

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

KB 5– Business Value Creation

December 2015

Answer 01

(a)

Relevant Learning Outcome/s:
1.4 - Strategic capability and competitive advantage

Suggested Detail Answer:

According to the resource-based view (RBV) of business strategy, resources that an organisation has in its possession or under its control give it the ability to compete in its industry and markets. Further it emphasis as that resources can be divided into threshold competencies and core competencies.

Threshold competencies are activities processes that are needed to meet minimum requirements or resources that must be sufficient to enable an organisation to compete successfully. In other words the assets or competencies which are needed to compete and survive in the market. The following threshold competencies can be identified relevant to the given scenario.

1. Five employees working in the office who are trained in software development.
2. The company owned a building which has more space and also the facilities where they carry out their software development activities

Core competencies are activities that a competitor finds difficult to imitate. These competencies are needed for developing a competitive advantage. The following core competencies can be identified relevant to the given scenario.

1. Leadership style of Anura.
2. More than 25 years of experience of Anura in the software industry serving both local and foreign companies.
3. Young software developer who has recently won a less international awards at reputed software development competitions was appointed as the auditor in charge of software innovations

(b)

Relevant Learning Outcome/s:

1.4 -Strategic capability and competitive advantage

Suggested Detail Answer:

The unique resources and core competences can be identified based on four qualities. These four qualities are sometimes identified by the letters VRIN:

- V – Value
- R – Rarity
- I – Inimitability
- N – Non-substitutability

According to the VRIN framework, competencies mentioned in the scenario can be assessed as follows.

1. Five employees working in the office who are trained in software development **(Value, imitable, not rare, substitutable)**.
2. The company owned a building which has more space and also the facilities where they carry out their software development activities **((Value, imitable, not rare, and substitutable)**.
3. Leadership style of Anura **(Value, not imitable, rare, substitutable)**
4. More than 25 years of experience of Anura in the software industry serving both local and foreign companies **(Value, not imitable, rare, substitutable)**
5. Young software developer who has recently won some international awards at reputed software development competitions was appointed as the auditor in charge of software innovations **(Value, not imitable, rare, substitutable)**

Answer 02

Relevant Learning Outcome/s:

2.1. 'Inventory management and warehousing
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Suggested Detail Answer:

After carefully analyzing the report provided by the consultants, it is very clear that we have several issues that need to be addressed in our supply chain if we are to regain the lost market share and grow in the future. The first three issues are clearly related to poor performance of our supply chain compared to our competition. The last two issues are more related to outward bound logistics on deliveries to customers and internal issues. I would recommend the following action points to be taken by the company,

1. Price of raw material:
 - Benchmark the raw material prices and negotiate with existing suppliers or develop new suppliers who can meet the market price points required.
 - Work with different divisions, cultures and economies to increase the bargaining power with suppliers and reduce the risk and uncertainty.
2. Higher level of inventory:
 - Implement a just in time (JIT) system collaborating with suppliers to improve delivery performance and reduce inventory days.
 - Maintain long term sustainable relationships with suppliers and improve the on time delivery of inventory.
3. Raw material wastage: Highlighted issue could be due to the quality of our raw material from suppliers. However, this could also be due to the market quality management system which we may need to revisit. However, if we could ensure the quality of our raw material is at the industry standard, we can then focus on streamlining our process as and quality management system to be in line with the competition.
4. Failure in delivery: I recommend to implement an internal electronic data interchange (EDI) system which the sales division would update with the orders received so that we could plan for the same accordingly and improve internal communication.
5. Online Sales: This is a great way to enhance our sales and we can also link this to our internal EDI as online orders. We can update the product information time to time and facilitate the customers to place the online orders. This would both enhance sales and reduce sales and marketing costs. Hence I recommend to enhance our online platform to be world class in line with our competitors.

Answer 03

Relevant Learning Outcome/s:

3.3 Quality management

Suggested Detail Answer:

(a)

As Marks Garments (Pvt) Limited is looking into implementing a good quality management system in the organization, top management should consider possible benefits and cost of the alternative quality management systems. In this process following elements of quality costs can be identified.

Prevention costs - Cost for arrangements to prevent defective items, or reduce the number of defects. E.g. Cost for controlling the quality of the materials and cost for any other activities for preventing defective items in the production process.

Inspection and testing costs - The costs of inspecting and testing output, to identify defective items or batches. E.g. Cost for checking the quality of final products before release to customers.

Internal failure costs - The costs of correcting defective items that are found by inspection and testing. E.g. Cost for reproduction of garment items which have some defects.

External failure costs - The costs of dealing with complaints from customers about defective items that have escaped detection in the inspection process and that have been sold to customers. E.g. Cost for handling returned stock and paying compensations to damaged parties.

Suggested Detail Answer:

(b) Philip B Crosby is known mainly for two concepts in TQM. Those are,

1. **Zero defects.** There should never be any defects in a product. Although this may seem an impossible ideal in practice, the aim nevertheless should be to eliminate all defects and achieve 100% quality. Marks Garments (Pvt) Limited may face some difficulties in applying this concept as garment manufacturing is a labour intensive business.
2. **Get it right the first time.** A product should not have to be corrected once it has been made. 'Right first time' is consistent with the idea of 'zero defects'. Marks Garments (Pvt) Limited can apply this principle by rejecting any defective item once detected in the process.

Answer 04

Relevant Learning Outcome/s:

6.4 Managing research and development

Suggested Detail Answer:

(a)

There are several potential problems with management of R&D within the organization that should be identified by the management of Pharamacare in the process of undertaking new product development

Organisation and Management – When R&D is a separate department, there may be problems with co-ordinating R&D activity with production (for the manufacture of prototypes and then for commercial production) and sales and marketing (for market research and managing a new product launch). Therefore management of Pharamacare (Pvt) Limited should pay special attention to coordinate with the production department and marketing department to develop new products to match with the domestic and European market requirement.

Financial – Difficulty in setting performance targets and also the huge cost structure associated with pharmaceuticals research. Sometimes the project may take too long to complete and costs can get out of control.

Evaluation and control – Assessing the progress of the research and also controls such as control for quality, testing of the developed product might give difficulties. This makes it difficult to assess the value of the new Ayurvedic medicine to the company.

Cultural issues – Unless the organisation has a culture that favors innovation, there may be problems for new product development. Therefore the management of Pharamacare should consider the extent to which rest of the organization welcomes the new Ayurvedic medicine product range.

(b)

Relevant Learning Outcome/s:

6.5 Managing Innovation

Suggested Detail Answer:

Innovations must be adopted by a sufficient number of people to become sustainable product in the market. Therefore customers may identify the new Ayurvedic medicine product range as an innovation and pass the five stages for adopting to new products.

Awareness - Individuals are exposed to the new Ayurvedic medicine product range, but do not have complete information about it.

Interest - Individuals become interested in the new Ayurvedic medicine and seek more information about it. Specially they may be interested in find the information about ingredients, side effects and dosage etc.

Evaluation - Individuals think about the innovation and apply it to their own personal circumstances. Evaluation leads to a decision to try the innovation. They may compare the benefits of new Ayurvedic medicine over the existing medicine for the same illnesses.

Trial - Individuals make full use of the new Ayurvedic medicine, to test it.

Adoption - Individuals are satisfied with the new Ayurvedic medicine and decide to continue to use it.

Answer 05

Relevant Learning Outcome/s:

5.7 - Managing culture and change

Suggested Detail Answer:

(a)

The culture at Sky Air before the new CEO took office seems to be a role culture. In a role culture, the authority of decision making is delegated to the individuals who have particular roles or positions within the organisation. Jobs and responsibilities are clearly defined. The individuals are expected to comply with the formal rules and procedures. The availability of HR policies demonstrates this.

However, with the arrival of the new CEO, the culture seems to be moving towards a person culture where the CEO believes that he is superior to the organisation. He believes that his expertise will drive the company and ignores the others in the organisation. His celebrity like character also shows that he might use the company to serve his personal interests.

(b)

Suggested Detail Answer:

Kurt Lewin, a psychologist, developed a model for change management in the 1940s. He suggested that successful change can be done through of three-stage process as given below.

Unfreeze - This is the process of finding a way to get people to end their resistance to change, in both individuals and groups. This is achieved by finding ways to strengthen the driving forces for change or to weaken the restraining forces that resist change.

In this situation any responsible manager as a change agent can explain the benefits of changing the prevailing culture at Sky Air by pointing out the negative consequences of not changing. It will assist them to enhance the readiness of employees to change the prevailing culture.

Movement - This stage involves making the change. It includes not just making the changes to operations and activities, but making changes to the thoughts, feelings and behaviour of the people affected. Therefore in this situation the change agent can give clear instructions to staff about the new patterns of behavior, providing resources supported by training in the new procedures. Further clear communication is necessary so that the staff understand what needs to be done.

Re-freeze - Re-freezing involves establishing the change as a new mind set, so that it now becomes accepted and the normal operating procedure. If employee has any problems the change agent must quickly sort them out, so that the staff is encouraged to follow the new system. Further the top management of Sky Air can provide additional rewards to encourage staff to follow the new procedures.

Answer 06

(a)

Relevant Learning Outcome/s:

- 4.3. Managing Products and brands.
- 4.5. Distribution and channel management
- 4.6 Managing marketing communication

Suggested Detail Answer:

The market positioning of a product defines how the company wants the customers to perceive it, and how the product differs from the other competing products in the market.

In the case of Berry Story, they can use the 'fair trade' and organic labels to show that their product is environmentally friendly in the European market as it is very concerned about environmental sustainability. Since ISO 14001 is concerned with environmental sustainability this could further add to the market positioning.

At the same time, Berry Story can use the ISO 9001 standard to project the image of high quality in the target market. Other certifications like organic, fair trade and ISO 14001 could further enhance to this image.

The company can position Berry Story as a value for money product in the Sri Lankan market with their competitive price point along with all the certifications mentioned above.

(b)

Suggested Detail Answer:

Brand Equity is the value of a brand name. The owner of a well-known brand can use the strength of the brand to sell more of the products. Brand equity can also be used to make product line extensions that would further enhance sales. Since Jehan has a strong desire to expand its products to overseas market and double its sales in the next five years he needs to strengthen and maintain its brand equity.

Berry Story needs to adopt a brand strategy, which is a long term plan for the development and protection of the Berry Story brand. Brand positioning would enable the formulation and implementation a brand strategy to understand how it would influence customers. The purpose of brand positioning is to set the brand apart, in a meaningful way, from the products of competitors.

In addition to that they can successfully design and implement marketing programmes such as CSR projects, creative advertising campaigns, and use of brand ambassadors etc. to promote and maintain its brand image in the minds of potential customers. Berry Story also needs to maintain the same quality standard as the existing products when they extend the product line to the branded products.

Further the company needs to take legal action against companies has limitation their brands if they get to know of such incidents

Suggested Detail Answer:

(c)

Effective distribution plays an important role when Berry Story attempts to double their sales in the next five years. Distribution is part of the marketing mix which comes under place. Getting the right products at the right time to the right places, so that the customer has the choice of buying the Berry Story products and not the competitor products is very important. The place in the marketing mix refers to the,

1. Distribution channels, and the choice of distribution channels
2. Distribution coverage, and the number of or spread of distribution channels
3. Location of sales outlets, the arrangement of the sales areas or sales offices
4. Outward logistics

The choices made need to ensure that the purchase is convenient to the customers and that it fulfills their needs. Berry story can follow the following methods of distribution,

1. Extensive Distribution.
By using a range of wholesalers and retailers, Berry Story can maximize the coverage of the market. Even though Berry Story is price competitive in the Sri Lankan market, it has the image of an international brand and an extensive distribution approach may dilute their brand equity. Hence, I do not recommend this method to be followed.
2. Selective Distribution.
Selective distribution is where the manufacturer uses a limited number of intermediaries to distribute its goods or services. Berry Story already follows this approach in the Sri Lankan market by dealing via super markets. This provides a more suitable approach to distribute the Berry Story products and they may have to find ways to understand whether the super markets currently operate with provide the distribution coverage required and whether the locations of the super markets are the most appropriate.
3. Exclusive Distribution.
The manufacturer gives exclusive distribution rights to one organization. Berry Story currently follows this approach in the overseas markets where they deal via agents. However it may be important to understand whether those agents in overseas markets follows the appropriate channels, provide the distribution coverage required. Hence, when Berry Story attempts to double his sales, its important to evaluate the effectiveness of the agent distribution and select the most appropriate agents who could provide the best place advantage for the brand.
4. Direct Distribution.
The manufacturer can directly sell to the consumer using online sales and the internet. This could also provide a useful channel to Berry Story where they can sell to markets that they do not currently operate in using direct distribution and can also enhance margins by avoiding the intermediaries.

Therefore, except for extensive distribution, the other three methods of distribution can be quite effective for Berry Story when it's planning to double its sales in the next five years.

(d)

Suggested Detail Answer:

Promotion is another important component of the marketing mix. Promotion covers all marketing activities that are focused on letting customers know about a product or service and persuades them to buy it. Some of the important promotional methods available to Berry Story could be,

1. Design of Packaging.

The design of the packaging in itself will convey a message to the consumer. Given the brand positioning Berry Story has developed, it is important for the company to design the packaging to ensure that the consumers perceive the brand the way they want them to see it. Hence, the designing of the packaging could provide an important promotional method to Berry Story.

2. Public Relations.

This involves publishing favorable news reports about the firm in the media. Given the socially responsible and environmentally friendly approach Berry Story adopts it can use the media for promotion of its products can also get the media to provide stories about the owner, Jehan, as a man with a mission to take a Sri Lankan brand to the world. This can provide a useful promotional method locally, but doing the same in international markets could be quite difficult.

3. Point of sale displays.

This involves positioning of the displays of the Berry Story products at a place, usually within a retail store, where customers are likely to see them. Berry Story can adopt this promotional method within super markets and also could request agents to follow similar promotional methods in overseas retail outlets where Berry Story products are sold.

4. Advertising.

This is a well-established promotional method. Berry Story can use media such as TV, radio, new papers, billboards, magazines, and websites to advertise their products. Whilst it might be feasible to use media such as TV and newspapers in Sri Lanka, it could be quite costly in overseas markets. However the company might be able to use media such as magazines, billboards and web sites to promote the product in overseas markets.

Answer 07

(a)

Relevant Learning Outcome/s:
5.8. Leadership

Suggested Detail Answer:

Transformational leaders are the leaders who are capable of seeing a need for strategic change, and leading the organisation through the change. They are capable of transforming organisations, individuals and groups. There are four elements of transformational leadership.

1. Idealized influence. The leader acts as an ideal role model for others to follow. In this case, the CEO is seen as a man of his word. He has also worked hard to rise up the ranks in the organization and has been very loyal by staying for over 22 years. He is also known for his empathy towards people and hence it is evident that Nuwan demonstrates the element of idealized influence.
2. Inspirational motivation. The leader can inspire and motivate others. (½ mark) Even though the case given is not very specific about this quality, it mentions that the organization has grown from strength to strength over the first five years the CEO's tenure. He also end the challenges despite the possibility of him losing his job. This demonstrate his confidence to motivate others to deliver the results they need to deliver. Hence, we can assume that Nuwan is an individual who can motivate others.
3. Individualized consideration. The leader shows real concern for the needs and feelings of others. This element is very evident in the case, where the CEO is well aware of the difficulties that the team is going through in terms of work pressure due to lack of employees and also their personal needs in relation to the bonus. By putting his own job at stake for the wellbeing of his employees, Nuwan clearly demonstrates the element of individualized consideration.
4. Intellectual stimulation. The leader challenges the followers to be creative and innovative, and achieve higher levels of performance. Again by achieving a higher level of company growth in the past as CEO, he has driven a performance driven culture. By being the first to go to rural areas with the concept of super markets, he seems to be driving creativity and innovation as well. Hence, we can argue that Nuwan demonstrate the element of intellectual stimulation.

Looking at the above it is evident that Nuwan demonstrates all four elements of transformational leadership.

(b)

Relevant Learning Outcome/s:

7.6. Evaluation and implementation of business level strategy

Suggested Detail Answer:

Porter's idea of generic competitive strategies and the idea that firms can successfully pursue a number of strategies based on price and perceived added value, have been extended into the concept of the strategy clock. The strategy clock is based on the view that in a competitive situation, a rational customer will seek value for money in their purchases, and value for money is provided through the combination of price and perceived benefits of the product or service.

Based on the strategy clock, there are different strategies a Retail City can adopt to overcome the situation.

Low price or No Frills Strategies.

Strategic positions 1 and 2 provide a mechanism to attract price conscious customers to the company. Whilst no frills and low price strategies may help to build volume, especially in a recession, this could lead to a price war among competitors that given the margins are already low, further lowering price can worsen the profit of the company. Hence, it is not recommended the company follow a strategy based on price.

Differentiation Strategies.

Strategic positions 3, 4 and 5 provide different variations of differentiation. However, a hybrid strategy requires the company to a low or price which could further worsen the profits and hence, it is not recommended the same. Strategic position 4, differentiation could provide a useful strategy for Retail City to follow. This would seek to provide the customers with benefits that they value through the products and services of the company that are different to the competitor's offerings.

The company can achieve the same by providing better products and services at a premium price or the same price as competitors. It is recommended to enhance their service at the super market and to follow a competitive pricing approach as charging a price premium would be difficult given the economic recession. Given that Nuwan has convinced the board not to follow tactics such as removing contract employees, cutting the bonus, he can make the staff more customer friendly and happy whilst providing a more efficient service than the competition. This would be difficult for competitors to imitate as they have already cut down on the staff and the bonus of the employees.

Strategic position 5, 6, and 7 requires the firm to charge a higher price and it is not recommended the same in the short term as this could result in loss on the existing customers. It do not recommended position 8 as it is not advisable for Retail City to cut down on the service and charge a standard price. Customers will eventually become aware and move to the competition. Hence the most appropriate strategy that would be recommended is to follow the differentiation strategy.

(c)

Suggested Detail Answer:

When strategies are selected and implemented, their progress and performance should be monitored. Management should check whether the organisation's strategies, taken both individually and collectively, are achieving their intended objectives. Strategic control involves the monitoring of progress towards strategic objectives, and taking control measures when actual performance indicates that strategic targets will not be met. Strategic controls involve both financial and non-financial performance. Balance scores card approach could provide a valuable method of monitoring the progress of set objectives during the six months period for Retail City. Based on the Balanced scorecard approach several KPIs for monitoring the strategic performance of the company during the six months period on the following four aspects can be formulated.

Financial aspects.

This includes the monitoring financial performance indicators of the company such as sales, net profit, working capital, etc. Therefore following KPIs can be recommended to monitor the performance of Retail City on financial aspects.

- Sales volume
- Profitability
- Basket value of the customers
- Sales growth beyond the breakeven point at rural retail stores
- Individual customers purchasing volume compared to the past.

Customer value and satisfaction aspects.

This includes the monitoring of customer satisfaction. These are leading indicators: if customers are not satisfied, they will eventually move to the competition. Given the differentiation strategy recommended, it is very important to measure, whether customers see added value in their services. Therefore the following KPIs can be recommended to monitor the performances of Retail City on customer value and satisfaction aspects.

- Degree of increasing customer satisfaction
- Sales volume per customer
- Customer retention ratio
- Net promoter ratio
- Number of lost customers

Operational aspects.

This perspective refers to internal business processes. Metrics based on this perspective allow the managers to know how well their business is running, and whether its products and services conform to customer requirements. Given the differentiation strategy it is important to ensure that their employees are providing better and more efficient service to customers. Therefore the following KPIs can be recommended to monitor the performance of Retail City on operational aspects.

- Point of sale efficiency
- Average waiting time in the queues for bill settlement
- Administered expenses in total revenue
- Labor productivity growth
- Supplier frequency

Innovation and learning aspects.

This perspective includes employee training and corporate cultural attitudes related to both individual and corporate self-improvement. Metrics can be put into place to guide managers in obtaining training funds where they can be beneficial most. Given the differentiation strategy it is important to ensure that their employees are well trained to provide an enhanced service to the customers and to be positioned differently, to their competition. Therefore the following KPIs can be recommended to monitor the performances of Retail City innovation and learning aspects

- Employee satisfaction index
- Employee trust rate to the company
- Average training cost per employee
- Expenses for research and innovation

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