

PILOT PAPER – 2023-2027 SYLLABUS

SL4.5 Integrative Case Study

Strategic Level

No of Pages: 16 No of Questions: 05

Time allowed: 3 Hours and 15 Minutes (Including 15 minutes of reading time).

Total Marks: 100

Exam Structure

This exam is consisting of two parts.

Scenario I: Published before the six weeks of the Exam.

Scenario II: Unseen and the Questions.

Answer all questions.

Other Instructions

- The answers should be in **English** language.
- Begin each answer on a separate page in the answer booklet.
- Only non-programmable calculators are permitted to use.

Scenario I (Pre-seen)

Sun, Sand and Hills Ltd.

A Case from the Hospitality Industry

Sun, Sand and Hills Ltd is a case study from the Sri Lankan hospitality industry. Set up initially as a small private sector business enterprise in foreign travel in the wee years of the open economy it soon enjoyed a phenomenal growth which enabled it to diversify into several related areas. Not many years later, it transformed to be a well-known medium sized company until it began encountering operational difficulties owing to lapses in financial and general business management practices. The company turns to a management consultant who is required to study the organization and develop a Management Report with the objective of setting it back on track. In this exercise the management consultant shall disregard the the possible impacts from Easter Sunday massacre, the COVID-19 pandemic and the going economic downturn.

Taking the plunge

Sun, Sand and Hills Ltd. (SSH) was set up in 1990 by Nihil Simons (NS) as a small, family owned business enterprise. By then the country had been into 12 years of open economic policies with prospects for the hospitality industry running high. There was a sense of optimism all around and NS, who had just turned 40, with many years of work experience in foreign travel, was contemplating leaving employment to set up his own business. After months of deliberation, he decided to take the plunge, and thus Sun, Sand and Hills Ltd., was born as a family owned business in the small business category of foreign travel in the hospitality industry in Sri Lanka.

Early years

As customary for start-ups, the first few years of SSH were one of sweat and toil. In the beginning, the company was engaged solely in offering local holiday and tour experiences for the benefit of low-end tourists from the European region. NS, during his employment as travel manager in two well-known travel agencies, had developed contacts with a large number of customers which stood in good stead in planning a choice of holiday packages with a focus on the seaside resorts in the Southern coastal belt of the country. With his familiarity with the facilities provided and the fares quoted by hotels and guest houses in the area, he decided to initially confine himself to this segment.

The initial capital came from NS's and his wife's savings. The company was also assisted by the local branch of Suhada Bank with whom he maintained cordial relations and turned to in times of financial needs. In the early days, NS operated from his residence in Mirihana, Kotte and conducted business affairs with the use of standard communicative equipment and three motor vehicles acquired on a lease agreement. The focus at the time was retaining and expanding its customer base as well as multiplying acquaintances through diligent relationship building and excellent service offering which enabled NS to steer the company to its growth phase within a relatively short period of time.

The growth phase

The mid-nineties witnessed a phenomenal growth in SSH. This was an era of new opportunities in the Sri Lankan hospitality industry which tempted NS to plan diversification into a few related areas. Since he had managed the company single-handedly so far, he was keen to look for a confidante who could advise and assist him in the expansionary moves. This prompted him to invite Raj Kumar (RK), his lifelong friend and schoolmate, to join the company on a full-time basis. RK had a degree in Marketing and expertise in the area of launching new products, which he thought would make him an excellent colleague for implementing new initiatives. By 1999, the company was shifted to a modest office in Nugegoda town with a small staff comprising travel executives and support staff. Needless to say, the next few years saw NS-RK combination driving the company with relentless passion yielding several notable outcomes.

The period 1995-2015 marked SSH's entry into several new areas.

Inbound Travel and Domestic Travel units under Manager Operations

First, with respect to its core business of inbound travel, it now began to focus on the high-end European tourist market as well. Venturing into domestic tourism took place in 1998 when it introduced several interesting travel packages (sea-side, hill-county and wildlife) for the benefit of local customers.

Outbound Travel unit under Manager Operations

By 2002 the company started to organize outbound holiday packages for local customers that took them to places of worship in India, Thailand, Myanmar and Indonesia.

Transport unit under Manager Transport

Further, promotion, bookings and visa-related work for inbound, outbound and domestic tourism were in the hands of Manager Marketing. Next, in 2006 the company's fleet of transport was

expanded and made a separate division. It organized transport facilities for the benefit of company's customers and in the presence of spare capacity let out vehicles to external tour operators.

Guest- houses unit under Manager Hotels

Finally, in the aftermath of the ethnic conflict (2010), with prospects of tourist arrivals rising to dizzy heights, the company went into hoteling by putting up 3 small guest houses in Beruwala, Kataragama, and Matale. Being of similar size with six rooms in each guest houses they are located facing the main roads to Matara, Kataragama and Knuckles. Further, they are staffed by young men and women from villages nearby. While not being well-trained they lack proficiency in the English language

Thus, by 2015 the company had become a company in the medium business category offering five different products.

The liaison office

Another development since 2015 was the setting up of a liaison office (coordinating and an overseas marketing office) in the Netherlands. Owned and managed by Dimuth Kumar (RK's son), a graduate in hotel management domiciled in the Netherlands, it is akin to an outsourced arm of the company. Most of the company's European business operations were channeled through this office. It was agreed to run this office independently of SSH with the services rendered including promotional campaigns paid for on a pre-determined basis. Further, the understanding was that the office was exclusively for the service of SSH with no personal work undertaken by DK. Recently a proposal for the development of a website to promote inbound tourism has been forwarded by the liaison office which is now being reviewed by the head office.

Method of funding

The expansion of the product portfolio involved both internal and external funding. With regard to internal funding the surpluses generated by the company were reinvested within the company. In addition, NS would even pump his personal savings and proceeds of personnel effects from time to time depending on the need. With regard to external funding Suhada Bank always came to its rescue with assistance coming in the form of long-term loan facilities and overdrafts. Having maintained a close rapport with the bank, securing credit facilities repayment had become a regular activity in the company.

Further developments

The suggestion to shift the SSH head office to more spacious environs with better facilities was mooted in 2016. Driven by the dual need to project a favorable image among customers and to accommodate the increasing volume and complexity of operations the suggestion for a modern office complex was discussed at the Board of Management and the core-management levels. Attention was also paid to possible locations and modes of funding for the proposed office complex. After much deliberation, a decision was taken to make use of office space on the ground floor of a modern shopping complex situated in Colombo 4. Further, it was decided to go for an outright purchase with the major portion of funds coming from the Suhada Bank. After intense negotiations the bank agreed to provide the requisite funds against the fixed deposits that SSH had with the bank permitting a grace period of four years ending December 31, 2020. And, having completed legal and procedural requirements related to the office complex (by late 2016), the company went to occupy its new abode in early 2017.

The company proceeded with its usual operations thereafter, and the scenario now turns to the end of 2022 which signified an unanticipated turn of events during the years 2021 and 2022.

The organization structure

The organization structure indicating key job positions as of December 31, 2022, is given in Figure-1.

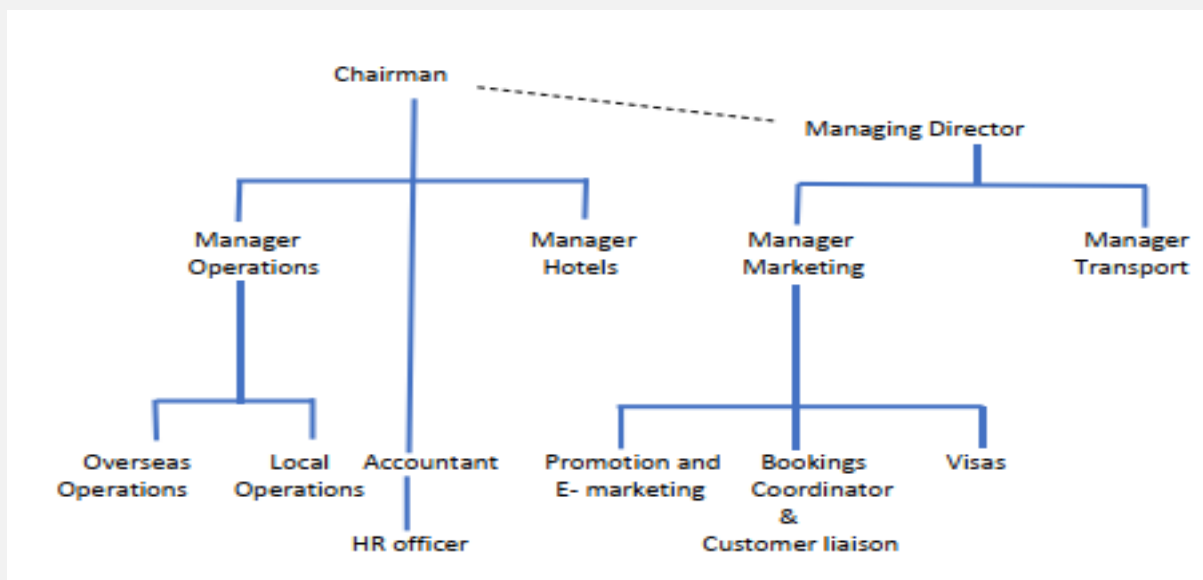
SSH consists of an unorthodox type of structure with the ownership resting with NS and family members. The Board of Management comprises NS, his wife and children while the top management constitutes NS (Executive Chairman) and RK (Managing Director, since 2012) with the latter reporting to the former via a lateral relationship. They also had their separate areas of responsibility. The core management team consists of four managers looking after Operations (foreign-inbound, outbound and domestic); Hotels (guest- houses); Marketing (promotions, bookings and visas), and Transport respectively. The Operations Manager and the Hotels Manager report directly to the Executive Chairman while the Marketing Manager and Manager Transport come under the Managing Director. The Accountant (who does not form part of the core management team) reports directly to the Executive Chairman while the Human Relations Officer reports to the Accountant.

The Accountant and the Human Relations Officer look after the small and basic Finance and an HR unit respectively. With the growth of the company, the preparation of final accounts has been outsourced to an external accounting firm instead of setting up a properly constituted finance

division. On the other hand, the role of the human relations officer is restricted to recruiting personnel and maintaining personal files. Furthermore, the accountant has always been one with a part qualification in accounting while the human resource officer's role has often been occupied by a person with work experience in personnel management.

Furthermore, SSH had a basic IT-driven management information system (MIS) under Manager Marketing. The purpose of the MIS was to generate information for the benefit of managers at different levels. However, there was a feeling all-round that the MIS was operating far below the optimal level. There is a general consensus that it ought to be upgraded to be in alignment with new trends in IT.

Figure 1: Organization Chart: Sun, Sand and Hills Ltd.



SSH had become a well-established medium scale family business over a period of 30 years (1990-2020). During this period, it performed exceedingly well to make its presence felt in a number of areas within the hospitality industry. Further, it contributed to the economy by way of earning foreign exchange and providing employment to many, either directly or indirectly.

NS always wanted to show his gratitude to RK for the important role played in the development of the company. In addition to his expertise in marketing, he played the role of friend, guide and philosopher to the company. Thus, as a gesture of goodwill, NS with the concurrence of the Board of Management decided to award shares equal to 20% of the share capital to RK and also admit him as a Board Member. A further portion of reserves was also capitalized during 2022, thereby increasing the share capital of the company.

Turning the searchlight inwards

Towards the end of 2020, the hitherto smooth and steady flow of events took an unfavorable turn. It came to open with the accountant claiming that the company was not in a position to service its debts on time. He posited that with the grace period of the loan facility (acquired to fund the new office complex) coming to an end, the company was compelled to incur the annual debt repayment instalment (interest and principal) which created a strain on its cash flows. Further, it was informed that revenue from the inbound tourism division as well as profitability had suffered a setback. Refer Annexes I and II for published accounts of 2021 and 2022 and Annex III for the segmental breakdown. Being the founder and thought leader of the company NS was becoming worried and concerned as evidenced by the excerpts of the staff meeting held on March 15, 2023.

Extracts from the address by NS to the staff at the meeting held on February 15, 2023, at the Conference Room of SSH Ltd.

“We have worked with commitment for three decades in the Sri Lankan hospitality industry, having started with humble beginnings as a small business. When I left a well-paid job to start this company, I took a big risk in my life. Perhaps when one takes such a risk the tension that is associated drives one to give his best. When Raju joined that gave us added strength to go into areas beyond inbound travel. I believe that’s how businesses grow and eventually become large enterprises”.

“Of course, like most other companies we also have had our share of problems. As you may also be aware diminishing profitability and liquidity problems have started to plague us lately. There are other operational matters too that deserve our attention and close scrutiny. I have also discussed them with Raju and we both agree, that it’s time to critically examine the past and present before determining future courses of action”.

“I have intimated in earlier meetings too that our customer satisfaction rating, according to the liaison office, has suffered lately which has affected the company. In addition, even where revenue had gone up profitability seem to have suffered. We both are not certain why and how this would have happened. Those who have been with us for long years will remember how passionate we had been serving our customers. In fact, this ardent desire to fulfill their needs has enabled us to come this far”.

“I also recollect that having developed the company to a medium scale business we took time off on several occasions to attend to our personal needs. I was of the belief that the strong work culture that we had inculcated within the company would prevail even during our absence physically from the office premises. But, I now understand that this has been an illusion. However, I do not propose to blame anyone. It is also pertinent to note that the markets have undergone drastic changes which we may have failed to capture. Let us now resolve to pause and investigate from all directions and begin the next stage of our journey”.

‘Last but not least, let me mention that in our legion of companies, SSH salary scales are considered to be on par with the highest-ranking competitors. As mentioned earlier, you will agree that you ought to be fair and just for such kindness shown by your employer. It’s our bounden duty to understand where we have gone amiss and take necessary remedial action so that we could work towards even better salaries in the future instead of a possible streak of layoffs!’.

Enter the consultants

In the evolving gloomy set-up, NS and RK entered into an intimate discussion on the course of action to be taken. NS with entrepreneurial expertise and RK with a marketing background were beginning to feel their limitations in handling the present dilemma. They knew that the Finance function of the company was weak and that the Accountant will be of limited use in putting things right. Therefore, NS and RK have approached you for advice and guidance. After a visit to the company and a few rounds of discussion with the two gentlemen (NS and RK) you have decided to accept the task to assist the company. You have prepared the Terms of Reference (TOR) for submission to the company which include: (i) Securing the services of an assistant consultant [Ruwanthi Gamage (RG), a final stage student of the CMA study programme with a fair knowledge of Strategy and Finance]; (ii) Completion of the assignment within a period of four months ending June 30, 2023; (iii) Spend the first two months (March and April 2023) to gather information while analysis and writing to take place in the next two months; (iv) Provide facilities and the freedom to gather necessary information; and (v) Remuneration details. Having agreed upon the terms and conditions you together with RG set down to work on March 1, 2023.

Information gathering

As planned the first two months were devoted to gathering information. This was carried out by RG under your guidance and supervision. The methodology adopted included observation and visits to different divisions in the head office, the guest houses, and the liaison office in the Netherlands for which RG was joined by NS and RK. In addition to observing operations and perusing documents, in-depth discussions were held with a wide range of stakeholders. A few

rounds of discussions were also held with the officials of the Suhada Bank in which NS participated. Further, discussions were held with a few external stakeholders that included state organizations involved in visa operations and tourism development.

Findings I

Some of the information of relevance is given below:

- i. The in-depth discussions with NS revealed that the corporate strategy that the company adopted over the years was largely emergent than deliberate. He confessed that being professional with experience in foreign travel, he was never guided by a strategic plan for his organization. According to him, he always had lady luck on his side, which seemed to have deserted him of late. 'Being a sensible person, I just made use of opportunities that came my way...And that's all...', he concluded.
- ii. Immediately after the appointment, RG recognized the incidence of liquidity problems that were becoming increasingly felt month after month. She made out that it was caused largely owing to the need to repay the loan facility secured for the purchase of the new office complex on top of the balances of the previously taken loans which stood at Rs. 100 million as of December 31, 2022.

Thereupon, RG persuaded the management to have a discussion with officials of the Suhada Bank with a view to getting the bank's concurrence for re-scheduling the loan portfolio. After intense deliberation, the bank agreed to re-set the loan portfolio at Rs. 400 million as at June 30, 2023, with a grace period of 2 years commencing on this day. Thereafter, debt settlement was to take place over seven years in equal annual installments at a debt servicing rate of 11% per annum. Further, granting this concession was subject to the submission of a viable interim plan (agreeable to the bank) before May 31, 2023, specifying how SSH proposes to enhance performance in order to pay back the loan in accordance with the proposed plan of repayment.

- iii. RG was instructed to develop a grid indicating market attractiveness and competitive position of the different products using company-generated and published information. The purpose of the exercise was to ascertain the alignment of market attractiveness against the competitive position of the different divisions. This would lead to an optimal reallocation of organizational resources.

-End of Scenario-

Sun, Sand and Hills Ltd.

Statement of Profit or Loss for the year ended 31st March

| | 2022 (in Rs.'000s) | 2021 (in Rs.'000s) |
|-----------------------------------|-----------------------|-----------------------|
| Revenue | 595,000 | 476,000 |
| Costs of Sales | <u>416,500</u> | <u>309,400</u> |
| Gross Profit | 178,500 | 166,600 |
| Other Income-FD interest | 4,000 | 4,500 |
| Selling and Distribution Expenses | 44,625 | 38,080 |
| Administrative Expenses | <u>81,396</u> | <u>85,680</u> |
| Operating Profit | 56,479 | 47,340 |
| Finance Costs | <u>52,410</u> | <u>51,406</u> |
| Profit Before Tax | <u>4,069</u> | <u>(4,066)</u> |

Sun, Sand and Hills Ltd.

Statement of Financial Position as at 31st March

| | 2022 (in Rs.'000s) | 2021 (in Rs.'000s) |
|------------------------------------|-------------------------|-------------------------|
| Assets | | |
| Non-Current Assets | | |
| Premises and Buildings (Valuation) | 928,348 | 910,145 |
| Equipment and Furniture (WDV)* | 197,243 | 187,323 |
| Vehicle including the Fleet (WDV) | <u>100,075</u> | <u>87,678</u> |
| | <u>1,225,666</u> | <u>1,185,146</u> |
| Current Assets | | |
| Inventories | 16,666 | 12,345 |
| Trade Receivables | 8,559 | 6,340 |
| Investments | 50,000 | 50,000 |
| Cash and Bank Balances | <u>343</u> | <u>567</u> |
| | <u>75,568</u> | <u>69,252</u> |
| Total Assets | <u>1,301,234</u> | <u>1,254,398</u> |
| Equity and Liabilities | | |
| Equity | | |
| Share Capital | 700,000 | 400,000 |

| | | |
|-------------------------------------|-------------------------|-------------------------|
| Reserves | <u>54,587</u> | <u>332,315</u> |
| Total Equity | 754,587 | 732,315 |
| Non-Current Liabilities | | |
| Long-term Loans | 400,000 | 400,000 |
| Current Liabilities | | |
| Trade Creditors | 57,139 | 42,325 |
| Creditors-Expense | 13,056 | 12,434 |
| Bank Overdraft | <u>76,452</u> | <u>67,324</u> |
| | <u>146,647</u> | <u>122,083</u> |
| Total Equity and Liabilities | <u>1,301,234</u> | <u>1,254,398</u> |

*New purchases included.

Annex III

Sun, Sand and Hills Ltd.

Segmental Breakdown

| | 2022 (in Rs. '000s) | | 2021 (in Rs. '000s) | |
|----------------------|---------------------|--------------|---------------------|--------------|
| | Revenue | Gross Profit | Revenue | Gross Profit |
| Company | 595,000 | 178,500 | 476,000 | 166,600 |
| Inbound/ domestic | 205,870 | 61,761 | 214,200 | 74,970 |
| Outbound | 210,630 | 66,117 | 142,800 | 49,980 |
| Hotels* | 119,000 | 29,619 | 71,400 | 21,420 |
| Transport | 59,500 | 21,003 | 47,600 | 20,230 |

*Capacity utilization in 2022 – 70%

Scenario I (Un-seen)

Sun, Sand and Hills Ltd.

A Case from the Hospitality Industry

Findings II

Given below are further findings of Miss Ruwanthika Gamage through her explorations.

- i. The grid indicating market attractiveness and competitive position of the different products are given in Annex IV.
- ii. The segmental breakdown of revenue and gross profit indicates a drop in revenue and profitability in the Inbound Travel Unit. The liaison office which was considered to be largely responsible for this trend, when visited revealed the absence of effective operating systems and good practices. The relationship network with agencies and sub-agents in Europe too was found to be at a low ebb. There were also indications that DK was not serving SSH with utmost loyalty which however was negated by RK. In this setup, LG wonders whether the mere introduction of a website would bring the desired results to SSH.
- iii. According to the Operations Manager, the low customer satisfaction ratings (expressed by the Executive Chairman) are not owing to service levels of foreign tourists but are associated with processing delays of booking confirmations and visa-related matters. This, however, comes within the purview of Manager Marketing. He also did not appear to be satisfied with the manner in which customer satisfaction levels are measured.
- iv. RG is of the view that domestic travel could be increased hurriedly in order to compensate for the drop in revenue of inbound travel. An aggressive local promotion campaign is likely to increase the capacity utilization of Guest-houses and Transport units which currently stand at 70% to 90%. The efforts to enhance capacity utilization will, however, entail an additional expense of Rs. 4.5 million. It is to be noted that even at the current 70% capacity utilization level the units enjoy profits. Further, the estimates are in line with predictions of local tourist promotion bureaus.
- v. The Marketing Manager is positive about a rise in inbound, outbound and domestic travel for the next couple of years. Agreeing with RG he informed that both outbound and domestic travel could be improved through the application of market penetrative strategies including publicity campaigns. While observing gross profit margins of domestic travel to be far less than that of inbound travel he expressed the possibility of upward revision of prices with respect to the former.

- vi. During visits to various divisions/ units and discussions with members of staff, RG has noted ample for room for more effective management (reduction and control) of costs. She contends that there is excessive fat everywhere and is of the view that Selling and Distributions Expenses and Administrative Expenses in particular can be reduced by at least one-fifth if a systematic approach to cost analysis is adopted. It also noted that the company does not make use of modern cost management techniques at present.
- vii. RG has identified a few broad themes in her discussions of quiet reflections subsequent to discussions with members of the staff:
 - a. It was voiced by quite a number of staff members, particularly at higher levels, that the company suffers from the lack of senior-level professional with general management acumen who could see things beyond functional expertise.
 - b. The company lacks sophistication in higher-order accounting as well as finance-related activities such as financial management and working capital management.
 - c. Lack of training and development for members of the staff in general and those in the guest-hotel division was highlighted as a distinct disadvantage.
 - d. The idea of investing in an ERP system came up during discussions. Whilst there were views in favor of and against consensus in the end was to appoint a committee to investigate the information needs of the company before deciding on the nature of the MIS. In addition, the suggestion for developing a website at the head-office level conflicted with the proposal that has come up from the liaison office.
- viii. NS has expressed his desire to ascertain the real profit (as against accounting profit) of SSH and its different business units. In this exercise, WACC can be assumed to be 20%. As per the current accounting practice senior management salaries of different units are charged under Administrative Expenses (owing to confidentiality) which may act as a limitation to the computation of real profits of different units.

-End of Scenario II-

Market Attractiveness and Competitive Positions of different divisions of SSH

| Business Unit | Market Attractiveness Factor | Weight | Rating H-L | Business Strength Factor | Weight | Rating H-L |
|----------------------|-------------------------------------|---------------|-------------------|---------------------------------|---------------|-------------------|
| In-bound Travel | Overall market size | 0.3 | H | Market share | 0.4 | L |
| | Annual market growth rate | 0.3 | H | Brand reputation and promotions | 0.5 | L |
| | Historical profit margin | 0.4 | H | Quality of the offerings | 0.1 | H |
| | | | | | | |
| Domestic Travel | Overall market size | 0.5 | L | Strength of relationship | 0.5 | H |
| | Annual market growth rate | 0.4 | L | marketing | 0.1 | L |
| | Competitive intensity | 0.1 | L | Brand reputation | 0.4 | H |
| | | | | Promotional effectiveness | | |
| Outbound Travel | Overall market size | 0.5 | L | Operating cost efficiency | 0.4 | L |
| | Economic factors | 0.5 | L | Product quality | 0.4 | H |
| | | | | Promotional effectiveness | 0.2 | H |
| | | | | | | |
| Transport | Political stability | 0.7 | H | Technical soundness | 0.5 | H |
| | Long weekends | 0.3 | H | Ability to hire when idle | 0.5 | H |
| Guest-houses | Social factors | 0.35 | H | Product quality | 0.35 | H |
| | High income presence | 0.4 | H | Brand reputation | 0.35 | H |
| | Annual market growth rate | 0.25 | H | Capacity utilization | 0.3 | L |
| | | | | | | |

YOU ARE REQUIRED TO:

Read all the questions prior to answering. This will enable you to understand the associated interlinkages ahead of organizing and presenting answers.

Assuming your role to be that of the consultant appointed to advise and guide SSH Ltd. you are required to **prepare a brief consulting report** to be presented to the Board of Management. The necessary information for this exercise is to be taken from Scenarios I and II, findings of RG, assistant to the consultant, and the knowledge and skills acquired during the different courses of the study programme. The report shall take the sequence of the questions given below with connectivity inserted to make it a unified whole, while maintaining a logical and a smooth flow. You are also required to prepare a **covering letter** (with the TOR including purpose, method and areas covered) to be given prior to presenting the report.

The areas to be covered in the consulting report:

a) Critical assess the current state of affairs of the company via:

- i. A financial analysis to highlight the overall profitability, segmental profitability, and liquidity of the company; and
- ii. An interpretation of the grid on market attractiveness and competitive position.

(20 Marks)

b) Justify the viability of the proposed debt-servicing plan under the stated assumptions.

(15 Marks)

c) Advise how the 'real' profitability (using Economic Value Added) of the company and its divisions could be measured based on the performance of 2022.

(10 Marks)

d) Critically comment on the possible impact of the following on the current status of the company:

- i. Absence of a general manager;
- ii. The finance unit;
- iii. The human relations unit; and
- iv. MIS unit.

(10 Marks)

e) Identify five reasons, in addition to what was discussed in part (d), that would have driven the company (including matters arising from the liaison office) to its current status. **Recommend** strategies (corporate/ functional/ operational) for rectification of lapses observed.

(25 Marks)

f) In light of the information given above and the suggested strategy imperatives **recommend** changes (with rationale) to be introduced to the organization chart.

(10 Marks)

Overall presentation and the covering letter

Organized presentation with clearly structured sections/ paragraphs/ connectivity etc. and the cover letter will merit.

(10 Marks)

(Total 100 Marks)

-End of the Question Paper-