Examiner's Answers

Some of the answers that follow in Sections A and B are fuller and more comprehensive than would be expected from a well-prepared candidate. They have been written in this way to aid teaching, study and revision for tutors and candidates alike.

These Examiner's answers should be reviewed alongside the question paper for this examination which is now available on the CIMA website at www.cimaglobal.com/e3papers

The Post Exam Guide for this examination, which includes the marking guide for each question, will be published on the CIMA website by early February at www.cimaglobal.com/e3PEGS

SECTION A

Answer to Question One

**Rationale**

This question examines learning outcomes from across the syllabus. Requirement (a) examines learning outcome C1(b) 'evaluate strategic options' and is designed to test candidates' ability to apply the Ansoff directional growth matrix. Requirement (b)(i) examines learning outcome C1(b) 'evaluate strategic options'. Requirement (b)(ii) examines learning outcome A1(e) 'recommend how to interact with suppliers and customers'. Requirement (c) examines learning outcome D1(e) 'recommend changes to information systems appropriate to the organisation's strategic requirements'.

**Suggested approach**

For requirement (a) candidates are expected to apply the Ansoff model to the sales development strategies highlighted in the unseen material. However, more importantly, candidates should also ensure that their answers fully consider how each of these strategies would assist Y in the achievement of its two strategic objectives (as presented in the pre-seen material). Therefore a mere presentation of an applied Ansoff matrix would not be sufficient to pass this requirement.

For requirement (b)(i) candidates are expected to demonstrate their knowledge and understanding of the concept of contribution and contribution per unit of limiting factor (CPULF), in order to calculate an optimum production mix for Y. This should be a straightforward calculation, providing that candidates calculate the correct contribution per unit in order to be able to successfully rank the three products based upon the CPULF. It is important that candidates undertake all elements of the
requirement, as it asks for the optimum production mix and the contribution from the optimum production mix for firstly, an order for Z, followed by Q and secondly, and order for Q only.

For requirement (b)(ii) candidates are expected to discuss the relative merits and difficulties of the proposals outlined in part (b)(i). Candidates are expected to discuss the operational and strategic issues relating to both proposals. Candidates are expected to make reference to their calculations from part (b)(i) above but this is only a minor part of this answer. Therefore candidates will not pass if they merely discuss their calculations.

For requirement (c) candidates are expected to consider the features of a website that would specifically assist Y in building and managing its relationships with its online customers. Therefore, answers must be focused upon customer relationship management and not merely upon generic features of a website such as security and layout.

**Requirement (a)**

Y’s two strategic objectives which it wishes to achieve, through its sales development strategies are as follows:

1. Engage with the widest range of customers through the development of Y’s markets and products through a wide variety of sales channels. The focus of this is on the delivery of what products the customer demands, where they are required and when they are wanted (SO1).

2. Enhance the customer experience through strong and effective customer relationship management. The focus of this is on clear and consistent branding and marketing to encourage customer retention and loyalty all the year round (SO2).

It is possible to use the Ansoff product market directional growth model to assess the sales development strategies proposed by Y.

<table>
<thead>
<tr>
<th>Products</th>
<th>Existing</th>
<th>New</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Market Penetration/Consolidation</td>
<td>Product Development</td>
</tr>
<tr>
<td>Markets</td>
<td>Existing</td>
<td>New</td>
</tr>
<tr>
<td></td>
<td>Market Development</td>
<td>Diversification Related/ Unrelated</td>
</tr>
</tbody>
</table>

**Market Penetration/Consolidation (Existing products to Existing customers)**

Market penetration is where organisations attempt to increase their market share in the existing market using the existing products. This addresses Y’s strategic objective 2, which is to “enhance the customer experience” and “to encourage customer retention and loyalty all the year round”.

Y believes that its retail stores should be a continuing outlet for its products and that greater effort needs to be made in improving the customer experience, through engaging better with customers and providing them with a wide range of high quality products. Therefore it must ensure that it continues to strengthen its product range and give its existing customers incentives to buy more of Y’s products, such as 2 for 1 offers or tasting sessions in store. This should help to increase sales to its existing customers.

Y clearly sees its current retail stores and franchises as a critical part of its growth of the business but that there must be a better emphasis upon creating a better relationship with the customer in these locations. Y must focus upon customer service and customer relationship management to make sure customers return frequently throughout the year. Y clearly states that it must invest more in customer relationship development in the retail stores and this should be through staff training and in the layout and facilities of each shop. In addition the optimisation of location is important for Y, ensuring that it retains the best performing retail stores in the most popular locations. The image and branding of the
Y store is also important and that the Y brand is clearly recognised in every location and Y must invest in this. This should help in achieving SO2.

Y also plans to sell more own label products to supermarkets, which is predicting an annual growth of 10% for 2014. This could be a highly successful strategy which could overcome the potential fall in sales due to closure of retail stores.

The closure of the retail stores is a form of consolidation and could be an effective way of improving the customer perception of Y, if it is carried out effectively. Y needs to make sure that it only closes those retail stores which are under performing or those which do not enhance the image of the Y brand, either because of poor location or poor performance.

Market penetration and consolidation strategies should help to achieve Strategic Objective 1, providing that it gets the right products in its retail stores and the retail stores are in the optimum location. The retail stores and franchises are also the best place to assist in achieving Strategic Objective 2, as it is here that its customers will experience the Y brand and where effective marketing and customer relationships must be built.

**Product Development (New products to Existing customers)**

This quadrant of Ansoff’s matrix is concerned with the development of a wider range of products in order to increase sales. This meets with Y’s Strategic Objective 1 to produce “products the customers demand”. The confectionery market has changed considerably in recent years and Y may need to conduct more market research to identify exactly what its customers want, or what they think they want. Y will also need to look at the ranges and quality of products that its many competitors offer. Y should try to be innovative and develop new, different products rather than simply copying its competitors. Y needs to try to lead the market, rather than follow the market.

It would appear that the website is being considered as a means to achieve product development, through the sale of new products such as hampers. Y must ensure that these products are complementary and do not detract from the chocolate product sales and that they do not reduce the quality image of Y. This could help to achieve Strategic Objective 1 if these new products are in fact demanded by the customers. However, Y needs to undertake research to establish the extent to which customers are interested in buying these complementary products through its website.

A further product development strategy is the manufacture of exclusive hand-made chocolates. This is highly innovative and could complement sales of other Y chocolates currently sold in supermarkets. This should help to achieve Strategic Objective 1 in providing a wide range of Y products in locations where they are required.

**Market Development (Existing products in New Markets)**

This quadrant concerns ways to develop and enhance the company’s current markets, by selling more of its existing products through new or enhanced sales channels and to new customer segments. This reflects Y’s Strategic Objective 1, which states “through the development of Y’s markets and products”.

A form of market development is the continued development of sales of Y’s own label products to new supermarket customers, as it is offering its products to supermarket customers who may not necessarily be customers of Y elsewhere. The most significant opportunity in this area is in the development of international supermarket sales.

This will require careful management of relationship with the supermarket customers to ensure Y’s sales are optimised and that Y maintains strong working relationships with the supermarkets, who are likely to be very large organisations. The sale of Y products in supermarkets should encourage a wider range of customers to buy Y’s products (Strategic Objective 1) and it should also allow Y to promote its brand in more locations and encourage year round sales (Strategic Objective 2). Y must try to achieve market development by improving its expertise in managing the large supermarket customers. It could do this by appointing a dedicated manager to be the point of contact for each supermarket chain. As supermarkets are key large bulk-buying customers, they may require immediate responses on availability and delivery of products. They may also demand that their IT systems are linked to Y’s IT systems for the exchange of data for ordering, invoicing and delivery.
information. If Y is serious about expanding this area of sales, it may require changes and investment in its IT systems to meet the sophisticated needs of the supermarket customers’ requirements for order placement, delivery advice and invoicing.

Furthermore, Y will need to negotiate payment terms with these new supermarket customers, as supermarkets often demand that payment will only be made to its suppliers 60 days after delivery. This may severely impact Y’s cash flows, as retail customers pay exactly on delivery of the products within the retail stores.

The Y website sales is also a form of market development for Y, as it can sell its whole range of existing products to a wide range of customers. This particularly applies to the potential international sales which could be exploited. Clearly there is a large potential for growth of sales of its chocolate products internationally through the website, helping to achieve Strategic Objective 1. However, it is important that the website is managed carefully to ensure that it enhances and complements the overall image and brand of Y and that it operates effectively and efficiently to ensure optimum customer satisfaction. The brand must be managed consistently across the website and customer management and communication must be effective.

However, if managed and developed effectively, Y’s website has a huge potential to assist in achieving both strategic objectives.

**Diversification (New products to New markets)**

Diversification concerns expansion into new markets with new products and is a way companies choose to expand in order to spread the risk of reliance on just one market sector. However, expanding into a new unknown type of market is very risky and many companies fail, often due to poor market research or lack of marketing. Another reason for failing in a diversification strategy is that some companies do not have adequate financial resources to bear losses in the early months, or even years, until the new business venture is established. A company that chooses to diversify needs to have the financial commitment to see the expansion settled and start to generate profits and cash flows, which takes time.

This diversification strategy would help Y to achieve Strategic Objective 1 which is “through the development of Y’s markets and products through a wide variety of sales channels”.

Y is planning to open 6 Y cafés early in 2015. These will be offering new and existing products to a wide customer base. However, this will require significant investment in city centre stores and staff recruitment and training. Clearly, this will certainly increase the potential range of customers and thus assist in achieving Strategic Objective 1. It should also help to achieve Strategic Objective 2 as these café’s would attract customers all year round and should help to enhance and build the Y brand.

Performance measures will need to be set and monitored for the “Y cafés” such as revenue per day, average revenue per customer, percentage of food waste and café utilisation levels at different times of the day. It will also be important to identify popular products and slow moving products and gifts, to reduce inventory write-offs.

A further example of diversification is the production of luxury hand made products sold as own label products to other retailers. Y will be using its reputation and expertise as a chocolate manufacturer to develop innovative products on behalf of new customers. This could open up a whole new market for Y but will require some investment in staff development. Again, this should assist in the achievement of Strategic Objective 1 by selling to a wide range of customers but the quality must be acceptable and satisfy customers’ demands which is likely to require higher quality than Y currently produces.
**Requirement (b)(i)**

The optimum production mix for the next 3 months assuming that Z and Q both place orders with Y, but priority is given to fulfil Z’s order in full.

<table>
<thead>
<tr>
<th>Product</th>
<th>1 EUR</th>
<th>2 EUR</th>
<th>3 EUR</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selling Price</td>
<td>26.00</td>
<td>32.00</td>
<td>37.00</td>
</tr>
<tr>
<td>Direct Labour (€8 per hr)</td>
<td>8</td>
<td>12.00</td>
<td>1.50</td>
</tr>
<tr>
<td>Material A (€3 per kg)</td>
<td>3</td>
<td>0.75</td>
<td>0.25</td>
</tr>
<tr>
<td>Material B (€6 per kg)</td>
<td>6</td>
<td>3.00</td>
<td>0.50</td>
</tr>
<tr>
<td>Material C (€10 per kg)</td>
<td>10</td>
<td>1.00</td>
<td>0.10</td>
</tr>
<tr>
<td>Variable ohd (€2 per hr)</td>
<td>2</td>
<td>3.00</td>
<td>1.50</td>
</tr>
<tr>
<td>Fixed ohd</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Profit</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Contribution per unit

Kg per unit of limiting Factor (Material C)

| Contribution Per Unit Of Limiting Factor (CPULF) | 62.50 | 25.83 | 20.00 |

**Optimum order of production**

1 2 3

**Optimum production mix**

<table>
<thead>
<tr>
<th>Optimum units produced</th>
<th>1</th>
<th>2</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td>KG of C</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3000 units of each for Z requiring 2700 kg C:</td>
<td>3000</td>
<td>300</td>
<td>900</td>
</tr>
<tr>
<td>Leaving 2,800 kg of Material C for the products required by Q</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Make Product 1 first</td>
<td>6000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6000 units x .1 kg</td>
<td>600</td>
<td>600</td>
<td></td>
</tr>
<tr>
<td>Make Product 2 second</td>
<td>6000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6000 units x .3 kg</td>
<td>1800</td>
<td>1,800</td>
<td></td>
</tr>
<tr>
<td>Make Product 3 third</td>
<td>800</td>
<td></td>
<td></td>
</tr>
<tr>
<td>800 units x .5 kg</td>
<td>400</td>
<td>400</td>
<td></td>
</tr>
<tr>
<td>Total Material C used</td>
<td>900</td>
<td>2700</td>
<td>1900</td>
</tr>
</tbody>
</table>
Therefore the optimum production mix each month for the next 3 months, assuming that the order with Z is supplied in full would be:

<table>
<thead>
<tr>
<th></th>
<th>Product 1</th>
<th>Product 2</th>
<th>Product 3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Z</td>
<td>3,000</td>
<td>3,000</td>
<td>3,000</td>
</tr>
<tr>
<td>Q</td>
<td>6,000</td>
<td>6,000</td>
<td>800</td>
</tr>
<tr>
<td>Total</td>
<td>9,000</td>
<td>9,000</td>
<td>3,800</td>
</tr>
</tbody>
</table>

The contribution which would be earned from this production mix.

**MAXIMISED CONTRIBUTION PER MONTH**

<table>
<thead>
<tr>
<th>Product</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Z</td>
<td>18750</td>
<td>23250</td>
<td>30000</td>
<td>72000</td>
</tr>
<tr>
<td>Q</td>
<td>37500</td>
<td>46500</td>
<td>8000</td>
<td>92000</td>
</tr>
<tr>
<td>Total contribution from luxury boxed chocolate products (per month)</td>
<td>56250</td>
<td>69750</td>
<td>38000</td>
<td>164000</td>
</tr>
<tr>
<td>Total contribution for 3 months</td>
<td>168750</td>
<td>209250</td>
<td>114000</td>
<td>492000</td>
</tr>
</tbody>
</table>

**Optimum production mix produced for Q if Z does not place an order**

<table>
<thead>
<tr>
<th>Units</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>KG of C</th>
</tr>
</thead>
<tbody>
<tr>
<td>Order for Q</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Make Product 1 first</td>
<td>6000</td>
<td>600</td>
<td></td>
<td>600</td>
</tr>
<tr>
<td>6000 units x .1 kg</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Make Product 2 second</td>
<td>6000</td>
<td></td>
<td>1800</td>
<td>1800</td>
</tr>
<tr>
<td>6000 units x .3 kg</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Make Product 3 third</td>
<td>6000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6000 units x .5 kg</td>
<td>3000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Material C used</td>
<td></td>
<td>3000</td>
<td></td>
<td>5400</td>
</tr>
</tbody>
</table>
The contribution earned from this production mix:

<table>
<thead>
<tr>
<th>Product</th>
<th>Product 2</th>
<th>Product 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contribution from sales to Q</td>
<td>37500</td>
<td>46500</td>
<td>60000</td>
</tr>
</tbody>
</table>

Total Contribution From Q (per month) 144000

Total contribution for 3 months 432000

Requirement (b)(ii)

Undertaking an order to supply Z in full, taking into account the effect this could have on Q

If Y supplies in full the order agreed with Z then it will achieve Strategic Objective 1 through the development of both its markets and its products. This would be achieved by the sale of a newly developed luxury product to Z’s customers. There is clearly a market for the luxury handmade chocolate products and this could be an excellent way for Y to exploit this market potential through the use of an established and prestigious brand name. Therefore it is a significant opportunity for future sales growth for Y.

However, these products will be sold as Z’s own brand label, meaning that the Y brand will not be featured as part of the product. Therefore Strategic Objective 2 will not be achieved, as there will be no association of these products with the Y brand. Y will in fact be producing chocolates in order to enhance the Z brand. However, Y management believe this to be a significant opportunity to work with a very prestigious customer which could be highly lucrative in the future, if Z were to place future orders with Y.

A risk in this is that although Z has also stated that it would be interested in further orders of luxury hand made products from Y it has not made an agreement to this and this order is very short term i.e. only 3 months, amounting to only 9,000 boxes. The order value is relatively small. These new products would be highly labour intensive and will require 15,000 hours of labour per month to be made available for this order. As these are luxury hand-made products, this may require additional overheads such as training costs and management supervision costs but there is no guarantee that Z will place any orders past the first 3 months. Z may have to spend a significant amount of money in set up costs and training yet there may be no long term benefit for Y in relation to customer Z. Therefore, before agreeing to this, Y must try to ensure from Z a long term relationship and some form of guarantee of a longer term contract for other products in the future, if not with Z then with other customers for Y’s luxury chocolate products. Z may not wish for Y to continue to supply luxury hand made products if these are not successful in the first three months of sales. For Y, there is a high degree of investment for a potentially short term gain with Z.

Clearly it is a significant opportunity for Y to work with Z and develop a new market opportunity, but it would not assist in developing Y’s own label. However, one of Y’s strategic growth opportunities is to produce a wider range of products through production of chocolates for other retailers and therefore it is a viable opportunity with a highly prestigious customer.

Considering the results of the calculations in part b(i) of the answer it is evident that by accepting this order Y will earn a contribution of EUR 72,000 per month from the order with Z (totalling EUR 216,000 for 3 months) and if Y could also optimise its production mix with sales to Q then it could earn an additional EUR 92,000 per month resulting in a total contribution of EUR 164,000 per month for 3 months (totalling EUR 492,000). This is through the optimisation of the limiting factor of Material C, which results in the need for Y to optimise the production of Product 1 due to it having the highest contribution per unit of Material C.
However, this would result in Y being unable to produce all of the units predicted by customer Q, the leading supermarket chain. There would be a shortfall in Product 3, as there would only be sufficient levels of Material C to make 800 boxes instead of 6,000 required of Product 3. A potential risk for Y is that because of this Q could refuse to accept an order of only 800 units of Product 3 and cancel the whole order.

Therefore, undertaking a contract with Z may have implications for Y’s relationship with Q. Y currently has a very good relationship with Q, to which Y has supplied its chocolate products for 3 years and therefore is an established customer. Y should not allow this contract with Z to damage its relationship with Q. The current relationship with Q allows Y to sell its own label products through Q’s supermarkets which achieves both Strategic Objectives 1 and 2. If the contract with Z is agreed in full then it is clear from the calculations that Q will not receive its full requirement of Product 3, as Material C is a limiting factor which does not allow for full production of required products for both Z and Q.

Y must maintain open and honest communication with Q about future prospects for the products it requires from Y. It would appear that customer Z will not want to order these three luxury hand made products past the first 3 months and therefore Y may be able to supply product 3 in full after 3 months, depending upon the continued availability of Material C. Therefore, Y may wish to negotiate with Q an order for product 3 after 3 months, possibly offering some form of discount incentive to Q for delay of the order. The contract with supermarket Q has not been signed and therefore there is room for negotiation in terms of timing and quantity of products.

Q is a large and prestigious customer itself, as the leading supermarket chain in the country. It already has an established relationship which it must attempt to build upon through the sale of new and innovative product offerings. Q has a high bargaining power and therefore Y must carefully manage its relationship with Q to ensure that it does not lose Q’s trust. This is an important opportunity for Y to enter the luxury chocolate market under its own brand name which could open up further opportunities with other supermarkets. Therefore, it must ensure that if it is to undertake the order with Z then it must maintain and continue its strong relationships with Q during this period.

**Undertaking an order to supply only Q**

From the calculations it can be seen that should the order by Z not be placed, then Y would be able to supply an order to Q in full, as there would be sufficient material C to do so. This would result in a contribution earned of EUR 144,000 per month, totalling EUR 864,000 for 6 months if the initial order as requested by Q is undertaken. However, this is less that the contribution of EUR 924,000 that could be earned over 6 months from optimising production for customer Z for the first 3 months followed by a three month order for Q only (EUR 492,000 plus EUR 432,000).

Y has a successful and long term relationship with Q and Q has stated that it predicts that these luxury products would be sold in its supermarkets for 6 months and beyond. This is an excellent opportunity for Y to develop its product range and to improve its brand image, thus achieving Strategic Objectives 1 and 2. Developing strong long term relationships with such a high profile customer would be a considerable competitive advantage for Y.

The contract is financially viable in that it could contribute EUR 144,000 per month for 6 months and potentially more if sales grow as predicted by Q. It is assumed that the shortage of Material C is only temporary, as stated in the scenario and therefore increased production levels could be achieved should predicted demand be achieved by Q.

An operational consideration for Y would be the labour required to undertake this contract. It is predicted that this would require 30,000 labour hours per month to meet Q’s contract (which is likely to equate to approximately an extra 190 staff, based on 40 hours per week). This is a significant number of staff and in addition more supervision and investment in training and equipment will also be required. However, if it is considered that this is a viable and long term contract, then this level of investment is likely to be considered acceptable by Y.
Requirement (c)

Note: Candidates are only required to provide two examples of functions of Y’s website.

In order for Y to retain its online customers it is necessary to build a relationship with them and create brand loyalty. Customer relationship management requires a company to keep customers loyal by demonstrating ongoing support, contact and making its customers feel valued.

Customer retention is clearly considered to be a critical factor for Y. Therefore Y must focus upon building long term relationships with its customers through its website, in order to develop loyalty to the Y brand. This will require Y to build effective customer contact and ensure a high quality of service.

The unseen material states that Y considers that a key factor in developing strong customer relationships will be the continued development and use of the Y website. The management of Y strongly believes that e-business will be a key feature of strengthening and building strong customer relationships. The features of Y’s website could include the following:

- For individual customers, implement a customer login system for existing customers where address, card details and important information such as birthdays and a range of delivery addresses can be stored. This will assist in making the customer ordering process easier and makes customers not want to switch once they have set up their log in details. This should make customers reluctant to use other retailers once they have set up a customer account with Y. This should assist in customer retention and loyalty and should allow Y the opportunity to communicate with customers more effectively.

- The website can be used effectively as a promotional and marketing tool to encourage customers to buy more frequently. Once Y has individual customers’ emails and personal details, Y can send them electronic promotional codes via email or through the website, linked to previous purchases and can send reminders via email of special dates. Discount offers can also be awarded to customers through the website.

- This feature could also be used for corporate customers. Discounts on multiple product purchases through the website could be offered to corporate clients buying multiple client gifts.

- Y could use its website technology to monitor customer activity and website searches and also to record customer buying habits. Information stored through the website could be used to send out direct and relevant promotional offers and discounts tailored directly to the buying behaviour of individual customers. Promotional activities, tailored directly to the buying behaviour of individual customers will make them feel special and unique and this should encourage increased purchasing activity.

- It would also be useful to have a customer feedback form on the website and an email support service through the Y website. Customer feedback forms allow the facility for two way communication and should provide Y with valuable information upon its products and its level of service provided. Building strong customer relationships is obviously key to Y’s growth strategies and therefore customers must be allowed and encouraged to provide their opinions. The website is an excellent medium to achieve this as customers are likely to be reluctant to provide opinions in the shops but are more likely to do so via the website feedback forms.

It is important that the website supports the other sales channels, that branding is consistent and that customers feel that they are merely stepping inside an on-line shop. Therefore, there must be product consistency and also brand consistency.
Answer to Question Two

Rationale

Requirement (a) examines learning outcome D1(b) 'evaluate alternative models of performance measurement' and is designed to test candidates' understanding of the characteristics of a service business. Requirements (b) and (c) examine learning outcome D1(c) 'recommend solutions to problems in performance measurement'.

Suggested approach

Requirement (a) should be a straightforward question, requiring candidates to identify and apply four characteristics of a service business. Answers must be focused upon those characteristics of a service business which make it different to other types of business. Also, candidates must support their answers with reference to the characteristics of P.

For requirement (b) candidates are expected to demonstrate a knowledge and understanding of the Fitzgerald and Moon 'Building Blocks Model' to evaluate the current process of performance measurement and target setting in P. Importantly, candidates are expected to critically evaluate the current processes carried out by P, using the Building Blocks model as a framework for identifying where weaknesses are occurring. Candidates are not expected to merely describe the model or to merely describe the current processes being carried out by P.

For requirement (c) candidates must recommend, with reasons, two suitable performance measures for P, taking into consideration the answers presented in both part (a) and (b) of the question. Part (a) of the answer considered the needs of a service business and part (b) considered the Building Blocks Model and its key dimensions of performance. Therefore candidates are expected to use these key dimensions to identify suitable performance measures for P, as a service business. Importantly, answers must be specific measures and not systems of measurement, such as the balanced scorecard or benchmarking. The question also specifically refers to measures within areas in which P must succeed.

Requirement (a)

The characteristics of a services business, using P to illustrate, can be explained as follows:

- The consultancy services, in the form of expertise and advice provided by P’s IT staff, are largely created and consumed simultaneously. Their service is perishable in that IT expertise and consultancy cannot be stored. Service perishability means that services must be rendered on the spot and cannot be stored for later use.

- IT consultancy activities will be heterogeneous (variable), in that it is hard to standardise the service since each IT staff member providing consultancy services will be different and offer a personalised service to clients. The service variability is determined by the particular client or circumstances surrounding the service.

- The consultancy service provided by P will be largely intangible in that there is no physical product for sale. The service cannot be experienced before it is bought by the client.

- There is no transfer of ownership of the service which is provided by P to its clients. Each client’s required IT service can only be received by that client.

- The reputation of P is maintained by the quality of its IT staff and their skills. A poor area of work for just one client could damage P’s reputation overnight. Therefore it is imperative for P to train its IT staff in the latest technology and for the company to be innovative in offering IT advice in new niche markets.
Requirement (b)
Fitzgerald and Moon's building block model aims to improve the performance measurement systems of service businesses such as P. It is a framework for the design and analysis of performance measurement system based upon three concepts: (1) dimensions, (2) standards and (3) rewards.

**DIMENSIONS:**
- Profit
- Competitiveness
- Resource Utilisation
- Quality
- Flexibility
- Innovation

**STANDARDS:**
- Ownership
- Achievability
- Equity

**REWARDS:**
- Clarity
- Motivation
- Controllability

1. Dimensions are the goals for the business and fall into two categories: downstream results (competitiveness and profit performance) and the upstream determinants of those results (resource utilisation, service quality, flexibility and innovation). These are the key areas for which P should develop specific performance measures.

2. Standards are the measures used to assess the performance of the dimensions above. These must be formulated so that those being measured take ownership of them, preferably through participation in the process of setting the standard. Importantly, each standard must be achievable in order to motivate the consultant or partner. The standards must also be fair, based on the realistic assessment of what is achievable by each individual.

3. Rewards are the motivators for the consultants and partners to work towards the standards set. The reward system should be clear and understandable by all of P’s staff and should encourage motivation. Any reward system must be related to areas of responsibility so that the staff have controllability in order to achieve motivation.

P's current performance information does not cover all the areas of the building block model. For the Dimensions aspect of the model, the downstream results appear to be addressed as market share and financial performance including monthly revenue and profit performance which are currently reported and measured by the senior partners at the monthly meetings.

However, the upstream determinants aspects of Dimensions are not covered adequately. P only measures the quality of the services it provides, through the use of client surveys. Innovation, flexibility and resource utilisation, all key determinants of overall business performance and
competitiveness are not measured by P. This is a serious weakness in P’s current performance measurement system.

On review of the Standards used, measurement of performance appears to be rather limited. P uses a budget to measure its financial performance but this will be internally focused and not based upon industry standards. Therefore it will be hard for P to assess its overall competitive position from this. P can use the market share information to assess its position in the industry and to compare itself with competitive performance but there appears to be no comparison with profits achieved by competitors. The client surveys used by P could be a very useful measure of performance but again it is not clear how this information is collected or used. Evaluation of customer satisfaction is a key aspect of performance management in a service business and it is something which P must develop and focus upon.

The IT staff reward system at P is related to performance which is assessed by the team manager. However, this is likely to be compromised by the current limited measurement of the dimensions of performance. It is highly unlikely that IT staff will understand how their performance is being measured as they clearly have no input into the reward system. There is likely to be little motivation relating to these rewards as they are easily achievable. Therefore, it is likely that the current reward system does not assist in P achieving improved competitive performance as the IT staff do not have any real incentive to improve their performance. Therefore it is imperative that new performance measures are introduced to motivate all IT staff to work more effectively and efficiently and to take ownership of the required service levels. These service levels need to be set using the “SMART” principle to ensure that they are measureable, achievable and fair.

The reward system for the 5 partners is based on the performance of the whole business rather than the individual partner’s contribution to performance. Therefore, it is likely that the reward is not controllable by the partner and this may affect his or her motivation.

Overall, the current performance information is not suitable for P taking into consideration its service based activities and its need to be more competitive within its industry.

**Requirement (c)**

*Note: Candidates are only required to present two examples of performance measures.*

One of the fundamental weaknesses identified in the answer to part (b) was that P only measures the downstream results and not the upstream determinants of its Dimensions. Therefore, in order to improve its performance information it must devise a range of performance measures to monitor these key determinants.

1. **Resource Utilisation**
P currently does not seem to measure resource utilisation which is a critical measure of productivity for a service related business.

An example of a performance measure would be the percentage of billable hours worked to the total working hours of the firm.

This would help P’s partners to monitor the productivity of its IT staff and would also form the basis of a better system of rewarding and monitoring the performance of individual consultants.

2. **Flexibility**
This is another key determinant of overall performance effectiveness and ability to improve competitiveness in the industry. Clearly, this is an important factor for P as many of its clients require P to respond to their needs 24 hours a day, 7 days a week. A measure of flexibility could be based upon the speed of delivery of the service.

An example of a performance measure could be punctuality, measuring the percentage of client jobs delivered on time or the percentage of out of office hours calls responded to within a set deadline. In addition, P could improve its measurement of client satisfaction. The existing client service survey could be analysed to include the client’s perception of whether objectives were achieved. P could also measure its ability to manage busy periods for example the levels of overtime worked.
3. Innovation

At the moment, the dimension of innovation is not measured. For a business such as P, operating in a highly technologically innovative and fast moving industry, innovation is a critical success factor and a key source of competitive advantage.

The success of its innovation activities could be measured by for example:

The time taken to launch a new consultancy service

Or

The number of clients (or percentage) that take-up a new service offered.
Answer to Question Three

**Rationale**

Requirement (a) examines learning outcome B3(b) 'evaluate ethical issues and their resolution'. Requirement (b) examines learning outcome B1(a) 'discuss the concept of organisational change'. Requirement (c) examines learning outcome B2(d) 'evaluate the role of leadership in managing the change process'.

**Suggested approach**

For requirement (a) candidates are expected to evaluate the scenario material to identify those areas in which Mr Fox has breached M's high ethical standards. This requires candidates to both evaluate Mr Fox's actions and to consider whether or not these are in breach of M's ethical standards for its suppliers. There are many issues presented in the scenario, some of which do and some of which do not breach M’s ethical standards. Therefore candidates must clearly explain why they believe Mr Fox’s actions breach these standards.

For requirement (b) candidates are clearly asked to evaluate B’s cultural web, therefore answers must focus directly upon the cultural aspects of B and not the general operational aspects. In addition, candidates must also consider how the cultural aspects of B would need to change. Again, this requirement relates directly to B’s culture change requirements and not mere operational changes.

For requirement (c) answers must focus directly upon the actions of M which could assist Mr Fox and B to improve the ethical standards.

**Requirement (a)**

It would appear that a number of ethical principles are being compromised by the behaviour of B, in particular by Mr Fox, the owner.

Firstly, the principle of integrity is being challenged, through Mr Fox encouraging the staff to be dishonest to M’s inspectors. The principle of integrity requires organisations to be truthful in all business dealings. Mr Fox is encouraging his staff to provide the inspectors with incomplete and misleading information regarding the unpaid overtime situation and this will clearly affect their assessment of B’s ability to comply with its high ethical standards. Furthermore, Mr Fox’s threatening undertone that staff will lose their jobs if they do not win this order is compounding staff behaviour through instilling fear, which clearly is very unethical and would not meet M’s standards of expected supplier behaviour. M requires the fair and proper treatment of staff and this pressure through fear would certainly be contrary to this.

Secondly, M’s staff must ensure that their judgement is not affected through the offer of gifts and inducements and that objectivity must be maintained at all times. M’s strict ethical policy expressly states that suppliers are prohibited from using bribes, gifts, or favours to gain a competitive advantage with M. The gifts offered to inspectors and the offer of paid trips to restaurants and local attractions would clearly be considered to be a bribe to take on the order. This is clearly against M's high ethical standards and would compromise the principle of objectivity.

Most of B’s management team have worked for B for fewer than 5 years. This is probably due to Mr Fox’s dictatorial management style and the little respect Mr Fox has for his managers resulting in high staff turnover. If managers are not allowed to make decisions, or influence Mr Fox’s decisions, they will be frustrated and will leave the company. This treatment of senior staff is unlikely to meet M’s high ethical standards.

In addition, other activities, such as not paying employees overtime for work done would also be unethical and would compromise M’s high ethical standards in relation to the fair and proper treatment of staff. Paying the national minimum wage is clearly within the law but the refusal to pay overtime for work undertaken and the reduction in health and safety training would not meet M’s ethical standards of behaviour.
Requirement (b)

There are a number of features embedded within B’s current culture which are likely to make it difficult for B to work in accordance with M’s high ethical standards. These can be analysed using the cultural web model.

Stories
These are the core beliefs of the company and often are based upon the history of the business and its successes and failures or its heroes and villains. B’s stories are largely founded upon its sense of strong family tradition which, Mr Fox, the current owner is very proud of. This is likely to have created a strong culture of conformity and the need for staff to believe and follow the leader’s beliefs and traditional family values. This has had a very positive effect on the business as it has created a high degree of loyalty from staff which may have been a factor in its high quality workmanship, as staff are highly experienced and take pride in the firm’s tradition. This culture of tradition and conformity is likely to make it very difficult to instil a need for change in B. However, it may be seen as a positive cultural aspect of B by M and the loyalty and high quality is in fact something to be encouraged to continue within the business.

Routines and rituals
These are the regular routines which occur in the business which often lead to regularised activities and behaviour. In B, the owner uses monthly bulletins placed upon notice boards to re-enforce conformity and the core beliefs of family traditions in the business. However, the bulletins have an undertone of threatening behaviour in that they remind staff of their need to be loyal to B as employment elsewhere in the country is difficult to find. Although it is probably very effective in creating loyalty it does so through fear of losing their jobs and this would likely be viewed by M as not meeting its high ethical standards for suppliers.

B has reduced its training activities in the last three years and this will go against M’s ethical standards in relation to its expectations that suppliers must provide staff health and safety training. Providing minimal training compounds the staff feelings of fear of redundancy as with no training, alternative employment will be difficult.

Power/ organisational structure
Mr Fox has what would appear to be a very authoritarian approach to management. Although there is a senior management team, Mr Fox makes most of the key decisions without any consultation with the other members of the team. Therefore power rests largely with Mr Fox. It would appear that this has had a negative effect upon the senior management team as most of the senior managers have been with B for fewer than 5 years, indicating a high turnover of senior management staff. This is not likely to be an effective way for B to manage its strategic decision making and M would be likely consider this approach to strategic management as not meeting its high ethical standards. The fair and proper treatment of its senior management team is equally as important to B’s success as the fair and proper treatment of its general staff. Therefore, this aspect of B’s current culture is likely to have to change if M is going to work effectively with B.

The organisational structure needs to change with an HR manager responsible for all HR activities and a factory manager responsible for manufacturing output. More liaison between the factory manager and HR is required to motivate all factory employees.

Control systems
Currently, control within the business appears to be carried out through threat and fear of redundancy. Although it does not state that Mr Fox explicitly tells staff that they will be made redundant, there is an underlying culture of controlling staff behaviour through the fear that they may lose their jobs. Most of B’s staff are over 50 and there is currently a high rate of unemployment in the country where B is located. Most staff have few qualifications and B offers them no other form of qualification or staff development and therefore if they were to lose their jobs then re-employment would be likely to be difficult. Therefore, Mr Fox can control their behaviour through this underlying sense of fear. Again, this will have to improve if M is to agree to place an order with B as this is likely to go against their high standards of ethical behaviour for suppliers.
**Overall Paradigm**

B’s current culture is one of conformity and tradition. The overriding assumptions are the strong family tradition and staff loyalty but this is driven by an underlying culture of authoritarian power and fear of redundancy. Although the strong family tradition and sense of loyalty and high quality are likely to be features of B’s culture which M will wish to exploit and retain, the aspect of fear and power dominance are aspects which M is likely to consider weaknesses of B and areas which need to be changed if M is going to be able to successfully work with B as a supplier. M expects fair treatment of staff.

**Summary**

At present, B is not a suitable supplier for M as it does not meet many of M’s ethical standards. Many changes will need to occur over a reasonable period of time, perhaps over 6 months to 1 year, in order for the management styles and organisational structure to change and settle down before M could choose B as a supplier. If B really wants to be a supplier to M, which operates with high ethical standards, then it needs to demonstrate its commitment to business ethics by making the necessary changes and by no longer intimidating its staff.

**Requirement (c)**

M must clearly communicate with Mr Fox that he needs to manage his management team only and not interfere with factory employees or bully his staff. M should suggest a suitable training session on the importance of delegation and motivation of employees.

M needs to work very closely with Mr Fox in re-educating him in his own behaviour and management style. Mr Fox clearly understands the importance of orderliness in his business and its continuity but he appears unaware that his behaviour is likely to be unethical and against M’s own ethical expectations. Mr Fox must be trained in M’s ethical standards and its expectations of suppliers. He should also be trained in management systems and styles which would be the most effective for his business. He has an incredibly loyal workforce which may be due to the economic conditions but more likely to do with the make-up of the staff. It is important that staff at all levels of the business are happy as well as loyal. M could train Mr Fox to help him understand the benefits of ethical behaviour and fair treatment of his staff and senior management team. He is likely to be reluctant to do this but if M insists that his re-training would be part of the contract then this might persuade him.

In addition Mr Fox should ensure that training is provided to B’s staff in health and safety in particular. This is a clear aspect of M’s high ethical standards and suppliers are monitored regularly in their health and safety training and compliance. Currently B provides minimal training to staff. This is likely to result in the higher potential for staff accidents and could be seriously damaging to the business. Good practice in health and safety activities is not only ethical but also likely to improve overall morale and an improvement in performance. Mr Fox should therefore run a series of initial health and safety workshops and presentations to both senior managers and staff. This then needs to be monitored regularly and a formalised system must be set up by B, with the help of Mr Fox to monitor and report on health and safety issues and progress.

M must also encourage B to introduce a fair payment system to its staff. As this order will guarantee work for B for the next two years, M must ensure that it offers a fair system of payment for the work done and that M’s contract does not itself put pressure upon B for its staff to have to work overtime with no extra payments. Therefore M and B must work closely together to develop a fair system of payment and a work schedule which will allow B to undertake the contract within agreed and specified deadlines and productivity schedules. Remuneration and work scheduling by M for this work undertaken by B should be fair and encourage loyalty and commitment and should discourage Mr Fox from forcing staff to work overtime with no payment. M should insist that any overtime worked in order to fulfil its own requirements must be paid at a fair overtime rate and their own payments to B must reflect this. It is important that M regularly monitors compliance of B’s payments to its staff.
Answer to Question Four

Rationale

Requirement (a) examines learning outcome A1(e) ‘recommend how to interact with suppliers and customers’ and is designed to test candidates’ understanding of customer segmentation. Requirement (b) examines learning outcome D1(e) ‘recommend changes to information systems appropriate to the organisation’s strategic requirements’ and is designed to test candidates’ understanding of e-business. Requirement (c) examines learning outcome A2(a) ‘evaluate the impact of the internet on an organisation and its strategy’ and is designed to test candidates’ understanding of Web 2.0 technologies.

Suggested approach

For requirement (a) candidates should undertake two distinct activities; firstly, to discuss the importance of segmentation to C and secondly, to then recommend appropriate customer segments for C. Candidates should ensure that their answers are directly related to the specific customer segments relating to C. Generic answers will not be awarded a pass mark.

For requirement (b) candidates are required to discuss the benefits of an e-business approach to C. It is important that candidates once again, apply these benefits directly to C.

For requirement (c) candidates are required to present two examples of Web 2.0 technology which C could use to engage more effectively with its customer segments. There are a wide range of potential technologies that candidates could discuss. Once again, pass standard answers must be applied directly to C.

Requirement (a)

Customer segmentation is the grouping together of customers based on the similarities they share. This normally involves dividing a broad target market into subsets of consumers who have common needs and priorities. This is important to C as it will assist in designing and implementing strategies to target these different customer segments more effectively. In addition, segmentation strategies can be used to identify the target customers and provide supporting data for positioning to target effectively its marketing and advertising information and ensure this is in the right location for each segment.

The importance of customer segmentation for C would include:

- Assisting in developing new services appropriate to its customers’ needs (for example, the new holiday lodges is a new service but it is vitally important that these are targeted at the correct customer segment which is interested in holidaying at C).

- Creating segmented advertising and marketing communications. Mass marketing can often miss its target audience. For example, adverts for forthcoming concerts placed in daily newspapers may not be seen by the young people who attend the concerts. Alternative targeted marketing to this segment would be advisable for example through web based media.

- Developing differentiated customer servicing in order to build better customer relationships and assist in developing greater levels of customer retention. For example, offering discounted family tickets or email offers sent directly to season ticket holders.

There are a number of ways in which C could segment its customers:

Geographic Segmentation

Customers can be segmented according to geographic location, for example by country, by region, by language, by postcode or by city. This approach often combines geographic with demographic data to create an accurate or specific profile. Geographic segmentation is important and may be considered the first step to international marketing.
Demographic Segmentation
Demographic segmentation is dividing customers into groups based on age, gender, income, occupation, religion, race, etc. This is a very useful approach for a business such as C as the customers that it attracts and wishes to attract come from a wide variety of demographic backgrounds. Understanding their behaviour is likely to be key to effectively targeting its customers.

Behavioural Segmentation
This form of segmentation divides customers into groups according to their knowledge of, attitude towards, usage rate or response to a service offered.

Lifestyle Segmentation
Lifestyle segmentation is measured by studying the activities, interests, and opinions of customers. C could use this form of segmentation to evaluate how its customers spend their leisure time and which external influences they are most responsive to and influenced by. Lifestyle is highly important to segmentation, because it identifies the personal activities and targeted lifestyle the target subject enjoys, or the image it is attempting to project. By identifying and understanding customer lifestyle, C can develop promotional mixes and tourism offerings which suit their customers' needs and wishes.

The key is for C to determine how to segment its customers in a way that will have the biggest impact on its business. For C, this is likely to be a mixture of demographic and lifestyle segmentation. This is likely to include an initial segmentation of customers based on age (young concert goers aged 18-25, single), young families (aged 25-45 married) and retired couples (55+) and also upon lifestyles and how customers spend their leisure time (for example interests in music/ architecture/ wildlife/ children's activities/ holidays). From these two forms of segmentation, C will be able to understand its customers better and will be able to more appropriately target its marketing activities to build better customer relationships.

Requirement (b)
E-business has been defined as ‘the transformation of key business processes through the use of internet technologies’. Activities which are often undertaken through an e-business approach would include on-line sales and service booking facilities, website marketing and online communications facilities such as email contact. C already has a website but it is clear that this is largely informational and not being effectively employed presently for e-business.

The potential benefits for C of employing an e-business approach would include:

Enhanced customer service and CRM through online bookings
Having an online booking facility would allow customer access to C's services 24 hours a day and therefore makes it easier for customers to make bookings for events and entry tickets to the attraction. This should encourage customers to make bookings as they can do this at a time and place which is convenient to them. This is particularly relevant to overseas visitors who are considering visiting the attraction.

In addition, a customer feedback facility through the website will enable C to respond more effectively to customer comments and queries, such as complaints about crowded cafes, and to provide more staff at peak times. This could reduce future customer complaints as problems are identified early.

Improved information access and communication
Having a website which allows for 24 hour access and email contact facilities will allow customers more information access and communication with C. This should improve customer satisfaction and encourage customers to use the website and make use of the contact facilities available. C could use the website to provide a wide range of information to its various customer segments but within one website location.

New attractions, such as night time tours of the castle, could be promoted by the website enabling existing and potential customers to find out about these new services.

Improved marketing
E-business could be undertaken through direct email contact with customers and season ticket holders, providing information and online offers and discounts. Emailing customers directly is a very
effective way to ensure that customer contact is maintained and retention rates improved. Customers could be sent email reminders about season ticket renewals and information on concerts and events such as holiday and festive activities. This would be a highly effective way of marketing services and maintaining customer segment relationships.

**Market penetration leading to higher visitor numbers**

C’s website could be used to attract customers from locations which they may not be able to reach through traditional advertising methods. The website is more likely to attract younger customers who are more comfortable with navigating and using website technology and making online purchases. E-business also opens up the possibility of a greater reach in terms of overseas sales and customer access.

**Reduced costs of operation**

By increasing the efficiency of payment methods, such as the use of online payment and banking facilities, C should be able to reduce its transaction, stationery, printing and postage costs. In the longer term C may be able to reduce its advertising expenditure in traditional areas such as radio advertising and leaflets but this will need considerable research to ensure that C only reduces traditional marketing activities if they are considered to be ineffective in generating business.

**Better information for control**

C’s own management information should improve through the monitoring of website access and sales activities. The use of the website and customer activity should be carefully monitored by C to assess the level and type of use by different customer segments and this can then help in formulating a tailored approach to marketing and customer relationship management.

**Requirement (c)**

*Note: Candidates are only required to present two relevant examples of Web 2.0 technology*

Examples of Web 2.0 technology which C could use to engage more effectively with its customer segments:

**Social media**

C could use social media technology to engage with its customers such as through the use of social media technologies including Facebook and Twitter. C could have its own Facebook and Twitter accounts where it could advertise forthcoming events and to provide feedback on recent events. These sites would also allow two way communication with customers and thus should facilitate an improved customer relationship.

Other forms of social media could be the use of Youtube whereby C could post videos of recent events or could use the site to post short adverts for forthcoming events. It could also be a very useful tool to advertise C’s facilities such as the function room used for weddings and conferences.

**Smartphone and tablet Application (app)**

C could consider developing a downloadable app for smartphones and tablet computers. The app could be designed to provide information and booking facilities and also to send out alerts to customers on forthcoming events and offers. An App would be a very useful tool for C to access a wide range of mobile customers who wish to transact and book tickets online wherever they are. This could be particularly useful to communicate with younger customers who are frequent users of mobile technologies.

**Website links and affiliations**

C could include within its own website direct links to other useful websites such as national and local tourism sites and links to google maps for information on directions for and location of C and other areas of interest locally. This provides useful additional information to C’s customers and helps to build a feeling of trust and confidence in C by its customers. C could also provide links to informational sites relating to local culture and history, such as historical societies.

**Electronic marketing**

The use of e-newsletters sent directly to customers and email alerts is a commonly used form of Web 2.0 activity used by organisations and one which could be effectively used by C. Customers who have
previously booked through the website would be required to present their email addresses to C which could be used to allow C direct access to these customers. This would be very useful to C, particularly for its season ticket holders who will be interested in events and activities which they may wish to attend. Keeping them regularly informed through email will allow C to target them directly through an e-newsletter facility.

**On-line shopping**
C has a shop on site which sells a range of gifts. C may wish to adopt an e-sales approach whereby it offers these products for sale through an online shop. This could be very useful to C as it would widen its market for its products to customers who cannot actually visit the attraction but who may wish to buy its products. This should increase C’s revenue from its range of gift products on sale.