

Case study question bank

Contents

Chapter 1 - Activity 1 – HW Inc. Approach to Strategy	2
Chapter 2 - Activity 2 – HW Inc. Vision and mission.....	2
Chapter 3 - Activity 3 - HW Inc. environmental analysis	2
Chapter 4 - Activity 4 - HW Inc. Portfolio analysis	3
Chapter 4 - Activity 5 – HW Inc. Customer Profitability Analysis.....	6
Chapter 4 - Activity 6 – HW Inc. Value creation system	8
Chapter 4 - Activity 7 – HW Inc. Financial analysis.....	8
Chapter 5 - Activity 8 – HW Inc. SWOT analysis	9
Chapter 6 - Activity 9 – HW Inc. Competitive strategies.....	10
Chapter 6 - Activity 10 - ABC factory-made picnic tables	12
Chapter 6 - Activity 11 - TDABC and call centers.....	13
Chapter 6 - Activity 12 – HW Inc. Cost of quality	14
Chapter 7 - Activity 13 – HW Inc. International expansion	17
Chapter 7 - Activity 14 – HW Inc. Joint development	19
Chapter 7 - Activity 15 – HW Inc. Growth strategies	21
Chapter 8 - Activity 16 – HW Inc. Investment appraisal and stakeholders.....	24
Chapter 8 - Activity 17 – HW Inc. Investment appraisal	27
Chapter 9 - Activity 18 - HW Inc. Strategic implementation	28
Chapter 10 - Activity 19 – HW Inc. Balanced scorecard	29
Chapter 10 - Activity 20 – HW Inc. Critical success factors and performance management .	32
Chapter 10 - Activity 21 – HW Inc. Economic value added	35
Chapter 10 - Activity 22 – HW Inc. Transfer pricing.....	37
Chapter 10 - Activity 23 – HW Inc. Benchmarking	39
Chapter 10 - Activity 24 – HW Inc. Divisional performance RoI and R.I.....	40
Chapter 11 - Activity 25 – HW Inc. Sustainability.....	42
Chapter 11 - Activity 26 – HW Inc. Sustainability and the accountant.....	45

Chapter 1 - Activity 1 – HW Inc. Approach to Strategy

This activity refers to the case of HW Inc., described in Appendix A of this learning resource.

Read sections A1 to A8 to familiarize yourself with the case. Then focusing more on sections A5 – A8, determine whether you think that HW Inc. has adopted a rational approach to strategic management? Do you believe that HW Inc. is taking an outside-in or an inside-out approach? Is there any evidence of emergent strategies? Give reasons for your assessment citing evidence from the case study information.

[Note: There is no one right answer to these questions as there is often a degree of subjectivity in how the information is interpreted. It is important, therefore, that you adopt the practice of justifying your views with supporting evidence.]

Chapter 2 - Activity 2 – HW Inc. Vision and mission

Turn to Appendix A of this learning resource, read the section A1 and attempt the following activity.

- Evaluate the vision, mission, and values statement of HW Inc. (Hint: use the framework by Campbell et al. (1990) or that of Lynch (2003) from section 2.3)
- What does this imply for the management accounting information requirements of the management team at HW Inc.?

Chapter 3 - Activity 3 - HW Inc. environmental analysis

Turn to Appendix A of this learning resource, read sections A.2 – A.3, and attempt the following activity.

- (a) Using the frameworks of PESTEL and Porter's five forces model, undertake an analysis of the business environment in which HW Inc. is currently operating.
- (b) What do you think are the key challenges facing HW Inc?
- (c) Critically evaluate how the management accountant of HW Inc. can contribute to the activity of environment analysis.

Chapter 4 - Activity 4 - HW Inc. Portfolio analysis

Boston Consulting Group portfolio analysis

Reece Jones, one of the independent members of the senior management team, has suggested that HW Inc. could use the Boston Consulting Group matrix to help assess its strategy at both company and store level. You have been asked to illustrate how the analysis could aid decision making about products and product groups within the company.

You have done a quick analysis and accessed the following information with which you could illustrate the principle behind the BCG portfolio analysis and how it might be used to aid decision making.

HW Inc. sells goods and services that can be categorized as: Home and Garden, Clothing, Electricals, Interior Design, and Financial Services.

You have worked closely with the marketing team at head office and ascertained that the sales of HW U.S., in relation to the total market, for the various categories in the U.S., is as shown in Table 4.4.

Table 4.4 Market share and market growth information

Category of goods and services	HW market share %	Market share of nearest competitor %	Market growth rate %
Home and Garden	15%	10%	12% - beginning to slow
Clothing	7.5%	10%	5% - and continuing at similar levels
Electricals	5%	4%	7% - but becoming highly competitive
Interior Design	2%	8%	30% - growth is linked to a trend among middle-aged couples
Financial Services	1%	5%	20% - looks as if this will continue, but the sector could become subject to increased government regulations

Other information provided on business units is as follows.

HW Inc. retail stores

The retail stores have not been as profitable in recent years as the market has become extremely competitive, and customers are becoming more sophisticated and demanding in their expectations. One way in which HW Inc. has attempted to compete is always to offer the latest products. This makes inventory obsolescence an issue. Judging the amount of inventory to hold to satisfy customer demand, without having massive inventory write-offs, can be difficult. Inventory management is a problem in the clothing market where products are seasonal, for example, summer range, winter range, and so on. This sector is also heavily influenced by the latest fashions. However, a new inventory management system is helping with the problem. The growth of the 'click and collect' service is working well and, along with online sales, is set to grow in the future in all product groups.

The use of concessions (companies that effectively rent space in the HW Inc. stores) also enables HW Inc. to provide a wide range of products to its customers. HW Inc. plans to try and increase the number of concessions in the next few years as it shares some of the risks between the partner companies. However, HW Inc. does not want to diminish the HW brand as they also plan to continue to develop and sell their "own brand" products. They also wish to retain their manufacturing capability as this provides a useful diversification from retailing and enables more control over the quality of certain product lines in which they have a manufacturing capability.

Clothing sales have been slowing in recent years, but the furniture sales are strong. The electrical goods market is competitive, particularly the audio-visual and kitchen aids ranges. The increased competition in the specialist electrical goods retailers has also hit the departmental stores such as HW Inc., along with the need always to offer the latest products highlighting the need for proper inventory management.

HW Inc. Interior Design

HW Inc. Interior Design has a range of corporate clients as well as retail customers. The design team copes with a variety of projects from single room design such as kitchen design for residential customers, to working with property developers and architects on both commercial and residential large-scale projects. They source products used in their designs from HW Inc. and a large number of other companies. They have a significant degree of autonomy over which products to recommend and are not necessarily tied to HW Inc. However, they always consider HW Inc. products and recommend them where they are suitable.

Dealing with several other companies helps the HW Inc. research and development team, who look after the HW Inc. product range, as the Interior Design division can gather and feedback information about the products of other manufacturers, and also customer trends. The Interior Design team are keen to expand their business and are looking to increase the number of corporate clients. In particular, they plan to target the state-owned and education sectors over the next few years. To do this, they will need to expand their design team and recruit additional staff with appropriate experience in those sectors.

HW Inc. Financial Services

The Financial Services division is seeking to increase the number of credit card customers over the next few years and is also planning to diversify into insurance products. The division already offers extended guarantees and insurance on products sold in the HW Inc. stores, particularly on electrical goods, such as fridges, washing machines, TVs, and computers. The management team is thinking of expanding into life insurance, travel insurance, car insurance, and home and contents insurance. It is a competitive market, but they believe that the volume necessary to breakeven on these products could be achieved if they can attract existing HW Inc. customers and build on the reputation of the HW brand. This will then provide a stable platform on which to expand the business in the future.

More recently, they have seen the administration costs increase, and the management team have highlighted this as an area where improvements could be made, perhaps via a benchmarking exercise. They also recognize that an increase in business will require an increase in qualified staff, and by adding a range of new products, it will create the need for additional training of the existing team.

HW Inc. product development and manufacturing

This division has seen material costs increase in recent years, and they are looking at the supplier relations to see if any savings can be made on the cost of materials. The division does not see a significant increase in business over the next few years but is seeking to maintain volumes at existing levels to retain the manufacturing capability, and within this to keep the product range up to date. This means replacing existing product designs with more up to date designs rather than developing entirely new product ranges. They see the next few years as being a consolidation of the division. Control of costs will be essential, and reviewing manufacturing methods is seen as part of that process, but they do not intend to spend a lot of new capital investment in plant and equipment. They feel that there is scope to improve in areas such as waste management, energy costs, productivity, and inventory management.

Activity requirements:

- (a) Critically evaluate the usefulness of using portfolio analysis, such as the Boston Consulting Group (BCG) matrix, in developing strategies to manage diverse organizations such as HW Inc.
- (b) Using the BCG matrix, analyze and comment on the portfolio of products and markets in which HW Inc. operates.
- (c) Briefly outline the financial controls that could be used to monitor and assess products in each category of the BCG.

Chapter 4 - Activity 5 – HW Inc. Customer Profitability Analysis

HW Inc. has found that a successful strategy of entering new markets and establishing the brand name is via mail-order or online catalog shopping. This keeps overheads low while building the brand and testing the market before opening high street stores. HW Inc. adopted this strategy in some areas of Africa by marketing clothing and accessories via a catalog and flyers. This worked reasonably well, and several stores have since been opened, but the mail-order side of the business is still quite strong. However, the operations director has become concerned about the growing marketing, distribution, selling, and administration costs of this activity.

The management team of HW Africa examined its customer ordering patterns for the past year and identified four different types of customers, as illustrated in Table 4.5. Much of the marketing is based around sending catalogs and flyers to all its customers several times a year. Orders are taken by mail, over the telephone, and more recently online. However, because of poor internet services in some areas, phone and mail orders are still used by a large number of customers. HW Africa maintains a Freephone number for customers to use when placing orders over the telephone, and, in keeping with its customer service promise, HW Africa prides itself on the personal attention it provides shoppers who order over the phone. All purchases are paid for by cheque or credit card. HW Africa has a very generous return policy if customers are not satisfied with the merchandise received. Customers use a pre-paid delivery service to return their unwanted items, which is paid for by HW Africa.

For ease of calculation, costs shown in Table 4.5 are provided in \$ amounts, but the local currency applicable to the specific country is quoted on the local websites.

Table 4.5 Sales and costs to serve for different types of customer

	Customer type 1	Customer type 2	Customer type 3	Customer type 4	Customer type 5
Initial sales	\$1,000	\$1,000	\$2,500	\$3,000	\$1,500
Number of items returned	0	4	2	14	2
Dollar value of items returned	0	\$200	\$500	\$1,500	\$250
Total number of orders per year – note each order is delivered separately	1	6	4	12	2
Analysis of the total number of orders by type					
Number of telephone orders per year included in total	1	0	0	12	0
Number of mail orders per year included in total	0	6	4	0	0
Number of online orders per year included in total	0	0	0	0	2

	Customer type 1	Customer type 2	Customer type 3	Customer type 4	Customer type 5
Average time spent on dealing with each phone order from customers; that is, time per order	15 mins	0	0	5 mins	0
Number of special deliveries	1	0	0	12	0
Number of regular deliveries	0	6	4	0	2

Prices are set so that the cost of goods sold is, on average, about 75% of the sales price. Note that returns are made at full sales value, so the cost of goods applicable is based on net sales, that is, initial sales less returns. HW Africa pays for the delivery costs of items (a small amount is built into the price of the product to cover the cost of deliveries), so delivery is free to the customer. Standard delivery is within 3 or 4 working days. However, if customers request a next day delivery or a weekend delivery, HW Africa makes a charge to the customer equivalent to the additional cost incurred. That is, HW still pays the standard delivery cost, but in these cases, any extra cost charged by the courier is passed on the customer. However, HW Africa does still incur an additional processing charge for arranging the special delivery.

HW Africa has developed the activity cost driver rates, shown in Table 4.6, for its support costs:

Table 4.6 Cost driver rates for costs to serve

Activity	Activity cost driver rate
Process mail orders	\$5 per order
Process phone orders	\$80 per hour
Process online orders	\$0.5 per order
Process returns (includes the cost of pre-paid postage)	\$15 per item returned
Standard delivery costs (incurred by HW Africa on all deliveries)	\$10 per delivery
Additional administration cost to arrange special delivery, that is, costs on top of standard delivery costs	\$4 per request
Maintain customer relations (send catalog and respond to customer comments and complaints)	Best estimate of \$50 per customer per year

Activity requirements:

- Using activity-based costing, determine the yearly profit associated with each of the five customers described.
- Comment on which customers are most profitable and why.
- What advice do you have for HW Africa regarding managing customer relationships with the different types of customers represented?

Chapter 4 - Activity 6 – HW Inc. Value creation system

Using the information in the case study related to the operations and the factory unit (section A.6 and A.7), undertake a value creation system analysis for HW Inc. It may be helpful to consider the retail outlets and the factory separately, that is, illustrate using separate value creation system diagrams, as shown in section 4.9.

Chapter 4 - Activity 7 – HW Inc. Financial analysis

HW Inc. is undertaking a review of its future strategy and has obtained figures relating to the industry average in terms of the financial ratios, shown in Table 4.7.

Analyze the financial performance of HW Inc. based on the figures provided in Appendix A (section A.8 and Exhibit A) of the case study – the income statement (profit and loss account) and balance sheet for HW Inc. and compare your analysis with the industry average provided.

What are the trends arising from the analysis of HW Inc.? What messages does this provide for HW Inc.'s management?

Is there anything in Exhibit B of the case study that the management of HW Inc. should consider?

What other aspects of performance would you investigate?

Table 4.7 Financial ratios for the industry average

Financial ratio	Industry average
Gross profit percentage of revenue	30.5%
Operating profit percentage of revenue	2.5%
Return on net assets (profit for year/net assets)	3.5%
ROCE - operating profit as percentage of capital employed (operating profit/long term borrowings plus equity)	6.2%
Asset turnover (sales revenue/long term borrowings plus equity)	2.5
Non-current asset turnover (sales revenue/non-current assets)	3.0
Gearing percentage (long term borrowings/equity)	40%
Current ratio (current assets/current liabilities)	2.0
Stock turnover (inventory/cost of sales) *365 = number of days stock held	100 days
Receivable days (trade receivables/revenue) *365 = average days to collect	75 days
Payable days (trade payables/cost of sales) *365 = average days to pay suppliers	90 days

Chapter 5 - Activity 8 – HW Inc. SWOT analysis

The following activities relate to the case study in Appendix A of this learning resource.

- (a) Undertake a SWOT analysis for HW Inc. (Hint: Use the environmental analysis undertaken from the activity in Chapter 3 and the portfolio analysis, value creation system, and financial analysis activities in Chapter 4 of this learning resources to help you).
- (b) Identify what you consider to be the main elements within each heading; that is, the key strengths, weaknesses, opportunities, and threats.

Chapter 6 - Activity 9 – HW Inc. Competitive strategies

The senior management team (C-suite) at HW Inc. is becoming concerned about the decline in profits of its business unit in Italy. They have asked the Managing Director of the Italian business to provide a full report outlining the reasons for the decline and a suggested strategy to improve HW's performance in the country for the next year.

While they were waiting for the formal report, the Finance Director at HW Head Office had reasons to contact the Managing Director of HW Italy about another matter but raised the issue of the declining profits. He made some notes during the conversation. One aspect that interested him is that the problem appeared to be focused on the Furniture and Interior Design section of the business.

The Managing Director was adamant that the electrical, clothing, and financial services parts of the business were all very profitable but that the furniture section has been hit hard by a new entrant to the market who was undercutting prices. An existing major competitor had responded by matching prices and increasing its marketing expenditure on furniture promotions. The furniture market in Italy had become intensely competitive in recent years as independent manufacturers and retailers had fought against the large chain stores gaining market share. The focus of competition in recent years has been on price. Italian consumers, although they were quite sophisticated in their tastes, were also prepared to shop around for the best deal.

There appeared to be different opinions within the local management team at HW Italy. The Marketing Director was suggesting that HW Italy should match the new entrant and the competitor move and promote furniture sales and reduce their prices to match. This proposal was based on the idea that the increased volume sales would generate the increased margin to pay for the advertising and increased overall profits and that the new entrant would be forced out of business, restoring the market to the usual competitor companies again. The new competitor was selling a basic design of furniture marketed under the slogan, "Quality at low prices." HW Italy was offering a wide range of furniture units of good quality with some leading brands, as well as the HW's own brand. Although HW offered a wide choice of product range, the difference was in style rather than the price, that is, units were of a similar price bracket and sales each year were reasonably consistent in terms of the mix of units sold.

The Operations Director felt that the production cost of the furniture was too high for them to compete and that they should reduce the inventory items of furniture and move the focus more towards clothing and electricals. The cost of the HW branded furniture that was manufactured in the HW U.K. factory and shipped to Italy had increased due to the fluctuating exchange rate against the Euro in recent months, and this would only reduce margins even more. Also, the cost of other branded furniture that was sold in the retail stores had increased from their suppliers.

The Interior Design services business, however, was good as they consistently made a net profit of 15% of sales revenue. The suggestion from the Operations Director was to reduce the number of furniture ranges offered for sale, perhaps limiting it to a small range of quality styles sold under the HW brand, and promote the Interior Design services. He illustrated his point by commenting that the manager of the Interior Design team had noticed a marked shift in

kitchen design that customers were not only looking for a good deal but also looking for functionality with style.

He criticized the Marketing Director’s suggestion on the basis that it would reduce HW to a strategy of cost leadership, which would be bad for the image of the company, whereas differentiating on quality and service would enhance this part of the business, and give it an edge in the market. The manager of the Interior Design team is confident that they could increase their sales of design services if they were able to offer a product range that fitted more neatly into the functionality with style category.

The Managing Director said the management team was preparing a detailed report and that they would forward this as soon as they were able.

During the conversation, the Managing Director had read out some figures relating to the kitchen units sold and the Interior Design business generated from kitchens, which the Finance Director of HW head office had jotted down. He has provided the information above, and the figures are shown in Table 6.21. He has asked you for an initial opinion on the implications of the two suggestions.

Table 6.21 Indicative figures from the kitchen section

Year	Total number of Kitchen Units sold	Sales Value of Kitchen Units	Interior Design Sales revenue generated from Kitchen design	Operating profit generated from Kitchen Units and Design together
		€m	€m	€m
2018	2,050	922,500	650,000	162,000
2019	2,700	1,080,000	600,000	144,000
2020	3,600	1,260,000	550,000	107,500

Note: Profit from Interior Design services usually is 15% of the sales value generated from Design. The Interior Design services part of the business is not restricted to selling HW branded goods but can select any kitchenware products from the range of manufacturers that HW stocks.

All the kitchen units are of a similar size – the design aspect comes from selecting appropriate units that are joined to create the desired kitchen, for example, base units, corner units, wall units.

Activity requirement:

- (a) Using the numerical information provided in Table 6.20, investigate whether a strategy of cost leadership is a viable option for HW Italy.
- (b) Based on what you know about HW Inc. and the information provided by the Finance Director recommend, with justification, a suitable competitive strategy that HW Italy could adopt. Also, highlight any additional information or analysis that you think should be undertaken before a final decision is made.

Chapter 6 - Activity 10 - ABC factory-made picnic tables

The furniture factory based in the U.K. has traditionally used a single rate of overhead recovery based on the number of units it has produced. The head office finance department has requested that they review whether they should adopt activity-based costing. They have ascertained the following information about two of their most popular ranges of a picnic table. They are planning to use this as an illustration of the benefits of ABC. The factory 'sells' the products it manufactures to the retail store division and usually adds a mark-up of 25% to the furniture products it makes. The accounting team has provided the information shown in Table 6.22.

Table 6.22 Basic data on picnic tables (figures provided in \$)

Product	Alpha range	Beta range
Output in units	12,000	14,000
Costs/cost drivers		
Direct materials in total	\$240,000	\$350,000
Direct labor in total	\$168,000	\$147,000
Total machine hours	2,100	2,400
Orders executed	150	110
Number of production runs	90	40
Number of shipments	50	15
Number of product returns from retail stores or regional depots	90	40

The production overhead is currently absorbed by using units, and the total of the production overhead for the period has been analyzed as shown in Table 6.23

Table 6.23 Analysis of production overhead related to picnic tables product

Activity pools	Annual costs \$	Cost driver
Production overheads	180,000	Machine hours
Material handling	78,000	Orders executed
Quality enhancing and inspection	130,000	Number of production runs
Delivery	26,000	Number of shipments
Production return management	15,000	Number of returns
Total	429,000	

Activity requirement:

- Calculate the selling price based on the current traditional method and using the ABC approach.
- How does this aid the decision making of HW's management team?

Chapter 6 - Activity 11 - TDABC and call centers

HW Inc. sells many product lines within its stores and prides itself on customer service. Product lines are looked after by product line managers. Typically, a product manager will take responsibility for liaison with everything about that product line or product group within the stores. They operate on a national basis, that is, a manager is responsible for a product group within all stores in the U.K. A product group could be health and fitness products, audio-visual products, kitchen products, lighting products, and so on. For small product groups, a manager might look after more than one group.

HW Inc. currently operates a central service call center that deals with customer calls for information and complaints. The costs of the call center are presently allocated based on 10% of the sales value of the product groups.

The manager of product Y is upset because he has just received a report, Table 6.24, showing the following information relating to the year 2020.

Table 6.24 Information for product group X and Y

	Product group X	Product group Y
Number of calls for information	5,000	2,000
Average length of call for information	10 minutes	6 minutes
Number of calls registering complaints	1,500	300
Average length of complaint calls	12 minutes	6 minutes
Sales volume	\$200,000	\$800,000

Product group Y contains products that are simple to use, and consumers have little concern about adverse health effects. Product group X includes products that are more complex to use and have quite a few health hazard warnings on their labels and in their instructions for use. The manager of product group Y argues that the current system is unfair as it does not trace call center usage direct to products. For example, product group Y bears four times the cost of group X, although group Y has far fewer calls associated with it and consumes less time.

- What activity cost driver would you recommend to improve the current system of assigning call center costs to product groups? Why is your method an improvement?
- Suppose that HW Inc. decides to allocate costs using an activity-based method and chooses the basis of minutes of calls as the activity cost driver. Suppose the average cost of handling a call is \$1 per minute. Compare the costs incurred by product group X and Y under the new system and the old.
- What actions can the product managers take to reduce the number of calls received by the call center? What might other functional areas of the business do to help reduce the number of calls per product?
- Who might resist the implementation of the new activity-based cost system?
- From HW Inc.'s point of view, how might the ABC system and the value creation system help in the assessment of whether to outsource the call center activities?

Chapter 6 - Activity 12 – HW Inc. Cost of quality

Furniture from HW Inc. Guildford store

The following letter was red-flagged and created a major alert at the HW local retail store and the management team of HW UK, who is demanding an immediate investigation into what went wrong and what was going to be done to stop it happening again.

Dear Sirs,

In December, I purchased a new house ready to begin working at my new job in Nottingham in January.

On the last Saturday in December, I decided to go shopping at one of your stores in the town where I currently live in Guildford, Surrey. I decided I would need a new dining table and chairs, sofa and armchair, as my current furniture had seen better days.

I arrived in the furnishings department in your Guildford store at 9:10 a.m. to beat the rush. I wandered around the department sitting on chairs, sitting on chairs at various dining room tables, sitting on sofas and armchairs, and looking through material sample books for 20 minutes before deciding to go off in search of an assistant. At the 'Pay Here' desk, I found someone and asked if anyone was available to help in the furnishings department.

'I could find someone for you,' the assistant replied with a degree of reluctance.

Someone was found – a person I had previously seen walking through the department several times. They very kindly offered to help and began to take my order. It took about 15 minutes to place the order on the computer system, which included several aborted attempts to find the order code for the items I required. I was left feeling not hugely confident that the goods I was purchasing had been processed correctly. I was informed that all the furniture had to be made to order and would take about six weeks to arrive.

When it came to paying, I had to go to the pay desk. A different assistant asked if I had an HW Inc. credit card, as this would allow me a 10% discount. I replied No, so I was persuaded to apply for an HW Inc. credit card to benefit from the discount. The application was processed at the till, credit check performed, and card granted. It took about 10 minutes as a manager had to be found to authorize the application. As the order for the sofa and armchair, and dining table and chairs came to more than \$1,000 – the limit allowed on a new card application, I was told I could put \$1,000 on the new card, which I duly did, and used my HSBC card to pay the balance – they very kindly allowed the 10% discount on the entire purchase. I was also persuaded to take out insurance offered with HW Inc.'s credit card costing \$3 to protect the purchase. It was then automatically added to the HW Inc. credit card bill.

Two weeks later I received a telephone call saying that the supplier of the sofa had a problem with their supplier of cloth, and it would take another three weeks for the furniture to be made. I would be contacted when it was ready.

One week later, I received a letter from the legal department of Visa Card Services. They apparently manage the credit card for HW Inc., telling me that the card was overextended by \$3 and unless this was cleared immediately, it would be stopped and legal action taken to recover the debt. The letter also informed me that the account would be charged with \$15 for

the administration costs. As the insurance had been charged to the credit card automatically, the total charged to the card was \$1,003. It seems to me to be unreasonable as it was an error on the part of the store employee. I have written to Visa Card Services explaining the situation and have paid the \$1,000 and suggested any additional charges be reclaimed from HW Inc. I have also asked Visa Card Services to cancel the card with immediate effect.

I also received a letter saying that my dining room table and chairs would be delivered on 21st January. There was a contact phone number to use if the date were inconvenient; if however, no communication was received, it would be assumed that the date was acceptable. I telephoned to arrange a more convenient date.

When the dining room table and chairs were delivered, the chairs were of a slatted back version, and not leather-backed, as had been ordered. The delivery staff were unhelpful, commenting that they had never delivered any leather-backed chairs with that style of table before and did not think that the company sold them. They did, however, leave the incorrect chairs so that I could sit down and suggested that I contact their administration office.

I contacted HW Inc., who said that the supplier was at fault and gave me a number to contact the supplier. I contacted the supplier and was told that the wrong chairs had been loaded on the van - I would be contacted with another delivery date. After two days, I contacted them again and spoke to a different person, and this time I was told the chairs were being made for me.

Four weeks later I received a letter saying that the chairs would be delivered on 3rd March. I telephoned again to say that the date was inconvenient – ‘Thank you – I will cancel the delivery,’ the girl answered and put the phone down. I wrote to you to lodge a complaint stating that if they were not delivered before the end of March, I would cancel the order, demand the return of the money, and purchase chairs from another source. No response was received. But I did receive another letter with another delivery date for 24th March – I rearranged work to enable me to be at home when they arrived. The chairs were delivered on that date, and the delivery staff kindly took away the incorrect chairs and left the new ones in their place.

On 16th March, I was contacted by HW Inc. to say that the sofa and the armchair were ready and that a delivery date could be arranged. You were unable to deliver them on 24th March, when I had arranged to take a day off work to take delivery of the dining chairs, but a date was arranged for April.

When the sofa and chairs were delivered in April (I had taken another day off work so that I was at home when they were delivered), the chairs were fine, but there was a snag on the sofa, which was very visible as it was on top of the backrest. The delivery driver noted this and advised that they would leave the sofa but that I should contact the administration office to see what they could do about replacing the sofa.

As the delivery van was driving away, and I was picking up the phone to contact the administration office, I noticed that there was also a mark on one of the seat covers that looked like oil. I pointed this out when I was in contact with the office. The lady from the office was very apologetic, and I was told that the sofa would be replaced. However, the next day I was told that the headrest element could be replaced but that I would have to pay for the seat cover, as this was not recorded on the delivery document as being at fault.

I would now like my money back for the sofa and matching chair, and you can collect the sofa and chair at your earliest convenience.

I look forward to hearing from you and thank you in advance for your kind assistance in this matter.

Yours faithfully

V. Annoyed Esq.

Required

- (a) What are the problems or failures in the above scenario, and how could they be overcome?
- (b) What are the costs for the company associated with the scenario outlined above?

Chapter 7 - Activity 13 – HW Inc. International expansion

HW Inc. to expand to a new country

HW Inc. is planning to increase its business in emerging economies. The management team has identified Bangladesh as a potential country in which to open stores. Bangladesh is set to be one of the top three fastest growing economies in the next few years. The country has a robust financial sector, and one of the key industries is textiles, which is also a significant export of the region. Its economy has grown on the back of exports of readymade garments. Manufacturers in the region supply clothing to discount companies such as Matalan. The Head Office team has identified the following information about the country.

The population is growing and are becoming more sophisticated consumers. The government-backed growth in telecommunications and technology within the country is fueling the growth of online shopping. Bangladesh is strategically important to the region as its seaports provide access to landlocked regions and countries such as Northeast India, Nepal, and Bhutan. China also sees Bangladesh as strategically important as it allows for a potential gateway to Tibet, Sichuan, and Yunnan.

The government of Bangladesh welcomes investment from foreign companies. It is keen to increase the competition in key industries in the country as a way of improving the economic growth of the country. More than 26% of the population live below the poverty line, so the government is keen to grow the economy and support local industries. Textiles and apparel manufacture are among the key employment industries. Unemployment in the country is about 5%, but many only work a few hours a week. There can be some bureaucracy to be overcome when setting up in business, and supply arrangements are not always as transparent as one might like. Still, generally, the prospect is particularly good for the U.K. and U.S.-based companies. The U.K. Government Export Office suggests that opportunities exist for companies offering quality, lifecycle costs, and after-sales service. Low-cost goods from China and India dominate the market, and as such, the market is very price sensitive.

The Bangladesh economy relies heavily on human resources, and the government is keen to promote education – approximately 20% of the total population (around 29 million people) are students.

Companies such as the International Homeware Company have recently opened stores in Dhaka and is reported to be doing exceptionally well with very favorable reviews on Facebook.

It is usual to appoint a local representative or local agent who understands the regulations and market when setting up a business in Bangladesh. The general advice is that working with a local partner is beneficial, as it is possible to set up an office to sell products and equipment to the end consumer. It is a requirement to register with the Bangladesh Investment Development Authority, and the Register of Joint Stock Companies. The local team suggests that it will be possible to open a store in Dhaka. They estimate that it will take approximately one year to gain the necessary permissions and establish the store, and trading would be able to begin in the second year.

Activity requirements

Using the model of Porter's Diamond outlined in section 7.5, assess whether Bangladesh is a viable option and one that HW could pursue. Also, identify any other aspects or areas of information that you feel HW should investigate before making a final decision.

Chapter 7 - Activity 14 – HW Inc. Joint development

HW Inc. expands into out-of-town stores in China JV

HW China is currently planning to expand its operations in the country. As in most countries, the trend towards out-of-town shopping is still popular and, in some cases, this is being supplemented by ‘Shopping Villages’. These are out-of-town single-story retail outlets where consumers can buy discounted top-quality brands. Luxury goods retailers have embraced the concept and are using them to sell old product lines that have been replaced in their high street stores. The shopping villages give consumers who are less wealthy the chance to buy luxury goods, and the retailer an opportunity to dispose of surplus stock and end-of-season product lines.

The Shopping Villages tend to be managed by their owners and management companies, who operate the sites quite aggressively in that they offer short term leases and can change the mix of companies represented depending on current trends. This practice, however, can be quite attractive to retailers where high street leases are typically much longer, so the Shopping Villages offer a lower risk in which to test the market. HW China has operated a small outlet in a Shopping Village near Beijing, which has shown some promise.

The short term lease is coming up for renewal, and HW China is now investigating the opportunity of closing the small store in the Shopping Village and opening a slightly larger store, more in line with an ‘out-of-town’ store, on a nearby site in the same area. To minimize the risk, HW China is considering entering into a joint venture agreement with a major food retailer. It is felt that this choice of partner would not pose a direct threat to HW China, as the product ranges are complementary but do not directly compete.

However, some of the luxury brands that HW Inc. stock such as Burberry, Prada, Amani, Abercrombie & Fitch, and Hugo Boss were not very happy with the fact that HW China had opened a small store in the Shopping Village, as these major brands have their own outlets in Shopping Villages. The “gift” culture in China means that these brands do very well in Shopping Villages where goods can be discounted by anything between 30% – 70%. These brands, therefore, see Shopping Villages as an excellent way to expand their consumer appeal outside of the large high street stores in which their goods are available. They are not happy about the prospect of HW China opening an out-of-town store, as they feel that this will confuse the consumer. In retaliation, they have indicated that they may not allow their brands to be sold in the out-of-town store.

HW China is keen to see the development approved as they are aware that at least two of their main competitors have opened up small scale stores in Shopping Villages on the fringes of major cities, so they are also testing the out-of-town market. The local government is keen to see the development go ahead, but there has been some opposition raised from the local community. Also, an agreement has been reached to established public transport links to service the operational superstore, but transport providers are now saying that as people will most likely travel in their cars to the site, they are no longer prepared to maintain the planned frequent services due to estimated low demand.

The central government has expressed concern recently about the impact that the growth in out-of-town stores and Shopping Villages is having on the high street and city center shops. It has commissioned research into the social impact of out-of-town shopping to report within the next six months. HW China has made no firm commitment yet other than to undertake a feasibility study with the Joint Venture Company.

Activity requirements:

- (a) Identify the market opportunities and threats that confront HW China if it adopts a strategy of developing more out-of-town stores in the future.
- (b) Undertake a stakeholder analysis concerning the strategic decision to open the out-of-town store on the fringes of Beijing.
- (c) Discuss the merits and drawbacks for HW China of pursuing out-of-town developments entirely on its own or as a joint development with other retailers. Pay special attention to the practical aspects and operational difficulties which may arise.

Chapter 7 - Activity 15 – HW Inc. Growth strategies

HW Inc. diversification into telecoms

Introduction

The senior management team has been investigating the possibilities of diversifying its activities. They have looked at supermarkets and other retailers that have successfully diversified into telecommunications and media, such as Amazon, Tesco, Virgin, and other major companies with the provision of the mobile phone and then into more media-related activities.

Caroline Quinn (Marketing Director of HW Inc.) has a contact in the media sector that has put HW Inc. in touch with a medium-sized telecommunication company that has ambitious plans to develop the company internationally, as well as to diversify into other areas of media such as TV. XYZ Inc. is looking for a friendly partner to help finance the expansion and would be open to talks about a possible partnership. Caroline Quinn, Shirley Valentine (Finance Director of HW Inc.), and Huang Zu (International Development Director at HW Inc.) have had an initial meeting with the Chairman and the Chief Executive Officer of XYZ Inc. At the meeting, the Chief Executive Officer of XYZ Inc. enthusiastically outlined the company's plans and seemed very keen to sell the idea of a partnership arrangement to HW Inc. One of the attractions for XYZ Inc. was to be linked to a company such as HW Inc. that had global recognition across six continents. The following is a brief outline of the background and plans of XYZ Inc.

XYZ Inc.

XYZ Inc. is a well-established company providing telecommunications services both nationally and internationally. Its business has been concerned with the provision of telephone lines and equipment and private telecommunications networks. XYZ Inc. has supplemented these network services by offering mobile phones, which, although highly competitive, is still an expanding market worldwide.

The company maintains a diverse customer base, including residential users, multi-national companies, government agencies, and public sector organizations.

Strategic development

The Chairman of XYZ Inc. stated within the latest Annual Report that there were three main areas in which the company aims to develop to remain a world leader in the telecommunications market. He believes that the three main growth areas reflect the evolving nature of the telecommunications market and will provide scope for development.

The areas in which development is planned are:

1. Expansion of the telecommunications business in the national and overseas markets, both by the company acting on its own and through partnership arrangements with other suppliers.

2. Diversification into television and multi-media services, providing the hardware to home entertainment and enhanced broadcasting services.
3. Extension of the joint ventures and strategic alliances to help extend their global reach, particularly in areas such as North America, Europe, and Asia.

The Chairman stated that their status as a world leader in telecommunications was built on a focus on the long-term development of continually improving its services to customers, developing high-quality up to date products, and being innovative, flexible, and market-driven.

Business opportunities

The Chief Executive of XYZ Inc. has stated that the major opportunities for the company lie in the following areas:

- Encouraging greater use of digital services, including making voice calls. Recent research suggests that customers are sending more texts and making fewer voice calls yet downloading more data.
- Provision of advanced services, and research and development into new technology, including superfast broadband and systems integration, for example, making services available on several digital platforms and making more use of the business ecosystem.
- The increasing freedom from government control via deregulation of markets in world-wide telecommunications services.

The company has used an extensive television and poster advertising campaign. This marketing campaign was designed to penetrate further the residential market by encouraging greater use of the digital services with varying charging incentives being offered to encourage customers to use the services more on a range of different digital platforms over fiber optic and superfast broadband connection to their home.

Investment plans

XYZ Inc. is currently planning on making a multimillion-dollar investment in new products that it believes will increase its market share in its domestic market. It currently enjoys a 55% market share in its local market, having previously been a state-owned provider of telecommunications services. It has been a private sector company for some years now, but the competition has found it difficult to make inroads into their domestic market. XYZ Inc. plans to make the most of this situation by investing in retaining the market share, if not increasing it still further.

Industry regulation

Despite the deregulation in some part of the world, several western countries in which XYZ Inc. has a relatively high market share presence, are strengthening the powers of the industry regulators to promote competition and deter anti-competitive behavior.

Activity requirements:

You have been asked by the Supervisory Board of HW Inc. to prepare a report covering the following points concerning XYZ Inc.:

- (a) Explain the nature of the factors in the business environment, which will influence XYZ Inc. in developing its business and increasing its market share [Hint: use PESTEL to undertake a brief environmental analysis].
- (b) To assess the extent of the potential market development opportunities available to XYZ Inc. [Note: Apply Ansoff's Product Market Growth Matrix to do this.]

Chapter 8 - Activity 16 – HW Inc. Investment appraisal and stakeholders

HW Inc. is considering opening a new warehouse in the North of Belgium. Currently, the stores in Antwerp and Aarschot are serviced by a warehouse just outside of Brussels. Building on its expansion program of opening new stores in Turnhout and Hasselt, and establishing a hub and spoke strategy to its logistics, the local management team of HW Brussels had been asked to investigate the possibility of opening a new warehouse/depot just outside of Herentals. See Figure 8.8.

One of the policies that HW Inc. has set is that for warehouses/depots to be beneficial, they must not cost more than 7% of the revenue generated from goods sold in the stores that it services and for which products pass through the depot. They usually are evaluated over five years based on a net present value calculation using a discount rate of 5%, which represents the relatively low risk attached to such an investment.

The main hub is based in Brussels, which is where the current sales from Antwerp and Aarschot are serviced. The management team believes that it would be more useful to establish a spoke so that a regional depot was supplied from Brussels, which then serviced the current stores in Antwerp and Aarschot, and the new stores in Turnhout and Hasselt. The benefit is that bulk deliveries can be made from Brussels to the regional depot, and smaller vehicles can then be used to split the bulk for delivery to the local stores.

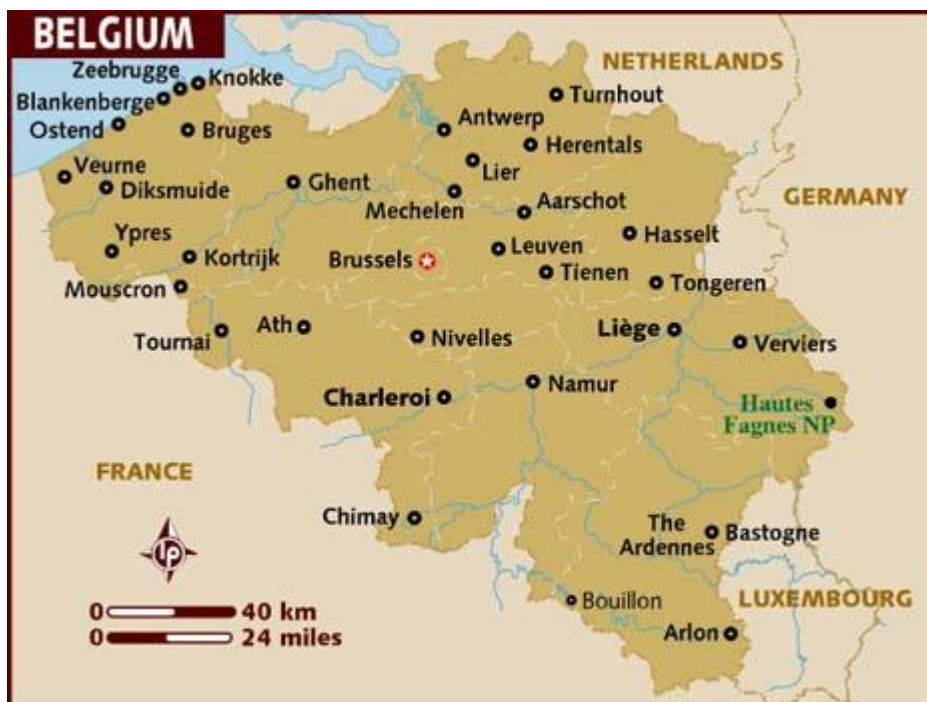


Figure 8.8 Map of Belgium

Current sales in Antwerp are €5.5m per annum and in Aarschot €4.5m per annum. Sales have been constant during the last three years and are expected to remain at that level for the

foreseeable future. The stores do good business, but consumers tend to shop locally so, for sales to grow, expanding the number of stores is the best strategy. However, once the new stores are opened, it is expected that there will be some cannibalization of sales, that is, people that visited the stores from Turnhout and Hasselt will now shop in the local stores. It is estimated that the effect will be to reduce the sales in Antwerp and Aarschot by 5%. Forecast sales for Turnhout and Hasselt together are expected to be €4.5m in the first year, growing by 10% (compound) a year for five years before stabilizing.

The cost of the new depot, land, and buildings is estimated to be €0.5m – a potential site has been identified that could be ready for operations within a few months of the decision to go ahead is made. Annual running costs are estimated to be €300,000 per annum, rising each year by inflation of 2.5% per annum. There is local unemployment, so it is expected that labor will not be difficult to obtain. A manager will need to be recruited at a salary of €25,000 per annum, and 20 workers employed on a shift pattern earning an average of €15,000 per annum – all salary costs are expected to increase by inflation. A forklift truck and 2 stackers (a smaller version of a forklift truck) would be needed immediately at a total cost of €18,000. These will be replaced at the end of five years with no residual value.

A fleet of 10 vehicles will be attached to the depot. A deal can be done with a local dealership. The fleet of medium-sized box trucks could be acquired immediately on a five-year lease rental, at a total cost of €250,000, covering the whole five year period. This cost includes maintenance for five years and all operating expenses, subject to a maximum mileage of 100,000 miles for each vehicle within the five years. HW Inc. would need to supply the drivers, who are each expected to earn €18,000 per annum – one driver per vehicle. The existing drivers, have raised some concerns as they see this as potentially reducing their earnings because they will be making fewer trips and the possibility of earning overtime could be reduced. However, the senior management team of HW Belgium felt that opening the depot would be better for the health of the current drivers and that there is less chance of them going over the maximum driver hours allowed in any one day imposed by the EU.

The central senior management team (C-suite) of HW Inc. is keen to expand in Belgium and is entirely behind the hub and spoke policy of distribution. There is some concern about the impact of BREXIT, but the management team is keen to go ahead anyway. The local bank is more than prepared to offer a competitive loan to finance the purchase of land, buildings, lorries, and forklift trucks at an annual interest rate of 3% as the bank is keen to expand its business with international companies. This cost of finance is not included within the current cost of capital of 5% that HW Inc. typically uses to evaluate investment opportunities. The local management team of HW Belgium feels that this would be the cheapest way to finance the depot and would only use the finance for this project. They, therefore, suggest that the marginal cost of capital of 3% should be used for evaluation purposes.

The local management team is also aware of local residents who have lodged a protest against the proposed site due to the increased number of lorries on the local roads that will result from establishing the depot. Half of the members of the local government (the local council in the Herentals town) are keen to see the development go ahead as it will help with employment. There is a re-election process due within the next six months, so HW Inc. is keen to push for a decision before the local elections. A few councilors have suggested that they

would press for traffic restrictions to be put in place, that is, no early morning or late evening deliveries.

The regional authorities (the municipality) are keen to see companies expanding in the area that has the potential to stimulate the local economy and are likely to support the proposal, providing the traffic issue can be resolved. The municipality oversees the local government but traditionally has not involved itself too deeply in local decisions. For the development to go ahead, HW Belgium needs approval from both the local council and the regional authority. Several of the competitor stores are not so impressed and are likely to try and make life difficult for HW Belgium stores to establish themselves in the new locations as the competitors try to hold on to their market share.

Activity requirements:

- (a) Undertaken a net present value calculation to establish whether the planned depot meets the requirements of HW Inc. Also, state any assumptions you make and indicate any other form of analysis that might be useful.
- (b) Undertake a stakeholder analysis for the strategic decision to establish a depot in Herentals. State the stakeholder group, their expectations, and the degree of power they may have concerning the strategic decisions.

Chapter 8 - Activity 17 – HW Inc. Investment appraisal

HW to expand to a new country

HW Inc is planning to increase its business in the emerging economies. The management team has identified Bangladesh as a potential country in which to open stores. Bangladesh is set to be one of the top three fastest growing economies in the next few years. The country has a robust financial sector, and one of the key industries is textiles, which is also a vital export of the region. Its economy has grown on the back of exports of readymade garments. Manufacturers in the region supply clothing to discount companies such as Matalan.

The local management team suggests that it will be possible to open a store in Dhaka and have provided some initial estimates of start-up costs (for ease of use, these have been provided in U.S.\$). These are shown in Table 8.33. They estimate that it will take approximately one year to gain the necessary permissions and establish the store, and trading would be able to begin in the second year.

Table 8.33 Estimated costs and revenues for Bangladesh

	\$
Allowance for legal fees and local agent costs to be paid during the year of set up	150,000
Annual rental of premises – it is anticipated that the premises will be acquired 4 months before the official opening to allow for fitting out the store and the training of staff on the product ranges. 4 months' rent will need to be paid for this period.	300,000
Arrangement fee for property dealer paid before opening plus a commission fee is payable each year equal to 1% of annual rental fee payable each year. Note this is paid from the date of acquisition of the premises, that is, a 1% fee is payable for the 4 months before the official opening	12,000
Fitting out of premises incurred before opening – treated as capital expenditure	400,000
Recruitment and training of staff before opening	50,000
Marketing costs announcing the launch of the store before the official opening	200,000
The initial investment in stock and working capital before opening – treated as capital expenditure	250,000
Sales revenue in the first year of operation following the official opening, rising by 10% per annum	3,000,000
A gross margin of 30% is anticipated	
Operating costs per annum, following the official opening, including all costs except rental of premises. These are expected to rise by 5% inflation in subsequent years.	350,000
For the purpose of planning, assume taxation of 40% is payable on operating cash flows and is paid in the year to which the charge relates. Legal fees and agents' fees are deductible expenses for tax purposes, and losses can be carried forward. Capital items are excluded from tax computations.	

The typical evaluation for these projects is over five years of operation. The cost of capital is estimated to be 6%.

Assume all costs and revenues occur at the end of the year.

Activity requirement:

Evaluate whether the Bangladesh store would be a viable proposition (undertake an NPV calculation over 6 years, that is, year 1 set up, followed by 5 years of trading).

Chapter 9 - Activity 18 - HW Inc. Strategic implementation

The following activity refers to the HW Inc. case study in Appendix A of this learning resource.

The CEO has heard about the beyond budgeting round table. He and has asked you to put together a briefing note on how beyond budgeting could be applied in HW Inc. And how it could be implemented if the senior management were convinced of the benefits. You can prepare the briefing as a PowerPoint presentation if you wish. [A briefing note is a short paper that quickly and effectively informs a decision-maker about an issue].

Chapter 10 - Activity 19 – HW Inc. Balanced scorecard

Timothy Kinder (Non-executive director) has suggested that the balanced scorecard, as developed by Kaplan and Norton, would be an appropriate model with which to monitor the performance of the company in the future.

Activity requirement:

- (a) Critically evaluate how the balanced scorecard model, developed by Kaplan and Norton, will assist the management team of HW Inc. in assessing the company's performance.
- (b) Illustrate for each business unit described below suitable objectives, performance measures, and initiatives that could be used as part of a balanced scorecard approach to performance management. [Note that you do not need an initiative for every objective. Usually, one per perspective is appropriate to illustrate your understanding].

HW Inc Retail stores

The retail stores are mostly high street stores, although HW Inc. is planning on opening an out-of-town store in China where it has already been relatively successful with a small store in a 'shopping village'. A shopping village is an out-of-town location where retailers have small outlets that are often devoted to selling end of season goods and disposing of surplus inventories. These are normally sold at a discounted rate to the latest products available in their high street stores.

The retail stores have not been as profitable in recent years as the market has become extremely competitive, and customers are becoming more sophisticated and demanding in their expectations. One way in which HW Inc. has attempted to compete is always to offer the latest products. This makes inventory obsolescence an issue, as judging the amount of inventory to hold to satisfy customer demand, without having massive inventory write-offs, can be difficult. This is a problem in the clothing market where products are seasonal, for example, summer range, winter range, and so on. This sector is also heavily influenced by the latest fashions. However, a new inventory management system is helping with the problem. The growth of the 'click and collect' service is working well and, along with online sales, is set to grow in the future in all product groups.

The use of concessions (companies that effectively rent space in the HW Inc. stores) also enables HW Inc. to provide a wide range of products to its customers. HW Inc. plans to try and increase the number of concessions in the next few years as it shares some of the risks between the partner companies. However, HW Inc. does not want to diminish the HW brand as they also plan to continue to develop and sell their own brand products. They also wish to retain their manufacturing capability as this provides a useful diversification from retailing and

enables more control over the quality of certain product lines in which they have a manufacturing capability.

Clothing sales have been slowing in recent years, but the furniture sales are strong. The electrical goods market is highly competitive, particularly the audio-visual and kitchen aids ranges. The increased competition in the specialist electrical goods retailers has also hit the departmental stores such as HW Inc., along with the need always to offer the latest products highlighting the need for proper inventory management.

HW Inc. Interior Design

HW Inc. Interior Design has a range of corporate clients as well as retail customers. The design team copes with a variety of projects from single room design such as kitchen design for residential customers, to working with property developers and architects on both commercial and residential large-scale projects. They source products used in their designs from HW Inc. and several other companies. They have a large amount of autonomy over which products to recommend and are not necessarily tied to HW Inc. However, they always consider HW Inc. products and recommend them where they are suitable. This helps the HW Inc. research and development team, who look after the HW Inc. product range, as the Interior Design division can gather and feedback information about the products of other manufacturers, and also customer trends.

The Interior Design team are keen to expand their business and are looking to increase the number of corporate clients. In particular, they plan to target the state-owned and education sectors over the next few years. To do this, they will need to expand their design team and recruit additional staff with appropriate experience in those sectors.

HW Inc. Financial Services

The Financial Services division is seeking to increase the number of credit card customers over the next few years and is also planning to diversify into insurance products. The division already offers extended guarantees and insurance on products sold in the HW Inc. stores, particularly on electrical goods, such as fridges, washing machines, T.V.s, and computers. The management team is thinking of expanding into life insurance, travel insurance, car insurance, and home and contents insurance. This is a competitive market, but they believe that the volume necessary to breakeven on these products could be achieved if they can attract existing HW Inc. customers and build on the reputation of the HW brand. It will then provide a stable platform on which to expand the business in the future.

More recently, they have seen the administration costs increase, and the management team have highlighted this as an area where improvements could be made, perhaps via a benchmarking exercise. They also recognize that an increase in business will require an increase in qualified staff, and by adding a range of new products, it will create the need for additional training of the existing team.

HW Inc. Product development and manufacturing

This division has seen material costs increase in recent years, and they are looking at the supplier relations to see if any savings can be made on the cost of materials. The division does not see a significant increase in business over the next few years. Still, it is seeking to maintain volumes at existing levels to retain the manufacturing capability, and within this to keep the product range up to date. It means replacing existing product designs with more up to date designs rather than developing entirely new product ranges.

They see the next few years as being a consolidation of the division. Control of costs will be essential and reviewing manufacturing methods is seen as part of that process, but they do not intend to spend a lot of new capital investment in plant and equipment. They feel that there is scope to improve in areas such as waste management, energy costs, productivity, and inventory management.

Chapter 10 - Activity 20 – HW Inc. Critical success factors and performance management

HW U.K. is planning to expand its stores in the north of the country. The management team of the HW U.K. subsidiary believes that there is scope to increase its overall sales by tapping into some of the U.K. Government's initiatives to stimulate the northern economy and, as the regional politicians call it, create a northern powerhouse.

Currently, HW U.K. is well known in the south of the country, and, based on their experience, the management team realizes that finding the right strategic location is a vital part of success on the high street. Also, enjoying economies of scale from the size of operation can aid cost management, and having the backing of a large parent company, which can provide finance, also aids success.

Citigroup is a retail company that owns nine of the top 20 retail locations in the U.K. HW U.K. has a store in the Citigroup held shopping center in Eldon Square, Newcastle upon Tyne (see Figure 10.7) and in the Citigroup Braeland, Glasgow (Scotland) center. HW U.K. has been in talks with Citigroup and understands that Citigroup is also keen to expand its presence in the north, as well as increasing its overseas locations. Currently, Citigroup has locations in Spain.

Citigroup offers shopping amenities that generate high footfall (the numbers of shoppers that enter a particular store) and long dwell times, that is, encouraging potential customers to spend a long time in the shopping center due to the other amenities that are on offer, such as food, and leisure activities. Both footfall, as well as purchase conversion rates, (which is the number of shoppers that enter the store who purchase products), are crucial to retail success, particularly when competitor stores are also present in the retail centers. This is highly likely as the shopping centers occupy large sites with thousands of square feet of retail space.

Citigroup offers security, cleaning, environmental and technical services to their retail tenants and is proud of their occupancy rates; that is, they have a remarkably high percentage of retail units occupied in their shopping centers. It does not look good or inspire customers if the shopping center has many empty retail units. The centers are equipped with the latest CCTV technology that monitors people entering and leaving the centers, and movement around the centers. The CCTV also monitors people moving and into and out of stores. The statistics are available to retailers. Marketing research indicates that store layout is also a critical factor in selling goods, and Citigroup can help with advice to new retailers.

HW U.K. has commissioned some marketing research to identify critical factors that will help the success of a store. The marketing research company has provided a preliminary report which included some interesting measures that they had identified.

The marketing research company has looked in detail at one of the successful HW U.K. stores in the south of the country. The store in question is located in Bournemouth, a seaside town. This is because the marketing research company had done some research for the local authority in Bournemouth and already had some general data about the area. They also did a detailed study of the HW U.K. store in Newcastle and of a significant competitor of HW U.K., which has a strong presence in the North of the U.K.. The competitor does not have a store in

Newcastle, so a store in Manchester was used as the comparison site (see Figure 10.7). The information in Table 10.6 shows data for the three stores.

Table 10.6 Performance data collected by the marketing research company.

Measure	HW Bournemouth Located in the High Street in a building owned by an independent property company	HW Newcastle Located within the Citigroup Newcastle shopping center	Typical major competitor store located in the Citigroup Trafford center Manchester
Customer satisfaction score out of 10	7.8	6.7	8.0
Passing trade – average number of people entering the shopping center per day	10,000	15,000	20,000
Footfall – average number of people entering the store per day	1,500	2,000	4,000
Point of purchase – average number of purchases made in-store per day	400	450	1,000
Annual sales from the store	£8.76m	£8.0m	£9.7m
Annual cost of goods sold from the store	£6.12m	£5.92m	£6.79m
Average value of click and collect sales per annum	£0.087m	£0.16m	£0.388m
Closing inventory value at the end of the last financial year	£1.04m	£1.776m	£1.058m
Number of employees in the store	292	316	275
Square foot of retail space in store	40,000 sq ft	45,000 sq ft	50,000 sq ft
Average number of product ranges stocked in store	25,000	26,000	15,000
Annual cost of wages for store staff	£4.38m	£4.538m	£3.947m
Opening hours of store	9:00 - 17:00 Mon – Sat 10:00 – 16:00 Sun	9:00 – 17:30 Mon - Sun	8:30 – 18:00 Mon – Sun
Annual rental cost of the property (includes all establishment costs such as security, cleaning, maintenance, energy costs)	£10m	£9m	£10.5m
Unemployment rate in the region	1.8%	8.1%	7.4%
Population growth in the region p.a.	1.6%	2%	3.2%
Percentage of population of working age in the town	62.6%	68.5%	66.0%
Average annual income of population in the region	£24,300	£20,862	£21,623
Average family household size	2.18	2.4	2.35

Activity requirements:

- (a) What are the critical success factors for new stores?
- (b) Based on the information provided, comment critically on the comparisons provided by the marketing research company. [Points to consider include: How useful are the comparisons to the management of HW U.K. in deciding on the success criteria for a successful store in the North of the U.K.? Are there any reservations, concerns, or questions you have about the comparisons provided? What could HW U.K. do to improve the performance of its existing store in Newcastle? When undertaking this activity, do not be afraid to use your own experience of shopping centers or common-sense reasoning in thinking of ideas.]

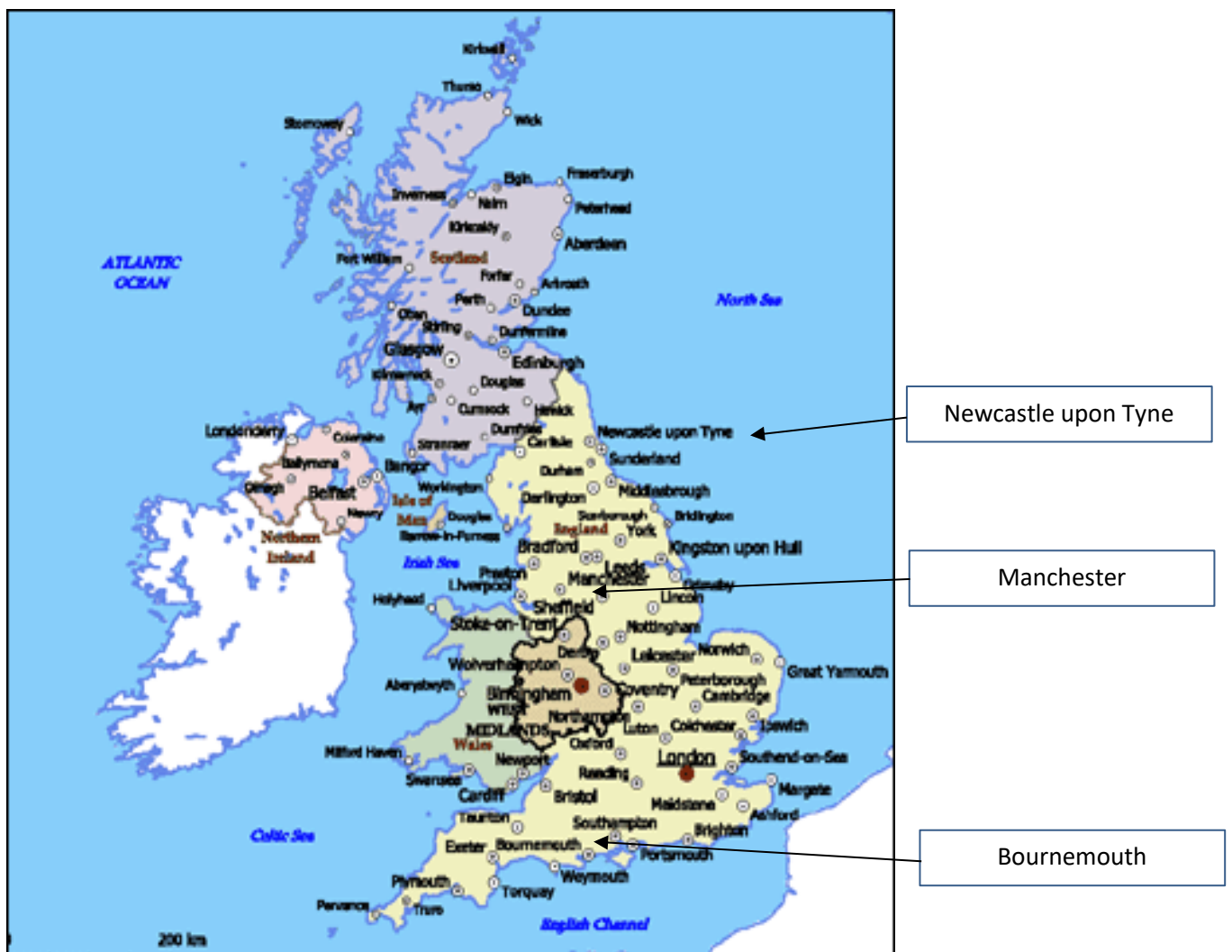


Figure 10.7 Map of U.K. – note location of Bournemouth, Newcastle upon Tyne, and Manchester.

Chapter 10 - Activity 21 – HW Inc. Economic value added

The senior management team (C-suite) of HW Inc. are understandably concerned about the loss in 2020 and the potential continued loss in the 2021 financial year. Michael Holding, a non-executive independent member, has suggested that HW Inc. should adopt the method of performance reporting known as economic value added (EVA™). He explained that it was developed by a firm of consultants, Stern Stewart, primarily as a way of measuring and incentivizing senior executive performance, as well as benefiting the whole organization. The focus is on shareholder value added, which he explained becomes a core part of the company culture.

He has suggested that using EVA™ could be beneficial for HW Inc. in identifying those parts of the business that add the most value. The Finance Director has asked you to investigate in more detail. Information is provided in Table 10.7.

Activity requirements:

- Critically evaluate the benefits and limitations of the Stern Stewart Consulting organization's EVA™ model.
- Illustrate how EVA is calculated by restating the results of the Products and Interior Design areas of business using the figures and information provided below.
- Comment upon your results and state any reservations you have about the analysis

Table 10.7 Extracts from profit and loss and balance sheet relevant to EVA calculation

	2018		2019		2020	
	Products	Interior Design	Products	Interior Design	Products	Interior Design
	\$m	\$m	\$m	\$m	\$m	\$m
Profit/(Loss) before interest and taxation	188.4	332.5	278.0	274.4	(91.5)	317.6
Taxation paid	45.0	79.4	67.6	66.7	5.4	67.4
The following costs have been extracted from the accounting information and were charged to the profit and loss account as an expense						
Depreciation	160.3	57.3	144.2	51.5	91.0	32.5
Research and Development	247.9	144.6	147.2	85.9	154.3	90.0
Marketing	322.8	271.8	234.8	177.7	222.3	158.8
Training	31.4	26.4	18.2	13.7	18.0	12.9

Balance Sheet information						
Net Assets	9,316.1	3,583.1	9,611.2	3,696.6	10,046.4	3,864.0

Notes:

Research and Development costs are to be written off over 3 years

Marketing costs are to be written off over 2 years

Training costs are to be written off in the year in which they are incurred.

The cost of capital of 6% is assumed.

Taxation is the actual taxation paid in each year.

Chapter 10 - Activity 22 – HW Inc. Transfer pricing

The Interior Design business of HW sells its services to customers of HW Inc. The division operates as a profit center and is free to recommend the best furniture, lighting, and kitchen units, etc., to suit the needs of the customer. The way it operates is to essentially purchase the units from the other divisions of HW Inc., either the factory or the stores, which it then sells to the customer, adding its own design fee to the total price. There is a type of extractor that the HW Interior Design division uses in its kitchen design. This device extract smells as well as steam.

The unit is manufactured by a small factory that HW Inc. acquired last year. Recently a dispute has arisen between the factory and the Interior Design management about the cost that the factory wants to charge the Interior Design division for the unit. The factory is confident that it can sell 100,000 units into the external market and has a capacity of 120,000 per year, so it can sell 20,000 units to the Interior Design business without affecting its own demand for external sales. However, the Interior Design business would like to buy 30,000 units. The factory believes that because of the superior quality of the product compared to its competitors, it will eventually be able to grow its external sales to the full capacity of 120,000 units within two years.

The factory division has offered to supply the Interior Design division 20,000 units at a transfer price equal to the normal selling price, less the variable selling and distribution costs that it would not incur on this internal order. The Interior Design division responded by offering an alternative transfer price of the standard variable manufacturing cost plus a 20 percent mark-up on cost. The two divisions have been unable to agree, so the operations director of HW Inc. has suggested a third transfer price equal to the standard full manufacturing cost plus a 15 percent mark-up. However, neither divisional managing director regards such a price as fair.

The information provided in Table 10.8 related to the factory forecast for next year.
Table 10.8 Factory forecast for next year.

	\$,000
Sales Revenue (100,000 units at \$240.00 each)	<u>24,000</u>
Direct Manufacturing Costs	
Bought-in materials	7,200
Labor	4,600
Packaging	800
Indirect Manufacturing Costs	
Variable overheads	200
Line production managers	600
Depreciation	
Capital equipment	3,000
Capitalized development costs	<u>1,200</u>
Total manufacturing costs	17,600
Sales and Distribution Costs	
Salaries of sales force	1,000
Carriage	400
General Overhead	<u>1,000</u>
Total costs	<u>20,000</u>
Profit	<u>4,000</u>

Notes

- 1 The costs of the sales force and indirect production staff are not expected to increase up to the current production capacity.
- 2 Depreciation for all assets is charged on a straight-line basis using a five-year life and no residual value.
- 3 An outside contractor provides carriage.
- 4 Note that the factory has the capacity to produce 120,000 units per year.

The information above relates to the factory. The product can be sold in the open market for \$240. However, it is used within the Interior Design kitchen designs and therefore has an “internal market” within HW Inc. There is a similar product of inferior quality in the open market that sells at \$180. At the moment the division has spare capacity but, as mentioned earlier, the management of the factory believe that they will be able to sell many more in the external market in future years and therefore may not be able to supply all of the Interior Design business needs in the future if capacity remains at the same level.

Activity requirements:

- (a) Calculate the three alternative transfer prices suggested by the managers.
- (b) Advise management on the transfer price to charge if there are no capacity constraints in the factory; that is, it can satisfy all demand from external customers and Interior Design.
- (c) Assume that there is now a capacity constraint in the factory and that they can only manufacture enough to satisfy the external customers. What should be the transfer price to Interior Design that would be in the best interests of the company as a whole?

Chapter 10 - Activity 23 – HW Inc. Benchmarking

Activity requirements:

- (a) Critically evaluate benchmarking as a technique for improving the profitability of HW Inc.
- (b) Provide advice to the management of HW Inc. on the types of benchmarking that could be used. Illustrate your answer with examples of areas of the business or activities that could be benchmarked.
- (c) Provide advice on the stages of conducting a benchmarking exercise in the context of HW Inc.
- (d) What other models and frameworks have you studied where benchmarking could be used to aid the analysis.

Use the information provided on previous activities for performance management (activity 20) and the balanced scorecard (activity 19) to help think of appropriate examples of benchmarking for HW Inc.'s various business activities.

Chapter 10 - Activity 24 – HW Inc. Divisional performance RoI and R.I.

(This activity is based on an old professional body examination question)

HW Inc. Product Development and Manufacturing (PDM) subsidiary division is organized on business units that operate in different countries, that is, they primarily manufacture for the local retail stores in the country, but allows HW Inc. to source products globally, and to maintain a production capability in most of the continents in which it operates. Where possible, they try and supply locally.

The management of the division assesses the performance of its business units in different countries based on a target return on investment (ROI) of 10% (having set this target some time ago in the belief that it is a good estimate of the cost of capital in the division). Overall, the subsidiary division seldom achieved a 10% return, but one of its business units – the Indonesia PDM Business Unit – which is a small unit, has repeatedly surpassed target performance, as shown in Table 10.8.

Table 10.8 – Performance of PDM business unit

Year	ROI
2020	22%
2019	20%
2018	20%
2017	18%

Table 10.9 shows the most recent results for the Indonesia PDM Business Unit.

Table 10.9 Recent performance of PDM division

	<u>Rp,m</u>	<u>Rp,m</u>
Revenues		540,000
Cash operating expenses	400,000	
Depreciation	41,000	
		<u>441,000</u>
Direct Business Unit Profit		<u>99,000</u>
Business Unit Assets:		
Opening balance		450,000

Currency is in Indonesian Rupiah and is shown in millions

Early in 2020, the Research and Development Division of HW Inc. head office was asked by the Indonesia PDM Business Unit to evaluate the development of a new product range targeted at the Indonesian market. The product has incredibly good prospects and is now nearing the end of its development phase. As further development and introduction of the new product would cost Rp90,000m, the HW Research and Development head office team believes that Indonesia PDM should now take the project on board and reimburse the initial development costs amounting to Rp30,000m. However, Indonesia PDM Business Unit management is reluctant to pursue the project further because their forecasts and computations show that the project is unlikely to produce returns of greater than 20% per annum.

Indonesia PDM estimates confirm that the new product would require an additional investment of Rp90,000m and that this would generate additional revenue of up to Rp150,000m per annum over seven years. Operating expenses are estimated at Rp118,500m per annum and are exclusive of depreciation. HW Inc.'s internal group accounting practice is to depreciate total expenditure on projects (inclusive of development costs) over the life of the project using the straight-line method.

The senior management team (C-suite) at HW Inc. was surprised by Indonesia PDM's rejection of the project because of their belief in the market prospects of the new product. To advise the senior management team at HW Inc. head office, you are required to analyze the situation as follows:

1. Make calculations to confirm (or otherwise) whether the investment in the new product is desirable for HW Inc., that is, the company as a whole. Would the Indonesian division take a different view of the cash flows to be included, and what might their decision be? (*i.e.*, Calculate NPV using relevant cash flows, first from the viewpoint of the head office, and secondly from the perspective of the Indonesian division).
2. Calculate Indonesia PDM Business Unit's Return on Investment (ROI) and Residual Income (R.I.) for (a) existing operations, (b) the new product, and (c) combined operations.
(Use a table for this purpose with (a), (b) and (c) as column headings, and ROI and R.I. as rows).
3. Make recommendations to the senior management team at HW Inc. head office and comment on the results of the two measures of divisional performance measurement. State which of the ROI or R.I. methods you would recommend.

Chapter 11 - Activity 25 – HW Inc. Sustainability

The following activities refer to the case study HW Inc. in Appendix A of this learning resource.

Read the following description of a sustainable framework in operation.

[Note: The narrative has been adapted from a statement by Walgreens Boots Alliance, which is the largest retail pharmacy, health and daily living destination across the U.S. and Europe, and therefore the activities mentioned actually exist within a real organization].

Activity requirement:

Identify the aspects of the CSR framework described below that illustrate that HW Inc. takes CSR seriously and note how the finance department is involved in the process of producing the CSR report.

EXTRACT FROM CSR REPORT 2020

Our flexible framework

The Group's CSR framework of priorities covers four key areas: community, environment, marketplace, and workplace. We call this framework "the HW Inc. scorecard," and it is used across our businesses. Each of our businesses' CSR plans is created based on local stakeholder engagement, an analysis of key issues, and meeting the Group's overall priorities. These are presented to the social responsibilities committee for approval and progress against these plans, and the scorecard is monitored centrally.

Community

We strive to support the communities in which we work. We provide our people with opportunities to devote their time, energy, and talent to support the causes that matter through volunteering and fundraising.

Environment

At HW Inc., we are determined to be a leader and an example to others in addressing the threat of climate change. We pursue many practical activities which contribute to the overall reduction of our carbon footprint.

Marketplace

Our mission to make people's lives easier by providing quality products that help with everyday life at reasonable prices comes alive through the relationships with or stakeholders in the business ecosystem.

Workplace

As a Group whose purpose is to deliver products and services that help make people's lives easier and more comfortable, it is second nature to make the wellbeing of our employees a priority. We continue to support our people through training and development so that they can both grow professionally and meet the evolving challenges of our industry.

The HW Inc. scorecard

Every year, after consultation with our stakeholders, we review the Group's priorities and, where appropriate, set new revised priorities within which targets can be set for the year ahead.

Our priorities focus on developing links with the community (community), reducing our carbon footprint (environment), sustainable products (marketplace), and healthy workplaces (workplace).

All our businesses have their own scorecard based on these four key areas and, consistent with the Group's priorities, set their own programs and targets as appropriate. There is a range of different strands of activity across each of the four key areas, and it is within this framework that plans are made by each business. These priorities are further divided into areas of focus and are apportioned around our 'wheel' structure (Figure 11.2), which is submitted to the HW Inc. social responsibilities committee for review.

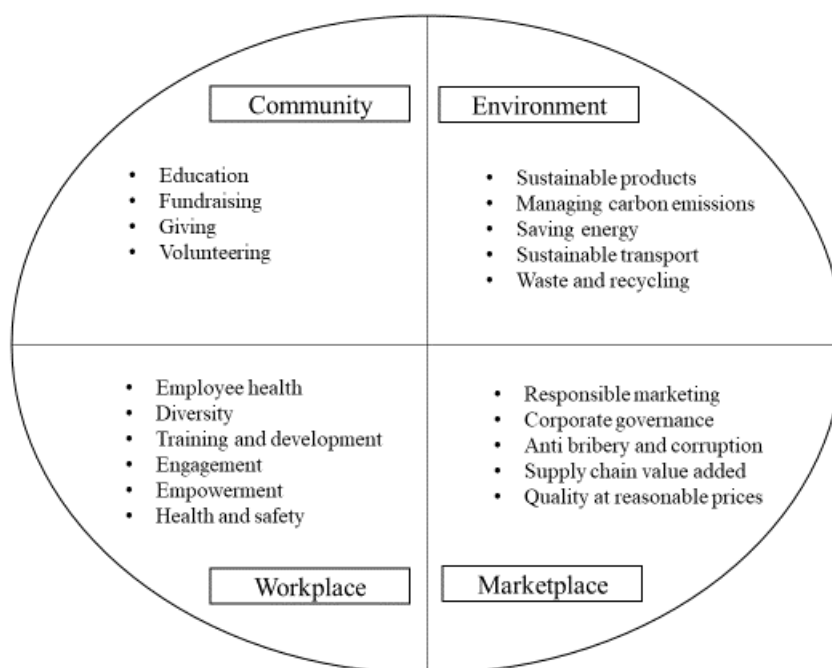


Figure 11.2 HW Inc.'s Sustainability wheel

We work across a range of retail product ranges, including furniture, garden equipment, electrical goods, clothing, and financial services and interior design, as well as embracing elements of manufacturing and distribution. Our businesses are of varying sizes and work in

different countries with different economic and social circumstances. As such, we have ensured that our CSR framework is robust enough to provide leadership and direction, yet flexible enough to consider differences in approach for each business working within the context of their local communities and markets. It is necessary to have a support structure that helps each business to develop and take ownership of a CSR agenda that is appropriate to local circumstances while remaining within the overall HW Inc. framework.

Our corporate social responsibility management

As part of our CSR program, we have a “champion” in each business (country) with responsibility for defining and delivering local CSR priorities and targets in line with the Group’s overall objectives. These objectives provide a framework for our businesses to establish their own priorities and targets that reflect the local business environment. Progress against these targets is monitored quarterly by the Group, and a senior business leader is accountable for each target.

Each “champion” works with an “action group” (which includes senior representatives of relevant business functions) for his or her individual business, and the “champions” hold teleconferences to share initiatives and internally report on their activity. They meet once a year to share their skills, experiences, and ideas with their peers and members of the social responsibilities committee. Formal and informal collaboration between “champions” helps us to share best practices and ensures that our businesses can benefit from progress made across the Group. For example, HW in the U.S. has worked in close partnership with HW in the U.K. on an energy-saving campaign for all its sites, including warehouses and support offices.

All “champions” across HW Inc. are supported by the Group’s CSR Director and coordinator, who provide guidance and additional expertise on working within the Group’s CSR framework. In addition, each “champion” is supported by colleagues from their respective business and a number of Group functions, including human resources, communications, and finance.

In March 2017, we launched an innovative learning and development program to support our corporate social responsibility “champions” with training on CSR theory and its practical implementation, developed in conjunction with Birkbeck University, London. It aims to ensure that each “champion” across the Group has a consistent knowledge and understanding of the CSR agenda, combined with the confidence to manage and collaborate with internal and external stakeholders. The program continues to thrive within the company with new “champions” completing the program each year.

Data management process

We have a Group-wide approach to recording, measuring, and reporting on our CSR performance. We have a set of reporting criteria and a set of CSR measures and performance indicators that are applicable across the Group. The CSR data captured is used to inform and assist in the development of each business’s individual CSR program.

The data presented within this report reflects the continuing operations of the Group. Data collected locally are first reviewed by our CSR “champions” and finance teams at a local level.

The data is then signed off by the local country Finance Director. The Continent finance teams then review this before being submitted to the finance team at head office, New York, and our central CSR team for final review. Finally, the data is independently assured by our auditors, KPMG, before publication in our annual CSR report.

Chapter 11 - Activity 26 – HW Inc. Sustainability and the accountant

Sustainability has become a ‘buzz’ word of recent years. Discuss how the management accountant can contribute to HW Inc. developing and maintaining a more sustainable approach to business.