Professional Level – Essentials Module

Business Analysis

Wednesday 11 June 2008

Paper P3

Time allowed
Reading and planning: 15 minutes
Writing: 3 hours

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.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

ACCA

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

The following information should be used when answering question 1.

1 Introduction

AutoFone was established almost twenty years ago at the beginning of the mobile telephone boom. It was formed by a dynamic Chief Executive Officer (CEO) who still remains a major shareholder of the company.

AutoFone brought two new concepts to the market. Firstly, it established retail shops where customers could go and handle the products and discuss mobile phone options with trained sales people. Before AutoFone, all mobile telephones were sold through the customer directly contacting the telephone network provider (like conventional home land line services) and were generally aimed at business rather than leisure users. Secondly, AutoFone sold products and services from all the four major network providers licensed by the government to provide telecommunications services in the country. Previously, customers could only choose products and services from within one network provider's range. AutoFone allowed customers to choose products and services across the range of the four providers and reflected this in the company's motto 'ethical advice: the customer's choice'.

In 1990, AutoFone signed a thirty-year supply contract with each provider. Although, in retrospect, these deals were on commercially favourable terms for AutoFone, the network providers were happy to agree these deals because none of them believed that mobile telephones could be successfully sold through retail shops. However, speaking in 2003, the managing director of one of the networks suggested 'that AutoFone had got away with incredible profit margins' when they signed the deals in 1990. The four network providers themselves had re-signed twenty-five year licence deals with the government in 1995. Under the terms of these deals, licences will be restricted to the four current providers until their renewal date of 2020.

Retail shops Division

AutoFone currently has 415 shops around the country. To reduce costs most shops are on the edge of (but not in) the main shopping area of the town they serve. It is usual for AutoFone to sign a fifty-year shop lease in return for low initial annual rental and a rent-free period at the start of the lease while the company fits out the shop to reflect AutoFone's corporate image. In 1997, AutoFone floated on the country's stock market to assist the funding of further shops and so continue its organic growth. The national coverage of its shops, the publicity generated by its CEO and a successful television advertising campaign culminated, in 2005, with it being rated by consumers as one of the top 20 brands in the country.

The CEO of AutoFone established the retail shops along, in his words, 'entrepreneurial lines'. He regards each shop as an independent business, having to achieve a profit target but without being closely monitored within these targets. He believes that the company is 'about providing opportunity to its employees, providing them with autonomy and responsibility to achieve their goals. It is not about monitoring them every hour of the day, stifling creativity and enthusiasm.' To support this approach, sales staff are given a relatively low basic salary with a substantial element of profit-related pay linked to the profit targets of the shop. Commission is also paid to sales staff who successfully sell mobile phone insurance to the customer. Each shop is relatively small, usually employing three or four people.

In recent years the CEO has been increasingly involved in television, sports promotion and charity work. At AutoFone he has established a strategic planning committee of senior headquarters managers to develop and implement the company's business strategy. This committee includes the two longest serving board directors. The strategy still continues to have at its heart the central business idea of giving independent and impartial advice to customers so that they can choose the best equipment and network for their needs.

Marketplace trends

Since AutoFone's arrival into the market, two significant trends have emerged:

(i) The licensed network providers have opened their own retail stores, usually in city centres. AutoFone has reacted to the opening of these shops by stressing AutoFone's independence and impartiality. Only at AutoFone can impartial advice be received on all four competing networks and their supporting services. The CEO now refers to this as 'our central business idea' and, as well as being core to their strategy, it is heavily emphasised in all their promotional material.

(ii) Mobile phones have become more sophisticated. Many now offer integrated cameras, mp3 players, web browsers and e-mail facilities. AutoFone offers these products in both its shops and through its Internet operation. Mobile phones are either purchased outright or provided on monthly contracts. The minimum contract period with the network provider is usually twelve months.

AutoFone has itself established its own Internet division, AFDirect, as a separate division within the group. It has also established an insurance division (AFInsure) offering insurance to cover loss or damage to mobile phones purchased from the company. Revenue earned from each division, analysed by the age of the customer, is shown in table 1.

Table 1: Analysis of AutoFone Sales: 2007 (all figures in $m)

		Age of customer					
		Under 15	**15–25**	**26–40**	**41–60**	**Over 60**	**Total**
Division	AutoFone retail shops	5	90	60	120	65	340
	AFDirect	0	15	20	8	2	45
	Total sales of mobile phones						385
	AFInsure	0	1	3	7	3	14
	Group total						399

Analysts agree that growth in the mobile phone business is slowing down and this is supported by the figures given in table 2 showing revenue from sales (both retail and Internet) for AutoFone and its competitors, the four licensed network providers, for the period 2003–2007.

Table 2: Market Analysis (all figures in $m) of sales of mobile phones

Company	**2007**	**2006**	**2005**	**2004**	**2003**
AutoFone	*385*	*377*	*367*	*340*	*320*
NetAG	350	348	345	340	305
09Net	390	388	380	365	350
PhoneLine	315	315	315	305	300
NetConnex	295	295	294	290	285
Total	**1,735**	**1,723**	**1,701**	**1,640**	**1,560**

However, while the AFDirect and AFInsure divisions are prospering, there are increasing problems in the retail shops division. Profitability has been declining over the last few years (see table 3) and this has had a demoralising effect on shop employees. One shop manager commented, in his exit interview, that the profit targets were unattainable in the current market. 'They might have been appropriate in 1997, but they are not in 2007.' Staff are particularly demoralised by spending time explaining a particular product to a customer who then leaves the shop and buys the product cheaper on the Internet. They have to wait for it to be delivered (usually two or three days) but they are prepared to do this to gain the lower prices offered by the direct Internet-based companies, including AFDirect. It is also increasingly common for customers who have bought from AFDirect to take their phones to AutoFone's retail shops for support and service. This activity is not recognised in the shop employee's reward package.

AutoFone's central city branch

Despite the overall decline in the profitability of the shops, one branch has continually met or exceeded its profitability targets and is held up by the CEO as an example of best practice – proof that the company's approach to mobile phone selling can still be profitably applied. This is the central city branch in one of the country's most prosperous cities.

The CEO arranged for three members of the strategic planning committee to visit the shop, posing as customers, to investigate the reasons for the shop's success. They found the staff very friendly and helpful. However, they also found that they were guided towards products and services which had higher profit margins. Further investigation showed this always to be the case and so customers were sold products which were profitable to the shop, rather than those best suited to the customer's needs. On receiving this information, AutoFone's board concluded that this was unethical as it compromised their central business idea which stressed impartial advice to guide the 'customer's choice'. The manager of the shop was reprimanded and asked to adhere to company policy. He resigned soon afterwards, followed by his two assistants. The shop is currently run by temporary staff and profitability has significantly dropped.

Future strategy

The two longest serving directors on the strategic planning committee are increasingly concerned about the company's decline in profitability (see table 3). They have written an internal paper suggesting that the retail division should be sold off and that AutoFone should re-position itself as an on-line retailer of phones. They believe that the retail shops business model is no longer appropriate. They argue that a company concentrating solely on Internet sales and insurance would be a 'smaller but more profitable and focused' business. The CEO is strongly opposed to this suggestion because it was the shop-based approach to selling mobile phones that formed the original business model of the company. He has a strong emotional attachment to the retail business. The two directors claim that this attachment is clouding his judgement and hence he is unable to see the logic of an 'economically justifiable exit from the retail business'.

Table 3: Extracted Financial Information for AutoFone (retail shops division only)

Extracted Financial Information (all figures in $m)

Extracted from the Balance Sheet

	2007	2006	2005	2004	2003
Total non-current assets	143	140	134	128	123
Current assets:					
Inventories	345	340	335	320	298
Trade receivables	1,386	1,258	1,216	1,174	1,120
Cash and cash equivalents	345	375	390	400	414
Total current assets	2,076	1,973	1,941	1,894	1,832
Total assets	**2,219**	**2,113**	**2,075**	**2,022**	**1,955**
Total shareholder's equity	150	155	160	165	169
Non-current liabilities:					
Interest bearing long-term loans	55	50	45	40	35
Other provisions	16	15	13	13	10
Total non-current liabilities	71	65	58	53	45
Total current liabilities	1,998	1,893	1,857	1,804	1,741
Total equity and liabilities	**2,219**	**2,113**	**2,075**	**2,022**	**1,955**

Extracted from the Income Statement

	2007	2006	2005	2004	2003
Revenue	340	337	332	320	305
Cost of Sales	250	252	230	220	205
Gross Profit	90	85	102	100	100
Wages & Salaries	39	38	37	35	33
Other expenses	40	38	35	30	30
Interest payable	4	4	3	3	3
Total	83	80	75	68	66
Net Profit before tax	7	5	27	32	34
Tax	2	3	5	4	4
Net Profit after tax	5	2	22	28	30

Extracted from annual reports

Number of employees	1,400	1,375	1,325	1,300	1,275

Required:

(a) **Using an appropriate model or models, analyse the competitive environment of AutoFone's retail shops division.**

Note: requirement (a) includes 2 professional marks. (20 marks)

(b) AutoFone's CEO is anxious to develop a rational and well argued case for retaining the retail shops division.

Write a briefing paper for the CEO to submit to the strategy planning committee explaining why the retail shops division should continue to form a key part of AutoFone's future strategy.

Note: requirement (b) includes 3 professional marks. (15 marks)

(c) The AutoFone retail shops division faces problems in remaining faithful to the original business idea of offering impartial advice to customers and developing an appropriate rewards system for its staff.

Evaluate what changes the AutoFone retail sales division should consider making to both its business idea and its rewards system. (15 marks)

(50 marks)

Section B – TWO questions ONLY to be attempted

2 Introduction

The Country Car Club (3C) was established fifty years ago to offer breakdown assistance to motorists. In return for an annual membership fee, members of 3C are able to phone for immediate assistance if their vehicle breaks down anywhere in the country. Assistance is provided by 'service patrol engineers' who are located throughout the country and who are specialists in vehicle repair and maintenance. If they cannot fix the problem immediately then the vehicle (and its occupants) are transported by a 3C recovery vehicle back to the member's home address free of charge.

Over the last fifteen years 3C has rapidly expanded its services. It now offers vehicle insurance, vehicle history checks (to check for previous accident damage or theft) as well as offering a comprehensive advice centre where trained staff answer a wide range of vehicle-related queries. It also provides route maps, endorses hotels by giving them a 3C starred rating and lobbies the government on issues such as taxation, vehicle emissions and toll road charging. All of these services are provided by permanent 3C employees and all growth has been organic culminating in a listing on the country's stock exchange three years ago.

However, since its stock market listing, the company has posted disappointing results and a falling share price has spurred managers to review internal processes and functions. A Business Architecture Committee (BAC) made up of senior managers has been charged with reviewing the scope of the company's business activities. It has been asked to examine the importance of certain activities and to make recommendations on the sourcing of these activities (in-house or outsourced). The BAC has also been asked to identify technological implications or opportunities for the activities that they recommend should remain in-house.

First review

The BAC's first review included an assessment of the supply and maintenance of 3C's company vehicles. 3C has traditionally purchased its own fleet of vehicles and maintained them in a central garage. When a vehicle needed servicing or maintenance it was returned to this central garage. Last year, 3C had seven hundred vehicles (breakdown recovery vehicles, service patrol engineer vans, company cars for senior staff etc) all maintained by thirty staff permanently employed in this garage. A further three permanent employees were employed at the garage site with responsibility for the purchasing and disposal of vehicles. The garage was in a residential area of a major town, with major parking problems and no room for expansion.

The BAC concluded that the garage was of low strategic importance to the company and, although most of the processes it involved were straightforward, its remoteness from the home base of some vehicles made undertaking such processes unnecessarily complicated. Consequently, it recommended outsourcing vehicle acquisition, disposal and maintenance to a specialist company. Two months ago 3C's existing vehicle fleet was acquired by AutoDirect, a company with service and repair centres nationwide, which currently supplies 45,000 vehicles to companies throughout the country. It now leases vehicles back to 3C for a monthly payment. In the next ten years (the duration of the contract) all vehicles will be leased from AutoDirect on a full maintenance basis that includes the replacement of tyres and exhausts. 3C's garage is now surplus to requirements and all the employees that worked there have been made redundant, except for one employee who has been retained to manage the relationship with AutoDirect.

Second review

The BAC has now been asked to look at the following activities and their supporting processes. All of these are currently performed in-house by permanent 3C employees.

– *Attendance of repair staff at breakdowns* – currently undertaken by permanent 'service patrol engineers' employed at locations throughout the country from where they attend local breakdowns.

– *Membership renewal* – members must renew every year. Currently renewals are sent out by staff using a bespoke computer system. Receipts are processed when members confirm that they will be renewing for a further year.

– *Vehicle insurance services* providing accident insurance which every motorist legally requires.

– *Membership queries* handled by a call-centre. Members can use the service for a wide range of vehicle-related problems and issues.

– *Vehicle history checks*. These are primarily used to provide 'peace of mind' to a potential purchaser of a vehicle. The vehicle is checked to see if it has ever been in an accident or if it has been stolen. The check also makes sure that the car is not currently part of a loan agreement.

Required:

(a) The Business Architecture Committee (BAC) has been asked to make recommendations on the sourcing of activities (in-house or outsourced). The BAC has also been asked to identify technological implications or opportunities for the activities that they recommend should remain in-house.

Suggest and justify recommendations to the BAC for each of the following major process areas:

(i) Attendance of repair staff at breakdowns;
(ii) Membership renewal;
(iii) Vehicle insurance services;
(iv) Membership queries; and
(v) Vehicle history checks. (15 marks)

(b) Analyse the advantages that 3C will gain from the decision to outsource the purchase and maintenance of their own vehicles. (10 marks)

(25 marks)

3 Introduction

The Accounting Education Consortium (AEC) offers professional accountancy education and training courses. It currently runs classroom-based training courses preparing candidates for professional examinations in eight worldwide centres. Three of these centres are also used for delivering continuing professional development (CPD) courses to qualified accountants. However, only about 30% of the advertised CPD courses and seminars actually run. The rest are cancelled through not having enough participants to make them economically viable.

AEC has developed a comprehensive set of course manuals to support the preparation of its candidates for professional examinations. There is a course manual for every examination paper in the professional examination scheme. As well as being used on its classroom-based courses, these course manuals are also available for purchase over the Internet. The complete set of manuals for a professional examinations scheme costs $180·00 and the web site has a secure payment facility which allows this to be paid by credit card. Once purchased, the manuals may be downloaded or they may be sent on a CD to the home address of the purchaser. It is only possible to purchase the complete set of manuals for the scheme, not individual manuals for particular examinations. To help the student decide if he or she wishes to buy the complete manual set, the web site has extracts from a sample course manual. This sample may be accessed, viewed and printed once a student has registered their email address, name and address on the web site.

AEC has recently won a contract to supply professional accountancy training to a global accounting company. All students working for this company will now be trained by AEC at one of its worldwide centres.

Web site

The AEC web site has the following functionality:
Who we are: A short description of the company and its products and services.
Professional education courses: Course dates, locations and standard fees for professional examination courses. This schedule of courses is printable.
Continuing professional development: Course dates, locations and standard fees for CPD courses and seminars. This schedule is also printable.
CPD catalogue: Detailed course and seminar descriptions for CPD courses and seminars.
Downloadable study material: Extracts from a sample course manual. Visitors to the site wishing to access this material must register their email address, name and address. 5,500 people registered last year to download study material.
Purchase study material: Secure purchase of a complete manual set for the professional scheme. Payment is by credit card. On completion of successful payment, the visitor is able to download the manuals or to request them to be shipped to a certain address on a CD. At present, 10% of the people who view downloadable study material proceed to purchase.
Who to contact: Who to contact for booking professional training courses or CPD courses and seminars. It provides the name, email address, fax number, telephone number and address of a contact at each of the eight worldwide centres.

Marketing strategy

The marketing manager of AEC has traditionally used magazines, newspapers and direct mail to promote its courses and products. Direct mail is primarily used for sending printed course catalogues to potential customers for CPD courses and seminars. However, she is now keen to develop the potential of the Internet and to increase investment in this medium at the expense of the traditional marketing media. Table 1 shows the percentage allocation of her budget for 2008, compared with 2007. The actual budget has only been increased by 3% in 2008.

Table 1
Percentage allocation of marketing budget (2007–2008)

	2008	2007
Advertising	30%	40%
Direct mail	10%	30%
Sponsorship	10%	10%
Internet	50%	20%

Required:

(a) Explain, in the context of AEC, how the marketing characteristics of electronic media (such as the Internet) differ from those of traditional marketing media such as advertising and direct mail. (10 marks)

(b) Evaluate how the marketing manager might use electronic marketing (including the Internet) to vary the marketing mix at AEC. (15 marks)

(25 marks)

4 Introduction

Retail pharmacies supply branded medicinal products, such as headache and cold remedies, as well as medicines prescribed by doctors. Customers expect both types of product to be immediately available and so this demands efficient purchasing and stock control in each pharmacy. The retail pharmacy industry is increasingly concentrated in a small number of nationwide pharmacy chains, although independent pharmacies continue to survive. The pharmacy chains are increasingly encouraging their customers to order medicinal products online and the doctors are being encouraged to electronically send their prescriptions to the pharmacy so that they can be prepared ready for the patient to collect.

Pharmacy Systems International (PSI)

Pharmacy Systems International (PSI) is a privately owned software company which has successfully developed and sold a specialised software package meeting the specific needs of retail pharmacies. PSI's stated objective is to be a 'highly skilled professional company providing quality software services to the retail pharmacy industry'. Over the last three years PSI has experienced gradual growth in turnover, profitability and market share (see Figure 1).

Figure 1: PSI Financial information

	2007	2006	2005
Turnover ($000)	11,700	10,760	10,350
Profits ($000) (pre-tax)	975	945	875
Estimated market share	26%	24%	23%
Number of employees	120	117	115

PSI has three directors, each of whom has a significant ownership stake in the business. The chief executive is a natural entrepreneur with a past record of identifying opportunities and taking the necessary risks to exploit them. In the last three years he has curbed his natural enthusiasm for growth as PSI has consolidated its position in the market place. However, he now feels the time is right to expand the business to a size and profitability that makes PSI an attractive acquisition target and enables the directors to realise their investment in the company. He has a natural ally in the sales and marketing director and both feel that PSI needs to find new national and international markets to fuel its growth. The software development director, however, does not share the chief executive's enthusiasm for this expansion.

The chief executive has proposed that growth can best be achieved by developing a generic software package which can be used by the wider, general retail industry. His plan is for the company to take the current software package and take out any specific references to the pharmaceutical industry. This generic package could then be extended and configured for other retail sectors. The pharmaceutical package would be retained but it would be perceived and marketed as a specialised implementation of the new generic package.

This proposed change in strategic direction is strongly resisted by the software development director. He and his team of software developers are under constant pressure to meet the demands of the existing retail pharmacy customers. On-line ordering of medicinal products and electronic despatch of prescriptions are just two examples of the constant pressure PSI is under from their retail customers to continuously update its software package to enable the pharmacies to implement technical innovations that improve customer service.

Ideally, the software development director would like to acquire further resources to develop a more standardised software package for their current customers. He is particularly annoyed by PSI's salesmen continually committing the company to producing a customised software solution for each customer and promising delivery dates that the software delivery team struggle to meet. Frequently, the software contains faults that require expensive and time-consuming maintenance. Consequently, PSI is being increasingly criticised by customers. A recent user group conference expressed considerable dissatisfaction with the quality of the PSI package and doubted the company's ability to meet the published deadline for a new release of the software.

Required:

(a) The proposal to develop and sell a software package for the retail industry represents a major change in strategy for PSI.

Analyse the nature, scope and type of this proposed strategic change for PSI. (10 marks)

(b) The success of any attempt at managing change will be dependent on the context in which that change takes place.

Identify and analyse, using an appropriate model, the *internal contextual features* that could influence the success or failure of the chief executive's proposed strategic change for PSI. (15 marks)

(25 marks)

End of Question Paper