

Strategic Professional – Essentials Examination

# Strategic Business Leader

Specimen 1 Examination  
Valid from September 2018 Exam Session



**Time allowed:**

4 hours including reading, planning and reflective time

This question paper is an integrated case study with one section containing a total of 100 marks and ALL Tasks must be completed.

All Tasks contain Professional Skills marks which are included in the marks shown above

**Do NOT open this question paper until instructed by the supervisor.**

**You must NOT write in your answer booklet until instructed by the supervisor.**

**This question paper must not be removed from the examination hall.**

Think Ahead

**ACCA**

# Strategic Business Leader

The Association of  
Chartered Certified  
Accountants

## Strategic Business Leader – Specimen Paper 1

You are Hoi Lui, a management consultant leading a small team which has been commissioned to prepare a consultancy report for the Data Communications Services (DCS) Company directors to help them plan for the next three years. DCS Company has two product areas. The largest area is the manufacture of data communications components which it mainly sells to original equipment manufacturers (OEM). The other smaller and less developed area is based on supply and support contracts for specialist IT management network systems, mainly to domestic medium-sized enterprises. You are a qualified accountant and your colleagues are Danny Leman, a company researcher, and Freddie Lithium who is a part-qualified finance professional. You and your team have collected and analysed the following information about DCS Company to help you prepare the consultancy report.

- Exhibit 1: A report on DCS Company's *organisational overview, the external environment and the business model* sourced and prepared by Danny Leman, your colleague
- Exhibit 2: A transcript from interview which was held between you and Java Peraya, the CEO of DCS Company.
- Exhibit 3: Summary of financial and business performance of DCS Company extracted from the Integrated Report (2012–2015) presented to you by the finance director of DCS Company
- Exhibit 4: The October board report, a recent board meeting notes which include strategic choices facing DCS Company – presented to you by the marketing manager of DCS Company
- Exhibit 5: An evaluation of alternative future strategies being considered by the DCS Company board, prepared and presented to you by your colleague, Freddie Lithium
- Exhibit 6: Minutes from the focus group meeting you held with middle management of DCS Company

Following your findings you are now starting to prepare the consultancy report and associated tasks for DCS Company.

The case requirements are included in the tasks shown below:

- 1 (a) **From the information you have collated, draft a section of the consultancy report for the directors of DCS Company to include the following:**
- (i) **An analysis of the industry and market which DCS Company is competing in, using an appropriate model.** (15 marks)
  - (ii) **An evaluation of the overall performance of DCS Company between 2012 and 2015 from an integrated reporting perspective.** (12 marks)
- Professional Skills marks are available for demonstrating analytical and evaluation skills relating to DCS Company's environment and performance. (4 marks)
- (b) You are now reviewing the transcript of the interview you held with Java Peraya, the CEO of DCS Company and you identify some key weaknesses relating to the governance of DCS Company which you want to include in the consultancy report.

### Required:

**Explain the key weaknesses of the current governance structure of DCS Company since it became a public limited company, recommending how they should be addressed.** (12 marks)

Professional Skills marks are available for demonstrating scepticism and analytical skills in identifying key weaknesses from the information given. (2 marks)

- (c) Under the *Strategy and resource allocation* heading in the October board report, the possibility of DCS Company supplying and supporting such technologies as cloud computing and big data analytics is referred to. To accompany the consultancy report a presentation is needed about the exploitation of such new technologies.

**Required:**

**Prepare information for two presentation slides to be presented to the DCS Company board, including relevant bullet points and supporting notes, highlighting the key benefits and identifying the main opportunities presented by big data analytics to DCS Company and its customers.** (6 marks)

Professional Skills marks are available for demonstrating communication skills in highlighting the key points to include in the slides and for clear supporting notes. (2 marks)

- (d) You have noted from information you have gathered that DCS Company has an increasing carbon footprint, which it estimates in total, but is failing to control adequately. As part of the consultancy report you are considering recommending to DCS Company that it commissions a specialist environment and sustainability consultancy company to assess these issues at DCS Company.

**Required:**

**Draft a concise section of the consultancy report which constructs the case for commissioning an environmental and sustainability audit of DCS Company, from both a financial and environmental perspective, suggesting ways in which the consultants might assist DCS Company managers to become more sustainable in the management of the DCS Company carbon footprint.** (5 marks)

Professional Skills marks are available for demonstrating commercial acumen in identifying how DCS Company could benefit from the findings of the audit. (2 marks)

**(60 marks)**

- 2 In the October board report, the executive directors refer to a number of factors affecting DCS Company and the need to choose one of two alternative strategic options. You now need to do the following:

**Required:**

- (a) **Draft a section of the report to identify and briefly discuss THREE main risks which DCS Company currently faces and plot them on a heat map, recommending appropriate strategies to manage those risks using an appropriate risk management framework.** (6 marks)

Professional Skills marks are available for demonstrating commercial acumen/judgement in identifying and locating the risks appropriately. (2 marks)

- (b) You are reviewing the spreadsheet prepared by your colleague Freddie Lithium which evaluates the strategic choices facing DCS Company in the next three years, to ensure its validity in supporting your recommendation in the consultancy report.

**Required:**

- (i) **Critically evaluate the contents of the spreadsheet including any assumption made by the DCS Company board.** (5 marks)

Professional Skills marks are available for demonstrating scepticism/evaluation skills in analysing the spreadsheet and any supporting assumptions. (2 marks)

- (ii) **Prepare some key recommendations for the consultancy report, using appropriate supporting evidence to advise which of the two strategies, *re-focus* or *re-align*, DCS Company should implement.** (5 marks)

Professional Skills marks are available for demonstrating commercial acumen skills in justifying the recommendations. (2 marks)

**(22 marks)**

- 3** You have highlighted from your interview with Java Peraya and from your notes from the middle management focus group meeting, that there are some key stakeholder management and engagement issues at DCS Company.

You are now preparing working notes, with relevant visual aids, which will form a key part of your presentation of the overall consultancy report.

**Required:**

- (a) Using appropriate stakeholder analysis, evaluate how the relative power and interests of the following three stakeholder groups and the strategies for engaging with them should have changed after DCS Company became a public limited company.**

- **Shareholders;**
- **Employees;**
- **Lenders.**

(9 marks)

Professional Skills marks are available for analytical skills for assessing the relative power and interest and how to engage with these stakeholders before and after flotation. (2 marks)

- (b) Criticise the CEO's and HR director's ethical and professional behaviour relating to the design, conduct, and reporting of the staff satisfaction survey.** (5 marks)

Professional Skills marks are available for scepticism and communication skills in identifying ethical and professional issues in the conduct of the survey and communicating these criticisms to the client in a way that is appropriate. (2 marks)

**(18 marks)**

## Exhibit 1

### Background report to the DCS Company

To: Hoi Lui  
From: Danny Leman  
Subject: Organisational overview, the external environment and the DCS business model  
Date: 20 November 2015

#### Notes:

#### Organisational overview

Data Communications Systems (DCS), a publicly listed company on the small companies' capitalisation (*SmallCap*) index of a national stock exchange, used to be a privately owned high technology company established in 1997 by computer engineer, Java Peraya. Due to a rapid expansion over the following years, DCS needed to source additional capital to fund its future growth and was floated on the national stock exchange in 2006. This allowed Java Peraya to realise his majority shareholding in the private company. 30% of the flotation was purchased by institutional investors and DCS also borrowed long-term funds to leverage the newly issued share capital. Before flotation, the company was almost exclusively financed from the founders' share capital, retained earnings and short-term finance.

#### External environment

DCS has its headquarters in Prydain, a prosperous developed nation with a stable and well established political system and which has highly developed labour laws including a national minimum wage and a newly introduced obligatory contributory pension scheme. The government, like many governments worldwide, has invested heavily in a national telecommunications infrastructure which has led to a significant growth in social media and where virtually 75% of the population are connected to the internet through a range of devices including mobile technology. The government is also proposing a new carbon tax which will affect companies which manufacture and provide IT network services such as data communications components and systems. The electronics and IT industry has recently been identified as a sector with an increasing carbon footprint caused by their applications, such as component cooling devices, complex telecommunications network components and cloud computing technology. Although DCS Company can approximately estimate its total carbon footprint from the manufacture and supply of components from its factory, it has not yet developed formal systems and processes to manage its carbon footprint throughout the value chain.

#### Business model

DCS has two distinct product/service areas – data communications components manufacture and the supply and maintenance of network management systems, including technical support.

The DCS employees are a mixture of technically qualified engineers, working in research and development (R&D), factory staff manufacturing and assembling products and an IT sales and service support team. Since the flotation of the company, 60% of production employees in the data communications components factory joined a major trade union. In 2012 the country suffered an economic downturn which led many companies to postpone technological investment and by then DCS employed 150 full-time employees.

The main revenue source for DCS is the high-volume low cost data communications component manufacture part of the business and it has 1% of the total market share, which accounts for approximately 65% of DCS's total turnover. DCS mainly sells and supplies large volumes of data communications components to original equipment manufacturers (OEMs), 30% of which are based outside Prydain on a continent which has a single currency which is devaluing against the Prydain dollar. Success in the data communications components sector comes from the economies of scale achieved by producing high volumes of reliable components and keeping prices low. DCS Company has achieved this despite producing components in a country where there is significant employment legislation setting minimum wage rates and conditions.

The second product area is much smaller and is based on supply and support contracts for specialist IT management network management systems, mainly to domestic medium-sized enterprises, which currently yields a relatively higher gross profit margin than the data communications component products. A key aspect of this second product area is the installation and support of big data analytics capability along with cloud computing storage, which can be used to replace existing costly IT architectures such as unsophisticated data warehouses to allow business clients to collect and analyse more targeted and timely data about their own customers and purchasing patterns. Much of this can be obtained from data held within social and business networking software.

## Exhibit 2

### Transcript from interview held between you and Java Peraya, the CEO of DCS Company.

*You:* Thank you very much Mr Peraya for showing me around the offices and factory. I found your staff and their comments very interesting.

First of all, could I ask you to tell me how you would describe how your company is structured and managed?

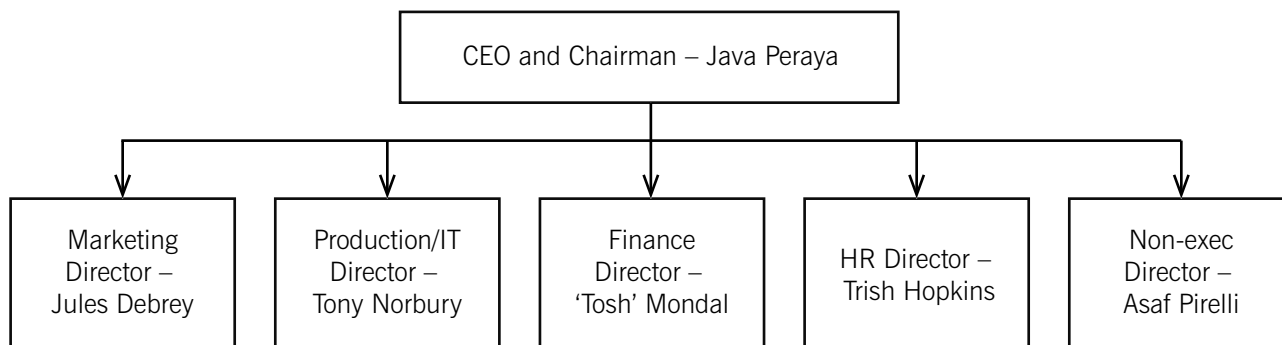
*Java:* I would describe DCS as fairly highly centralised. I suppose in 'management speak' we would describe the DCS management structure as a 'functional bureaucracy'. We prefer not to allow too much managerial or departmental autonomy, for their own good of course, to ensure that they act in the best interest of DCS and to avoid irresponsible risk taking, which unfortunately has happened occasionally in the past.

We expect middle managers to respect and respond positively to senior management requests or directives and not to question these unless they are very sure of their facts. This is probably a legacy from the pre-flotation era, where much of the strategic direction was always decided by me and my closest senior directors, most of whom were my family and trusted friends.

*You:* Would you mind explaining how your company is directed by describing your corporate governance arrangements to me please?

*Java:* Yes I can – please look at this chart.

Java hands you an extract of the organisational chart represented below:



*Java:* Since 2006 DCS has been governed by a board of directors with me acting as CEO and chairman, giving me sufficient control to effectively direct the company and take strong leadership over the board, encouraging debate and driving the agenda. The board comprises a marketing director, Jules. He was my original sales manager employed by the company, who I have known a long time now. We also have a production and IT director, Tony, who has been with the company for over 10 years. He has a strong background in data communications hardware components. Tosh is our finance director. He joined the company just before the company was listed on the national stock exchange. Trish Hopkins is our female HR director and we also benefit from an independent non-executive member of the board. We were very fortunate to appoint Asaf because he is a very talented businessman and also an executive director of one of our two largest suppliers. This means that he has a really good knowledge of our business and of the data communications industry.

*You:* That is really useful background Mr Peraya. So what about standing governance committees which presumably report to the board?

*Java:* We have an audit committee constituted of three experienced network engineers who focus on and investigate internal control and quality failures when they arise. To promote more independence, we have also appointed a non-executive director as chairman on this committee who is a former compliance officer at an airport, whose background is in air traffic control and aviation regulation, but she is also a telecommunications expert.

*You:* What about a risk committee and do you have nominations or remunerations committees?

*Java:* DCS has no separate board appointed risk, remuneration or nominations committees. All strategic and long-term planning initiatives are initiated and decided upon by the main board led by myself and, of course, our management structure and culture is such that we embed risk management through having that close control over staff that I mentioned to you previously. As for salary, we strongly believe that all board members should be on a fixed salary to encourage them to take a longer term perspective rather than rewarding them with short-term performance bonuses.

As far as recruitment, remuneration and succession planning is concerned, I personally approve and manage all middle to senior staff recruitment and staff promotions, so there is no need for formal induction processes for our directors or senior management.

*You:* Now that you are a listed company, how do you report to and engage with your shareholders, particularly institutional shareholders?

*Java:* DCS does not have special governance or reporting structures to engage with shareholders, including institutional shareholders, but of course we do meet our minimum company law obligations in relation to statutory reporting to shareholders, shareholder democracy, voting and other constitutional rights.

*You:* That was all very useful Mr Peraya, but what I would like now is more data on the overall performance of DCS and a copy of the October board report, which I know was considering the strategic options facing DCS.

*Java:* Certainly, I will ask Tosh Mondal to send you our summarised integrated reporting data attached on a spreadsheet. I will also ask the marketing director to send you the board report for October.

*You:* Thank you very much Mr Peraya.

### Exhibit 3

Extracts of the integrated reporting data (2012–2015) from the finance director – Tosh Mondal

#### Financial performance: (all figures in \$m)

<b>Financial periods:</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Sales revenue (domestic and international)	6.95	7.40	6.80	4.75
Cost of sales	4.97	4.85	4.25	2.62
Gross profit	1.98	2.55	2.55	2.13
Overhead expenses	1.12	1.51	1.41	1.30
Profit before tax and finance costs	0.86	1.04	1.14	0.83
Finance costs	0.69	0.38	0.37	0.14
Tax expense	0.02	0.06	0.08	0.15
Profit for the year	0.15	0.60	0.69	0.54

#### Other data:

	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>
Number of employees	127	135	143	150
Staff turnover (%)	10%	7%	5%	4%
% of orders delivered late	10%	8%	7%	5%
Forward contract order book (number of orders)	2,500	3,750	4,150	3,505
Customer complaints as a percentage of total orders and existing contracts	3.4%	2.4%	2.0%	1.5%
Employee satisfaction survey score (100% max)	61%	65%	68%	72%
Investment in non-current manufacturing equipment as a percentage of sales revenue	7%	8%	8%	10%
R&D expenditure as a percentage of sales revenue	3%	5%	5%	6%
Carbon emissions in kg per \$1,000 sales revenue	80	75	65	60



## Exhibit 4

### The October board report for DCS Company

To: The Board of Directors – DCS  
Subject: Strategic overview – DCS Company  
From: Jules Debrey (marketing director)  
Date: 12 October 2015

#### Introduction:

This report is based on information obtained from all the executive directors of DCS, under several main headings. The report highlights risks, opportunities and the future outlook for DCS. It also focuses on strategy and resource allocation, highlighting a key strategic decision which the board will need to make in the near future.

#### **Risks and opportunities: What are the specific risks and opportunities which affect DCS's ability to create value over the short, medium and long term, and how is the organisation dealing with them?**

By 2014, the international market for data communication components started to saturate and decline.

For the supply and support of contracts for specialist IT network management systems, we are now finding it increasingly difficult and costly to maintain the required level of network support. It is getting harder to recruit high calibre staff to DCS. The headquarters of DCS, although a modern site, is in a geographical location which is unattractive for key personnel to relocate to. Our specialists in the systems support side of the business are currently overstretched because many key staff have been 'head hunted' or taken early retirement.

Lenders have until recently been quite willing to lend DCS additional long-term funds at competitive interest rates, but are now tightening their credit lines to the company and placing covenants on us to keep financial gearing within acceptable limits. They are also increasing their interest rates to compensate for the additional financial risk. It is unlikely that any future growth or investment can be financed from further debt and we would need to use our considerable cash reserves or utilise internally generated funds. Currently, DCS has a geared cost of equity capital of 12%.

#### **Future outlook: What challenges and uncertainties is DCS likely to encounter in pursuing its strategy, and what are the potential implications for its business model and future performance?**

DCS currently manufactures approximately 50% of all data communications components used in its own products. The rest of the complete components, including semiconductors and microprocessors, are bought in from two multi-national global suppliers. These suppliers have since 2006 become the key players in the market through a succession of acquisitions and mergers, where previously there were many more suppliers, all with a much smaller market share. Recently, serious production problems have resulted from periodic component shortages from these key suppliers, creating significant delays in manufacturing, assembly and customer deliveries. One of our recently acquired OEM customers accounts for 40% of our sales in this area.

Marketing forecasts for 2016 and beyond indicate stronger growth from the supply and sales support for specialised IT management services to currently installed networks in the domestic financial sector, rather than from the manufacture of components to OEMs or for the installation of new networks to large companies. The other potential growth area is in providing cloud computing and big data analytics capability to the SME sector. Including DCS, there are currently only three companies which provide these specialist services in Prydain.

#### **Strategy and resource allocation: Where does DCS want to go and how does it intend to get there?**

As executive directors, we need an appropriate strategy for the next three to five years. On current trends we are looking at approximately a 10% year on year decline in our revenues for the next three years. At this forthcoming board meeting we need to discuss and decide on the best strategy for us as a company.

We need to decide between two strategies. Do we re-align the business to make it less reliant on the high volume, low margin components segment and re-allocate resources from the data communications segment into this higher added-value sector of network management and support? To do this we will need to further exploit technologies such as cloud computing and, in particular, big data analytics which seem to offer lower cost data storage, better understanding of consumer preferences and ability to develop more bespoke products and services. Alternatively, should we re-focus on our core capability in the data communications components manufacturing area, where we have such expertise, experience and where most of our turnover is currently generated?

## Conclusions:

The DCS board should now evaluate the risks and opportunities and take a key decision. DCS also needs to consider how it will implement its chosen strategy and how it will finance it. See further information below.

### Forecast tangible benefits and costs resulting from various potential scenarios

In 2015 we have estimated that the net cash contribution from the data communications components segment of the business is \$1.55m and the net cash contribution from the network supply and support is \$0.85m. These are after interest and tax. The expectation is that total cash flow contribution will continue to decline by about 10% each year if we do nothing.

#### Re-focus strategy:

We can implement this strategy by re-organising our sales and support teams, making manufacturing cost efficiencies and targeting our data communications component customers more effectively. If we are successful, we estimate that we can at least maintain the total cash contribution of DCS at the current level of \$2.4m for the next three years.

#### Re-alignment strategy:

With a re-alignment of the business towards the network supply and support segment, the net cash contribution from the communications components sector is forecast to decline by 10% per year for the following three years. This is regardless of how the net cash contribution from the network and IT systems support business is expected to grow under any of our assumptions. Forecast annual fixed costs and working capital savings from the decline in the data communications manufacturing area are expected to be \$0.35m from general costs and will also result in annual carbon tax cost savings of \$0.15m, giving a total saving of \$500,000 per annum for the next three years (2016–18). *Note that these forecast savings are independent of which growth forecast below emerges.*

Table 1 below shows the projected growth in the cash flow from the network supply and support segment in the next three years; the additional fixed costs of this investment; and the savings to be made in the data communications division, should the re-alignment and additional investments take place.

**Table 1: Alternative growth forecasts for DCS Company under the re-alignment strategy**

Re-alignment strategy and probabilities for growth	Probability of growth materialising (%)	Forecast annual increase in cash fixed costs (\$m)	Forecast annual savings from decline in data communications segment (\$m)
Additional cash contribution from the network support business will grow by <b>25%</b> each year for the next three years from the 2014 level	60	+0.75	-0.5
Additional cash contribution from network support business will grow by <b>15%</b> each year for the next three years from the 2014 level	30	+0.45	-0.5
Additional cash contribution from network support business will grow by <b>10%</b> each year for the next three years from the 2014 level	10	+0.25	-0.5

Exhibit 5

An evaluation of strategy choices facing DCS Company

You asked your colleague Freddie Lithium to evaluate the alternative strategies based on the information contained in the October board report. Freddie has now given you his work in the spreadsheet below:

Strategy evaluation for DCS, using payback method						
Strategy 1: Re-focus strategy:			2015	2016	2017	2018
With total cash contribution maintained:			\$'m	\$'m	\$'m	\$'m
Data communications			1.55			
Network supply and support			0.85			
(1) Total for Strategy 1:			2.40	2.40	2.40	2.40
<b>Strategy 2: Re-alignment strategy</b>			<b>Growth:</b>		<b>Probability:</b>	
Network supply and support (\$0.85m)	25%		0.60	1.063	1.328	1.660
	15%		0.30	0.978	1.124	1.293
	10%		0.10	0.935	1.029	1.131
(2) Expected value from network growth:				1.024	1.237	1.497
(3) Data communications (\$1.55m)	10%	decline	1.55	1.395	1.256	1.130
(4) Total cash contribution from Strategy 2: (2 + 3)				2.419	2.492	2.627
(5) Incremental cash contribution (4 – 1):				0.019	0.092	0.227
<b>Additional annual fixed costs based on expected growth:</b>						
		<b>Growth:</b>	<b>\$m</b>	<b>Probability:</b>		
Network supply and support (\$0.85m)	25%	0.75	0.60	0.450	0.450	0.450
	15%	0.45	0.30	0.135	0.135	0.135
	10%	0.25	0.10	0.025	0.025	0.025
(6) Expected value of additional cash fixed costs:				0.610	0.610	0.610
(7) Cash fixed cost savings (Data comms)				0.500	0.500	0.500
(8) Net additional cash fixed costs:				0.110	0.110	0.110
Incremental cash contribution from Strategy 2: (5)				0.019	0.092	0.227
Incremental cash fixed costs (8)				0.110	0.110	0.110
Incremental net cash contribution from Strategy 2 compared with Strategy 1				-0.091	-0.018	0.117
<b>Cumulative payback period = 2 years and eleven months</b>						

## Exhibit 6

### Notes from the middle management focus group meeting

Having read the integrated reporting data and studying the transcript of the conversation you had with Java Peraya, you needed more background information about some of the key issues which had come to your attention. You therefore invited a representative team of middle managers to a focus group meeting and asked them key questions, from which the following comments were noted:

#### Quote 1 from a management accountant in the finance directorate

*'When undertaking capital investment appraisal we have a strict policy of evaluating investments or projects over a maximum of three years and to ignore cash flows beyond that date, to ensure that any investment we make must pay back within that time period. This ensures that we do not accept unviable projects.'*

#### Quote 2 from an engineer in the network supply division:

*'What really annoys me is the fact that in 2011, the CEO and HR director introduced an annual staff survey. Although they promised anonymity, the survey required us to give details of our age, ethnicity, length of service and the department in which we are employed. I was called to a meeting last year by the production manager who implicitly threatened me and made comments such as 'if you don't like working here, why not look for another job?' It was made very clear to me that this meeting was private and was to be kept confidential. I was not permitted to discuss the existence or outcomes of these meetings with other members of staff, or there would be consequences.'*

#### Quote 3 from a technician in the data communications components division:

*'I felt the staff satisfaction survey was designed in a way which dissuaded negative feedback and key issues known to be of concern to staff obtained from the informal 'grapevine' were deliberately omitted from the survey questions. In addition, the way the results were presented by managers, and the visual graphics used, seemed to play down the negative feedback and concentrated only on the positive factors. For example, emphasis was made of how well staff regarded their own performance, and that of their team members, which seemed to have more favourable feedback, compared with other questions about confidence in the leadership of the company. I didn't think this presented the true picture of our feelings.'*

#### Quote 4 from a sales support engineer:

*'We are rushed off our feet. Due to key staff leaving, our sales areas are getting larger and it is difficult to get around to all our customers. This means we have difficulty getting our orders in on time and are often late to appointments. Although sales productivity might be improving, because fewer of us are covering a greater geographical area, customers are not as satisfied as they used to be and are making more complaints.'*

After this meeting you went back to your office and scheduled a meeting in the following week with Danny and Freddie, to start preparing the consultancy report findings for DCS Company.

**End of Question Paper**

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# Answers

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*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 this 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 the case information. The 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.*

**1 (a) Background section of consultancy report**

*One mark per relevant point for discussing any relevant environmental model such as Porters five forces, or PESTLE.*

**Introduction**

The first part of this report analyses DCS Company's market and the industry using the Porter's Five Forces model.

**(i) Bargaining power of buyers**

DCS is competing in two markets. In the data communications component market which is more mature and where it has less than 1% of the market share, it is a supplier of marginal significance, despite 65% of its gross profit or cash contribution being generated in this segment. Its customers in the neighbouring single market (30%) with its own currency are likely to demand low prices, high quality and reliability. They may not accept late delivery of orders. It appears that alternative sources of supply are readily available and that switching costs are relatively low. Multinational OEMs have significant bargaining power in this market, particularly the OEM which accounts for 40% of DCS's current data communications component sales.

In the second market, where network management systems are supplied to mainly domestic, SMEs and a few larger companies, the buyers appear to have less bargaining power. DCS is catering for each customer's specific needs and so each solution is, to some degree, a bespoke solution. This makes it much harder for buyers to compare products and prices of potential suppliers. Alternative sources of supply are much more difficult to find as there only three companies (including DCS) in this specialist marketplace.

**The bargaining power of suppliers**

Although DCS manufactures 50% of all components used in its data communications products, reducing its overall reliance on suppliers in this sector, it seems unlikely that DCS will be able to exert much influence on its suppliers, which provide the other 50%. As a relatively small player in the data communications market, the company does not have the power to exert buyer pressure on its two large suppliers, either in terms of price or delivery. Current problems associated with the delivery of components are having a significant impact on the company's ability to meet customer deadlines and expectations.

Suppliers of financial capital, namely lenders, have gained more bargaining power as DCS has had to borrow more to sustain their recent growth.

If labour is seen as a supplier, then evidence again suggests that DCS is in a relatively weak position particularly since there has been a limited trade union membership since 2006. However, the union members are mainly in the data communications components division where employee remuneration and employment rights are already compliant with Prydain's national employment laws. The scenario also indicates the difficulty of finding high calibre network staff with DCS's small size and location making it difficult to attract the key personnel necessary for future growth in this sector.

**Threats from new entrants**

DCS is operating in an industry where the costs of entry are significant because it is capital and knowledge intensive. Economies of scale compel new entrants to enter at significant output levels or suffer a cost disadvantage. Furthermore, the need to offer comprehensive aftersales support, although a problem for DCS, does also create a significant barrier to new entrants. Finally, the exit costs and barriers such as industry-specific knowledge, skills and assets, reduce the attractiveness of the marketplace to new entrants.

**Threats from substitutes**

There is evidence that large, successful, high technology companies are particularly vulnerable to ignoring the challenge from disruptive new technologies which can replace the need for certain high technology products and services overnight. However, the relatively small size of DCS may give it a competitive advantage in its ability to respond quickly and flexibly to change, as long as it can attract the right calibre of expertise to achieve this.

**Rivalry amongst competitors**

Very different levels of competition are being experienced in the two market places DCS is operating in. It is clear that the high volume, low-margin component business offers intense competition with buyers who are able to use their size to extract favourable prices. DCS only has 1% of this market. The ability of DCS to generate better market share and volumes through product innovation in this market seems highly unlikely.

The intensity of rivalry in the network management systems sector is significantly less in this specialist market. DCS is dealing with a smaller number of large and medium-sized users, designing products specific to their needs. In Porter's terms, DCS is adopting a focused differentiation strategy. In these low-volume high-margin markets, the emphasis has to be on increasing the volume side of the business, but at the same time making sure that they have the resources to attract and support new customers.

- (ii) The following is an evaluation of the performance of DCS against the six capitals of <IR> and how these are being transformed at DCS between 2012 and 2015.

#### Financial capital

The financial data shows revenue reaching a peak in 2014, before falling away (by just over 9%) in 2015.

Although 2014 was a record year for revenues, increased cost of sales meant that gross profit declined significantly. The gross profit margin has declined every year in the period under consideration, and the reasons for this need to be investigated. The rapid fall in 2015 suggests that operating costs have not been brought under control to reflect the sudden sales decline.

	2015	2014	2013	2012
Gross profit margin (gross profit/revenue)	28.49%	34.46%	37.50%	44.84%

In 2015, although DCS seems to have made reductions in overhead costs, finance costs have increased despite the fall in revenue, leading to a progressive decline in net profit margin in the period under consideration.

	2015	2014	2013	2012
Net profit margin (net profit before interest and tax/revenue)	2.16%	8.11%	10.15%	11.37%

The overall financial picture is of a company which has failed to control its core operating and finance costs as it generated increases in revenue until 2014 and as revenues fell in 2015. Finance costs are increasing as a proportion of net profit before interest and tax (NPBIT) as shown below:

	2015	2014	2013	2012
Interest cover ratio (finance costs/NPBIT)	1.26	2.74	3.08	5.93

#### Manufacturing capital

Working manufacturing capital seems to be reducing. This is confirmed by the forward contract order book. This has fallen from 3,505 in 2012 to 2,500 which will require fewer components, work-in-progress and finished products needed at the factory. It is also clear that capital budgeting and investment is slowing from 10% to 7% of turnover over the period. The R&D budget is also falling and is at 3% of turnover in 2015 compared with 6% in 2012, which is a 50% decline. These statistics indicate a clear depletion of the manufacturing capital of DCS.

#### Human capital

DCS seems to be seeing a depletion of high value human capital and morale may be seen as low. Recruitment and succession planning seem to be poorly planned and coordinated – leading to insufficient skilled people being recruited or promoted to replace staff either leaving the company or retiring early. There is just over 15% fewer staff at DCS in 2015 compared with 2012.

However, human capital has performed reasonably well from a productivity perspective. Analysing the data, productivity reached a peak in 2014 and has only fallen slightly in the last financial year:

	2015	2014	2013	2012
Sales revenue per employee (\$'000)	54.72	54.81	47.55	31.66

The sales support element of human capital is not performing well, however. The number of late contracts has doubled since 2012 and the number of complaints from customers has increased from 1.5% of orders to 3.4%.

#### Social and relationship capital

Social capital measures cultural health within the company and one of the ways this can be assessed is by using staff satisfaction surveys. The case indicates that employee satisfaction has been declining between 2012 and 2015. The increase in trade union membership may be a symptom of this. The case indicates that the survey measures such aspects as confidence in the leadership, opinions about personal growth and individual wellbeing. Each year since the surveys were launched, the satisfaction ratings have fallen by more than 15%.

#### Intellectual capital

Another area where DCS seems to be failing is in its maintenance and transformation of intellectual capital. There has been a depletion of intellectual capital, through skilled staff being either underutilised or leaving the company. This can be related to two areas:

- Staff turnover
- R&D.

Clearly the stock of intellectual capital is closely correlated to the stock of human and cultural capital. DCS seems to be depleting all three of these and its staff turnover has increased by 150% since 2012.

### **Natural capital**

It is clear that DCS has a growing carbon 'footprint' and that it is unable to identify where precisely in its value chain the carbon footprint is most problematic. The information in the case shows that the overall carbon emissions are increasing. Carbon emissions have risen by 1/3 since 2012.

The case clearly indicates that the main cause of the carbon footprint is in the data communications components manufacturing division. This is already a high volume and relatively lower margin sector of the business which will be subject to additional carbon taxes under the government proposals. There is also likely to be a greater carbon cost with this sector as a significant proportion of these components are exported to the nearby continental trading community.

### **Conclusions**

DCS needs to be aware of the dynamics relating to its market and industry, particularly the power of key customers and over reliance on two main suppliers. It must also be aware of and manage the threats from substitutes and new entrants in its two main business segments.

On the company's performance against the six capitals of <IR>, DCS's performance in several areas is weak and indicates a strategic drift which will need to be addressed.

## **(b) Governance and internal control**

### **Introduction**

In DCS's case there seem to be significant shortcomings in regard to the governance structures against broad principles of good governance. In particular, as a listed company, the board of DCS Company will be accountable to *institutional investors*. This formal investor relations function seems to be lacking at DCS and should be formalised. However, there are general weaknesses in a range of governance arrangements at DCS and these include weak internal controls, which are a key responsibility of the audit committee and these may have led to the poorly managed R&D policy and the ineffective capital budgeting process.

These specific shortcomings are as follows:

#### **Non-separation of the role of chairman and CEO**

This is a serious weakness and leads to lack of independence within the board by vesting too much power in one individual who may be able to dominate the board of DCS. The two roles are very different in nature. The CEO is responsible for directing and implementing strategic plans and for leading the executive team. The chairman is responsible for ensuring that the board of directors operates effectively, that it is properly constituted and is managed impartially to encourage open and transparent discussion. These roles should be separated.

#### **Lack of independent non-executive directors and diversity**

DCS only has one independent NED to scrutinise the executive directors and to exercise independence of judgement and scepticism where appropriate. DCS's independent NED is an executive director of one of DCS's two main suppliers which is inappropriate. The company should appoint NEDs who are 'independent' and increase the diversity of the board, both in terms of functional expertise and business acumen and to benefit from the broader experience of those who have worked for other companies. The gender balance on the board needs addressing. Only the HR director is female.

#### **No director or senior management induction policy**

There seems to be no director induction process at DCS which is important in ensuring that directors and senior managers understand the mission, strategic objectives and cultural values of the organisation. Introducing such a programme will help integrate new senior staff into DCS and help them make more immediate and valuable contributions.

#### **Lack of risk, nominations and remuneration committees**

DCS seems to have no formal board appointed committees for the above. A public limited company is expected to have a committee which identifies, assesses and recommends strategies to mitigate risk. There is also no independent committee to consider board appointments or their pay structure. A particular problem related to appointments and rewards is evident from the case. At the senior level, this could have been avoided by having a formal nominations and remunerations committee to consider such appointments. A key shortcoming is the failure to adequately align director pay with the longer-term interests of the shareholders. No-one on the board is allowed share options and all are on a fixed salary meaning that company performance is not aligned to their rewards. A nominations committee would also have addressed some of the problems regarding poor selection and appointment of senior candidates, and the lack of succession planning.

#### **Poorly constituted audit committee**

The audit committee seems to be unsatisfactory for a number of reasons. First there seems to be no-one with any real financial expertise and this may be why costs are getting out of control. Most of the members are technical managers from the operating core of the business. There is only one independent NED when generally accepted principles of corporate governance would recommend at least two, if not more. The audit committee does not seem to have proper oversight over the capital budgeting of the company or scrutinise significant expenditure on capital expenditure or R&D. DCS should therefore change the constitution of the audit committee to include more NEDs and members with more financial expertise. It should also review the remit of the audit committee to include induction and responsibility for oversight of the capital budgeting process, and to scrutinise the effectiveness of the financial reporting process, and its relationship with external auditors.



### **Inadequate reporting and engagement with institutional shareholders**

There is a block of 30% institutional investors who seem to be largely ignored or treated as if they were like any other private individual shareholder. This is a key weakness as the institutional block vote is significant and if the shareholding is withdrawn or sold, this could create uncertainty in the market and a serious reduction in the share price. DCS needs to create formal reporting and communication channels with its institutional investors to ensure that they continue to engage with and invest in DCS.

**(c) Candidates may well approach these slides differently but the main benefits and opportunities they should identify should fall under the following main headings:**

- **Cost reduction**
- **More sophisticated analysis of customer data including customer behaviour, sentiments and preferences**
- **Faster and better decision-making**
- **Research and development analysis for new products and services**

#### **Presentation slides**

##### **Slide 1: Benefits of big data analytics**

###### **Bullet points:**

- Sentiment analysis
- Soft surveillance and consumer behaviour tracking
- Open communication channels with clients
- Predictive analytics (which can monitor inventory levels and ensure product availability)
- Analysis of customers' purchasing behaviours

**Notes:** As DCS operates in a country with 75% of the population connected to the internet and presumably purchasing a significant proportion of their products and services online, DCS can sell data analytics capability to its clients. It can do this by showing them how to use this capability to capture, store and process data from their customers. By developing sophisticated marketing analytics with big data, DCS's clients can properly evaluate their own marketing performance, gain insight into their customers' purchasing patterns, discern key market trends and permit them to make evidence-based marketing decisions.

##### **Slide 2: Further opportunities to DCS customers of big data analytics**

Further opportunities offered by big data analytics for DCS's customers, include the following:

###### **Bullet points:**

- Potential to unlock significant value
- Ability to collect more accurate and detailed performance information
- Big data allows ever-narrower segmentation
- Sophisticated analytics can substantially improve decision-making
- Big data can be used to develop the next generation of products and services

**Notes:** Big data analytics makes information about DCS customers' clients more transparent and allows DCS's customers to collect more accurate and timely information at a fraction of the costs of hosting expensive architectures such as data warehouses and allows DCS's clients considerable cost savings using cloud computing capability or open source software such as 'Hadoop clusters' for storing and processing large amounts of data. Using this, and through 'data mining' using social and business networking data, DCS's clients can undertake a much more sophisticated analysis of their customers and therefore much more precisely tailor their products or services allowing valuable insights which would otherwise remain hidden and unlock more customer value. The other key opportunity is to allow DCS's clients to develop bespoke products for their customers based on their precise needs and consumer behaviours.

**(d) Recommendations about sustainability issues**

Environmental and sustainability issues should have more prominence at DCS. When it was a private company, there would have been more flexibility regarding 'corporate citizenship' and a private company is not as visible to the general public as far as its social and environmental policies are concerned. However, a public limited company is expected to take into account environmental capital in its strategies and policies. DCS has a reputational stake in this. It also has a financial stake, because a carbon footprint which is not properly controlled usually leads to financial inefficiencies as well as environmental costs.

DCS would gain benefits from the expertise of a reputable consultancy firm which specialises in environmental and carbon control. They would need to ensure that DCS is not accused of 'greenwashing' by paying 'lip-service' to green issues but visibly reducing their carbon footprint. They would analyse DCS's value chain from its suppliers, its in-bound logistics to its manufacturing processes and to its outbound logistics. These consultants would examine from top to bottom the policies, processes and procedures of the company. They can advise on the carbon content of raw materials and components and on how to be more fuel efficient in ordering, in production, avoiding or reducing waste and improving their quality control and recycling capabilities. They could advise on carbon offset programmes, ethical sourcing, green manufacturing, more sustainable travel policies and about the logistics of delivering their products and providing their services to customers. For example, having to send staff all over the country and to the nearby continent has a carbon cost, but also a financial cost.

Another explicit financial cost which DCS must take into account is the proposed carbon tax which will add further costs to its already relatively narrow margins on the data communications components business. These consultants could end up helping DCS not only to reduce and control their carbon footprint at the micro level, but to reduce their tangible costs and potential tax liabilities at the same time.

2 (a) The potential risks which the company could face whether or not it re-aligns its business are as follows:

*(Note: Candidates only need to discuss any three of these to gain maximum marks)*

Strategic risk, business risk, financial risk and environmental risk.

*(Note: Markers can give additional credit for any reasonable risks identified from the case information and give a Professional Skills mark for a reasonable positioning of the risks in the heat map)*

Heat map for key risks faced by DCS Company



**Strategic risk**

The key strategic risk which DCS faces is the increased competition in the data communications components manufacturing market, the reduced margins and potential decline in the future. At the same time DCS faces the risk of missing an opportunity to use its competencies to develop the potentially more profitable area of its business. DCS currently faces lower market share and declining shareholder value and this is projected to be a 10% decline year on year for the next three years. To reduce or avoid these risks, DCS could re-align its business towards the more profitable domestic market by investing in the network support business in terms of increased R&D, fixed asset investment and improvements in policies relating to staff retention and recruitment to support this potential growth area. This would also reduce its general cost base.

**Business risk**

As already explained in the five forces analysis, apart from heavy dependence on its main business sector of data communications (65% of its total turnover), DCS is facing economic risk from overdependence on key customers (one of the OEM customers accounts for 40% of its sales). DCS is also overreliant for its supplies of data communications sub-components on two large multinational suppliers from which it currently faces serious supply shortages. It also risks further losses of staff and greater recruitment difficulties caused by poor staff morale and due to the unattractive location of DCS's headquarters. Under the TARA framework, it is advisable to reduce these risks by widening the supplier and customer base. From a supply perspective, the benefits of this strategy would be to spread the risk of a disruption to the supplies from one or both of the two current suppliers. The strategy would also help DCS in terms of bargaining power, particularly if it is not getting favourable terms from them. Similarly, widening the customer base, or concentrating on a higher value strategy will reduce its dependence on the data communications business and also the bargaining power of their main OEM customer and help their profitability. DCS can reduce the staff retention and recruitment risk by adopting tactics and implementing policies to improve the culture of the organisation and the morale of their key staff. This could be achieved through offering greater empowerment and devolving more authority to middle managers. An improvement in intrinsic rewards and in pay and conditions, or allowing staff to relocate, or work from other geographical locations which are more attractive to them, may also help to mitigate this risk.

**Financial risk**

The main risk is the devaluing currency in the main market into which DCS sells a significant proportion of its data communications components. A weakening currency in the economic community from which customers settle their payments means that DCS is facing a currency translation exposure as monies received in the devaluing currency will effectively reduce the turnover collected from customers in these markets. Under the TARA framework, the risk could be reduced or transferred by using foreign currency hedging instruments or by taking out loans in the denomination of the weaker foreign currency, using the payments from the continental customers to offset the liability. The other main financial risk is the high level of gearing and the risk of breaking bank covenants and of default. This risk could be mitigated by either converting some of the debt into equity or by repaying or redeeming loans from DCS's considerable cash reserves, or by issuing more shares.

### Environmental risk

DCS is not itself at risk of potential environmental impact, but is facing a risk of creating an increased carbon footprint or environmental impact which it is not effectively managing and which may itself create environmental costs and incur a carbon tax liability. This risk could be transferred through carbon offset strategies, avoided by ceasing to manufacture or distribute goods in a way that creates such a significant carbon footprint, or reduced through pursuing tactics or strategies to avoid waste and reduce emissions.

- (b) Table 1 of exhibit 4 makes a number of assumptions. These are as follows:

The 'do nothing' strategy is not considered an option by the board. A reasonably quick financial analysis would confirm that this is not a viable option, but that confirmation has not been included in the October board report or in Freddie Lithium's spreadsheet.

Therefore, a financial evaluation of the 'do nothing' option against the other two options would give a more complete picture. In fact, are there any other strategic options available to DCS? These do not seem to have been considered by the board.

Is it reasonable to extrapolate that a recent decline of 10% in total DCS revenues is indicative of future trends in cash contribution by segment? There seems to be no explanation of how the relative cash contribution of each segment in 2015 was arrived at, other than being calculated after interest and tax. The definition of cash contribution also needs to be investigated further to verify whether it is calculated before capital expenditure or is a free cash flow, because the forecasts might differ, depending on how this cash flow is defined.

Is it possible to assume that annual additional fixed costs will be constant in each year of the forecast planning period as stated? In reality, there might be greater fixed cost expenditure in the first year of the new strategy and less in the subsequent years.

Is it reasonable to assume that fixed cost savings in the data communications plant would be the same regardless of which growth forecast emerges? This seems unreasonable as potential savings in that division would probably depend to some extent on the level of growth which materialises from Strategy 2, if implemented.

The calculations within the spreadsheet all seem accurate, but time value for money has not been taken into account. If the cash flows *after interest and tax* were discounted, they would need to be discounted by the geared cost of capital, which is estimated at 12%. Making this adjustment to the cash flow will yield a net present value for the project and will change the payback estimate. This is shown below:

	2016 (\$m)	2017 (\$m)	2018 (\$m)
Net incremental cash flow from re-alignment:	-0.09	-0.02	+0.12

Net present value =  $(-0.09 \times 1/1.12) - (0.02 \times 1/1.1 \cdot 1.12^2) + (0.12 \times 1/1.1 \cdot 1.12^3) = (-0.08 - 0.016 + 0.085) = -0.011$

This means that Strategy 2 (the re-alignment strategy) has a negative NPV of \$11,000 which means it does not pay back in the three-year planning horizon.

- (c) Recommendations to the DCS board

The purely financial evaluation in (b) above shows that DCS should not re-align towards the higher-value more differentiated network support segment, although undiscounted payback would indicate that it just repays for itself within three years.

However, the strategic and broader business benefits to be gained from re-aligning in this way are that it will help DCS become a differentiator, concentrating on higher value, lower volume business, rather than continuing to maintain an increasingly challenging cost focus. This might be preferable to remaining as active in the high volume low margin data communications manufacturing business, particularly as the company is so reliant on two key suppliers, where supplies are being disrupted and where 30% of their OEM customers are representing an increasing risk of higher currency translation costs.

From the performance data in the <IR> spreadsheet, it seems that manufacturing cost control is one of the key problems for DCS, so the business benefits will include the ability to transfer resources from the manufacturing to the support side and the potential to make labour cost savings in the manufacturing area which is more labour intensive and where labour and employment costs in Prydain are high. DCS can also reduce its carbon footprint further and reduce its environmental impact.

The IT benefits for DCS will be that it will develop greater capability in the new emerging technologies of cloud computing and big data processing services which will give it a competitive advantage over traditional players in the data electronics market.

The strategy to re-align the business will make a small negative net present value of -\$11,000 over the next three years, which on the face of it would not justify the strategy on financial grounds alone, assuming that the forecasts were valid. However, while DCS directors were unable or unwilling to consider the cash flows beyond a three-year planning period, due to subjectivity and prudence, it is reasonable to assume that there would be additional positive net cash flow benefits accruing to DCS, well beyond the planning horizon. These seem to be rising exponentially from the trend observed. It could also be assumed, particularly in such a competitive and innovative sector as data communications, that the ability of DCS to maintain its current market share and overall turnover over time could be questioned, should no investment or re-alignment of the business take place.

Therefore considering both strategic and wider business reasons, DCS would be advised to implement the re-alignment of the business and focus on expanding the network support side of the business and invest in the necessary fixed costs, staff recruitment and working capital required, by using internally generated funds or issuing more shares.

### 3 (a) Working notes with relevant visual aids

Using the Mendelow matrix it can be established that before DCS was listed or quoted on the national stock market, it had the following stakeholder groups:

<b>Before flotation:</b>	<b>Described follows:</b>
Shareholders	– these were private shareholders comprising the founder’s majority holding and possibly those of family and close business associates
Employees	– mainly non-unionised and loyal to a smaller family oriented business
Lenders	– insignificant borrowings before flotation – presumably overdraft and other short-term loans
<b>After flotation:</b>	<b>Described as follows:</b>
Shareholders	– wider group of public individual investors and a 30% holding by institutional investors
Employees	– more skilled staff, but operating core staff mostly unionised
Lenders	– much more powerful and interested – higher gearing and covenants in place

The following table shows the Mendelow matrix positioning and strategies for these groups before and after flotation: *(Note: Alternatively a grid could be presented where arrows could be used to indicate where stakeholders had moved within and between quadrants after being publicly listed)*

Stakeholder groups	Mendelow grid position and strategy before flotation	Mendelow grid position and strategy after flotation
Shareholders	High power/high interest – actively involve	Lower power/high interest – keep informed (particularly institutional shareholders)
Employees	Low power/high interest – keep informed	Higher power/high interest –keep satisfied or involve more actively
Lenders	Low power/low interest – minimal effort	Higher power/high interest – keep well informed and keep satisfied

The strategies DCS Company management would adopt pre- and post-flotation would differ as determined by the changed positions on the Mendelow matrix. The main change in strategies would be as follows in relation to the above stakeholders:

**Shareholders:** Clearly before the flotation, private shareholders, being the owner and his family or close friends, would have far more interest and power than the majority of shareholders after the flotation, so the need to actively involve is less necessary, but evidence from the case suggests that there is a lack of engagement with institutional shareholders which could be problematic as this group has far more power than other shareholders, so DCS should develop reporting and communications channels with this important group.

**Employees:** Before flotation most employees were non-unionised and the culture of DCS was not to involve, engage or inform employees and expect them to follow instructions. After flotation 60% of the data communications workforce are now unionised and additional employment legislation such as minimum wage and mandatory company pensions are being introduced which will force DCS to not only keep employees and their representatives informed and fairly well satisfied, but also to more actively involve them– in particular regarding the pension arrangements.

**Lenders:** Before flotation DCS was predominately funded from shareholders’ funds and had few borrowings, so this stakeholder had little power or influence and possibly little interest in DCS, particularly if the loan capital represented an insignificant proportion of the lender’s total portfolio. After the flotation, DCS has become increasingly more highly geared in order to expand into new markets and therefore the risk faced by the lender is greater and this increases the lenders’ level of interest in DCS and its ability to sustain this level of borrowing and to repay the original capital. As lenders have placed legally binding covenants on the company preventing it from exceeding its current gearing levels, it also has more power over DCS, meaning that DCS will have to keep lenders well informed and certainly keep them satisfied.

### (b) Professionally and ethically, there are some issues relating to how the staff satisfaction survey has been conducted, which we would like to highlight.

In theory, such surveys are beneficial to organisations and to staff if conducted properly as they help management gain a better understanding of how staff are thinking, what their attitudes and opinions are and can act as a sounding board from which management can act and make the necessary changes which can improve the culture and productivity of staff.

**Lack of integrity** – Unfortunately it appears that staff may have been misled in that there were assurances given that the survey responses would be anonymous, but the personal information required gives the impression to staff that management can identify the respondents of the survey.

**Lack of objectivity** – From discussions with staff representatives, it is possible that key areas known to be of concern to staff (obtained from the informal grapevine) may have been omitted from the survey and the survey could have dissuaded people from giving negative feedback, particularly about confidence in management. From a statistical perspective, the results were presented in quite a subjective way by using graph styles which may have misrepresented the true findings, focusing more on the aspects which staff found most positive.

**Professional competence and due care** – The design of the survey and the way in which results were presented may be viewed as being somewhat unprofessional and may not have achieved what it was intended to achieve. This could have been avoided if more care had been taken with its design.

**Confidentiality** – One matter of serious concern relates to the fact that some employees were identified and interviewed by senior managers as a result of their apparent negative responses to the survey. This action appears to have breached the fundamental principle of confidentiality.

**Professional behaviour** – DCS Company management should not attempt to identify 'dissident' staff or schedule and conduct interviews with these individuals, as it could be described as demonstrating unprofessional behaviour. This is particularly worrying when some interviewees perceive that they have been intimidated or even threatened by the comments made at some of these meetings. Another point we would wish to raise is the danger of operating 'double standards' when the survey was supposed to be anonymous, but staff identified for interview were themselves required to keep confidential the fact that they had been identified and interviewed.

*Note: Markers have the latitude to award Professional Skills marks for Professional and behavioural skills demonstrated in the answers given throughout the paper as described below:*

- **Communication**  
Inform  
Persuade  
Justify
- **Commercial acumen**  
Demonstrate awareness  
Use judgement  
Show insight
- **Analysis**  
Investigate  
Scrutinise  
Reflect
- **Scepticism**  
Probe  
Question  
Challenge
- **Evaluation**  
Assess  
Estimate  
Appraise

- 1 (a) (i)** Up to four marks per element of Porter's five forces affecting DCS.  
(Up to a maximum of 15 marks in total)
- (ii)** Up to three marks per capital or for possibly discussing the elements of integrated reporting, including any relevant calculations – using data from the performance table.  
(Up to a maximum of 12 marks in total)
- (b)** One mark per relevant point for criticising or identifying the key weaknesses in the current governance structure of DCS and one mark per relevant point, up to a maximum of four marks, for suggesting how the governance arrangements could be improved.  
(Up to a maximum of 12 marks in total)
- (c)** One mark per relevant point for identifying customer benefits of big data analytics.  
(Up to a maximum of 6 marks)
- (d)** One mark per relevant point for making the case for DCS commissioning environmental and sustainability consultants to help it better understand how to measure and control its carbon footprint and one mark per relevant point for briefly explaining why DCS should have a better awareness of sustainability and environmental impacts, from both a carbon footprint and financial perspective.  
(Up to a maximum of 5 marks in total)

Professional skills may be additionally rewarded as in the following rubric:

How well has the candidate demonstrated Professional skills as follows:	Not at all	Not so well	Quite well	Very well
1 (a) Analytical and evaluation skills in assessing the environment and performance of DCS Company	<i>The candidate has failed to select an appropriate environmental scanning model or to analyse the performance of the company against any of the six capitals of &lt;IR&gt;. The candidate has therefore failed to adequately analyse or evaluate either the strategic position or the overall performance of the company meaningfully.</i>	<i>The candidate has demonstrated some basic analytical and evaluative skills in the environmental scanning model selected. The candidate has only identified one or two of the six capitals of &lt;IR&gt; and has omitted many of the key performance indicators (KPI) or ratios in their evaluation of company performance.</i>	<i>The candidate has demonstrated good analytical and evaluative skills in the environmental scanning model selected, using key facts from the case. The candidate has also selected some of the most important KPIs or ratios when evaluating company performance against most of the six capitals.</i>	<i>The candidate has demonstrated comprehensive analytical and evaluative skills in the environmental scanning model or models selected, using most of the key facts from the case. The candidate has also selected comprehensive and appropriate KPIs or ratios when evaluating company performance against all of the six capitals.</i>
	<b>0</b>	<b>1.5</b>	<b>2.5</b>	<b>4</b>
1 (b) Analytical and scepticism skills in identifying the main CG deficiencies and how to remedy	<i>The candidate has failed to demonstrate any scepticism of the CEO's answers given in the interview and has therefore failed to analyse weaknesses or make any meaningful recommendations for CG improvement.</i>	<i>The candidate has demonstrated some limited scepticism in analysing the CEO's responses in the interview by identifying some CG failures, but has only made a few recommendations for CG improvement.</i>	<i>The candidate has demonstrated scepticism of the CEO's responses in the interview by identifying several of the key CG failures. The candidate has also made some sensible recommendations for CG improvement.</i>	<i>The candidate has demonstrated deep scepticism of most of the CEO's responses in the interview by identifying many of the key CG failures. The candidate has also made all of the obvious recommendations for CG improvement.</i>
	<b>0</b>	<b>0.5</b>	<b>1</b>	<b>2</b>
1 (c) Communication skills in highlighting the key points and for clear supporting notes	<i>The candidate has failed to use a slide format to communicate the benefits of big data for either the business or their customers.</i>	<i>The candidate has only loosely used a slide presentation format, but has either far too many or too few points or has failed to identify benefits for both the business and customers. The candidate has produced some notes but they are either too long or fail to adequately explain the main points.</i>	<i>The candidate has used a slide format and bullet points, and has covered both benefits to the customers and the business, but there may be too many of them or they have not been expressed succinctly enough. There are slide notes, but they only loosely explain the bullet points selected.</i>	<i>The candidate has appropriately selected and prioritised the key points about benefits to the customer and to the business in a logically flowing bullet list and has produced clear supporting notes which relate closely to the points selected.</i>
	<b>0</b>	<b>1</b>	<b>1.5</b>	<b>2</b>
1 (d) Commercial acumen skills in identifying how DCS could benefit from the findings of the environmental audit	<i>The candidate has demonstrated no appreciable commercial acumen for identifying any reasonable grounds for commissioning an environmental audit on either environmental or financial grounds.</i>	<i>The candidate has demonstrated some commercial acumen in identifying a few reasonable grounds for commissioning an environmental audit but has missed some of the most important justifications on either environmental or financial grounds.</i>	<i>The candidate has demonstrated commercial acumen in identifying several reasonable grounds for commissioning an environmental audit and has identified some of the most important justifications on both environmental and financial grounds.</i>	<i>The candidate has demonstrated astute commercial acumen in identifying many if not most of the reasonable grounds for commissioning an environmental audit and has strongly justified them on both environmental and financial grounds.</i>
	<b>0</b>	<b>0.5</b>	<b>1</b>	<b>2</b>

- 2 (a) Up to a maximum of two marks per risk for identifying and describing three key risks which DCS faces and plotting them on some form of heat map, whether or not they re-align their business or not. A further one mark per relevant point can be awarded for explaining how each of these three risks can be mitigated using the TARA framework. (Up to a maximum of 6 marks)
- (b) Up to five marks to be awarded for questioning any assumptions in Table 1 of the October board report, including the recommendation that the cash flows should be discounted.
- (c) Up to five marks may be awarded for recommending a strategy for DCS with reasoned arguments which may or may not contradict the financial evaluation of the cash flow forecasts undertaken.

Professional skills may be additionally rewarded as in the following rubric:

How well has the candidate demonstrated Professional skills as follows:	Not at all	Not so well	Quite well	Very well
2 (a) Commercial acumen skills and judgement in identifying and locating risks appropriately on a heat map	<i>The candidate made no attempt to construct a heat map so they failed to illustrate the probability and impact of the categories of risk detailed in the scenario.</i>	<i>The candidate attempted to construct a heat map as required. However, either the accuracy of plotting the risks was wrong or the presentation of the diagram was below standard so it did not help to support the candidate's answer.</i>	<i>The candidate constructed a good heat map, plotting the main risks identified in the scenario correctly. However, the candidate did not reference the heat map to their answer so its usefulness was very limited.</i>	<i>The candidate constructed an accurate heat map, plotting all of the main risks identified in the scenario correctly. The heat map was carefully referenced to the answer thereby constituting part of an effective risk management framework.</i>
	<b>0</b>	<b>0.5</b>	<b>1</b>	<b>2</b>
2 (b) Scepticism and evaluation skills in analysing the spreadsheet and supporting assumptions	<i>The candidate showed no evidence of scepticism, and accepted both the content and underlying assumptions of the spreadsheet without question.</i>	<i>Although the candidate displayed a cursory level of scepticism, they failed to challenge the assumptions which underpinned the analysis contained within the spreadsheet.</i>	<i>The candidate displayed evidence of some professional scepticism when analysing the spreadsheet and supporting assumptions. However, this scepticism was not evident in the required critical evaluation of Freddie Lithium's spreadsheet.</i>	<i>The candidate demonstrated strong professional scepticism of the content of Freddie Lithium's spreadsheet in Exhibit 5 together with its supporting market growth assumptions. This provided authority to the critical evaluation of the strategic choices presented.</i>
	<b>0</b>	<b>0.5</b>	<b>1</b>	<b>2</b>
2 (c) Commercial acumen skills in recommending strategic option to implement	<i>The strategic option recommended by the candidate was purely based on the application of academic theory, rather than any display of sensible and practical commercial acumen.</i>	<i>The candidate demonstrated only superficial commercial acumen when evaluating the strategic options, to the extent that it really did not contribute to the recommendation.</i>	<i>The candidate has demonstrated some limited commercial acumen when determining which of the two options to recommend, but it was not explicitly mentioned in the answer.</i>	<i>The candidate has demonstrated incisive commercial acumen when determining which of the two strategic options to recommend. This was clearly evidenced in the answer.</i>
	<b>0</b>	<b>1</b>	<b>1.5</b>	<b>2</b>



- 3 (a)** Up to one mark per stakeholder group for identifying and briefly explaining where each of the three stakeholder groups is situated in the Mendelow matrix before and after the company was quoted and listed on the national stock exchange in 2006, including how strategies to manage them would need to have changed.  
(Up to a maximum of 6 marks in total)
- (b)** Up to one mark per relevant point about the professional ethics or fundamental principles relating to the introduction, conduct and reporting of the staff satisfaction survey.  
(Up to a maximum of 6 marks)

*Note: Candidates need not refer to all five of the fundamental principles to gain all six marks on offer.*

Professional skills may be additionally rewarded as in the following rubric:

How well has the candidate demonstrated Professional skills as follows:	Not at all	Not so well	Quite well	Very well
3 (a) Analytical skills for assessing the relative power and interest and how to engage with these stakeholders before and after flotation	<i>The candidate was unable to identify that Mendelow's matrix was the correct analytical framework to use in this instance. By failing to select the correct model the candidate was unable to effectively analyse the stakeholders detailed in the scenario.</i>	<i>The candidate was able to demonstrate a basic understanding of Mendelow's matrix, but inadequately used relevant information from the DCS scenario in this analytical framework. In effect, the candidate was unable to apply their knowledge of a major syllabus model in a meaningful and useful way.</i>	<i>The candidate demonstrated good analytical skills by applying scenario information correctly to Mendelow's matrix. However, they did not use this analysis to determine the most appropriate way to engage with the three stakeholder groups.</i>	<i>The candidate comprehensively and accurately demonstrated how to apply Mendelow's matrix to a changing business situation. The candidate correctly mapped out the position of each of the three stakeholder groups both before and after the DCS flotation, and as a result was able to explain how best the company could engage with each of them.</i>
	<b>0</b>	<b>0.5</b>	<b>1</b>	<b>2</b>
3 (b) Scepticism and communication skills for identifying ethical issues in the survey and for explaining these diplomatically in writing	<i>The candidate failed to sceptically assess the behaviour of those conducting the survey against the five core ethical principles defined in the 'ACCA Code of Ethics and Conduct' to structure their criticism of the CEO and HR director's behaviour.</i>	<i>The candidate correctly identified the five core ethical principles from the 'ACCA Code of Ethics and Conduct', but failed to satisfactorily use them as a structure for their answer. This suggested that the candidate's ability to sceptically apply and criticise behaviour against business ethics was quite superficial.</i>	<i>The candidate has demonstrated scepticism of director behaviour against the five core ethical principles and used these to criticise the CEO and HR director's ethical and professional behaviour. However, the answer did not focus specifically on the issue of the conduct of the survey</i>	<i>The candidate has demonstrated very good sceptical and communications skills when discussing failure to comply with the five core ethical principles and used these to comprehensively criticise the CEO and HR director's ethical and professional behaviour. The answer makes specific reference to the way the staff satisfaction survey was conducted, so appropriately used the ethical principles to address the requirement.</i>
	<b>0</b>	<b>1</b>	<b>1.5</b>	<b>2</b>