

UNIVERSITY OF BOLTON
INSTITUTE OF MANAGEMENT
MSC ACCOUNTANCY AND FINANCIAL
MANAGEMENT
SEMESTER 1 EXAMINATION 2019/2020
STRATEGIC BUSINESS LEADER
MODULE NO. ACC 7530

Date: Friday 17 January 2020

Time: 10.00 – 2.00

INSTRUCTIONS TO CANDIDATES:

There are THREE questions on this paper.

Answer all questions.

This examination is 4 hours.

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DIAMOND SHOES

Diamond Shoe Co Ltd manufactures and sells shoes in the country of Bernland. The company has strong values and aims to deal fairly in all business transactions.

The company has grown steadily since its inception in that late 19th century but is now facing significant competitive pressure from overseas suppliers and internet shopping.

In the light of this change in the external environment, the financial performance of the company has declined rapidly and as a result the directors have recently commissioned a firm of business analysts (Phoenix Consultants) to undertake a review of the Diamond Shoes business designed to help them understand the strategic position of the company.

As a result of the decline in recent performance, outcome of this review and the production of a SWOT analysis by the consultants, the directors are now considering their future strategy.

The following exhibits provide additional information relevant to Diamond Shoes:

Exhibit 1 – company history and background

Exhibit 2 – SWOT analysis of Diamond Shoes (extract from recent consultants review)

Exhibit 3 – email to FD concerning recent strategy discussions

Exhibit 4 – summary financial information

Exhibit 5 – extract from internal control report

Exhibit 6 – memo and email re website project

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The case requirements are as follows and you will be told which role you are taking in each task:

1 *You are a member of the external consultants team involved in the recent review of Diamond Shoes.*

The Board, alarmed by the results of the SWOT analysis, has requested that you provide them with more detailed information regarding the recent performance of the manufacturing division. The board is also concerned that given these results, it may not be wise to invest in the upgrade of the production facilities.

Required:

Prepare a briefing paper for the board meeting which:

(a) Analyses the financial performance and position of Diamond Shoes presented in the extracts of the financial statements (10 marks)

Professional skills marks are available for demonstrating *analysis skills* in considering the information presented and the impact on Diamond (4 marks)

(b) Evaluates the financial and non-financial issues of the proposed investment of \$37.5 million in upgrading its production facilities. (Ignore the time value of money) (10 marks)

Professional skills marks are available for demonstrating *commercial acumen* skills to demonstrate awareness of the impact of the proposed investment on Diamond. (4 marks)

(Total: 28 marks)

2 *You are a recently appointed Finance manager in Diamond Shoes.*

The FD has requested that you bring “a fresh pair of eyes” to the strategic options facing the business which can be determined from the recent SWOT analysis produced by the external consultants.

Required:

Prepare a report for discussion at the next board meeting which evaluates the alternative strategic options that Diamond Shoes could choose to secure its future position. (18 marks)

Professional skills marks are available for demonstrating *evaluation skills* in assessing the options presented and the impact of each on Diamond (4 marks)

(Total: 22 marks)

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- 3 A few days later the FD called you into his office and expressed concern that following your review of the strategic options resulting from the SWOT analysis, the purpose and direction of Diamond seemed to be misunderstood by the management and staff. He is worried that this misunderstanding may also permeate to external stakeholders e.g. Diamond's customers.

The FD has tabled an agenda item for the next board meeting to highlight the need to establish these key concepts to ensure all stakeholders clearly understand the purpose of the business.

Required:

Prepare a memorandum for the FD which explains the importance of mission, values and objectives in defining and communicating the strategy of Diamond Shoes to stakeholders and suggests how this might be achieved
(12 marks)

Professional skills marks are available for demonstrating communication skills in clarifying the need for a clear understanding amongst senior personnel and stakeholders of the future direction of Diamond

(4 marks)

(Total: 16 marks)

- 4 It is now three months later. A new chief executive has been appointed and is working closely with the board of directors and the Diamond Family to improve performance. The CEO is particularly concerned about the recently identified failures in internal control.

You are a new consultant employed by the CEO who has requested that you assist him in resolving these concerns.

Required:

A briefing paper for the CEO which:

- (a) Explains to the CEO why the internal control system at Diamond might be ineffective and identifies and explains the internal control deficiencies that led to the increased product failures
(12 marks)

- (b) Recommend specific measures which would improve information flow from the QC lab
(8 marks)

Professional skills marks are available for demonstrating scepticism and communication skills by basing explanations of significant control weaknesses and recommendations for improvement on the information provided
(4 marks)

(Total: 24 marks)

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- 5 The board is also concerned about the perceived failure of the new website project. He sees this project as a critical development for the future success of the business and wishes to present his view to the board at the next scheduled meeting.

You are a recently appointed Finance manager in Diamond Shoes.

Required:

Prepare TWO presentation slides, together with accompanying notes, for the CEO to present to the board which:

Identifies the potential problems with project management and outlines strategies available to address these identified problems in the website project

(8 marks)

Professional skills marks are available for demonstrating *communication skills* in presenting the points in the slides concisely and for supporting notes which will make the issues clear to the board

(2 marks)

(Total: 10 marks)

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Exhibit 1 - Extract from the current Diamond Shoes website:

Company background and values

Diamond Shoes was formed in 1895 by Richard and William Diamond, two brothers who owned and farmed land in Detatown, in the country of Bernland. At this time, Bernland was undergoing a period of rapid industrial growth and many companies were established that paid low wages and expected employees to work long hours in dangerous and dirty conditions. Workers lived in poor housing, were largely illiterate and had a life expectancy of less than forty years.

In contrast, the Diamond brothers held a set of beliefs that stressed the social obligations of employers. Their beliefs guided their employment principles – education and housing for employees, secure jobs and good working conditions. Diamond Shoes expanded quickly, but it still retained its principles.

Today, the company is a private limited company whose shares are wholly owned by the Diamond family. Diamond Shoes still produce and supply footwear to retailers in Detatown. They now also own almost one hundred retail shops throughout Bernland selling their shoes and boots. The factory (and surrounding land) in Detatown is owned by the company and so are the shops, which is unusual in a country where most commercial properties are leased. In many respects this policy reflects the principles of the family.

The original Diamond family were keen to promote private ownership and were averse to risk and borrowing. They believed that all stakeholders should be treated fairly. The current Diamond family are still passionate about the beliefs and principles that inspired the founders of the company.

Although the Diamond family still own the company, it is now totally run by professional managers. The last Diamond to have operational responsibility was Jock Diamond, who commissioned and implemented the last upgrade of the production facilities some 15 years ago. In the past five years the Diamond family has left the running of the company entirely to the professional managers that they appointed.

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Exhibit 2

PHOENIX Consultants



REPORT EXTRACT – SWOT ANALYSIS:

Strengths

Significant retail expertise: recognised as a successful retailer with excellent supply systems, bright and welcoming shops and shop employees who are regularly recognised, in independent surveys, for their excellent customer care and extensive product knowledge.

Excellent computer systems/software expertise: innovative computer systems developed in-house by the company's information systems department. These systems not only concern the distribution of footwear, but also its design and development.

Research and development: acknowledged, by the rest of the industry, as a leader in computer-aided footwear design and distribution.

Significant property portfolio: The factory in Detatown is owned by the company and so is a significant amount of the surrounding land. All the retail shops are owned by the company.

Weaknesses

High production costs: Bernland is a high labour cost economy.

Out-dated production facilities: The actual production facilities were last updated 15 years ago. Current equipment is not efficient in its use of either labour, materials or energy.

Restricted internet site: Software development has focused on internal systems, rather than internet development. The current website only provides information about Diamond Shoes; it is not possible to buy footwear from the company's website.

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Exhibit 2 continued

Opportunities

Increased consumer spending and consumerism: Despite the decline of its manufacturing industries, Bernland remains a prosperous country with high consumer spending. Consumers generally have a high disposable income and are fashion conscious.

Product development: Parents spend a lot of money on their children, with the aim of 'making sure that they get a good start in life'.

Increased desire for safe family shopping environment: A recent trend is for consumers to prefer shopping in safe, car-free environments where they can visit a variety of shops and restaurants. These shopping villages are increasingly popular.

Growth of the green consumer: The numbers of 'green consumers' is increasing in Bernland. They are conscious of the energy used in the production and distribution of the products they buy. These consumers also expect suppliers to be socially responsible. A recent television programme on the use of cheap and exploited labour in Ontaria was greeted with a call for a boycott of goods from that country. One of the political parties in Bernland has emphasised environmentally responsible purchasing in its manifesto. It suggests that 'shorter shipping distances reduce energy use and pollution. Purchasing locally supports communities and local jobs'.

Threats

Cheap imports: The lower production costs in other countries provide a constant threat. It is still much cheaper to make shoes in Ontaria, 4000 kilometres away, and transport the shoes by sea, road and train to shops in Bernland, where they can be offered at prices that are still significantly lower than the footwear produced by Diamond Shoes.

Legislation within Bernland: Bernland has comprehensive legislation on health and safety as well as a statutory minimum wage and generous redundancy rights and payments for employees. The government is likely to extend its employment legislation programme.

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Exhibit 2 continued

Political change: One of the most popular political parties in Bernland has emphasised environmentally responsible purchasing in its manifesto for the forthcoming general election. It has also stated that it would be keen to support local businesses to further develop their presence in the latest technological and environmentally friendly production methods. This presents both a threat and an opportunity for Diamond.

As previously stated shorter shipping distances will have a beneficial effect on energy use and therefore pollution. In addition, purchasing locally supports communities and local jobs. To ignore this political change therefore will be potentially detrimental to the brand and reputation of Diamond.

Exhibit 3

Email

From: CEO

To: FD

Subject: Recent board meeting

Date: Today

As you will be aware, senior management have recently suggested that the company should consider closing its Detatown production plant and move production to another country perhaps outsourcing to established suppliers in Ontario and elsewhere.

This suggestion was immediately rejected by the Diamond family, who questioned the values of the senior management. The family issued a press release with the aim of re-affirming the core values which underpin their business. The press release stated that 'in our view, the day that Diamond Shoes ceases to be a Detatown company, is the day that it closes'.

Consequently, the senior management team was asked to propose an alternative strategic direction.

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Senior Management Strategic Proposal

- The senior management team's alternative is for the company to upgrade its production facilities to gain labour and energy efficiencies.
- The cost of this proposal is \$37.5m.
- At a recent scenario planning workshop the management team developed what they considered to be two realistic scenarios. Both scenarios predict that demand for Diamond Shoes' footwear would be low for the next three years. However, increased productivity and lower labour costs would bring net benefits of \$5m in each of these years.

After three years the two scenarios differ.

- The first scenario predicts a continued low demand for the next three years with net benefits still running at \$5m per year. The team felt that this option had a probability of 0.7.
- The second scenario (with a probability of 0.3) predicts a higher demand for Diamond's products due to changes in the external environment. This would lead to net benefits of \$10m per year in years four, five and six.
- All estimated net benefits are based on the discounted future cash flows.

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Exhibit 4

Summary Financial information:

The following financial information (see Figure 1) is also available for Diamond Shoes.

Figure 1: Extracts from the financial statements of Diamond Shoes (20X5 – 20X7)

Extracted from the statements of profit or loss
 (all figures in \$m)

	20X7	20X6	20X5
Revenue	700	750	850
Cost of sales	(575)	(600)	(650)
Gross profit	125	150	200
Administration expenses	(95)	(100)	(110)
Other expenses	(10)	(15)	(20)
Finance costs	(15)	(10)	(5)
Profit before tax	5	25	65
Income tax expense	(3)	(7)	(10)
Profit for the year	2	18	55

Extracted from statements of financial position (all figures in \$m)

Trade receivables	70	80	90
Share capital	100	100	100
Retained earnings	140	160	170
Long term borrowings	70	50	20

In 20X5, Diamond Shoes paid, on average, their supplier invoices 28 days after the date of invoice. In 20X6 this had risen to 43 days and in 20X7, the average time to pay a supplier invoice stood at 63 days.

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Exhibit 5

Extract from Internal Control Report

The Board commissioned an internal control review as a result of a recent increase in products failing the final quality checks.

An extract of the results of this report are noted below:

Identified weakness

Checks are carried out in the QC (quality control) laboratory, which tests finished goods products before being released for sale. It was noted that the product failure rate had risen from 1% of items two years ago to 4% now, meaning an increase of hundreds of items of output a month which were not sold on to customers. These failed products have no value to the company once they had failed QC as the rework costs involved were not economic.

Because the increase was gradual, it took a while for the Operation Director to realise that the failure rate had risen.

Outline of review process undertaken

A thorough review of the main production operation revealed nothing that might explain the increased failure and so attention was focused instead on the QC laboratory. As a result it was decided to interview some of the members of staff directly involved in the process.

Extract of interview with the Operation Director:

For some years, the QC laboratory, managed by Miss G, had been marginalised in the company, with its two staff working in a remote laboratory well away from other employees.

The Operations Director stated:

“Although I was directly involved in the design of the internal control systems in Diamond, I rarely visited the QC lab because of its remote location”.

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Exhibit 5 continued

On further questioning it was established that the Operation Director never routinely asked for information on product failure rates to be reported to him and did not understand the science involved in the QC process. He relied on the two QC staff, Miss G and her assistant Mr Z, both of whom did have relevant scientific qualifications.

Extract of interview with the two QC staff

Both Miss Hand Mr Z considered themselves low paid. Whilst in theory they reported to the Operations Director, in practice, they conducted their work with little contact with colleagues.

Miss H stated "The work is routine and involves testing products against a set of compliance standards. A single signature on a product compliance report was required to pass or fail in QC and these reports were then filed away with no-one else requesting access to verify the accuracy of the process"

It was eventually established that Miss G had found a local buyer to pay her directly for any of Diamond's products which had failed the QC tests. It was further established that the increased failure rate had resulted from her signing products as having 'failed QC' when, in fact, they had passed.

Miss H made that following statement. "I kept the proceeds from the sales, and also paid my assistant Mr Z, a proportion of the proceeds from the sale of the failed products"

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Exhibit 6

Email re emergency board meeting - Failures in website project

To: FD From:

CEO Date:

Today

Subject: New website project

As you will note from the attachment, the board is very concerned at the progress of our new website as they see this as a key strategy for our future growth.

The board have requested that we consider how to address the issues identified and prepare a presentation for the board in advance of the meeting with the project manager addressing the strategies available to Diamond to address the issues in the website project regarding project constraints.

You will appreciate that this information is required asap.

Attachment:

Update on the website project:

As you are aware, the Board has given the go-ahead to redesign Diamond's website to make it more convenient for customers to use.

The project is currently at week 12 and problems have been identified with the functionality of the new site and the fact that it is not easy to navigate. The Project Manager has expressed concern about the rising costs of the project and the time needed to improve the functionality. He estimates that the change to the functionality will delay the project by three weeks. He understands that improved customer satisfaction (by making the website easy to use) is important.

The Board has had feedback from the project team members who have complained that there has been a lack of visibility of the project manager. Team members have said that they were unaware of any deadlines as they had not been shown any plan or schedule of work and this had made it difficult to prioritise tasks and understand how they can contribute to the project.

The Board has called an emergency meeting with the Project Manager in order to come up with some immediate solutions which address the project slippage.

END OF PAPER