

THE PUBLIC ACCOUNTANTS EXAMINATIONS BOARD

A Committee of the Council of ICPAU

CPA (U) EXAMINATIONS

LEVEL THREE

BUSINESS POLICY AND STRATEGY - PAPER 14

MONDAY, 8 DECEMBER 2008

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.

SECTION A

Question 1

DESIRE SUPPLIES LTD

Habib and Madina Ssozi own and manage the firm Desire Supplies Ltd (DSL), a cosmetics firm based in Kampala. The firm was founded in 1993 when Habib and his second wife Madina sold their chain of small barbershops and saloons and borrowed heavily from First Chartered Bank to set up a big cosmetics business in Wandegaya. Habib had studied hair care and cosmetology at a prestigious Beauty School in Nairobi. He also did a diploma in marketing at university.

Besides selling a wide range of cosmetic products, the firm also buys and sells hair care products such as hair clippers, brushes, combs, hair nets, hair driers, hair curlers and sterilizers mainly to hair dressing saloons across Uganda. The manufacturers are almost entirely non-Ugandan; most of them are based in the United States of America and Dubai. However, about 20% of the products are sourced from Europe, mainly France and the United Kingdom.

The company has achieved success very quickly and the initial loans have already been repaid ahead of schedule. The company now owns a large shop with a warehouse/ distribution centre on Kampala Road in the central business district of Kampala, which is seven times the size of the original shop at Wandegaya. Turnover, now in excess of Shs 800 million has increased by more than 40% each year and shows little signs of slowing down. Despite this apparent rapid growth DSL only accounts for about 40% of the current market, leaving potential for growth. The company is run cost effectively, with minimum staffing. Habib, as Managing Director is solely concerned with the marketing and financial reporting side of the business. He spends most of his time in the selling role, product sourcing and in customer care which he rates as a major contributor to the company's success. The only other key manager is his daughter Hajara who is responsible for managing the warehouse staff, arranging for distribution, general administration, management reporting and shop display. The company started with nine employees, in addition to Habib, Madina and Hajara, and now has 17. Employees rarely leave the company. This is because they are all recruited from Kayunga, the home village of Madina. The employees are almost entirely employed in the distribution and packaging function, although there are three other sales people apart from Habib, but they only deal with the smaller buyers who come to the shop. With the continued growth in turnover it is inevitable that the number of employees will have to increase. It is expected that there will have to be a total of about 40 employees, all non-managerial in three years if sales continue to increase at the current rate.

The success of DSL can be accounted for by a number of factors. Habib is a very good salesman who is responsible for looking after all the major accounts. He is popular and much of the business is built around his personal relationship with his prominent suppliers and the key clients. There is a considerable amount of customer loyalty which is mainly attributable to Habib, and both he and his wife are always accessible to customers and go out of their way to provide an unrivalled first class service. The company has also managed its purchases wisely.

Most of the products are purchased abroad and therefore require payment in foreign currency. DSL has been able to benefit from the relative weakness of the US dollar against the Uganda shilling for its American supplies. For the European supplies, the strength of the euro has enabled DSL to negotiate lower purchasing prices. However it is questionable as to how long this situation concerning foreign exchange can go on.

Habib has also developed strong links with his suppliers and has, until recently, attempted to trade with only a few so that his lines of communication and control are kept as simple as possible. Most of his current suppliers have been with him since the start of the company. This has provided the company with reliable and good quality products. In fact, DSL has exclusive distributorship of certain products for example it has the sole rights to distribute 'Clear Essence', a beauty product recognised to be the best on the market. This product's strength has enabled the company to build customer loyalty. However, as demand has increased, existing suppliers have not been able to keep up with the necessary volumes, and Habib has had to look for and buy from new manufacturers. This makes him travel a lot outside Uganda in the quest for suppliers.

The company has benefited from a period of relatively steady growth of the economy and even with the current world credit crunch, Habib has argued that demand for beauty products is usually recession – proof. DSL has no major competitors. Many of the small competitors in the wholesale marketplace have chosen to concentrate on buying cheap Chinese beauty products of poor quality or solely on hair care business; saloon furnishings, supply of towels, razors etc, leaving the basic beauty business to DSL.

There are some major international companies who make shampoos, conditioners and other cosmetic products who have tried to enter the Ugandan market, but have not been quite successful due to lack of local support. Furthermore, these are large companies and Habib believes that they do not currently see his company as a major threat.

Habib believes that part of the company's success stems from the fact that he has an organization with minimal administrative overheads. He obtains all his products from external sources and adds value mainly through branding and maintenance of customer care. He believes that the strategy is not mainly about beating the competition but serving the real needs of the customer. The company has also been able to develop a strong relationship with the country's two leading manufacturers of cosmetic products, Tivom Ltd and Mosana Ltd providing it with relatively good quality and low cost products for the lower segment of the market. Although the margins are relatively small, the volumes involved more than compensate for this.

The company has had to undertake increased investment as a result of the large growth in turnover. The building of the warehouse, the increased inventory holding costs, capital expenditure on items such as inventory management systems, security systems and delivery trucks could not be financed only from current earnings. The company's bank, First Chartered Bank, has been able to lend more money to the company considering that the original loans have been paid ahead of schedule.

All the success which DSL has achieved has not diminished Habib's appetite for growth, especially with a new South Sudan frontier, which is a highly potential market. He questions the ability of the company to continue its current growth in the prevailing environment and is therefore looking for ideas which may facilitate corporate expansion.

He has now approached you, a qualified accountant, to provide some options for him to consider, and has availed to you the following information:

Performance of Desire Supplies (U) Ltd: 2004-2008

	2004	2005	2006	2007	2008	2009
						Forecast
	Shs million					
Turnover	210	300	420	600	840	1,200
Cost of sales	133	204	294	420	580	840
Marketing costs	20	22	25	30	33	38
Distribution costs	27	36	40	47	55	64
Administration	4	4.5	6	9	15	20
Interest payment	<u>6</u>	<u>8.5</u>	<u>24</u>	<u>30</u>	<u>36</u>	<u>48</u>
Operating profit	<u>20</u>	<u>25</u>	<u>31</u>	<u>64</u>	<u>121</u>	<u>190</u>
Loans	50	72	200	240	300	400
Inventory	21	35	45	70	120	200

Additional Information:

	2004	2005	2006	2007	2008	2009 Forecast
Number of suppliers	10	15	25	30	45	60
Range of products	20	40	60	75	90	110
Total number of employees including Habib, Madina & Hajara	10	10	12	15	17	25

Required:

- (a) Define and explain the term “value chain analysis”, describing the components of a value chain.
(5 marks)
 - (b) Using the concept of value chain analysis, demonstrate how Habib has been able to achieve this success.
(10 marks)
 - (c) Evaluate the current position of DSL highlighting any financial and strategic issues concerning future developments which you feel should be brought to the attention of Habib.
(15 marks)
 - (d) Identify reasons for potential corporate decline and advise on how Habib could avoid them in the context of the case study scenario.
(10 marks)
 - (e) As his consultant, prepare a report for Habib, identifying and assessing the strategies which he could consider in attempting to further the company's development.
(10 marks)
- (Total 50 marks)**

SECTION B

Question 2

Ayato Ltd manufactures and sells ten types of wheat flour. All the flour is sold as Ayato Ltd's own brands. The range currently manufactured includes wheat flour at all the different stages of the product life cycle.

Ayato Ltd has a functional organization structure. Thus, it has separate marketing and management accounting departments. Currently, the management accounting department attempts to support marketing by calculating the contribution margin on every product when it is first brought onto the market and by producing monthly profit/loss statements for the whole company. The profit/loss statements show the aggregate gross and net profit or loss made by Ayato Ltd. There is no analysis produced to show the performance of individual products or market groupings.

The management accounting department also prepares an annual budget for the company and monthly statements showing actual performance compared to budget. The only budget report produced for the marketing department is one which shows a comparison of budget and actual spending in total.

Marketing has four brand managers. They each control Shs 50 million of discretionary spending on advertising and promotional expenditure each month. All of the Shs 200 million is usually spent. Marketing has recently complained that management accounting is too remote and does not provide them with appropriate information. Marketing has expressed a desire for 'more helpful' information and criticized the monthly profit statement as 'useless' because it is historical whereas marketing is 'forward-looking'.

The chief accountant has replied that marketing is only one of the many demands placed on his time and he is doing his best.

Required:

- (a)
 - (i) Recommend what you consider to be appropriate Management Accounting policy that will meet the needs of the Marketing department. Justify your recommendations. **(6 marks)**
 - (ii) Discuss the specific information that Management Accounting should provide to satisfy the needs of the Marketing department. **(8 marks)**
- (b) Describe an appropriate organizational relationship for Management Accounting and Marketing, in the light of your recommendations in (a) above. Explain why you consider your suggested structure to be appropriate.

(6 marks)

- (c) Discuss the view that the monthly historical profit statement is 'useless'.

(5 marks)

(Total 25 marks)

Question 3

Mebo Bank Uganda Limited (MBL) is a member of a leading Pan African Banking group, the Bican Bank with operations in some 70 countries worldwide. MBL is facing an interesting dilemma – it has just disposed of all its property and buildings and decided to rent all the required offices. It has also decided to recruit a cleaning company to perform cleaning services for all its offices countrywide. Further, it now wants to abandon having an in-house information technology (IT) department as well as a customer service department. The argument by the Chief Operations Manager Mr. Daniel Katimbo is that those services are not the reason why the bank exists. He says; 'We are not in business of real estate, nor information technology nor pleasing people who visit the bank. We are in banking and financial services business. The only problem is the extent to which we can abandon those non-core services to others.'

The increasing competitiveness in banking has meant that the bank has to immediately think about how to outsource certain activities to outsourcing partners in parts of the world with lower labour costs. This in turn is likely to bring resistance from the MBL's employees association, an in-house trade union, against the export of jobs, and criticism from customers of poor service as a result of limited understanding of the local environment of the outsourcing partners. The argument is centred around which competences and resources the bank should retain and develop and what activities can be more efficiently outsourced.

Assume you are the Finance Director of MBL.

Required:

- (a) Define and explain the concept that MBL is trying to adopt.

(5 marks)

- (b) Write a memo to the Chief Operations Manager explaining the strategic and operational advantages and disadvantages of moving the IT and customer service departments to an outside provider?

(15 marks)

- (c) What competitive advantage might the bank gain from a better understanding of its core competences?

(5 marks)

(Total 25 marks)

Question 4

Total Quality Management (TQM) is a specific approach to quality assurance that aims at developing a quality culture throughout the firm. In TQM, organisations consist of 'quality chains' in which each person or team treats the receiver of their work as if they were an external customer and adopts a target of 'right first time' or zero defects. Many organisations believe that the introduction of TQM is a method of achieving distinctive competitive advantage.

Required:

- (a) Discuss the possible impact of performance indicators on the behaviour of operational managers when introducing TQM as a competitive strategy.
(10 marks)
- (b) In light of your answer in part (a) above, explain how an organisation can ensure that TQM is successfully implemented.

(15 marks)

(Total 25 marks)