

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

KB5 – Business Value Creation

December 2019

SECTION 1

Answer 01

Relevant learning outcome/s: 1.2

Value creation process.

Study text reference: Pages 4, 8 and 9

(a)

- **Inbound logistics** – inbound logistics refers to receiving materials from suppliers, handling and storing them, and distributing them to the production departments. Being a yoghurt manufacturing company, its main raw material is milk. Milkycoo collects milk from farmers and stores it in its cooling rooms per the health and safety standards. It is evident that this has added value as the quality is ensured and wastage is minimised. When the production department requests the raw materials, they are delivered to the production floor.
- **Operations** – this involves making the yoghurt – converting milk and other ingredients into yoghurt, which is then followed by quality control, labelling and packaging, before the goods are delivered to customers.
- **Outbound logistics** – this involves storing finished goods and distributing them to customers. Yogurts are stored in a separate warehouse and Milkycoo distributes them to nearby supermarkets as and when required. This too has to be done to ensure the quality of the yoghurt is preserved, and these activities generate value.
- **Marketing and sales** – this involves informing customers about the product and persuading them to buy it. Milkycoo has mainly done this through advertising and sales promotions, which helps to increase sales, and this is considered a value generating activity.
- **Service** – this involves providing services to customers after the delivery of the goods. After sales services, customer support and helpline are a few examples. According to the given scenario, these kinds of services are not required by the customers of Milkycoo, since this is a consumer good.

(b)

- HRM will be concerned with ensuring Milkycoo has suitable, trained and skilled people to carry out operations. Thus, having HRM will ensure that the recruitment, training and rewarding of staff is done in such a way that it ensures high quality, efficiency and effectiveness in/of the work done.
- Procurement – this ensures that the required quality inputs are obtained at the right time, at an economical price. It ensures that there are no delays and the produced goods are of high quality. Efficient, effective and economical procurement systems add value to the organisation.

(Total: 10 marks)

Answer 02

Relevant learning outcome/s: 2.2

Inventory management and warehousing.

Study text reference: Pages 47 and 48

(a)

Inventory management ensures that materials are available when needed for production (or for other purposes) without incurring delays with regard to placing an order with a supplier and waiting for delivery. Similarly, finished goods are held to ensure that customer demand is met immediately without the need for them to wait till the goods are produced. This will help to prevent pile-ups and shortages of inventory.

- Rainyday does not record and monitor its inventory levels properly. As a result, there are non-moving stocks in the warehouse. Due to holding of unnecessary stock in the warehouse, the company has capacity issues in the warehouse, and it needs to hire extra space during peak seasons. Holding unnecessary inventory results in costs, and these costs do not necessarily generate value.
- At the same time, in some instances, certain inventories are out of stock when they are requested by the factory for production. As a result there are a lot of complaints relating to delays in production.
- Though the company maintains bin cards to update the finish goods inventory, it is not accurate.
- It was observed that many of the materials bought were damaged due to bad warehousing and there were many complaints from distributors about umbrellas being of poor quality.

Therefore inventory management is very important for Rainyday since it helps the company to record and monitor inventory levels properly. Apart from that, it will help the company to keep inventory costs to a minimum (by preventing excessive inventory but without unacceptable delays).

(b)

A warehouse management system (WMS) is an IT system for controlling the movement and storage of goods within the warehouse.

- An efficient WMS helps companies to reduce costs by minimising the amount of unnecessary inventory. A WMS provides an automated link between order processing and logistics management in order to pick, pack and ship products from the warehouse. Since Rainyday has no link between its production departments, when purchasing the raw materials there are lot of unnecessary stock in the warehouse. With the WMS that issue can be rectified since the system could easily link the production requirements with the purchasing department and the suppliers.
- A WMS can be used for modelling the physical storage facilities in the warehouse (racking and location of racks etc.). For example, certain products that are often sold together or are sold more often than others can be grouped together or placed near the delivery area. Finished goods in high demand can be separately stored, so that they can be easily picked and shipped to customers.
- A RFID or barcodes 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 the management with an analysis of this data to control inventory levels and maximise the use of warehouse space. Rainyday already has issues with regard to capacity in its warehouse due to poor utilisation of space. This problem can be resolved by using a WMS system.
- A WMS will ensure that once raw materials are received they are checked properly to ensure quality and then stored carefully in a manner that will enable easy retrieval. This will prevent unwanted costs and wastage of raw materials. The same applies for finished goods – they are stored safely and in a manner that enables quick dispatch.
- A WMS creates value by allowing efficient planning of operations and control.
- A WMS will ensure proper maintenance of records, which ensures inventory records and orders are done properly. This will help the monitoring and control of inventory levels so that there are no shortages or excessive inventory; and this reduces the cost of having too much inventory or damages caused to inventory.

(Total: 10 marks)

Answer 03

Relevant learning outcome/s: 3.3

Quality management.

Study text reference: Pages 81 – 89

(a) Quality costs consist of four elements.

- Prevention costs – these include arrangements to prevent defective items or reduce the number of defectives. Improvements to the manufacturing processes of pharmaceuticals, training of workers, quality engineering, statistical process controls etc.
- Inspection and testing costs – these include the costs of inspecting and testing output to identify defective items or batches. Identification of defective products involves having a team of inspectors.
- Internal failure costs – these include the costs of correcting defective items that are found by inspection and the testing process. Examples of internal failure costs include cost of rework, rejected products, scrap etc.
- External failure costs – these include the costs of dealing with complaints from customers about defective items that have escaped detection in the inspection process and have been sold to customers. The shipment of defective products can dissatisfy customers, damage goodwill and reduce sales and profits. The company had to pay a fine of Rs. 5 million due to various complaints made by customers.

(b) Six Sigma is a quality programme designed to reduce costs, defects and help lower costs, save time and improve customer satisfaction. Key features of the Six Sigma approach include the following.

- Six Sigma's aim is to avoid waste and inefficiency, thereby increasing customer satisfaction by delivering what the customer is really expecting.
- Project teams are established to achieve the required improvements in processes. These project teams consist of representatives from every department or aspect of operations that might contribute towards making the required improvements.
- Acceptable standards are established to see whether the required quality standards have been achieved.
- The Six Sigma approach is based on statistical standards that establish a goal of no more than 3.4 defects per million units or procedures.
- The higher the Sigma value, the fewer the deviations (i.e. fewer the defects).
- The Six Sigma approach relies heavily on statistical measurements. Actual performance is measured and compared with the target.

(Total: 10 marks)

Answer 04

(a)

Relevant learning outcome/s: 6.3

E-business

Study text reference: Pages 284 and 285

- The subscription model – this enables Knowledge Hub to collect a subscription fee from consumers who access the website that has the content (including magazines, journals and other material). It could charge a fee, which varies with the amount of material the consumer accesses (more access to content could be provided at a higher fee).
- The advertising model – this will enable Knowledge Hub to provide newsletters and journals to consumers without a price. It earns revenue from advertising by providing marketing and advertising services to companies.
- Merchant model – this involves using the Internet to sell goods and services. Customers are able to order the items online and also pay for it online. The products can be delivered digitally.

(b)

- Value proposition – how will providing newsletters and other content online provide value for customers? Would customers find it more beneficial than traditional print media?
- Revenue – how will it generate revenue for Knowledge Hub? Is it by advertising or by subscriptions, or a mix of both?
- Market opportunity – the company should consider the market and its segmentation. What are the commercial opportunities that exist in this market? What is the potential size of the market?
- Competitive environment – how many competitors offer the same service using e-commerce? If many exist it might be hard for Knowledge Hub to compete.
- Competitive advantage – what can the company offer to customers that competitors cannot?
- Management team – who will be responsible for the e-commerce operations? Would a new manager be needed?
- Market strategy – how does Knowledge Hub intend to enter this market? How will it be positioned in the target market?
- Organisation of operations – how will Knowledge Hub organise work to deliver the services? What changes are needed to operational procedures? Since this is a new way of doing business the company should first study the background of the new operations, and new processes should be added.

(Total: 10 marks)

Answer 05

(a)

Relevant learning outcome/s: 5.3	
Talent attraction and retention.	
Study text reference: Page 190	
Advantages of internal recruitment	Advantages of external recruitment
Internal promotion can improve the morale and motivation of the workforce.	The organisation may not have employees with the skills required for the job.
Internal recruitment provides a career development opportunity to existing employees. Career development helps with talent retention.	External recruitment may introduce 'fresh thinking' and new ideas to the organisation.
Existing employees have a performance record, as such the employer would already know about their strengths and weaknesses. Making internal appointments may therefore be less risky than external appointments.	There may not be an existing employee who is the right person for the job. Appointments to senior management positions, for example, are often made by external recruitment. Similarly, appointments of talented individuals for career progression are often external – from business schools and universities.
The employees may already know the people they will be working with, if they are successful in getting the job.	There may be more vacancies than there are candidates to fill by internal promotion.
Internal promotion is an inexpensive method of recruitment – avoiding the costs of advertising or recruitment consultants' fees. Internal recruitment may also be much quicker.	The vacancies may be for junior jobs that existing employees do not want to apply for.

(b)

Stages in a socialisation process

The process of socialisation and getting new employees to fit into the organisation happens in three stages.

Stage of socialisation	
Before joining the organisation	Employers use the selection process, especially selection interviews, to inform the individual about the organisation and what will be expected from them. Interviews are also intended to ensure that the organisation employs the 'right type' of person, who seems likely to fit in well.
On first joining	<p>On first joining the organisation, new employees will have ideas about what to expect. Reality may match these expectations, or the job may not be what the individual was expecting.</p> <p>When the employee's expectations differ from reality, a socialisation process is needed to make the individual familiar with the organisation's standards, methods and culture.</p> <p>If the new employee remains unhappy, they will resign.</p>
Familiarisation	<p>After the employee has joined the organisation, the socialisation process should begin. The process ends only when the new employee:</p> <ul style="list-style-type: none">• Is comfortable in the organisation and in his/her work team.• Has internalised the 'norms' of the organisation and their fellow workers.• Feels accepted and valued.• Understands the job, and also the rules, procedures and informal practices of the organisation.• Knows what is expected of them in the job.

As new employees settle into the company, their productivity will improve.

(Total: 10 marks)

SECTION 2

Answer 06

Relevant learning outcome/s: 4.3, 4.7 and 4.5

4.3 Managing products and brands

4.7 Managing the product life cycle.

4.5 Distribution and channel management.

Study text reference: Pages 133, 139, 140, 155 – 157

- (a) The new herbal shampoo is in the introduction stage of the product life cycle, and its marketing mix could be designed as follows.

Product: Develop a product that meets the needs of customers in a target market. If the product is very new, this may be difficult and the first producers may not get the product features 'right' the first time. At this stage, there may be significant changes to the product features in order to make the product more attractive. **The ayurvedic nature and fragrance of the product can be** improved further.

Price: The pricing strategy for the new shampoo could be a price skimming strategy, where a high price is charged in the belief that a sufficient number of customers will be willing to pay this price. Or the pricing strategy could be a market penetration pricing strategy, where a low price is charged in order to build up demand for the new product. Due to its unique Ayurveda nature and herbal formulas, charging a high price at this stage is appropriate.

Place: There will probably be limited distribution channels for a new product and the challenge for the manufacturer is to find ways of making the product available to customers to buy. However, the herbal shampoo is a consumer good that may be classified under shopping goods, thus the product should be available for purchase at convenient places.

Promotion: Spending on advertising and promotions may need to be high, initially to make potential customers aware of the existence of the product, then to create interest, and then to persuade customers to buy it.

- (b) At the introduction stage of a product there is hardly any profit due to low sales growth and high expenditure. Unit costs are high due to low output and costly sales promotions.

(c) **Requirements for successful brand positioning**

- **Relevance:** "Akbambaru" should be positioned in a way that it has meaning for consumers and meets consumers' needs (i.e. healthy, stronger hair).
- **Clarity:** The meaning of the brand should be distinct, and should be easy to communicate to consumers, and easy for consumers to understand.
- **Coherence:** The same image of the brand should be promoted consistently through all aspects of the marketing mix. For example, a high quality brand needs to be supported through high quality products and high prices and possibly exclusive distribution.
- **Patience:** It can take a long time to establish a successful brand.

(d) Key decisions in channel management that ALP may look into include:

- **Price policy**
ALP needs to consider its price lists and discount policies so that the interests of intermediaries/middlemen (wholesalers and retailers) are taken into consideration, and not just the interests of ALP.
- **Terms and conditions of sale**
Channel management involves making agreements about payment terms, expired and damaged items, and delivery times.
- **Territorial rights**
ALP may choose to distribute its shampoo in any of the following (or combination of) channels.
 - Extensive distribution
 - Selective distribution
 - Direct distribution
- **Definition of responsibilities**
Clear demarcation of responsibilities needs to be agreed upon with the middlemen. For example, if ALP use wholesalers or retailers for distributing its products, who will be responsible for handling customer complaints or dealing with outdated products?

(Total: 25 marks)

Answer 07

Relevant learning outcome/s: 5.7, 7.3 and 7.4

5.7 Managing culture and change.

7.3 Strategic purpose of an organisation.

7.4. Formulation of business level strategy.

Study text reference: Pages 252, 253, 318, 323, 324, 338 and 339

(a) SWOT analysis

Strengths

- Technical expertise of the founding partners
- Availability of the required equipment since the company acquired ST (Pvt) Ltd
- Capable staff who have prior experience in the satellite company ST (Pvt) Ltd

Weaknesses

- Loan capital for working capital requirements
- No proper HR department
- Cultural issues could arise with the staff of the previous company
- No prior working experience of the founding partners

Opportunities

- 50% illegal market for TV services

- Price conscious consumers
- Potential for growth in the industry – middle income country where majority of the population is able to afford TV services

Threats

- DTV service is a highly regulated service
- High switching costs due to high investment
- New entrants to the market
- Recoverability of customer premises equipment if a customer switches to other operators
- This cable TV service may be outdated due to changing technology/technological advancements.
- Redundancy programme – some of the ST employees have considered this as a serious threat to their way of life

(b) Porters’ generic competitive strategies can be used to evaluate the proposed business case of launching the cable TV services.

- Cost leadership – the objective is to become the lowest-cost producer in the industry. The traditional method to achieve this objective is to produce on large scale, which enables the business to exploit economies of scale.
- Differentiation – per this strategy, the business targets much larger markets and aims to achieve a competitive advantage through differentiation across the whole industry. Differentiation is about charging a premium price that more than covers the additional production costs, and about giving customers clear reasons to prefer the product over other less differentiated products.
- Focus – this involves concentrating on a particular niche market and by understanding the dynamics of that market and the unique needs of customers within it, develop uniquely low cost or well-specified products for the market. Because this strategy involves serving customers in the market uniquely well, it tends to build strong brand loyalty amongst customers, and makes the particular market segment less attractive to competitors.

According to the given scenario, we recommend a “cost leadership strategy” for MTT to follow as they expect the following changes in relation to the market leader DTV.

	Market leader	Model suggested
Cost: Monthly rental	Y\$ 8	Y\$ 7
Set-up cost	Y\$ 30	Y\$ 25
Benefit: No. of TV channels (satellite TV)	60	90

Since the service under reference cannot be differentiated, a differentiation strategy is not appropriate. Also, if the company tries to combine more than one strategy, it risks losing its competitive advantage and becoming “stuck in the middle” .

(c) Kubler-Ross Model

The five stages of grief		
1	Denial	This is a conscious or unconscious refusal to accept the fact that change will happen. It is a defense mechanism.
2	Anger	<p>The individual becomes angry. Anger can be expressed in different ways, but often involves feeling anger at others. <i>"Why me?" "It's not fair" "Who is to blame?"</i>.</p> <p>Knowing this may help managers to avoid over-reaction when employees show strong anger at proposals for change.</p>
3	Bargaining	People may then seek to bargain and negotiate a compromise, as a part of their anger. Typically, they might seek to postpone the change and 'buy some time'. However, this does not lead to a sustainable solution .
4	Depression	Depression sets in when the individual begins to recognise the fact that the change will happen and starts facing reality. It is acceptance, but with regret and unhappiness. The individual may experience sadness, regret, uncertainty, or fear for the future. It is unwise to try to cheer up the individual at this stage. Let the individual go through his/her grief, because they are beginning to accept the change.
5	Acceptance	<p>The individual accepts the change that will happen, and looks at the change with more emotional detachment and objectivity. <i>"I can't prevent it from happening. I might as well prepare for it"</i>.</p> <p>However, the nature of acceptance varies between individuals and the situation that they face.</p>

It is important to understand that Kubler-Ross did not intend this to be a rigid series of sequential steps or a process. An individual might not experience all five of the grief cycle. They may go through one or more stages twice. Some stages might be revisited. Some stages might not be experienced at all. Individuals may feel some of the stages much more strongly than others.

Even so, the model provides a reference point that enables an organisation's managers to understand what individual employees may be feeling, and deal with the problem accordingly. The model predicts that individuals will accept the change in the end (*people facing death will eventually accept it*).

(Total: 25 marks)

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