
Answers

Note

It is not always possible to publish suggested answers which comprehensively cover all the valid points which candidates might make. Credit will be given to candidates for points not included in the suggested answers, but which, nevertheless, are relevant to the requirements.

In addition, in this integrated case study examination points made in one question may be re-introduced or fully developed in other question(s) as long as these are made in the specific context of the requirements of the part of the question being answered.

The suggested answers presented below may give much more detail than would be expected from most candidates under examination conditions; they may also have used a particular approach or model which should not be taken as the only approach or model which could have been used. Different approaches and structuring of the answers are expected and full credit will be given for relevant and appropriate solutions to the tasks given. The answers provided here are therefore intended to support revision and tuition for future examinations.

Finally, it should be noted that candidates will not get full professional skills marks in a task requirement if they have not presented their answers according to the format asked for. For example, if a task is to be completed using a report and evaluation skills are tested, even if the answer has met the specifically stated evaluation criteria, candidates will not be able to earn all the professional skills marks available if they have not used the report format.

1 (a) Briefing paper: Environmental analysis

Introduction

The operating environment that *SmartWear* has been experiencing has been very challenging and could explain in part the reasons for the recent downturn in its business fortunes. Although competition will undoubtedly have a significant part to play, all businesses will have been exposed to the same general environmental conditions. So, gaining a better understanding of the environment will help the board to decide how best to successfully adapt the current operations of *SmartWear*, and take advantage of opportunities emerging from the external environment.

Political issues

The precarious situation of the coalition government in Noria has created a sense of uncertainty within the business community. Without confidence in political continuity, investors are less inclined to risk their money. This will make it more difficult for companies, like *SmartWear*, to raise the necessary finance to grow the business further, or even sustain its current position. The high levels of growth which had been previously achieved no longer appear to be achievable, so the *SmartWear* board may need to reconsider the company's strategic goals and focus on consolidating the company's position in the market during this difficult and uncertain political period.

Economic factors

The current record high levels of unemployment, high price inflation and a resultant deep recession does not help the retail sector in Noria. However, it is reasonable to assume that with less disposable income, consumers would be more inclined to purchase their clothing needs from value retailers like *SmartWear*. Indeed, the company has benefited from this economically-driven behavioural shift.

Should an economic recovery start next year, as suggested by the Finance Minister, then this would improve business prospects for all retailers in Noria. With rising employment and lower inflation, consumers may decide to return to more upmarket clothing retailers and away from low-end companies like *SmartWear*. The board should consider its international portfolio of businesses in order to manage the risk associated with diverse national economies, since currently inflation and unemployment in Southland is much lower than in Noria. Therefore, any planned strategic expansion should be in international markets rather than domestically.

Social developments

The demand from consumers for cheaper clothing has required these items to be sourced from low cost economies. There has become an expectation that clothing will remain low priced, which limits how companies like *SmartWear* can compete. This could increase the number of new entrants into the low end of the market and suggests that only those companies who are able to sustain high volume sales will succeed in the long run. The board needs to bear all of this in mind when it is considering its growth plans and deciding how best to satisfy consumer demands going forward.

Technological influences

The growth of e-commerce in the general retail sector has completely altered the competitive dynamic. Once developed, any online platform can be extended to include a variety of products, therefore new clothing e-retailers can emerge from previously non-competing businesses who have simply broadened their product offering. The resultant increased supply of clothing goods to the market with potentially contracting demand will put downward pressure on prices, squeezing the margins of all companies including *SmartWear*. The board is advised to consider the opportunities presented to *SmartWear* from developing and operating its own e-commerce platform, as this could allow for substantial revenue growth without the need to establish a costly network of retail outlets and would allow a rationalisation of the portfolio of physical retail outlets, to release funds and reduce operating costs.

(b) Major risks arising from the SmartWear business model

Operational risk

There is a high dependency on overseas suppliers to continually provide *SmartWear* with the necessary clothing items to sell in its European retail outlets. These manufacturers are based a considerable distance from the core sales markets, which can make the supply lead time very long and reduces the company's ability to respond to changing customer demands. This could lead to the added risk that if goods are over-ordered from the manufacturers then any surplus over demand may need to be sold at a discount, thereby reducing profitability.

To reduce the company's exposure to these operational risks, *SmartWear* needs to focus on the skills of the professional buyers who work closely with the marketing and sales teams to accurately predict the continuous demand levels for all clothing items. This should ensure that there is neither a 'stock-out' where any goods demanded are unavailable to customers, nor excessive inventory held. An effective inventory management system would provide information on levels of stock held in each retail outlet so that these could be internally re-distributed to meet volatile sales demands, rather than requiring new products to be ordered.

Strategic risk

The company currently pursues a cost leadership strategy which enables it to competitively price its products in its target markets; which has proved successful to date. However, cost leadership means that *SmartWear* must be the lowest cost supplier to the market, which is only possible if it can maintain high volume activities to absorb its cost base. However, with the growing emergence of e-retailers in the market, who do not need to employ sales staff or operate costly retail outlets, it threatens the fundamental cost effectiveness of the current *SmartWear* business model.

To mitigate these risks the board needs to rethink its whole strategic approach. It would not seem feasible for *SmartWear* to devise a strategy to differentiate its business, as this would cause brand confusion to its core customer base and require significant investment. Therefore, the emphasis should be on cost control, with any avoidable costs extracted from the business model. At the same time the company could continue to invest in those overseas markets which are more receptive to the current business model. This would result in further scale economies, particularly if non-core business functions are centralised rather than duplicated.

Foreign exchange risk

SmartWear currently operates in Noria and two other European countries, with their own currency. Also, the manufacturers of all *SmartWear* products are based in Asia and will expect payment in their functional currencies. Therefore, the current business model exposes the company to volatility in the relative movement of exchange rates which could potentially result in higher costs, consume excess cash and reduce corporate profitability. As a listed company in Noria, *SmartWear* will have to prepare its financial statements in the Norian currency. This requires the value of assets and liabilities held in each operating country to be translated to the Norian currency, again possibly negatively impacting on declared profit. As inflation in Noria is rising in comparison with the countries in which it obtains its supplies, there will be an upward pressure on direct costs. If foreign exchange risk is not managed effectively, any negative effect on reported performance could signal a reduction in *SmartWear*'s share price to the stock market and this would not be well received by investors.

To reduce the possible damaging consequences of foreign exchange movements on *SmartWear*'s business operations and reported performance, the board should ensure that it has effective treasury management. This will ensure that any transaction exposure, deemed too risky for the company, is hedged using appropriate financial instruments. To minimise any losses on translation of assets and liabilities from overseas operations matching could be employed, with *SmartWear* ensuring that liabilities are matched as closely as possible with assets for all of the different foreign currencies it deals in.

Competition risk

Competition is normally the greatest risk to any commercial organisation, since there is a limited amount of market available for all to compete in. The *SmartWear* business model has successfully positioned itself at the low end of its target market, where it has become the market leader. However, during the economic recession in Noria, it is likely that many established competitors will also seek to gain more of the lucrative budget-conscious end of the clothing market. This is directly targeting *SmartWear*'s dominant position, which has already resulted in an erosion in its market share. The risk is that unless action is taken by the board, the situation will worsen and *SmartWear* will cease to be market leader.

To limit the potential damaging effect of competition, *SmartWear* need to engage more closely with its customers. By anticipating and satisfying the changing demands from its core markets, the company can stay ahead of competition by successfully adjusting its marketing mix. Although there is no guarantee of customer loyalty, such a proactive approach will make the company more aware of the risks presented by competition and deal with them more effectively.

Market risk

This relates to the risk of changing conditions in the marketplace, such as the increasing tendency of consumers to shop online. This particular aspect of market risk presents significant challenges to traditional retail businesses like *SmartWear*, where failure to successfully adapt could make the current business model obsolete over a relatively short period of time.

To reduce the market risk, *SmartWear* needs to adapt and embrace the growing online shopping public as this could result in substantial revenue growth, which is core to achieving its strategic goals. The board needs to commission market research and evaluate the option to develop and manage its own online sales platform.

2 (a) Report

To: The Board
From: Consultant
Ref: Southland market

Introduction

This report provides an analysis of *SmartWear*'s strategic position in the Southland market, with a particular emphasis on why this specific country appears to be a suitable location for a clothing retailer, and discusses the implications of withdrawing from the market in Centrum.

Factor conditions

The basic and advanced factors describe the country's resources and how it chooses to invest in itself, which can often be relevant to the competitiveness of particular industries. The factors vary in nature and range from availability of human resources, levels of education and knowledge to infrastructure, liquidity on stock markets and available natural resources.

Although Southland does not have a particularly large population, around 60% are of working age and over 90% of these are in employment. This group will comprise the potential market for all clothing retailers, such as *SmartWear*, who could further refine and target the under 30-year-old age group. It is also clear that the country has extensive transportation links between its population centres, which is of critical importance for *SmartWear* in allowing goods to be moved to market cheaply and quickly.

Domestic demand conditions

Domestic demand conditions in any country can be a major source of competitive advantage for that country. It is not only the size of the market which is important, but also the relative sophistication of domestic customers. The configuration of a market often shapes how competitors interpret and respond to customers' demands, which in turn encourages companies to be innovative and enhance their competitive positions and meet the high standards required for service delivery.

The existence of a vibrant and competitive domestic retail industry in Southland is suggested because retailing is one of the country's dominant business sectors. Consequently, it is likely to have the positive characteristics which should make it an attractive proposition for *SmartWear* to operate its business model in.

Related and supporting industries

The success of any market depends both on the presence of suppliers and related support industries within the country. Therefore, apart from access to available sources of direct supply, a network of related and supporting organisations is equally important if a company is to succeed in a particular country. In the retail sector, where the companies only sell what others make, it is vital that there are reliable transport and distribution systems to continuously supply the retail outlets with goods for its shelves. Also, there needs to be well developed marketing media accessible to effectively promote the business offerings to a wide consumer audience.

Southland, being a developed European country with good transport links and concentrations of population in major cities, is very likely to have the right infrastructure to support a vibrant retail industry. The developed capital markets provide companies with a source of finance which is necessary to promote their business in a free market economy. Therefore, it seems to be an ideal location for *SmartWear* to further grow its business successfully.

Firm, strategy, structure and rivalry

This aspect is concerned with how businesses are organised and managed, and the culture they adopt to achieve corporate success. These can vary considerably between countries, with cultural aspects in particular significantly influencing how competition develops.

In Southland, where *SmartWear* now operates 30 retail outlets since it opened its first store six years ago, it is delivering significantly better financial performance than at home. This suggests that the *SmartWear* business model suits the retail environment and culture in Southland, so it is a suitable country to further grow the business.

(b) The decision to close the 20 worst performing retail outlets in Noria and withdraw and close all 15 stores in the country of Centrum, presents a number of strategic implications for *SmartWear*.

1. These closures represent a reduction of between 15% and 20% of current business operations. Although this does not necessarily equate to a similar reduction in revenue, and may improve overall reported profit, it will give the impression to the market that the business is contracting. As such it might be more difficult for the company to raise finance from new investors, particularly if the stock market reflects the perceived downsizing with a commensurate fall in share price.
2. The financial resources which would be released from the sale of any redundant property, as well as savings in running costs, could be reassigned to more lucrative and profitable areas of the business. Alternatively, these funds could be used to invest and grow the business in countries more conducive to the *SmartWear* business model, such as Southland.
3. The decision to close so many retail outlets at one time for purely financial reasons may prove very unsettling and disconcerting to employees not directly affected by the planned closures. In any service company like *SmartWear*, where they are heavily reliant on the performance of their employees, it is essential that staff remain closely engaged in the business at all times. Therefore, the board will need to be set aside sufficient resources for a change management

programme which not only covers the planned closures but also manages the remaining business, and communicates the rationale behind the decision to all key stakeholders. It might also be necessary for a public relations exercise to be conducted to preserve the company's reputation in the wider market place.

4. Withdrawing entirely from a country may have considerable implications on the company, both financially and legally. There will undoubtedly be statutory redundancy payments due, and these may be significant depending on the number of staff employed and their length of service. There may be a prescribed redundancy procedure to follow to ensure that the company is fully compliant with local employment law. There could also be residual taxation issues which need to be addressed before the *SmartWear* can repatriate its invested funds and completely withdraw from Centrum.

The ethical issues arising from the decision to both reduce activity in Noria close operations entirely in Centrum should be carefully considered as it is pragmatic, in a purely business sense.

1. *SmartWear* is currently incurring heavy losses, which can be attributed to the underperforming operations in Noria and Centrum and there are no reliable signs of recovery or turnaround. Consequently, the decision is in the best interests of the investors in *SmartWear*, to whom the board has a fiduciary duty. It would be unethical to continue to operate knowing that it is destroying business value and potentially harming other areas of the business.
2. The fairness of the decision depends on whose perspective is being considered. Those employees who are to be made redundant may consider that they have been treated unfairly by *SmartWear*, however, if objective criteria have been fairly and consistently applied when taking the decision, then the company cannot be accused of acting unethically. The fact that all affected retail outlets are to close means that all staff are to be made redundant, so in legal terms no employees are being unfairly dismissed.
3. There appears to be no legal reasons why the company cannot reduce its operations in Noria, withdraw from Centrum and make staff redundant. So, provided that *SmartWear* has strictly adhered to relevant employment legislation there is no legal impediment to taking this decision. The decision may ultimately preserve far more jobs elsewhere throughout the company over the long run. Therefore, on balance the decision is the ethically right course of action for the company if it will help it to prosper and remain a going concern.
4. The social footprint which would be left following *SmartWear's* withdrawal from Centrum may have residual damaging consequences for that country's economy. With rising unemployment, it is quite probable that the redundant staff will find it very difficult to obtain alternative employment.

Conclusion

Viewing all of the national influencing factors holistically, it is apparent that Southland offers a good business environment for a clothing retailer like *SmartWear*. Results over the first six years that *SmartWear* has been operating in this country illustrate that the market is well established and a good strategic fit for the *SmartWear's* business model. If the board is considering further growth opportunities then developing the Southland market further appears a suitable option to pursue.

The decision to reduce capacity in Noria and withdraw completely from Centrum seems, on balance, to be ethically acceptable. The consequences to those losing their jobs may seem harsh, but the outcome may ultimately deliver the greatest good to *SmartWear*, its investors and its many stakeholders.

3 Memo

To: Buying and merchandising director

From: Consultant

Ref: Supply chain management issues

Introduction

The recent internal audit report on the supply chain management arrangements at *SmartWear* highlighted a number of issues which require your immediate attention. There were three areas which clearly indicate internal control weaknesses with the procurement processes at *SmartWear* that illustrate operational inefficiencies and have negative impacts on the company's financial performance.

(i) Cost controls

As already stated, the buying of clothing from overseas suppliers comprises a significant proportion of the *SmartWear* cost structure. However, as the business is positioned at the low-price end of the market, the only way that margins can be sustained is through very effective cost control.

The internal audit report claims that a 'culture of carelessness' has developed among *SmartWear* buyers who do not engage closely with the clothing suppliers. The result is that the cost of individual supply contracts is not periodically reviewed or compared against industry averages, and only renegotiated when they come up for renewal after several years. This means that *SmartWear* could be incurring avoidable increases in its cost base, and a resultant erosion of gross margins. This is particularly damaging during the periods of economic difficulty when other structural costs are rising due to higher inflation, but the company is unable to raise its own selling prices to compensate without damaging its competitive position.

(ii) Corporate social responsibility issues

Supply contract terms and conditions stipulate minimum standards for the treatment of a supplier's workforce. However, recent reports have clearly indicated that some *SmartWear* suppliers have been in breach of this contract term, but the buying team

has not challenged these manufacturers' practices. This could be because the buying department is under pressure to maintain low costs, so they do not wish to impose additional costs on the suppliers who may attempt to pass these on to *SmartWear*.

A stated strategic goal of the company in its mission statement is to function at the highest standards of social responsibility, and to expect the same from its suppliers. It is therefore wholly unacceptable to knowingly permit such unethical practices to continue for financial expediency. This has been compounded because the issue was not reported to the board and now this association may damage the reputation of *SmartWear* with consumers and investors.

(iii) Poor reporting around supplier relationships

Key to any control system is regular and accurate reporting on performance so that any problems or serious issues can be identified and rectified without unnecessary delay. At *SmartWear* only those issues which are considered to be of a serious nature are brought to the attention of the board and senior management. However, the basis upon which the term 'serious' is defined is open to wide interpretation. The result is that low level staff are deciding which matters need to be escalated, and this in turn could lead to cover ups or business failures going unaddressed.

Procurement is a core function of the *SmartWear* business, since it accounts for a significant proportion of direct cost and so influences the company's profitability. The board, being accountable to the shareholders, must ensure that it safeguards corporate assets and maximises shareholder returns. However, in the absence of reliable and complete information the board is currently unable to discharge its duties effectively; this leaves the company's investors exposed to avoidable lower returns.

Recommended control improvements

Each of the procurement control weaknesses evaluated require an appropriate and immediate response from the board. The following recommendations are proposed for your further consideration:

(i) Cost controls

The buyers need to be tasked to be more proactive in their management of the supply contracts to ensure that the company is getting best value for money. Contract periods could be shortened to allow for any potential cost savings to be realised more frequently. The careful monitoring of the quality of the products manufactured and the efficient delivery of orders placed should ensure that the suppliers aim to continuously meet the terms of their contracts with *SmartWear*.

The buyers require carefully drafted job descriptions, setting out the expectations and competences needed to fulfil this important role at *SmartWear*. Management should then set individual objectives and targets, with performance-based rewards, to motivate the buying team to deliver results which will ultimately improve corporate performance.

(ii) Corporate social responsibility issues

Those suppliers who are in clear breach of their supply contract need to be formally advised that they must immediately bring the working conditions at their factories up to the minimum acceptable standard, or the contract will be cancelled. However, their remedial actions will need to be independently validated and that this might best be achieved through *SmartWear* auditors making periodic unannounced spot checks at supplier factories.

A concerted public relations effort will need to be made to reassure the buying public and investors that *SmartWear* has taken the necessary action to deal with the issue. This will require the drafting of a clearly worded statement communicated on the most appropriate media.

It is also important to stress to the buying department that although prudent financial management of the supply chain is key to business success, any unethical behaviour presents a major risk to the company.

(iii) Poor reporting around supplier relationships

Standardised procurement reports should be produced and submitted to senior management on a frequent basis. These reports must provide an update on all current supply contracts, and remove any subjectivity by defining the reporting parameters. This control will ensure that the procurement team do not become complacent and manage the supply chain effectively and in the best interests of the company. Through these reports the board will be fully aware of this important aspect of the *SmartWear* business model, and so can take appropriate action to optimise operational and financial performance.

4 Report

To: Board

From: Sales and marketing director

Ref: Benefits of a customer database system

Introduction

The evaluation of any major business investment must consider a wide range of strategic and operational factors, and it seems apparent from the current performance of *SmartWear* that the company is not effectively engaging with its customer base. The development of a customer relationship management [CDMS] system, which includes a customer loyalty programme, would help to attract new business, improve customer retention and yield more sales.

- (a) There are a number of benefits arising from the development of a customer database system (CDMS) for *SmartWear*, these include:

The primary purpose of a CDMS system is to help a business engage more effectively with its customer base, by helping everyone in the company better understand the needs of the and requirements of the customers. Without a thorough appreciation of each relationship, it will be difficult for *SmartWear* to exceed customer expectations and gain sustainable competitive advantage. The CDMS provides users with ready access to relevant data using a single common and controlled interface, wherever they work in the company including overseas operations. CDMS empowers users to deliver a more responsive service to customers, which ultimately contributes towards their increased retention through the associated loyalty scheme.

Through a better alignment of customers and core business processes, a CDMS system can help the company attain greater market share and grow more efficiently in its target markets.

The centralisation of customer and business process data offers the opportunity to convert these into meaningful decisions and profitable actions. Big data which accumulates in the CDMS system is not in itself a solution, but the basis for developing new insights which can be used to develop the business further. Having access to all customer and related business data in one database allows for timely and well-informed decisions to be taken which can enable the company to be more responsive to its core markets. A CDMS system will help *SmartWear* use this understanding of the marketplace and then to successfully target further growth.

CDMS technology allows all staff to get their work done anywhere and at any time, by providing a set of tools to improve customer relationships and the associated business process which matter. If the staff are unable to access customer data, they are unable to engage with customers, therefore by accessing the CDMS data remotely, it allows them to work at any location – so increasing their productivity.

Controlling access to sensitive customer information is critically important and is required by data protection legislation. This can be achieved by securely storing the CDMS database at one location in the cloud, which offers significantly greater protection compared to storing customer data locally in spreadsheets or on multiple systems. Through high level security and automatic back-up, this data can be protected from unexpected and unforeseen events. CDMS security profiles and settings enforce controls so that both teams and individual users have appropriate permissions to access records consistent with their role.

- (b) It is essential that the investment is also acceptable in financial terms by delivering enhanced returns to shareholders. The financial appraisal illustrates that the new system will deliver a net present value [NPV] of \$7 million during the first five years of its operation, and this yields an 18.4% return on the initial cash outlay. However, this NPV computation is based on a number of underlying assumptions which are questionable in terms of their accuracy and relevance.

1. Contribution, being the excess revenue generated after variable costs have been deducted is also constant at \$22 million throughout the five-year period. The estimated amount is questionable because it would be highly unlikely that such a large benefit could be gained in the first year. It is also unlikely that it would be a constant amount over the whole period, as it should reflect the company's forecast sales profile, which should be assumed to rise each year, as this is fundamental to the justification of the CDMS investment. This amount will also be impacted by inflationary pressure, and for both these reasons these benefits should be forecast to rise annually from a lower initial figure over the five-year period under consideration.
2. The total investment figure of \$38 million includes the cost of a five-year maintenance and support contract. It is more likely that the agreement is to pay a maintenance charge each year rather than the whole amount at the start of the five-year period, therefore this cost should have been spread evenly over the duration of the contract period by allocating 20% of the total contract sum to each of the five periods. The terms of the agreement need to be reviewed so that this can be clarified.
3. It is known that during periods of economic recession inflation can run quite high. Despite this the costs of operating the CDMS is set at a constant level of \$2 million each year. This is quite unrealistic and unless all prices and costs are expressed in money terms rather than real terms, the marginal effects must be accurately reflected in the cash flows.
4. The 8% interest payable on the loan should not be included as a separate cash flow item since it is part of the financing decision and is included within the discount factor. This means that using the current weighted average cost of capital is not truly reflective of the financial risk associated with the investment. However, if interest costs are included in the cash outflows, the equity cost of capital, not the weighted average cost of capital, should be used in the computation. However, the equity cost of capital, which would be at a higher rate, due to the financial risk it incorporates, is not available in the case information.

5. Corporation tax is correctly charged [or refunded] against net cash flows. However, the tax rules regarding this type of investment need to be considered as it might be possible to claim allowances. These have not been considered or included in the NPV computation, but could be a significant financial incentive for *SmartWear*. Any allowances claimed would increase the post-tax next cash flows and improve the resultant NPV.
6. It is probable that there would need to be an injection of additional working capital to operate the CDMS post-implementation, and this is a relevant cash flow. However, as this is viewed as a five-year project, the additional working capital invested would be returned to *SmartWear* at the end of time period 5.

Conclusion

By developing a CDMS strategy *SmartWear* should be able to significantly increase the revenue generated from all of its markets, thereby turning around those currently poorly performing areas. Using the data collected, more effective and targeted marketing campaigns can be conducted, helping the company to promote its products to new customers. This will generate a new revenue stream and help to deliver the stated strategic goal to grow in all core markets.

After applying the adjustments to the NPV computation suggested above, the board needs to compare the costs and benefits of the new CDMS system against the current arrangements. Clearly there are risks associated with any business decision. However, it is apparent that the risk of doing nothing seems far greater. The opinion of the institutional investor, discussed at the recent board meeting, suggesting that *SmartWear* was becoming too remote from its core markets, provides some justification for changing the current system.

- 5 Note that a typical candidate may only make 5–6 bullet points, but this answer includes a comprehensive range of points, some of which a well prepared candidate might have made.

(a) Board presentation on integrated thinking

Slide 1

Benefits of Integrated Thinking	
1.	Holistic and strategic perspective
2.	Long v short term outlook
3.	Improved corporate reputation
4.	Better corporate governance
5.	Increased employee engagement
6.	Enhanced stakeholder management
7.	Transparent and effective communication
8.	Effective risk management
9.	Increased connectivity

Notes:

1. By taking a holistic or integrated approach, the board of *SmartWear* is provided with a full range of inter-related factors which allows it to focus on creating sustainable business value from a strategic perspective. The strategic focus and future provides great insight into the interdependency between strategy, the business model and value creation. To help the board turn around the business and create value, it should adopt integrated thinking as this will enable the alignment of the low cost-low price business model to the changing market opportunities and enable the company to improve performance sustainably.
2. The board needs to devise and implement a successful strategy which focuses attention on key business issues which drive performance and value creation in the long term so that it can turn around business fortunes. Integrated thinking utilises a broader information base than traditional business decision-making, which tends to focus on relatively short-term financial outcomes. The board's decision on whether or not to implement the proposed CDMS must be based on a range of integrated issues, and not simply the appraised financial outcome.
3. Joined up thinking which results in better performance can be used to promote and market the business more widely. This will strengthen the corporate image and reputation of *SmartWear* and could allow it to capture even greater market share, as well as consolidating its dominant position in the market place. There is a direct correlation between brand value, good reputation and business value; so the shareholders will ultimately benefit for this approach.
4. Integrated thinking can lead to improvements in the governance arrangements in *SmartWear* by enhancing accountability over a broad base of business capitals as well as encouraging a greater understanding of their interdependencies. The resultant better corporate governance should offer greater assurance to shareholders that the board is acting in their best interests through the careful stewardship of all business assets.
5. At *SmartWear*, employees can make a very valuable contribution to the operational effectiveness of the company. The knowledge and capabilities of employees must be developed and utilised to best effect, and this can best be achieved through integrated thinking. This management approach actively encourages employee engagement in all aspect of business activity such as better engagement with customers via CDMS and empowers individuals to contribute to the delivery of higher levels of performance.

6. Successful stakeholder management is vital for any successful business, as it enables the company to respond to the demands of its key stakeholders quickly and effectively. Integrated thinking contributes to good relationships with key stakeholders as it considers how and to what extent the company understands, takes into account, and responds to their legitimate needs and interests.
7. Integrated thinking requires the continuous transfer of information throughout the company, and so by default improves the lines and nature of internal communication. This more transparent approach will improve inter-departmental cooperation and enhance the efficiency and effectiveness of business operations. This should reduce avoidable and unnecessary costs being incurred and improve *SmartWear*'s financial performance.
8. Many investors struggle to understand how managing the relevant risk factors contributes to value creation over time into investment decisions, because the information which is often presented is insufficiently strategic, comparable and sector specific. As a result, there is the risk that capital is not being directed efficiently towards retail models at *SmartWear* which create rather than destroy value.
9. Two of the biggest challenges faced by any company are breaking down organisational silos and changing existing data capture processes. Integrated thinking will challenge these entrenched behaviours allowing for improved connectivity of people and information, thereby giving the board a holistic view of the interrelated and dependent factors which affect *SmartWear*'s ability to create value over time.

(b) Briefing paper for CFO

Introduction

The integrated reporting <IR> framework is a more informative model of external reporting to stakeholders, as it gives them a broader and richer picture of the organisation and how value can be created in the longer term and in a more sustainable way. It therefore gives them a better basis for decision-making and whether to buy, hold or sell their investments.

I will now brief you on why shareholders will find this a more useful model. Essentially it is because the <IR> framework of external reporting focuses on a wider range of sources of value creation than the traditional reporting model which concentrates mostly on financial information. It is based on the concept that there are a wider range of capitals which the organisation has control or influence over and how maintenance and development of these capitals over the short and longer term can affect and create value in other capitals, including financial capital.

The primary purpose of <IR> is to improve the quality of information available to providers of financial capital, including investors, by communicating broader and more relevant information which can assist them in their investment decisions. The *SmartWear* board has decided that an effective way to promote integrated thinking throughout the company is to implement a version of the <IR> framework. This will encourage more holistic thinking about the suitability of various strategic approaches which both grasp business opportunities and mitigate business risks, while building greater investor and stakeholder confidence in the company. Indeed, by improving internal management processes, <IR> can also lead to greater trust and credibility with customers – and this is key to *SmartWear*'s future success.

The <IR> framework comprises six different reporting components or capitals as they are referred to. When considered in an integrative manner these capitals will provide a more complete appraisal of *SmartWear*'s performance to investors, and other users of corporate information, and allow the board to make more informed strategic decisions.

Financial capital refers to the pool of funds which are available to *SmartWear*, including both debt and equity finance. The focus here is on sourcing necessary funds, rather than their application in the business. However, investors will want to know how financial capital has been deployed in the past, and what the future plans based around a holistic and well-rounded strategy might be. With more integrated thinking and management <IR> provides far greater clarity on core business issues and performance, which can be very reassuring to investors.

Intellectual capital is fundamental to future earning potential, linking investment, innovation, knowledge management and managing external relationships to the delivery of competitive advantage. The careful management of supplier networks and understanding the changing market conditions, through the new CDMS system, will demonstrate a good use of intellectual capital in *SmartWear*. Effective development of intellectual capital leads to innovation and investment in resources which can have a longer term and more sustainable benefit for financial capital.

Human capital consists of the capabilities, knowledge, skills and experience of the company's employees and management. This is particularly important to a service organisation like *SmartWear*, as retailers are reliant on their staff to generate business value. Understanding the importance of human capital in *SmartWear* should focus management attention on developing talent and realising the financial benefits of investing in our human resources.

Social and relationship capital at *SmartWear* relates specifically to the strength and efficacy of supply chain relationships and customer loyalty. It is only by building such relationships that a retail company can operate as a successful business. The proposed changes to improve supply chain management arrangements alongside the development of the new CDMS system will enhance social and relationship capital in *SmartWear*. Building social capital internally and externally leads to more motivated and productive workforce and engaged, loyal and profitable customers.

Natural capital refers to any inventory of natural resources or environmental assets which could provide a flow of useful goods or services, both now and in the future. The promotion of a strong social and environmental responsibility ethos in the *SmartWear* will strengthen its reputation among consumer and the investment communities, such as adopting a responsible purchasing policy of sourcing local products, where possible, and using suppliers which have a more responsible attitude to

product packaging and environmental management. A better reputation in these areas will make the company more attractive to invest in and do business with leading to an increase in financial capital over the longer term, regardless of the short-term costs of following such policies.

1 (a) Up to 2 marks for each well-developed aspect of general environmental analysis such as the suitable use of PEST, or PESTLE, SWOT.
 (Up to a maximum of 10 marks)

(b) Up to 2 marks for each major risk facing *SmartWear* assessed, including the following:

- Operational risk
- Strategic risk
- Foreign exchange risk
- Competition risk
- Market risk

(Up to a maximum of 6 marks)

Up to 2 marks for each relevant mitigation to an assessed major risk facing *SmartWear*, such as those listed above.

(Up to a maximum of 6 marks)

(Up to a maximum of 10 marks in total)

Professional skills may be additionally rewarded as in the following rubric:

How well has the candidate demonstrated professional skills as follows:	Not at all	Not so well	Quite well	Very well
1 Professional skills marks are available for evaluation skills by appraising and assessing the identified risks at SmartWear objectively before relevant solutions are suggested.	<i>The candidate has failed to demonstrate evaluation skills.</i> <i>The candidate has omitted significant areas of risk from the answer, and has shown no professional judgement in explaining how to mitigate those risks that were assessed.</i>	<i>The candidate has demonstrated some limited evaluation skills.</i> <i>The candidate has attempted to assess some risks facing SmartWear and suggested some relevant mitigating actions.</i> <i>However, the candidate has omitted some of the most significant risks and failed to clearly explain their consequences to SmartWear.</i> <i>Also the candidate did not make reasonable or sensible recommendations to mitigate the risk assessed.</i>	<i>The candidate has demonstrated good evaluation skills.</i> <i>The candidate clearly attempted to assess some of the most significant risks facing SmartWear at this time and suggested some appropriate actions to mitigate their damaging consequences.</i> <i>However, more care and attention should have been applied to assess and control those risks that specifically related to the SmartWear business model.</i> <i>The answer has been presented in a briefing paper format.</i>	<i>The candidate has demonstrated excellent evaluation skills.</i> <i>The candidate assessed the most significant risks facing SmartWear and its business model.</i> <i>The candidate recommended mitigation actions that are both proportionate and will effectively address the major risks assessed.</i> <i>The answer has been presented in a briefing paper format.</i>
	0	1	3	4

- 2 (a)** Up to 2 marks for the analysis of each aspect of *SmartWear's* performance in the country of Southland using the information provided:
- Factor conditions
 - Domestic demand conditions
 - Related and supporting industries
 - Firm strategy and competitive rivalry
- (Up to a maximum of 8 marks)

- (b)** Up to 2 marks for each strategic and or ethical implication arising from the decision:

- Perceptions of divestment as a strategy
- Increased profitability due to cost savings
- Financial resources released for more productive activities
- Effect on employees and social footprint from unemployment
- Legal and regulatory issues
- Maximum of 8 marks for strategic issues
- Maximum of 8 marks for ethical issues

(Up to a maximum of 12 marks)

Professional skills may be additionally rewarded as in the following rubric:

How well has the candidate demonstrated professional skills as follows:	Not at all	Not so well	Quite well	Very well
2 (a) Professional skills marks are available analysis skills by the careful consideration of information and findings, and reflecting on how they can be used to understand SmartWear's strategic position in the Southland market.	<i>The candidate demonstrated poor or no analysis skills.</i> <i>The candidate failed to identify or use the data required to analyse SmartWear's strategic position in the Southland market.</i> <i>Those analytical points that were made were not supported by the evidence provided in the case study.</i>	<i>The candidate demonstrated limited analysis skills.</i> <i>The candidate has identified some of the data provided in order to analyse SmartWear's strategic position in the Southland market.</i> <i>However, the structure of the answer was not very clear or easy to follow.</i>	<i>The candidate demonstrated good analysis skills.</i> <i>The candidate has presented a report which has identified most of the data necessary to analyse SmartWear's strategic position in the Southland market.</i> <i>The candidate attempted to structure the analysis in a coherent and logical way, which made it fairly easy for members of the SmartWear board to follow.</i>	<i>The candidate demonstrated excellent analysis skills.</i> <i>The candidate has presented a report which has identified and used the most important and relevant data to analyse SmartWear's strategic position in the Southland market.</i> <i>The candidate provided an answer that was structured and presented in a way that made it user-friendly for the SmartWear board.</i>
	0	0.5	1	2

How well has the candidate demonstrated professional skills as follows:	Not at all	Not so well	Quite well	Very well
2 (b) Professional skills marks are available for applying scepticism by probing deeply into the underlying issues and problems that may arise from this strategic decision, beyond what is immediately apparent.	<p><i>The candidate has failed to demonstrate any real scepticism.</i></p> <p><i>The candidate merely identified a number of strategic and/or ethical issues without into how they related to – or arose from – the decision taken.</i></p>	<p><i>The candidate has demonstrated some limited scepticism.</i></p> <p><i>The candidate attempted to probe into some of the strategic and/or ethical implications of the closure decision taken by the SmartWear board.</i></p> <p><i>However, the tone of the answer fell short of the level of scepticism expected.</i></p>	<p><i>The candidate demonstrated a good level of scepticism.</i></p> <p><i>The candidate has identified and clearly explained most of the strategic issues and ethical concerns that may arise from the closure decision taken by the SmartWear board.</i></p> <p><i>The answer provided offered reasonable balance and depth of discussion.</i></p>	<p><i>The candidate demonstrated an excellent level of scepticism.</i></p> <p><i>The candidate has identified and clearly explained the main strategic issues and ethical concerns that are likely from the closure decision taken by the SmartWear board.</i></p> <p><i>The answer focused directly on the implications to SmartWear as a business, and the positive and negative impacts the decision will have on its stakeholders.</i></p>
	0	0.5	1	2

- 3** Up to 2 marks for the evaluation of the internal control at *SmartWear* in each area identified in the internal audit report. [Max 2 marks per issue]

The candidate may deal with the issues and the recommendations together:

- Cost control issues
- Corporate and social responsibility issues
- Reporting and supplier relationship issues

(Up to a maximum of 6 marks in total)

Up to 2 marks per recommended improvement to each of the areas of control weakness identified, such as within those headings listed above. [Max 2 marks per recommendation]

(Up to a maximum of 6 marks)

Professional skills may be additionally rewarded as in the following rubric:

How well has the candidate demonstrated professional skills as follows:	Not at all	Not so well	Quite well	Very well
3 Professional skills marks are available for commercial acumen by using professional judgement when recommending solutions to those issues highlighted in the internal audit report.	<i>The candidate has not demonstrated commercial acumen. The candidate made no attempt to link the internal control issues in the audit report to the associated improvements.</i>	<i>The candidate has demonstrated limited commercial acumen. The candidate made some attempt to evaluate the issues and recommend improvements but did not extract these from the report. Then answer lacked a coherent and logical structure.</i>	<i>The candidate has demonstrated good commercial acumen. The candidate mainly used the information contained in the report to evaluate the internal control problems and recommended control improvements. The answer was a memo but could have been structured and presented more clearly for the benefit of the buying and merchandising director.</i>	<i>The candidate has demonstrated excellent commercial acumen skills. The candidate correctly used the information contained in the report to evaluate the internal control problems and provided sensible recommended control improvements. The answer was a memo which was structured logically and targeted at the needs of the buying and merchandising director.</i>
	0	1	2	4

4 (a) Up 2 marks for benefit of a customer database management system:

- Engaging more effectively with customers to create loyalty
- Harnessing the benefits of big data for analysis and decision-making
- More flexible ways of working
- Data security

(Up to a maximum of 6 marks in total)

(b) Up 2 marks for each developed point about any errors, assumptions or omissions identified in the CDMS investment appraisal:

- Inherent unreliability of cash flow forecasting
- Optimistic assumption of early year benefits
- Assumption of constantly accruing benefits
- Assumption that maintenance and support would be paid for in one year
- Assumptions around constancy of the CDMS operating costs
- Including finance costs when discounting by WACC
- Impact of capital allowances on cash flows

(Up to a maximum of 10 marks in total)

Professional skills may be additionally rewarded as in the following rubric:

How well has the candidate demonstrated professional skills as follows:	Not at all	Not so well	Quite well	Very well
4 (a) Commercial acumen by demonstrating the benefits of introducing a CDMS system at SmartWear.	<i>The candidate has not shown commercial acumen.</i> <i>The candidate has not made any attempt to link the benefits of introducing a CDMS to the current situation at SmartWear.</i>	<i>The candidate has shown limited commercial acumen.</i> <i>The candidate made some attempt to link the benefits of introducing a CDMS to the situation at SmartWear.</i> <i>However, the candidate has not tailored the response specifically to the needs of the sales and marketing director.</i>	<i>The candidate has shown good commercial acumen.</i> <i>The candidate has explained the benefits of introducing a CDMS to the situation at SmartWear and made a concerted effort to address the needs of the sales and marketing director.</i> <i>The answer is in report format.</i>	<i>The candidate has shown excellent commercial acumen.</i> <i>The candidate has strongly described the benefits of introducing a CDMS to the situation at SmartWear, with respect to the current position that they find themselves in.</i> <i>The candidate clearly considered the issues from the perspective of the sales and marketing director.</i> <i>The answer is in report format.</i>
	0	0.5	1	2

How well has the candidate demonstrated professional skills as follows:	Not at all	Not so well	Quite well	Very well
4 (b) Scepticism skills by questioning the facts presented, as sufficient evidence to support the NPV computation.	<p><i>The candidate demonstrated no scepticism.</i></p> <p><i>The candidate has failed to identify important omissions from the NPV computation contents.</i></p> <p><i>The candidate has not challenged the underlying assumptions.</i></p>	<p><i>The candidate demonstrated limited scepticism.</i></p> <p><i>The candidate has identified some of the omissions and errors from the NPV computation.</i></p> <p><i>The candidate made a limited attempt to challenge some of the wrong underlying assumptions but was not overly convincing.</i></p>	<p><i>The candidate demonstrated good scepticism.</i></p> <p><i>The candidate's report has identified most of the important omissions and errors from the NPV computation and explained them fairly clearly in the answer.</i></p> <p><i>The candidate challenged most of the wrong underlying assumptions.</i></p>	<p><i>The candidate demonstrated excellent scepticism.</i></p> <p><i>The candidate's report identified all of major omissions and errors from the NPV computation.</i></p> <p><i>The candidate challenged the main incorrect underlying assumptions coherently, logically and convincingly.</i></p>
	0	0.5	1	2

- 5 (a)** One mark per bullet point and accompanying explanatory note for the slide about how integrated thinking contributes to the creation of long-term value at *SmartWear*:
- Holistic perspective
 - Consideration of short and long term
 - Adding value
 - Sustainable growth
 - Improved reputation and governance
 - Connectivity

(Up to a maximum of 6 marks)

- (b)** Up to 2 marks for fully explaining each aspect of <IR> integrated reporting to the finance team and how each would lead to creating long term shareholder value for *SmartWear* investors.

- Financial capital
- Intellectual capital
- Human capital
- Social capital
- Natural capital

(Up to a maximum of 6 marks)

Professional skills may be additionally rewarded as in the following rubric:

How well has the candidate demonstrated professional skills as follows:	Not at all	Not so well	Quite well	Very well
<p>5</p> <p><i>Communication skills and the ability to persuade investors using compelling and logical arguments about integrated thinking.</i></p> <p><i>Persuade using compelling and logical arguments demonstrating the ability to counter argue when appropriate.</i></p>	<p><i>The candidate demonstrated poor communication skills, and failed to present the information clearly in an unambiguous way.</i></p> <p><i>The candidate did not communicate effectively to the audience.</i></p>	<p><i>The candidate demonstrated some basic communication skills.</i></p> <p><i>However, the candidate's statement did not adopt an appropriate tone for communication to the audience.</i></p>	<p><i>The candidate demonstrated good communication skills.</i></p> <p><i>The candidate has presented the answer in a suitable format for the audience, both with the slides and briefing paper.</i></p> <p><i>The tone and style adopted is appropriate for effective communication to board.</i></p>	<p><i>The candidate demonstrated excellent communication skills.</i></p> <p><i>The candidate provided slides and notes that communicated the main facts about integrated thinking to the board.</i></p> <p><i>The notes were structured in a way that was both informative to the audience and would have been convincing to shareholders about the merit of adopting <IR>.</i></p>
	0	0.5	1	2