CHARTERED ACCOUNTANTS EXAMINATIONS

PROFESSIONAL LEVEL

P5: STRATEGIC MANAGEMENT

WEDNSEDAY 17TH DECEMBER 2014

TOTAL MARKS – 100: TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question. You will be told when to start writing.

2. This paper is divided into TWO sections:

   Section A: One (1) compulsory question.
   Section B: Four (4) Optional questions. Attempt any three (3).

3. Enter your student number and your National Registration Card number on the front of the answer booklet. Your name must **NOT** appear anywhere on your answer booklet.

4. Do **NOT** write in pencil (except for graphs and diagrams).

5. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.

6. All workings must be done in the answer booklet.

7. Present legible and tidy work.

8. Graph paper (if required) is provided at the end of the answer booklet.

SECTION A

Question one is compulsory and must be attempted.

QUESTION ONE

(a) ZEMA Ltd. Is a manufacturing company based in Luanshya but now is considering options of growth in order to grow its revenues and expand market share. The following are the options available to the company:

Option 1: Open new plant in Lusaka, cost = K1m, revenue = K2m

a) Demand grows (0.3)
b) Demand constant (0.3)
c) Demand declines (0.4)

Option 2: Expand Luanshya plant, cost = K0.5m, revenue = K1.5m

a) Demand grows (0.2)
b) Demand constant (0.5)
c) Demand declines (0.3)

Option 3: Continue operating at current levels, cost =K0.5m, revenue = K1m

a) Demand grows (0.3)
b) Demand constant (0.4)
c) Demand declines (0.3)

Required:

(i) Draw a decision tree from the data given above. (15 marks)

(ii) Advise management of ZEMA on action to take. (10 marks)

(b) Assembling a capable management team is a cornerstone of the organization building task. The most important consideration is to fill key managerial slots with smart people who are clear thinkers, good at figuring out what needs to be done and skilled in "making it happen" and delivering result. In short, an organization needs to have a capable strategic leadership and systems in place.

(i) Describe any five (5) characteristics that should be possessed by successful strategic leaders that have been identified. (10 marks)

(ii) Major problems may arise in an organization if politics grows rampant, and if powerful managers gain such dominance that they can suppress the views of managers who oppose their interests.

Required:

Briefly explain any five (5) such problems that may arise. (5 marks)

[Total: 40 marks]

SECTION B

Answer any Three (3) questions in this Section.

QUESTION TWO

(a) In coming up with a strategy a number of factors should be considered if success is to be achieved. Discuss any five (5) such factors that are necessary in shaping desired strategy**.** (5 marks)

(b) Describe Porter and Miller process for capturing new IT-based opportunities. (5 marks)

(c) An organization is experiencing poor performance due to rampant changes that are taking place at both the micro and macro-economic levels. As a consultant you have been approached by management to help improve the matter. After deep reflection you feel that you could use one of the business models in particular the McKinsey model to re-engineer the business. Draw and describe this model and how you are going to use it in this assignment. (10 marks)

[Total: 20 marks]

QUESTION THREE

(a) Strategic alliances may provide strategic appeal or benefits to companies that are involved. Discuss such benefits that may be gained from these alliances. (10 marks)

(b) Entering into the foreign market requires a lot of strategic planning effort, but does not provide all answers to success in foreign markets. Explain any five limitations of strategic planning. (10 marks)

[Total: 20 marks]

QUESTION FOUR

(a) Outline any 10 factors that may drive change in an industry thereby forcing a company to change its growth and competitive strategy. (10 marks)

(b) Discuss the consequences the company may face from any of the five (5) stakeholders if it does not take into account ethical considerations when implementing business strategies. (10 marks)

[Total: 20 marks]

QUESTION FIVE

(a) Describe the areas of environmental data that must be included in strategic database.

(8 marks)

(b) A multinational corporation operating in Zambia has a branch in Malaysia. The company procures a number of supplies from the Malaysian subsidiary (B). The following information relates to this company (A):

	A	**B**
	K'000	K' 000
Cost of production	50,000	10,000
External sales	90,000	24,000

Required:

(i) Compute the profits for A, B and the company using transfer price at market price. (9 Marks)

(ii) What are the consequences of setting a transfer price at market price? (3 Marks)

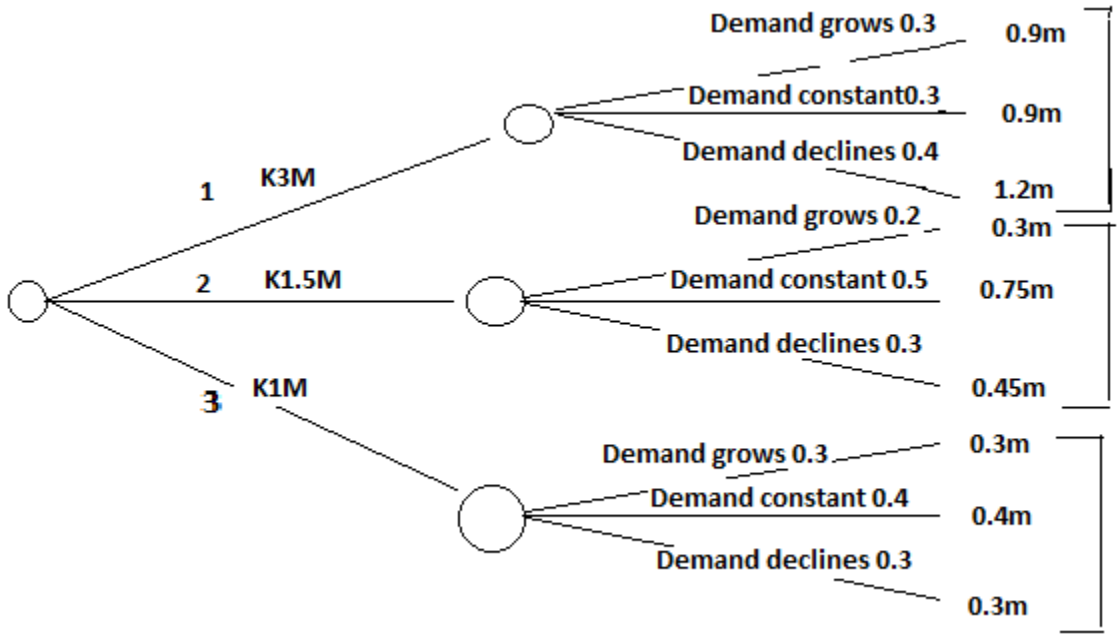
[Total: 20 marks]

END OF PAPER

P5 SUGGESTED SOLUTIONS

QUESTION ONE

(a) (i) Decision Tree



Incremental revenues

Option 1: Construct new plant in Lusaka

K3m – K1m = K2m

Option 2: Expand Luanshya plant

K1.5m – K0.5m = K1m

Option 3: Do nothing

K1m – K0.5m = K0.5m

(ii) Advise to management

Construct another plant in Lusaka.

(b)

(i) A number of key characteristics of good and successful leaders have been identified by several authors, which include:

- **Vision, Eloquence and Consistency**

  One of the key tasks of leadership is to give the organization a sense of direction of vision.The leaders are also eloquent enough to communicate this vision to others within the organization in terms that can energize people and they consistently articulate their vision until it becomes part of the culture of the organization.

- **Commitment**

  A strong leader is someone who demonstrates commitment to his/her particular vision, often leading by example.Leading by example can mean doing what one preaches; this kind of commitment is a powerful signal to employees within the organization. If it is cost minimization the CEO is the first to do it.

- **Being Well Informed**

  Good leaders develop a network of formal and informal sources that keep them well informed about what is going on within their organization.They develop feedback- channels of finding out what is going on within the organization so that they do not have to rely on formal information.

- **Willingness to delegate and empower subordinates**

  Good leaders are good delegators. They recognize that unless they do delegate, they can quickly become overloaded with responsibilities.They also recognize that empowering subordinates to make decisions is a good motivational tool.Delegating also makes since when it results in decisions being made by those who must implement them.Although good leaders will delegate many decisions to lower level employees, they will not delegate those they judge to be critical to the future success of the organization.

- **Astute use of Power**

Good leaders tend to be very astute in their use of power, which means three things.

First, Good leaders play the power game with skill preferring to build consensus for their ideas.

Secondly; Good leaders often hesitate to commit themselves publicly to detailed strategic plans or precise objectives since in all probability, the emergency of unexpected contingencies will require adaptation. It is important to note that good leaders often have precise private objectives and strategies that they would like to see the organization pursue time and methods of accomplishment is not precisely stated.

Thirdly; Good leaders possess the ability to push through programmes in a piecemeal fashion. The successful leaders tries to push through his ideas, one piece at a time so that they appear incidental to other ideas, though in fact they are part of a larger programme or hidden agenda that moves the organization in his desired direction under their leadership.

- **Emotional intelligence**

Emotional intelligence is a bundle of psychological attributes that many strong leaders exhibit; they include self-awareness, self-regulation, and motivation empathy and social skills

Self-awareness refers to the ability to understand ones moods emotions and drives as well as their effects on others

Self-regulation is the ability to control or re-direct disruptive impulses or moods to think before acting.

Motivation refers to a passion for work that goes beyond money or status and a propensity to pursue goal with energy and persistence.

Empathy means understanding the feeling and viewpoints of subordinates and taking those into account when making decisions

Social skills are defined as friendliness with a purpose having abilities to manage disputes between managers and better able to find common grounds and purpose among diverse constituencies.

(ii) If politics grow rampant, and if powerful managers gain such dominance that they can suppress the views of other managers who oppose their interests, major problems may arise which include:

i. Checks and balances fade
ii. Organization inertia increases
iii. Performance suffers
iv. Sectionalism and separatism emerges
   -Tribal empires
   -Nepotism
   -Regionalism etc
v. Shareholders' interests suffer
vi. Managerial ethics are not adhered to
vii. Personal integrity and transparence of managers are questionable

QUESTION TWO

(a) There are six major contributing factors to the shaping of strategy in an organization which may include the following:

1. SOCIETAL, POLITICAL, REGULATORY AND CITIZEN CONSIDERATIONS

   What an enterprise can and cannot do strategies is always constrained by what is legal, by what is in compliance with government regulations and policies, by what is considered socially acceptable and by what constitutes community citizenship. More and more companies now consider societal values and priorities, community concerns and for the potential for onerous legislation and regulatory requirements. The concept of corporate, social responsibility is now showing in company's mission statements.

2. INDUSTRY ATTRACTIVENESS AND COMPETITIVE CONDITIONS

   Industry attractiveness and competitive conditions are big strategy – determining factors. When a firm concludes its industry environment has grown unattractive, and it is better of investing company resources elsewhere, it may craft a strategy of disinvestments and abandonment. When competitive conditions intensify significantly, a company must respond with strategic actions to protect its position. A strategist therefore, has to be a student of industry and competitive conditions.

3. SPECIFIC COMPANY OPPORTUNITIES AND THREATS

A well-conceived strategy aims at capturing a company's best growth opportunities and defending against external threats to its well being and future performance. The particular business opportunities a company has and the threats to its position that it faces are key influences on strategy.

4. ORGANISATIONAL STRENGTHS, WEAKNESSES, AND COMPETITIVE CAPABILITIES

Experience shows that in matching strategy to a firm's internal situation, management should build strategy around what the company does well and avoid strategies whose success depends heavily on something the company does poorly or has never done at all. A company's strategy ought to be grounded in what it is good at doing (ie its organisational strength and competitive capabilities and avoid what it is not so good at doing i.e. its organisational and competitive weaknesses.

5. THE PERSONAL AMBITIONS, BUSINESS PHILOSOPHIES AND ETHICAL BELIEFS OF MANAGERS

Managers' decisions are often influenced by their own vision of how to compete and how to position the enterprise and by what image and standing they want the company to have. Managers' personal ambitions, business philosophies, and ethical beliefs are usually woven into the strategies they craft. Sometimes the influence of the manager's personal values and experiences is conscious and deliberate, at other times it is unconscious. Attitudes toward risk also have a big influence on strategy. Risk avoids favour "conservative" strategies that minimise downside risk, have a quick payback and produce sure short term profits. Risk takers lean more toward opportunistic strategies where bold moves can produce a big pay off over the long term. Managerial values also shape the ethical quality of a firm's strategy.

6. THE INFLUENCE OF SHARED VALUES AND COMPANY CULTURE ON STRATEGY

An organization's policies, practices, traditions, philosophical beliefs and ways of doing things combine to give it a distinctive culture. A company's values and culture sometimes dominate the kind of strategic moves it will consider or reject. This is because culture related values and beliefs become so

embedded in managements thinking and actions that they condition how the enterprise responds to external events. **(Give any five – 5x4 =20 marks)**

(b) (i) Competing in information age

Step 1. Assess information intensity

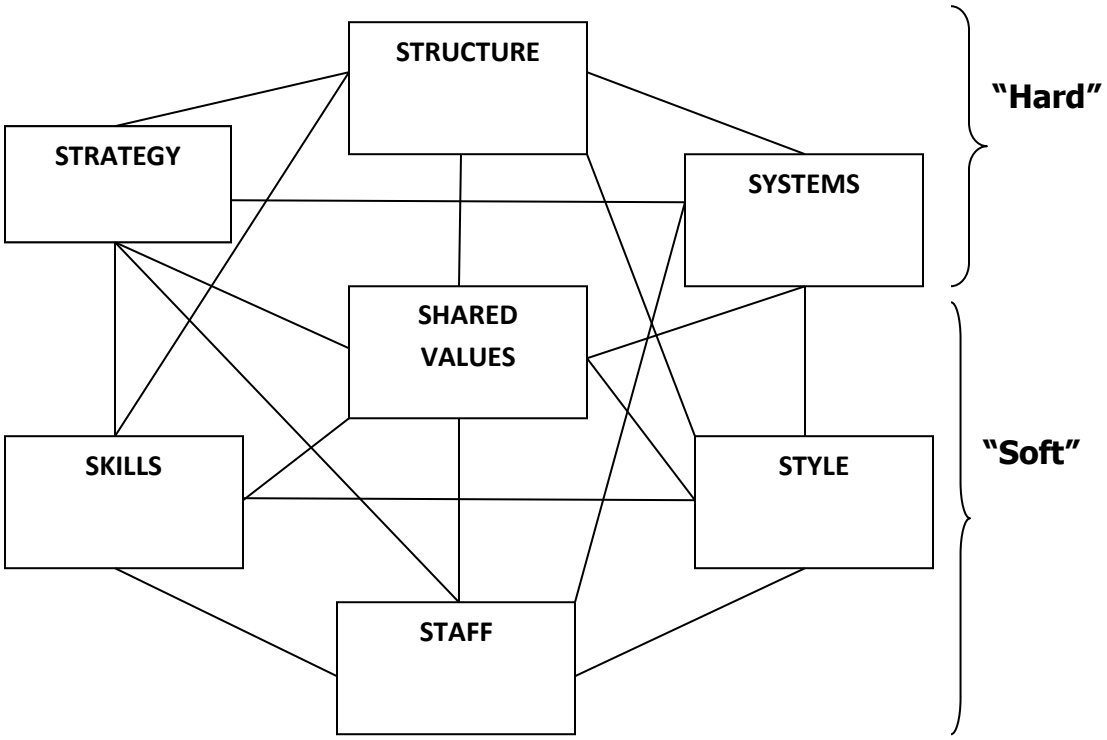
Step 2. Determine the role IT in industry structure

Step 3. Identify and rank the ways in which IT might create competitive advantage.

Step4. Investigate how IT might spawn new businesses.

Step 5. Develop a plan to exploit IT.

(c) The McKinsey Model



The McKinsey 7 "S" model is a useful way of looking at organizations facing organizational change from a cultural perspective. The model represents an organization as a set of interconnected and interdependent subsystems.

1. **Structure.** Determines the division of tasks in the organization and a hierarchy of authority from the most senior to junior.
2. **Strategy.** A way in which an organization runs to outperform its competitors or how it intends to achieve its objectives.
3. **Systems.** The technical systems.

   These are the hard elements which are easily quantified or defined, and deal with facts and rules.
4. **Staff.** People in the organization.
5. **Shared values**. Guiding beliefs of people in the organization about why it exists.
6. **Style.** The shared assumptions, ways of working and attitudes of management.
7. **Skills.** Things that the organization does well

These are the soft elements which are equally important.

QUESTION THREE

(a)

Strategic Alliances are a favourite and potentially fruitful means for entering a foreign market or strengthening a firm's competitiveness in world markets.Many foreign companies are particularly interested in strategic partnerships that will strengthen their ability to gain a foothold in foreign markets. Strategic appeal or benefits for such Cross-border Alliances include the following:

1. Gaining better access to attractive country markets.
2. To capture economies of scale in production and/or marketing cost reduction can be the difference that allows a company to be cost-competitive.
3. To fill gaps in technical expertise from either partner and/or knowledge of local markets (buying habits and product preferences of consumers, local customers and so on).

4. To share distribution facilities and dealer networks, thus mutually strengthening their access to buyers.
5. Cross border allies can direct their competitive energies more toward mutual rivals and less toward one another, teaming up may help them close the gap on leading companies.
6. Benefit comes into play when companies desirous of entering a new foreign market, conclude that alliances with local companies are an effective way to tap into a partner's local market knowledge and help it establish working relationships with key officials in the host-country government.
7. Alliances can be a particularly useful way for companies across the world to gain agreement on important technical standards – they have been used to arrive at standards. (At least 5 must be given – 5x2 =10 marks)

(b) SOME LIMITATIONS OF FORMAL STRATEGIC PLANNING

Planning of course has its limitations. It is not the answer to all managerial problems. Some critical shortcomings are reviewed in this section.

1. ENVIRONMENT MAY PROVE DIFFERENT FROM THAT EXPECTED
   Forecasting is not an exact science and plans that are based upon predictions that prove incorrect may fail. Unexpected events in government action such as a contract cancellation, a change in labour union activities, a decline in economic activity, or a sudden price discount by a major competitor – all are uncertainties that make planning difficult.
2. INTERNAL RESISTANCE
   In many organisations the introduction of a formal planning system raises anti-planning biases that can prevent effective planning. In larger organisations, old ways of doing things, old rules, and old methods may be so entrenched that it is difficult to change them.

3. PLANNING IS EXPENSIVE
   In a typical corporate planning effort of even a medium-sized company a significant effort is required to do effective planning. The time of may people is occupied and costs are incurred for special studies and information. Planning is expensive and managers throughout the planning process must continuously apply a cost-benefit gauge.

4. CURRENT CRISES

Formal strategic planning is not designed to get a company out of sudden current crises. It helps the company to improve its current performance in the future given the current poor state.

5. PLANNING IS DIFFICULT

Planning is hard work. It requires a high level of imagination, analytical ability, creativity, and fortitude to choose and become committed to a course of action.

Planning involves a different type of mental process from that generally employed in dealing with day to day operating problems.

6. PLANS WHEN. COMPLETED LIMIT CHOICE

Plans are commitments, or should be, and thus they limit choice.They tend to reduce initiative in a range of alternatives beyond the plans. This should not be a serious limitation but should be noted.

7. IMPOSED LIMITATIONS

Besides the intrinsic limitations of strategic planning, there are imposed limitations that deserve note. Planning systems will probably not be effective when they are excessively ritualistic and formal, when line managers try to delegate the task to staff, when managers give lip service to planning but make their attention to short-range problems and neglect thinking about the future.

(5 limitations must be given – 5x2 = 10marks)

QUESTION FOUR

(a) Industrial conditions change because forces are in motion that creates incentives or pressure for change.

The most dominant forces are called driving forces because they have the biggest influences on what kind of changes will take place in the industry's structure and environment. These driving forces are:

1 **Changes in the Long-term industry growth rate**

Changes in the long- term industry growth rate shifts in industry growth up or down are a force for industry change because they affect the balance between industry supply and buyer demand, entry and exit and how hard it is for a firm to capture additional sales.

2. Changes in who buys the product and how they use it.

Shifts in buyer demographics and emergence of new ways to use the product can force adjustments in customer service offerings (credit, technical assistance, maintenance and repair), open the way to market the industries products through different mix of dealers and outlets.

3. Product innovation

Product innovation can broaden and industries customer base, rejuvenate industry growth, and widen the degree of product differentiation among rival seller.

4. Technological change

Advances in technology can dramatically alter an industry's landscape, making it possible to produce new/or better products at a lower cost and opening up who knew industry frontiers – capital.

5. Process Innovation

Technological change can also alter unit costs, capital requirements, minimum efficient plant sizes, desirability of vertical integration and learning or experience curve effects.

6. Marketing Innovation.

When firms are successful in introducing new ways to market their products can spark off buyer interest, widen industry demand, increase product differentiation and lower costs – which may affect competitiveness with rivals.

7. Entry or exit of major firms

The entry of one or more foreign companies into a market once dominated by domestic firms nearly always produces a big shake up in industry conditions.

Entry by a major firm produces a "new ballgame" not only with new key player but also the competitive rules – while exit changes industry structure by reducing the number of market leader.

8 Diffusion of Technical know-how

As knowledge about how to perform a particular activity or to execute a particular manufacturing technology spreads, any technically – based competitive advantage held by firms possessing this know how erodes. This occurs through scientific journals, trade publications, on site plant tours, word-of-mouth among suppliers and customer, and hiring away of knowledgeable employees.

9. Increasing Globalization of the industry

Global competition usually changes patterns of competitive advantage among key players; certain firms may launch aggressive long term strategies to win a globally dominant market position.

10. Changes in cost and efficiency.

In industries where significant economics of scale are emerging or strong learning effects are allowing firms with the most production experience to undercut rivals' price, large market share becomes a distinct advantage that all firm's are pressured to adopt volume building strategies.

11. Emerging Buyer Preference for a Differentiated instead of a commodity product (or for a more standardised product instead of strongly differentiated products)

Sometimes growing numbers of buyers decision, that a standard product at a bargain price meets their needs as effectively as a premium priced brands offering more features and options

12. Regulatory Influence and government policy changes

Regulatory and government actions can often force significant changes in industry practices and strategic approaches.

13. Changing societal concerns, Attitudes and life Styles

Emerging social issues and changing attitudes and life – styles can be powerful instigators of industry change. Consumer concerns about salt, sugar, chemical additives, cholesterol, and nutrition are forcing the food industry to re-examine food processing techniques and introduce healthier products.

14. **Production uncertainty and business risk**

A young, emerging industry is typically characterised by an unproven cost structure and much uncertainty over potential market size, R and D costs and distribution channels. Emerging industries tend to attract only the most entrepreneurial companies.

(b)

The consequences that would result when a company does not take into account ethical considerations to its five (5) stakeholders when implementing its business strategy, may include any of the following actions by the five constituencies :

(i) Concerned Investors/shareholders

(1) (i) Complain at the annual general meeting of shareholders
(ii) Appeal to the board of directors or
(iii) Sell their stock

(2)Convened employees can

i) Unionize and bargain collectively

(ii) Seek employment elsewhere,

(3) Suppliers can

(i)Find other buyers

(ii)Pursue other market alternative

(4) Customers can

(i) buy from other company's or can do anything
(ii) Litigate in courts of Law

(5) The community or society can

(i) May cease to purchase from other sellers
(ii) May litigate in courts of law.
(iii) Do anything from violent protest marches to stimulating political and government action. A company may truly care about business ethics and corporate social responsibility is proactive rather than reactive in linking strategy and ethics.

QUESTION FIVE

(a) Nine areas of Environmental Data that ought to be included in a database for strategic planners include:

(i) Competitive data. Information derived from Porter's five forces analysis.
(ii) Economic data. Past growth and predictions of future growth in GDP and disposable income, interest rates etc.
(iii) Political data. Governments influence on industry.
(iv) Legal data. Likely implications of recent legislation to be introduced in the future.
(v) Social data. Changing habits, attitudes, cultures and educational standards of the population as a whole and customers in particular.
(vi) Technological data. Technological changes that have occurred or will occur and their implications for the organization.
(vii) Geographical data. Data about individual regions or countries, each of them potentially segments of the market with their unique characteristics.

(viii) Energy supplier's data. Energy sources, availability and price of sources of supply generally.

(ix) Data about stakeholders in the business. Employees, management and shareholders, the influence of each group, and what each group wants from the organization.

(b)

Transfer pricing

(i)	**A**	**B**	**Total**
	K'000	K' 000	K' 000
External sales	90,000	24,000	114,000
Cost of production	50,000	10,000	60,000
Company profit	40,000	14,000	54,000

(ii) Consequences

- The company's overall profit will remain unchanged.
- The subsidiaries' profits will also remain the same since the transfer price is the market price.

END OF SUGGESTED SOLUTIONS