

SBL Specimen Exam 2 Suggested Solution

In the Strategic Professional Examinations, it is not always possible to publish suggested answers which comprehensively cover all the valid points which candidates might make. Credit will be given to candidates for points not included in the suggested answers, but which, nevertheless, are relevant to the requirements. In addition, in the integrated case study examination candidates may re-introduce points made in other questions or parts of questions as long as these are made in the specific context of the requirements of the question being answered.

The suggested answers presented below inevitably give much more detail than would be expected from most candidates under examination conditions and include most of the obvious points evidenced from both the pre-seen information and the additional information provided in the case study exam information. These answers are therefore intended to provide a structure of the approach required from candidates and cover the range and depth of knowledge relating to each task which might be demonstrated by the most well prepared and able candidates. They are also intended to support revision and tuition for future examinations.

Task 1)

Report to board of Yexmarine

Introduction

This report evaluates the two proposed investment projects – a new range of sailing dinghies versus a new range of luxury yachts. There is \$10m available to invest in either project, but not enough funds to complete both. This report evaluates the two projects and makes a recommendation.

Sailing dinghies

Financial benefits

The project has a positive net present value of \$5.5m, indicating it should create value for Yexmarine. It seems that revenue would soon be earned from the sailing dinghies and the payback period of under four years appears acceptable, given the five year time horizon for improvements in Yexmarine's financial performance set by the chief executive. The investment would leave surplus funds of \$6m for investment elsewhere.

As a cheaper and simpler craft, the market for sailing dinghies is likely to be wider, and the demand may not vary as much as for cruising yachts due to economic conditions, so the investment may represent effective diversification. Fashion changes are unlikely to affect the demand for sailing dinghies and they have the potential to become a steady long-term cash cow for Yexmarine.

As Yexmarine is larger than the other companies that currently manufacture sailing dinghies in Neoland, it should be able to take advantage of economies of scale, particularly after the move to the new premises.

Financial drawbacks

The gross and operating profit margins of 35% and 12% are lower than Yexmarine's current margins and the chief executive's targets. Having a price of \$4,000 which is lower than the sector average of \$5,000 may initially help Yexmarine establish itself in this segment of the market, but often sailing dinghies will be bought as a one-off purchase, so having low prices to encourage repeat purchases is not effective.

Having the lowest price might also be a problem if the dinghies are seen as lower quality. The target market appears to be families who are learning to sail with their children, and who are likely therefore not to wish to compromise on a perceived lack of safety features which they may associate with a lower price option.

Non-financial benefits

By entering this market, Yexmarine would be differentiating itself from its main competitors. It would be adopting a clear cost leadership strategy in the new market, going some way to address the concern that it is losing market share in the cruising yacht market. The standard design of sailing dinghies is simpler than cruising yachts, so this may allow for a learning curve effect and ultimately more efficient production.

A customer purchase of a dinghy could be the start of a relationship which will result in subsequent business for Yexmarine, including repair and maintenance work and perhaps, in some instances, eventual trading up to a more expensive cruising yacht.

Non-financial drawbacks

Yexmarine faces a significant amount of local competition in this market. Although other manufacturers are smaller, they are long-established. As the design of sailing dinghies is simpler than cruising yachts, it may be difficult for Yexmarine to differentiate its dinghies from its competitors.

The move may also lead to confusion as to what Yexmarine's overall strategic position is. Yexmarine being associated with a cheaper, simpler product will potentially cause confusion as to where it stands in the cruising yacht market.

Luxury yachts

Financial benefits

This investment also has a positive net present value of \$7m. Both the gross and operating profit margins on luxury yachts of 62% and 28% are higher than the current targets. The yachts are aimed at very rich customers, who may be less affected by an economic recession and may not economise on luxury products. High returns from this product could generate surplus funds for investment elsewhere.

Financial drawbacks

The net present value calculation is likely to be an expected value based on figures which are very uncertain, because Yexmarine does not currently have a presence in this market. The figures may hide considerable variations, including the possibility that Yexmarine will fail to succeed in this market. Given the high selling price, the forecast figures will be significantly affected by quite a small number of sales, indicating the need for sensitivity analysis.

The difference between the gross and operating profit margins of 34% is rather larger than for Yexmarine overall (25% current and forecast), indicating that relatively high fixed costs which would be incurred whatever the sales level.

As Yexmarine will also be selling to foreign customers, it will face foreign exchange risk if it bills in their currencies.

The planned investment utilises all the available surplus funds of \$10m from the sale of the two Hameldon sites. This means that Yexmarine's future would be very dependent on the success of this investment over the next few years and raises the question of additional finance requirements if expenditure turns out to be higher than expected. Costs would not start being recouped until revenue was received in three years' time. No payback target has been set, but a payback period of six years appears to be lengthy in the light of the chief executive's targets relating to improving performance within the next five years.

Non-financial benefits

Producing luxury yachts would mean Yexmarine was clearly differentiated from its main local cruising yacht competitors. Success in this market would give Yexmarine an international presence and may also make the company more appealing to investors if it sought a listing. Production of bespoke yachts could make better use of the craftsmanship skills which Yexmarine's employees have. Once Yexmarine has started constructing luxury yachts, some of the features could perhaps be incorporated into the cruising yachts.

Non-financial drawbacks

Yexmarine faces established foreign competition in this market, including larger manufacturers. The number of customers in the market is likely to be limited. Breaking into this market will not only involve considerable expenditure but also time resource from management, with no certainty of success. It is difficult to see how Yexmarine could differentiate itself sufficiently from established competitors. The benefits from the move to the new premises, the ability to produce standardised products more efficiently, would not be relevant for luxury yachts constructed individually.

Recommendations

Yexmarine should not enter the luxury yacht market. The prospect of success against established manufacturers is insufficiently high and the commitment of current financial and non-financial resources too great and quite uncertain. Possibly the board

might reconsider the investment if Yexmarine achieves a listing and additional finance becomes available.

Yexmarine should consider entering the sailing dinghies' market, as its size may give it economies of scale and it would be compatible with the planned changes in moving to new production facilities. However, diversifying into sailing dinghies would not help Yexmarine address the issues it currently faces in the cruising yacht market.

Task 2a)

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Dear Tony

Establishment of strategy committee at Yexmarine

Thank you for giving me the opportunity to comment on your proposal. I agree that there is a case for establishing a strategy committee, given the important strategic decisions which Yexmarine may need to take over the next few years if financial performance is to be improved and the proposed transformation of Yexmarine's business takes place. There will also be a need for reappraisal of governance structures if Yexmarine seeks a listing.

Governance regulations will require the setting up of other board committees, for example the audit committee, and you will need to consider how the strategy committee fits within the overall committee structure.

Benefits of strategy committee

Strategic planning

The terms of reference you propose include strategic planning. Decision-making will be enhanced if investment projects are viewed in the light of plans to achieve long-term strategic objectives. Long lead times and the large capital expenditure required make it important for decisions on investments to fit within the strategic planning framework.

Review of environment

The terms of reference emphasise the importance of the committee actively seeking to be aware of environmental factors and particularly what competitors are doing. Consideration of these factors is very important in determining the suitability and feasibility of strategic options. If competitors are already established or planning a large investment in a particular market, Yexmarine may not succeed in that market or will need to spend too much to make an impact in it.

Consideration of strategic options

Establishing a strategy committee should ensure that sufficient time is given to considering strategic options. Board meetings have to consider a range of issues, and this may limit the time available for a full discussion of strategy.

Problems with strategy committee

Confusion of responsibilities

Governance best practice states that certain decisions must be reserved for the main board, including decisions about major investments. This is to ensure proper board accountability. The proposal that the strategy committee should be responsible for choosing strategic options to be recommended for board approval may lead to confusion between the responsibilities of the committee and the board. It could also mean the board being required to act as a 'rubber-stamp' for decisions made in this committee, which would limit the input of directors who are not members of the strategy committee. It would be more in line with governance best practice for the committee to evaluate strategic options and to then present them to the board for consideration and decision-making.

Role of non-executive directors

Governance requirements also recommend the need for strategic proposals to be scrutinised and challenged. This is, in particular, the responsibility of non-executive directors. However, the proposed membership of the committee does not include any non-executive directors. Non-executive directors can bring wider perspectives, based on their own experience, to strategic decision-taking and can also help ensure decisions are taken in the light of what is acceptable to key stakeholders.

Frequency of meetings

The frequency of meetings is not defined. But the committee's terms of reference include environmental monitoring, which needs to be continuous. Therefore, meetings will need to be regular. A minimum number of meetings each year, to ensure that regular consideration is given to environmental issues, should be specified, with one-off meetings being held if there is a particularly significant opportunity or threat arising from the environment that need to be considered.

Financial aspects

There is no specific mention in the terms of reference to the committee considering the financial aspects of strategies. The finance director has not been included as a member of the committee. This may mean that financial aspects are given insufficient consideration, so you should consider whether the finance director should be a committee member. The terms of reference also should specify the need for the committee to consider financial aspects. This should be supported by specification of the financial information which the committee needs to consider.

Links between corporate and operational strategy

The terms of reference also fail to mention the links between corporate strategy and operational strategy. There may potentially be confusion about how much autonomy functional directors have in decision-making in the light of the overall strategic framework determined by the strategy committee.

Human resources

In addition, the terms of reference do not have anything about the committee considering internal resources and capabilities. Whilst members of the committee can provide assessment of the areas where they have operational responsibilities, the exclusion of the human resources director from the committee means there is a danger that personnel issues may not be considered. These may be particularly important in the light of the changes which employees will experience when they move to the new facility in Lympool.

I hope you find these comments constructive. Please do not hesitate to get in touch if you wish to discuss these points further.

Yours sincerely

Consultant

Task 2b)

Briefing notes for board of Yexmarine on the impact on the change process

Impact on the change process

The organisational change process can be viewed using a standard model of change. The stages are getting employees prepared for changes in behaviour, processes and operations (unfreezing), the move to new premises itself (change) and the rapid settling down into the new situation (refreezing). Employee dissatisfaction could have consequences for each stage of this process.

Unfreezing

Employees' beliefs that their opinions will be ignored will hinder any process of consultation during this stage. Employees may be reluctant to offer opinions if they feel no notice will be taken of them, or if they fear that expressing opinions which are unpopular with management could be held against them. There also seems to be a risk that more experienced or specialist employees will leave the company. This will mean that there will be a lack of motivated employees who could lead the process of change and help convince other employees.

Change

The actual move to the new premises is likely to require employees making a commitment of time greater than their normal employment to ensure disruption is kept

to a minimum. Employees may be unwilling to make this extra commitment if they are not rewarded for it.

This is also the time that new processes will be introduced. If employees have not tried to learn them properly or resent them, there is a risk that management could face active resistance from employees, increasing the level of disruption which the move will cause. This could result in service to customers being disrupted.

Refreezing

There is a significant risk that employees will revert to old routines after the move has taken place. This will require management time to correct and is likely to increase resentment, particularly if employees still regard Yexmarine's management as coming from a different culture. This could mean decreased operational efficiency due to significant employee turnover. As a result, Yexmarine may find that the quality of service given to customers falls.

Task 3a)

Report to chief executive

Introduction

This report deals with suggestions to mitigate risks made by the operations director.

Flooding risk

The assessment of flooding risk as non-serious could be justified if the risk was said to be remote. However, as Yexmarine's new site will be in a coastal town with recent experience of flooding and more predicted to occur, the risk seems potentially serious. Further investigation should be undertaken to determine the overall impact and probability of flooding.

If the risk is assumed to be low probability but high possible impact, transferring the risk to an insurance company would be an appropriate general strategy. However, if the risk is considered to be higher probability, insuring might become very costly or the insurance options open to Yexmarine may become limited.

Watching for flood warnings would give advance warnings of trouble, but there is no mitigating activity to reduce the impact of floods if they do occur. Yexmarine will be dependent on the state of local flood defences, but they may not be enough.

Further risk mitigating activities

Yexmarine should take some flood precautions itself to prevent or slow the impact of flooding. Yexmarine should also have a contingency plan to reorganise premises or move some assets, for example electrical machinery or computers. The plan should also include steps to clean its premises up as quickly as possible if they have been flooded. However, contingency planning will not be able to prevent damage to the premises or the yachts themselves if flooding is serious.

Product obsolescence risk

Yexmarine needs to be aware of what its main competitors are doing. However, just trying to catch up with competitors will take time and is essentially a reactive strategy.

Adding additional features to current models may be seen as being reactive and not making Yexmarine distinct from its competitors, and expenditure on limited changes could produce negative returns.

Further risk mitigating activities

Yexmarine needs to take steps to be aware of developments internationally as well as locally, so it can recognise innovations which may take it ahead of its competitors.

Yexmarine also needs an overall innovation strategy. This would start by developing an infrastructure which includes advanced information technology, human resource design capability and production processes flexible enough to be able to cope with continual evolution. Product development processes can be built on the back of this infrastructure. Yexmarine also needs a new marketing message and refreshed image, and to make better use of marketing media.

Data risk

The activities listed will provide some protection provided they are operated thoroughly. All software used must be regularly updated and back-ups taken regularly and stored separately using cloud storage. Passwords will help restrict access, although to enhance security there should be different levels of password allowing access to different information, and password protection procedures including the requirement for regular changes. Physical access barriers will help control over non-staff onsite, but cannot protect against loss of data on computers taken offsite or when data is being transferred.

Further risk mitigating activities

The controls given will also be strengthened by general controls that promote risk awareness or review risks, including training, identification of unusual online activity and appointment of an information security officer.

Reputation risk relating to products and services

The activity of monitoring public opinion is clearly justified. Benchmarking against competitors can be helpful for both products and services. For products it can establish where Yexmarine may be able to differentiate itself, for services it can establish where its levels are better or worse than competitors and suggest targets.

A quality management programme is relevant to repair services (customers want their products repaired properly) and also to yacht construction. However, customers, when

buying a boat, will assume it conforms to specifications and is safe, and that will not determine their buying decision.

Further risk mitigating activities

There is no mention of monitoring the opinion of existing customers. This needs to be highlighted as a separate activity, as it may provide early warnings of product problems and also identify threats to maintaining relationships with customers,

Yexmarine also needs to take action on factors which will influence buying, deciding the focus it will give and ways it will make existing products appear more appealing than its competitors'. Marketing initiatives will also be needed to reinforce these messages.

Task 3b)

Briefing notes for board of Yexmarine on benefits of e-marketing

Building communities

E-marketing can enhance Yexmarine's customers' perception of belonging to a community. Discussion forums on Yexmarine's website, or groups on social media such as Facebook, can help answer customers' questions. They also can encourage customer responsiveness, customer-to-customer contact, and customer-generated content on issues connected with yachting which interest them. Further sub-communities could also be developed. Owners who've recently bought their first yacht would be one possibility.

Communities could be a source of direct commercial advantage – for example yacht purchasers being entitled to membership of an Extranet. Yexmarine can also use the information gleaned from the online communities to feed into product development and other process improvements.

Individualisation

E-marketing can result in marketing being better targeted at individual customers. E-marketing allows for a more systematic collection of information about individuals and their preferences than face-to-face contact allows. It provides opportunities for individuals to initiate contact by means such as banner ads. Individualised content can be delivered through webpages and email, with users supplying details that ensure they receive what will be of interest to them. Websites or social media can provide ways for users to express likes and dislikes or ask questions, giving the impression that their concerns matter and also enabling Yexmarine to understand what its customers' requirements are.

Use of social media

It is certainly true that the more use is made of social media, the wider the reach is likely to be. Making use of the most currently popular forums can help correct the impression that Yexmarine has an old-fashioned approach. Wide social media use by

a younger demographic can mean that Yexmarine's reach can be extended beyond its current, older, customer base, which is important for the company's long-term appeal. Social media use can also be a part of an international marketing strategy, which may become more important for Yexmarine depending on the product investment decisions it makes.

Promotion of employee expertise

E-marketing can offer a number of avenues to promote staff expertise. Blogs by senior or specialist staff offer the chance to display knowledge. Their benefit can be enhanced by interaction by customers, so that they address the areas of interest to customers or questions customers have. Video links on websites can film staff demonstrating their work. This can promote interest from customers, and can also strengthen the relationships with them, as customers see staff that they have dealt with in action.

Marketing major product developments

E-marketing provides many ways in which major product developments can be promoted. Some of these, such as mailshots, will be linked to the individualisation of marketing. E-marketing offers various methods to create interest. Social media gives the chance to communicate key features, sustaining a 'buzz' by releasing details. Yexmarine can use a viral marketing campaign by supplying a promotional message by email, which is then forwarded on by other users. The response sites offered by social media allow for adaptability by responding to concerns raised. The website can offer still images with a wider potential circulation than promotional brochures and can offer video tours or demonstrations, highlighting yachts' particular selling points.