CIMA

Final Level Management Accounting – Case Study

15 FLCS

PRE-SEEN MATERIAL, PROVIDED IN ADVANCE, FOR PREPARATION AND STUDY FOR THE EXAMINATION TO BE HELD ON THE AFTERNOON OF THURSDAY, 23 MAY 2002

INSTRUCTIONS FOR POTENTIAL CANDIDATES

This booklet contains the ***pre-seen case material*** for the May 2002 examination. It will provide you with context information that will help you to prepare yourself for the examination on 23 May.
You may not take this copy of the pre-seen material into the examination hall. A fresh copy will be provided in the examination hall.
Unseen material will be provided for the examination: this will comprise further context information and the examination question.
The examination will last for three hours.
You will be required to answer one question which may contain more than one element.

Contents of this booklet:

This page is blank

Global Incorporated

Introduction

Global is a well-established and substantial supermarket group incorporated and based in the country of Westland, with its headquarters in Midcity. It has developed from what was once, early in the twentieth century, a family grocery business, to a company owning a large number of high street grocery stores, which prospered as transport of manufactured foods became cheaper. It used its ever-increasing volume requirements to buy at lower prices than its much smaller rivals. Strategy was initially driven by cost leadership. Prior to the development of supermarkets, it was one of the largest grocery retailers in the world.

The initial development of self-service groceries was ignored by Global, which regarded personal customer service as significant, and the potential labour savings as irrelevant. Its immense buying power led to very satisfactory profits. However, developments in Westland moved in ways that Global did not anticipate. Labour became more expensive in conditions of full employment after the second World War, with increasing legislation protecting employee rights. The personal service on which Global had prided itself was being priced out of the market. The leverage of its vast buying power over domestic suppliers became less effective under successive anti-trust legislation, which constrained buying power to reflect real differences in costs incurred by the suppliers. Under this legislation, other customers could demand comparable prices, unless the suppliers could show differences in cost arising from variations in manufacture, packaging and distribution. Perhaps more important for the longer term, customers regarded the new self-service stores as modern and preferable, and the Global stores as old-fashioned and dull.

Market Stores, which is also incorporated and based in Westland, had originally been a smaller rival of Global, but had been an early developer of self-service grocery stores. It continued to innovate, developing larger stores. It found that labour savings increased, and that a wider range of groceries and general merchandise could be sold in these stores without excessive stockholding costs. The customers liked this, and were also attracted by the first out-of-town stores, which were even larger, and provided easy and free car parking for customers, avoiding town centre congestion. Customers were no longer limited to buying what they could carry away by public transport; they could, if they wished, fill their cars.

Market Stores has continued to innovate in retailing, introducing additional facilities and services into its stores, such as post office boxes, cash-point banking facilities, baby-changing facilities, mother and baby parking facilities, home-delivery service, special food counters (such as fresh fish), in-store bakery, pharmacy, coffee shop, loyalty card discount schemes, petrol stations.

The market in which Market Stores and Global operated changed into one in which, with the development of a "one-stop shop" pattern, customers could buy most or all of their weekly food and other regular requirements in a single visit. The market comprises a large number of local catchment areas within which customers can reach a supermarket in a relatively short time. In some cases, these catchment areas overlap.

By the time that Global started to assess developments by Market Stores, and recognised that the market for groceries may have changed, investors had been attracted to Market Stores because of its high growth rate and attractive margins. Market Stores used its resulting high share price to acquire a number of smaller groups, and to raise new capital to continue to build out-of-town stores. Every time Market Stores reviewed its building programme, it commissioned larger stores.

[continued]

Global had responded to the developments by Market Stores, and followed it in converting stores to self-service, and in building out-of-town stores. But this was initially done on an experimental basis, to see if there were genuine savings to be achieved. Development did not occur on the same scale as, or with the speed of, Market Stores. Global did no more than follow Market Stores in selling a much wider range of products. Nor did Global do more than follow Market Stores in the introduction of bar coding of products and prices and the introduction of electronic point-of-sale (EPOS) technology.

Market Stores had, many years ago, overtaken Global to become the largest and most profitable supermarket group in Westland.

Global and Market Stores – financial information for years ended during 2001

	Global	*Market Stores*
Sales	$43·9 billion	$211·4 billion
Profit after tax	$1·43 billion	$7·10 billion
Shares	900 million	4,700 million
Earning per share	$1·59	$1·51
Information at 31 January 2002:		
Share price at 31 January 2002	$34·96	$56·65
Price / Earnings ratio	22·0	37·5
Market capitalisation	$31·46 billion	$266·3 billion

Note: Figures are given in billions unless stated otherwise. One billion = 1,000 million

The latest published quarterly "like for like" sales growth figures (that is, for comparable stores, excluding new openings) show that Market Stores is growing at a rate of over 5% each year in these terms, whilst Global is achieving under 2%. To this must be added the vast area of new sales space being built each year by Market Stores. It is also expanding overseas very rapidly, and is rumoured to be likely to make further acquisitions.

Analysts working for consumer organisations broadly agree that Market Stores, with its greater turnover leading to immense purchasing power, buys more cheaply than Global. It can match selling prices or sell even more cheaply without damaging margins. Measurements of this are disputed, and confused by the number of special promotions that Global normally operates to stimulate customer interest. Measurement is also confused by quality issues; Global targets more affluent customers than Market Stores, and claims to place more emphasis on quality.

A greater proportion of Market Stores' sales comes from very large out-of-town superstores, while a considerable proportion of Global's sales are generated in smaller stores in central locations. Market Stores is believed to have a significantly higher spend per customer visit.

Global has also come under pressure from other fast-growing competitors, which have either prospered by being more "up market", in an era of growing affluence, or have built very strong regional market shares. Some of these now appear to be able to buy at least as effectively as Global.

Preparations for a strategy meeting

Gabriel Eisenstein, Chairman of Global, has asked the members of the board of Global and the senior managers to attend a meeting to review strategy.

Global's board members and senior management

Members of the board:

Gabriel Eisenstein	Chairman, non-executive director
Carl Frosch	Non-executive director
John Falke	Non-executive director
Alfred Strauss	Non-executive director
General Thomas Frank	Non-executive director
John Parker	Chief Executive Officer and President
David Cohen	Finance Director
Jack Louis	Operations Director, Westland

The senior management:

Charles le Grand	Vice President, Information Systems
James Stuart	Vice President, Purchasing
Arthur Miller	Vice President, International
Susan Hageman	Vice President, Human Resources

Profiles of Global's board members and senior management

Gabriel Eisenstein, the non-executive chairman, was formerly the senior partner of Eisenstein & Co, Merchant Bankers, who act for Global, and have done so for very many years, in its relatively few acquisitions and more frequent fund raising requirements. He had become aware of increasing investor dissatisfaction with the limited progress made by Global, and the adverse comparisons being made with Market Stores, and other competitors. He realised that raising more capital on attractive terms was going to be quite difficult, and that, without a very good case being made by the company, the main institutional investors might refuse to participate.

Carl Frosch is a non-executive director, and a former partner in Frosch & Frosch, legal advisors to large corporations. He had discussed the position of Global with the Westland anti-trust authorities, and received clear, but unwelcome, advice. Acquisitions in Westland would only be permitted on a limited scale, even though Global is now much smaller than Market Stores. Global may be permitted to buy stores in areas where it has few stores, but would at best be allowed to increase the number of stores owned by no more than 10% each year. If more acquisitions were proposed, it may be forced to sell stores to balance its presence in other areas where it dominates the market. The political and regulatory environment is generally unfavourable. The farming lobby claims that supermarkets exploit farmers and discriminate against small local suppliers. The environmental lobby complains that the growth of out-of-town superstores leads to increased car usage.

John Falke is the president of Universal Insurance, which is a major investor in Global, holding 5% of the share capital and a significant amount of loan stock. He is a non-executive director of Global. He had met his fund management team, and had been advised that it wished to reduce its holding in Global, which the team considered to be significantly overweight in view of the limited growth prospects. He considered that, if this is the best policy for Universal Insurance, either he would have to force changes at Global which would make it a more attractive investment, or resign from its board.

[continued]

Alfred Strauss is a non-executive director of Global, and was formerly the partner within Global's auditors with responsibility for Global. He is concerned that, while Global's accounts met all relevant standards, and presented no problems to his former firm, he would have preferred a more conservative view to be taken on certain issues. In particular, he is concerned that Global appears to depreciate investments in store fittings and information technology more slowly than Market Stores. He is also concerned by differences in accounting for pension liabilities, as Global has proportionately many more long-service employees than Market Stores.

General Thomas Frank had recently retired from the army, and had accepted an invitation to become a non-executive director of Global. He was busy trying to find out quite what his responsibilities were, and in which way he could contribute. However, he found the aims and strategy of Global to be unclear, despite his separate discussions with the other directors and many of the senior managers.

John Parker is 60. He has been Chief Executive Officer (CEO) of Global for four years, the culmination of a lifetime working for the company. His career had started as a trainee in a grocery shop. He had risen from a store manager to a regional manager, and eventually progressed, via Human Resources, to the post of Vice President, Westland Retail Operations, prior to becoming CEO. He is well known locally as the (non-executive) chairman of the Midcity Football Club. He is known nationally as a past chairman of the Retail Business Federation, and has often appeared on television to comment on possible regulation of the industry, and new developments. He is concerned that the growth of Market Stores continues to outstrip that of Global but could not see any easy answer in terms of improving operations in Westland. He liked the present Global supermarkets just the way they were – many long-service staff that he knew by name, customers he could talk to. He was pleased he had been able to persuade the board last year to increase job security and pension benefits for long-service employees.

However, he recognised that something had to be done to please the investors and raise the share price. He thought he might have to re-consider his ideas, if changes to the supermarkets could attract new customers into the stores. He had discussed his personal financial position with a financial advisor from the auditors, and it was clear that he needed a contract renewal in June 2003 to take him up to retirement at 65. He also needed a significant profit from his share options if he were to enjoy the sort of retirement income he envisaged. His share options, granted when he was appointed, were at present worthless, as the current share price was well below the option price.

David Cohen had been appointed Finance Director two years ago, having previously been an audit partner with the auditors, but not directly concerned with the Global audit. He found the accounting system to be rather old-fashioned. He hoped to develop a new integrated system as part of any (much overdue) information systems update. He understood the concerns expressed by Alfred Strauss regarding depreciation and pension liabilities. He felt uneasy in discussions with the institutional investors and financial analysts, who were always seeking "guidance" on likely future statements on profits, though profits had been stable and predictable. When asked further questions about future plans, he did not respond. The accounts for 2001 were still not finalised, but he had circulated, before the meeting, a summary statement, showing very limited progress in a difficult market. (This financial statement is given as *Exhibit 1.)*

Jack Louis had been appointed as Operations Director, Westland four years ago. He is responsible for controlling the stores through a structure of regional offices, and has responsibility for sales policy and sales promotions in Westland. Previously he had been Vice President, Purchasing for eight years. While he has been in the company all his working life, he does not share John Parker's view of present operations. If he had the opportunity to succeed John Parker as CEO, he would like to cut staff considerably and close many of the smaller stores. He would like to carry out such a policy now, but sees no prospect of gaining support.

Charles le Grand had been appointed Vice President, Information Systems two years ago. He had previously held a similar position with a major European supermarket group, where he had installed new advanced systems. He had been appointed by Global with the implied brief to modernise its systems, but he was uncertain whether he could persuade the board to authorise the very considerable investment required. Part of the problem related to the limited success to date of the on-line home shopping development in Westland.

James Stuart was Vice President, Purchasing. He had moved into this role four years ago after a career in purchasing with other major groups. He found that Global valued relationships with old established suppliers, and that other senior managers and directors tended to intervene to protect their old friends whenever he wished to change suppliers. He felt that he was achieving little, and would not be averse to a move to another group, that would allow him more latitude to make an impact. He felt there was scope for reducing buying prices with firm management. Even 1% would be very big money.

Arthur Miller had joined Global two years ago as the first person to hold the appointment of Vice President, International. At 40 years, he was the youngest of those to attend the meeting. His career had been in supermarket management and regional management, including three years in Canada. He found the present overseas operations to be "a dreadful muddle", with no clear strategy, and no clear rationale for why the various investments had been made. Some investments had been sound and traded profitably. Others were at best marginal. All were quite small. While overall they added up to 12% of Global's turnover, they contributed less than 2% of the profit. Global's market share did not exceed 3% in any of the international markets in which it traded. He did not think he could recommend selling the present portfolio until he could be clearer regarding his next possible personal move. Ideally, he would sell most of the present overseas stores, retaining only the most profitable operations, and then persuade Global to make a really major overseas investment. If he succeeded, he could see a seat on the board, and the prospect of becoming CEO in due course. If there was any opportunity at this meeting, he was going to press for new investment in international operations.

Susan Hageman had been Vice President, Human Resources, for ten years, but had not been involved before in a meeting such as that planned. She was uncertain of quite what to expect, but was preparing papers on matters that concerned her, in case there was an opportunity to raise them. In particular, she wished to raise the case for a policy of allowing early retirement for some long-service employees to provide scope to recruit younger staff, especially from ethnic minorities, even though she did not think the CEO would be enthusiastic. She would also like to get involved with Global's operations outside Westland, to achieve a universal employment policy. It appeared that in many countries, staff enjoyed far greater job security and holiday entitlements than did Global staff in Westland.

The non-executive directors' dinner

The non-executive directors had all travelled to Midcity, where Global had its headquarters, the night before the meeting. As the CEO was away at a Retail Business Federation dinner in another city, they found it convenient to eat together and discuss problems.

Gabriel Eisenstein made it clear that something must be done – the company could not carry on drifting. A radical improvement in performance was needed to gain market support. Given that Global had always filled major posts from internal candidates whenever possible, he suggested that the meeting would be a good opportunity to look at an overall succession plan.

John Falke said that he thought that institutional investors would support any major acquisition in Westland, provided that it was secured by a sound property element in the valuation. He expressed disappointment that Carl Frosch's explorations suggested limited scope to acquire further supermarket businesses in Westland. However, there would be support for investment in another type of retail business or other service industry, such as hospitality, in Westland, if there were a clear business management plan to convince the analysts. Retailing, he stated, was a difficult industry in which to establish and retain a clear competitive advantage.

[continued]

Alfred Strauss commented on stretched resources and the possible need, in a year or two, for a rights issue to maintain the present business, unless profits improved or working capital was considerably reduced, or investment in existing stores cut back.

General Frank, asked for his preliminary views, said that none of the senior management team that he had met to date had obvious leadership qualities – but that it would be interesting to see their performance in the meeting.

The strategy meeting

The Chairman outlined the problem of needing to raise earnings and show a positive trend. He considered that greater growth was needed to boost the share price and enable future rights issues.

The CEO, reporting on current trading, and short-term forecasts, indicated that like-for-like sales in the current quarter were expected to rise by up to 2%. However, Market Stores was showing a much stronger trend, and may be growing by 5% to 7% each year in terms of like-for-like sales. Including the new stores being built each year, Market Stores is growing in total at well in excess of 15% each year. Global profits would probably be no more than static at best, and may fall slightly. He regarded maintaining the dividend as a priority, even if it meant restraining investment.

Alfred Strauss commented that this could only lead to a further fall in the share price.

The Chairman opened up the meeting, seeking suggestions for the way ahead.

The Operations Director, Westland stressed the problem of keeping the major supermarkets and superstores up-to-date and constantly refurbished to compete with Market Stores. With the large number of stores, it was difficult to achieve the target of modernising each store every seven years. If necessary, to have sufficient funds for this refurbishment, he was prepared to see the closure of some of the smaller, older stores, though this would involve significant personnel redundancies.

Both the CEO and the Vice President, Human Resources stressed the importance of having due regard for employees in difficult times, and protecting their interests as far as possible. Global had a deserved reputation as a good employer; this could easily be lost.

Questioned by Alfred Strauss, the Finance Director confirmed that some 20% of Global's more than 2,000 stores in Westland made no significant profit. The Vice President, Purchasing commented that the additional volume from this 20% of the stores helped towards obtaining the best purchasing terms. The Operations Director, Westland suggested that, without this volume, the number of suppliers could be reduced and the supply chain simplified. He continued by saying *"If we have learned anything from our exercises in activity based costing, it is that overheads are driven by complexity. The more complex the operation, the more non value adding co-ordination costs there are. The way ahead is to focus on core products, reducing the number of product lines and the number of listed suppliers. If we force suppliers to compete to remain Global suppliers, we could capture more of the value chain from our chosen suppliers, recovering our marketing costs and our sales data costs".*

The Finance Director raised the question of whether pressure should be put on suppliers to provide extended trade credit to finance refurbishment. Carl Frosch wondered whether the anti-trust authorities would accept this, but thought that it could be possible, provided that the credit taken did not extend beyond that taken by close competitors. This information was not available, and needed to be investigated. The CEO and the Vice President, Purchasing both commented on the long-term loyalty and support of many suppliers who had worked with Global, in some cases for fifty years.

The development of on-line home shopping was discussed. The Vice President, Information Systems stated that, after initial difficulties, the system was fully operational and reliable, but major investment was required to achieve a "state of the art" system. He commented that it appeared that all key dates had been met, and that sales targets had been achieved. The Operations Director, Westland commented less favourably. There were still significant numbers of queries that had to be resolved on the telephone with customers. The system costs and system support staff costs were high. There was also the problem that using store staff to pick orders from supermarket shelves placed irregular loads on store staffing; this was not practicable when the stores were busy. Home shopping orders were then delayed, which led to more queries. Questioned by the Vice President, Information Systems, he confirmed that the frequent delivery delays were caused by operational and staffing problems in stores, rather than information system problems. There was a separate problem that also affected this issue. The basic information on sales by product was still very slow, and Purchasing, waiting for this information, was unable to prevent a high level of stock-outs. This problem particularly affected special promotions and products sold at exceptionally low prices which are widely advertised. He agreed to circulate a note of the problems after the meeting. (This is given as *Exhibit 3.)*

A related issue caused some inconclusive discussion. Both the Operations Director, Westland and the Vice President, Information Systems commented that, on their reading of the original justification for on-line home shopping, it should have been in profit by the time present sales levels were reached, but that the current reports showed significant losses. The Finance Director said that this was a matter of the allocation of overhead costs for the information system and the stores. He was asked to provide a clear report and a post audit report on the project for a subsequent meeting. It was considered undesirable to proceed too far with this venture without knowing whether it was profitable.

The Vice President, International suggested that sales growth rates in a number of countries were more attractive than those in Westland, and that trading profits were potentially significantly higher. He considered that it would be sensible to go for a major acquisition which was big enough to make a significant difference to Global's earnings, rather than a series of small investments like the present scattered Global international operations. Challenged by both the CEO and John Falke on whether this was a high-risk strategy, he commented that "doing nothing" in Westland also appeared to be a high-risk strategy, with very limited possible outcomes. He presented some brief statistics on the market and the competing stores in Eastland, and was asked to provide further data.

The question was raised of who would manage the acquired company. The Vice President, International stressed the need for good local management, by local nationals, who understood local customers and tastes. The CEO stressed the desirability for top jobs to be held by Westland nationals to ease communication with head office.

General Frank suggested that a major acquisition within Westland should be considered. However, no-one present had any clear ideas of potential acquisitions or synergies. This was left for further investigation.

Summing up, the Chairman commented on the need for all ideas to be followed up for a further meeting as soon as more data was available. He stated that he would discuss with the CEO what information would be immediately available for prompt circulation, and a programme for collating further relevant information for another meeting in two to three months' time.

[continued]

Immediately after the meeting

The non-executive directors decided that it was too late to travel from Midcity, and that it would be useful to discuss outcomes with John Parker, the CEO.

Gabriel Eisenstein made it clear to John Parker that there was no prospect of a contract renewal for him unless immediate action was taken to improve Global's earnings. The share price had fallen over the past two years from over $50, reflecting the lack of growth. Proposals had to be found that would appeal to the financial markets; it was no use being sentimental about long-serving employees or old-established suppliers when the group itself was running into difficulty.

Gabriel Eisenstein then discussed the further information requirements, and agreed that basic data regarding the Eastland market should be circulated to those at the meeting.

The document circulated a few days after the meeting, comprising the data for Eastland Supermarket Groups, is given as *Exhibit 2.*

Other required information should be distributed before the next meeting. The methods of obtaining this, and the timetable, were discussed and agreed.

John Parker then left and the non-executive directors continued their discussions.

General Frank commented that there was limited indication of possible innovative thought from most of those present, apart from the Vice President, International. But he recognised that speaking out in the presence of one's immediate superior, and possibly being seen to criticise him, could be very difficult, especially in a very traditional organisation.

Exhibit 1

Summary financial statement circulated by David Cohen

Global's draft summary data for 2001 – subject to audit

Year ended 31 December	*2001*	*2000*	*1999*
	$ billion	*$ billion*	*$ billion*
Sales	43·90	41·50	38·40
Cost of goods sold	34·60	32·54	29·80
Gross profit	9·30	8·96	8·60
Store and administration costs	5·89	5·64	5·52
Depreciation	0·92	0·91	0·79
Interest	0·35	0·34	0·37
Profit before tax	2·14	2·07	1·92
Tax	0·71	0·68	0·63
Profit after tax	1·43	1·39	1·29

At 31 December	*2001*	*2000*	*1999*
	$ billion	*$ billion*	*$ billion*
Fixed assets	7·56	7·40	6·96
Current assets	9·08	8·28	8·17
Less current liabilities	(4·61)	(4·11)	(3·69)
Net current assets	4·47	4·17	4·48
Total assets less current liabilities	12·03	11·57	11·44
Long-term liabilities	4·56	4·40	4·58
Shareholders' equity	7·47	7·17	6·86
	12·03	11·57	11·44

[continued]

Exhibit 2

Basic financial data for the top 5 Eastland supermarket groups for years ended during 2001

Supermarket group:	*A*	*B*	*C*	*D*	*E*
Sales	€34·10 billion	€28·26 billion	€16.86 billion	€13.36 billion	€7.56 billion
Profit / (loss) after tax	€1·28 billion	€0·44 billion	€0·49 billion	€0·37 billion	€(0·03) billion
Shares	7,140 million	1,950 million	2,560 million	1,020 million	490 million
Earnings per share	€0·179	€0.23	€0.19	€0·36	€(0·06)

Information at 28 February 2002

Share price at 28 February 2002	€3·40	€5·40	€3·65	€5·20	€1·67
Price / Earnings ratio	18·9	23·5	19·2	14·4	–
Market capitalisation	€24·28 billion	€10·53 billion	€9·34 billion	€5·30 billion	€0·82 billion

Exchange rate : assume €1= $0·86

Summary balance sheet information at dates in 2001

Supermarket group:	*A*	*B*	*C*	*D*	*E*
	€ billion	*€ billion*	*€ billion*	*€ billion*	*€ billion*
Fixed assets	16·40	10·91	7·17	14·78	1·53
Current assets	2·76	6·04	1·66	3·74	0·94
Less current liabilities	(7·21)	(7·09)	(3·84)	(4·38)	(1·07)
Net current assets / (liabilities)	(4·45)	(1·05)	(2·18)	(0·64)	(0·13)
Total assets less current liabilities	11·95	9·86	4·99	14·14	1·40
Long-term liabilities	3·25	1·81	0·92	7·88	0·24
Shareholders' equity	8·70	8·05	4·07	6·26	1·16
	11·95	9·86	4·99	14·14	1·40

Summary profit and loss account information for years ended at dates in 2001

Supermarket group:	*A*	*B*	*C*	*D*	*E*
	€ billion	*€ billion*	*€ billion*	*€ billion*	*€ billion*
Sales	34·10	28·26	16·86	13·36	7·56
Profit before tax	1·75	0·71	0·73	0·52	(0·14)
Less tax	0·47	0·27	0·24	0·15	(0·11)
Profit / (loss) after tax	1·28	0·44	0·49	0·37	(0·03)

Statistics – Eastland Stores (figures for years ended during 2001)

Supermarket group:	*A*	*B*	*C*	*D*	*E*
Eastland total stores	697	470	249	488	1,319
Eastland superstores *	297	304	242	160	–
Eastland sales **	€29·8 billion	€20·2 billion	€16·2 billion	€12·8 billion	€7·56 billion
Employees (thousands)	225	197	109	87	60

* Superstores are large out-of-town stores. The number is included in the total number of stores above.

** Eastland sales exclude overseas sales by the groups.

Percentage of own brand products sold (figures for years ended during 2001)

Supermarket group:	*A*	*B*	*C*	*D*	*E*
Percentage of own brand products sold	53	62	31	45	48

Latest quarterly data on like-for-like sales

Supermarket group:	*A*	*B*	*C*	*D*	*E*
Percentage increase / (decrease) in like-for-like sales, over 1 year	4·4	6·1	5·2	4·2	(5·1)

Total growth: latest quarterly data

Supermarket group:	*A*	*B*	*C*	*D*	*E*
Percentage increase / (decrease) over 1 year	9	8	12	7	(3)
Estimated market share	25	18	15	10	6

Home shopping

Eastland on-line sales (€ billion)

1997	*1998*	*1999*	*2000*	*2001*	*2002 forecast*
0·9	1·9	5·3	7·7	10·6	13·9

On-line sales as a percentage of total sales are at less than half those in Westland, but are growing rapidly as Internet access increases. Most are made by supermarket A, with a store-based distribution system. Other supermarkets are mainly still experimenting, in some cases with dedicated warehouses being used for order picking and delivery. One minor supermarket group, with an overall market share of well under 5%, probably has some 15 to 20% of the on-line market.

[continued]

Exhibit 3

MEMORANDUM

To: *Members of the Board, Global*

From: *Charles le Grand, Vice President, Information Systems*

Date: *4 March 2002*

Subject: *Information Systems and Home Shopping*

The present apparent losses on home shopping reflect some operational problems, and some poor accounting.

The original proposals, years ago, assumed that picking (selecting from the shelves the items ordered by customers and packing them) would be done in slack time by "free" store staff. The cost was ignored. Picking is done on the basis of when staff have spare time, but is charged to the Home Shopping cost centre, thus reducing the cost of normal store operations. If dedicated staff were engaged, it would cost the Home Shopping cost centre no more than is charged by the various stores, and picking would be done when required. However, store managers would be under further pressure to control their costs by reducing store staff.

The original proposals considerably underestimated the stock-out problem. This has always existed, because the main stock control systems are over 20 years old. The problem is made worse by the heavy use of special promotions, advertising a limited range of products at low prices, which leads to erratic demands on suppliers. The main accounting and stock control system is so slow that the home shopping data is often used to "forecast" the main system output, especially in providing early indications of the success of the various promotions.

Queries arising from stock-outs have added significantly to system costs. Customers complain if a product is out of stock and a substitute product is delivered.

On present volumes, the home shopping is unprofitable, but this ignores any customer gain achieved by Internet shoppers also visiting stores. We know that on average Internet customers have higher average incomes and spend more per visit.

End of the pre-seen material

FLCS

Management Accounting – Case Study

Pre-seen material