Answers

In Essentials module papers it is not always possible to publish a suggested answer which is fully comprehensive. Credit will be given to candidates for points not included in the suggested answers but which are relevant to the questions.

The suggested answers presented below give more detail than would be expected from a candidate under examination conditions. The answers are intended to provide guidance on the approach required from candidates, and on the range and depth of knowledge, which would be expected from an excellent candidate.

1 (a) The current strategic position of *greenTech* could be summarised in a brief SWOT analysis. Credit will also be given to candidates who have used appropriate alternative models or frameworks.

Strengths
- The company has a good financial position, with, by April 2008, a cash surplus of $17 million.
- The company has explicitly positioned itself as a focused differentiator in a very competitive market place.
- The company has a stable, successful management team that has been in place since 1990.
- The company has important core competencies in the production of green technology. It was the development of these competencies that formed the basis of Professor Ag Wan's suggestion.

Weaknesses
- Despite recent increases, marketing as a whole is under-funded. It currently stands at about 0·3% of turnover.
- None of the marketing budget is specifically aimed at the sale of fully assembled green computers. This was recognised by Lewis-Read, who believed that the company should invest in marketing these computers to both home and corporate customers.
- The current process for ordering and configuring computers has a number of efficiency problems. This leads to low conversion of enquiries into accepted orders.

Opportunities
- The Lewis-Read proposal points out that the government has just agreed a preferential procurement policy for energy efficient computers with high recyclable content.
- The general public is increasingly conscious of the need to conserve the environment. 'Green consumers' are increasing both in numbers and visibility.
- Other industrial sectors are looking for opportunities to provide products that are quiet, recyclable and have low emissions.
- Web-based technology now exists that allows customers to construct virtual prototypes of machines and equipment.

Threats
- Although sales are increasing, the company is still relatively small in global terms and so it is unlikely to be able to compete with the established global suppliers of fully assembled computers. There are significant barriers to entry to this market.
- Lack of manufacturing capability is a threat as it makes the company vulnerable to problems in the supply chain. The acquisition of a manufacturing company to address this is part of Fenix's proposal.

(b) The team from the accountants Lewis-Read has suggested a strategy that protects and builds on the company's current position. Johnson, Scholes and Whittington identify two broad options within this approach. The first concerns *consolidation* which may include downsizing or withdrawal from certain activities. The second is *market penetration* where an organisation gains market share, usually by increasing marketing activity. This seems to be what Lewis-Read has in mind.

However, their proposal appears to envisage market penetration in only one of the three specific sectors served by *greenTech*, the provision of fully assembled green computers. This focus is probably based on a perception of high potential demand coupled with low current marketing investment in this area. Trends suggest that the overall market for this type of computer should be growing rapidly. Domestic customers and companies are increasingly aware of their carbon footprint and wish to reduce consumption both on ethical and economic grounds. The scenario also states that the government is promoting energy efficient computers with high recyclable content in their procurement policy. Consequently, demand should be growing. On the other hand, *greenTech*'s marketing spend suggests that not only is the overall budget relatively small, but that none of it appears to be specifically aimed at the green consumer. In contrast, over half of the budget is currently specifically targeted at the electronics industry or home buyers of components. This lack of marketing investment may explain the relatively small growth in sales in the fully assembled green computer's revenue stream. Thus it appears that the company is failing to address a growing market because its marketing spend is too small, with none of it specifically focused on that sector.

It is possible that *greenTech*'s reluctance to market their computers directly to domestic and commercial companies is due to their perception that they will be seen to be competing with two of their commercial customers. This will require careful consideration. However, withdrawal from some activities is a legitimate tactic within a 'protect and build' strategy. Perhaps the loss of some commercial customers will be more than compensated for by direct computer sales to customers.

The second proposal, from the team representing the corporate recovery specialists, Fenix, is to develop products to offer a more comprehensive service to the electronics industry. This is a strategic direction of *product development*, where organisations deliver modified or new products to existing markets. Fenix's suggestion is primarily focused on adding new products (expanded product range) and services (special requirements) beyond current capabilities. The scenario suggests that 70% of the electronics industry currently use *greenTech* components somewhere in their products. However, there may be scope for supplying more products and services to these established customers as well as supplying to those who do not currently use *greenTech*'s products.

Fenix also makes the point that buying a manufacturing capability will protect the supply chain. *greenTech* currently has no manufacturing capability of their own and so they are at the mercy of their suppliers. These suppliers might raise prices, supply competitors, fail to meet demand or go out of business. A manufacturing facility could avoid all of these as well as perhaps providing an opportunity to cut supply costs. Furthermore, it could be argued that supplying a more comprehensive range of products to established customers may help protect current business with these customers.

However, Fenix recognise that manufacturing is beyond *greenTech*'s current capabilities. Consequently, there is the issue of how these capabilities will be acquired. Their proposal is for the company to spend its cash surplus acquiring companies that already have these capabilities. It would be costly, risky and time-consuming to develop these capabilities organically. So, although *greenTech* has no experience of making acquisitions and making them work, Fenix's suggestion of acquisition seems very sensible.

The final proposal from Professor Ag Wan from MidShire University is for *greenTech* to look for opportunities where the company could use its core competencies with green technology within other industries and products. This is the strategic direction of *finding new uses for existing products and knowledge*. Johnson, Scholes and Whittington provide an example: 'manufacturers of stainless steel have progressively found new applications for existing products, which were originally used for cutlery and tableware. Nowadays the uses include aerospace, automobile exhausts, beer barrels and many applications in the chemical manufacturing industry.' For the company itself, this is probably quite a radical way of looking at itself. Instead of being seen as essentially a components supplier it becomes a supplier of ideas and technology. Professor Ag Wan's suggestion makes *greenTech* re-consider what industry they are in and this reflection should allow them to see a potentially much bigger market (green technology) in which they have already demonstrated capabilities in one sector (electronics).

Contemporary social trends also support Professor Ag Wan's suggestion. All industries will have to find greener ways of working if they are to satisfy three important forces. The first is the 'green consumers' who wish to purchase from companies with demonstrable sustainability policies. The second is governments who are increasingly likely to pass laws on emissions and responsibility for waste disposal. The third force is the increasing cost of disposal as the number of potential disposal sites decreases. Thus the market for *greenTech*'s products, know-how and testing should be large and increasing.

The problem facing *greenTech* is how they will find these markets and exploit them. Professor Ag Wan's suggestion is that the surplus cash should be spent on finding these markets using market research.

The scenario states that *greenTech* opted for the third option (from Professor Ag Wan) and put it into operation. This briefing paper suggests why this option was selected by the company. Although all three of the suggestions are feasible it argues that Ag Wan's proposal is a more suitable fit.

The first suggestion, from Lewis-Read, appears to address the imbalance between a large potential market (green computers) and an under-promoted and under-sold product (fully assembled green computers). However, the supply of computers is a very competitive market and the money that *greenTech* has to spend on marketing is probably insufficient for it to make a serious impact. There are already global brands supplying computers at highly competitive prices. It must be recognised that *greenTech*'s products could be sold initially at a premium price to reflect its niche position. However, if the market-place demands it, the major suppliers will have little difficulty in producing machines that directly compete with *greenTech*. The product can easily be imitated. Indeed the scenario reveals that *greenTech* already supplies two medium-sized computer manufacturers with components for green products in their range. These manufacturers might feel uneasy about *greenTech* becoming a significant competitor and consequently withdraw their business, so weakening this revenue stream. *greenTech* may be better advised to position their fully assembled computers as a complete kit, just as kit car manufacturers are prepared to provide assembled cars to customers without the time or expertise to assemble them.

Overall, Lewis-Read's proposal does not appear to be a particularly *feasible* strategy. Johnson, Scholes and Whittington suggest that an assessment has to be made about the extent to which the organisation's current capabilities (resources and competences) have to change to reach the *threshold* requirements for a strategy. In the case of *greenTech*, major investment would be required to overcome entry barriers and maintain market share. It is unlikely that the cash available would be sufficient to cope with the global players who already supply fully assembled computers.

The second suggestion, from Fenix, has many good points. *greenTech* is currently reliant on its suppliers because it lacks a manufacturing capability. It appears to make sense to move upstream in the supply chain to secure supply. Flexibility in the products supplied and reduced costs are also attractive bonuses. However, the company has grown organically and it is still run by the management team that formed it in 1990. It has no experience in acquiring companies, integrating them and running them successfully. All evidence suggests that many acquisitions do not deliver the benefits that had been claimed for them, even when they are acquired by experienced managers. Furthermore, it is likely for cost reasons that the acquired company would be in another country, perhaps creating both language and cultural difficulties. Overall, *greenTech* appears to be a relatively conservative, risk-averse company and so it is the unfamiliarity and risk associated with this proposal that means it should be rejected. In the terms of Johnson, Scholes and Whittington, the Fenix proposal is not a particularly *acceptable* strategy to the existing management because of the risk involved with acquisition.

Professor Ag Wan's suggestion may have won by default; after all the television show has to have a winner! However, it also has two significant strengths. The first, central to his proposal, is that it allows the company to see itself in a new and exciting way. The recognition of these core green technology and know-how competencies and their significance in an important and expanding market should be very motivating to *greenTech*'s management and employees. Secondly, it has to be recognised that most of *greenTech*'s current business activities are with fellow electronics companies or enthusiasts. Professor Ag Wan's proposal continues that tradition. Transactions will be business-to-business, often at quite a technical level. *greenTech* is comfortable with and experienced in such transactions. Professor Ag Wan's suggestion appears to be suitable, in that the strategy addresses the situation in which the company is operating. It is acceptable because it is in line with the expectations and values of the shareholders. Finally, it appears to be feasible as it does not require excessive funding and most of this funding is focused in one specific area: market research. The proposal is an excellent cultural fit and so was justifiably selected as the winner in the programme.

(c) **(i)** A number of issues can be identified in this process.

First of all, 40% of enquiries do not proceed after the delivery and payment details have been sent to the customer. The scenario suggests that this is of concern to *greenTech* because it wastes time and effort. However, it also impacts upon Xsys and for both of these companies this wastage means the loss of significant selling opportunities. The reason for this high wastage rate is not specified. Three possibilities include:

- The cost of the computer was more than expected. In this case it would be useful to supply the cost as soon as delivery details have been completed. This means making sure that the web site has access to Xsys pricing details.
- The delivery date was later than required. Although it would be tempting to automatically show the delivery date on the screen alongside cost details, this might not be commercially sensible. It would be better to direct effort at reducing the delivery time so that it was no longer an issue.
- Finally, the delay gives the customer time to reflect and change their mind. It would be preferable to get customer commitment much earlier in the ordering process.

The credit check is performed too late in the ordering cycle. 20% of orders are rejected at this point. Hence *greenTech* and Xsys have wasted time and money communicating with the customer. The suggestion again is to bring payment and credit checking forward to the start of the ordering process. This would remove two processes from the *greenTech* swim lane: 'request delivery date' and 'e-mail delivery and cost details'.

Bringing ordering, payment and payment checking to the start of the process eradicates the need for Xsys to provide two delivery dates, one on initial ordering and a second on confirmation.

The problem of delivery time could be addressed by using EIM (or a similar courier company) to deliver directly to the end customer. This would remove two further processes from the *greenTech* swim lane – 'agree delivery date' and 'arrange delivery to customer'.

Making the changes proposed above now only leaves 'place confirmed order' and 'test computer' in the *greenTech* swim lane. 'Place confirmed order' can be automatically triggered near the start of the ordering process. If responsibility for testing was given to Xsys (and there are good reasons why it should be), then there would be nothing left in the *greenTech* swim lane. *greenTech* becomes a virtual supplier and the sales department can get on with making sales rather than processing orders.

(ii) The design of processes can be viewed as an *implementation* of strategic planning. This is normally associated with what Johnson, Scholes and Whittington term the *design lens*. It views strategy development as the deliberate positioning of an organisation through some analytical, directive process. It is often associated with 'top-down' design in that the objectives and goals are determined first and then processes are designed to realise them. In the context of the scenario, the new strategic direction now being followed will required a set of processes designed to facilitate business-to-business transactions with potential new customers. Process is following strategy. As a result process design and associated measures should align with business goals and objectives.

Alternatively, the investigation and potential re-design of the way processes take place within an organisation supports the lenses that Johnson, Scholes and Whittington termed, respectively, experience and ideas. An investigation of current processes might suggest that process goals and measures may not be aligned with strategy. This may be because the processes have diverged from their original specification or it may be because the strategy is not operationally feasible and the people undertaking the processes to implement it know this. Consequently, processes are often modified by employees and managers to make them workable and eventually, strategy is modified to accept this.

The re-design of processes may lead to incremental changes or it may lead to a significant strategic shift. Opportunities discovered while focusing on specific processes may have very significant repercussions. In the case study, the potential role of *greenTech* as a virtual supplier may be very interesting to the board. It would eradicate delay, reduce operational costs, reduce delivery costs and perhaps provide better (but certainly quicker) customer service. However, this is quite a significant strategic move and the decision to follow the chosen strategy would have to be re-evaluated if the company changed its strategic position.

2 **(a)** The product life cycle model suggests that a product passes through six stages: introduction, development, growth, shakeout, maturity and decline. The first Rock Bottom phase appears to coincide with the introduction, development and growth periods of the products offered by the company. These highly specified, high quality products were new to the country and were quickly adopted by a certain consumer segment (see below). The life cycle concept also applies to services, and the innovative way in which Rock Bottom sold and marketed the products distinguished the company from potential competitors. Not only were these competitors still selling inferior and older products but their retail methods looked outdated compared with Rock

Bottom's bright, specialist shops. Rock Bottom's entry into the market-place also exploited two important changes in the external environment. The first was the technological advance of the Japanese consumer electronics industry. The second was the growing economic power of young people, who wished to spend their increasing disposable income on products that allowed them to enjoy popular music. Early entrants into an industry gain experience of that industry sooner than others. This may not only be translated into cost advantages but also into customer loyalty that helps them through subsequent stages of the product's life cycle. Rock Bottom enjoyed the advantages of a first mover in this industry.

Hein's leadership style appears to have been consistent with contemporary society and more than acceptable to his young target market. As an entrepreneur, his charismatic leadership was concerned with building a vision for the organisation and then energising people to achieve it. The latter he achieved through appointing branch managers who reflected, to some degree, his own style and approach. His willingness to delegate considerable responsibility to these leaders, and to reward them well, was also relatively innovative. The shops were also staffed by young people who understood the capabilities of the products they were selling. It was an early recognition that intangible resources of skills and knowledge were important to the organisation.

In summary, in the first phase Rock Bottom's organisation and Hein's leadership style appear to have been aligned with contemporary society, the customer base, employees and Rock Bottom's position in the product/service life cycle.

The second phase of the Rock Bottom story appears to reflect the shakeout and maturity phases of the product life cycle. The entry of competitors into the market is a feature of the growth stage. However, it is in the shakeout stage that the market becomes saturated with competitors. The Rock Bottom product and service approach is easily imitated. Hein initially reacted to these new challenges by a growing maturity, recognising that outrageous behaviour might deter the banks from lending to him. However, the need to raise money to fund expansion and a latent need to realise (and enjoy) his investment led to the company being floated on the country's stock exchange. This, eventually, created two problems.

The first was the need for the company to provide acceptable returns to shareholders. This would have been a new challenge for Hein. He would have to not only maintain dividends to external shareholders, but he would also have to monitor and improve the publicly quoted share price. In an attempt to establish an organisation that could deliver such value, changes were made in the organisational structure and style. Most of the phase 1 entrepreneur-style managers left. This may have been inevitable anyway as Rock Bottom would have had problems continuing with such high individual reward packages in a maturing market. However, the new public limited organisation also demanded managers who were more transactional leaders, focusing on designing systems and controlling performance. This style of management was alien to Rick's approach. The second problem was the need for the organisation to become more transparent. The publishing of Hein's financial details was embarrassing, particularly as his income fuelled a life-style that was becoming less acceptable to society. What had once appeared innovative and amusing now looked like an indulgence. The challenge now was for Hein to change his leadership style to suit the new situation. However, he ultimately failed to do this. Like many leaders who have risen to their position through entrepreneurial ability and a dominant spirit, the concept of serving stakeholders rather than ordering them around proved too difficult to grasp. The sensible thing would have been to leave Rock Bottom and start afresh. However, like many entrepreneurs he was emotionally attached to the company and so he persuaded a group of private equity financiers to help him buy it back. Combining the roles of Chairman and Chief Executive Officer (CEO) is also controversial and likely to attract criticism concerning corporate governance.

In summary, in the second phase of Hein's leadership he failed to change his approach to reflect changing social values, a maturing product/service market-place and the need to serve new and important stakeholders in the organisation. He clearly saw the public limited company as a 'shackle' on his ambition and its obligations an infringement of his personal privacy.

It can be argued that Hein took Rock Bottom back into private ownership just as the product life cycle moved into its decline stage. The product life cycle is a timely reminder that any product or service has a finite life. Forty years earlier, as a young man, Hein was in touch with the technological and social changes that created a demand for his product and service. However, he had now lost touch with the forces shaping the external environment. Products have now moved on. Music is increasingly delivered through downloaded files that are then played through computers (for home use) or MP3s (for portable use). Even where consumers use traditional electronic equipment, the reliability of this equipment means that it is seldom replaced. The delivery method, through specialised shops, which once seemed so innovative is now widely imitated and increasingly, due to the Internet, less cost-effective. Consumers of these products are knowledgeable buyers and are only willing to purchase, after careful cost and delivery comparisons, through the Internet. Hence, Hein is in a situation where he faces more competition to supply products which are used and replaced less frequently, using a sales channel that is increasingly uncompetitive. Consequently, Hein's attempt to re-vitalise the shops by using the approach he adopted in phase 1 of the company was always doomed to failure. This failure was also guaranteed by the continued presence of the managers appointed in phase 2 of the company. These were managers used to tight controls and targets set by centralised management. To suddenly be let loose was not what they wanted and Hein appears to have reacted to their inability to act entrepreneurially with anger and abuse. Hein's final acts of reinvention concerned the return to a hedonistic, conspicuous life style that he had enjoyed in the early days of the company. He probably felt that this was possible now that he did not have the reporting requirements of the public limited company. However, he had failed to recognise significant changes in society. He celebrated the freeing of 'Rock Bottom from its shackles' by throwing a large celebration party. Celebrities were flown in from all over the world to attend. It seems inevitable that the cost and carbon footprint of such an event would now attract criticism.

Finally, in summary, Hein's approach and leadership style in phase 3 became increasingly out of step with society's expectations, customers' requirements and employees' expectations. However, unlike phase 2, Hein was now free of the responsibilities and controls of professional management in a public limited company. This led him to conspicuous activities that further devalued the brand, meaning that its demise was inevitable.

(b) At the end of the first phase Hein still had managers who were entrepreneurial in their outlook. It might have been attractive for them to become franchisees, particularly as this might be a way of protecting their income through the more challenging stages of the product and service life cycle that lay ahead. However, by the time Hein came to look at franchising again (phase 3), the managers were unlikely to be of the type that would take up the challenge of running a franchise. These were managers used to meeting targets within the context of centrally determined policies and budgets within a public limited company. Hein would have to make these employees redundant (at significant cost) and with no certainty that he could find franchisees to replace them.

At the end of phase 1, Rock Bottom was a strong brand, associated with youth and innovation. First movers often retain customer loyalty even when their products and approach have been imitated by new aggressive entrants to the market. A strong brand is essential for a successful franchise as it is a significant part of what the franchisee is buying. However, by the time Hein came to look at franchising again in phase 3, the brand was devalued by his behaviour and incongruent with customer expectations and sales channels. For example, it had no Internet sales channel. If Hein had developed Rock Bottom as a franchise it would have given him the opportunity to focus on building the brand, rather than financing the expansion of the business through the issue of shares.

At the end of phase 1, Rock Bottom was still a financially successful company. If it had been franchised at this point, then Hein could have realised some of his investment (through franchise fees) and used some of this to reward himself, and the rest of the money could have been used to consolidate the brand. Much of the future financial risk would have been passed to the franchisees. There would have been no need to take Rock Bottom public and so suffer the scrutiny associated with a public limited company. However, by the time Hein came to look at franchising again in phase 3, most of the shops were trading at a loss. He saw franchising as a way of disposing of the company in what he hoped was a sufficiently well-structured way. In effect, it was to minimise losses. It seems highly unlikely that franchisees would have been attracted by investing in something that was actually making a loss. Even if they were, it is unlikely that the franchise fees (and hence the money immediately realised) would be very high.

3 (a) The judicious use of selected financial ratios should have indicated some cause for concern, leading to further investigation of the company and the industrial sector itself. It would have been very helpful to identify typical financial ratios in the sector that RiteSoftware is operating in. However, in the absence of such information, comparison between the two years will provide some evaluation and a basis for further investigation.

However, before calculating and commenting on the ratios, there are a number of things directly discernable from the financial figures provided by the company.

– Firstly, goodwill is the most significant non-current asset. If the company is in the position that it needs further funding, then the extract suggests that there is little to secure this funding against. Most lenders prefer to lend against tangible assets, such as property. The value of goodwill has also increased substantially since 2007, suggesting an acquisition. It would be useful to investigate this further.

– Secondly, although trade receivables year on year have increased, in percentage terms, about the same as revenue, trade payables have increased significantly more. The efficiency ratios should cast more light on this; but it appears that the company may be using trade payables to finance cash flows. This hunch might be supported by the fact that the bank overdraft was actually reduced in 2008.

– Thirdly, although sales revenue increased by 10% in the period, cost of sales grew by a greater percentage, leading to a reduction in profit. It seems reasonable to assume that labour costs largely contributed to this cost of sales increase. The percentage increase in staff was almost 30%, a significant proportion for a small company to integrate and profitably utilise.

– Finally, the extract from the accounts shows no retained profit, suggesting that this is being distributed to shareholders. This needs to be investigated.

Profitability
Two profitability ratios can be calculated from the extracted financial information. The ROCE (Return on Capital Employed) has almost halved. Although the actual profit remained the same, it was achieved with significantly higher borrowing.

The net profit margin has also almost halved. The absolute figures are also very low (less than 1% in 2008) and this needs further investigation to see if such a figure is viable, or representative of the industry sector.

Efficiency
The general observation about trade payables made above appears to be borne out by the ratios. The average receivables settlement remains the same, suggesting good credit management in an expanding business. However, average payable days have increased significantly and are now beyond the 30 days normal for this business.

Sales revenue per employee has dropped from $33,500 in 2007 to under $29,500 in 2008.

Liquidity
Liquidity (measured through both the current and acid test ratios) has declined slightly during this period. Also, the values are rather low (approximately 0.76:1) and so this too would need investigation. Perhaps liquidity is traditionally low in this industry sector.

Financial gearing
The two gearing ratios discernible from the extracted information both give cause for concern. The gearing ratio itself has jumped from 25% to above 43%. The interest cover ratio has dropped to 2 from 7.5. Again, the sector needs investigation.

Conclusion
The financial figures of RiteSoftware do suggest that everything was not well and that further investigation was necessary. The figures suggest rising debt, cash flow problems, lowering efficiency and very poor profitability. Further investigation might have revealed that RiteSoftware was typical of the industry. However, it might have also identified the problems that led to the company's eventual demise.

(b) The lack of a formal evaluation of the financial figures of RiteSoftware is the subject of the first part of the question. However, the financial position is just part of the analysis required of the potential supplier. The question requires FOUR further ways in which OneEnergy failed to follow a proper evaluation procedure. In this model answer, the four suggestions are:

1 A failure to investigate the supplier's organisational structure and ownership
2 A failure to evaluate functional requirements
3 A failure to evaluate non-functional requirements
4 A failure to set proper evaluation criteria and follow a selection process

However, other appropriate suggestions made by the candidate will be given credit.

Organisational structure and ownership
The evaluation should have included an investigation into the structure of RiteSoftware, its shareholders and directors. A simple inquiry at Companies House (for example) would have revealed that the managing director of RiteSoftware had the same surname as the HR director of OneEnergy. The HR director could then have been asked directly if he was related to the managing director of RiteSoftware. Of course, there may have been no impropriety intended, but the fact would have come to light and been considered in the evaluation. Many organisations will either not procure from companies where directors and senior managers have relatives or will ask for that information to be disclosed by the supplier in order that it can be weighted in the evaluation of alternative suppliers.

Functional requirements of the software
The evaluation process did not formally define the functional requirements of the required system. The scenario mentions that three months ago, another set of amendments was requested from RiteSoftware to allow one of the divisions in OneEnergy to pay bonuses to lorry drivers in a certain way. This functional requirement should have been defined in advance in the process and it would have then been compared with the functions offered by the package. The gap between requirement and package could then be evaluated in advance. This allows two things. Firstly, the match of functionality and package will form part of the evaluation. It is not expected that every function requirement will be completely fulfilled but the degree of compromise has to be assessed in some way. Secondly, an understanding of the gap allows the compromise to be managed in advance. For example, in the context of the pay for lorry drivers it might have been possible to change the pay structure in such a way that rewarded the drivers but avoided the expense of commissioning and maintaining software amendments.

Non-functional requirements of the software
Many software packages do actually offer most of the functionality that the users require. However, how they deliver that functionality is very important and usability can be a great differentiator between competing packages. In the scenario, it seems clear that non-functional requirements such as user-friendliness have not been considered properly in the evaluation. If they had been then it would be unlikely that users would have problems understanding some of the terminology and structure of the software. Problems leading to comments such as 'it just does not work like we do' should have been identified in advance. Understanding user competencies and expectations would allow the gap between users' ability and the requirements of the package to be properly assessed. This measure would be part of the evaluation. Again, if the package is selected, the gap can be planned for in advance so that the extra training costs, alluded to in the scenario, are budgeted for at the outset.

Evaluation criteria and process
Finally, the scenario suggests that the board decided to purchase the RitePay software package without evaluating alternative solutions. It was felt that payroll rules and processes were relatively standard and so there was no need to look further than a package recommended by the HR director. Certainly, the discovery that the HR director is related to the managing director of RiteSoftware now puts his impartiality in doubt. Furthermore, subsequent requested amendments to the functionality of the package suggest that OneEnergy's payroll rules were not as standard as expected. However, the real problem with choosing one solution without evaluating alternatives is that there is no auditable evidence about how the supplier and the product were selected. At best this looks amateurish; at worst it might cause concern to the non-executive member of the board and its internal auditors. OneEnergy is a plc. The scenario suggests that the company does have a policy on competitive procurement. Avoiding it raises the chance of impropriety, reduces the opportunity of negotiating a good deal, and should attract the attention of non-executive directors and other significant stakeholders.

4 (a) The salary package initiated by the new management team has had some unforeseen side effects. Although high bed occupancy rate appears to be a reasonable measure of effectiveness it has led to a series of consequences.

A significant number of bookings are sold through a late booking Internet-based agency. The scenario explicitly mentions lastsecondhotels.com, but it is likely that the company also sells through other agencies. All such bookings are normally at a discounted price. People are attracted to these sites by the low price they offer and the savings that can be made on the published price. Firstly, a commission has to be paid to the agency, so eroding the price even further.

There is some evidence in the published comments about selling to groups: 'Full of school children on a trip … will not be using this chain again'. Selling to groups is a good way of selling beds because effectively one booking sells many beds. However, groups may be disruptive to other guests, particularly if it is a group of schoolchildren. This also again suggests discounted prices, with guests who are unlikely to use some of the premium services on offer, such as the restaurant.

Basing a bonus on a percentage occupancy figure often invites the manipulation of the data to meet that target. Clearly, the hotels have tried in a number of ways to fill beds. However, another way to meet the target is to reduce the denominator; how many beds are available every night. There is evidence in the scenario that hotel managers have declared bedrooms unfit for use or claimed that they are being used for other purposes. Monitoring the number of beds actually available would be quite difficult.

Attracting guests through agencies, group bookings and other discounted methods may attract the sort of customer who is unwilling to spend money on other services in the hotel. There is plenty of evidence of this from the quotes given on the web site. For example, 'cheap, but don't eat there. The price for breakfast was extortionate'. The achievement of the net profit figure is undermined by a combination of cheap room prices and an unwillingness to use services once the guest is there. The hotels might be more profitable if guests were willing to consume food and drink on the premises once they had arrived.

Given the discounted room rates, managers need to cut costs even more if they are to achieve any sort of net profit.

Evidence from the scenario suggests that they are doing this by:

– **Hiring cheaper, less competent staff** 'The serving staff were uncommunicative. Staff were more interested in talking to each other than to the customers.' 'The staff were surly and uncommunicative'.
– **Using poorer quality products** 'Restaurant food was very expensive and of poor quality'.
– **Reducing capital investment** 'No internet connections in the rooms or public areas, very disappointing'.
– **Reducing operational costs** 'The bath was cracked and the windows were dirty. Cheap, but badly in need of a clean'.
– **Over-charging for food and drink** 'Food was expensive and dull'.

In effect, the two measures in the bonus scheme are incompatible. The largest part of the bonus is from high occupancy levels. Consequently managers focus on this, using a number of ways to achieve high occupancy. However, discounting room rates means that the profit margin is being eroded. The only way for managers to make their secondary bonus is to further cut costs by employing cheap labour, suppliers and products. This has to be reinforced by reducing expenditure on maintaining or improving the current infrastructure of the hotel. Unfortunately, not only is this not working (guests are not using the restaurant), but traditional higher spending clients are not staying any more, put off by their fellow guests and the evident lack of investment. 'Much worse than last time we visited it. It used to be such a lovely hotel'.

So, in conclusion, the reward system initiated by the new management team may achieve the occupancy targets but it will not achieve the profitability targets. The scheme needs to be re-thought.

Furthermore, most reward schemes have elements of fixed salary, group-related performance pay and individual-related performance pay. In the context of Elegant Hotels, the group could be conceived as the hotel chain, or as the employees working in each hotel. It appears that much of the manager's salary is determined by individual-related performance pay. The achievement of the required performance is largely in his or her control because he or she has the authority to cut bedroom rates (to achieve occupancy targets) and to cut costs (to achieve net profit margins). This means that individual managers may financially benefit but the overall performance of the hotel group suffers as a result of customers being unwilling to stay in future at other hotels in the chain. From a different group perspective, the poor performance of the group of employees delivering the service in the hotel is also not reflected in the manager's pay. So, hiring and managing unhelpful, incompetent staff has no adverse effect on the manager's eventual reward. Not only is the basis of the manager's reward system flawed, but so is the balance between individual elements. The company might benefit from reducing the individual performance element and introducing elements based on the performance of the hotel group as a whole and on the performance of the hotel staff as a whole.

(b) **Define**

This stage is about defining the customer, their Critical to Quality (CTQ) issues, and the core business processes involved. One of the key issues here is to define who the customers are, what their requirements are for products and services, and what their expectations are. This is a key issue for Elegant Hotels because the scenario does not really consider customers at all. Profitability and efficiency appear to be the main objectives of the hotels, not servicing customer needs. The customer quotes give some guide to what customers actually want: Internet connections, peace and quiet, helpful staff, good quality food, a good night's sleep. The business process should be about fulfilling these expectations, not about filling rooms and improving margins.

Measure

Measuring is about setting appropriate performance measures for the core business process. Elegant Hotels is currently measuring the wrong things. Measures should probably be centred around customer satisfaction. A data collection plan will have to be developed for the core business process. Data may be collected directly through customer questionnaire analysis and, less directly, through other measures such as frequency of re-booking with the chain.

Analyse

Once collected, the data needs to be analysed to determine the root causes of defects and opportunities for improvement. Gaps will be identified between current performance and the target performance, defined in the measurement stage. It is likely that improvement opportunities will have to be prioritised. A better understanding of the process will also help identify sources of variation and allow them to be tackled. In the context of the inappropriate measures used at Elegant Hotels, no analysis of the results appears to have been undertaken. 'Improvement' opportunities have been initiated by local managers vested with responsibility for meeting the targets.

Improve

This stage concerns the implementation and improvement of the target process (customer satisfaction) by designing solutions that fix current problems and prevent others from occurring. Improvements are required to achieve and exceed target performance. These improvements need to be carefully defined, explained and managed.

Control

Finally, controls are necessary to keep the process on the new course and to avoid people reverting to the old ways. A monitoring plan needs to be developed, documented and implemented. Systems and structures need to be altered to institutionalise the changes. This may lead to changes in staffing, training and how people are rewarded. This, of course, is absolutely essential at Elegant Hotels where poorly thought-out incentive schemes have actually led to poorer performing hotels, particularly in delivering customer satisfaction.

1 **(a)** Up to 1 mark for each significant point up to a maximum of 12 marks

(b) Up to 1 mark for each significant point in the evaluation of each proposal up to a maximum of 4 marks for each proposal. There are three proposals, giving a maximum of 12 marks. Up to 1 mark for each significant point in the justification of the winning proposal up to a maximum of 6 marks. 2 professional marks for appropriate tone, recognition of context of scenario, conviction of answer

(c) **(i)** Up to 1 mark for each identified deficiency, suggestion or implication up to a maximum of 10 marks

(ii) Up to 1 mark for each significant point up to a maximum of 6 marks. Up to 2 professional marks for clarity of the analysis

2 **(a)** Up to 1 mark for each relevant point up to a maximum of 6 marks for each phase. Three phases required, giving a maximum of 18 marks

(b) Up to 1 mark for each relevant point up to a maximum of 7 marks

3 **(a)** Up to 1 mark for each non-ratio based observation up to a maximum of 5 marks
Up to 1 mark for each ratio based observation up to a maximum of 5 marks
Up to 3 marks for summary and integration of answer, giving a maximum of 13 marks overall

(b) Up to 1 mark for each relevant point up to a maximum of 3 marks for each failing. Four failings required, giving a maximum of 12 marks overall

4 **(a)** Up to 1 mark for each relevant point up to a maximum of 15 marks

(b) Up to 1 mark for an appropriate description of each stage
Up to 1 mark for its application to Elegant Hotels
5 stages, giving up to a total of 10 marks