

## Corporate Strategy and Contemporary Issues

### Instructions to candidates

- (1) **Time allowed:** Reading and planning - 20 minutes  
Writing - 3 hours
- (2) **Marks:** 80 marks
- (3) The examination will be conducted as an open book examination.
- (4) This question paper should be answered entirely in the **ENGLISH** language.
- (5) Your answer must be submitted in the answer booklets provided at the Examination Hall.
- (6) Any pre-prepared papers included in your answer WILL NOT be marked.
- (7) After the instruction to stop writing at the end of the paper, you will be given five minutes to assemble your answer booklet/s.

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JULY 2016

## **MD Builders PLC**

MD Builders PLC (MDB) is a large scale conglomerate operating in the construction industry and has expanded its operations into various sub-sectors such as road construction, piling, real estate development, steel engineering projects and construction of bridges. MDB has established separate strategic business units (SBUs) for each area of business.

MDB Development Unit as a SBU is focussed on the real estate sector, which is growing rapidly. Even though it currently contributes an insignificant amount of total revenue of MDB, the directors are highly positive about the future prospects of this industry and the possibility of this SBU generating sufficient revenue in the future.

As a result of the declining trend in contributions in construction projects to the total revenue of the company, serious consideration was given by the board of directors at their recent board meetings with regard to the future prospects of MDB and its strategies in order to overcome future challenges in the construction sector. Accordingly, the committee which was appointed by the board of directors scrutinised the current state and gathered information regarding alternative lucrative business opportunities to overcome future problems anticipated for the company and provide long-term sustainability. The committee reported to the board of directors last month and the board decided to further evaluate the possible alternative strategic business options available for MDB to consider. The committee is of the opinion that diversification is one of the strategic options to overcome future business challenges.

The committee identified possible investment opportunities in power and the real estate sectors. As the government is currently not in favour of thermal power generation the committee decided to obtain information on hydropower generation. Accordingly they have gathered and presented the following information to the board.

## (1) Investment in Hydropower Project

The hydropower project could be located in the Nuwara Eliya district of the Central Province of Sri Lanka. It is expected to utilise water resources of the Maskeli Oya to generate electricity, which will eventually be delivered to the national grid of the Ceylon Electricity Board (CEB). Moreover the committee has researched on market capacity and they expect local electricity sales to increase by 6.5% in 2016, in comparison to the growth of 4.2% in 2015. Further, it is forecasted that demand (and sales) of the “domestic” and “industry” categories of electricity will continuously increase in the next few years.

The following cash flow forecast was presented by the committee for further consideration.

	<b>Rs. million</b>							
Year	Y1	Y2	Y3	Y4	Y5	Y6	Y7	Y8
Capital expenditure	(591)	(660)	(679)					
Revenue				337	350	379	393	431
Operational and maintenance expenses				(38)	(40)	(41)	(43)	(45)
Working capital increase				(88)	(11)	(12)	(14)	(15)

*\*Assume that the operations would continue at the year 8 level for the foreseeable future.*

*\*Ignore taxation.*

MDB has already obtained the consent from TMD constructors, the parent company of MDB, to finance the project by an internal loan at the rate of 13%. Meanwhile MDB has commenced initial negotiations with PACS bank to finance the hydropower project through a bank loan at a rate of 11%.

## **(2) Acquisition of a new company (KLC Housing Developers (Pvt) Ltd)**

The committee emphasised on the opportunities available to MDB under the 'Megapolis' concept. According to the Minister of Megapolis and Western Development, it was noted that the government in their budget proposals presented in November 2015 had allocated Rs. 10 billion for the series of projects earmarked for implementation under the Megapolis Development Plan.

Given the above proposed developments in the construction industry, the committee provided information on a possible investment opportunity in the real estate sector. This opportunity emerged from the "Megapolis" strategic plan of the government which could be taken into consideration by the MDB Development Unit.

The committee has become aware that KLC Housing Developers (Pvt) Ltd (KLC), a company in the real estate sector is searching for a prospective buyer to sell their business. Accordingly the committee believes that KLC could be acquired as it would help MDB to expand its business capabilities in the real estate sector. The committee compiled the following information in regard to KLC.

KLC is one of the leading private sector township developers in Sri Lanka, and is well known in the industry for its unstinted commitment to exemplary standards of professionalism, reliability in township developments and to go beyond its customers' expectations, offering unique housing solutions to match individual needs along with flexible repayment schemes. The industry experience of KLC, its professional expertise and in-depth knowledge of the property market are competitive advantages which would enable MDB to grow its real estate portfolio in a sustainable manner. KLC has reported reasonable growth in the past and has significant market share compared to its competitors. The committee however has noted a few problems at KLC over the last few years such as poor corporate governance practices, a high level of labour turnover, loss of key management personnel, unfavourable trade union actions and the unethical usage of a trademark which has exposed KLC to litigation. These concerns have forced the board of directors of KLC to expedite their selling decision.

The following financial forecast was presented to the board to evaluate the proposed acquisition of KLC.

	<b>Rs. million</b>					
Year	Y1	Y2	Y3	Y4	Y5	Y6
Net operating profit after tax (NOPAT)	320	345	350	366	370	375
Depreciation	45	52	54	56	59	61

*\*Assume that the operations would continue at the year 6 level for the foreseeable future.*

\*A Weighted Average Cost of Capital (WACC) at the rate of 12% can be used for the business valuation of KLC.

Extracts of the financial position of KLC for the current year are given below.

	<b>Rs. million</b>
Equity and liabilities	
Stated capital	2,100
Total debt	820

\*Total number of shares : 210 million

In a business interview with the CEO of KLC, it was revealed that the bidding price is in the range of Rs. 15 – Rs. 20 per share.

**Required:**

Assume that you are the head of the committee appointed by the board of directors of MDB.

You have been asked to **prepare** a report to the board of directors evaluating the different strategic options proposed above in order to prosper in the future.

Your report should include the following:

- Environmental analysis of MDB by considering the different strategic options.
- Formulation and evaluation of the proposed business strategies.
- Evaluation of the financial viability of the given business alternatives.
- Corporate governance practices, human resource strategies and risk management strategies for MDB to adopt.
- Recommendations and conclusion.

**(Total: 80 marks)**

<b>Allocation of marks</b>	
Introduction	<b>02</b>
Executive summary	<b>08</b>
Analysis	
• Environmental analysis	<b>12</b>
• Strategy formulation and evaluation	<b>18</b>
• Financial viability	<b>15</b>
• Corporate governance, human resource strategies and risk management strategies	<b>15</b>
Recommendations and conclusion	<b>10</b>
<b>Total</b>	<b>80</b>