

# **Corporate Strategy and Contemporary Issues**

## **Pilot Paper Unseen**

### **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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**Unseen Material**

**Tharuka and Nalin** recently attended a seminar organized by Apparel exporters association of Sri Lanka under the theme “Opportunities and Challenges for the apparel exporters in Sri Lanka”. Many industry experts made presentations at the seminar and highlighted many challenges face by the industry. At the conclusion of the seminar, Tharuka made a request from Nalin to develop a concept paper detailing issues confronted by AAPL and Nalin’s proposals to overcome those issues and grow the business. The Board of Directors of AAPL had a special meeting at its Head office on 2<sup>nd</sup> March 2016 to discuss the proposals of Nalin.

**The following are some of the proposals made by Nalin in his report.**

**PROPOSAL 1**

With the economic recovery of the American and European markets, demand for AAPL’s products has increased over the last couple of months. The existing factories of the company are running at a full capacity and as a result AAPL is unable to accommodate new orders now. The company needs to increase production capacity to accommodate the increase in demand the company is expected to get from next year onwards. The initial capacity requirement increase will be 230,000 available hours per month.

The demand increase of the company’s products consists of formal wear, sportswear and swim wear and expected to change within the next 5 years is as follow:

|            | Y1      | Y2      | Y3      | Y4      | Y5      |
|------------|---------|---------|---------|---------|---------|
| formalwear | 115,000 | 120,750 | 124,910 | 129,060 | 135,250 |
| sportswear | 69,000  | 68,400  | 66,240  | 64,440  | 62,550  |
| swimwear   | 46,000  | 47,000  | 48,000  | 51,100  | 52,000  |
| Total      | 230,000 | 236,150 | 239,150 | 244,600 | 249,800 |

I am confident that the company can price formalwear, sportswear and swimwear at an hourly rate of USD 2.40, USD 2.20 and USD 2.00 respectively. These prices are expected to inflate at a rate of 2.5% per year.

I have identified two opportunities available in foreign countries(Vietnam and Bangladesh ) to cater this demand. I believe that investing in a foreign country will be beneficial due to labour shortage experienced by the apparel sector in Sri Lanka.

Investment in Vietnam

Vietnam is an emerging market for apparel manufacturers. A factory which currently produces apparels is available for sale in Vietnam. The seller expects a payment of USD 6.5 million paid upfront for it. The factory has a production capacity of 325,000 hours per month. Average working time per person per month is 176 hours in Vietnam.

Direct labor in the Vietnam market is expected to be USD 80 a month, and the rate is expected to grow at a rate of 2.5% per year. Factory overhead is expected to be USD 750,000 during the 1<sup>st</sup> year and has an annual growth of 10%. Capital allowance given under the tax regulations for the investment is USD 72,000 per year, only for the first 5 years of operations. AAPL has to pay a tax of 25% in Vietnam.

### Investment in Bangladesh

There is an opportunity to start a factory by investing in Bangladesh. This investment requires USD 7.5 million and the factory can be built within this year and it will be ready for production by April 2016. The factory will have a production capacity of 300,000 hours per month. Average working time per person per month is 176 hours in Bangladesh.

Direct labor in the Bangladesh market is expected to be USD 60 per month, and the rate is expected to grow at a rate of 2.5% per year but in the past market salary rates have varied substantially due to government intervention. Factory overhead is expected to be USD 600,000 during the 1<sup>st</sup> year and has an annual growth of 12.5%. Capital allowance given under the tax regulations for the investment is USD 120,000 per year, only for the first 5 years of operations. AAPL has to pay a tax of 27.5% in Bangladesh.

Earnings from both investments are subjected to tax in Sri Lanka at the rate of 15%. Further it is estimated that market risk of Bangladesh and Vietnam is higher than Sri Lanka by 10% and 5% respectively.

### **PROPOSAL 2.**

Regardless of the healthy profit levels generated by the company, it's facing difficulties in managing cash flows, due to recent investments done. The Company had only USD 1 million cash balance at the end of last financial year and currently doesn't have a sufficient cash reserve to invest in the new factories. Having considered this situation I am suggesting to list the company in Colombo Stock Exchange (CSE) to get the finance required for expansion. It is estimated that AAPL's non-current assets has a market value of USD 290 million.

### **PROPOSAL 3**

AAPL supplies its products at the moment to customers in USA and EU. However our competitors follow different strategies compared to us which enables them to offer a wide range of products to wide range of markets. Therefore I am suggesting to review our corporate strategy which will enable the company to generate more profits in long run.

As part of strategy review, I am suggesting to review marketing aspect as well. Social Media has gone through a rapid growth since 2010 and has become very popular method of reaching potential customers. Global brands are using Social Media such as Facebook and Twitter to keep their customers engaged with their brands. However AAPL has no social media presence at present.

You are working as a Director – Advisory, of Lead consulting (Pvt) Limited. Mr. Robert – Chairman of AAPL has approached you and request you to **evaluate** the proposals given by Nalin and **advise** the Board of Directors of the company.