Mock One

Business Analysis

P3BA-MK1-Z17-Q

Time allowed: 3 hours 15 minutes

This paper is divided into two sections:

Section A This ONE question is compulsory and MUST be attempted
Section B TWO questions ONLY to be attempted

Do NOT open this paper until instructed by the supervisor.

Paper P3

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Section A – This ONE question is compulsory and MUST be attempted

1 Introduction and industry background

Datum Paper Products designs and manufactures textile fabrics for use in the paper industry. The company is based in Homeland, which is in Europe. Its main customers are large European and American paper making companies and while the Homeland market is fairly stable, over 80% of DPP's products are sold abroad. Its customers use highly expensive capital equipment, with a new paper mill costing $300 million or more.

The paper makers supply paper to global newspaper and book publishers who themselves are under pressure to consolidate as a result of the growing competition from alternative information providers, such as TV and the Internet. The industry, therefore, carries many of the signs of a mature industry, the paper manufacturers have considerable overcapacity and are supplying customers who themselves are facing intense competition. Paper makers are looking to reduce the number of suppliers and for these suppliers to meet all their needs. The net result is heavy pressure on suppliers such as DPP to discount prices and improve international service levels, although there is little potential to increase sales volumes to achieve further economies of scale.

DPP's response to this more competitive environment has been to attempt to secure higher volumes through increasing their market share and to search for cost reductions in spite of the need to improve customer service levels.

Currently, DPP has four Homeland plants manufacturing different parts of their product range. Any consolidation, including acquisition, is best done on a regional basis and a logical place to start seems to be countries in the same region as Homeland.

Strategic options – acquisition or a greenfield site?

Ken Drummond is Managing Director of DPP, and has spent a lifetime in the paper industry but has had little experience in acquiring other companies. The pressures faced by the regional industry mean that there are, in reality, two strategic options to achieve the necessary restructuring. Firstly, there are opportunities to buy existing companies available in most regional countries. The identification of suitable target companies, the carrying out of due diligence procedures before negotiating a deal and integration of the acquired company typically takes a year to complete. The second option is to move to one of the less wealthy countries in Europe where operating costs are significantly lower. There are significant government incentives in these countries for firms that move to a new or greenfield site in one of the many economically depressed areas. The greenfield option would take up to three years to get a plant set up and operating.

The acquisition option

The initial search for possible acquisition candidates has revealed a family owned and managed firm, Papier Presse, based in Awayland, some 800 kilometres from DPP's main plant in the Homeland. Papier Presse has three manufacturing plants in Awayland, each heavily unionised and controlled by the owner Philippe Truffaud. Papier Presse's markets are exclusively with Regional paper makers and it has no significant international business outside of the Region. The technology used is more dated than DPP's and manning levels are significantly higher. Papier Presse's product range has some significant overlap with DPP's but there are also some distinctive products. Philippe's son, Francois, is Sales and Marketing Director and his son-in-law, Henri, is Operations Manager. Philippe himself is the third generation of Truffauds to run the firm. Ken recognises the considerable differences between DPP and its potential partner – language being only the most obvious one.

The sales, service and distribution systems of the two firms are totally distinct but their customers include the same Regional paper makers. Reconciling the two information systems would be difficult, with customers looking for much higher service levels. Historically, DPP, with its own research and development function, has a better record of product improvement and innovation. However, Papier Presse is better regarded by its customers for its flexibility in meeting their changing demands. In terms of strategic planning DPP contributes to the strategic plans drawn up at divisional level, while the family dominance at Papier Presse means that planning is much more opportunistic and largely focused on the year ahead. Each company has to operate within a climate of heightened environmental concern over toxic by-products of the manufacturing process. There are other similarities in that both companies have felt that product superiority is the route to success but whereas DPP's is through product innovation; Papier Presse's is through customer service. Clearly integrating the two companies will present some interesting challenges and the family ownership of Papier Presse means that a significant premium may have to be paid over the current book value of the company.

The greenfield option

Ken, however, also recognises that the apparent benefits of moving onto a new greenfield site in one of the less wealthy countries in the Europe would itself bring difficulties. One obvious difficulty is the lack of a modern support infrastructure in terms of suppliers, distributors and logistical support. There is also a strong tradition of government intervention in company growth and development. Although there are government agencies looking to attract new companies to set up in these countries, there are considerable bureaucratic and time-consuming procedures to overcome. Above all there is continuing government financial support for small inefficient, formerly state-owned, companies making the products for the national paper makers, who themselves are small and inefficient compared to the customers being supplied by DPP and Papier Presse.

Table 1: Financial information on DPP and Papier Presse ($'000,000) for most recent year

	Datum Paper Products	*Papier Presse*
Revenue	195.5	90.0
Cost of sales	122.2	67.5
Gross profit	73.3	22.5
Sales & administration	27.4	9.0
Marketing	9.5	1.4
Research &Development (R&D)	4.5	0.5
Depreciation	10.0	1.0
Operating profit	21.9	10.6
Net assets	275.0	148.0
Employees	1,250	750
Share of major regional markets:		
- Homeland	45%	14%
- Awayland	10%	60%
- Other countries in Europe	15%	25%
Analysis of sales		
- Sales outside Europe	50%	5%
- North America region	40%	3%
- Rest of World	10%	2%

Required:

(a) **Assess the advantages and disadvantages of Datum Paper Products acquiring Papier Presse.** (18 marks)

Professional marks will be awarded in part (a) for appropriate structure and clarity of analysis. (2 marks)

(b) **Assess the advantages and disadvantages to Datum Paper Products taking the greenfield option as opposed to the acquisition of Papier Presse.** (14 marks)

(c) **Assess whether or not DPP is facing strategic drift, and suggest new strategies that the company can take to re align its strategic direction with the environment.** (14 marks)

Professional marks will be awarded in part (c) for appropriate structure and fluency of the report. (2 marks)

(50 marks)

Section B – TWO questions ONLY to be attempted

2 Good Sports is an independent sports goods retailer owned and operated by two partners, Alan and Bob. The sports retailing business in Homeland has undergone a major change over the past ten years. First of all the supply side has been transformed by the emergence of a few global manufacturers of the core sports products, such as sports shoes and football shirts. This consolidation has made them increasingly unwilling to provide good service to the independent sportswear retailers too small to buy in sufficiently large quantities. These independent retailers can stock popular global brands, but have to order using the Internet and have no opportunity to meet the manufacturer's sales representatives. Secondly, Homeland's sportswear retailing has undergone significant structural change with the rapid growth of a small number of national retail chains with the buying power to offset the power of the global manufacturers. These retail chains stock a limited range of high volume branded products and charge low prices the independent retailer cannot hope to match.

Good Sports has survived by becoming a specialist niche retailer catering for less popular sports such as cricket, hockey and rugby. They are able to offer the specialist advice and stock the goods that their customers want. In recent years Good Sports has become increasingly aware of the growing impact of e-business in general and e-retailing in particular. They employed a specialist website designer and created an online purchasing facility for their customers. The results were less than impressive, with the Internet search engines not picking up the company website. The seasonal nature of Good Sports' business, together with the variations in sizes and colours needed to meet an individual customer's needs, meant that the sales volumes were insufficient to justify the costs of running the site.

Bob, however, is convinced that developing an e-business strategy suited to the needs of the independent sports retailer such as Good Sports will be crucial to business survival. He has been encouraged by the growing interest of customers in other countries to the service and product range they offer. He is also aware of the need to integrate an e-business strategy with their current marketing, which to date has been limited to the sponsorship of local sports teams and advertisements taken in specialist sports magazines. Above all, he wants to avoid head-on competition with the national retailers and their emphasis on popular branded sportswear sold at retail prices that are below the cost price at which Good Sports can buy the goods.

Required:

(a) **Provide the partners with a short report on the advantages and disadvantages to Good Sports of developing an e-business strategy and the processes most likely to be affected by such a strategy.** (15 marks)

(b) Good Sports has successfully followed a niche strategy to date.

Assess the extent to which an appropriate e-business strategy could help support such a niche strategy. (10 marks)

(25 marks)

3 Matt is the Managing Director of HCC, a small haulage contracting company that he founded 12 years ago. Originally, Matt was a heavy goods vehicle driver himself, working for other contractors, but he was intent on establishing his own haulage business. Having obtained a loan, Matt acquired a heavy goods vehicle (HGV) and began to work from home. Over time the business expanded and now HCC operates a fleet of 24 heavy goods vehicles (tractor units as they are called) and 48 trailers which are hooked on to the tractor units. A quarter of the current fleet of tractor units was acquired in the last financial year, replacing older units that were becoming too expensive to maintain. HCC now employs 20 full-time and a varying number of part-time drivers. The part-time staff work as and when required.

Matt acquired a small plot of land six years ago and built a house on it that he and his family occupy. In addition, he built a garage with facilities for minor servicing and repairs on the same site. Living on site has enabled him to offer a 24-hour service to clients. Consequently, movement of tractor units and trailers in and out of the site occurs at all times of day and night. There have been objections raised by local residents and administrative officials to the disturbance, and the local newspaper has at various times reflected this criticism.

In addition to haulage, HCC obtained a license to undertake forklift truck training. This has proved to be a successful diversification as there is a regular stream of customers. This training takes place mostly in HCC's own garage facilities.

It became clear to Matt that the land on which the garage facility is built was inadequate for the needs of his growing business. In addition to the inadequacy of the maintenance provision for a growing fleet, it became impossible to house the entire tractor units and trailers operated by the business. This problem was compounded when, as frequently occurs, the client's own trailers were attached to the tractor units and parked overnight on HCC's land.

One year ago, Matt entered negotiations to lease some land that would more than satisfactorily accommodate all the tractor units and trailers. The land is situated on an industrial estate 5 km from the existing facility. In addition, there is room to build a repair and maintenance facility which would be adequate for the needs of the fleet. Matt believes that surplus land on the site can be used for storage of trailers for local companies. Following agreement of a lease arrangement, which was concluded just before the completion of the last financial year, HCC occupied the land on which there were no buildings erected or utilities supplied. Since taking possession of the land, a large security fence has been erected and a small portable cabin placed on site. Water, sewerage and electricity utility services have been supplied and negotiations are taking place for the installation of a large diesel tank adequate to service other vehicles besides those of HCC.

Matt recruited Julia, a part-time bookkeeper, four years ago. Prior to Julia's arrival HCC applied a policy of paying all invoices immediately upon receipt. On the other hand, debtors took longer than the credit period allowed and HCC suffered a cash flow shortage resulting in a large bank overdraft.

Julia introduced some basic financial accounting procedures into the company. In addition to exercising some control over the company's expenditure, she has reduced the debtors' collection period to about half its former level. Creditors are now paid when the invoices fall due rather than immediately upon their receipt. Such control had been lacking prior to her arrival at the company. The bank manager has praised Julia for her efforts and informed Matt that in his opinion the control measures now introduced have saved the business from liquidation. As a consequence of the improvement in financial control, the bank has been willing to fund additional loans for the development of the new land. In making its decision, the bank required HCC to supply its statutory financial statements and a cash flow forecast for the development.

Julia has persuaded Matt of the need to provide information that will be useful for strategic management purposes. Her own background and experience have been focused on the provision of a bookkeeping service, but she is enthusiastic about the challenge of obtaining and presenting strategic management accounting information.

The company faces strong competition for haulage contract work. Typically, haulage contractors operate on a low-margin basis and smaller companies often sub-contract from large-scale hauliers.

HCC carries haulage for a variety of customers as well as undertaking some sub-contracting. Much of the haulage work the company carries out is seasonal. Approximately 70% of its revenue is derived from Capok, a local company that manufactures soft furnishings such as cushions and pillows.

Following the recent appointment of a new transport manager, Capok has begun to employ other hauliers besides HCC. Over the last two months, the haulage work HCC has received from Capok has reduced by about a third.

Required:

(a) **Assess the nature of competitive forces to which HCC is subject.** (10 marks)

(b) **Produce a position appraisal for HCC that identifies and evaluates the internal and external factors to which the company is exposed.** (15 marks)

(25 marks)

4 The Jay-C organisation provides corporate communication services and has grown very rapidly in the last five years owing to both an increased market for such services and an increasing share of the market. The increase in business through existing customers has placed severe strains on all parts of the business within Jay-C, but the board is keen to push forward with expansion plans, even if it means compromising shareholder value in the short term. The company has eight board members – two of them are non-executive directors. The board members see themselves as being in the business of managing risk and up to now all their risks have paid off well. The last Annual General Meeting was a heated affair and many shareholders, unions and financial backers voiced grave concern over the rate of expansion. After the meeting, the CEO commented to the only two-non executives, "Don't worry, we know best. We'll push ahead with the plans anyway".

Jon Dee is the new financial director, internally promoted from the US Division. Jon has the task of organising the finance for the global expansion plans under International Financial Reporting Standards (IFRS), and despite raising concerns about forecast cash flow in memos to the CEO/Chairman, George Nonre, he is keen to impress the board members with his professional expertise and prowess, despite his relative inexperience in global finance. He sees hedge funds and spreading funding offshore, which he managed in the US, as the way of getting around the risk associated with these expansion programmes.

George Nonre is due to retire in 18 months' time and is keen to leave on a high note, so he is driving the expansion forward on all fronts. He also wants his successor to be one of three current directors, but he is keeping his preference a closely guarded secret to maintain pressure on them to support the Jay-C expansion plans. .

Required:

(a) **Explain the main cultural and ethical problems present in Jay-C and how these could be managed. Where appropriate support you answer with reference to recent corporate governance legislation or recommendations.** (15 marks)

(b) **Identify and briefly explain an appropriate way of selecting George Nonre's successor and explain the role of the nomination committee in the succession process.** (10 marks)

(25 marks)

End of Question Paper