

CA



THE INSTITUTE OF
CHARTERED ACCOUNTANTS
OF SRI LANKA

SUGGESTED SOLUTIONS

KB 5 – Business Value Creation

June 2016

Answer 01

(a)

Relevant Learning Outcome/s:
1.1.1. Explain the concept of value creation and its importance to business (including shareholder value, customer value, employee value, supplier value and societal values)

Suggested Detail Answer:

Value chain outlines the activities that help a business to add value. The overall margin of the business is determined by how effectively a business carries out the value adding activities. According to Michael Porter, value adding activities consist of primary activities and support activities.

- Management will be able to understand and analyse the value creating activities and ensure that they are effectively carried out to enhance the value creation to its customers.
- They can also understand which activities provide a competitive advantage over its rivals.
- By analysing the value chain, decisions can be made about,
 - (i) How the creation of value can be improved and more value created.
 - (ii) To identify which activities cost more than the value created, and therefore destroy value.

Note: Students are not expected to provide answers the same way the Examiner has suggested. Examiner has freedom to decide reasonable marks for demonstrating the understanding of the value chain model, identifying their activities and showing how the value chain helps to create value for a firm)

(b)

Relevant Learning Outcome/s:
1.2.1. Explain the primary and supporting activities involved with creating value to business (introduction to value chain)

Suggested Detail Answer:

Human Resource Management

Business organisations depend on the quality and skill of the employees to achieve success. In order to ensure that the company maintains and enhances its competitive edge, the following factors in regards to human resources need to be ensured.

1. Attract the best academic and non-academic staff to the organisation over their rivals.
2. Employees are provided with the proper training and development to enhance their skills in conducting academic programs.
3. Pay and reward system is sufficiently attractive so that the company is able to attract them over its competition.
4. Implement systems to keep the work force motivated with proper staff welfare and grievance handling procedures.

Technology Development

Technology Development involves the adoption of technologies such as IT systems or new product development to support the primary activities. Therefore apex management can create value through new technologies in the following ways:

1. Develop an effective Learning Management System (LMS) to facilitate students to find learning materials and assessments.
2. Develop an effective learning environment by using modern technology in the class rooms.
3. Adopt modern technology to reduce the administration costs and increase the efficiency of the operational process

Procurement.

It consists of the procurement of material and other items from suppliers. Therefore Apex can get the material at the right time, at the right cost and quality required by using appropriate procurement procedures. Further Apex can create the value in the following ways:

1. Provide excellent services to students by using quality study materials
2. Improving the efficiency in the teaching and learning processes by using high quality teaching equipment (E.g. projectors, computers etc.)

Firm Infrastructure

Apex can improve the value of its business by using appropriate finance, quality control or administrative systems based on the firm infrastructure as it is important for its strategic capability in all its primary activities. Therefore Apex may create the values in the following ways:

1. Provide high quality services to students by using proper administration and quality control systems.
2. Improving the efficiency in the teaching and learning process by using proper administration and quality control systems.
3. Improving the image of the organisation by providing quick responses to both student and employee inquiries.

Note: Examiner has the freedom to give reasonable marks for demonstrating the knowledge on possible ways of creating value by any supportive activity of the value chain.

Answer 02

Relevant Learning Outcome/s:

2.4. Supply chain information systems

Suggested Detail Answer:

- (a) In order to reduce the cost and improve efficiency various information technology applications can be used in supply chain management. Some of the most commonly used applications are,
1. Internet - Internet can be used to locate suppliers and find the best prices available in the market.
 2. Intranet - Intranet can link external parties to the company's internal network. This could fast track the order placements with the purchasing department and also suppliers can be given access to parts of the intranet where they can have proactive information on fast selling items and prepare the required supply for future orders.
 3. Electronic Data Interchange (EDI) - EDI can allow suppliers to connect with the organization electronically. Here unlike the intranet system, the supplier and Super Mart systems can communicate with each other. This can be used to place the order, review the progress of the orders placed and also for settling payments.
 4. Radio Frequency Identification Devices (RFID) - RFID can be used to identify items of goods automatically. RFID can help Super Mart to have a more accurate record of their inventory, locate items easily and track the status of their orders from the point of dispatch by the supplier.

Note: Examiner has the freedom to give reasonable marks for identifying and explaining at least 04 methods of applications of information technology for improving the efficiency of the supply chain process in the given scenario)

- (b) If Super Mart implements an e-procurement system, the company will get the following benefits:
1. Cost reduction by eliminating process inefficiencies and purchasing agent overheads.
 2. Reduced inventory levels. Since orders are easier and cheaper to place and process, Super Mart can order more frequently and, therefore hold less inventory.
 3. Wider source of suppliers. Goods can be sourced from a wider range of supplier and thereby can enable Super Mart to find the best price in the market unlike entering in to long term contracts.
 4. Quicker ordering. E-procurement can enable Super Mart to select and place orders online making the ordering process faster.

5. Better control on parts of inventory. Provides greater transparency and accountability over manual processes.
6. Intangible benefits Staff is able to focus on their primary function and given greater process efficiency can enable Super Mart to reduce the head count of the Purchasing Department.
7. Credit control. Suppliers will be more willing to work with the company, as their manual work will reduce and the order management cost will be reduced. They will also have better transparency and better credit control.

Note: Examiner has freedom to give marks for any acceptable advantages of having an e-procurement system for Super Mart.

Answer 3

Relevant Learning Outcome/s:

3.5.1 Analyse the systematic decision process in planning for locations

Suggested Detail Answer:

- (a) The location of the operation is another aspect of operations where value can be created.

The following factors should be considered by Mission House when choosing a location:

- **Close to key suppliers**
Manufacturers could benefit from locating their operations closer to their supply chain whereby they reduce the supply chain cost and overall lead time required to get the goods to the customer. Since Sri Lanka is unable to find its raw material from its own country it is viable to locate the factory in South Africa since administration and transportation costs are low.
- **Cost**
Companies can gain a competitive advantage over rivals, or at least maintain a threshold competence by locating their operations in a low cost location where costs of labour and materials are lower and benefit from low cost of production. Mission house should consider at which location they have low labour and materials costs. According to the information provided the average wages in South Africa is lower than Sri Lanka and due to the lower labour cost it is viable to set up the factory in SA. The high population and the low literacy rate provide a good opportunity to find unskilled employees for the factory.
- **Close to Customers**
Locating operations close to customers could lower transport cost and lead time of outbound logistics. Since Mission House has its key customers in EU, Middle-East and USA, Mission House should consider a location with the lowest distribution cost to serve products to target customers.
- **Community Factors**
Community factors may affect the willingness of existing employees to stay with the company and move to the new location. Therefore Mission House should consider where employees are willing to stay due to the community factors such as quality of life, quality of local services and quality of utility services etc. Thereby S/L will be a better location.
- **Availability of infrastructure facilities**
Since Mission House is manufacturing tyres, it may need uninterrupted power supply, water supply, communication and a good road system. Therefore those factors also become very crucial in selecting the appropriate site.

Note: Examiner has freedom to give marks for any acceptable factor relevant to the given scenario.

- (b) There are different methods of deciding on a new location for operations
1. Location cost-volume-profit (CVP) analysis
Estimate the fixed costs and variable costs of operating at each possible new location, and select the least-cost location, based on expected activity levels.
 2. Centre of gravity method
Look for a location that is geographically in a location that seems to minimise total travel times and transportation times (for inward bound raw materials and outward-bound finished goods), and so is expected to minimise shipping/transportation costs.
 3. Factor rating method
Identify the factors that should affect the location decision and award a maximum rating score (a weighted maximum number of marks) to each factor. Then for each possible location, decide the score for each factor. Add up the scores for each location for all the factors. Select the location with the highest total score.

Note: Examiner has freedom to give marks for any acceptable method relevant to the given scenario.

Answer 04

Relevant Learning Outcome/s:
5.6.1. Analyse how to incorporate knowledge management to enhance business performance (including knowledge worker/knowledge codification, knowledge abstraction and knowledge diffusion/managing tacit and explicit knowledge)

Suggested Detail Answer:

- (a) **Outline** four (04) features of a learning organization.

Features of a learning organisation are,

- (i) **A Learning approach to strategy**
Strategy development is based on experimentation and feedback. The organization learns from experimenting and adapts.
- (ii) **Participation in policy making**
All members of a learning organization have the opportunity to contribute to policy making. Everyone can contribute to the learning process.
- (iii) **Information**
Information is used, not as a method of management control, but as a resource for the entire organization to use.
- (iv) **Accounting system**
Accounting systems are designed so that they assist in learning. In particular, accounting systems provide information about how cash is generated and used, because cash is a key resource.
- (v) **Boundary workers and gaining knowledge from the environment**
Members of the organization who come into contact with the external environment should pass on to others within the organization all the information they gather from the environment.
- (vi) **Learning Culture**
Everyone who works for the organization understands that part of their task is to keep improving their knowledge and to share their knowledge with other members of the organization.

Note: Examiner has freedom to give marks for any acceptable features of a learning organization relevant to the given scenario.

- (b) **Analyse** how a learning organization culture can enhance the performance of Protect.

Protect has operations in a variety of countries and have a member base of 3,500. The challenges they face in each country could be quite unique. If the knowledge of these workers in different countries can be shared within the organization, they could immensely enhance their performance. Some of the ways in which a learning organization culture could enhance their performance are as follows,

- (i) They can share different ways in which they have been able to influence policy makers in different countries that could enable new projects to be implemented faster minimizing resistance.
- (ii) New members (both volunteers and employees) can be trained faster reducing the learning curve of onboarding new members.
- (iii) People can experiment using different strategies that have been effective in different countries and reduce experimentation failures.
- (iv) Researchers can learn from the work of other researchers throughout the organization which can enhance the quality of their work and speedup the research process.
- (v) Reduce the cost of operations by avoiding duplication of work by strategies that have failed to deliver results irrespective of cultural differences.
- (vi) Makes the tacit knowledge more explicit and easier to transfer. This could avoid difficult and time consuming methods of accessing knowledge that is sometimes buried in paper archives.
- (vii) Make members more collaborative and build informal networking among members.

Answer 5

(a)

Relevant Learning Outcome/s:
5.8.1. Identify main leadership approaches (including trait approach, behavioural approach and situational approach to leadership)

Suggested Detail Answer:

Situational leadership theory proposes that the most effective approach to leadership depends on the work situation. There is no one right way to lead that will fit all situations. The ability of a manager to be an effective leader depends on the particular situation (which can vary) and the leadership style that they use.

(b)

Relevant Learning Outcome/s:
5.8.2. Recommend appropriate leadership types for different business situations

Suggested Detail Answer:

Hersey and Blanchard developed another situational theory and argue that the most appropriate leadership style depends on the work situation. Hence the leader should change their leadership style to meet the requirements of the work situation. According to them subordinates or team members are at different levels of personal development. The appropriate leadership style depends on the maturity of the subordinates. According to Hersey and Blanchard, the maturity of the members depends on:

- a. Competence in their job maturity.
- b. Commitment to the organisation's goals – psychological maturity.

According to them, leaders engage in,

- a. Directive activity. Giving guidance and direction.
- b. Supportive activity. Giving social and emotional support.

Appropriate level of activity from a leader depends largely on the maturity of the team.

They identify 4 leadership styles:

- (i) Delegating style. Amount of directive activity low and amount of supportive activity low.
- (ii) Telling/Directive Style. Directive activity high and supportive activity low.
- (iii) Supporting/Participating Style. Supportive activity high and directive activity low.
- (iv) Selling style. Both activities high.

When analysing the two teams under Nilan, Project team A seems to be at a higher level of subordinate maturity when compared to Project team B. The Project team A leader is well experienced and has worked with Nilan for a long time. The average experience of the team is also greater. Hence the competence in job maturity is higher. At the same time, they are a high performance team and meets targets within the given time frame. Hence the psychological maturity also seems to be higher compared to Project team B. Considering the same, a delegating style of leadership style seems more appropriate for Project A as Namal (project leader) understands the expectations of Nilan and the team is capable of delivering organisational expectations. They are capable of making the decisions and seem to be less reliant on Nilan. Hence, the delegating style seems more appropriate.

In the case of project B, the Supporting Style would be more appropriate. Manik is experienced and has a track record of delivering results. Hence too much of direction could demotivate her. However since the team lacked direction from the previous project leader and are behind the scheduled timelines, a high level of support activity would be required from Nilan.

Section 2

Question 6

(a)

Relevant Learning Outcome/s:
4.7. Managing the product life cycle

Suggested Detail Answer:

According to the given scenario, the hotel is at **maturity stage**. It can be further proved by the following features given in the scenario.

- Riverside Hotel experienced a rapid growth in the past years in terms of number of guests and profits. Further the hotel has faced a slowdown in the growth rate.
- Market share and profits have also faced a declining trend. However the hotel is still generating positive cash flows.

Therefore it was noted that the hotel has passed its growth stage of the PLC and now arrived to the maturity stage.

(b)

Relevant Learning Outcome/s:
4.8. Service marketing

Suggested Detail Answer:

As the hotel is in the service business, the extended marketing mix (7Ps) will be applied. Therefore the service marketing mix relevant to Riverside Hotel is given below.

- **Product**
Product consists of luxury rooms and suites, and other facilities such as a swimming pool, gymnasium which are available to all resident guests and a business centre, spa, and an ayurvedic center which are available on payment. Therefore all the service components and brands of each service can be included into the “Product” of the given scenario.

- **Price**
All the listed prices of each service and payment terms and conditions can be included in the price element of the marketing mix. Therefore prices of rooms and suits, discounts rates and payment methods and conditions belong to the price element.

- **Place**
Location of the hotel is included in the place element of the marketing mix. The Place is a very important element in the marketing mix for a hotel to attract customers. The location of the hotel is the place where services are provided and received by the customers.

- **Promotion**
The Promotion element consists of all the promotional efforts of the Riverside Hotel. Therefore advertising, sales promotions, public relations, personal selling, direct marketing etc. adopted by Riverside Hotel includes to the promotional element, e.g. seasonal discounts.

- **People**
All the human elements involved in providing services include the people element of the marketing mix. The services provided by the waiters in the restaurant of the hotel, management, room service staff, staff in the reception to welcome the guests to the hotel are a few examples of the people element. They can create a pleasant environment to customers and it has a direct impact on customer satisfaction of the services provided by the hotel.

- **Processes**
Process is the steps to be followed by guests for getting the service of Riverside Hotel. For E.g.: The hotel must ensure that customers make reservations for rooms and food before they arrive at the hotel.

- **Physical evidence**
All the physical aspects that may have an impact on the quality of services provided by Riverside Hotel will consist of physical evidence. The architectural design of the Riverside hotel, staff uniforms, colours used by the hotel, decorations, website design, are a few examples for physical evidence of the hotel. It can provide very powerful images to attract customers to the hotel.

(c)

Suggested Detail Answer:

Product

The hotel management should consider some modifications to the product element with the following improvements for the purpose of increasing sales

- Luxury rooms and suites need to have more space and facilities given to it and the suites should have more space than the luxury rooms.
- The beds have to be larger and more comfortable.
- Provide more facilities for guests- for example suites could be given free access to the spa and the ayurvedic center, while luxury rooms could have free access to one of them.
- A more private dining area for guests of luxury rooms and suites.

Price

The Riverside Hotel management can make the following modifications to the price element for improving the performance of the hotel.

- Revise the room rates for the suites based on the number of guests.
- Offer special discounts for seasons and types of guests.
- Arrange facilities to make payments by different channels etc.
- Offer special packages for special groups such as families and staff of different companies.

Place

The Riverside Hotel management can make the following modifications to the place element for improving the performance of the hotel.

- Ensure the environment is clean and there are no disturbances to the customers
- Take action to develop the surrounding road system for improving the convenience of customers to access the hotel premises.

Promotions

The Riverside Hotel management can make the following modifications to the promotion element for improving the performance of the hotel.

- Design new advertising campaigns
- Carry out sales promotions by offering special rates offering special discounts for frequent occupiers of luxury rooms or suites based on a loyalty program.
- A direct marketing campaign using social media and web base promotions etc.
- Designing new PR programs to enhance the credibility of the hotel

People

The hotel management can take the following action to improve performance through people.

- Allocate staff to handle the needs of guests in luxury rooms and suites. Special training might be needed on how to interact with guests.
- Motivating hotel staff by deploying an attractive rewards scheme.

Process

The hotel management can take the following action to improve processes which leads to higher customer satisfaction and to improve the results of the hotel.

- A faster check in and check out process for the luxury rooms and suites.
- Introduce an easy to use online booking system etc.

Physical evidence

The hotel management can take the following action to improve the “physical” evidence element.

- An enhanced ambience for the luxury rooms and suites. Each suite could be decorated on a unique theme (jasmine suite and lotus suite and so forth).
- Refurbishment/construction to make the location more natural and relaxed.

Note: Examiner has freedom to give marks for any acceptable suggestion for improving the marketing mix of the hotel)

(d)

Relevant Learning Outcome/s:
4.9. Customer relationship management

Customer Relationship Management (CRM) is the establishment, development, maintenance and optimization of long-term, mutually valuable, relationships between consumers and organisations. Many companies provide customised services by using CRM based computer software and customer databases. Therefore the Riverside hotel can obtain certain benefits by having a good customer relationship strategy.

The benefits to the hotel are given below:

- Hotel management can ensure that customers have a memorable experience and thus also generate positive word of mouth and revisits.
- Help to boost the reputation of the hotel and further boost revenue and occupancy based on positive word of mouth recommendations.
- Good CRM will also ensure that the hotel will obtain feedback from customers and the hotel should take action on specially the negative comments. This will help to improve the operations of the hotel.
- Ability to identify customers who have come many times to the hotel. This will also enable to implement loyalty cards, and promotions for customers who are in this category. Further their choices/preferences could be noted and adhered to and the check in for such customers could be handled faster.
- Further good CRM could ensure that the hotel collects data on all customers. This will give a rich pool of data such as demographics, preferences of the customers which will aid in decision making.

- For example if a lot of visitors were observed to prefer peace and quiet and closeness to nature, the hotel could now take action to further ensure that it happens. Further this pool of data will also give insights on consumer behavior, what are the consumers' wants and how they decide their requirements. Example whether the consumer is price sensitive or not.

Note: This is not a direct theory based question. Students are supposed to answer based on their general understanding of CRM. Therefore the examiner has freedom to give marks for any acceptable benefit of CRM to the hotel.

Answer 07

Relevant Learning Outcome/s:
6.3. E-business (Pages 285-286)

Suggested Detail Answer:

(a) There seems to be an emerging trend in Sri Lanka to buy books online. However 70% still prefer to buy books from physical stores. The following issues need to be considered when Denuma is to establish an online business division:

1. **Value Proposition**

How could the online platform provide value to the customers? 35% of the people who bought books online have mentioned "convenience" as a consideration. Hence the online platform will have to give considerable attention to the speed of the system and user friendliness.

2. **Revenue**

How will the business generate revenue for the company? The online platform can give access to markets that Denuma has not already reached. However, already they are present in all major cities in the island. Hence, additional revenue generation from the online business platforms through untapped markets could be questionable.

3. **Market opportunities**

What is the potential market size? What is the market segmentation? Since there seems to be a lack of availability of books in the local market, especially in the international textbook market, there could be a potential market opportunity to cater to this segment. Since the higher education students are much more tech savvy, the potential to buy books online could be higher. There is no longer a need to operate expensive retail locations with sales staff; the company can provide these books at lower prices than the competition which can result in an increase in revenue and profitability.

4. **Competitive environment**
The case doesn't provide much information about the competition in the local market. Both local and international online competition need to be considered.
5. **Competitive advantage**
In this case although the case is not specific, they would be able to offer a wide range of books at lower prices.
6. **Market strategy**
How will they enter the market to attract customers? Since 70% of the surveyed participants preferred to buy books from physical stores, they will have to carry out a lot of promotion and advertising to create awareness of the advantages.
7. **Organisation of operations**
How will they change their current processes to adopt to the delivery of services through an online platform?
8. **Management Team**
Who will be responsible to manage the operations? Mr. Sukitha will have to initially lead the team if they are to set up an online operation as he has the most experience setting up an online business.

Note: The students are not expected to provide answers to the extent that is provided above. Therefore the examiner has freedom to give marks for any acceptable explanation about the issues to be considered in establishing an online division.

(b)

Relevant Learning Outcome/s:
7.3 Strategic purpose of an organization

Suggested Detail Answer:

Strengths

- Denuma has more than 22 years of experience and a good reputation in the stationary industry in Sri Lanka.
- Sukitha's experience in working for a leading book store chain in UK and his involvement in setting up the online sales channel for the book store.

Weaknesses

- Varieties of publications are limited. Denuma Publishers were mainly from Authors of Piyadasa's friends and books are hardly selling.
- 20% of the book store space was taken by non-moving publications.

Opportunities

- 30% more people entered higher education in 2015. Willingness to purchase books via internet will increase.
- 33% of the survey participants have purchased at least one book online and it means that there is an opportunity to increase the percentage further in the future.

Threats

- Online purchasing is not that popular in Sri Lanka and as a result 70% of Sri Lankans prefer to buy books from physical stores. Therefore it appears that there is no threat. But with the introduction of a new business, the possibility of new entrants to the online market cannot be ruled out.

Note: The students are not expected to provide answers to the extent that is provided above. Therefore the examiner has the freedom to give marks for the general explanation about the strategic planning process relevant to the given scenario.

(c)

Relevant Learning Outcome/s:
7.6 Evaluation and implementation of business level strategy (Pages 359-360)

Suggested Detail Answer:

According to McKinsey's 7 S model the following are the elements to be considered in the successful execution of strategy.

Structure	-	The division of tasks in the organisation and hierarchy of authority, responsibility and decision making. In this case Sukitha will be the head of the online business division.
Strategy	-	Strategy is how it intends to achieve its objectives. Here strategy should focus on higher education students and the international text book market.
Systems	-	Systems are the procedures and processes designed for getting things done. When planning the online business division more consideration has to be given to IT systems.
Staff	-	These are the people in the organization. IT knowledge experience and attitudes of the staff should be considered.
Skills	-	These are the competencies, the company possesses. 22 years of experience in the business and Mr. Sukitha's experience will add value to the new online division.

- Style - Ways of working and attitudes of the management. Contradictions may arise between the present physical stores and the online business division.
- Shared values- How the new business division increases overall value and consistency with the existing strategy of the organization.

NOT FOR SALE

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