Exam focus – the pre-seen case study for the November 2010 Strategic level exams

BPP subject specialists Doug Haste, Dave Halford and Daniel Clark analyse the pre-seen case study for the November 2010 Strategic level exams from the viewpoint of each of the three papers (E3, F3 and P3)

Since the introduction of the new syllabus in May 2010 CIMA have used a **pre-seen case study as the basis for the 50 mark Section A question** in each of the three Strategic level papers (E3, F3 and P3).

In this article we will begin by looking at the purpose of the new pre-seen case study before going on to review, from the perspective of each of the Strategic level papers, how the pre-seen information was used in the May and September 2010 exam sittings and what the **key issues are in the latest pre-seen.**

Purpose of the pre-seen

It is very important that you understand that **CIMA do not expect significant amounts of your time to be tied up in researching the industry**. This can wait until the next stage of your exams – the T4 Part B Case Study exam.

Under the old syllabus the practical scenario was only revealed on the day of the real exam. By giving you a **pre-seen** case study, CIMA aim to ensure that **no candidate is put at an advantage or disadvantage by their level of familiarity with the industry** involved in the practical scenario. All candidates will now have time to ensure that they have a **basic understanding of the main issues involved** in the case study before walking into the exam.

If CIMA had expected detailed analysis before the exam, they would have given you access to the pre-seen material much earlier than 6 weeks before the exam, which deliberately restricts the amount of time you have to research the pre-seen.

The latest pre-seen

In the latest pre-seen we are provided with details of DEF - a European airport operator based in a country outside the Euro zone; it is owned by a number of local state governments.

We would draw your attention to **Manchester airport**, which is owned by a number of councils and also to **Leeds Bradford international airport** which was publically owned until May 2007 and is of a similar size to DEF.

Although **extensive research is not necessary**, we would encourage you to **build some awareness of the issues that these airports have faced**, for example:

- the issues that caused Ryanair to withdraw most of its flights from Manchester airport in 2009, and the difficulties that there have been in extending the car park facilities and its current development plans
- the sale of Leeds Bradford airport for £145.5m in May 2007

A useful link is http://www.manchesterairport.co.uk/manweb.nsf/Content/AboutUs, it will also be useful to research the Manchester Airport Group on Wikipedia. There are a number of articles on Leeds Bradford International Airport on the BBC website.

The full text of the pre-seen can be found at www.cimaglobal.com/strategicpreseen; you will need to read the pre-seen before reading the remainder of this article.

F3 Financial Strategy Exam perspective

In the previous pre-seen, written for the May and September 2010 exams, it is fair to say that **the pre-seen data was of limited importance**. In the May 2010 exam the main theme was whether to invest locally or in the USA; the pre-seen had in fact indicated that Asia and Africa were the likely areas of expansion. In the September (re-take) exam, the main requirement was to evaluate the price to pay for the acquisition of a European company; the details in the pre-seen were relevant to part biii (for 12 marks) because this required an awareness of the bank covenants that the company faced. However, even here the covenants were re-stated in the exam question.

It remains to be seen whether the pre-seen will continue to be of limited importance to the F3 exam. In the pre-seen that relates to the November exam sitting, there are certainly more numbers than in the previous pre-seen; these numbers may not be crucial but they certainly flag a number of areas that could well be developed on the day of the exam.

In the latest pre-seen DEF is an unlisted regional airport operator. In order to accommodate its forecast increase in passenger numbers (approximately 9% p.a. compound growth) we are told that **it will need to expand**. This is an area that would lend itself to an NPV analysis.

We are also told that DEF has **3 key financial objectives**:
(i) it does not run at a loss
(ii) all creditors are paid on time
(iii) gearing must not exceed 20%

We can analyse DEF's current performance in respect of these, but you should expect this analysis to be affected by new issues on the day of the exam.

Not running at a loss	**Total forecast loss for year ended 30 June 2011 = D$ 3.7m**
Paying creditors on time	*(Trade payables / cost of sales excluding depreciation) x 365* ((9,450m – 0.13m)* / (25.45m – 5m)) x 365 **= 166 days approx**
Gearing	*debt / (debt + equity)* 22.7m / (22.7m + 130.53m) **= 14.8%**

** tax is assumed to be a payable and is deducted from total payables to give trade payables*

- **The objective for not operating at a loss is not being met**. However, in note 1, underneath the financial statements, we are told that depreciation is D$5m. Accounting depreciation is not tax allowable, and when it is added back to the operating loss this converts the loss into a taxable profit (this is consistent with the fact that DEF is subject to a tax *charge* in 2011). Although this should be noted, it is still probable that DEF is worried about its profit position and you may be asked to assess to analyse DEF's expansion plans on the day of the exam.
- **Paying creditors on time** can be assessed by measuring payables days. The calculation of payables days is **approximate**, we don't have an exact number for trade payables and you should use purchases instead of cost of sales excluding depreciation in the exam if this information is given. However, you may be asked on the day of the exam to calculate payables days and to assess how reducing payables days will impact on DEF's debt levels.

- **Gearing is not currently an issue**, **but may** be expected to **change**, for example as a result of an expansion, or a reduction in payables days.

What does this tell us about DEF? We cannot say for sure but a preliminary view would indicate the following potential issues:

- Evaluation of a plan to expand the airport so that it can meet its proposed increase in passenger numbers; either **forecasting** the impact of the expansion on **profit, or NPV** or both. This may involve extra car parking, or even the construction of a hotel.
- **Acquisition** of a business (overseas or domestic).
- The strategic, financing and risk implications of the above investments; students should carefully note the **strategic objectives** given in the pre-seen.
- **Forecasting** to advise whether objectives will be hit and possible control action required. This could involve discussing the impact of DEF paying its creditors more quickly.
- **Valuing DEF** – either to assess the price at which it should list on a stock market or sell to the investment bank (IVB), or to assess whether to accept a take-over bid from a rival (e.g. TUV airport).

Understanding the main issues from an E3 Enterprise Strategy Exam perspective

As per F3 the pre-seen used for the May and September exams did not greatly influence the actual answers to the unseen scenarios presented in E3. May's exam did require some reference back to the pre-seen in order to answer requirements concerning the organisational structure and ethical stance of the company. However in September the unseen could be tackled without reference to the pre-seen at all. These are however early days for pre-seen and so we should not presume that it can be ignored in future sittings of E3.

In the latest pre-seen we are told that DEF are forecasting a 43% increase in passenger numbers over the next 4 years, however we are not told where these customers will come from. Will they be flying with budget or business class airlines, and how will DEF manage this within its very public commitments to ethical trading and being a good corporate citizen?

The pre-seen then hints at an expansion of DEF's primary activities, and this in turn will require that it upgrades its infrastructure in order to be able to service the wider needs of the passengers including car parking, shopping and perhaps accommodation. All of this must be achieved within the specified 20% gearing levels.

Areas of the E3 syllabus that could be examined within the context of the pre-seen include:

- **Stakeholder management** – how to manage different stakeholders in light of proposed expansion including the LSGs, staff, airlines, passengers and local communities
- **Ethics and CSR** – any airport expansion will result in more flights, noise, pollution and traffic. How do these fit within DEF's published strategic objectives. Sustainable trading is a distinct possibility for examination. The land to the east of the airport has been earmarked; is this near residential housing or maybe it is home to a protected plant or animal species?
- **Strategic choices and evaluation** – applying the Suitable, Acceptable and Feasible framework to options including, construction of a hotel (perhaps with leisure facilities), building a business class lounge to attract the North American airline mentioned, pitching for more budget airline customers via price cuts, outsourcing the management of retail concessions and/or car parking services
- **Information Systems Strategy** – evaluating the importance of better quality management information such as detailed product/service profitability analysis in light of the limited segmental information provided on DEF's revenues

- **Marketing strategies** – evaluating the benefits of adopting a relationships marketing approach, requiring investment in better IT to allow perhaps detailed customer profitability analysis

From an E3 perspective, it's always worth remembering that the examiner is more interested in **what you can do, not what you know**. By this we mean you must be able to **apply any relevant theories** to DEF and its particular circumstances as outlined on the day of the real exam. Any generic lists of the advantages and disadvantages of a strategy focused on business class passengers, without reference to DEF's business model specifically, will score well under half marks. Equally, ensure that you understand and apply the **CIMA verbs** correctly. Discuss / explain / evaluate etc, does not mean 'produce a list of poorly explained observations unrelated to the scenario at hand'!

Understanding the main issues from a P3 Performance Strategy Exam perspective

The previous pre-seen did provide hints that were picked up in the May and September 2010 exams. The pre-seen mentioned the company's plans to open up a subsidiaries in Africa and Asia and it was the African subsidiary that formed the focus of Q1 in the May paper. However, nearly all the detailed information to be used in developing a solution was found in the unseen. In the September paper, there were three themes, and only one of these required knowledge of the pre-seen. This was an analysis of post-completion audits, which should not have been a surprise to anyone as the company had well-flagged problems with the control of capital projects.

So what are the hints that may develop into a question, or part of a question? Some possibilities are:

- **Security** – this is perhaps the most significant area of risk for an airport as it can literally be a matter of life and death. There is quite a detailed description of security procedures at DEF and they do not seem to have had many problems in the past. However, employing an IT-resistant Head of Security whose responsibilities have not been reviewed for many years suggests there may be some complacency here and a possibility of things going wrong.
- **Competitive risks** – there is clearly an aggressive competitor in TUV and DEF's financial performance suggests that this may be having an impact. Might DEF have to counter some type of competitive move?
- **Financial risks** – the examiner has been clear that financial risk will form a part of question 1. Aybe has significant borrowings so may need to consider how to manage interest rate risks, or even liquidity risks if the loans are called in for any reason. As a purely domestic business, DEF's exposure to foreign exchange risk is limited but they are negotiating with a new customer who wishes to pay in US$. A new revenue stream in US$ will mean exposure to economic risk, which is a topic the examiner has said he will revisit. Note also that, as most of DEF's business relates to holidaymakers going to Europe, any appreciation of the Euro against the D$ will make these holidays more expensive, and may damage DEF's revenue. For an organisation with a high fixed cost base, this could be a serious matter.
- **CSR and ethical risks** – DEF has pledged itself to high standards of ethics and corporate responsibility and being local authority-owned will increase the level of scrutiny it faces. Airports face many CSR issues including noise, carbon emissions and impact on the surrounding area. Any lapses here may have serious consequences. QEG's offer of a free audit opens the way to a question on issues and considerations in environmental auditing, if that is where the examiner wants to take this.
- **Corporate governance** – DEF has some unusual corporate governance arrangements, to say the least. There does not seem to be much in the way of scrutiny and stakeholder engagement. The desire of the LSGs to sell their shares could open up a question in this area, as a new external shareholder may look for better standards of accountability. If you are asked to consider improvements, though, make sure you don't just throw the UK Code at them. You will need to

consider appropriate arrangements for DEF's circumstances and explain why they would be helpful in improving control and management of the business.

Do remember that in writing up risks and controls in the exam, you should aim to be as specific as possible. **Why** is this a risk to DEF, when it may not be a risk to other organisations? **How** will the control help and what will it do? Are there any downsides or other considerations to take into account?

Good luck in your final preparations. ***Remember that your preparation should focus on preparing for the whole exam, and should not be dominated by over-researching the pre-seen case material.***

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