

# THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

*A Committee of the Council of ICPAU*

## CPA (U) EXAMINATIONS

### LEVEL FOUR

#### BUSINESS POLICY - PAPER 17

**MONDAY, 18 JUNE 2007**

#### INSTRUCTIONS TO CANDIDATES

1. Time allowed: **3 hours**
2. Section **A** has **one** compulsory question carrying 50 marks.
3. Section **B** has **three** questions and only **two** are to be attempted.  
Each question carries 25 marks.
4. Please, read further instructions on the answer book.

**© 2007 Public Accountants Examinations Board**

## SECTION A

### Question 1

Africair is a well known African airline whose main operational area was in Southern Africa, where it has a strong route network. African airlines were having a rough time in trying to compete with each other, because many of them were too small and did not enjoy the economies of scale of the larger international carriers. The African routes were characterised by thin traffic leading to low passenger seat load factors. At the same time many African airlines faced stiff competition from European airlines with heavy traffic originating from European destinations. The heavy traffic consisted of both business and tourist passengers. African airlines responded differently to these threats to their existence with some of them going completely out of business. Africair fell on hard times after a period of expansion in the late 1990s and early 2000s and the Table 1. below shows how profits declined from Shs. 2.6 billion in 2004 to a loss of Shs.3.01 billion by 2006.

**Table 1. Africair's record.**

	2002	2003	2004	2005	2006
Turnover (Shs.billion)	10.961	11.845	13.055	14.109	14,249
Pre-tax profit (Shs.billion)	2.07	2.41	2.60	1.42	(3.01)
Employees	471	490	519	575	617
Seat kilometres offered	57000	61700	65000	75500	81700
Seat kilometres sold	40000	42500	44900	50600	52300
Seat load factor (%)	70	69	69	67	64
Number of aircraft	15	16	19	22	28

Seat load factor is the filled capacity of the aircraft.

Capital spending in the three years up to 2006 was Shs 8 billion. In 2007 Africair intended to take 3 aircrafts out of service, and was looking for a partner to help penetrate the European market.

The total market for African air travel during the period was as shown in Table 2.

**Table 2 Total air travel**

	2002	2003	2004	2005	2006
Passenger kilometres flown (millions)	1,600	1,700	1,800	1,900	1,800
% change from previous year	10	6.3	5.9	5.6	(5.3)

Africair was not alone in making losses in 2006. Four major African airlines made bigger losses, the largest loss for the year being 30% higher than Africair's. The world's scheduled airlines in total made a loss of 0.5% on revenues in 2006, compared with a loss of 0.8% on revenues in 2005.

**Table 3. Airlines ranked by kilometres flown**

<b>Rank</b>	<b>Airline</b>	<b>Kms in millions</b>
1	Central African Airways	132,500
2	Air Zambezi	132,400
3	Africa South Airways	108,400
4	Nile Airways	86,800
5	Sahara Air	66,700
6	Kilimanjaro Airways	65,900
7	Air Victoria	54,900
8	Red Sea Airlines	54,700
9	Gold Coast Air	53,400
10	Africair	52,300

Africair was the tenth largest African airline by 2006 in terms of the number of passenger kilometres travelled. However, it is small (40%) in comparison with the large African carriers (see Table 3).

**Required.**

- (a) Use the information given to analyse the present Africair business strategy and comment on it. (20 marks)
  - (b) Assess why Africair is making losses. (15 marks)
  - (c) Suggest what Africair should do in the future. (15 marks)
- (Total 50 marks)**

**SECTION B****Question 2**

It has been traditional to divide the consideration of product diversification into two broad types – related and unrelated diversification.

**Required:**

Explain what is meant by these types of diversification and the circumstances when each would be applicable.

**(25 marks)**

### Question 3

Rhino Batteries (Uganda) Limited is a wholly owned subsidiary of Universal Motor Services (East Africa) Limited based in Nairobi Kenya. Rhino Batteries manufactures and sells motor vehicle batteries of various types:

- **Rhino standard:** the cheapest battery in the range for the mass market and for small to medium capacity reconditioned vehicles.
- **Rhino extra:** a high quality product generally considered to be very good value for money.
- **Rhino super:** for heavy duty vehicles.

Rhino Batteries enjoys a good name in Uganda and is well known in the motor vehicle market.

Universal Motor Services has many interests apart from battery manufacture and distribution. It manufactures brake pads and other vehicle components, which it distributes through its motor vehicle service centres spread throughout Kenya. The motor vehicle service centres sell petrol and also carry out a wide range of motor vehicle servicing activities as well as being an outlet for Universal Motor Services spare parts.

Rhino Batteries (Uganda) is now considering a change in strategic direction. This has been prompted by a realisation that the vehicle battery market has now reached a mature stage and sales of new batteries are not going to be easy. There is also competition from other local battery manufacturers who are independent and who are not restricted in their strategy by head office requirements; additionally there are overseas battery manufacturers who have entered the market with deep pockets and can offer attractive incentives to the distributors of their batteries.

Rhino Batteries (Uganda) has held several meetings with its parent company and has requested to be allowed to enter the emerging and potentially lucrative market in Sudan as well as Rwanda, Burundi and later to Ethiopia and Somalia as soon as the political situation calms down. Universal Motor Services has made it clear that Rhino Batteries' ideas are rejected as they will result in competition with Universal's own products and expansion plans. Instead of this, Universal Motor Services has advised Rhino Batteries to emulate its business in Kenya by distributing other motor vehicle spares and by moving into the motor vehicle service centre business which would help to provide an avenue for Rhino's sales. Universal has promised that it would be ready to provide all the financial backing for this strategic direction.

**Required.**

- (a) Explain the external environmental factors that should be considered when Rhino Batteries is making its strategic choice.  
**(9 marks)**
- (b) Advise Rhino Batteries on the barriers to entry it is likely to face while adopting its parent company's proposed strategy.  
**(8 marks)**
- (c) If Rhino Batteries enters the motor vehicle service centres business do you feel that its competences can satisfy the critical success factors of the service centre business?

**(8 marks)**

**(Total 25 marks)**

**Question 4**

To what extent would you say that the product life cycle as a marketing model is a valid tool for product analysis when applied to the real world?

**(25 marks)**