

## SECTION A

The following exhibits provide information relevant to the question

### QUESTION 1

#### **EXHIBIT 1: Company information – the background, objectives and business model of the company: Maddy restaurants.**

Maddy is a fast-food chain which operates restaurants in several locations. It was established by the current board members, who are all shareholders, when they opened the first Maddy restaurant in 20X2. The restaurant quickly gained a good reputation, through positive customer reviews on social media, for the quality and price of its food, for its customer service and for its cleanliness. Since then, Maddy has grown quickly. By August 20X5 it had opened another 12 restaurants under the Maddy brand, with the same overall business model, product range and look and feel as the original restaurant.

Maddy's overall objective is to maximise shareholder wealth. To achieve this overall objective, Maddy has two supporting aims:

1. To increase the number of restaurants.

Maddy has ambitious growth objectives to increase the number of restaurants, including franchise restaurants. Though Maddy is a successful business, the lack of available finance has meant that the rate of opening its own new restaurants has recently slowed.

2. To achieve like-for-like\* revenue growth of at least 15% each year.

The board believes a key factor in achieving this is for Maddy to achieve industry-leading performance across a range of factors relating to quality of service.

\*Like-for-like revenue growth is that achieved by means other than the growth due to the opening of new restaurants and excludes growth from other one-off events which may distort the measurement of performance.

In order to help achieve its overall objective, Maddy has recently established eight franchise restaurants consistent with the first supporting aim to increase the number of restaurants, including franchise restaurants. One of these franchise restaurants is located in a neighbouring country, where the Maddy brand is not widely recognised.

Each franchise is owned and managed by a franchisee and is operated as a business which is totally separate from Maddy. The franchisee pays franchise fees to Maddy and in return is able to trade under the Maddy brand. All food items, cooking equipment, fixtures and fittings and marketing materials are provided to the franchisee by Maddy, to the extent that from the customer's point of view, a franchise restaurant is indistinguishable from one owned by Maddy. The franchise fees paid by the franchisee to Maddy have two elements:

1. A one-off set-up fee which varies in amount according to the size of a new franchise. This covers the costs of fixtures, fittings and equipment, as well as staff training and the initial marketing of the new restaurant in the local press and online, using social media and pay-per-click advertising. For some of the new franchises, the set-up costs incurred by Maddy have exceeded the set-up fee agreed with the franchisee and the board is keen to ensure that this does not happen in the future.
2. An on-going fee of 10% of the franchisee's revenue is paid to Maddy, in return for provision of an extensive IT infrastructure, continuing IT and marketing support, and licence to trade under the Maddy brand.

**Note:** All food items must be purchased by the franchisee from Maddy and the costs of these are additional to the franchise fees.

**EXHIBIT 2 : Performance reporting – a request for an evaluation of Maddy’s current performance report.**

Before Maddy continues with the next phase of its growth plans, the board has asked you for advice relating to performance reporting at Maddy.

The board wants you to evaluate whether the current performance report (Appendix 1), which it uses on a quarterly basis, is fit for purpose. The board has instructed that you are not required to evaluate the performance of any aspect of Maddy’s business.

**EXHIBIT 3 : Minimum performance levels – details of work required on the measurement of qualitative performance of Maddy’s franchises.**

All franchisees are subject to minimum performance levels set by Maddy across a range of financial and qualitative measures. If a franchisee fails to meet these levels, a board member will visit the franchisee to help support them to improve performance. Continued failure could lead to termination of the franchise.

Maddy has only recently started to collect data relating to cleanliness of the franchise restaurants. Cleanliness is one measure subject to minimum performance levels and is measured using customer surveys. Customers fill out a paper form giving just one overall score, between 1 and 5, for cleanliness and some other aspects of the quality of service and place these in a box in exchange for a chance to win a free meal. The franchisee collates these responses onto a spreadsheet at the end of each quarter and sends a summary of the results to Maddy for inclusion in the next performance report.

The work the board requires on this area is in two parts:

1. The board would like you to explain the difficulties in interpreting data about cleanliness and advise it on the problems there may be with the data on cleanliness received from the franchisees.
2. The board has then asked you to recommend and evaluate possible alternative methods to assess the area of cleanliness.

**EXHIBIT 4: Transfer pricing proposal – information related to a request to evaluate a transfer pricing proposal from a franchise based in another country.**

In 20X5, the first Maddy franchise restaurant established in a neighbouring country was opened. This restaurant is geographically close to Maddy's warehouse from where it distributes food items to its own restaurants and franchises in its home country. Food items can move freely between the two countries and there are no tariffs or administrative barriers to doing this.

Maddy usually negotiates fixed prices with food suppliers for one year, so it is also able to fix the price it charges franchisees for food items for the same period. The franchisee in the neighbouring country, while accepting that it must purchase all food items from Maddy, has asked that it be charged for these at the market price it would pay for the nearest equivalent products in its own country. The board has asked you to evaluate the franchisee's proposal.



## REQUIREMENTS

It is now 1 September 20X5.

Write a report to the board of Maddy to respond to its instructions for work on the following areas:

**(i) performance reporting**

(14 marks)

**(ii) minimum performance levels: cleanliness**

Note: there are 10 marks available for the first part of the work required on this area and 8 marks available for the second part of the work required on this area.

(18 marks)

**(iii) transfer pricing proposal**

(8 marks)

Professional marks will be awarded for the demonstration of skill in communication, analysis and evaluation, scepticism and commercial acumen in your answer.

(10 marks)

## **SECTION B**

### **QUESTION 2**

**The following exhibits provide information relevant to the question**

**EXHIBIT 1: Company information – the background, industry sector and objective of the company:  
Morlich**

Morlich plc is a retailer based in Teeland. The company offers a complete optical care service including eye tests and the prescription and supply of contact lenses, spectacles and optical aids. All prescribed items are ordered by Morlich from supplying companies.

Morlich's main objective is the maximisation of shareholder returns through providing: 'an excellent service which is renowned for being the best in its field and supplying goods of perfect quality.'

Morlich has several shops throughout Teeland and all the shops operate to the same processes and procedures. The industry Morlich operates in is increasingly competitive where brand strength is becoming an important critical success factor and customer satisfaction is seen as key. Other companies are increasing their advertising spend to enhance their brand strength and are also keen to maximise their intellectual capital by employing knowledgeable employees because such employees are seen as key in enhancing and developing brand strength.

**EXHIBIT 2: Benchmarking exercise – details of a benchmarking exercise requested by the chief executive officer (CEO).**

The chief executive officer (CEO) of Morlich has been concerned recently about the decline in Morlich's operating margin. She asked Morlich's management accountant to undertake a benchmarking exercise to try to ascertain if this is an industry-wide issue. He collected the financial data presented in Appendix 1 for both Morlich and its main competitor in Teeland, Shiel, for the last financial year but has now left the company. Included with this data are the measures the management accountant felt the benchmarking exercise should address.

The CEO has asked you, as a management consultant in this area, to complete the benchmarking exercise by calculating the suggested performance measures and evaluate whether these measures are appropriate and sufficient for this industry.



**EXHIBIT 3 : Current process – an explanation of the current process of ordering and receiving goods at Morlich.**

The current process for ordering the spectacles and contact lenses involves the optician asking an administrator to place the order with the supplier. There are many suppliers of these products, a situation which has resulted from different opticians over the years having used different supplying companies. The goods are then delivered to Morlich. An administrator in Morlich is then required to inspect the quality of the spectacles which have been received and to count that the number of pairs of contact lenses which have been received is correct.

The customer is then notified by Morlich that their goods have arrived. It often takes a few days for the customer to be notified as there are usually many goods delivered from each supplier and supplies can arrive on any day of the week, often on a day when there is only one administrator working.

Given the high standards of production which Morlich's suppliers work to, there are usually no returns or damaged goods. However, as it takes some time for Morlich to notify customers of the arrival of their order, goods frequently go missing. Morlich has to pay for the re-order of these goods if its administrators have originally recorded them as successfully received.

After notification, customers are then required to check the goods on Morlich's premises to confirm that they are happy with the quality. It is very rare, given the high standards of production alluded to earlier, for customers to reject the goods on the basis of quality.

The CEO believes that Morlich's current process may be inefficient in the present environment and would like you to assess how Morlich could improve the current process of ordering and receiving goods by using business process reengineering (BPR).

**EXHIBIT 4: Appendix 1 – financial and other key data for Morlich and its main competitor, Shiel.**

		A	B	C
1	<b>Appendix 1</b>			
2				
3	<b>Financial data for year ended 30 June 20X5:</b>			
4			<b>Morlich</b>	<b>Shiel</b>
5			<b>\$m</b>	<b>\$m</b>
6				
7	Revenue		8.40	21.84
8	Cost of sales		1.20	3.60
9	Advertising costs		3.40	6.20
10	Other operating costs		3.00	6.00
11	Operating profit		<b>0.80</b>	<b>6.04</b>
12	Financing costs		0.00	0.75
13	Tax		0.22	1.48
14	Net Income		<b>0.58</b>	<b>3.81</b>
15				
16	<b>Other key data:</b>			
17	Number of employees		480	950
18	Customer satisfaction		50.00%	Unknown
19	Operating profit margin (year ended 30 June 20X4)		12.00%	16.00%
20	Training spend - product knowledge		\$0.50m	\$2.00m
21	Training spend - managerial skills		\$0.05m	\$1.00m
22				
23	<b>Suggested performance measures for benchmarking:</b>			
24				
25	Operating profit margin growth			
26	Customer satisfaction			
27	Product knowledge training spend per employee			
28	Revenue per employee			

## REQUIREMENTS

It is now 1 September 20X5.

Respond to the CEO of Morlich's request for work on the following areas:

(a) the benchmarking exercise;

(12 marks)

(b) the current process

(8 marks)

Professional marks will be awarded for the demonstration of skill in analysis and evaluation, scepticism and commercial acumen in your answer.

(5 marks)

### QUESTION 3

The following exhibits provide information relevant to the question:

**EXHIBIT 1 : Company information – the background, key objective and recent performance of the company: Spiggie.**

Spiggie is a listed company based in Seeland and sells insurance products, such as home and vehicle insurance, directly to consumers. Unlike its competitors, who do most of their business online, most of Spiggie's business is done over the telephone although it does some limited business online. Most of Spiggie's 3,500 staff are telephone call centre operators who sell insurance products to customers, handle insurance claims and deal with customer queries. Spiggie's annual payroll cost for the call centre operators is \$84m.

Spiggie's objective is to maximise long-term shareholder wealth. The majority of shares are held by a small number of institutional investors who tend to retain their shareholdings for many years. The institutional investors are unhappy with the company's recent performance, in particular its share price relative to that of other companies listed in the insurance sector of the Seeland Stock Exchange.

There are 12 directors on the board. Currently, each is paid an annual salary of \$850,000, which contains only a small performance-related element.

In order to manage Spiggie's overall risk, the directors can choose to transfer some of this risk to other insurance companies by taking out its own insurance with them, known as re-insurance. The cost of doing this reduces Spiggie's profit. Currently, around half of Spiggie's risk is re-insured in this way.

**EXHIBIT 2: Building block model – use of the Fitzgerald and Moon building block model to improve performance at Spiggie.**

The shareholders have been told that the use of Fitzgerald and Moon's building block model for service businesses may help improve Spiggie's performance. The shareholders are not familiar with the model and have asked you, as a performance management expert, for your advice.

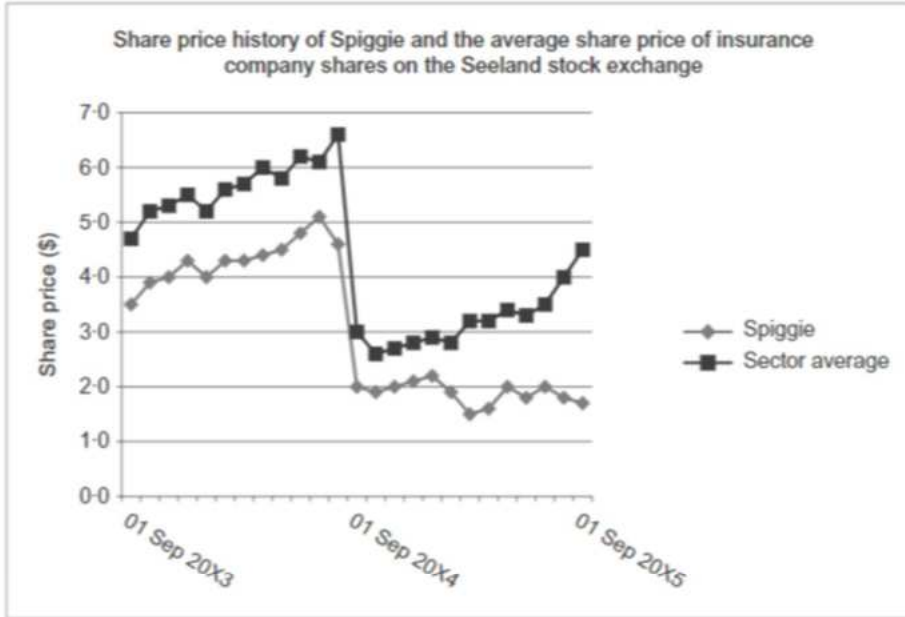
The shareholders want a specific explanation of each of the four determinants (quality of service, flexibility, resource utilisation and innovation) in the dimensions block and why measuring them would help to improve Spiggie's performance. Then, for each determinant, they would like you to recommend a justified performance measure.

**EXHIBIT 3 : Proposed ESOS – details of the executive share option scheme (ESOS) being proposed by Spiggie’s shareholders.**

The shareholders also believe that Spiggie's recent poor performance may be due to its reward systems. They have asked for your advice on the benefits and problems of a proposed executive share option scheme (ESOS) for the board of directors. To help you, you have been given an extract from a recent press article, which includes historical data on the share prices of Spiggie and the insurance sector average (Appendix 1).

The shareholders have been negotiating the terms of the ESOS with the board for some time. Subject to your advice, they are about to approve a deal where each director will be given an option to buy 200,000 shares in two years' time at today's market price of \$1.70 per share. In two years' time, each director can decide whether or not to exercise their share options depending upon the prevailing share price. The directors' basic salary will not change following the introduction of the ESOS.

**EXHIBIT 4: Appendix 1 – share price history of Spiggie and average share price information for insurance companies on the Seeland Stock Exchange and extract from the Seeland Financial Gazette.**



**More bad news for Spiggie investors**

*The price of shares in Spiggie has fallen for the second month in a row. A recent consumer survey voted customer service at the company's call centre the poorest in the industry. Many customers complained that they had waited up to an hour for their calls to be answered at busy times and often ended the call before the call was answered. Customers also said that call centre staff were impolite and did not take the time to fully understand what they had called about.*

**REQUIREMENT:**

It is now 1 September 20X5.

**Respond to Spiggie's shareholders' request for work on the following areas:**

**(a) building block model;**

(12 marks)

**(b) proposed executive share option scheme (ESOS)**

(8 marks)

Professional marks will be awarded for the demonstration of skill in analysis and evaluation, scepticism and commercial acumen in your answer.

(5 marks)