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Institute of Certified Management Accountants of Sri Lanka
Level 5 - May 2012 Examination

Examination Date : 20th May 2012 **Number of Pages :** 06
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. Attached to the question are **Scenario I** given in advance and **Scenario II**
3. The answers should be given in the **English language**.

| <u>Subject</u> | <u>Subject Code</u> |
|-------------------------------|---------------------|
| Integrative Case Study | (ICS - 405) |

Question (100 Marks)

Blue Sky Group

Write a report as a consultant to Blue Sky by highlighting the strengths, weakness, opportunities and threats.

Blue Sky is currently having and proposing the required business strategies to be adopted by Blue sky to successfully administer the current situations in such a manner to create value to the group.

Your analysis should consider the following aspects but not necessary limited to them.

1. Scanning the environment that Blue Sky is currently facing
2. Merits and demerits of present diversification strategies
3. A critical analysis on the investment in Leisure limited and its consequences
4. The impact of the macro economic variables on group
5. Ways of handling the present problem pertaining to the threat of losing key management personnel
6. Strategies to deal with the consequences of the foreign exchange policy of the government
7. the price of a share to be offered in an event of a private placement
8. Complexities and problems that prevail in the present production processes and systems in the ceramic sector
9. Any changes if required to the governance structure within the group of Blue Sky

Scenario I

Overview

“Blue Sky’ is a public company incorporated in Sri Lanka with the Mission of “Running healthy core businesses, leveraging strengths into new ventures, and working together with people to be Sri Lanka’s Corporate Leader”. The Vision of the Company is to grow into a diversified business conglomerate with strategic investments in several key growth sectors, including financial services, manufacturing, power and leisure thus maintaining high quality Standards, practical innovation, creative thinking and a customer- oriented approach to achieve corporate objectives with one vision, one team and one success. Several discussions and meetings have been held in order to review key corporate and investment strategies in the given socio- economic and political environments.

Mr. Kumudu, the Chairman who also holds the office of Chief Executive Officer (CEO) of the Company considers “growth” as a process led through innovation, customer caring and integration of best service and practices. Hence, what matters is not the aggregate value of its parts within the group but the Company’s value as a whole to build a platform of creating value through innovation inspired conglomerate which will be able to be a competitive force for change.

At a recent Board Meeting, Mr. Kumudu reiterated this idea and went on saying that;

“We lead in big growth themes, ones that are critical to the national economy and those that will pave the way for greater wealth creation and national output. We consider of best integrated practices. Our Company is led by the precepts that we must lead by being listeners and thinkers. Each of our sister companies in the Group has demonstrated perseverance and resilience. They have challenged the status quo and revolutionized their individual sectors, redefining the rules of the game. They have all individually established themselves by deconstructing the “established norms”, by innovating beyond the conventional thinking. I, as your Chairman, am a believer in the power of financial accountability and long-term thinking. In my life, I have constantly gone against the grain and the conventional wisdom in pursuit of what I believe. All were successes but the failures allowed me to pave the way for greater wisdom. The experience and the knowledge from every failure helped me to orchestrate a new beginning.” Chairman/CEO further highlighted the opportunities available to Blue Sky under the prevailing economic conditions.

He is in strong belief that the political and economic conditions prevail in Sri Lanka are really conducive for new investments in various sectors. He emphasized the need for capitalizing the opportunity and pushes the boundaries in achieving our corporate objectives while realizing national goals as well. Some of the independent Directors did not fully accept his idea saying that opportunities surge on the surface might have been embedded with huge risks and therefore it is needed to carry out lengthy and comprehensive analyses from sustainability point of view instead of being fascinating with short term profitability. These differences created somewhat arguments in Board Meetings all the time. However, most of the senior management team supported the views of the CEO and the Financial Controller commented on new investment decisions as cited below.

“The potential is there, it is how we tap the opportunities to release that latent which will determine our pace of economic resurgence. Corporates in Sri Lanka need to think beyond the individual confines and objectives collectively. We must map an ambitious path for national progress. It is not that Sri Lanka’s economic progression will be unhindered. However, an open mind, a realistic approach and optimism will take us to the targets. One of the major objectives is for us to be the future powerhouse of corporates Sri Lanka and one of the key catalysts in infusing a culture of dynamism to the national industry. Optimism will drive our desire to create a new era in Sri Lanka”.

Profile of the Company

The Company was incorporated as a public limited company in 2010 and obtained a listing for its shares on the DiriSavi Board of the Colombo Stock Exchange in 2011 with a stated capital of above Rs.30 billion. Blue Sky operates as a diversified investment holding company and the principal activities of the subsidiary companies include Investments, Manufacturing and Marketing of Ceramic Ware and Sanitary Ware, Accepting Deposits, Providing Lease Facilities, Hire Purchase, Mortgage Loans and other Credit Facilities, Real Estate Development and Factoring. In addition, hotel operations are also intended to be carried out soon.

It is mentioned that Directors place a high degree of importance on sound corporate governance practices and are committed to the highest standards of corporate governance. Board consists of 6 Directors of which four are non-executive. Two Non-Executive Directors are independent. Chairman of the company holds the office of CEO as well. In addition, he holds either Deputy Chairman Position or Chairman Position on all the subsidiaries of the Group. CEO holds about 65% of share capital of the company. Both Audit Committee and Remuneration Committee consist of three non-executive directors each.

The Consolidated Financial Statements of the company for the period ended 31 March 2011 is given below.

| Balance Sheet as at 31st March 2011 | | Rs' 000 | |
|---|-------------------|-------------------|--|
| Assets | Company | Group | |
| Property, Plant and Equipment | 30,000 | 5,000,000 | |
| Intangibles | - | 10,000 | |
| Goodwill | - | 11,000,000 | |
| Investment in Subsidiaries | 12,000,000 | - | |
| Other Investments | 7,500,000 | 27,000,000 | |
| Other Assets | 5,970,000 | 15,990,000 | |
| Total Assets | 25,500,000 | 59,000,000 | |
| Liabilities | 40,000 | 25,000,000 | |
| Stated Capital | 26,000,000 | 26,000,000 | |
| Reserves | (540,000) | 6,000,000 | |
| Minority Interest | - | 2,000,000 | |
| Total Liabilities and Equity | 25,500,000 | 59,000,000 | |

| Income Statement for the period ended 31 st March 2011 | | Rs'000 | |
|---|--|-----------|-------------|
| | | Company | Group |
| Revenue | | - | 5,000,000 |
| Cost of Sales | | - | (2,400,000) |
| Gross Profit | | - | 2,600,000 |
| Other Operating Income | | 80,000 | 250,000 |
| Administrative Expenses | | (160,000) | (650,000) |
| Distribution Expenses | | - | (430,000) |
| Finance Cost | | (10,000) | (90,000) |
| Profit/(Loss) from Operations | | (90,000) | 1,680,000 |
| Value Added Tax on Financial Services | | - | (95,000) |
| Profit/(Loss) before Tax | | (90,000) | 1,585,000 |
| Income Tax (Expense) / (Income) | | 25,000 | (310,000) |
| Profit / (Loss) for the Period | | (65,000) | 1,275,000 |
| Attributable to : | | | |
| Equity Holders of the Parent | | - | 600,000 |
| Minority Interest | | - | 675,000 |
| Net Profit for the Period | | - | 1,275,000 |

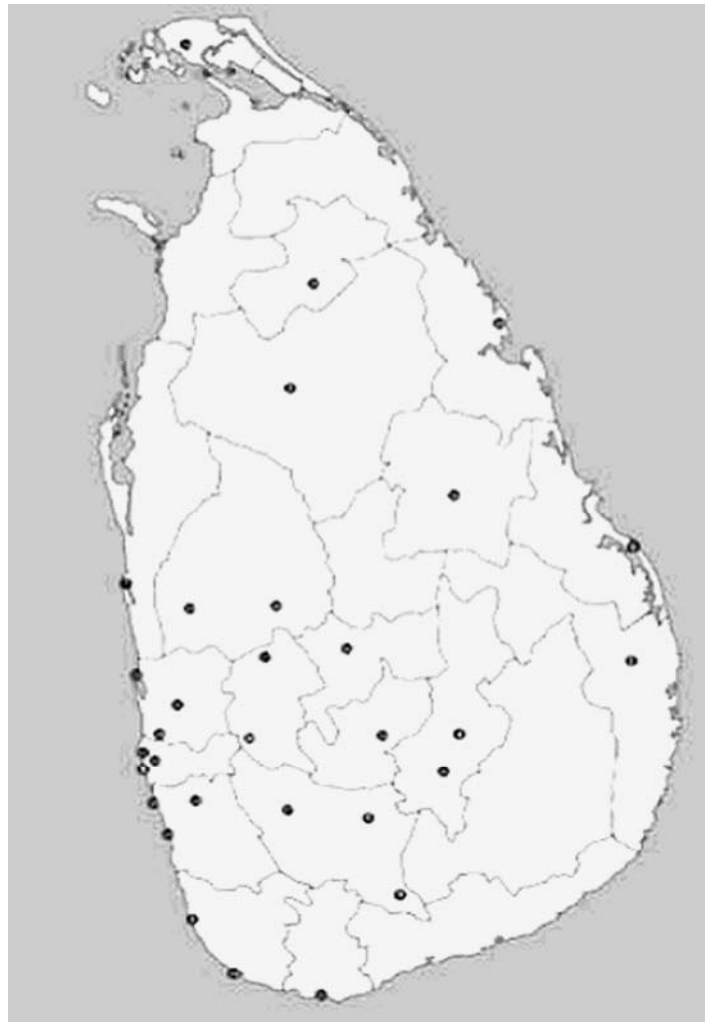
Acquisition of Subsidiaries

The fair value of assets acquired and liabilities assumed of Ranwan Ceramics, Easy Finance and Leisure limited were as follows.

| | Rs'000 |
|---|-------------------|
| <u>ASSETS</u> | |
| Cash and Cash Equivalents | 365,000 |
| Treasury Bills | 1,700,000 |
| Placements with other Banks | 860,000 |
| Loans and Advances | 1,400,000 |
| Loans | 4,100,000 |
| Lease Rentals Receivables | 13,000,000 |
| Real Estate Stock | 200,000 |
| Advance for Vehicle Stock | 190,000 |
| Other Debtors, Deposits and Prepayments | 910,000 |
| Investments in Securities | 1,500,000 |
| Intangible Assets | 10,000 |
| Property, Plant & Equipments | 4,580,000 |
| Income Tax Recoverable | 70,000 |
| Inventories | 1,300,000 |
| Total | 30,185,000 |
| <u>LIABILITIES</u> | |
| Deposits from non-bank customers | 15,000,000 |
| Interest Bearing Loans and Borrowings | 5,000,000 |
| Trade & Other Payables | 1,600,000 |
| Debentures | 450,000 |
| Retirement Benefit Liability | 120,000 |
| Deferred Taxation | 510,000 |
| Dividends Payable | 25,000 |
| Income Tax Payable | 12,000 |
| Bank Overdraft | 880,000 |
| Total | 23,597,000 |
| NET ASSETS | 6,588,000 |

Easy Finance has an island wide distribution network as given in this figure 1.

1. Ambalangoda
2. Ampara
3. Anuradhapura
4. Avissawella
5. Bandarawela
6. Badulla
7. Balangoda
8. Batticaloa
9. Chilaw
10. Dehiwala
11. Embilipitiya
12. Galle
13. Gampaha
14. Colombo
15. Horana
16. Jaffna
17. Kalutara
18. Kandy
19. Kegalle
20. Kiribathgoda
21. Kuliyaipitiya
22. Kurunegala
23. Matara
24. Negombo
25. Nugegoda
26. Nuwara Eliya
27. Panadura
28. Polonnaruwa
29. Ratnapura
30. Trincomalee
31. Vavunia



Easy Finance is the third largest financial institution in Sri Lanka, accounting for approximately 11% of the industry assets. One of the key performance area of Easy Finance is leasing for three-wheels with an average of 30,000 three wheelers per year. Stringent Risk Management Process, Strong Capital Base, Experienced Management Team, Customer Focus have been identified as core competencies of Easy Finance Ltd. Some of the key performance statistics of Easy Finance Ltd., for the last five years are given in the Table 1 below.

Table 1: Summary of financial statistics

| | 2007 Rs. '000 | 2008 Rs. '000 | 2009 Rs. '000 | 2010 Rs. '000 | 2011 Rs. '000 |
|------------------------|------------------|------------------|------------------|------------------|------------------|
| Gross Income | 914,463 | 1,310,792 | 2,778,862 | 3,580,173 | 4,130,993 |
| Interest Income | 849,978 | 1,229,406 | 2,082,418 | 3,431,950 | 3,953,032 |
| Interest Expenditure | 432,856 | 655,624 | 1,318,058 | 2,238,847 | 2,249,805 |
| Net Interest Income | 417,122 | 573,782 | 764,360 | 1,193,103 | 1,703,227 |
| Profit Before Taxation | 173,108 | 282,401 | 355,214 | 555,315 | 878,290 |
| Net Profit | 77,056 | 178,776 | 205,833 | 359,608 | 500,161 |
| Loans & Advances | 977,435 | 1,100,386 | 1,805,470 | 2,834,414 | 4,193,815 |
| Total Assets | 4,666,343 | 6,990,516 | 10,744,098 | 14,009,461 | 17,185,263 |
| Total Liabilities | 4,311,689 | 6,403,090 | 9,769,080 | 12,659,364 | 15,428,830 |

One factory of Ranwan Ceramic located in the Western Province operates two kilns with a combined capacity of approximately 4,000 square meters a day. The factory is outfitted with state of the art technology to produce homogeneous porcelain floor tiles to meet the highest international quality standards. The factory equipped with a 2,500 ton SACMI press, the only one of its kind in Sri Lanka, is used to press the pre-fired tiles from powder with higher compaction power and accuracy required to produce almost impervious tiles after firing. The Rotocolour MPS, the world's most advanced silicon roller based printing technology, is used to ensure that the prints stretch from end to end thereby eliminating unprinted edges on the tile, which is commonly visible with traditional silk screen printing. The technology also enables to produce natural random prints, which improves the aesthetic beauty of tiled floor. Finished products have compliance with ISO 13006 group B I International Standards.

The surface quality, flatness and rectangularity are checked for each tile using advanced optical sensors and devices. The tiles are packed and palletized using automated packing and robotic palletizing machines are used in arranging shipments. Stringent quality assurance system is adhered to before releasing the products into the market. Sampling & testing of finished products are done to ensure compliance of physical, technical and visual properties of finished goods.

The other factory which manufactures Glazed Ceramic Tiles and Vitrified Glazed Floor Tiles was set up as a Board of Investment (BOI) enterprise with 10 year tax holiday ending January 2013 and operates 2 kilns with a capacity of 7,500 square meters per day. The factory is equipped with the latest technology to meet stringent quality standards set by the company.

A capacity expansion project is in progress to increase the output by 3,500 square meters per day from February 2012. Total installed capacity of the factory after expansion will be 11,000 square meters per day. Total tile manufacturing capacity at present stands at approximately 11,500 square meters per day while both factories operate at close to 100% capacity utilization. With the completion of the current factory expansion in Horana, the total installed capacity of tiles will be increased to 15,000 square meters per day from Feb 2013.

Vitreous China Sanitary Ware and Fire Clay Sanitary Ware Factory located in Western Province is the most recent venture by Ranwan Ceramic Ltd. in a state of the art manufacturing facility, entering in to the sanitary ware segment. The factory was set up at a cost of LKR 1.8 billion and commenced commercial operations in April 2009. The factory which operates under Ranwan Ceramic as a fully owned subsidiary being the only sanitary ware manufacturer in Sri Lanka and it was also recognized as one of the most modern and state of the art production plants in Asia and one of the first plants in the region to manufacture fine fire clay products. This operates as a BOI approved project and enjoys a six year tax holiday and concessionary tax rates thereafter.

Ranwan Ceramic Ltd is considered to be the market leader in the ceramic and porcelain floor tile segment commanding a 44% market share in Sri Lanka. Ranwan Ceramic Ltd. competes mainly with manufacturers from China, Thailand and India in addition to local manufacturers. Superior Product Quality, Product Range, Innovative Designs, Distribution Network and Strong Brand Presence are the core competencies of Ranwan Ceramic Ltd. Key performance statistics of Ranwan Ceramic Ltd for the last five years are given Table 2 below.

Table 2: Five year summary

| | 2007 Rs. '000 | 2008 Rs. '000 | 2009 Rs. '000 | 2010 Rs. '000 | 2011 Rs. '000 |
|------------------------|--------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| Revenue | 1,941,535 | 2,594,180 | 3,474,819 | 3,741,172 | 4,451,169 |
| Gross Profit | 781,470 | 1,039,214 | 1,472,464 | 1,643,484 | 2,118,720 |
| Profit Before Taxation | 528,502 | 383,495 | 643,396 | 537,892 | 1,001,644 |
| Net Profit | 466,627 | 329,032 | 610,786 | 517,882 | 964,310 |
| Total Assets | 2,761,612 | 3,866,262 | 5,679,455 | 6,198,462 | 6,484,875 |
| Total Liabilities | 1,330,830 | 2,232,154 | 3,026,045 | 3,137,960 | 2,598,550 |

Future plans for Ranwan Ceramic have been developed based on the few assumptions including a demand driven growth can be expected. Construction sector is envisaged to contribute significantly to the country's economy which is projected to grow at a GDP growth rate of 7.5% in 2012 and 9.0% in 2013. Growth in construction sectors and demand for tile and sanitary ware products are positively correlated which is expected to drive demand in the future. Ranwan Ceramic Ltd. expects to capitalize on this expected growth in demand by investing in capacity expansion and in a new factory. Further, the company expects to increase market share through the expansion of its current distribution network and investment in new markets.

Leisure Limited

Leisure Limited was incorporated in June 2010 under the Companies Act No. 7 of 2007 and is expected to operate in leisure sector of Blue Sky. Leisure Limited has planned to invest in a luxurious five star resort with more than 380 rooms. It has already invested in the 14 acre freehold land at a cost of LKR 268.06 million. The initial design concept for the hotel was carried out by WATG of Singapore, one of the world's leading design consultants for the hospitality, leisure and entertainment industry. The first stage architectural designs have already been completed.

The hotel is located in the vicinity of Negombo, on the coast. The site for the project consists of vacant beachfront land vegetated by coconut palms and ground cover plants. The beach is of rich yellow sand and looks directly out onto the ocean, framed on either side by stone breakwater piers. An attractive river mouth meets the sea nearby, and the site is bordered by small dwellings set in a tropical setting.

As well as luxurious guest rooms and suites, the programme of facilities includes ballrooms, multiple restaurants, luxury spa & fitness as well as a children's water park, parking and service areas. The design seeks to evoke the grandeur of Sri Lanka's evocative past. References to the classical architecture of Galle Face and Government buildings seek to root the project in the islands culture, and double height lobby and lounge spaces will make the interior spaces equally splendid. The hotel accommodation is orientated entirely towards the ocean, giving every room a sea view and a balcony. In front of the hotel block, extensive landscaped gardens and pools will provide space for guests to relax. The pools will give a variety of swimming & sun bathing environments for those that choose not to swim in the sea.

Located at the front of the site is the conferencing facility, composed of a ballroom which is divisible into 4 spaces, pre-function and support areas. There are dedicated rooms for wedding participants, and covered walks linking back to a retail arcade and the hotel lobby spaces.

The spa will be designed as a 'village' facility set within a walled water garden. Amongst the lily filled ponds will be treatment pavilions, a salon, and fitness studio and relaxation area. Lush tropical planting will screen the spa for privacy, and a water connection allows users to swim to the beach if they prefer a change in environment.

The service facilities one would expect at a five star property are all located on site – back of house accommodations to support a luxury hotel, covered parking and engineering spaces are all sensitively located on lower level so as not to distract from the ambience. The resulting design is a grand and commodious building, setting a new standard for accommodation in Sri Lanka. The hotel has the potential to become ‘the’ setting for society events, weddings and gatherings.

Despite the fact that Leisure Limited has not commenced its commercial operations, the principal business activities of Leisure Limited are given below.

1. To construct, purchase, lease or otherwise acquire hotels, buildings and land for the use of any undertaking for operating hotels and to furnish, equip, improve, develop and exploit same and to manage and market leisure related properties and resorts taken on lease, rent or by management agreement or acquired.
2. To carry on the business of hoteliers and proprietors of restaurants and hotels guest houses, cabanas, chalets, cottages, inns, bars, cafes, holiday resorts, and as providers of facilities for sports games, amusement, recreation or entertainment of any kind.
3. To establish and or to carry on the business of a spa and to equip, maintain, manage and conduct health resorts to provide facilities to feel and be part of nature to organize and operate natural and transitional healthcare systems such as panchakarma, herbal body massage, rejuvenation, therapy, heat treatment, and all other natural traditional treatment methods to promote physical well being and carry on any business of a like nature.
4. To carry on the business of tourist and travel agents and contractors, or to provide travelling and other facilities, tour guides for local and foreign tours and to reserve and book hotels and to arrange other lodging facilities.
5. To carry on any other business which in the opinion of the Directors of the Company may be advantageously or conveniently carried on with any of the above business or be calculated directly or indirectly to enhance the value of or render profitable any of the Company’s activities or to further any of its objects.

The Board of Investment of Sri Lanka (BOI) approved the investment application made by the Company to construct and operate a 300 plus roomed five star hotel in Negombo with an investment of Rs 4,520 million. Signing of the BOI agreement will be conditional upon the company receiving preliminary clearance from the BOI by obtaining the following approvals.

1. Location approval to set up the hotel from the Urban Development Authority (UDA) or relevant local government authority, the Central Environment Authority (CEA) and other state agencies relating to the project.
2. Final approval from the Sri Lanka Tourist Development Authority (SLTDA)

As of now, the company has obtained the following approvals;

- Preliminary approval of the Sri Lanka Tourism Development Authority.
- Preliminary approval of the Board of Investment.
- Preliminary approval of the Urban Development Authority.
- Approval of Ministry of Defense, Public Security, Law and Order.
- Land clearance from the Negombo Municipal Council.

Approval of the Coast Conservation Department (CCD) and Central Environment Authority (CEA) are yet to be obtained. In order to obtain approval from the CCD and CEA, the company has submitted an Environment Impact Assessment (EIA) study for evaluation by the Technical Evaluation Committee (TEC) who will call for subsequent public comments. The company is of the view that signing of the BOI agreement will take approximately four months, provided that the above approvals are obtained.

SOME OF THE EVENTS OCCURRING AFTER THE BALANCE SHEET DATE OF BLUE SKY

There have been following events occurred.

1. In June 2011, the company directly acquired 51% of Lion & Company which owns several large companies having the largest distributing and logistic networks in Sri Lanka. Lion & Company has a diversified group of companies engaged in the businesses of imports, exports, distribution, travel, shipping, freight forwarding, insurance broking, construction, interior décor, medical and air services. The total purchase price is Rs.3 billion of which the obligation of the Company is to meet 51% constituting Rs.1.58 billion. Further, Ranwan Ceramic, a subsidiary of the Company acquired 20% of the shares of Lion & Company.
2. Ranwan Ceramics acquired 100% stake in Ever Painting (Pvt.) Ltd for Rs.125, 000,000/- in April 2011.
3. The Company has entered into an agreement in June 2011 to acquire 25,000,000 Ordinary Shares constituting 50% of the issued shares of OG Apparels Lanka Limited at a total consideration of USD 7,262,500.00. The Company has paid USD 3,500,000 at the end of December 2011. OG Apparels Lanka Limited is a Company incorporated in Sri Lanka, registered under Section 17 of the Board of Investment of Sri Lanka Law and engaged in the business of manufacture and export of apparels.
4. Leisure limited is under construction and it is intended to commence its operation in 2014. In order to fund the balance capital requirement of Leisure limited, the company made an Initial Public Offering of 20,000,000 shares at a price of Rs.25/- each in June 2011. With this public issue, the Stated Capital of the Company was increased to Rs.26, 000,000,000/-. The share issue was oversubscribed on the opening day itself.

Transactions with entities that are controlled or jointly controlled or significantly influenced by Key Managerial Personnel or their close family members, or shareholders who have either control, significant influences or joint control over the entity, are given in Table 3 below.

| Table 3: Transactions with Related Parties | | Rs. '000 | |
|---|------------------|-------------------|--|
| Nature of the Transaction | Company | Group | |
| Fixed Deposits Accepted during the period | - | 100 | |
| Fixed Deposits Held at the period end | - | 3,000 | |
| Interest payable on Fixed Deposits | - | 62,000 | |
| Interest paid on Fixed Deposits | - | 20,000 | |
| Dividend paid on shareholding | - | 230,000 | |
| Bank Balance | - | 5,500 | |
| Letter of Credits opened during the period | - | 40,000 | |
| Short Term loans | - | 900,000 | |
| Short Term loan Repayments | - | 900,000 | |
| Fixed Deposit & REPO Opened During the Year | - | 8,300,000 | |
| Sales of Goods / Services | - | 18,000 | |
| Leasing Interest Income | - | 1,500 | |
| Investments made | 6,900,000 | - | |
| Short Term Advances given | 22,000 | - | |
| | 6,922,000 | 10,480,100 | |

REVIEW OF SOME AREAS IN THE ECONOMY

Leisure Sector

Sri Lanka experienced 16 years of rapid expansion of its tourism sector between 1967 and 1982. Tourist arrivals increased at an average annual rate of 20%, reaching a level of 407,230 in 1982. However after 1983, tourist arrivals to Sri Lanka were highly volatile on the back of travel advisories imposed upon the country with the onset of the armed conflict. During the ceasefire, the country witnessed an all time high in terms of tourist arrivals where numbers reached 566,203 in 2004.

The outlook for the Sri Lankan tourism industry is very promising after the end of the three decade long ethnic conflict in May 2009 and the era of potential stability and peace. The removal of travel advisories by countries such as Britain saw a marked increase in tourist arrivals during the latter part of year 2009.

The end of the internal conflict has opened up new vistas for the travel and tourism industry in Sri Lanka. According to the Sri Lanka Tourism Promotion Bureau, tourist arrivals in Sri Lanka in December 2009 rose by 16.2% to 56,862 compared to the comparable period in the previous year, while overall tourist arrivals increased by 2.1% to 447,890 for the whole year up to December 2009, despite the sharp drop during the first few months. The arrivals, which had been declining, year-on-year, at an average rate of 18.3% during the first five months of 2009, increased significantly with the end of the conflict in May and grew, year-on-year, at an average rate of 20.4% in the subsequent 7 month period.

Adverse travel advisories issued by some countries were subsequently retracted or relaxed as the circumstances changed. The largest number of tourist arrivals was recorded from India (83,634), followed by the UK (81,594), the Maldives (31,916) and Germany (29,654) in 2009. Increases were also noted from the Middle East, France, Australia, Singapore and Malaysia. Nearly 80% of tourists visited for holiday and pleasure, while 8.6% came for business purposes.

Colombo city hotels witnessed the re-implementation of the minimum room rate policy from 1st November 2009. This has benefitted the city hotels in particular and the industry in general and has created market stabilization, increased revenue and a viable platform to hoteliers to enhance investments in their ventures. The room occupancy rate, which dropped to around 40% during the war which was waged over three decades have been gradually increasing. In view of the increased demand, Sri Lanka's star class hotels increased their charges for accommodation.

As the number of tourist arrivals in 2010 has grown by 46% year on year basis to 654,476, measures will be taken to increase the number of hotel rooms and upgrade tourism related infrastructure and facilities to cater to the requirements of the larger number of arrivals.

According to the UNWTO, Sri Lanka recorded the highest growth in tourist arrivals during the first two months of 2010 (50% growth reported). The report states that Sri Lanka outperformed 23 other countries with double-digit growth rates. Saudi Arabia was ranked second (45%) with Israel ranking third (+37%), while Vietnam (+36%) at the fourth place and Nepal (+30%) fifth. According to the SLTDA, the tourist arrivals in Sri Lanka from January to September 2010 amounted to 445,225 compared to 309,142 for the comparable period in 2009 (which is a 44% increase).

The Northern and Eastern Provinces are earmarked by the Government of Sri Lanka as focal areas for tourism development. The opening of these two Provinces to tourism activity is critical to Sri Lanka's future as a sustainable tourism destination. In view of the vast income generation potential of the tourism industry, Sri Lanka Tourism Development Authority has taken several measures to develop the tourism sector in the Northern and Eastern Provinces, which were affected by the conflict, as well as their selected areas of the island as prime tourist destinations. The government intends to promote the coastal cities of the Eastern Province, such as Arugam Bay, Passekudah and Trincomalee as premier recreational centers in the Eastern Province as it is known to have the best beaches in the island. Kalpitiya and other selected inland islands are also expected to be developed into attractive tourist resorts. SLTDA is also promoting a series of festivals to cater to the various segments of tourists.

The Sri Lankan government expects to double its tourism income to USD 1 billion by 2015 from the current level of around USD 350 million. Sri Lanka's strategic tourism plan targets 2.5 million tourists by the year 2016 and will require 58,000 rooms across the island nation to bring this objective to reality. Currently, Sri Lanka's tourism product comprises of approximately 15,000 rooms with a concerted drive to enhance capacity to 22,000 rooms by the year 2012. With 2011 nominated as the "Visit Sri Lanka year", Sri Lanka's tourism stakeholders are optimistic and confident of the potential of the industry. Occupancy rates as at July 2010 as an average was 72.4%. The greater Colombo and Colombo city hotels' occupancy rates were well above 86.5% while the South coast and the East coast occupancy rates were 71.6% and 70.1% respectively. The hill country enjoyed an occupancy rate of 60.9% while the hotels which are situated in the ancient cities enjoyed an average occupancy rate of 63.1%.

Further, given the limited supply of hotel rooms, the room rates could rise by approximately 20% in the coming six months. Many local hoteliers together with both local and foreign investors have already ventured into building new hotel properties, which could add nearly 800-1,000 rooms by the end of 2013. According to the BOI, USD 250 million worth of Foreign Direct Investments (FDIs) have poured in to the hotel and leisure sector in the first quarter of 2010, compared with USD 602 million for the whole of year 2009. The 2011 Budget has identified tourism as a "Billion Dollar Business", as the country has immense potential achieving such an outcome. Despite the steep growth in arrivals, the income from this segment has been moderate. From a hotel income point of view, the 2011 Budget has proposed to reduce tax on income earnings from tourism and related business from 15% to 12%.

The World Tourism Organisation and the World Travel and Tourism Council have made presentations to captive audiences on the Vision 2020. The boom in hotel sector is said to be particularly beneficial for women and first time employment seekers. They talk about infrastructure, open skies and the free flow of money and goods. Further, lots of measures are being taken to develop required infrastructure and supportive services to expand the tourism industry in Sri Lanka with a view to earn sizable foreign exchange earnings as a thrust of economic development of the country. However the main problems arising from tourist harassment, sex tourism, and child prostitution were never taken into discussion at policy levels. Estimates of child prostitutes in South Asia, which are difficult to come by, place the number for Bangladesh at 10,000, India 400,000-500,000, Pakistan 40,000 and Sri Lanka 30,000.

The competition for tourism industry cannot be simply ignored. Apart from well established tourist destinations in Thailand, Malaysia, Singapore, Maldives, Nepal and Bangladesh, India has major destinations such as Goa, Kerela, Tamil Nadu, Karnataka, Himachal Pradesh and Andhra Pradesh.

Financial Services Sector

The Sri Lankan Financial System comprises of Licensed Commercial Banks (“LCBs”), Non-Banking Financial Institutions (“NBFIs”) such as finance and leasing companies, Specialized Financial Institutions, such as Primary Dealers in Government Securities and Unit Trusts and Contractual Savings Institutions, such as Employees’ Provident Fund and Insurance Companies. Given below is a breakup of the total assets of the Sri Lankan Financial System for the period, 2008 to 2010.

| | SLR in Billions | | |
|--|-----------------|----------------|----------------|
| | 2008 | 2009 | 2010 |
| Banking Sector | 3,294.6 | 3,835.2 | 4,533.2 |
| Central Bank | 597.1 | 821.9 | 985.4 |
| Licensed Commercial Banks | 2,259.9 | 2,506.6 | 2,969.3 |
| Licensed Specialized Banks | 437.6 | 506.7 | 578.5 |
| Other Deposit Taking Financial Institutions | 285.9 | 315.7 | 400.9 |
| Registered Finance Companies | 175.6 | 185.3 | 233.6 |
| Co-operative Rural Banks | 105.4 | 124.5 | 160.6 |
| Thrift and Credit Co-op. Societies | 4.9 | 5.9 | 6.7 |
| Other Specialized Financial Institutions | 239.7 | 257.4 | 354.8 |
| Specialized Leasing Companies | 109.9 | 111.8 | 154.1 |
| Primary Dealers | 84.4 | 99.8 | 125.8 |
| Stock Broking Companies | 3.2 | 6.4 | 13.2 |
| Unit Trusts/Unit Trust Management Companies | 6.8 | 10.6 | 23.0 |
| Market Intermediaries | - | 27.1 | 37.0 |
| Venture Capital Companies | 1.4 | 1.5 | 1.6 |
| Credit Rating Agencies | 0.1 | 0.2 | 0.1 |
| Others | 33.9 | - | - |
| Contractual Savings Institutions | 1019.8 | 1205.5 | 1401.5 |
| Insurance Companies | 155.2 | 181.0 | 221.7 |
| Employees’ Provident Fund | 655.4 | 772.0 | 902.0 |
| Employees’ Trust Fund | 92.4 | 107.3 | 125.9 |
| Approved Private Provident Funds | 97.1 | 121.9 | 126.2 |
| Public Service Provident Fund | 19.7 | 23.3 | 25.7 |
| Total | 4,840.0 | 5,613.8 | 6,690.4 |

Tile and Sanitary Ware Manufacturing Sector

Sri Lanka’s ceramic industry boasts a history dating back several centuries. Sri Lankan ceramic products are unique, distinctive and elegant compared to other Asian Competitors as it illustrates the influence of ancient craftsmanship. It makes Sri Lanka a world leader in traditional ceramic products. One of the major strengths of the Sri Lankan ceramic industry is the availability of raw materials locally such as kaolin, ball clay, feldspar, silica quartz and dolomite. They are available at a reasonable cost and the purity and the quality of these raw materials contribute to the high standard of the products. The other distinct advantage enjoyed by Sri Lanka is the availability of highly skilled and literate work force at reasonable wage rates. They are well trained and exceptionally efficient. Availability of gifted designers, chemists, technologists and engineers contribute to the high standard and internationally recognized products. Sri Lanka Ceramics Council established in 2003 under guidance of the Ceylon Chamber of Commerce is the apex body for consensus building among manufacturers, research and development institutes, universities, government institutes and other stakeholders in the ceramic industry.

Sri Lankan ceramic industry supplies three main ceramic products to the local and international market. These are Tableware (both porcelain and stoneware or earthenware), Ornamental Ware and Ceramic Tiles. According to the International Trade Center (ITC), Sri Lankan market share in the Tableware segment, which includes other household articles also, is 0.65%. In Ornamental ware it is 0.92% and in glazed tiles (wall and floor) is 0.19%. The value of production of the local tile industry is estimated at LKR 20 billion per annum. The tile industry can be broken down in to two main sub segments, Wall Tiles and Floor Tiles. Floor Tiles make up approximately 70% of the total production value of the sector amounting to LKR 14 billion per annum with a production volume at 12.5 million square meters per day. The rest is contributed by the wall tile segment with a production volume of 5 million square meters per day and an estimated value of LKR 5 billion per annum. The industry has recorded an average growth rate of 6-7%. Major cost components of ceramic industry are given in Figure 2 below.

Figure 2: components of ceramic products



Even though the ideas of CEO was dominating most of the meetings for a quite long period, the non executive directors and some senior managers have been raising their voices to consider other qualitative factors and risks components in finalizing the strategic decisions. As a result the Board meets frequently to figure out its corporate strategies and to develop a clear road map for channeling the resources of the Group in an efficient and productive manner.

The Chairman reiterates that his views will win the support from the Board and the senior management when the time passes despite the strong counter arguments put forwarded by some directors and managers. Hence, Blue sky is in a half way of its journey with respect to strategic decisions.

End of Scenario I

Scenario II – A continuation of Scenario I

Despite the fact that the chairman of the company Mr Kumudu is always optimistic about taking challenges and capitalize the opportunities that exist, a lot of overshadows are apparent mainly due to changes in economic and political situation of the country. As a result, the majority of the top management is of the view that the socio economic and political environment is not going to be conducive for achieving sustainability in the course of business operations. The strategy of building networks and alliances with a view to achieve a sustainable growth with diversified investment in crucial business sectors is challenged. Instead, the general perception of a manager about the corporate strategy has changed and they argue that investments which are potential of generating quick cash inflows with shorter life span should be looked for rather than planning for sustainable business opportunities.

Finance manager argues that the profit at present is more important than venturing onto new sophisticated and potential business opportunities which will assure long term profit, as we face huge uncertainty about the future. The risk of such a business strategy is relatively less when compared with other long term investments.

During the current year, Blue Sky experienced many cash flow problems and the expected profit was also well below the expectation. Owing to this situation all the senior managers are trying to protect the businesses for which they hold direct responsibilities instead of considering the value be created through the chain of the entire group.

The CEO is busy with holding meetings with senior management and with the board one after the other to streamline investment and corporate strategies to face any challenge and make sure that the entire group of companies would do better in the future.

Current developments in a nut shell;

- Estimated cost of further constructions and infrastructure required for Leisure Limited is going to be materially changed due to price escalation.
- The contract price for the construction at Leisure Limited has been agreed as cost plus basis.
- The commencement of commercial operations of the Leisure limited has be delayed by another one year at least
- Approval of the Coast Conservation Department (CCD) and Central Environment Authority (CEA) for leisure limited has not been given as yet and the company is required to resubmit the Environment Impact Assessment report after considering the additional impacts on the environment and the bio diversity
- Even though the projection of tourist arrivals in Sri Lanka is likely to increase, a research has revealed that there is huge mismatch between the profiles of tourists and the market expectations
- Expected economic development and the progress have been pulled back due to the uncertainly, mismanagement and corruption in the country
- Likely economic sanctions on Sri Lanka on the charges of human right violations during the post war period and at present

- The management is currently facing a problem of raising more funds either through equity issue or by borrowing. Both options are under review and the bankers are seeking for more collateral for considering the approval of additional loans. Deputy finance manager has suggested to go for a private placement by issuing another 10 million shares to raise the additional funding requirement
- It has been proposed to work to get listed on the main board from the dirisavi board of the Colombo stock exchange
- Further, the term structure of the interest rates takes an upward trend
- The government has taken a decision to float the foreign exchange rate
- It has revealed in an analysis that most of the operations within Lion and Company and its related parties are materially exposed to foreign exchange risks in additions to other prevailing risks
- The government has opted to further increase the gearing position mainly from foreign sources with a view to expand the economic development.
- Concessions given on GSP+ will be reconsidered within another 6 months period
- Human resources manager of Ruwan Ceramics has resigned due to the pressure from unsolved labour issues pertaining to salaries and working conditions
- Employees of OG apparels are considering for trade union actions after failing a number of negotiations had with the top management
- It has been learnt that there is an internal pressure to disperse the share ownership of the company but the CEO who holds more than 90% of shares of the Blue Sky is stick to the policy of not diluting the ownership. Due to the pressure he agreed to reduce his equity to 75% and make changes to board of directors by bringing more directors. However all the names proposed by the CEO to the boards are related parties. In this reform structure it was agreed to give 15% of shares to employees in Blue Sky.
- The demand for the ceramic products have increased due to special orders from abroad but the company will have to face capacity problems if the additional orders are accepted
- The cost of quality checking at Ruwan ceramics is supposed to be curtailed but quality management department vehemently is against for this proposal

End of Scenario II
End of Question Paper

CMA INTEGRATIVE CASE STUDY – (ICS - 405)
May 2012 - Marking Grid

| | Marks | A | B | C | D | E |
|--|------------|---|--|---|--|---|
| 1. Management Accounting Sound technical knowledge in Management Accounting | 20 | High level of Management Accounting awareness relating to world examples 17-20 | Good Management Accounting awareness relating to case study examples 11-16 | Some level of Management Accounting awareness relating to few case study examples 10-14 | Low level Management Accounting awareness 5-9 | Lack of Management Accounting awareness 0-4 |
| 2. Application of theories Diverse knowledge clearly applied in an analytical and practical manner in solving the problems in the case study. | 20 | High level of application of theory in an analytical manner in solving problems in the case study 17-20 | Good level of application of theory in an analytical manner solving problems in the case study. 11-16 | Some level of application of theory in an analytical manner solving problems in the case study. 10-14 | Low level of application of theory in solving problems in the case study 5-9 | Lack of application of theory in solving problems 0-4 |
| 3. Identifying key issues Issues to be identified and prioritized in a logical manner with a clear rationale. | 10 | High level of recognition of key issues and these being prioritized logically with a clear rationale. 8-10 | Good level of recognition of issues and these being prioritized logically 5-7 | Some level of recognition of issues and these being prioritized 3-4 | Low level of recognition of issues 1-2 | Lack of recognition of issues 0 |
| 4. Decision making skills Ability to recognize and present appropriate alternate solutions and make effective judgment in a logical & rational manner. | 20 | High level of ability to recognize and present appropriate alternate solutions and make effective judgment in a logical and rational manner 17-20 | Good level of ability to recognize and present alternate solutions and make effective judgment in a logical and rational manner. 11-16 | Some level of ability to recognize and present alternate solutions in a logical and rational manner 10-14 | Low level of ability to recognize alternate solutions 5-9 | Lack of ability to recognize alternate solutions 0-4 |
| 5. Logical arguments Ability to communicate effectively with realistic recommendations in a concise and logical manner. | 20 | High level of ability to communicate effectively with realistic recommendations in a concise and logical manner 17-20 | Good level of ability to communicate effectively with realistic recommendations in a concise manner 11-16 | Some level of ability to communicate effectively with realistic recommendations in a concise manner 10-14 | Low level of ability to communicate effectively 5-9 | Lack of ability to communicate effectively 0-4 |
| 6. Communication skills Style and synthesis in evaluation of a good report to higher management. | 10 | High level of combining ideas and experiences in a professional manner using relevant appendixes 8-10 | Good style in writing a Management Report encompassing ideas and recommendations with some appendixes 5-7 | Some style in writing a Management Report encompassing ideas and recommendations 3-4 | Poor style in writing a Management Report 1-2 | Lack of knowledge in writing a Management Report 0 |
| TOTAL | 100 | | | | | |