The Institute of Certified Management Accountants

STRATEGIC BUSINESS ANALYSIS

INSTRUCTIONS TO CANDIDATES

1. CANDIDATES ARE REMINDED THAT THEY SHOULD HAVE NO BOOKS, NOTES, PAPER OR OTHER MATERIAL IN THEIR POSSESSION UNLESS THEIR USE IS SPECIFICALLY PERMITTED BY "INSTRUCTIONS TO CANDIDATES" SET OUT BELOW.

2. READING TIME IS OF 10 MINUTES DURATION

3. EXAMINATION IS OF 3 HOURS DURATION

4. This paper consists of 7 questions printed on 4 pages.
   PLEASE CHECK BEFORE COMMENCING. This is a FINAL paper.

5. THIS IS AN OPEN BOOK EXAM.

6. Please read instructions at the top of each section carefully before answering.

7. Each section has an equal weighting in the allocation of marks.

8. Electronic hand held calculators are permitted.

9. **EXAM PAPER IS TO BE HANDED IN INTACT AT CONCLUSION OF EXAM.**

SECTION A

Answer this COMPULSORY question in this section

Question One

The Rappa Port Authority has been concerned about its share price deterioration over the year (2006) from $2.70 to $2.60 per share, despite its profit increasing by 12 per cent over the same period. The Managing Director believes that the market has not incorporated the strategic aspects of the business in its estimation of share price value.

The management accountant, Celine Whitney, has now been asked to come up with a "scratch-pad" analysis of strategic value, in order to ascertain if the MDs beliefs are reasonable. Based on previous discussions with managers, Celine considers that the seven "Key Value Drivers" of the business are as follows:

1. Sales Growth Rate
2. Operating Profit Margin
3. Tax rate
4. Fixed Capital Investment rate
5. Working Capital Investment rate
6. Cost of Capital
7. Planning period

The cost of capital for the company is 8 per cent, and the Tax rate is 40 per cent. Celine believes that a two year planning period is sufficient and that the growth rates of the various drivers can be maintained at the same levels as over the previous year. The financial information pertaining to the last two years is as follows:

	In 000s	
	2005	**2006**
Sales	$4,500	$4,950
COGS and Expenses	($3,750)	($4,110)
Operating Profit	$750	$840
Fixed Capital	$1,800	$1,890
Working Capital	$1,500	$1,650
Marketable Securities	$500	$400
Ext Debt & Obligations (@Book Value)	$900	$1,000
Ext Debt & Obligations (@ Market Value)	$1,000	$1,200
Capital and Reserves (@ Book Value)	$2,900	$2,940
Number of Shares Issued	985	1,000

Required:

1. Calculate the ‘Value Driver’ rates to be used in the Strategic Value Analysis (SVA) Model.

2. Calculate the ‘Free Cash Flows’ during the planning period, and the ‘Continuing Value’ of the business at the end of the planning period.

3. Calculate the Value to Shareholders and comment on the difference between the book, market, and strategic aspects of the company’s share value.

Note: Discount Factors @ 8%:

Year 1 = .92593

Year 2 = .85743

SECTION B

Answer any ONE of the TWO questions in this section.

Question Two

"The recent rise of operational - i.e. non-financial - performance measures represents an attempt to re-assert the primacy of operations over financial measures. By using non-financial measures, managers attempt to track progress on the actionable steps that lead to a company's success in the market."

Discuss how the use of financial and non-financial performance measures can be used as a means of evaluating an organisation's progress towards its strategic objectives.

Question Three

"Even in a highly competitive industry, marketing executives place more importance on the planning aids, performance evaluation techniques and control measures developed in managerial accounting that on those developed in the mainstream of marketing theory."

Comment on the above, and discuss the links available between management accounting and marketing.

SECTION C

Answer any ONE of the TWO questions in this section.

Question Four

"Cost-plus is the safest way to price and still remain in business. Such a method always ensures that you sell a product for an amount more than it cost the business to bring it to the point-of-sale."

Discuss the above statement in depth.

Question Five

"The costs of advertising a product line, and of training an organisation's sales force, should be considered as investments, and treated very similar to how research costs are amortised in the financial accounts."

Discuss the above statement in depth.

SECTION D

Answer any ONE of the TWO questions in this section

Question Six

Ratio analysis is commonly taught at the introductory accounting level. Two unresolved issues in this area include (1) determination of the correct configuration of the numerator and denominator of these ratios, and (2) the determination of which ratios provide meaningful information in predicting business performance or bankruptcy (e.g., the Z score model).

Discuss these issues in depth.

Question Seven

A huge issue in finance has been the attempt to determine whether an optimal capital structure (OCS) exists for businesses, and what this capital structure might look like. Using your own hand-drawn graphs, discuss how theoretical approaches to the determination of an OCS can be reconciled with the "traditional approach".