



© Copyright Reserved

Serial No.....

Institute of Certified Management Accountants of Sri Lanka
Strategic Level
May 2015 Examination

Examination Date : 23rd May 2015 **Number of Pages :** 07
Examination Time: 1.30 p.m. – 4.30 p.m. **Number of Questions:** 05

Instructions to Candidates

1. Time allowed is **three (3) hours**.
2. Total: **100** Marks.
3. Answer **all** questions in **Part I** and any **three (3)** questions from **Part II**.
4. The answers should be in **English Language**.

<u>Subject</u>	<u>Subject Code</u>
Strategic Management Accounting	(SMA / SL 1 - 401)

PART I

Answer **all** questions

Question No. 01 (40 Marks)

Nokia's started its operations in 1865 when by establishing a wood-pulp mill in Finland and started manufacturing paper. The company evolved first into a conglomerate encompassing several industries ranging from paper to chemicals and rubber products and in the 1990s with a clearly defined strategy into a dynamic global telecommunication company. In the late 1970s mobile phones and telecommunications infrastructure products were developed for both domestic and International customers and it became a global leader in digital communication technology in 1990s. Nokia faces a tight competition in the telecommunications industry. Among other factors the ability to exploit the opportunities created by continuous technological and market changes helped Nokia to gain competitive advantages and value creation ahead of administrative controls. Hence, Nokia's control and information systems are sensitive to changes that are likely to take place in a dynamic and technology driven market. Nokia was well aware the need of understanding the fundamental changes and crucial turning points in its environment.

The demand for mobile phones has been increasing surprisingly in early 90s and players in the industry adopted different methods to gain their market positions and bearings in the market place. Today Nokia is a leading supplier of mobile phones, mobile and fixed telecom networks including related customer services. Nokia also supplies solutions and products for fixed and wireless data communications, as well as multimedia terminals and computer monitors.

Nokia comprises of three business areas namely Nokia Telecommunications, Nokia Mobile Phones and Nokia Communications Products. The Corporate Research Center that Nokia has established is equipped with modern technology and experts. It has sales in over 130 countries and employs more than 50000 people worldwide. In 1987, Nokia recorded a turnover of 2.6 billion USD and it rose in 1997 to 9.8 billion UDS. CEO of Nokia is in the view that its success in financial performance was mainly due to clear business focus. The composition of sale showed that 85% of total sales came from Europe including a 40% share from Finland itself in 1999. However, only 5% of revenue comes within Finland at present but the rest of Europe covers around 51%. The rest distributed as 23%, 18% and 3% among Asia Pacific region, America and other countries respectively.

Global success may have been impossible without information systems that support management in strategic decision making. Nokia has emphasized the role of knowledge management in global success. Nokia Research Centre states that knowledge creation supply and utilization are the most essential tasks in modern business world. Further, the research unit is in the view that the tacit (implicit) knowledge was the key to success.

The knowledge management system provides Nokia with new ideas about future organizations and their nature of activities. Further, new product development is carried out based on strict prioritization of pilot projects which are used to test future vision. In fact, the system at Nokia does not predict the future but creates knowledge that can be used to understand when it arrives. The modern knowledge management philosophy underlying all the information systems including management accounting systems, Nokia plays an important role in supporting the realization of global strategies.

In 1995, Nokia described four elements of management accounting system in Nokia that were responsible for excellence in performance.

First is a culture for continuous improvement. The urgency to change for excellence in performance was emphasized in all activities. The strategy was to focus on global telecommunication high value added business and uphold the company values in every activity and business. These values comprise of Customer satisfaction, Respect for the individual, Achievement and Continuous learning.

Secondly, performance management was aligned to corporate strategies and values. Each business unit defines and gives priority to its own targets and performance indicators for customer satisfaction. The challenge faced was the trade-off among the timing of launching the product to the market (with assurance of performance, features, reliability, delivery accuracy and lead time), operating efficiency (cycle time first time pass yield cost efficiency working capital in days) and people's involvement (target setting understanding communication, empowerment, team work). All these are measured and linked to the three core processes namely product process, customer commitment process and management and support process.

Thirdly, the organization was re-engineered to create value. It defined its software and hardware. Software includes values management philosophy and core competencies while hardware consists of organizational structure processes and management systems. Therefore the organization is used to make the strategy to reach the vision through value creation.

Fourthly, controllership was aligned to business development. Accounting teams who are dedicated to specific customers and controllers close to customers with understanding of their business to help drawing long-term financial plans. Nokia believed that accounting teams have adequate and relevant competencies to evaluate customers' long-term viability and the value of Nokia's solution to the customer over time. Further, Nokia follows value –based pricing.

Despite the fact the Nokia was enjoying successes all the time with good financial performance over many years, by 2010, it started facing huge challenges from its competitors and changes in the market conditions. This was mainly due to more user-friendly experience offered in Android and Apple's IOS software compared to Nokia's Symbian platform. At present, Nokia manages to hang on at the second position in terms of global market share for the telecommunication industry.

You are required to:

- (a) **Explain** the concept of Global success from strategic management accounting perspective.
(04 Marks)
- (b) **Explain** how and why the understanding of business environment is crucial to Strategic management accounting of Nokia.
(06 Marks)
- (c) **Critically evaluate** whether **four (4)** elements of the management accounting system in Nokia contributed for excellence in performance.
(12 Marks)
- (d) **Explain** how strategic management accounting could assist the management to create value and regain the market share in relation to three major operations namely Nokia telecommunications, Nokia Mobile Phones and Nokia Communications Products with emphasis on the stage of its business life cycle.
(08 Marks)
- (e) **Discuss** possible reasons from strategic management accounting perspective as to why Nokia lost the market share later on.
(05 Marks)
- (f) **Explain** the possible risks that Nokia had likely ignored in light of good financial performance over time.
(05 Marks)

(Total 40 Marks)

End of Part I

Part II

Answer any **three (3)** questions

Question No. 02 (20 Marks)

A study shows that “Tesco”, a large retail chain in UK, determined that the company’s primary fixed asset base was its stores. Accordingly, the management created strategic partnership with construction companies to lower costs and maintain the quality of store facilities. In addition, Tesco monitored competitor product pricing to reduce customer prices and gain market share. Tesco also enhanced its technology by offering store that track customer patterns of buying.

You are required to:

- (a) **Discuss** the role of strategic management accounting in Tesco with reference to the above scenario.
(06 Marks)
- (b) **Briefly explain** market and competitor analysis and **discuss** the importance of customer analysis to Tesco.
(08 Marks)
- (c) **Name three (3)** financial performance measurements and **comment** whether financial performance measurements themselves are sufficient for Tesco to assess its success? Justify your answer.
(06 Marks)

(Total 20 Marks)

Question No. 03 (20 Marks)

Business Machine Unit (BMU) manufactures small electronic products and sells them through its online store. The manager of BMU is dissatisfied with the profitability of one of its product lines and believes that some market repositioning and a new marketing strategy may be appropriate. 15,000 units of that product are sold each month at a price of Rs.4,000/- each with an average cost of production and distribution of Rs.3,000/- per unit.

A target costing team revealed that no changes to the product design were made in the recent past and proposed to change the product design to cater for an up-market. This would increase the unit product cost to Rs.3,400/- and selling price as Rs.4,500/-.

BMU manager questioned the success of selling at increased priced in a very crowded market. However, the team is confident that even 17,000 units per month can be easily sold at the new price mainly due to increased quality of the product and the option of a “cash back voucher” which it offered with every unit of the product sold. This cash back voucher is worth of Rs.6,000/- and given as a rebate that to be redeemed to the customer’s credit card by visiting the BMU store’s website during a specific time period between 30 and 40 days after sale. A 12-digit code printed on the voucher is required to be entered in the space directed in the website.

The BMU manager is sceptical about the potential cost and effectiveness of the proposed strategy. The target costing team says that a financial analysis should be carried out on the following working assumptions.

- Only 60% of cash back voucher will be redeemed.
- Each redeem of a cash back voucher will generate an additional purchases of other products with average sales per voucher amounting to Rs.2,500/-.
- This additional sales will give a contribution margin of 20%.

You are required to:

- (a) **Write** a report to BMU manager by comparing the financial outcome of the present situation with the proposed strategy under the given working assumptions suggested by the target costing team. **(10 Marks)**
- (b) “After critically reviewing the results of your financial analysis in answer to part (i), the BMU manager remains unconvinced of the merits of the proposal even after examining the analysis given in the answer to part (i) above. In particular, he questions the working assumptions and is in the opinion that the most pessimistic scenarios such as 100% redemption of cash back vouchers and no extra sales might result from the extra website traffic. Therefore, a worst case scenario should be assessed to be on the safe side”. With reference to the above;

Discuss the limitations of both the target costing team’s and BMU manager’s suggested approaches in analyzing the proposal, and **suggest alternatives** as to how a rigorous financial analysis can be conducted in this case (calculations are not needed to suggesting alternatives). **(10 Marks)**

(Total 20 Marks)

Question No. 04 (20 Marks)

The Alpha Division (AD) of Traditional Group has recently completed research and development (R&D) work on a new consumer electronic product, at a cost of Rs 40,000,000. Following the conversations with various functional managers within AD, Amal Dias (the business unit's general manager) developed the following forecast during the four phases of the product's life cycle.

	Introduction	Growth	Maturity	Decline
Expected sales Units	20,000	50,000	100,000	10,000
Unit cost incurred in production and distribution (Rs.)	410	340	300	380

A dispute has developed between Amal Dias and AD's marketing manager about the most appropriate selling price to be charged for the product in the introduction phase. Amal Dias has stated that while AD should not aspire to make a profit on the product in this phase, the price charged should nevertheless be high enough to recover the production and distribution cost **in this phase in full plus one quarter of the R&D costs**. By contrast, the marketing manager believes that the price should be kept to a minimum in the Introduction phase whereby the price would equal the per-unit lifecycle cost of the product (where R & D is included in lifecycle cost). She further believes that consumers are potentially quite price-sensitive and that the sales quantities indicated above can be taken as a guideline but should not be taken for granted.

However, the CEO of the group is unimpressed by this internal conflicts within AD and in any case he cannot understand why the selling price should differ between different phases of the lifecycle. He has decided to direct Amal Dias to adopt a constant selling price in all phases of the lifecycle. Further, he plants to achieve following explicit profit targets in relation to the product.

- Net profit of at least 47% of sales at each phase of the product lifecycle, before taking account of R & D costs.
- Net profit of at least 20% of sales over the product lifecycle as a whole, after taking account of R & D costs.
- **Note: Ignore inflation and the time value of money.**

You are required to:

- (a) **Calculate** the prices proposed for the launch phase by Amal Dias and the marketing manager separately. **(04 Marks)**
 - (b) **Discuss** the suitability of each price calculated under (a) above and mention likely reasons for the variations of unit production and distribution cost at different phases of the product life cycle. **(08 Marks)**
 - (c) Assuming that CEO directed Amal Dias to take the average of the two prices which you arrived at in your answer to part (a) above as the constant selling price in all phases of the lifecycle, **Comment** whether AD will achieve the profit targets set out by CEO? Justify your answer with calculations. **(04 Marks)**
 - (d) **Critically evaluate** whether a constant selling price in all phases of the lifecycle is appropriate in this scenario. Make appropriate reference to the results of your calculations in part (a), and be specific about any proposals for changing the pricing strategy. **(04 Marks)**
- (Total 20 Marks)**

Question No. 05 (20 Marks)

The Pulp Fiction Division operates as an autonomous wholly-owned subsidiary of the Group. This division publishes popular fiction in both electronic (e-book) and physical forms. The division has exclusive rights to publish a limited number of very popular authors, and although the quantity of such titles published each year is small, nevertheless total sales are significant because of the volume of demand for each new title. The manager of the division has sought ways to improve profitability in recent years but with limited success. He attributes this mainly to the need to deal with large and powerful customers. Physical books are sold to supermarkets and online retail booksellers, which re-sell them to the general public. The distribution model for e-books is slightly different. The e-books are offered for sale on the website of a major online bookseller, but the contract for sale is between the Pulp Fiction Division and the consumer, with the online bookseller simply providing a marketplace. The online bookseller charges the Pulp Fiction Division a fee for this service and requires that the e-books must be compatible exclusively with its market-leading, e-book reading software.

You are required to:

- (a) **Evaluate** the advantages and disadvantages of the business model by which the Pulp Fiction Division distributes its e-books at present, and **suggest** a potentially more profitable alternative with adequate reasons and justifications. **(10 Marks)**

- (b) The manager of the Pulp Fiction Division would like to have the Division to be benchmarked against another publishing company. However, he is unsure as to whether this would be of interest to another company. **Suggest** reasons why another publishing company (which is not part of the Group) might be willing to co-operate with the Pulp Fiction Division in a benchmarking exercise.

(10 Marks)

(Total 20 Marks)

End of Part II

Present value table

Present value of 1.00 unit of currency, that is $(1 + r)^{-n}$ where r = interest rate; n = number of periods until payment or receipt.

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

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

End of Question Paper