



Enterprise Pillar  
E3 – Enterprise Strategy

20 November 2012 – Tuesday Morning Session

**Instructions to candidates**

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| You are allowed three hours to answer this question paper.   |
| You are allowed 20 minutes reading time <b>before the examination begins</b> during which you should read the question paper and, if you wish, highlight and/or make notes on the question paper. However, you will <b>not</b> be allowed, <b>under any circumstances</b> , to open the answer book and start writing or use your calculator during this reading time. |
| You are strongly advised to carefully read ALL the question requirements before attempting the question concerned (that is all parts and/or sub-questions).  |
| ALL answers must be written in the answer book. Answers written on the question paper will <b>not</b> be submitted for marking.  |
| You should show all workings as marks are available for the method you use.  |
| The pre-seen case study material is included in this question paper on pages 2 to 6. The unseen case study material, specific to this examination, is provided on pages 8 and 9.   |
| Answer the compulsory questions in Section A on page 11. This page is detachable for ease of reference.  |
| Answer TWO of the three questions in Section B on pages 14 to 19.  |
| Maths tables and formulae are provided on pages 21 and 22.   |
| The list of verbs as published in the syllabus is given for reference on page 23.  |
| Write your candidate number, the paper number and examination subject title in the spaces provided on the front of the answer book. Also write your contact ID and name in the space provided in the right hand margin and seal to close.  |
| Tick the appropriate boxes on the front of the answer book to indicate the questions you have answered.  |

**E3 – Enterprise Strategy**

TURN OVER

## **Pre-seen case study**

V, a private limited company in a European country (SK), which is outside the Eurozone, was founded in 1972. The currency in SK is SK\$. V is a travel business that offers three holiday (vacation) products. It has a network of 50 branches in a number of major cities throughout SK.

### **History of the company**

V achieved steady growth until six years ago, when it found that its market share was eroding due to customers increasingly making online bookings with its competitors. Direct bookings for holidays through the internet have increased dramatically in recent years. Many holiday-makers find the speed and convenience of booking flights, accommodation or complete holidays online outweighs the benefits of discussing holiday alternatives with staff in a branch.

V's board had always taken the view that the friendly direct personal service that V offers through its branch network is a major differentiating factor between itself and other travel businesses and that this is highly valued by its customers. However, V found that in order to continue to compete it needed to establish its own online travel booking service, which it did five years ago. Until this point, V's board had never engaged in long-term planning. It had largely financed growth by reinvestment of funds generated by the business. The large investment in IT and IS five years ago required significant external funding and detailed investment appraisal.

Much of V's business is now transacted online through its website to the extent that 60% of its revenue in the year ended 30 June 2012 was earned through online bookings.

### **Current structure of V's business**

V offers three types of holiday product. These are known within V as Package, Adventure and Prestige Travel. V only sells its own products and does not act as an agent for any other travel companies. It uses the services of other companies engaged in the travel industry such as chartered airlines and hotels which it pays for directly on behalf of its customers.

#### ***Package***

"Package" provides holidays mainly for families with children aged up to their late teens. These typically are for accommodation in hotels (where meals are part of the package) or self-catering apartments (where no meals are provided within the package).

#### ***Adventure***

"Adventure" caters for people aged mainly between 20 and 30, who want relatively cheap adventure based holidays such as trekking, sailing and cycling or who wish to go on inexpensive back-packing holidays mainly in Europe and Asia.

#### ***Prestige Travel***

"Prestige Travel" provides expensive and bespoke holidays mainly sold to couples whose children have grown up and left home. The Prestige Travel product only provides accommodation in up-market international hotel chains in countries across the world.

All three of these products provide holidays which include flights to and from the holiday destinations and hotel or self-catering accommodation. V has its own customer representatives available at the holiday destinations to provide support to its customers. All-inclusive holidays (in which all food and drinks are provided within the holiday price) are offered within each of the three product offerings.

### **Support products**

V supports its main products by offering travel insurance and foreign currency exchange. The travel insurance, which is provided by a major insurance company and for which V acts as an agent, is usually sold along with the holidays both by branch staff and by staff dealing with online bookings.

Currency exchange is available to anyone through V's branches irrespective of whether or not the customer has bought a holiday product from V. A new currency exchange product is provided by V through which a customer purchases an amount of currency, either in SK's home

currency (SK\$) or else in a foreign currency and this is credited on to a plastic card. The card is then capable of being read by automated teller machines (ATM's) in many countries across the world allowing the customer to withdraw cash in the local currency up to the amount that has been credited on to the card.

### **Marketing of products**

V relies for the vast majority of its business on the literature, available in hard copy and online, which it provides on the holiday products it sells. Exceptionally, V is able to offer some of its existing holiday products at discount prices. These may be offered under any of the three main products offered but they are mostly cut-price holiday deals which are available under the Package holiday product label.

### **Sales structure**

Staff in each of the 50 branches accept bookings from customers and all branches have direct IT access to head office. Online enquiries and bookings are received and processed centrally at head office, which is located in SK's capital city.

Branch managers have some discretion to offer discounts on holidays to customers. V offers a discount to customers who buy holidays through its online bookings. The branch managers have authority to reduce the price of a holiday booked at the branch up to the amount of the online discount if they feel it is necessary to do so in order to make the sale.

### **Financial information**

V's revenue, split across the holiday and support products offered, for the financial year ended 30 June 2012 is summarised as follows:

|                  | <i>Revenue<br/>SK\$ million</i> |
|------------------|---------------------------------|
| Package          | 90                              |
| Adventure        | 60                              |
| Prestige Travel  | 95                              |
| Support products | 5                               |

The overall net operating profit generated in the financial year to 30 June 2012 was SK\$35 million and the profit for the year was SK\$24 million, giving a profit to sales ratio of just under 10%. V's cash receipts fluctuate because of seasonal variations and also because V's customers pay for their holidays shortly before they depart.

Further details, including extracts from V's income statement for the year ended 30 June 2012 and statement of financial position as at 30 June 2012 are shown in Appendix 1.

### **Financial objectives**

V's key financial objectives are as follows:

1. To grow earnings by, on average, 5% a year.
2. To pay out 80% of profits as dividends.

### **Foreign exchange risk**

V has high exposure to foreign exchange risk as its revenues received and payments made are frequently in different currencies. It normally settles hotel bills and support costs, such as transfers between hotels and airports in the local currencies of the countries where the hotels are located. It normally pays charter airlines in the airline's home currency. Scheduled airline charges are settled in the currency required by the particular airline.

V is exposed to fluctuations in the cost of aircraft fuel incurred by airlines which are passed on to travel businesses. It has often been necessary for V to require its customers to make a supplementary payment to cover the cost of increases in aircraft fuel, sometimes after the customer had thought that the final payment for the holiday had been made.

### **Board composition and operational responsibilities**

The Board of Directors comprises five people: an Executive Chairman (who also fulfils the role of Chief Executive), a Finance Director, an Operations Director, an IT Director and a Human Resources Director. The Executive Chairman founded the business in 1972. He has three grown-up children, two of whom successfully pursue different business interests and are not engaged in V's business at all. The third child, a son, is currently taking a "year out" from study and is going to university next year to study medicine.

The branch managers all report directly to the Operations Director. In addition, the Operations Director is responsible for liaising with airlines and hotels which provide the services offered by V's promotional literature. The IT Director is responsible for V's website and online enquiries and bookings. The Finance Director is responsible for V's financial and management accounting systems and has a small team of accountancy staff, including a part-qualified management accountant, reporting to her. The Human Resources Director has a small team of staff reporting to him.

### **Shareholding**

There are 90 million SK\$0.10 (10 cent) shares in issue and the shareholdings are as follows:

|                          | % holding |
|--------------------------|-----------|
| Executive Chairman       | 52        |
| Finance Director         | 12        |
| Operations Director      | 12        |
| IT Director              | 12        |
| Human Resources Director | 12        |

### **Employees**

V employs 550 full-time equivalent staff. Turnover of staff is relatively low. High performance rewards in terms of bonuses are paid to staff in each branch if it meets or exceeds its quarterly sales targets. Similarly, staff who deal with online bookings receive a bonus if the online bookings meet or exceed quarterly sales targets. V's staff, both in the branches and those employed in dealing with online bookings, also receive an additional bonus if they are able to sell travel insurance along with a holiday product to customers.

Employee development for staff who are in direct contact with the public is provided through updates on products which V offers. Each member of branch and online booking staff undertakes a two day induction programme at the commencement of their employment with V. The emphasis of the induction programme is on customer service not on details relating to the products as it is expected that new staff will become familiar with such product details as they gain experience within V.

### **Safety**

V publicly states that it takes great care to ensure that its customers are as safe as possible while on holiday. To date, V has found that accidents while on holiday are mainly suffered by very young children, Adventure customers and elderly customers. There has been an increase in instances over the last year where customers in resort hotels have suffered severe stomach complaints. This has particularly been the case in hotels located in resorts in warm climates.

### **Executive Chairman's statement to the press**

V's Executive Chairman was quoted in the national press in SK in January 2012 as saying, "We are maintaining a comparatively high level of revenues and operating profit. This is in a period when our competitors are experiencing very difficult trading conditions. We feel we are achieving this due to our particular attention to customer service. He cited V's 40 years of experience in the travel industry and a previous 99% satisfaction rating from its customers as the reasons for its success. He went on to state that V intends to expand and diversify its holiday product range to provide more choice to customers.

### **Board meeting**

At the next board meeting which took place after the Executive Chairman's statement to the press, the Operations Director expressed some concern. He cast doubt on whether V was able

to provide sufficient funding, marketing and IT/IS resources to enable the product expansion to which the Executive Chairman referred. The Operations Director was of the opinion that V places insufficient emphasis on customer relationship marketing. The Finance Director added at the same meeting that while V presently remained profitable overall, some products may be more profitable than others.

The Executive Chairman responded by saying that V's high level of customer service provides a sufficiently strong level of sales without the need to incur any other marketing costs. He added that since V achieved a high profit to sales ratio, which it has managed to maintain for a number of years, it really didn't matter about the profits generated by each customer group.

#### **Retirement of the Executive Chairman**

The Executive Chairman formally announced to the Board in July 2012 that he intends to retire on 30 June 2013 and wishes to sell part of his shareholding in the company. The Board members believe the time is now right for V, given its expansion plans, to enter a new stage in its financing arrangements, in the form of either debt or equity from new providers.

**Extracts from V's income statement and statement of financial position****Income statement for the year ended 30 June 2012**

|                            | <i>Notes</i> | <i>SK\$ million</i> |
|----------------------------|--------------|---------------------|
| <b>Revenue</b>             |              | 250                 |
| Operating costs            |              | <u>(215)</u>        |
| Net operating profit       |              | 35                  |
| Interest income            |              | 3                   |
| Finance costs              |              | (4)                 |
| Corporate income tax       | 1            | <u>(10)</u>         |
| <b>PROFIT FOR THE YEAR</b> |              | <u>24</u>           |

**Statement of financial position as at 30 June 2012**

|                                     | <i>Notes</i> | <i>SK\$ million</i> |
|-------------------------------------|--------------|---------------------|
| <b>ASSETS</b>                       |              |                     |
| <b>Non-current assets</b>           |              | 123                 |
| <b>Current assets</b>               |              |                     |
| Inventories                         |              | 3                   |
| Trade and other receivables         |              | 70                  |
| Cash and cash equivalents           |              | <u>37</u>           |
| <b>Total current assets</b>         |              | <u>110</u>          |
| <b>Total assets</b>                 |              | <u>233</u>          |
| <b>EQUITY AND LIABILITIES</b>       |              |                     |
| <b>Equity</b>                       |              |                     |
| Share capital                       | 2            | 9                   |
| Share premium                       |              | 6                   |
| Retained earnings                   |              | <u>60</u>           |
| <b>Total equity</b>                 |              | <u>75</u>           |
| <b>Non-current liabilities</b>      |              |                     |
| Long-term borrowings                | 3            | 50                  |
| Revenue received in advance         |              | 3                   |
| <b>Current liabilities</b>          |              |                     |
| Trade and other payables            |              | 35                  |
| Revenue received in advance         |              | <u>70</u>           |
| <b>Total liabilities</b>            |              | <u>158</u>          |
| <b>Total equity and liabilities</b> |              | <u>233</u>          |

## Notes:

1. The corporate income tax rate can be assumed to be 30%.
2. There are 90 million SK\$0.10 (10 cent) shares currently in issue.
3. 30% of the long-term borrowings are due for repayment on 30 June 2014. The remainder is due for re-payment on 30 June 2020. There are debt covenants in operation currently which restrict V from having a gearing ratio measured by long-term debt divided by long-term debt plus equity of more than 50%.

*End of Pre-seen Material*  
*The unseen material begins on page 8*

TURN OVER

## SECTION A – 50 MARKS

[You are advised to spend no longer than 90 minutes on this question]

### ANSWER THIS QUESTION

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#### Question One

##### Unseen case material

##### Customer profitability

At a recent Board meeting the Executive Chairman stated that he was not concerned with the level of profitability generated by each customer as, overall, V has achieved a high profit to sales ratio for a number of years. However, the Finance Director believes that a more detailed understanding of V's product profitability should be carried out by V before making any decision about future product expansion. Also at this Board meeting, the Executive Chairman stated that V should focus on the increasing demand for Prestige Travel holidays and that this is backed up by the fact that V's Prestige Travel products are the best performing for the business, based upon revenue earned.

Following the Board meeting, the Finance Director instructed the Management Accountant to undertake an analysis of the revenues, cost of sales and administration costs associated with each of V's holiday products. The following information was identified for the year ended 30 June 2012.

|                                       | Package        | Adventure      | Prestige Travel |
|---------------------------------------|----------------|----------------|-----------------|
| Revenue from in-branch bookings       | SK\$9,000,000  | SK\$3,000,000  | SK\$85,500,000  |
| Revenue from online bookings          | SK\$81,000,000 | SK\$57,000,000 | SK\$9,500,000   |
| Total Revenue                         | SK\$90,000,000 | SK\$60,000,000 | SK\$95,000,000  |
| Cost of sales as a % of Total Revenue | 60%            | 65%            | 75%             |

The Management Accountant has also analysed the sales revenues earned from each type of holiday product.

|   |           |           |           |
|---|-----------|-----------|-----------|
| Average sales price of a holiday product booked in-branch | SK\$3,000 | SK\$2,000 | SK\$5,000 |
| Average sales price of a holiday product booked online    | SK\$2,700 | SK\$1,900 | SK\$5,000 |

Note: A 'holiday product booked' refers to a total holiday package and may vary in terms of the number of people booked onto each package. For example, a 'Package' holiday product may include 4 people (2 adults and 2 children). A 'Prestige Travel' holiday product may only include 2 people.

##### V's administration costs

In order to establish the net operating profit of each of V's holiday products, the Management Accountant has analysed the total administration costs of V. These administration costs are in addition to the cost of sales. He has identified that there are four administrative processes carried out by V's staff that make up the total administration costs, which are nearly all fixed. The Management Accountant has determined the average cost for each administrative process, which is shown below:

| Administrative process                        | Average cost per process                     |
|---|--|
| 1. In-branch holiday order processing         | SK\$600 per holiday product booked in-branch |
| 2. Online holiday order processing            | SK\$200 per holiday product booked online    |
| 3. Late booking processing                    | SK\$400 per late booking processed           |
| 4. After-sales queries/ complaints processing | SK\$550 per after sales query/ complaint     |

| <b>Other information:</b>  | <b>Package</b> | <b>Adventure</b> | <b>Prestige Travel</b> |
|--|----------------|------------------|------------------------|
| Late bookings processed as a % of <b>total</b> holiday products booked each year                   | 35%            | 12%              | 6%                     |
| Number of after sales queries/ complaints as a % of <b>total</b> holiday products booked each year | 27%            | 10%              | 75%                    |

1. The administration costs of in-branch holiday order processing include the costs incurred in the time taken by branch staff discussing holiday options with customers and the subsequent completion of associated holiday ordering paperwork and administrative activities, including organising flights and hotel accommodation on behalf of the customer.
2. The administration costs of online holiday order processing are significantly less than in-branch costs due to less staff interface and the use of more automated order processing of hotel accommodation and flights.
3. Late booking administration costs are incurred if a customer books a holiday product within 2 weeks of departure. This requires administration time in processing accommodation, foreign currency and arranging flights at short notice. Late bookings, whether booked online or in-branch, are directed straight to a team at V's head office for processing. The costs are treated the same, whether booked online or in-branch. Late booking costs are in addition to the normal order processing costs.
4. After-sales queries administration costs result from customers changing their original bookings or making general enquiries after booking. This may include re-checking or making changes to flight or accommodation details. Sometimes errors occur during the booking process, for example due to staff in-branch processing orders incorrectly or due to customers using the website information incorrectly. Customers' complaints are dealt with by a specialist team at V's head office. Customer complaints are often due to customers being misled by customer sales representatives at the time of booking, largely due to the sales representatives not having sufficient product knowledge.

The Management Accountant has advised the Finance Director that the cost per administrative process identified in the table above are aggregate figures and give the average cost per holiday product booked.

#### **Customer Relationship Marketing and E-business**

V's Executive Chairman does not consider marketing to be a primary activity, as historically much of its business has come from word-of-mouth recommendations and repeat business. The Executive Chairman is confident that word-of-mouth recommendations have been successful in the past and will continue to be successful and that the high level of customer service offered by V is a key factor in this. However, the Operations Director, who is responsible for the marketing of V's products, considers that competitive forces have made customer retention more difficult. This is because customers are now more likely to shop around for the best holiday deals and are not necessarily loyal to one holiday tour operator. In particular, the main competitive threat to V appears to come from the proliferation of online holiday tour operators and travel agency services, many of which make use of sophisticated information systems.

The Operations Director believes that customer retention and loyalty could be improved by developing customer relationship marketing and by focusing more on 'e-business' and the use of V's information systems to transact more of its holiday product business.

*End of unseen material*

*The requirement for Question One is on page 11*

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*Required*

(a) **Discuss** the benefits to V of following an emergent approach to strategy development rather than undertaking a long-term planning approach. *(5 marks)*

(b) (i) **Analyse**, for each of in-branch and online bookings, the net operating profit and the net operating profit percentage for (i) Package, (ii) Adventure and (iii) Prestige Travel holiday products. *(15 marks)*

(ii) **Discuss** how V could improve the product profitability of each of its three holiday product types.  
Your answer should take into account the results of your analysis in (b)(i) and also consider any other information that would be relevant in helping V's Board determine how it could improve its product profitability. *(10 marks)*

(c) (i) **Evaluate** the strategic and competitive impact a Customer Relationship Marketing approach could have on V's customer retention. *(8 marks)*

(ii) **Discuss** TWO strategic benefits and TWO strategic barriers to e-business for V. *(12 marks)*

*(Total marks for Question One = 50 marks)*

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*(Total for Section A = 50 marks)*

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*End of Section A  
Section B starts on page 14*

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## SECTION B – 50 MARKS

[You are advised to spend no longer than 45 minutes on each question in this section]

ANSWER TWO OF THE THREE QUESTIONS – 25 MARKS EACH

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### Question Two

PPP, an electricity generating company based in a European country, Z, was a monopoly supplier until 1995. Z's Government de-regulated the electricity market in 1995 and since then PPP has faced increasing competition from eight other electricity generating companies competing in Z.

PPP currently generates its electricity using only fossil fuels. However, the electricity generating companies' customers (which supply electricity to the final users within Z) are increasingly concerned about environmental issues. Many of these customers are willing to change to a different electricity generating company which generates some of its electricity from renewable sources.

Since 2010, PPP has lost 5% of its customers to competitors who generate electricity from a range of sources, including renewables.

PPP's organisational structure is hierarchical, its decision making is often slow, and its management style is bureaucratic. Many of PPP's employees belong to trade unions and there is usually much resistance to any new initiatives or changes to working arrangements.

In 2010, Z's Government agreed to conform to an overall European Union target of generating 20% of electricity production from renewable sources such as hydro, nuclear and wind generated power by 2020. In 2011, Z's Government announced plans for incentive payments to be awarded to those electricity generating companies investing in projects to generate renewable energy. Through a government initiative called the 'Renewables Pledge', Z's electricity generators are all now required by law to provide a proportion of their electricity generation from renewable sources or pay a penalty fee to the Government.

In January 2012, the Chief Executive Officer (CEO) of PPP, who had been with the company since the 1970's, retired. He had always been sceptical of the Government's drive towards renewable energy and he had often blocked any initiatives for the company to move towards renewable electricity generation. The new CEO is a strong supporter of wind based electricity generation and he recently stated to the Board of Directors 'if PPP is to survive and thrive, it must develop a strategy for wind powered electricity generation. However, this cannot happen overnight as the old style of management must change so that we remain competitive in the industry. We simply must not continue to lose customers'.

The new CEO wishes to exploit Z's windy countryside in the north of the country for wind powered electricity generation. However, gaining planning permission for wind powered generators has proved to be difficult so far in Z. Many proposals have been delayed in the planning system, often due to local residents' opposition. On average, the planning application for a wind powered generator in Z takes 2 years for a decision to be made by local government. The national Government is introducing new laws to force local governments to make decisions more quickly.

The new technology needed to operate and manage wind powered electricity generation will require extensive investment and training in new techniques and skills and require changes to PPP's culture. PPP's engineers have threatened strike action in order to gain large pay increases to compensate for the new working arrangements. Large pay increases would make PPP uncompetitive in the industry.

*The requirement for Question Two is on the opposite page*

*Required*

- (a) **Explain** the internal and external triggers for change which have prompted the need for PPP to develop a strategy for wind powered electricity generation. *(6 marks)*
- (b) **Evaluate**, using Lewin's Force Field Analysis model, the forces which are driving and restraining change in PPP. *(8 marks)*
- (c) **Evaluate:**
- (i) the **type** of change, in terms of speed and extent, which needs to occur in PPP in relation to both the move to wind powered electricity generation and its management culture. *(3 marks)*
  - (ii) the methods of managing resistance to change for PPP. *(8 marks)*

*(Total for Question Two = 25 marks)*

*Section B continues on page 16*

TURN OVER

### Question Three

GGG is a privately owned unlisted company which runs 20 residential care homes for the elderly. A residential care home for the elderly is a building where a number of older people live and receive care (that is, their physical needs are provided for), normally on a full-time basis. The elderly residents may pay the care home fees themselves or they may be paid by their relatives or by the local government authority.

The elderly residents of GGG's care homes are all capable of making decisions for themselves. All of GGG's care homes are located in and around two cities both located in the south of country X. GGG employs around 400 staff in the care homes, some of whom work part-time, and a small team of highly experienced administrators. GGG's care homes all have modern facilities and their staff are highly trained and dedicated. GGG has always been a profitable business, even though its care homes normally have a small amount of spare capacity. GGG has approximately 25% market share in the south of country X. The remainder of the market is shared by a small number of local government funded and operated care homes and some other small private businesses.

Due to the rising costs of operating care homes as a result of increased regulation and the general economic environment, a number of small privately owned care homes in the region have recently closed. The owners of some other privately owned care homes are considering closing or selling them. GGG is also aware that this trend is occurring nationally across country X.

A national shift in the demographics of the population in the last 30 years has resulted in a significant rise in the proportion of elderly members of society. Added to this, the increased social movement of families has resulted in an increasing demand for care home places for the elderly. GGG undertakes limited advertising, relying more on word-of-mouth recommendations and referrals from local hospitals and doctors to obtain its customers.

The prices charged to care home residents by the local government authority run care homes are lower than those charged by GGG, due to central government subsidies. However, the Managing Director of GGG is confident that the services and facilities provided by GGG are superior to those offered by the local government funded care homes.

Although GGG currently offers only full-time care for its elderly residents, there is a growing need for the market to offer 'relief care' packages. This is where elderly people, who do not normally live in residential care homes, could use any of the 20 care homes' facilities for short periods of time (normally 1 week), in order to enable their normal carers (usually family members) to take holidays or rest periods.

A number of GGG's elderly residents are often referred to local hospitals by their doctors for treatments and therapies. Many of GGG's staff are fully qualified nurses and these treatments and therapies could be undertaken by the staff of GGG in each of its care homes. These hospital visits for treatments and therapies can be disruptive and upsetting for residents who often prefer to remain in GGG's care homes and be cared for by staff with whom they are familiar. However, if GGG were to offer these additional facilities within its care homes it will need investment in training and new facilities.

*The requirement for Question Three is on the opposite page*

*Required*

- (a) **Analyse** the opportunities available to GGG, using Ansoff's strategic directional growth vector matrix. *(10 marks)*
- (b) **Evaluate** the opportunities available to GGG in each of the four areas of the Ansoff strategic directional growth vector matrix using Johnson, Scholes and Whittington's Suitability, Acceptability and Feasibility framework. *(10 marks)*
- (c) **Recommend**, with your justifications, which strategic directions, as set out in Ansoff's strategic directional growth vector matrix, would be most appropriate for GGG to follow. *(5 marks)*

*(Total for Question Three = 25 marks)*

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*Section B continues on the page 18*

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#### Question Four

DDD Ltd is a medium sized engineering and manufacturing company. DDD designs, manufactures and installs combined heat and power (CHP) generators. These CHP generators provide an emergency back-up heat and electricity source if the normal national grid service is disrupted. DDD manufactures a range of small off-the-shelf CHP units for offices and shops and these are priced at approximately £20,000 each. DDD also manufactures large bespoke CHP units for customers and these units are priced between £250,000 and £500,000. DDD also provides contract service, repairs and maintenance operations for all of the units it sells. DDD currently has three large bespoke jobs in progress:

- a CHP unit for a large city hospital in its home country;
- two large CHP units for an overseas hotel chain; and
- a CHP unit in a large central government building in its home country.

DDD is very reliant on the expertise and industry knowledge of its staff and DDD often requires them to be able to work on several designs and installations at the same time. However, some of DDD's highly respected senior engineers often complain about difficulties of communication and coordination with senior managers. These senior engineers have also expressed their frustration at their lack of input to decisions. DDD has a high staff turnover compared to other similar organisations.

DDD currently has a functional organisational structure. However, some members of the Board think that the functional structure has sometimes resulted in a lack of integration of the key activities of the company, resulting in job disruption and delays. This can be a significant problem if the customer's contract includes penalties for late delivery of the product or service. Despite having a functional structure, DDD has a highly centralised decision making process, as some of the Directors believe that decentralisation would lead to a loss of control.

The Board of DDD is considering moving towards a divisionalised structure in order to provide more focus. However, having worked for a divisionalised organisation previously, the Finance Director has concerns that this type of structure may adversely affect DDD's performance. The Finance Director has recommended that a more flexible structure be considered. She also believes that a move towards a more decentralised approach to management and control would facilitate flexibility and innovation.

DDD has recently learnt that it has won a large contract for several large bespoke CHP units which will be used to support a major international sporting event which will take place in six years' time. This contract will require DDD's staff to work alongside many different organisations including government agencies, service suppliers, energy and management consultants and other large engineering companies. It will require DDD to design and install a range of CHP products in collaboration with other organisations, working to a fixed deadline date. This is the largest contract that DDD has ever undertaken, estimated to represent about 60% of its total sales revenue for each of the next six years. The Board of Directors is hopeful that if it is successful in delivering this contract, then it could lead to other similar prestigious contracts in the future.

*The requirement for Question Four is on the opposite page*

*Required*

- (a) **Evaluate** the benefits and drawbacks to DDD of having:
- (i) A functional structure
  - (ii) A divisional structure
- (6 marks)*
- (b) **Evaluate** the benefits and drawbacks to DDD of having a centralised as compared to a decentralised decision making process.
- (6 marks)*
- (c) **Recommend**, with your justifications, an appropriate organisational structure for DDD to enable it to meet the needs of the large contract it has recently won.
- (13 marks)*
- (Total for Question Four = 25 marks)*
- 

*End of Question Paper*

*Maths Tables and Formulae are on Pages 21 and 22*

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## MATHS TABLES AND FORMULAE

### Present value table

Present value of \$1, that is  $(1 + r)^{-n}$  where  $r$  = interest rate;  $n$  = number of periods until payment or receipt.

| Periods<br>( $n$ ) | Interest rates ( $r$ ) |       |       |       |       |       |       |       |       |       |
|--------------------|------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|                    | 1%                     | 2%    | 3%    | 4%    | 5%    | 6%    | 7%    | 8%    | 9%    | 10%   |
| 1                  | 0.990                  | 0.980 | 0.971 | 0.962 | 0.952 | 0.943 | 0.935 | 0.926 | 0.917 | 0.909 |
| 2                  | 0.980                  | 0.961 | 0.943 | 0.925 | 0.907 | 0.890 | 0.873 | 0.857 | 0.842 | 0.826 |
| 3                  | 0.971                  | 0.942 | 0.915 | 0.889 | 0.864 | 0.840 | 0.816 | 0.794 | 0.772 | 0.751 |
| 4                  | 0.961                  | 0.924 | 0.888 | 0.855 | 0.823 | 0.792 | 0.763 | 0.735 | 0.708 | 0.683 |
| 5                  | 0.951                  | 0.906 | 0.863 | 0.822 | 0.784 | 0.747 | 0.713 | 0.681 | 0.650 | 0.621 |
| 6                  | 0.942                  | 0.888 | 0.837 | 0.790 | 0.746 | 0.705 | 0.666 | 0.630 | 0.596 | 0.564 |
| 7                  | 0.933                  | 0.871 | 0.813 | 0.760 | 0.711 | 0.665 | 0.623 | 0.583 | 0.547 | 0.513 |
| 8                  | 0.923                  | 0.853 | 0.789 | 0.731 | 0.677 | 0.627 | 0.582 | 0.540 | 0.502 | 0.467 |
| 9                  | 0.914                  | 0.837 | 0.766 | 0.703 | 0.645 | 0.592 | 0.544 | 0.500 | 0.460 | 0.424 |
| 10                 | 0.905                  | 0.820 | 0.744 | 0.676 | 0.614 | 0.558 | 0.508 | 0.463 | 0.422 | 0.386 |
| 11                 | 0.896                  | 0.804 | 0.722 | 0.650 | 0.585 | 0.527 | 0.475 | 0.429 | 0.388 | 0.350 |
| 12                 | 0.887                  | 0.788 | 0.701 | 0.625 | 0.557 | 0.497 | 0.444 | 0.397 | 0.356 | 0.319 |
| 13                 | 0.879                  | 0.773 | 0.681 | 0.601 | 0.530 | 0.469 | 0.415 | 0.368 | 0.326 | 0.290 |
| 14                 | 0.870                  | 0.758 | 0.661 | 0.577 | 0.505 | 0.442 | 0.388 | 0.340 | 0.299 | 0.263 |
| 15                 | 0.861                  | 0.743 | 0.642 | 0.555 | 0.481 | 0.417 | 0.362 | 0.315 | 0.275 | 0.239 |
| 16                 | 0.853                  | 0.728 | 0.623 | 0.534 | 0.458 | 0.394 | 0.339 | 0.292 | 0.252 | 0.218 |
| 17                 | 0.844                  | 0.714 | 0.605 | 0.513 | 0.436 | 0.371 | 0.317 | 0.270 | 0.231 | 0.198 |
| 18                 | 0.836                  | 0.700 | 0.587 | 0.494 | 0.416 | 0.350 | 0.296 | 0.250 | 0.212 | 0.180 |
| 19                 | 0.828                  | 0.686 | 0.570 | 0.475 | 0.396 | 0.331 | 0.277 | 0.232 | 0.194 | 0.164 |
| 20                 | 0.820                  | 0.673 | 0.554 | 0.456 | 0.377 | 0.312 | 0.258 | 0.215 | 0.178 | 0.149 |

| Periods<br>( $n$ ) | Interest rates ( $r$ ) |       |       |       |       |       |       |       |       |       |
|--------------------|------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|                    | 11%                    | 12%   | 13%   | 14%   | 15%   | 16%   | 17%   | 18%   | 19%   | 20%   |
| 1                  | 0.901                  | 0.893 | 0.885 | 0.877 | 0.870 | 0.862 | 0.855 | 0.847 | 0.840 | 0.833 |
| 2                  | 0.812                  | 0.797 | 0.783 | 0.769 | 0.756 | 0.743 | 0.731 | 0.718 | 0.706 | 0.694 |
| 3                  | 0.731                  | 0.712 | 0.693 | 0.675 | 0.658 | 0.641 | 0.624 | 0.609 | 0.593 | 0.579 |
| 4                  | 0.659                  | 0.636 | 0.613 | 0.592 | 0.572 | 0.552 | 0.534 | 0.516 | 0.499 | 0.482 |
| 5                  | 0.593                  | 0.567 | 0.543 | 0.519 | 0.497 | 0.476 | 0.456 | 0.437 | 0.419 | 0.402 |
| 6                  | 0.535                  | 0.507 | 0.480 | 0.456 | 0.432 | 0.410 | 0.390 | 0.370 | 0.352 | 0.335 |
| 7                  | 0.482                  | 0.452 | 0.425 | 0.400 | 0.376 | 0.354 | 0.333 | 0.314 | 0.296 | 0.279 |
| 8                  | 0.434                  | 0.404 | 0.376 | 0.351 | 0.327 | 0.305 | 0.285 | 0.266 | 0.249 | 0.233 |
| 9                  | 0.391                  | 0.361 | 0.333 | 0.308 | 0.284 | 0.263 | 0.243 | 0.225 | 0.209 | 0.194 |
| 10                 | 0.352                  | 0.322 | 0.295 | 0.270 | 0.247 | 0.227 | 0.208 | 0.191 | 0.176 | 0.162 |
| 11                 | 0.317                  | 0.287 | 0.261 | 0.237 | 0.215 | 0.195 | 0.178 | 0.162 | 0.148 | 0.135 |
| 12                 | 0.286                  | 0.257 | 0.231 | 0.208 | 0.187 | 0.168 | 0.152 | 0.137 | 0.124 | 0.112 |
| 13                 | 0.258                  | 0.229 | 0.204 | 0.182 | 0.163 | 0.145 | 0.130 | 0.116 | 0.104 | 0.093 |
| 14                 | 0.232                  | 0.205 | 0.181 | 0.160 | 0.141 | 0.125 | 0.111 | 0.099 | 0.088 | 0.078 |
| 15                 | 0.209                  | 0.183 | 0.160 | 0.140 | 0.123 | 0.108 | 0.095 | 0.084 | 0.079 | 0.065 |
| 16                 | 0.188                  | 0.163 | 0.141 | 0.123 | 0.107 | 0.093 | 0.081 | 0.071 | 0.062 | 0.054 |
| 17                 | 0.170                  | 0.146 | 0.125 | 0.108 | 0.093 | 0.080 | 0.069 | 0.060 | 0.052 | 0.045 |
| 18                 | 0.153                  | 0.130 | 0.111 | 0.095 | 0.081 | 0.069 | 0.059 | 0.051 | 0.044 | 0.038 |
| 19                 | 0.138                  | 0.116 | 0.098 | 0.083 | 0.070 | 0.060 | 0.051 | 0.043 | 0.037 | 0.031 |
| 20                 | 0.124                  | 0.104 | 0.087 | 0.073 | 0.061 | 0.051 | 0.043 | 0.037 | 0.031 | 0.026 |

Cumulative present value of \$1 per annum, Receivable or Payable at the end of each year for  $n$  years

$$\frac{1-(1+r)^{-n}}{r}$$

| Periods<br>( $n$ ) | Interest rates ( $r$ ) |        |        |        |        |        |        |       |       |       |
|--------------------|------------------------|--------|--------|--------|--------|--------|--------|-------|-------|-------|
|                    | 1%                     | 2%     | 3%     | 4%     | 5%     | 6%     | 7%     | 8%    | 9%    | 10%   |
| 1                  | 0.990                  | 0.980  | 0.971  | 0.962  | 0.952  | 0.943  | 0.935  | 0.926 | 0.917 | 0.909 |
| 2                  | 1.970                  | 1.942  | 1.913  | 1.886  | 1.859  | 1.833  | 1.808  | 1.783 | 1.759 | 1.736 |
| 3                  | 2.941                  | 2.884  | 2.829  | 2.775  | 2.723  | 2.673  | 2.624  | 2.577 | 2.531 | 2.487 |
| 4                  | 3.902                  | 3.808  | 3.717  | 3.630  | 3.546  | 3.465  | 3.387  | 3.312 | 3.240 | 3.170 |
| 5                  | 4.853                  | 4.713  | 4.580  | 4.452  | 4.329  | 4.212  | 4.100  | 3.993 | 3.890 | 3.791 |
| 6                  | 5.795                  | 5.601  | 5.417  | 5.242  | 5.076  | 4.917  | 4.767  | 4.623 | 4.486 | 4.355 |
| 7                  | 6.728                  | 6.472  | 6.230  | 6.002  | 5.786  | 5.582  | 5.389  | 5.206 | 5.033 | 4.868 |
| 8                  | 7.652                  | 7.325  | 7.020  | 6.733  | 6.463  | 6.210  | 5.971  | 5.747 | 5.535 | 5.335 |
| 9                  | 8.566                  | 8.162  | 7.786  | 7.435  | 7.108  | 6.802  | 6.515  | 6.247 | 5.995 | 5.759 |
| 10                 | 9.471                  | 8.983  | 8.530  | 8.111  | 7.722  | 7.360  | 7.024  | 6.710 | 6.418 | 6.145 |
| 11                 | 10.368                 | 9.787  | 9.253  | 8.760  | 8.306  | 7.887  | 7.499  | 7.139 | 6.805 | 6.495 |
| 12                 | 11.255                 | 10.575 | 9.954  | 9.385  | 8.863  | 8.384  | 7.943  | 7.536 | 7.161 | 6.814 |
| 13                 | 12.134                 | 11.348 | 10.635 | 9.986  | 9.394  | 8.853  | 8.358  | 7.904 | 7.487 | 7.103 |
| 14                 | 13.004                 | 12.106 | 11.296 | 10.563 | 9.899  | 9.295  | 8.745  | 8.244 | 7.786 | 7.367 |
| 15                 | 13.865                 | 12.849 | 11.938 | 11.118 | 10.380 | 9.712  | 9.108  | 8.559 | 8.061 | 7.606 |
| 16                 | 14.718                 | 13.578 | 12.561 | 11.652 | 10.838 | 10.106 | 9.447  | 8.851 | 8.313 | 7.824 |
| 17                 | 15.562                 | 14.292 | 13.166 | 12.166 | 11.274 | 10.477 | 9.763  | 9.122 | 8.544 | 8.022 |
| 18                 | 16.398                 | 14.992 | 13.754 | 12.659 | 11.690 | 10.828 | 10.059 | 9.372 | 8.756 | 8.201 |
| 19                 | 17.226                 | 15.679 | 14.324 | 13.134 | 12.085 | 11.158 | 10.336 | 9.604 | 8.950 | 8.365 |
| 20                 | 18.046                 | 16.351 | 14.878 | 13.590 | 12.462 | 11.470 | 10.594 | 9.818 | 9.129 | 8.514 |

| Periods<br>( $n$ ) | Interest rates ( $r$ ) |       |       |       |       |       |       |       |       |       |
|--------------------|------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|                    | 11%                    | 12%   | 13%   | 14%   | 15%   | 16%   | 17%   | 18%   | 19%   | 20%   |
| 1                  | 0.901                  | 0.893 | 0.885 | 0.877 | 0.870 | 0.862 | 0.855 | 0.847 | 0.840 | 0.833 |
| 2                  | 1.713                  | 1.690 | 1.668 | 1.647 | 1.626 | 1.605 | 1.585 | 1.566 | 1.547 | 1.528 |
| 3                  | 2.444                  | 2.402 | 2.361 | 2.322 | 2.283 | 2.246 | 2.210 | 2.174 | 2.140 | 2.106 |
| 4                  | 3.102                  | 3.037 | 2.974 | 2.914 | 2.855 | 2.798 | 2.743 | 2.690 | 2.639 | 2.589 |
| 5                  | 3.696                  | 3.605 | 3.517 | 3.433 | 3.352 | 3.274 | 3.199 | 3.127 | 3.058 | 2.991 |
| 6                  | 4.231                  | 4.111 | 3.998 | 3.889 | 3.784 | 3.685 | 3.589 | 3.498 | 3.410 | 3.326 |
| 7                  | 4.712                  | 4.564 | 4.423 | 4.288 | 4.160 | 4.039 | 3.922 | 3.812 | 3.706 | 3.605 |
| 8                  | 5.146                  | 4.968 | 4.799 | 4.639 | 4.487 | 4.344 | 4.207 | 4.078 | 3.954 | 3.837 |
| 9                  | 5.537                  | 5.328 | 5.132 | 4.946 | 4.772 | 4.607 | 4.451 | 4.303 | 4.163 | 4.031 |
| 10                 | 5.889                  | 5.650 | 5.426 | 5.216 | 5.019 | 4.833 | 4.659 | 4.494 | 4.339 | 4.192 |
| 11                 | 6.207                  | 5.938 | 5.687 | 5.453 | 5.234 | 5.029 | 4.836 | 4.656 | 4.486 | 4.327 |
| 12                 | 6.492                  | 6.194 | 5.918 | 5.660 | 5.421 | 5.197 | 4.988 | 4.793 | 4.611 | 4.439 |
| 13                 | 6.750                  | 6.424 | 6.122 | 5.842 | 5.583 | 5.342 | 5.118 | 4.910 | 4.715 | 4.533 |
| 14                 | 6.982                  | 6.628 | 6.302 | 6.002 | 5.724 | 5.468 | 5.229 | 5.008 | 4.802 | 4.611 |
| 15                 | 7.191                  | 6.811 | 6.462 | 6.142 | 5.847 | 5.575 | 5.324 | 5.092 | 4.876 | 4.675 |
| 16                 | 7.379                  | 6.974 | 6.604 | 6.265 | 5.954 | 5.668 | 5.405 | 5.162 | 4.938 | 4.730 |
| 17                 | 7.549                  | 7.120 | 6.729 | 6.373 | 6.047 | 5.749 | 5.475 | 5.222 | 4.990 | 4.775 |
| 18                 | 7.702                  | 7.250 | 6.840 | 6.467 | 6.128 | 5.818 | 5.534 | 5.273 | 5.033 | 4.812 |
| 19                 | 7.839                  | 7.366 | 6.938 | 6.550 | 6.198 | 5.877 | 5.584 | 5.316 | 5.070 | 4.843 |
| 20                 | 7.963                  | 7.469 | 7.025 | 6.623 | 6.259 | 5.929 | 5.628 | 5.353 | 5.101 | 4.870 |

## FORMULAE

### Annuity

Present value of an annuity of \$1 per annum, receivable or payable for  $n$  years, commencing in one year, discounted at  $r\%$  per annum:

$$PV = \frac{1}{r} \left[ 1 - \frac{1}{[1+r]^n} \right]$$

### Perpetuity

Present value of \$1 per annum, payable or receivable in perpetuity, commencing in one year, discounted at  $r\%$  per annum:

$$PV = \frac{1}{r}$$

## LIST OF VERBS USED IN THE QUESTION REQUIREMENTS

A list of the learning objectives and verbs that appear in the syllabus and in the question requirements for each question in this paper.

It is important that you answer the question according to the definition of the verb.

| LEARNING OBJECTIVE   | VERBS USED  | DEFINITION   |
|--|---|--|
| <b>Level 1 - KNOWLEDGE</b><br>What you are expected to know.   | List<br>State<br>Define   | Make a list of<br>Express, fully or clearly, the details/facts of<br>Give the exact meaning of   |
| <b>Level 2 - COMPREHENSION</b><br>What you are expected to understand.   | Describe<br>Distinguish<br>Explain<br><br>Identify<br><br>Illustrate  | Communicate the key features<br>Highlight the differences between<br>Make clear or intelligible/State the meaning or purpose of<br>Recognise, establish or select after consideration<br>Use an example to describe or explain something   |
| <b>Level 3 - APPLICATION</b><br>How you are expected to apply your knowledge.  | Apply<br>Calculate<br>Demonstrate<br><br>Prepare<br>Reconcile<br>Solve<br>Tabulate                              | Put to practical use<br>Ascertain or reckon mathematically<br>Prove with certainty or to exhibit by practical means<br>Make or get ready for use<br>Make or prove consistent/compatible<br>Find an answer to<br>Arrange in a table   |
| <b>Level 4 - ANALYSIS</b><br>How are you expected to analyse the detail of what you have learned.                        | Analyse<br>Categorise<br>Compare and contrast<br><br>Construct<br>Discuss<br>Interpret<br>Prioritise<br>Produce | Examine in detail the structure of<br>Place into a defined class or division<br>Show the similarities and/or differences between<br>Build up or compile<br>Examine in detail by argument<br>Translate into intelligible or familiar terms<br>Place in order of priority or sequence for action<br>Create or bring into existence |
| <b>Level 5 - EVALUATION</b><br>How are you expected to use your learning to evaluate, make decisions or recommendations. | Advise<br>Evaluate<br>Recommend   | Counsel, inform or notify<br>Appraise or assess the value of<br>Advise on a course of action   |

*Enterprise Pillar*

*Strategic Level Paper*

*E3 – Enterprise Strategy*

*November 2012*

*Tuesday Morning Session*