

STRATEGIC BUSINESS MANAGEMENT

Time allowed- 3:30 hours

Total marks- 100

[N.B. - The figures in the margin indicate full marks. Questions must be answered in English. Examiner will take account of the quality of language and of the manner in which the answers are presented. Different parts, if any, of the same question must be answered in one place in order of sequence.]

- | | Marks |
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| 1. a) Mr. Rahmat is the Chairman of ABC Ltd. He has been invited to participate in a TV talk-show on the topics 'importance of alignment of corporate's purpose and culture', 'dangers of mismatch between corporate image and corporate identity' and 'CSR as a threat to the purpose of an organization'. In this context, he has sent a note to you, Mr. Abir, CEO of ABC Ltd., asking answer to following questions: | |
| i) Is there always a perfect alignment between an organization's purpose and culture? | 2 |
| ii) Discuss the dangers of mismatch between corporate image and corporate identity. What strategies are possible for closing this difference gap? | 2 |
| iii) How can the emergence of the importance of corporate social responsibility be seen as a threat to the purpose of an organization? | 2 |
| b) Mr. Jalil, MD of PQR Ltd. asked you, Mr. Zamil, CFO of PQR Ltd., to list and briefly explain the factors that hinder the progress of new product development. | |
| Requirement: | |
| List and briefly explain the factors that hinder the progress of new product development. | 3 |
| c) Innovation can be a major source of competitive advantage of business firms, even though it comes with a burden of cost and uncertainty. Management would have to decide whether it would be a leader or follower in the industry regarding innovation. | |
| Requirement: | |
| State FIVE competitive advantages associated with being a first mover in product innovation in an industry. | 3 |
| 2. Surma Mineral Water Limited is one of the many companies producing bottled mineral water. The company was established in 2005 and has grown rapidly. Mr. Kazi Wasim has served as the managing director since the inception of the company. He is an accomplished entrepreneur and has received many awards both at home and abroad. | |

The industry

The competition in the bottled water industry revolves around pricing as each producer attempts to use penetration pricing strategy in order to capture maximum market share. Most of the materials used in the industry are imported

A decade ago, the industry had few players. Currently, there are numerous companies with low exit rate. The industry for most part of its existence, has remained unregulated and does not require huge initial capital. Since the inception of production of bottled mineral water, the government has been battling rubber pollution in major urban centers. The drainage systems are often choked with used plastic materials, which are not biodegradable. To address this menace, government is considering a special tax to raise money to clear the waste. Again, a bill is before parliament which when passed into law would require all to use biodegradable materials for packaging their products

Based on the concern expressed by the government over the years, a new body known as Plastic Waste Regulatory Authority was set up early 2020 to regulate the industry. The regulator is expected to enforce certain minimum standards to sanitize the industry and minimize the effect of its activities on the environment. This measure, according to the experts, will restrict new producers entering the sector.

The bottled mineral water produced is sold to corporate bodies in the form of water dispensers and bottled water. Also, they supply water to households and retailers through key distributors. The

margins of the key distributors are very low and only make reasonable profit on huge volumes. As a result, the key distributors tend to resist any price hikes by the producers. The past experience shows that anytime price increases, demand slows down as alternative sources of drinking water are sought by consumers. Again, some bulk distributors who perceive producers as raking in so much profit have ventured into production of bottled water in the past. Corporate clients are also cutting their expenditure on water. There are some companies that have commenced importation of bottled mineral water for their own use.

Most of the companies in the industry depend on only two sources of water – Water and Sewerage Authority (WASA) or bore hole. The industry water demand constitutes 8% of WASA output. The producers have also not formed any association to deal with issues affecting them collectively. The water supply is increasingly becoming erratic, unreliable, and very expensive with the withdrawal of government subsidies, further squeezing the margins of the sector. The working conditions of most of the workers in the sector is nothing to write home about and it has been difficult negotiating for better conditions, since they did not belong to any labor union. However, with the passage of the new labor law, it has become easier for the workers to join existing labor unions. As a result, most of the workers now belong to Industrial Workers Union.

The producers within the sector have a fair share of the market and no single company dominates the market. The market survey conducted indicates that the highest market share of the leading companies is 10%.

Expansion Plans

Surma Mineral Water Ltd currently has presence only in Dhaka and its surrounding settlements. The company is proposing to expand its operations to four regional towns in the country. The detail of the proposed investment is presented as follows:

The company has estimated investment outlays of BDT 200,000 (000) fixed capital items. This outlay includes BDT 25,000 (000) to be expended to acquire the land for the factory. The rest of the amount will be incurred on water processing and packaging plant that will be depreciated on straight-line basis over five years with scrap value. At the end of fifth year, the company will sell off the assets for BDT 60,000 (000). Additional initial investment is expected to be made in receivables and inventory of BDT 50,000 (000) and the short-term payables of BDT 20,000 (000) will be generated by the project. No further investment would be made in working capital during the project life and the initial investment would be recouped at the end of the fifth year.

The Board of Directors have tasked the Finance Director to advise the Board on whether to lease or buy the plant using a NBFIL loan.

The company could purchase the plant for cash using a bank loan on which the current rate of interest is 20% before tax. The trade-in value is BDT 20,000 (000). If the plant is purchased, the company can claim tax depreciation allowance of 25%, on a reducing balance basis over the plant's five-year life.

The company could lease the plant under an agreement which would entail payment of BDT 52,000 (000) at the end of each year for the next five years. The tax authorities allow lease payment for tax purposes. The corporate rate of tax is 25% and tax is payable one year in arrears. The company's required rate of return is 15%.

Requirements:

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| a) Assess the general environment in which Surma Mineral Water Ltd operates. | 6 |
| b) Analyze the nature of competition faced by Surma Mineral Water Ltd. | 6 |
| c) Advise management on the best option between lease or buy. Support your advice with relevant calculations. | 6 |
| d) Explain TWO other factors you will consider in reaching your conclusion in (c) above. | 2 |

3. a) GYM Ltd., a limited liability company, operates twelve fitness centers around Bangladesh. The facilities at each center are of a standard design and each center contains a heated twenty-five meter swimming pool, a sauna, a gymnasium and a fitness lounge. Each center also provides supervised child care facilities. The day-to-day operations of each center are the responsibility of a center manager, who is required however to manage the center in accordance with strict company policies. The center manager is also responsible for preparing and submitting monthly accounting returns to head office in Dhaka.

By law, each center must have a license to operate from the local government authority. Licenses are granted for periods of four years and are renewable at the end of each four-year period subject to satisfactory inspection reports from the inspecting authority. The average annual cost of a license is Tk.95,000.

All customers of the centers are enrolled as 'members'. Members pay a Tk.1,500 joining fee, plus Tk.800 per month for 'peak' membership or Tk.400 per month for 'off-peak' membership. Fees are payable annually in advance. All fees are stated to be non-refundable.

One of the fitness centers was closed between May and August in the financial year just ended, after a serious accident in the sauna involving chemicals. The center was re-opened at the end of August, but head office management issued an instruction to all the fitness center managers that the sauna facilities should be shut down until further notice.

Head office also is sued the fitness center managers with revised guidelines for the minimum levels of supervision for child care. This followed complaints from some dissatisfied members to the local government authority. Center managers have been finding it difficult to provide the additional supervision specified in the revised guidelines and some of them have recommended strongly that the childcare facilities should be withdrawn.

Each center operates early morning fitness sessions for members that run from 07.00 to 08.00 on four days each week. Every center has had problems with late arrivals by staff, and many members have complained strongly that they have turned up for sessions that were shortened in length or did not run at all.

Training staff is costly and time consuming but staff retention rates in the fitness centers are poor. In addition, staff turnover rates among the center managers are also high. Most leavers complain of excessive directions imposed on them by head office and by company policy.

Three of the fitness centers are expected to have run at a loss for the year to 31 December (just ended) due to falling membership. GYM Ltd. has invested heavily in building a hydrotherapy pool at one of these centers, with the aim of attracting members who are past retirement age. Completion of construction is behind schedule and costs to date are far in excess of the original budget. The pool is now expected to open within the next two months.

The company has experienced cash flow difficulties in the current year. As a consequence, head office management has decided to defer by at least one year the replacement of gym equipment in most of its centers.

Requirement:

Identify and explain the business risks that should be assessed by the management of GYM Ltd. Identify how each of the business risks identified may be linked to a financial statement risk.

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- b) TEL Electronics Ltd is a wholesale distributor of household electrical products of major electronic brands. The company currently sells on credit to all its customers. Although the credit term is net 20 days, the receivables turnover days has been 15 days. The company's annual credit sales revenue is TK.80 million, and its contribution margin ratio is 30%. Bad debt is 2% of sales revenue, and credit collection cost is TK.50,000 per annum.

Management is considering extending the credit period to net 30 days. It is expected that the implementation of this proposal would attract new customers, and the annual revenue would increase by 20%. It is also expected that both the existing and the new customers will probably take the full 30 day's credit. To mitigate the probable lengthening in the receivables turnover days, management proposes that the extension in the credit period be combined with the introduction of a cash discount policy of 2% on all payments made within the first 10 days of the credit period. It is expected that 30% of all customers will pay their accounts early to take the discount.

Consequently, the receivables turnover days would increase to 24 days. While the bad debt will remain at 2% of sales revenue, the annual credit collection cost will increase to Tk.65,000.

The company's cost of capital is 24%.

Requirement:

Evaluate the proposed change in the credit policy and recommend whether the proposed change should be implemented.

8

- c) JBL Limited took a 5-year loan of US\$ 20 million in January 2020 at a fixed interest rate of 12% per annum from an investment bank to finance a plant expansion project. At the time of taking loan, JBL was exporting a significant proportion of its output to a foreign market. Thus, it was sure that it would be able to earn U.S. dollars to make dollar payments on the loan. For about a year now, JBL has not been able to export its output to its foreign market due to trade restrictions. It sells only to buyers in Bangladesh for the Bangladesh Taka. The company now prefers to have its interest obligation in Bangladesh Taka rather than U.S. dollar.

On the advice of the Treasury Manager, JBL has entered a currency swap arrangement with a bank to manage the underlying risk exposure. Per the terms of the swap, JBL will continue to honour its obligations under the actual loan. Under the swap, JBL and the bank will exchange interests and principals in the appropriate currencies. With a pre-arranged exchange rate of Tk.86.50/USD1, the notional principals under the swap arrangement are agreed at US\$20 million and TK.130 million. The 12% interest rate on the existing dollar loan will continue to apply to both the original dollar loan and the dollar interest payments under the swap arrangement. The interest rate that will apply to the Taka notional principal is set to 15%.

Requirement:

Evaluate how JBL Limited can use the currency swap to manage the underlying risk exposure.

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4. INTRACO Ltd (INTRACO) is an international company with a presence in Bangladesh providing spare parts for the automotive industry. It operates in many different jurisdictions with different currencies. During 2020, INTRACO experienced financial difficulties partly due to the COVID- 19 pandemic marked by a decline in revenue, a reorganization and restructuring of the business and as a result reported a loss for the year. An impairment test of goodwill was performed, but no impairment was recognized. INTRACO applied one discount rate for all cash flows for all cash-generating units (CGUs), regardless of the currency in which the cash flows would be generated. The discount rate used was the weighted average cost of capital (WACC), and INTRACO used the 10-year government bond rate at its jurisdiction as the risk-free rate in this calculation.

Furthermore, INTRACO built its model using a forecast denominated in the parent company's functional currency. INTRACO felt that any other approach would require a level of detail that was unrealistic and impracticable. INTRACO argued that the different CGUs represented different risk profiles in the short term. Still, there was no basis for claiming that their risk profiles were different over a longer business cycle.

INTRACO has tested for the impairment of its non-current assets. It was decided that a building located in Vietnam was impaired due to flooding in the area. The building was acquired on 1 April 2020 at 25 million Dong (Vietnam currency) when the exchange rate was 82 Dong to Taka. The building is carried at cost. On 31 March 2021, the building's recoverable amount was deemed 17.5 million Dong. The exchange rate at 31 March 2021 was 86 Dong to Taka. Buildings are depreciated over 25 years. The tax base and carrying amounts of the non-current assets before the impairment write-down were identical. The impairment of the non-current assets is not allowable for tax purposes. INTRACO has not made any impairment or deferred tax adjustment for the above. INTRACO expects to make profits for the foreseeable future and assume the tax rate is 25%. No other deferred tax effects must be taken into account other than on the above non-current assets.

Requirement:

Evaluate the acceptability of the above accounting practices under IAS 36: Impairment of Assets and recommend the accounting treatment of the above transaction to the directors of INTRACO for the year ended 31 March 2021, including financial statements extracts in accordance with relevant International Financial Reporting Standards.

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5. a) Parag Chemist Ltd is a company engaged in the manufacturing of various drugs for the local market. There have been series of ethical infractions within the company. Some top managements have been accused of insider trading, bribing of some key staff of the regulatory authorities and attempts to cover up alleged distribution of expired drugs. There is total breakdown of ethical standards within the company. The board of directors have expressed grave concerns about the current happenings in the company. At its last quarterly meeting, the board resolved to engage the services of a corporate governance expert to help address the situation. The board understands that there are two major approaches to managing ethics in an organization.

Requirement:

As a corporate governance expert, you have been engaged by the board to advise it on TWO approaches to the management of ethics in organizations.

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- b) The International Federation of Accountants (IFAC) Code of Ethics discusses the need for professional accountants to be aware of and avoid conflict of interest situation as well as maintain independence in carrying out their professional duties. The professional accountant is exposed to several threats to independence, which are likely to lead to conflict of interest. A threat may arise where an assurance firm provides services other than assurance services to an assurance client.

Requirements:

- i) Identify the specific threat a professional accountant or assurance firm faces by providing the following services:

Preparing accounting records and financial statements.

2

Valuation services.

2

- ii) Suggest TWO measures each a professional accountant can take to minimize the threats identified in (i).

4

6. During the past year, the management of Dhaka Limited faced many challenges, including several customer complaints, loss of some key customers and a high level of employee turnover. At a meeting of the Board of Directors, the Chief Executive Officer presented a report on the financial performance of the company during the period, and, in his closing remarks, he said, "Overall, we have done very well, notwithstanding the challenges we faced." Some members of the Board were not happy with these remarks and accused him of doing a "partial evaluation" of the company.

Requirement:

- a) Explain FOUR limitations of the use of financial measures for evaluating the performance of the company.

4

- b) Describe THREE financial measures and THREE non-financial measures that Dhaka Limited may use to evaluate its performance.

6

7. Luna is a junior member of an audit firm and has just returned to work after taking compassionate leave to care for her sick mother. For financial reasons, Luna needs to work full-time. Luna has been having difficulties with her mother's home care arrangements, causing her to miss several team meetings, which usually occur at the start of each day, and she needs to leave work early as well. In terms of her capabilities, Luna is very competent at her work, but her frequent absence puts severe pressure on her and her overworked colleagues. Luna's manager knows that workflow through the practice is coming under intense pressure and in order that the team's output is not affected, had a discussion with the audit team on Luna's circumstance. This has however led to some members of the audit team undermining Luna at every given opportunity, putting Luna under even greater stress.

Requirements:

- a) In accordance with the IFAC's code of ethics, assess three (3) possible fundamental ethical principles that might have been breached.

3

- b) Recommend the possible actions that the manager should take as a member of the Institute of Chartered Accountant, Bangladesh in dealing with this ethical dilemma.

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