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THE INSTITUTE OF  
**CHARTERED** ACCOUNTANTS  
OF SRI LANKA

# **SUGGESTED SOLUTIONS**

**KB5 – Business Value Creation**

**December 2017**

# SECTION 1

## Answer 01

<b>Relevant Learning Outcome/s: 1.3</b>
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Stakeholders
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Study text reference: Pages 18 and 19
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(a)

- **Employees of ABC** – have high interest but low power. However if the employees get together and form a union they could have high power.

Therefore employees of ABC should be kept informed about the activities of the company.

- **People-Watch** – have high interest and a high level of power. ABC should consider their request to improve the work environment in the manufacturing premises. If not they might create a very bad reputation of the company within the general public.

Therefore the management of ABC should consider the views of People-Watch very carefully when taking decisions.

- **Customers of ABC and the public**

Customers are the key players of any organisation. They have high power as well as high interest over the organisation. Customers of ABC will get to know that the company is not providing the required health and safety measures for its employees on the production floor due to the bad publicity on social media sites regarding the current issues of ABC. As a result they will be reluctant to buy ABC products.

Therefore the management of ABC should consider the views of People-Watch very carefully when taking decisions.

- **Regulatory authorities, government and labour department** – have high power but a low level of interest. They can influence the organisation by taking legal action against the company for not meeting the adequate health and safety measures for the employees. Stakeholders in this segment must be treated with care.

Therefore ABC should keep them satisfied by complying with the required standards and ensure that the regulations of the country are met. It should also change its approaches if regulations are changed, in order to prevent these stakeholders from becoming interested.

		Level of interest	
		L	H
Power	L		Employees
	H	Regulatory authorities, government and labour department	Customers, general public and People-Watch

(b)

- **Legal responsibility** – it is essential that ABC complies with the relevant rules and regulations of the country as well as the health and safety measures adopted by the country for labourers who work, especially in factories. It should also implement any changes if these rules and regulations are changed.
- **Social responsibility** – this involves being a good corporate citizen and making a positive contribution to society. As a good corporate citizen and socially responsible entity, ABC needs to consider implementing the changes recommended by People-Watch by providing the required facilities at the workplace. Also it has a social responsibility towards the environment when producing plastic products as its final output. ABC should try its level best to reduce the impact to the environment when using plastics.
- **Economic responsibility** – this involves making profits and providing an acceptable return to shareholders. Thus in any decision ABC makes, it has to ensure that this objective is achieved.

**(Total: 10 marks)**

## Answer 02

<b>Relevant Learning Outcome/s: 2.3</b>
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Physical distribution and logistics systems
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Study text reference: Page 47
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(a)

- **Location of warehouses** – QPL needs to decide whether it should have one central warehouse or many. The aim is to reduce delivery times and costs. If for example QPL has outlets in many locations and also distributes to many locations, it might need many warehouses.
- **Method of transport** – this determines how goods will be transported; by road, rail, sea, or air. For example if goods are imported, what mode is used for transportation within the country has to be determined by QPL.
- **Size of transport vehicle** – whether QPL should use large transport vehicles to transport goods.

(b) A warehouse management system (WMS) is an IT system for controlling the movement and storage of goods within a warehouse and processing associated transactions such as receiving goods, putting them away, picking goods for shipment and shipping them. A WMS monitors the progress of products through the warehouse.

- An efficient WMS helps companies to reduce costs by minimising the amount of unnecessary inventory held in store. It also helps companies to keep lost sales to a minimum level by having enough inventory on hand to meet demand.
- A WMS can be used for modeling the physical storage facilities in the warehouse such as racking and location of racks. For example, if certain products are often sold together or are sold more often than others, they can be grouped together or placed near the delivery area to speed up the process of picking, packing and shipping to customers.
- A WMS provides an automated link between order processing and logistics management in order to pick, pack and ship products from the warehouse.
- RFID or bar coding can be used to track where products are held, which suppliers they come from, and the length of time they are stored. A WMS then provides management with an analysis of this data to control inventory levels and maximise the use of warehouse space.

**(Total: 10 marks)**

## Answer 03

<b>Relevant Learning Outcome/s: 6.4 and 6.5</b>
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6.4 – Managing research and development
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6.5 – Managing innovation
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Study text reference: Pages 293 and 294
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(a)

1. **Organisation and management** – when R&D is a separate department, there may be problems with the coordination of R&D activity with other departments such as production and marketing.
2. **Financial** – it is difficult to set financial performance targets for R&D at the outset as it is difficult to plan in advance. Since R&D could be complex and take a long time to materialise, it would be difficult to assess uncertain returns and it would also pose challenges in controlling costs.
3. **Evaluation and control** – whether it is applied or pure research, it would be difficult to assess the value of the work to the company.
4. **Cultural issues** – unless the organisation has a culture that promotes innovation, short-term commercial targets, bureaucracies and conservativeness could hinder R&D efforts of the company.
5. **Uncertainty** – there is uncertainty regarding the outcome.

(b) The pace of technology change is fast. All companies are affected by change to a greater or lesser extent, and unless the companies are able to respond to change and innovate where appropriate, they could lose their competitive edge in the market.

Innovation is important to a business in two main ways. It not only provides new products to the market to continuously entice the customer, it also improves product and process performance by developing new ways of manufacturing or delivering a service. Innovation is not always about developing something completely new; it could also be making incremental improvements to products and services and creating value. This would enable the company to position itself as a forward-looking company and continuously entice customers with a unique selling proposition.

On the other hand, innovation can also provide completely new products or services that a company can take to the market first. Hence, innovation could provide a company with a first mover advantage, whereby the company penetrates the market faster and demands a higher price with a healthy margin. However, for how long they could sustain the same would depend on the ability of its competitors to provide similar or completely new innovations to the market that could substitute for the existing product. Therefore it is important for companies to continuously innovate to stay ahead of their competition.

**(Total: 10 marks)**

## Answer 04

<b>Relevant Learning Outcome/s: 3.2 and 3.3</b>
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3.2 – Product design and process selection
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3.3 – Quality management
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Study text reference: Pages 78 and 81
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- (a) **Batch production** – this manufacturing process produces a quantity or batch of an item, and every item in the batch is same. It may produce batches of similar but slightly different products, which will result in a higher unit production cost compared to that of chain manufacturing.

**Chain manufacturing** – this method is used largely either in the mass production of a standard item, or the continuous production process of a high volume item. Key features of this type of manufacturing are high volume of standard output and low unit production costs.

- (b) **Four elements of quality costs**

- Prevention costs – costs incurred to prevent defective items or reduce the number of defects (e.g. inspection of fruits before using them to make jam)
- Inspection and testing costs (appraisal cost) – costs incurred to inspect and test output (e.g. supervisor checking the jam to see if it has been made appropriately, tasting it)
- Internal failure costs – costs incurred in correcting defective items that are found through inspection and testing (e.g. jam that is thrown away due to its poor quality)
- External failure costs – costs incurred in dealing with complaints from customers about defective items that have escaped detection in the inspection process and have been sold to customers (e.g. loss of customer orders, return of jam bottles from shops).

### **How to minimise quality cost**

Since inspection costs and costs of correcting errors do not add value, they should be avoided entirely. The aim should be to achieve zero defects in production.

**(Total: 10 marks)**

## Answer 05

<b>Relevant Learning Outcome/s: 5.7</b>
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Managing culture and change
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Study text reference: Page 243
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- (a) Based on the scenario it can be observed that AAL has a power culture. This is because power is concentrated with Arun. He makes all the decisions as he is the owner of the business and does not allow employees to raise their opinions. This implies that there is autocratic decision making. Further, power cultures have few formal rules, which also can be seen at AAL.
- (b) AAL is in the business of developing advertisements and providing other marketing services to clients. This requires a lot of creativity and designing skills. Since the employees are talented individuals they need some freedom to develop marketing solutions. Therefore a task culture is recommended. This encourages power and authority of individuals based on their expertise and knowledge. It might also prevent them from leaving AAL and also make them involved in business activities.

**(Total: 10 marks)**

## Answer 06

### Relevant Learning Outcome/s: 7.3, 7.4 and 7.7

7.3 – Formulation of business level strategy

7.4 – Evaluation and implementation of business level strategy

7.7 – Monitoring and control

Study text reference: Pages 258, 328, 341 and 345]

- (a) Tastycola is expected to expand the existing production capacity by setting up new production facilities in order to achieve economies of scale. It focuses on the mass market and currently operates under intense competition as a few large firms sell similar products at similar prices.

In the soft drink industry there is little opportunity to differentiate. Tastycola is unable to differentiate its production under Option 1 since it is expecting to expand the same production for the mass market. Due to high market competition, customers are also very conscious about the price of the product.

Therefore the No Frills strategy under Bowman's Strategy Clock is the most suitable strategy for this expansion option.

The No Frills strategy combines a low price with low perceived product benefits. It is suitable for a product/market where customers are very price conscious. It is also suitable for markets where there is little opportunity for competition on product features.

- (b) Porter suggested that there are three generic strategies for competitive advantage, and in order to be successful a company must choose only one of these strategies.

1. Cost leadership
2. Differentiation
3. Focus

Cost leadership – according to this strategy the business seeks to achieve the position of the lowest cost producer in the industry as a whole. It can charge the same price as its competitors, knowing that this would enable it to generate a bigger profit per unit, or it can charge a lower price than the competitors.

Differentiation – the aim of the differentiation strategy is to convince consumers in the market to buy the product due to its distinctive characteristics. The distinctive features of the product add value to the customers.

Focus strategy – this strategy focuses on being the cost leader or achieving product differentiation in a particular targeted segment or niche market. Here the business concentrates its attention on one or more particular segments or niches within the total market, and does not try to serve the entire market with a single product.

By analysing the above generic strategies it is advisable for Tastycola to implement a focus strategy when implementing Option 2, since Tastycola has identified that there are some consumers who now seek soft drinks made from natural ingredients without any preservatives or sugar. Currently such products are not supplied in the domestic market



Alternatively

*This product seems to have a high perceived value and thereby could be considered a niche market product. Since it is new to the market it might come under a focused differentiation strategy.*

- (c) (i) No one leadership style is best for all situations, but it is useful to understand what your natural approach is, so that you can develop skills that you may be missing. It is unwise to neglect either tasks or people, but equally, a compromise between the two approaches will likely result in only average team performance, because you neither meet people's needs nor inspire excellent performance.

The Blake Mouton Managerial Grid is a popular framework for thinking about a leader's "task versus person" orientation.

The grid is based on two behavioral dimensions:

- **Concern for people:** this is the degree to which a leader considers team members' needs, interests and areas of personal development when deciding how best to accomplish a task.
- **Concern for production:** this is the degree to which a leader emphasises concrete objectives, organisational efficiency and high productivity when deciding how best to accomplish a task.

<b>Concern for people</b>	High	1.9 Country club	9.9 Team
	Low	1.1 Impoverished	9.1 Task
		Low	High
		<b>Concern for production</b>	

According to the scenario given, the CEO of Tastycola (Ramesh) seems to be more concerned on the task (production) than people. People in this category believe that their team members are simply a means to an end. The team's needs are always secondary to productivity. This approach can drive impressive production results at first, but low team morale and motivation will ultimately affect people's performance. Ramesh makes his own decisions expecting compliance from his staff. He pays more attention to achieving results, ignoring the subordinates' needs. This might enable quick decisions but might demotivate staff. So his leadership style comes under Task according to the Blake Mouton Managerial Grid.

Suresh in contrast appears to be a leader who 'consults', as he makes decisions upon consultation with his team. He is attentive to staff needs and has developed satisfying relationships with his subordinates. He pays little attention to achieving results. So in his leadership style he pays more attention to people and less attention to tasks. His leadership skills come under Country Club according to the Blake Mouton Managerial Grid. The Country Club or "accommodating" style of manager is most concerned about his/her team members' needs and feelings. He assumes that, as long as the team members are happy and secure, they will work hard. What tends to be the result is a work environment that is very relaxed and fun, but where productivity suffers because there is a lack of direction and control.

(ii) Recommended strategy should be Team Management. The reason is in the present competitive environment, the company should focus on production to achieve a high level of productivity. At the same time, the company should also keep the experienced employees to get maximum output without giving opportunities to competitors to recruit its experienced employees.

(d) **Financial KPIs**

- Increase in net profit margin, increase in Return on Assets (e.g. 5% by 2019)
- Increase in sales volume, ROI, profitability (e.g. 10% by 2019)

**Non-financial KPIs**

- Increase in the number of positive public opinion (e.g. 10% by 2019) feedback reduction in number of defects (e.g. 10% by 2019)
- Reduction in customer complaints, increase in market share (e.g. 5% by 2019)

**(Total: 25 marks)**

## Answer 07

<b>Relevant Learning Outcome/s: 4</b>
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Value creation through marketing
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Study text reference: Pages 122, 123, 163 and 171
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(a) (i) **Appropriate target markets**

According to the details given in the scenario, the following characteristics of the two airlines can be identified.

Airline 1 – it only has a few number of jets. When looking at the facilities provided by the airline it shows that passengers are provided more spacious comfortable seats, variety in selecting food and beverages, and freely available entertainment. More luggage can be taken without paying any additional fees.

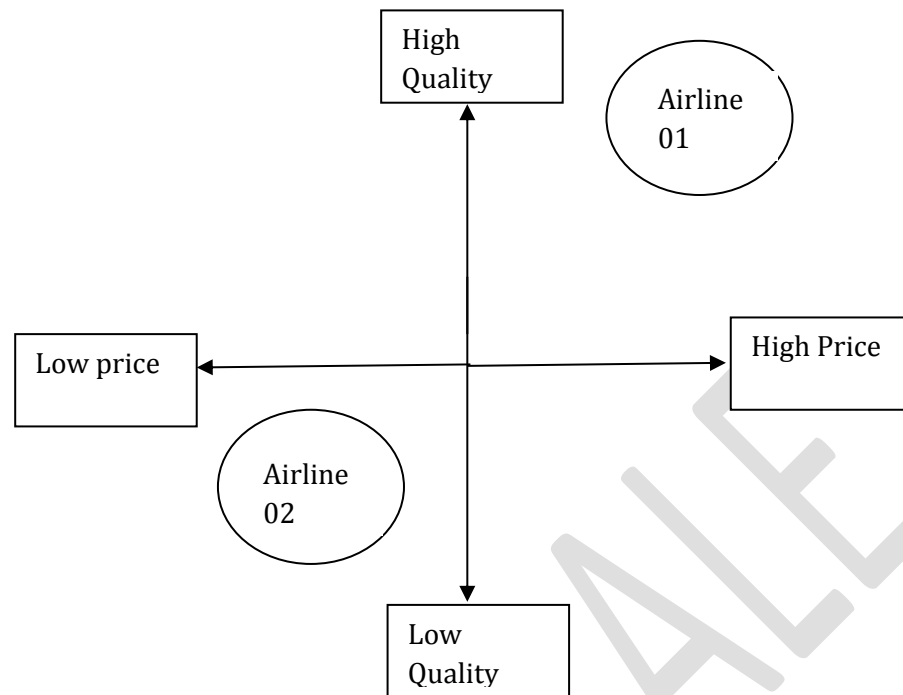
Airline 2 – it has a large number of jets, which only have economy class and budget seats. Budget passengers have to pay for checked-in luggage and meals. Economy class passengers can choose their meals from a pre-set menu and only one luggage can be checked in. Based on the facilities offered by the two airlines it seems that they can segment the market based on the level of income of the passengers.

Accordingly, the following target markets can be recommended for the two airlines.

Airline 1 can be targeted to the **high-income earners** and Airline 2 can targeted to **low-income earners**.

- (ii) When considering the facilities provided by Airline 1, it is more concerned about providing a quality service at a higher price. Therefore Airline 1 can be positioned as a 'premium service provider' in the market.

Airline 2 is catering to budget travelers at a lower cost by providing limited resources or facilities. If they need meals and extra facilities it will be provided at a fee. So Airline 2 can be positioned as 'economy' (low quality, low price).



- Recommend two segments with justification
- Suggested positioning for two products with positioning map

(b) **Marketing mix for Airline 1**

**Product** – jets with luxury facilities, providing quality service in the cabin.

**Pricing** – should have a market skimming pricing strategy (high price). Price discrimination can be applied with premium prices for suites, high prices for deluxe, and above average prices for premium economy classes.

**Place** – place means the location of service touch points. The airport, ticket counters etc. should be located everywhere. Therefore it should be at the airport in Singapore and other premium destinations. Tickets can be bought from the head office, travel agents and online.

**Promotion** – advertising in the media to reach premium customers, online promotions and personal selling.

**People** – front office employees and cabin crew should be professional and provide a courteous professional service.

**Process** – the processes from ordering, checking-in, checking-out, entertainment, and all other services should be provided efficiently and safely (better to introduce special checking counters and ground handling processes).

**Physical evidence** – since the airline is targeting high-income consumers, the ambience will need attention. The place has to be attractive, calm and have all the facilities expected by such consumers. Picking a colour code would be beneficial, for example deluxe can be one colour scheme (e.g. use a flower or a bird as the theme), with suites having another.

- (c) CRM is the establishment, development, maintenance and optimisation of long-term, mutually valuable relationships between consumers and organisations. To develop a relationship with customers, it is not sufficient to simply gather information about them. This information should be put to use in a way that strengthens the bond between the company and customer.
- Dealing with industrial customers – the company could communicate with industrial customers regularly. They can use information obtained about customers' future intentions and buying preferences to make selling propositions (e.g. arranging tour packages for corporates).
  - Dealing with repeat customers for consumer goods or services – the company can have a record of customers' details and their preferences, so that if there are any sales promotions to travel certain countries, they can inform the customers about these promotions well in advance.
  - Using knowledge about the customer to improve the service – if Sunny Travels PLC is able to establish a database of its customers, it will encourage customer loyalty and repeat purchases.
  - Using knowledge of the customer to send personalised sales promotions – the company can use its knowledge of customers to send personalised communications to them by emails or letters, providing information about new products, sales promotions etc.
  - Improve customer loyalty by showing that the company knows about the customer personally.
  - Analyse information to understand more about the customers to satisfy their needs.

**(Total: 25 marks)**

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