the level of competition and the fact that there are low-cost producers outside the UK.
- There is likely to be a short product life cycle as typically these lifestyle brands come and go as far as fashion is concerned

- 65% of sales are to professional divers and these products may be less attractive to them than the recreational divers
- WeDive will need to source a supplier(s) as it has no experience in manufacturing
- There is little scope for using WeDive's existing expertise
- The new strategy will require marketing expenditure and social media may be insufficient to attract a wide customer base
- This strategy is still UK focussed and may offer limited scope for growth

Option 2: focus on core product but expand market overseas

Option 2 in terms of the Ansoff matrix constitutes market development.

Advantages

- Exporting drysuits builds on existing competences and is consistent with WeDive's differentiation strategy
- WeDive already have a tried and tested product that has been well received by the market
- It may be possible to achieve better expansion by targeting contracts with professional divers rather than recreational ones, using existing links with police, armed forces etc
- Overseas markets may be more price sensitive/have different price elasticities which could increase their profitability
- It may be sensible to try out one or two markets initially that are more close to the UK in terms of the size, fit and climate requirements.

Disadvantages

- WeDive's brand name may not be recognised in export markets although once established, this strategy will help to create a global brand
- The nature of the product may not work in some countries – eg different fabric may be required for tropical rather than cold water diving
- The product may require amendments to the fit to suit different population sizes and characteristics
- Risk arises due to the lack of familiarity with overseas markets although this will be reduced if WeDive find the right distribution partner
- WeDive is likely to face competition from existing players in these markets
- A factor to consider is where the suits will be made and whether WeDive has the production capacity to cater for the increased volumes.

Preliminary conclusions

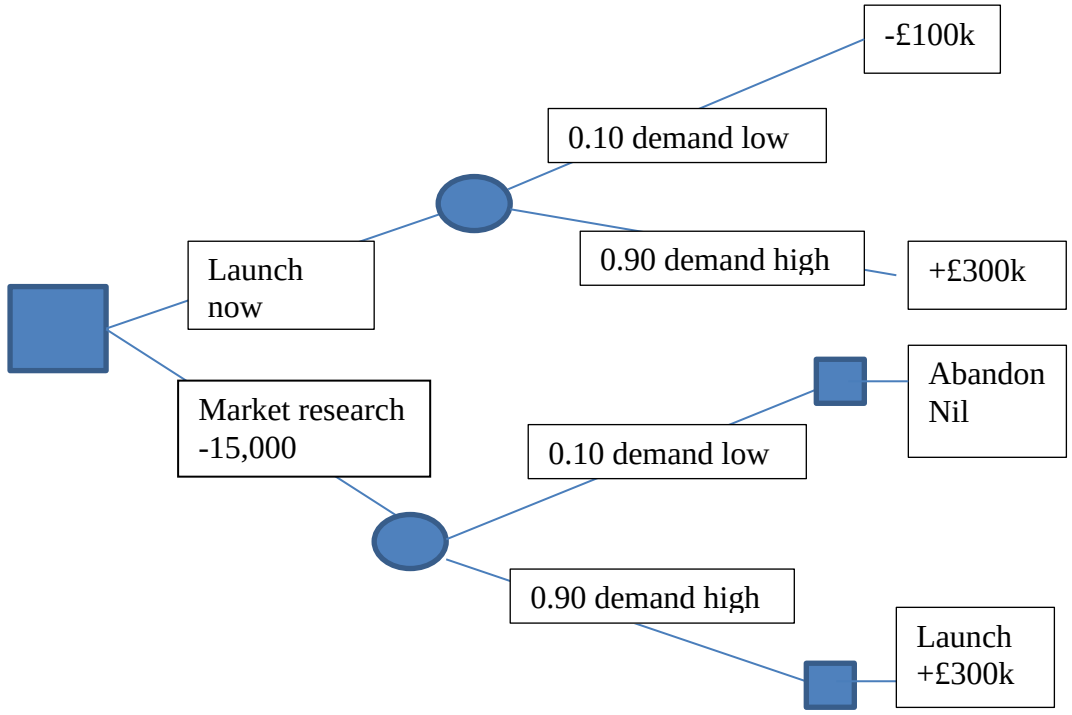
- The existing product has a three year warranty and may not involve frequent repeat purchases so it seems sensible to consider opportunities to expand revenue
- Either option will help reduce dependence on the existing UK market and on professional dive contracts in particular

- Market research of either strategy offers the opportunity to reduce the risk of expansion
- WeDive needs to consider financial projections before making a decision
- Option 2 is probably more likely to be successful in the longer term as it makes use of existing expertise and builds on WeDive's differentiation strategy. The company could consider selling online initially as a means of export then find distributors if it becomes clear that there is demand.

Requirement (a)
The requirement to evaluate the two alternative strategies was straightforward and well done by most candidates. A significant number of candidates identified that WeDive is currently a differentiator, focussed on a niche market. Many started their discussion by positioning the proposed strategies within the Ansoff matrix as product development and market development respectively. Most candidates produced sensible answers setting out the advantages and disadvantages of the two strategies and showed good knowledge of the specific issues relating to overseas expansion. Some used the "suitability, feasibility, acceptability" approach to good effect to generate a range of points. The better candidates went on to reach a conclusion as to which of the strategies might be more appropriate for WeDive, recognising the need to obtain more detailed financial projections before making a final decision.

Total possible marks	15
Maximum full marks	14

(b) Decision Tree



Launch now without MR: (0.9 x 300k) + (0.1 x (100k)) = 260k

With MR: (0.9 x 300k) + (0.1 x 0) = 270k less 15k research cost = 255k

Hence financially it is better not to undertake MR but this is based on EV which is a long term average and not necessarily applicable to a one-off decision. It also ignores risk:

Without MR, actual outcomes are +300 or -100, spread of 400k in potential return

With MR, actual outcomes become +300 or zero. Therefore depending on WeDive's attitude to risk it may be worth paying £15k for the ability to minimise downside risk despite the lower expected outcome.

Requirement (b) This was the first time that a decision tree has been examined and answers were very variable. For candidates who knew how to draw the tree, and then do the simple expected value calculations, this requirement was a source of easy marks. Many lacked the required technical knowledge however which resulted in some non-attempts. Sensible candidates who used the numbers in the scenario to produce an expected value calculation and then went on to make some relevant comments were still able to score a pass however.	
Total possible marks Maximum full marks	7 6