

ACCA

Paper SBL

Strategic Business Leader

Study Text

British library cataloguing-in-publication data

A catalogue record for this book is available from the British Library.

Published by:

Kaplan Publishing UK
Unit 2 The Business Centre
Molly Millars Lane
Wokingham
Berkshire
RG41 2QZ

ISBN 978-1-78740-095-5

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Printed and bound in Great Britain

Acknowledgements

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Introduction

How to use the Materials

These Kaplan Publishing learning materials have been carefully designed to make your learning experience as easy as possible and to give you the best chances of success in your examinations.

The product range contains a number of features to help you in the study process. They include:

- 1 Detailed study guide and syllabus objectives
- 2 Description of the examination
- 3 Study skills and revision guidance
- 4 Study text
- 5 Question practice

The sections on the study guide, the syllabus objectives, the examination and study skills should all be read before you commence your studies. They are designed to familiarise you with the nature and content of the examination and give you tips on how to best to approach your learning.

The **Study Text** comprises the main learning materials and gives guidance as to the importance of topics and where other related resources can be found. Each chapter includes:

- The **learning objectives** contained in each chapter, which have been carefully mapped to the examining body's own syllabus learning objectives or outcomes. You should use these to check you have a clear understanding of all the topics on which you might be assessed in the examination.
- The **chapter diagram** provides a visual reference for the content in the chapter, giving an overview of the topics and how they link together.
- The **content** for each topic area commences with a brief explanation or definition to put the topic into context before covering the topic in detail. You should follow your studying of the content with a review of the illustration/s. These are worked examples which will help you to understand better how to apply the content for the topic.
- **Test your understanding** sections provide an opportunity to assess your understanding of the key topics by applying what you have learned to short questions. Answers can be found at the back of each chapter.
- **Summary diagrams** complete each chapter to show the important links between topics and the overall content of the paper. These diagrams should be used to check that you have covered and understood the core topics before moving on.

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Our Quality Coordinator will work with our technical team to verify the error and take action to ensure it is corrected in future editions.

Icon Explanations



Definition – Key definitions that you will need to learn from the core content.



Key point – Identifies topics that are key to success and are often examined.



Illustration – Worked examples help you understand the core content better.



Test your understanding – Exercises for you to complete to ensure that you have understood the topics just learned.



Supplementary reading – These sections will help to provide a deeper understanding of core areas. The supplementary reading is **NOT** optional reading. It is vital to provide you with the breadth of knowledge you will need to address the wide range of topics within your syllabus that could feature in an exam question. **Reference to this text is vital when self studying.**



Tutorial note – Included to explain some of the technical points in more detail.

On-line subscribers

Our on-line resources are designed to increase the flexibility of your learning materials and provide you with immediate feedback on how your studies are progressing.

If you are subscribed to our on-line resources you will find:

- 1 On-line referenceware: reproduces your Study Text on-line, giving you anytime, anywhere access
- 2 On-line testing: provides you with additional on-line objective testing so you can practice what you have learned further
- 3 On-line performance management: immediate access to your on-line testing results. Review your performance by key topics and chart your achievement through the course relative to your peer group.

Ask your local customer services staff if you are not already a subscriber and wish to join.

ACCA Performance Objectives

In order to become a member of the ACCA, as a trainee accountant you will need to demonstrate that you have achieved nine performance objectives. Performance objectives are indicators of effective performance and set the minimum standard of work that trainees are expected to achieve and demonstrate in the workplace. They are divided into key areas of knowledge which are closely linked to the exam syllabus.

There are five Essential performance objectives and a choice of fifteen Technical performance objectives which are divided into five areas.

The performance objectives which link to this exam are:

- 1 Ethics and professionalism (Essential)
- 2 Stakeholder relationship management (Essential)
- 3 Strategy and innovation (Essential)
- 4 Governance risk and control (Essential)
- 5 Leadership and management (Essential)
- 6 Evaluate investment and financing decisions (Technical)
- 7 Identify and manage financial risk (Technical)
- 8 Evaluate management accounting systems (Technical)
- 9 Plan and control performance (Technical)
- 10 Review and report on the finding of an audit (Technical)

The following link provides an in depth insight into all of the performance objectives:

https://www.accaglobal.com/content/dam/ACCA_Global/Students/per/PER-Performance-objectives-achieve.pdf

Progression

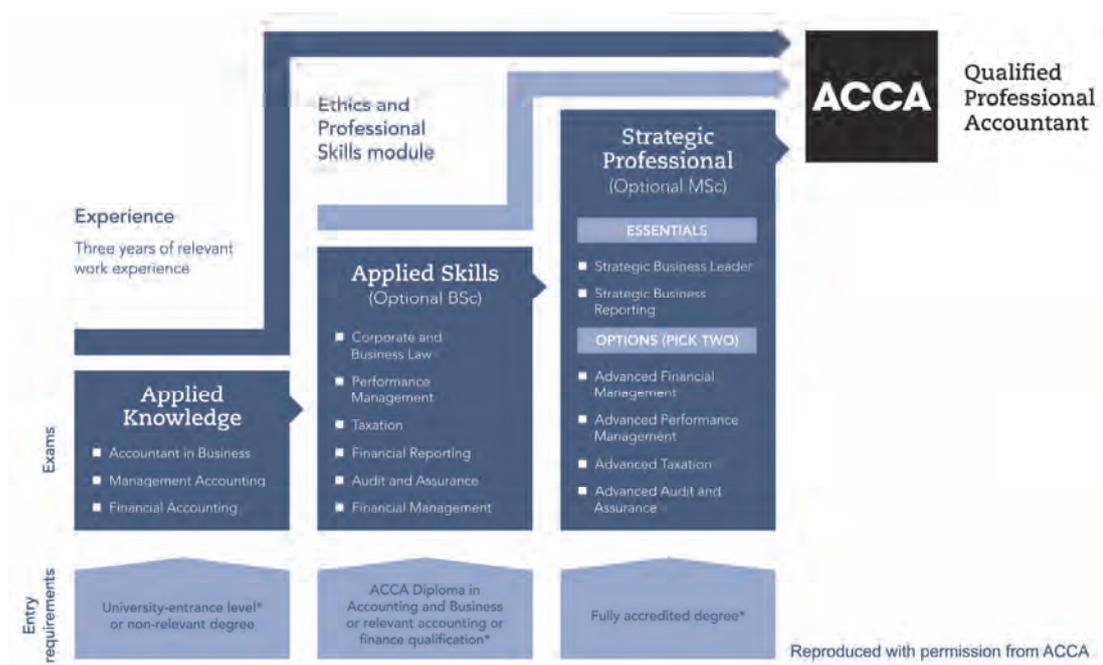
There are two elements of progression that we can measure: first how quickly students move through individual topics within a subject; and second how quickly they move from one course to the next. We know that there is an optimum for both, but it can vary from subject to subject and from student to student. However, using data and our experience of student performance over many years, we can make some generalisations.

A fixed period of study set out at the start of a course with key milestones is important. This can be within a subject, for example 'I will finish this topic by 30 June', or for overall achievement, such as 'I want to be qualified by the end of next year'.

Your qualification is cumulative, as earlier papers provide a foundation for your subsequent studies, so do not allow there to be too big a gap between one subject and another. We know that exams encourage techniques that lead to some degree of short term retention, the result being that you will simply forget much of what you have already learned unless it is refreshed (look up Ebbinghaus Forgetting Curve for more details on this). This makes it more difficult as you move from one subject to another: not only will you have to learn the new subject, you will also have to relearn all the underpinning knowledge as well. This is very inefficient and slows down your overall progression which makes it more likely you may not succeed at all.

In addition, delaying your studies slows your path to qualification which can have negative impacts on your career, postponing the opportunity to apply for higher level positions and therefore higher pay.

You can use the following diagram showing the whole structure of your qualification to help you keep track of your progress.



5 Evaluation

- (a) **Assess** and use professional judgement when considering organisational issues, problems or when making decisions; taking into account the implications of such decisions on the organisation and those affected.^[3]
- (b) **Estimate** trends or make reasoned forecasts of the implications of external and internal factors on the organisation, or of the outcomes of decisions available to the organisation.^[3]
- (c) **Appraise** facts, opinions and findings objectively, with a view to balancing the costs, risks, benefits and opportunities, before making or recommending solutions or decisions.^[3]

The examination

The examination is based on an integrated case study containing a number of assignments which will vary at each examination.

These assignments or tasks may require the candidate to take on different roles, depending on the situation. The number of marks allocated to all these assignments or the sub-parts of these will add up to 100 in total.

Within the total marks available, there are 20 Professional Skills marks. Usually each task will contain some professional skills marks which may vary by examination, depending on the requirements. All tasks must be completed.

The examination is of 4 hours duration, but this includes Reading, Planning and Reflection time (RPRT). This time can be used flexibly at any time during the exam.

	Number of marks
Varying number of tasks	100
Total time allowed: 4 hours	

Examination tips

Note: make sure you read the ACCA's Strategic Business Leader – Examiner Approach Article

The SBL exam is different from any other exams that you have sat before and good exam technique is vital for success. In particular you should use this time to ensure that you understand the requirements, highlighting key verbs, consider which parts of the syllabus are relevant and plan key calculations.

Time management

You will have four hours (240 minutes) to read and analyse the case study and requirements, plan your approach to answering each of the tasks, and produce full answers to them all.

The examiners' recommended approach is that you allocate at least 40 minutes to reading and annotating the case, leaving 200 minutes for planning and writing up your answers.

Given the 20 professional marks are earned **how** you write your answers (rather than writing anything extra), this means 200 minutes for 80 technical marks, or 2.5 minutes per technical mark.

Using the reading time effectively

Your objective here is to read and understand the scenario and requirements fully within 40 minutes.

Start by reading the requirements, so that when you read through 12 or more pages of exhibits, you can evaluate the information and link all pieces of relevant information to the requirements. As you do this, start thinking about the implications of what you are reading, and mentally compile a big picture of the organisation and the issues it is currently facing.

The exam you will be sitting is (currently) paper-based so you should highlight and annotate those areas of text that you consider to be useful to answering the questions, linking them to the different requirements.

Weaker candidates annotate far too much, so try to be selective and prioritise issues as you go along.

Planning answers

Start by analysing the requirement itself:

- What role are you adopting?
- Who is the task addressed to and what do they want?
- What verbs have been used to express the requirement?
- Are there any limitations of scope highlighted?
- Are there any key issues mentioned that need addressing?
- Which professional skill(s) is being explicitly tested?

Next you could assess what approach you will take:

- Are any calculations, ratios or other quantitative analysis required?
- Does the question lend itself to the use of a specific theoretical model?

The SBL syllabus has many frameworks and models that were developed to make analysis more focussed and effective, and to help develop strategic responses. The exam task will not specify which model to use (if any), so you need to decide which is/are the most useful. It is also perfectly reasonable to use parts of models if some aspects are less relevant – it is not an "all or nothing" decision.

Given the above, you are now in a position to start writing up a plan:

- Start by setting up key headings – these should now be obvious from the wording of the requirement and the choice of model.
- Start filling in key issues under the headings, firstly from what you remember and then by looking again at your annotations on the exam paper.
- Some students write too much detail on their plans, wasting time, whereas others do not have sufficient information in order to take the plan and write up an answer. You will only find this balance through practice and experimentation.

Earning professional skills marks as you write up your answers

To demonstrate professionalism and earn skills marks you need to do the following:

- Address the requirements as written, taking particular notice (again!) of the verbs used
- Make sure you include the most important, relevant and crucial points relating to the requirement.
- Only make relevant points and try not to include superfluous information or make unsupported points.
- Show deep/clear understanding of underlying or causal issues and integrate or link different sources of information from various parts of the scenario or different exhibits to make points
- Avoid repeating points already made.
- Show your ability to prioritise and make points in a logical and progressive way, building arguments rather than using a random or 'scattergun' approach to answering the question.
- Structure and present your answers in a professional manner through faithfully simulating the task as would be expected of the person being asked to carry it out and always have a clear stakeholder focus in mind when constructing the answer.
- Demonstrate evidence of your knowledge from previous learning or wider reading and apply this knowledge appropriately to strengthen arguments and make points more convincing.
- In addition to being clear, factual and concise, you should express yourself convincingly, persuasively and with credibility.

Introduction to the strategic business leader exam

Chapter learning objectives

Upon completion of this chapter you will be able to:

- understand the aims and structure of the Strategic Business Leader (SBL) exam and how it is marked
- understand what it means to be a "strategic leader"
- understand the professional skills required in the SBL exam and how they are examined.

1 Introduction

The aim of the exam

The aim of the Strategic Business Leader (SBL) exam is to demonstrate organisational leadership and senior consultancy or advisory capabilities and relevant professional skills, through the context of an integrated case study.

The examination requires candidates to demonstrate a range of professional skills demanded by effective leaders or in advising or supporting senior management in directing organisations.

Role play

The basic structure of each exam will require the candidate to take the **role** of an organisational leader or as a consultant or adviser to senior management.

For example, in sample assessment 1, candidates were asked to adopt the role of an external management consultant throughout the case, whereas in sample assessment 2 roles included being chairman of the nominations and corporate governance (NCG) committee in task 1, an assistant auditor in task 2 and a project manager in task 5. In each scenario candidates were expected to "get into character" and be very careful to consider who they were working for and who the report was for and what they required.

2 The strategic leader

Being a leader

Increasingly the role of accountants is that of professional advisors and leaders within business.

A leader is expected to be able to

- analyse a business situation and
- provide and implement appropriate, effective and sustainable solutions

This means that they can

- be clear and focussed, identifying the key issues in any situation
- analyse and address ethical concerns
- use technical models and quantitative analysis to draw out key issues, establish causality and integrate a wide range of factors into a coherent argument
- make clear recommendations that meet and exceed the needs of users and are 'fit for purpose'.

The SBL exam will test the extent to which you can fulfill this role and demonstrate this skill set.

Thinking strategically

Strategic analysis is covered in great depth within the strategic business leader syllabus but at this stage it is sufficient to remind you of the key characteristics of thinking strategically.

Having a strategic perspective means the following:

- Taking a **long term perspective**.

In the exam you could be presented with a problem and a potential solution but are expected to ascertain that the solution is nothing more than a short-term 'fix' and fails to address the longer term issues facing the firm, such as a decline in its main markets.

- Looking at the **whole organisation** as well as individual products/divisions/strategic business units (SBUs).

For example, suppose a division is looking to introduce a new low-cost product – how could this affect sales of other company products that are currently marketed as high-quality, luxury items? Could the low cost item erode the existing brand name? Should the new product be sold under a different brand name?

- Setting the **direction** of the whole organisation and integrating its activities.

A new strategy could require a change in the firm's organisational structure, governance structures and IT systems. All of these will need to be integrated to ensure success.

- Considering the views of **all stakeholders**.

A project may create wealth for shareholders but would pollute the environment – would you accept it?

- Analysing the organisations **resources** and defining resource requirements.

For example, a company that has previously sold mainly to middle-aged consumers is considering targeting teenagers. Is the company's brand name strong enough to move into the new market?

- Relating the organisation to its **environments**.

All strategies need to be 'positioned' in respect of what is happening within markets, key trends, the activities of competitors and so on.

- Looking at gaining a sustainable **competitive advantage**.

How is the firm currently competing – is it on the basis of low cost, high quality or a strong brand name? Does the new strategy ensure a sustainable competitive edge going forwards?

In the exam most, if not all, of the questions will have a strategic context, so pitch your answer accordingly.



Test your understanding 1 – MacDonald Farm Ltd

The company

The entire share capital of MacDonald Farm Ltd is owned by Ken MacDonald and his wife, Jane. Their business consists of owning and running a 1,200 hectare farm, with land split between rearing lambs and growing a range of fruit and vegetables, including sugar beet.

MacDonald Farm Ltd is in the country of Florentinia, which is currently part of an economic union that includes the following systems and rules:

- There are no trade barriers or tariffs for the sale of goods between member states.
- There is a uniform, high level of tariffs that countries outside the union have to pay. This means for example, that there are few imports of African cane sugar and that imported New Zealand lamb is relatively expensive for consumers.
- Farmers within the union receive subsidies based on how large their farms are.

Recent events

Most of MacDonald Farm Ltd's produce is sold to large supermarket chains, who have been exerting more pressure on the farm to reduce prices. As a result the farm has started to see a decline in its annual trading profits, which in recent years have averaged \$180,000 per annum.

In a recent referendum the people of Florentinia voted to leave the economic union with the "Flexit" scheduled to take place within the next two years. At this stage it is unclear what type of trading deals (and associated rules and restrictions) will be negotiated between Florentinia and the economic union and between Florentinia and other countries outside the union.

Proposal

Ken MacDonald is worried about the future and is therefore investigating using 200 hectares to set up a new exclusive 18-hole golf course.

Preliminary research suggests that planning permission will be forthcoming and demand projections are encouraging, given that membership waiting lists at the two existing golf clubs in the area exceed 350. If the project goes ahead, the new golf club is expected to be much better appointed than the two existing courses nearby.

Advantages and disadvantages

Ken has discussed the golf club idea with Jane and their sons, Rory and Callum, and they have together drafted the following list of advantages and disadvantages:

Advantages	Disadvantages
<ul style="list-style-type: none"> • Golf club income could help replace lost farm subsidies • Stable source of income • Could sell farm produce to the golf club restaurant generating extra income 	<ul style="list-style-type: none"> • The family has no experience of running a golf club • The club could adversely affect the farm – e.g. extra noise during lambing season • Lost income from the land currently used for other purposes • Will need to build additional gates for access • Weedkiller used on golf putting greens could get blown onto vegetables • Damage to roads and farm tracks from additional cars
<p>Required:</p> <p>You have been appointed as a management consultant by Ken MacDonald to advise the family.</p> <p>Briefly explain the most important strategic issues this case presents.</p>	

3 Professional skills

3.1 Overview

Employability and professional skills

Employers have consistently informed the ACCA and other professional accountancy bodies that their employees need to possess certain professional and ethical skills, in addition to the technical knowledge and skills that they expect of a qualified accountant.

The main capabilities that employers are seeking in qualified accountants are the ability to communicate appropriately, demonstrate commercial acumen, deploy analytical skills, adopt a sceptical stance and evaluate data and business information effectively.

These form the basis of the professional skills listed in the syllabus:

- Communication
- Commercial acumen
- Analysis
- Scepticism
- Evaluation

How the skills are examined

Depending on the particular professional skill being examined in the requirement, the examiner will be looking for that skill to be evident in how you answer the question in respect of the technical points you make. Demonstrating professional skills should therefore not be viewed as a distinct exercise separate from earning technical marks but rather as influencing how you answer the requirement.

The exam will contain 20 professional skills marks in total, distributed across the different tasks and be subject to the following:

- (1) All five professional skills must be tested in each exam.
- (2) Only one professional skill will be tested per requirement or part requirement.
- (3) The marks per professional skill tested will always lie within a range of 2-4 marks.
- (4) When awarding professional skill marks, markers will use a professional skills grid, which will be consistently applied to the skill concerned on a sliding scale as follows:

Total marks for skill in this requirement	Skill demonstrated "not at all"	Skill demonstrated "not so well"	Skill demonstrated "quite well"	Skill demonstrated "very well"
2	0	0.5	1	2
3	0	1	2	3
4	0	1	2	4

Within each box, the answer will give further guidance to help assess the extent to which skills have been demonstrated.

It is extremely important that you understand what these professional skills are in more detail so that you know what is being expected of you.



Professional skills – Marking guide

For example, in sample assessment 1 part 2(b) you were asked to review a spreadsheet prepared by a colleague. This was to evaluate the strategic choices facing DCS Company and to ensure the spreadsheet's validity in supporting your recommendation in a consultancy report.

Within this – part 2(b) (i) you were asked to critically evaluate the contents of the spreadsheet including any assumption made by the DCS Company board for 5 marks. The professional skills aspect, for 2 marks, was given as follows:

"Professional Skills marks are available for demonstrating scepticism skills in analysing the spreadsheet and any supporting assumptions."

The marking guide for this explained how marks were awarded as follows:

How well has the candidate demonstrated Professional skills as follows:	0	0.5	1	2
Scepticism skills in analysing the spreadsheet and supporting assumptions	The candidate showed no evidence of scepticism, and accepted both the content and underlying assumptions of the spreadsheet without question.	Although the candidate displayed a cursory level of scepticism, they failed to challenge the assumptions which underpinned the analysis contained within the spreadsheet.	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.	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.

3.2 Communication

Definition

- Inform** concisely, objectively, and unambiguously, while being sensitive to cultural differences, using appropriate media and technology.
- Persuade** using compelling and logical arguments demonstrating the ability to counter argue when appropriate.
- Clarify** and simplify complex issues to convey relevant information in a way that adopts an appropriate tone and is easily understood by the intended audience.

In the ACCA's Strategic Business Leader – Examiner Approach Article, this is summarised as meaning that you have to express yourself clearly and convincingly through the appropriate medium while being sensitive to the needs of the intended audience.

The appropriate medium

You need to be able to present using a range of formats – reports, slides, letters, briefing documents etc. – so it is important to be aware what is considered to be best practice for each.

For example, in sample assessment 1, one requirement asked for slides with supporting notes. The expectation was that students would select key points, prioritise them and then present them in a logical order with a maximum of five points per slide. The accompanying notes were key as well as it was here that further detail and explanations could be added.

The intended audience

It is vital that you are aware of the recipient of the communication, so you can produce “the right message for the right person”.

Key questions to consider are the following:

- who is the recipient?
- why have they requested the report (or slides or...)? Is there a key underlying question that they want an answer to?
- what are their key concerns likely to be?
- what arguments are more likely to persuade them?
- what level of technical discussion is appropriate?
- what do they already know?

This is also known as having "user focus".

3.3 Commercial acumen

Definition

In the syllabus, having commercial acumen is described as the ability to:

- (a) **Demonstrate** awareness of organisational and wider external factors affecting the work of an individual or a team in contributing to the wider organisational objectives.
- (b) Use **judgement** to identify key issues in determining how to address or resolve problems and in proposing and recommending the solutions to be implemented.
- (c) Show **insight** and perception in understanding work-related and organisational issues, including the management of conflict, demonstrating acumen in arriving at appropriate solutions or outcomes.

In the ACCA's Strategic Business Leader – Examiner Approach Article, this is summarised as meaning that you have to show awareness of the wider business and external factors affecting business, using commercially sound judgement and insight to resolve issues and exploit opportunities.

Acquiring commercial acumen

In an ideal world you will have worked within a number of different industries and gained valuable experience and insight as a result. However, this will not be the case for the vast majority of students, so the required acumen needs to be gained in other ways.

Some aspects of commercial acumen can be learnt. For example, when you study franchising, licencing and joint ventures as possible business vehicles you will see that a key issue in 'the real world' is often how risks and returns are shared out among the different parties.

However, the best way to acquire the required insights is to do wider reading, whether through newspapers, journals or other sources. The examiners have made it clear that students will be rewarded for demonstrating wider reading by bringing real life examples into their answers.

When reading articles you should ask the following:

- What influenced the decisions made by the company concerned?
- What influenced whether those decisions turned out to be successful or not?

While no pre-seen is issued, exam cases will be based on industries that are relevant to students world-wide, so there should be scope to bring in factors relating to real companies.

3.4 Analysis

Definition

In the syllabus, analysis is described as the ability to:

- (a) **Investigate** relevant information from a wide range of sources, using a variety of analytical techniques to establish the reasons and causes of problems, or to identify opportunities or solutions.
- (b) **Enquire** of individuals or analyse appropriate data sources to obtain suitable evidence to corroborate or dispute existing beliefs or opinion and come to appropriate conclusions.
- (c) **Consider** information, evidence and findings carefully, reflecting on their implications and how they can be used in the interests of the department and wider organisational goals.

In the ACCA's Strategic Business Leader – Examiner Approach Article, this is summarised as meaning that you have to thoroughly investigate and research information from a variety of sources and logically process it with a view to considering it for recommending appropriate action.

Another way of understanding this is to recognise that to analyse something is to examine it in detail in order to discover its meaning or essential features. This will usually involve breaking the scenario down and looking at the fine detail, possibly with additional calculations, and then stepping back to see the bigger picture to identify any themes to support conclusions.

Requirements may be unstructured but your analysis should be structured and have purpose

You will not be given a specific framework to work with in the requirement but will be expected to identify key data and use appropriate metrics and models, where useful, to analyse it.

The exam will be written to ensure that key data is spread across more than one exhibit and/or that key issues require some "digging" to unearth them, particularly when presented with large amounts of raw numerical data.

There should always be a purpose to the analysis – e.g. to identify reasons for a problem, to assess an opportunity or to generate solutions. It is therefore important to ask yourself why you are doing a particular calculation or using a specific framework – what will this reveal? Will it help answer the key questions?

'Analyse' does not mean 'describe'

A common complaint by examiners of higher-level papers is that students are asked to analyse something but weaker answers merely describe the scenario without really adding any additional insight.

For example, if asked to **describe** a company's organisational structure, then you might comment that it has a basic functional structure. However, if asked to **analyse** the structure, then you might consider:

- **causes** – why has it got a functional structure? Has it been this way for years? What advantages does/did it gain from this? Are these arguments still valid?
- **context** – consider the wider picture. For example, maybe the structure was developed when the company had a more limited product range but now there is a strategic need to diversify the product portfolio and enter new markets.
- **consequences** – perhaps the company has outgrown its current structure and needs to adopt, say, a divisional approach to enable its new strategies?

Numerical analysis

If asked to analyse a set of financial statements, the end result will be a set of comments about the performance of the business with supporting evidence.

This could involve the following:

- (1) You could break down your analysis into areas of profitability, liquidity, gearing and so on, depending on the requirement. You may not have time to calculate every possible ratio, so decide which areas are more likely to help.
- (2) Under each heading look at key figures in the financial statements, identifying trends (e.g. sales growth) and calculating supporting ratios (e.g. margins).
- (3) Try to explain what the figures mean and why they have occurred (e.g. why has the operating margin fallen?)
- (4) Start considering the bigger picture – are the ratios presenting a consistent message or do they contradict each other? Can you identify common causes?
- (5) Finally you would then seek to pull all this information together and interpret it to make some higher level comments about overall performance.

The main error students make is that they fail to draw out any themes and conclusions and simply present the marker with a collection of uninterpreted, unexplained facts and figures.

3.5 Scepticism

Definition

In the syllabus, scepticism is described as the ability to:

- (a) **Probe** deeply into the underlying reasons for issues and problems, beyond what is immediately apparent from the usual sources and opinions available.
- (b) **Question** facts, opinions and assertions, by seeking justifications and obtaining sufficient evidence for their support and acceptance.
- (c) **Challenge** information presented or decisions made, where this is clearly justified, in a professional and courteous manner; in the wider professional, ethical, organisational, or public interest.

In the ACCA's Strategic Business Leader – Examiner Approach Article, this is summarised as meaning that you have to probe, question and challenge information and views presented to you, to fully understand business issues and to establish facts objectively, based on ethical and professional values.

Responsible accountants and auditors need to probe into issues, to question assumptions, scrutinise what is presented to them and challenge the status quo. These skills are also important for accountants in other functions. For example management accountants, particularly in relation to the budgetary planning and control process, will need to exercise scepticism where careful scrutiny of variances and their causes is concerned.

Not taking things at face value

Scepticism means not accepting things at face value.

For example:

- Looking for weaknesses in governance structures.
- Not believing something just because a director said it – many students are reluctant to challenge directors, even when they express very debatable viewpoints!
- Questioning data and how it was put together:
 - Who prepared it?
 - How competent are they?
 - Is there anything missing – what additional information is required?
 - Why did they produce it – what are they trying to achieve?
 - Could this result in bias?
 - What assumptions have they made and are they realistic?
 - Has the data been verified?

Ethical perspectives

Ethics is developed in great detail in later chapters. However, based on your earlier studies it is worth noting that potential solutions and strategies should be assessed against ethical frameworks, the public interest and professional codes.

The need for tact

For example, suppose a senior manager has presented a proposal for a new project. It is more tactful to suggest that forecast growth rates may be too 'optimistic' (coupled with arguments relating to industry growth, actions of competitors, etc), rather than claiming that the manager concerned was trying to deceive the Board to get funding.



Test your understanding 2 – Scepticism

You work in the mergers and acquisitions division of Global Foods Inc, a multinational group that specialises in food and drink products. The company has grown primarily through acquisition targeting smaller businesses that have high quality products but lack the financial, managerial and marketing resources to fully exploit them.

Kanter Ice Cream is a small ice cream manufacturer set up by George Kanter, a nutritional biologist. George has developed a way of making low fat, non-dairy ice cream that tastes just as good as traditional dairy high-fat products. George has financed the company through its first year from personal savings and by taking out a second mortgage on his home and has had some success in winning sales contracts from local health food shops. He is now considering selling the company to release equity.

George has approached you to discuss a potential valuation and has provided the following details:

	<i>Forecast for next year</i>	<i>First year of trading (actual) Unaudited</i>
	\$000	\$000
Sales	60	30
Cost of sales	(15)	(10)
Gross Profit	45	20
Distribution costs	(10)	(5)
George's salary	–	(10)
Net profit	35	5

Required:

Explain five reasons why you should exercise scepticism regarding the figures presented by George.

3.6 Evaluation

Definition

In the syllabus, evaluation is described as the ability to:

- (a) **Assess** and use professional judgement when considering organisational issues, problems or when making decisions; taking into account the implications of such decisions on the organisation and those affected
- (b) **Estimate** trends or make reasoned forecasts of the implications of external and internal factors on the organisation, or of the outcomes of decisions available to the organisation
- (c) **Appraise** facts, opinions and findings objectively, with a view to balancing the costs, risks, benefits and opportunities, before making or recommending solutions or decisions.

In the ACCA's Strategic Business Leader – Examiner Approach Article, this is summarised as meaning that you have to carefully assess situations, proposals and arguments in a balanced way, using professional and ethical judgement to predict future outcomes and consequences as a basis for sound decision-making.

Having a balanced argument

A key aspect of evaluation involves demonstrating **balance**, taking into account a broad range of issues, such as the following:

- Looking at both financial and non-financial indicators.
For example, project A may have a higher NPV than project B but that does not necessarily mean that it should be preferred. What if project B has a more positive impact on the company's "green credentials" due to having a less damaging impact on the environment – would that make the directors choose project B instead?
- Looking at the needs of wider stakeholders and not just shareholders.
For example, in an attempt to reduce costs and boost profits, a car manufacturer is considering using cheaper components in its engines. These are expected to fail after 4 years whereas the current components usually last the life of the car. Should the needs of shareholders be prioritised over those of customers?
- Balancing both risk and return.
There are many ways of measuring the "return" of a proposal, ranging from profit-based metrics such as ROCE to cash-based approaches, such as NPV. However, return cannot be viewed in isolation but rather the risk-return trade off should be considered – does the extra return on one proposal outweigh the additional risks? How has risk been incorporated into the decision-making – for example, using different discount rates when calculating NPVs.
- Incorporating implementation aspects
A project may look attractive in terms of risk and return but that does not mean that it would be feasible for this company to undertake it – does it have sufficient resources, can it raise the finance required, can it achieve key deliverables in the timescales needed?

Prioritisation

Another key aspect of evaluation is that points are weighed and prioritised so that the most important issues are developed and discussed. Quality is more important than quantity in the SBL exam.

In prioritising points you could consider the following:

- Is the issue a strategic one or operational?
For example, a new rival entering the market with a superior product (strategic threat) is more serious than problems with the air-conditioning in one of the firm's offices (operational issue).
- How urgently is a response needed?
For example, the resignation or death of the CEO would require immediate action to reassure shareholders.

- What is the potential impact or materiality of the issue?
For example, a company is considering a product recall due to safety concerns. How much will it cost to rectify and what is the possible cost if nothing is done and customers end up suing the company for injuries received?
- How likely is the issue to materialise?
With the product recall issue mentioned above, how likely is it that customers will be injured and to what extent? If sued, then what are the chances of the company winning?
- Do not under-estimate the importance of ethical issues.
Suppose in the product recall example it would be cheaper for the company to ignore the problem, even taking into account the costs of being sued. You could argue that the company should go ahead with the recall as that would be the ethically responsible thing to do.
- What is the relevance of the issue to the key question that is being addressed?
For example, suppose the key issue at the heart of the question is declining quality and that the directors are looking for ways to improve quality and remain competitive. If discussing outsourcing as a possible solution, then quality-related issues should be seen as more important than, say, cost ones, although (obviously) a balance must be struck between these.



Test your understanding 3 – Expected Values

XYZ plc is a large manufacturing company that specialises in the innovative use of new technologies. Forecast results for the next year are as follows:

- Revenue – \$100 million
- Profit – \$20m

Unfortunately both of these are around 10% lower than the actual results for last year so the Directors are looking for new investment opportunities.

One new possibility is project FG4526, which involves the use of a pioneering new composite material with exciting properties that are still being researched. The cash flows for the new project are estimated to be:

- Probability of 40%: NPV = \$30m
- Probability of 50%: NPV = \$2m
- Probability of 5%: NPV = (\$120m)

The expected value of the above outcomes is $0.4 \times 30 + 0.5 \times 2 + 0.05 \times (120) = +\$7m$

Should the company proceed with the project?

3.7 Summary

In summary, to demonstrate professionalism and earn skills marks you need to do the following (based on the ACCA's *Strategic Business Leader – Examiner Approach Article*):

- Make sure you include the most important, relevant and crucial points relating to the requirement.
- Show deep/clear understanding of underlying or causal issues and integrate or link different sources of information from various parts of the scenario or different exhibits to make points.
- Only make relevant points and try not to include superfluous information or make unsupported points.
- Avoid repeating points already made.
- Address the requirements as written, taking particular notice of the verbs used.
- Show your ability to prioritise and make points in a logical and progressive way, building arguments rather than using a random or 'scattergun' approach to answering the question.
- Structure and present your answers in a professional manner through faithfully simulating the task as would be expected of the person being asked to carry it out and always have a clear stakeholder focus in mind when constructing the answer.
- Demonstrate evidence of your knowledge from previous learning or wider reading and apply this knowledge appropriately to strengthen arguments and make points more convincing.
- In addition to being clear, factual and concise, students should express themselves convincingly, persuasively and show credibility in what they say and how they express themselves.



Test your understanding 4 – MacDonald Farm Ltd – Continued

Recap

The entire share capital of MacDonald Farm Ltd is owned by Ken MacDonald and his wife, Jane. Ken and Jane are concerned about the future impact of Flexit and growing supermarket power and are investigating using 200 of their 1,200 hectares to set up a new exclusive 18-hole golf course. Preliminary research suggest that planning permission will be forthcoming and demand projections are encouraging, given that membership waiting lists at the two existing golf clubs in the area exceed 350.

The golf club company

It is proposed that MacDonald Farm Ltd will sign a 100-year lease with a new company, Calum Golf Club Ltd, which will pay an annual rent of \$50,000 to MacDonald Farm Ltd for use of the land.

The issued capital of the golf club company will be two \$1 ordinary shares, owned by Mr and Mrs MacDonald, and the remainder of its initial funding will be \$2 million in the form of 15% per annum irredeemable loan stock. Fifty local business men, including Mr MacDonald, have each agreed to purchase \$40,000 of this stock. The terms of the debenture loan stock issue prohibit a dividend being paid on the two ordinary shares so that any surplus is applied for the benefit of the club and its members.

Of the funds thus raised, \$450,000 will be spent on converting farmland to become a landscaped golf course. A further \$50,000 will provide working capital.

The club house company

The remaining \$150,000 will be used to purchase a 25% stake in a separate company, Tarpon Club House Ltd, that will develop and operate a club house. This will have conference facilities, a sports hall, two bars and a restaurant. A local property company will subscribe the other 75% of the share capital of Tarpon Club House Ltd.

Calum Golf Club Ltd will pay an annual rent of \$50,000 for the use of the club house, but Tarpon Club House Ltd will manage and run all facilities offered there, taking the profits that will be earned.

When ready to commence business in January 20X6, the new golf club will be much better appointed than the two existing local courses.

Costs and revenues

Annual operating expenses of Calum Golf Club Ltd are budgeted at \$900,000.

On the revenue side, Calum Golf Club Ltd's share of profits on the investment in Tarpon Club House Ltd is expected to total \$200,000 in 20X6, the first year of operations. Green fees, chargeable to non-members using the golf course, are expected to amount to an additional \$100,000 a year.

On the assumption that target membership levels are achieved, annual subscriptions are initially to be set at \$1,000 for each member. This will be \$200 less than for full membership at the two rival golf clubs in the area. In addition, no joining fees will be payable in the first year of operation, but thereafter (as with the other two clubs) they will be equal to one year's subscription.

Breakeven analysis

Based on the above data the break-even point for Calum Golf Club Ltd has been estimated at 600 members:

Expected fixed costs	\$900,000
Income from Club House	\$200,000
Green Fees Income	\$100,000
Net costs to be covered	\$600,000
Membership fee	\$1,000
Break-even membership	600

Task

You are a management consultant advising the MacDonald family.

Prepare slides for use in a presentation to the family that addresses risk and return. There is no need for accompanying notes.

Test your understanding answers



Test your understanding 1 – MacDonald Farm Ltd

The key strategic issues facing the MacDonald family are both external environmental factors:

Flexit

There is huge risk and uncertainty relating to the post-Flexit trading environment:

- How much trade will MacDonald farms continue to do within the economic union or will new tariffs price its products out of current markets?
- Will new trade rules with countries outside the economic union result in increased imports of African sugar and New Zealand lamb?
- If so, then will there be a system of new tariffs or will imported goods be cheaper than those produced by MacDonald farm?
- Presumably MacDonald Farm will lose existing farming subsidies but will the Government of Florentinia replace this with anything to support domestic farmers?

The power of supermarkets

Large supermarket chains have been exerting more pressure on the farm to reduce prices. Even without the problems that may arise due to Flexit, MacDonald Farm is facing a major strategic threat here:

- Will supermarkets continue to squeeze prices as they appear to have the power to do so?
- Could MacDonald Farm find other retailers to use as an alternative to the larger supermarkets?
- Could MacDonald Farm offset the power in some way, such as building its own brand strength or specialising in a niche with less competition, such as producing organic foods?

Implications

Both of these factors mean that there is considerable uncertainty whether MacDonald farm has a sustainable competitive strategy over the longer term.

The key issue facing the family is therefore how to reduce this uncertainty and develop a less risky income stream going forwards.

(Note: issues such as noise, new gates and weedkiller are all operational matters rather than strategic ones)



Test your understanding 2 – Scepticism

1 George's expertise and experience

George may be an expert biologist but there is no indication that he has any experience or expertise in accounts preparation and/or forecasting. Now it may be the case that he has had help from a professional accountant but we should not assume either the completeness or accuracy of the figures presented. Furthermore we should not assume that his lack of experience means that he has over-estimated the forecasts – it may be that George has under-estimated how desirable his new ice cream might be to major supermarket chains, for example.

2 George's motivation and interest

George is keen to sell the business to “release equity”, so may, either consciously or unconsciously, be over-optimistic in his expectations regarding future success. He wants Global Foods to make an offer so wishes to make Kanter Ice Cream more attractive as a potential target. Furthermore, he will understand that higher forecast profits are likely to result in a higher offer price, so, again, may try to make the results look better to boost his return.

3 Unaudited accounts

While not a point to be laboured, there is the possibility than an audit might find errors in the actual results for the first year, resulting in a different profit figure.

4 Problems with figures that have been included

Some key figures are given without supporting assumptions and evidence. For example, is there any evidence, say in terms of commitments from new customers, to justify the 100% increase in revenue? Other figures seem too low – for example, a salary of \$10,000 would not reflect market rates for a senior manager or director. For next year there is no salary at all – in both cases profit would need adjusting to reflect a more realistic figure.

5 Categories that appear to be missing

A final area of concern is that certain key costs appear to be absent altogether – for example, in order to penetrate the competitive, brand-conscious ice cream market significant expenditure on marketing would be required. No costs have been included for this.



Test your understanding 3 – Expected Values

Based on your knowledge of expected values from F9, you could have answered the question as follows:

The expected NPV is positive, so the project should be accepted. This would be expected to boost shareholder wealth, thus helping to meet the company's primary objective of maximising shareholder value. However the use of expected values can be criticised on the following grounds:

- *The expected value represents a long term average so may not be appropriate for a one-off decision*
- *The use of expected values loses the information regarding the spread of possible outcomes, so may not reflect the risks concerned*
- *The decision rule does not fully incorporate the risk aversion of key stakeholders.*

While this is all correct, the answer is limited in as much as it does not really **evaluate** the information fully and misses the key point:

- There is a 5% of a negative NPV of \$120m, probably sufficient to bankrupt the company based on its forecast results.
- While the expected NPV is positive, there is a 5% chance of destroying shareholders' investments.
- This is very unlikely to be acceptable to shareholders – the risks are too great.



Test your understanding 4 – MacDonald Farm Ltd – Continued

Tutorial Note:

*The key professional skill here is **communication** – in particular the idea of **user-focus** – you are asked to discuss risk and return from the **MacDonald's** perspective, rather than the golf club or the debenture holders or the property company or risks in general. The investment proposed should give them reliable income of \$56,000 per annum unless the golf club performs very badly.*

SLIDE 1

Introduction/objectives

- To analyse risk/return for the MacDonald family from the Calum Golf Club
- Key question: Does the golf club provide a low risk source of income?

SLIDE 2

Context – 1 – Flexit

Significant uncertainty!

- Tariffs
- Access to markets
- Competition
- Loss of subsidies

SLIDE 3

Context – 2 – Increasing supermarket power

Increasing pressure on margins

- Pressure on prices
- Difficult to counter
- Likely to get worse

SLIDE 4

Scenario 1: the golf club is extremely successful:

You will receive an annual rent of \$50,000 and interest of \$6,000 on the debentures.

- No dividends can be paid on profits.
- You will also have a 100% equity stake in a successful golf company

SLIDE 5

Scenario 2: the golf club just hits its BEP:

- You will still receive an annual rent of \$50,000 and interest of \$6,000 on the debentures.
- No dividends can be paid on profits.

SLIDE 6

Scenario 3: the golf club fails to attract enough members to hit BEP:

- Unless the situation is particularly bad, you will still receive rent of \$50,000 and interest of \$6,000.
- No additional liability on shares
- If interest cannot be paid, then the debenture holders may insist on a receiver. Uncertainty
- If rent cannot be paid, can the farm reclaim the land? Uncertainty

SLIDE 7

Conclusion and preliminary recommendations

Unless the golf club does very badly, you should receive a steady income of \$56,000 per annum

The investment gives a higher return than farming and at a lower risk, and is thus recommended on financial grounds.

However, before proceeding, we recommend that you seek to clarify/address the following risk areas:

- What is the legal position concerning the land and club house should rent not be paid?
- What assets are the debentures secured on, if any, as this will affect possible outcomes should interest not be paid?