CIMA

Final Level

Management Accounting – Case Study

15 FLCS

20 November 2003

Thursday afternoon

INSTRUCTIONS TO CANDIDATES

You are allowed three hours to answer this question paper.
This booklet contains the examination question and both the pre-seen and unseen elements of the case material.
Answer the question, which is on a detachable page so that you can refer more easily to the question at the same time as the information within both the pre-seen and unseen material.
The Assessment Matrix is available on the page after the requirement, for your reference.
Maths Tables and Formulae were provided within the question paper booklet and are available elsewhere on the website.
Write your examination number, your contact ID and your name on a double-sided card, which must be attached to your answer book. Write FLCS on the line marked "Subject" on the front of the answer book.
Do NOT write your name or your contact ID anywhere on your answer book.

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The organisations and characters featured in this scenario are entirely fictitious. Any similarity to any person living or dead, or any firm or organisation, is entirely coincidental.

Homejay Incorporated

Background

Homejay Incorporated (Homejay) has been trading for over a hundred years and has a number of areas of business that include some global brands that are highly profitable. It is a multinational company that predominantly manufactures and retails consumer goods for its home market in the USA and in Europe. It has few business interests in the Far East at present.

It has three main lines of business, which are do-it-yourself (DIY) stores, furniture stores and electrical consumer products. It also owns a cosmetics company and a chain of greeting card shops.

Homejay's shares are traded on an international stock market and are widely held by leading financial institutions and pension funds. Over a period of 50 years up to 1994, Homejay's share price growth has exceeded market analysts' expectations and it has been widely regarded as a good investment. However, for the last nine years its share price has not achieved the expectations of market analysts and the company's earnings per share has fluctuated and is now below the level achieved nine years ago. A number of management initiatives have been undertaken to improve growth, profitability and the company's share price.

Homejay has five business units, which are run as autonomous decentralised businesses, each with a general manager. The business units are:

Fixitco

Fixitco operates over 270 do-it-yourself stores throughout Europe, and retails both branded and own brand goods. It stocks a wide range of consumer goods including paints and other DIY materials and equipment, as well as garden equipment and garden furniture. It also retails some furniture products and electrical products manufactured by other Homejay business units. Fixitco has contracts with several DIY manufacturers which manufacture ranges of products under the Fixitco brand name. It has no DIY stores in the USA. Fixitco expanded the number of stores in the early 1990s, but has not opened any new stores for the last eight years.

Woodyco

Woodyco manufactures and sells mid to lower priced domestic furniture in the USA and in Europe. It has expanded its geographic coverage mainly by acquisitions of small competitors in areas where it did not operate. Its acquisitions have included manufacturing plants as well as retail outlets.

Woodyco manufactures domestic furniture including a number of ranges of kitchen cabinets, living room furniture, bedroom furniture, home-office furniture and storage units. It has nine manufacturing plants. It has 60 retail outlets in the USA and in Europe selling its own brand furniture as well as retailing selected ranges of kitchens and some other furniture through Fixitco stores in Europe. It also sells some of its ranges of products to other furniture retailers. It has not opened any new retail outlets in the past three years.

Electryco

Electryco manufactures its own brand of domestic electrical consumer products. These include laundry products, dishwashers, ovens, hobs, some lighting products and some smaller electrical appliances including food processors, kettles and toasters. It sells 97% of its products to a wide range of retailers in the USA and to some parts of Europe. The remaining 3% of sales are made through Fixitco stores in Europe. Electryco does not have any sales outlets of its own.

Cosmetco

This business unit is a cosmetics manufacturing company, which produces branded low-price cosmetics aimed at the bottom end of this competitive market. It sells its products in the USA and in some European countries, directly to high-street retailers.

Cardco

This business unit retails greetings cards in high-street shops in two European countries. Cardco purchases its greetings cards from a large range of both small and large manufacturers of greetings cards. Cardco owns or leases over 150 outlets in key high-street positions.

Location of Homejay's business units' management

The Homejay head office is located in a large city in the USA, and includes all corporate functions, including Human Resources, Corporate Finance and Corporate Planning departments. Each of the five Homejay business units is located in a different city. Woodyco, Electryco and Cosmetco's senior management are based in different cities in the USA, and Fixitco and Cardco's senior management are based in two different European cities.

Homejay's recent financial results

During the 1970s and 1980s the company went through a period of rapid growth and high profitability was achieved, together with substantial growth in its share price. It acquired a variety of businesses, some at large premiums. Some businesses have continued to operate in much the same way as before acquisition, and now report into one of Homejay's business units.

A summary of the turnover, operating profit and capital employed for each of the business units for the last two financial years is shown as *Appendix 1* (on page 14). This appendix also shows the latest forecast results for 2003/04.

Appendix 2 (on page 15) shows a summary profit and loss and balance sheet for Homejay for the last two financial years.

Since 1994, Homejay has experienced an overall decline in its earnings per share, although it has fluctuated within this period. Homejay's earnings per share at $0·22 in the year to February 2003 was some $0·06 per share lower than that achieved in the year to February 1994. *Appendix 3* (on page 16) shows Homejay's actual earnings per share compared to its expected earnings per share. The expected figures represent its annual planned results that had been communicated to the market.

Key personnel

Ralph Black – Chairman

Ralph Black, aged 58, is planning to retire at the end of December 2004, after more than 12 years with Homejay. He became Chairman when the company was experiencing a period of expansion. However, in recent years he has been disappointed with the lack of growth that the company has experienced. While Ralph Black has blamed the economic conditions for Homejay's disappointing performance in his last few annual reports, he also understands that the company needs to change the way it manages its business, if results are to improve significantly in the future.

Andy Mottram – Chief Executive

Andy Mottram, Chief Executive, aged 48, joined the company in 1992. He had previously worked for over 20 years with another global retailer, and had enjoyed a challenging business life, with his previous company's financial results improving far beyond inflation level each year. He joined Homejay two years before the company's earnings per share started to decline, and he has had to critically review a number of areas of the business. He has been responsible for much cost cutting, some of it rather random, and he is feared, rather than respected, by most of Homejay's managers.

Barry Milo – General Manager of Fixitco

Barry Milo has been with Fixitco for 16 years and prior to that was a regional manager for a competing chain of DIY stores. He is 45 years old and has a personal philosophy of never leaving his desk until after 8 o'clock each evening. While he works very long hours, he enjoys his work and the challenge of managing the 270 Fixitco stores across Europe.

He joined Fixitco as a regional manager responsible for all stores in two countries. When the previous general manager resigned to join another larger competitor in 1998, he was promoted to general manager as he had produced an impressive growth record in some of the stores under his control.

Joseph Logan – General Manager of Woodyco

Joseph Logan joined Woodyco over 20 years ago. He is 52 years old with a career in manufacturing and is very well liked and respected within Woodyco. He has worked in the furniture business all of his life but has no professional qualifications. He has risen to his current position through a combination of sheer hard work and being in the right place at the right time.

He joined Woodyco in the early 1980s as one of its factory mangers, worked long hours, got noticed, and was promoted to become Woodyco's manufacturing operations manager. When Woodyco's previous general manager retired in 1992, Joseph Logan was the one manager within the company who understood the business unit best, and he was appointed general manager. Joseph Logan is responsible for both manufacturing and retailing of Woodyco's products, but has limited retailing experience. He is, however, supported by an able senior management team.

Suzie Green – General Manager of Electryco

Suzie Green is a qualified electrical engineer who had worked in Japan for a leading electrical manufacturer in her twenties and then decided to return to the USA in 1990. She joined a small manufacturer of domestic electrical appliances as operations manager but the role and the responsibilities did not live up to her expectations.

She then moved to Electryco as manufacturing operations manager in 1992, and has enjoyed a challenging role for the last 11 years. In 2001, the general manager took early retirement because of ill health, and she eagerly accepted the offered promotion to become general manager.

Jayne Reed – General Manager of Cosmetco

Jayne Reed, aged 44, has worked for several cosmetics companies and has managed Cosmetco since before Homejay acquired the company. She has initiated a number of successful changes within the business unit and has driven forward much product development by her determination to see the business unit become more profitable.

Mitch Rayfield – General Manager of Cardco

Mitch Rayfield, aged 48, joined Cardco shortly after Homejay acquired it in 1982, as a shop manager. He worked his way up within the business unit and was appointed general manager in 1998. His experience in this business area was sound and his reputation as a tough, but fair, manager was well known.

Maxine Gill – Finance Director

Maxine Gill had qualified as a management accountant in the late 1980s while working for a car manufacturer, and stayed with that company for a further five years, holding the role of Chief Accountant. She left to join the head office team of a global electrical manufacturing company as group management accountant. She enjoyed this demanding role and was responsible for initiating a number of changes in both electronic data systems and the way that divisions were monitored. She was headhunted to join Homejay as Finance Director in April 2002, when the previous Finance Director, Peter Wade, left to join a larger global retailing company.

Mark West – Corporate Marketing Director

Mark West, aged 51, joined Homejay from another global retailer two years ago and has spent much of his time learning the businesses and trying to understand the rationale behind how the marketing budgets are spent by each business unit. He has also been researching how effective alternative marketing methods may be. He has worked in sales and marketing for a number of large multinational companies over the last 30 years. Andy Mottram has challenged him to deliver substantial turnover growth over the next two-year period to February 2006, and has left him to work with the general manager of each of the business units to see how this can be achieved.

Paul Simpson – Head of Corporate Planning

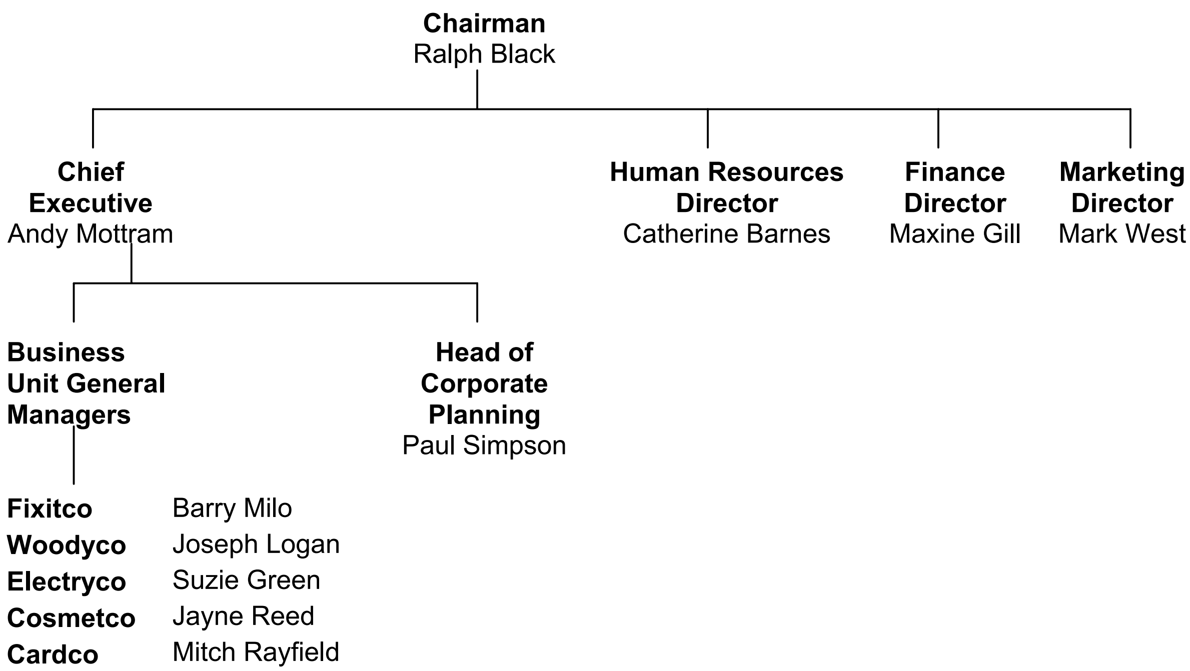
Paul Simpson has been with Homejay for over 15 years and has seen the company grow in both turnover and complexity. He had always worked very well with, and was a close friend of, the previous Finance Director, Peter Wade. His department was responsible for preparing one, five and ten-year plans and worked closely with finance and planning staff within each of the business units.

Since Maxine Gill joined Homejay in 2002, Paul Simpson's department has been under increasing pressure to produce a detailed analysis demonstrating where Homejay's results have differed from plans. Maxine Gill wanted to identify whether it was revenue shortfall or higher costs that resulted in lower net margins. Paul Simpson has also had to prepare reports justifying the basis of how future plans had been prepared. The working relationship between the corporate planning department and the Head Office finance team is not very good at present. Furthermore, there is a lack of rapport and trust between Maxine Gill and Paul Simpson. The latter cannot understand why Maxine Gill is spending so much time analysing past plans.

Catherine Barnes – Director of Human Resources

Homejay employs over 28,000 staff in the USA and in Europe, and the company's Director of Human Resources is Catherine Barnes. She joined Homejay in 2000. She has been reviewing a number of areas of the company's HR policies and has recently started to make a number of changes. She has been responsible for encouraging staff not to work long hours and has seen the level of staff training increase for the first time in 2002, to meet the agreed corporate target for staff training days.

Homejay's current organisation chart is shown below.



There are also four non-executive directors.

TQM introduced

In 1992 Andy Mottram had introduced a total quality management (TQM) programme into all areas of the company. This was heralded with a new mission statement and a training programme that aimed to have all employees trained in the ethos of TQM by the end of 1992.

The company's mission statement in 1992 was "to be a leading manufacturer and retailer of quality consumer goods in our chosen markets, with all employees participating in achieving quality standards in every area of the business".

The TQM initiative was initially greeted by most of Homejay's managers with scepticism, but some progress has been achieved in most areas of Homejay. The company decided to focus on quality and improving efficiency. By the mid 1990s there were some improvements in all areas of Homejay's business units, but this had been mainly achieved by a disproportionate amount of cost cutting. However, it was considered by many managers that too much emphasis had been placed on achieving short-term performance targets.

All of Homejay's business units have met, or exceeded, quality standards in some areas of their business, but none of the business units has achieved all of the quality targets set.

The balanced scorecard

Ralph Black was at heart a salesman and had seen the company grow significantly, but felt that too much emphasis had always been placed by the Board on financial measures. By 1998, some five years after Homejay started to experience difficulties in increasing its earnings per share, Ralph Black considered that the company should be looking at a more varied selection of performance measures.

Ralph Black decided to introduce the balanced scorecard concept to Homejay in 1999. The four different perspectives were measured and reported by all business units for the financial year ended February 2000. The measures that were agreed to be produced for the financial perspective included some that were already being monitored, such as growth in turnover, gross margins, net margins, return on capital employed and working capital measures. Some new financial measures were also introduced. The majority of the new performance measures that were introduced to each of the business units were in respect of the other three areas of the balanced scorecard. These are the customer perspective, the internal business process and the learning and growth process.

The general manager of each business unit is responsible for ensuring that appropriate measures for all four areas are produced. The measures are reviewed each month and are critically analysed as part of the planning cycle. The business unit general managers use the balanced scorecard measures to identify which areas of their businesses are improving and which areas need more management attention to address problems. For example, the general manager of Fixitco, Barry Milo, has identified that sales had been lost for certain product lines due to lack of stock, whereas at other times Fixitco has had to sell large amounts of stock at greatly reduced prices when seasonal lines have not produced the expected level of sales.

The customer perspective measures have also identified that Woodyco has a loyal customer base, as over 65% of customers who purchase Woodyco furniture or kitchens, have purchased goods previously from Woodyco.

Each of Homejay's business units has targets for the introduction of new products, which are currently as follows:

Business unit	*Target % of new products each year (as % of turnover)*
Fixitco	2%
Woodyco	15%
Electryco	10%
Cosmetco	20%
Cardco	10%

All of the manufacturing plants have met their safety targets. Furthermore, Homejay's initiative to invest in its staff has resulted in most business units meeting their targets for staff training.

The balanced scorecard statistical reports have confirmed that Electryco is having problems meeting customers' expectations in respect of quality. It is experiencing a higher than usual fault level on some of its products. Furthermore, it is not introducing new products, or new models, as quickly as some of its competitors. Many, but not all, of the current quality problems that Electryco is experiencing have been associated with new products. Some new products appear not to have had all of the manufacturing and design problems identified and rectified prior to launch. So while Electryco has met its innovation target, this has resulted in missed quality targets.

The Homejay business units

Fixitco

Homejay currently has over 270 DIY stores operating throughout Europe. The business unit is concentrating on improving turnover and identifying consumer trends, so that demand can be met at key times.

Barry Milo was concerned that the sales prior to Christmas 2002 could have been higher if a number of stores had been better stocked with some seasonal products. He had experienced the opposite in some stores, when they overstocked on Fixitco's own brand of paints that turned out to sell badly, despite a big marketing campaign.

Some slow-moving stock items, and even entire product ranges, have recently been rationalised as it was identified that they were not selling well and taking up too much floor space. More market research work is being undertaken to ensure that Fixitco stores maximise their sales potential.

It has been identified that the time taken by suppliers to meet orders is too long and Fixitco is working with its external suppliers to try to reduce lead times. It is also working closely with the manufacturers of its Fixitco own brand range of products to ensure that goods are manufactured in accordance with contract terms and are available to meet customers' demand.

Fixitco has been developing and improving its IT systems over the last few years and the latest phase of its management information system is specifically designed to speed up the procurement process and, in particular, to highlight fast-moving stock at an early stage. This should allow management to review its stock levels for these product lines and, where possible, ensure that stock is held at the right stores to meet demand. The new procurement and stock control system became operational in June 2003. The new system has already enabled Fixitco to meet demand for some product lines more quickly than previously achieved. However, the system appears to have prompted orders for items already in stock, causing Fixitco to carry larger than usual stock for some items. After investigation, it was found that this was partly caused by some items having more than one stock number. The reason for the rest of the extra stock has not yet been identified. Furthermore, Fixitco management has identified that the new system has created lower stock levels for some product lines, which has not helped the business to meet customer demand at peak times.

Barry Milo has identified that 25 stores need a major refit to make them more appealing to customers, especially where they are in direct competition with other local DIY chains. Some of these stores have seen declining or low growth in turnover in the last few years, and it is now becoming urgent to address the problem. It is estimated that the refit of these 25 stores will entail capital expenditure of around $45 million and reduced sales while the refits are undertaken. Sales at these stores during refurbishment could be up to 35% lower for the three months when work is being carried out. Additionally, increased marketing spend would be required to re-launch the refitted stores, estimated to be around $8 million. The re-launched stores are expected to compete more effectively with other local DIY stores.

Woodyco

Within the furniture market that it operates in, Woodyco manufactures and sells low-cost furniture in its own branded outlets in the USA and in Europe, and also supplies and retails furniture and kitchen cabinets through Fixitco stores in Europe. It also retails some product lines to other furniture retailers. Woodyco currently has 60 retail outlets.

Split of Woodyco actual sales	*2002/03*	*2001/02*
In Woodyco retail outlets	72%	69%
In Fixitco stores	18%	19%
To other retailers	10%	12%

During the 1980s and the early 1990s, Woodyco acquired over eight different furniture manufacturers or furniture retailers and by 1996 was a strong competitor in the highly fragmented furniture business. Many of the products that are manufactured in Woodyco's different factories, across several countries, complement each other, but there is some duplication of similar product lines. Woodyco operates three large manufacturing plants, as well as six smaller factories, that each produces its own brand of furniture. While the TQM approach has seen an increase in quality and improved operating methods in each of these nine furniture factories, Joseph Logan recognises that there is a need to review Woodyco's current manufacturing capacity and factory production methods.

The management capabilities in the companies that Woodyco acquired vary widely. The companies are still largely managed as they were pre-acquisition. Woodyco's business performance is subject to the vagaries of furniture design and fashion trends. In 1999, one of the Woodyco furniture manufacturing plants recruited a young design engineer, who has since won a design award for several pieces of furniture. This has resulted in a strong growth of sales in that area of the Woodyco business, but has masked a decline in some other product lines.

Woodyco has a number of well-known brands of furniture, with high consumer awareness of some of its brand names. However, many customers, and potential customers, do not know that Woodyco owns all of the brands of furniture.

An analysis of Woodyco's actual operating profit for the last two financial years is summarised below:

	2002/03	*2001/02*
	$ million	*$ million*
Turnover	1,365	1,248
Cost of sales	737	661
Gross margin	628	587
Selling and distribution costs	405	373
Administration	63	61
Allocation of head office costs	95	90
Woodyco operating profit	**65**	**63**

Due to the competitive nature of the low-cost furniture market, Woodyco has experienced falling gross and net margins in the last few years. It has targeted a number of areas for cost reduction, but most of these have not materialised. Some efficiency improvements have been made, but more flexibility in production is required. Joseph Logan is planning to review the manufacturing capabilities of Woodyco's nine factories.

The nature of the furniture business is such that sales peak around the times of its twice-yearly reduced-price sales periods in the summer and in January. Sales targets were achieved towards the end of the last financial year by reducing prices further in its post-Christmas sales, but this had a detrimental effect on the margins achieved.

Electryco

This business unit manufactures its own brand of domestic electrical consumer products and does not trade directly with the consumer. It supplies a number of large high-street electrical retailers and department stores in both the USA and Europe. It also sells some of its appliances in Fixitco stores, but this amounted to only 3% of Electryco's turnover in 2002/03.

In recent years, despite the TQM and balanced scorecard initiatives, some appliances have suffered from an increased level of faults. The business unit management has been investigating how this happened and has identified a number of areas where quality control was lacking and also where product design has been the reason for the recurrent faults in some of its products. Electryco's management has been working hard to improve the quality of these products to retain its good brand image. This has necessitated a fundamental redesign of one entire range of products. It has also resulted in increased repair and replacement costs for faulty appliances that are under warranty.

Electryco's general manager, Suzie Green, is confident that these quality problems can be easily overcome and that they will have no long-term effect on Electryco's other products. However, the business unit has been slow in developing and launching new models in some of its ranges.

The electrical appliance market is highly competitive. It is becoming increasingly apparent that Electryco will have to review its pricing structure for those products that have not been selling as well as planned, mainly due to competitors' products being priced lower than Electryco's. Many of Electryco's products have a number of superior features and have achieved a good reputation in the marketplace, although the current fault problems may affect this image.

Electryco's marketing department is planning a major new marketing campaign to promote its products. However, market research has repeatedly confirmed that price is a key selling point, rather than the product's features. The business unit's pricing policy for its entire range of appliances is currently being reviewed.

Cosmetco

Cosmetco had undertaken a three-year product development programme following much market research, which concluded during 2001/02. During this three-year period, substantial marketing and product development costs were incurred. It has produced new ranges of products that are selling well and has established itself in this competitive market. Cosmetco achieved turnover growth of almost 16% in the last financial year to February 2003. Together with reduced product development costs, this helped to achieve a growth of $5 million in this business unit's operating profit to $21 million in 2002/03.

Jayne Reed is confident that she can continue to grow this business and has set her sales team challenging targets for the next two years. The marketing of the new product range appears to have been very successful and she feels that the business unit should continue to spend similar amounts on marketing over the next few years, to that incurred in 2002/03.

Cosmetco signed up a young actress for marketing purposes during 2000 for a four-year contract. In early 2003, the actress won an award, and this has resulted in a higher than forecast demand for Cosmetco products, mainly in the USA. However, early discussions about renewing the contract have indicated that a significant rise in the fee would be required. Furthermore, Cosmetco has experienced some problems with the actress fulfilling her contractual obligations at promotional events. Jayne Reed is confident that these problems can be overcome, and is hopeful of significantly higher sales in 2003/04.

Cardco

This business unit has seen its turnover and operating profit from the sale of greetings cards grow very slowly. The business was acquired in 1982. While it has always been a profitable business unit, it has not grown at the rate of several of its European competitors. Mitch Rayfield has welcomed all of the corporate initiatives to improve quality and customer service and his business unit has usually met all of the agreed targets.

Meetings with market analysts

When Maxine Gill joined Homejay in April 2002, it was just before the final financial results were due to be published for 2001/02. She was disappointed that the company had not warned the market that the company's earnings per share (EPS) for 2001/02 was likely to be much lower than the $0·24 expected by the market. The company achieved EPS of only $0·21 for the year to February 2002, which was its lowest level for 6 years. The business plan for the year to February 2003 indicated that EPS would increase to $0·25, and this level of EPS had been communicated to the market.

One of the first tasks that Maxine Gill undertook was to review Homejay's performance from the standpoint of its shareholders. She already knew that Homejay had not performed particularly well for its shareholders over the last few years and that its operating profit had not been as good as the directors and the business unit general managers' had planned for.

Maxine Gill arranged a series of meetings with some of the leading market analysts who were responsible for Homejay's market segments. She was rather surprised at the favourable reception she received from some of them. Apparently, the previous finance director, Peter Wade, as well as Ralph Black and Andy Mottram, had never met with any of the analysts to understand their views of Homejay.

Maxine Gill quickly established a good rapport with the key market analysts with whom she met, and learned much about the company and why the market had valued its shares down on many occasions. There were two main reasons for Homejay's low market valuation. First, some market analysts had believed that the prices paid for some of the companies that Homejay had acquired in the past were too high. The market analysts explained that they did not see any reason why some of the companies (some in the Woodyco business unit as well as Cosmetco) were worth more than their pre-acquisition values.

The market analysts had discussed with Maxine Gill that the company's performance was poor, particularly given the strong brands that it had in both Fixitco and Woodyco. Some analysts stated that they were also disappointed with the company's slow progress with building profits in other parts of the company.

One of the analysts with whom Maxine Gill met illustrated why the market lacked confidence in Homejay. The market analyst showed Maxine Gill a graph *(which is shown in Appendix 3)*, which demonstrated that Homejay's actual financial performance, as measured by earnings per share (EPS), has always been lower than the planned EPS that had been communicated to the market.

Homejay management remuneration

Homejay's company policy is to offer its managers a competitive salary and a performance-related bonus. This applied to over 7,000 of Homejay's managers around the company, from junior managers to senior managers.

The performance-related bonus for senior managers is linked to achieving each business unit's target return on capital employed (ROCE) each year. The target ROCE would be agreed before the start of the financial year, when business plans had been approved by the Homejay Board. Junior managers' performance bonuses were not related to ROCE, but instead were linked to achieving their individually set objectives, which include meeting key quality standards. Their line managers are responsible for setting objectives.

Over 85% of Homejay's managers received their performance-related bonuses in the year ended February 2003 despite the company not meeting its EPS target.

Competitor analysis

All of Homejay's business units monitor their market shares and their competitors closely. Except for Fixitco, Homejay's business units do not have any significant market share in their respective markets. Fixitco is one of eight dominant DIY chains in the countries in which it operates, with an estimated market share of about 12%. It is second to another large chain that has a market share of around 18%. There are also a large number of smaller chains of DIY stores that together account for just under 20% of the total market.

Woodyco has increased its market share over the last few years, partly as a result of winning a design award in 2000. However, its market share is still small, at less than 4%, as there are a large number of companies operating in the furniture business.

Electryco has a small market share, less than 4%, in the domestic electrical appliance market, but it has been able to command a price premium for some of its products.

2003/04 latest forecast

The original budget for Homejay for the year to February 2004 was a net profit before interest and tax of $240 million, which was a substantial increase on the previous year's actual results of $214 million. Maxine Gill and Andy Mottram had both been working closely with each business unit to ensure that they were able to deliver this planned level of operating profit. This level of budgeted profit had also been communicated to the market.

However, the half-year results showed that the planned increases in profitability were not materialising, although sales were almost as planned. The latest forecast also confirmed that Homejay was unlikely to meet its expected profits, as shown in *Appendix 1*. The latest forecast shows a forecast net profit before interest and tax of $223 million, which will represent only a 4·2% increase from 2002/03 assuming that this forecast is achieved.

Maxine Gill was very concerned that the market analysts who had started to trust her, would again be disappointed at Homejay's failure to deliver its expected level of growth and profitability. This would, no doubt, adversely affect Homejay's share price.

Introduction of new IT systems

Soon after Maxine Gill joined Homejay in April 2002, she decided to implement some new IT systems for the finance department. The first system to be implemented was a forecasting system. The previous system was cumbersome and did not allow business units to access and manipulate actual data from the company's other systems. The new financial and business forecasting system was now linked into Homejay's other management information systems, thereby allowing staff to access what had happened, using actual data from the company's nominal ledger, and to prepare more realistic forecasts for the rest of the financial year.

Each business unit produces updated detailed forecasts for the rest of the current financial year, every quarter. The new forecasting system enabled each business unit to input new data for their rest-of-year forecast, which would then be added to the actual data for the financial year to date. The system has facilitated both local and head office management to view and interrogate the latest full-year forecast.

The system became operational at the start of the current financial year, in March 2003, and, despite a few teething problems and the need for staff training, the system has worked well. However, what Maxine Gill has found is that business units have continued to prepare over-optimistic forecasts. It appears that the integrity of the forecast for the rest of the financial year is too heavily dependent on unrealistic sales targets and achievement of margins. Margins have always been lower towards the end of the financial year (February), due to two main factors. These are the reduced prices in its January sales and the clearance of old and slow-moving stock at low margins.

Maxine Gill is hoping that cost control within the business units will improve as the next phase of the finance IT system is implemented. The next phase of the new finance system aims to deliver detailed data on costs across all product lines for each business unit, allowing management to monitor product profitability and control costs more effectively.

2004/05 business plans

Homejay's business planning cycle started in May 2003 with the Homejay Board agreeing the strategic goals and outline plans, which were cascaded down to each business unit for it to use in its plans. Ralph Black continued to issue a directive for strong growth in turnover, but he also wanted to see how each business unit could achieve a much higher level of profitability than they currently appeared to be able to deliver. He also wanted the business units to put together realistic and achievable plans given the problems the company was experiencing with over-optimistic plans in the current financial year.

The business units have prepared the first iteration of their business plans, and have submitted them to Paul Simpson's Head Office planning department. These plans comprise a detailed one-year plan and outline plans for a further three years, covering profitability, capital expenditure and working capital requirements for each business unit, together with a commentary that outlines major changes in business operations.

Paul Simpson was concerned that the plans that had been submitted by each of the business units for 2004/05 showed an overall increase in profitability of 19% from the latest forecast for the current financial year, with only a 17% increase in sales. He felt that every year plans were made that appeared to be over-ambitious. He was aware that each business unit's general manager had failed to deliver what he/she had planned in the past. A consolidated plan for Homejay was in the process of being prepared by Paul Simpson's department for consideration at the planning review meeting in early November 2003.

The general managers of Fixitco and Woodyco had defended their forecasts to Paul Simpson by stating that profitability in the past had fallen short of the original plans for a variety of reasons. These included external events beyond their control, including the poor economic conditions. In the Woodyco business, Joseph Logan stated that achieving margins was heavily dependent on selling products at their recommended prices, which in the past have had to be reduced significantly on several occasions to remain competitive and in order to sell slow-moving stock. Additionally, there had been several product lines that had experienced cost over-runs and higher than anticipated rectification costs of furniture items after they had been delivered and fitted in customers' homes. Both general managers considered that their plans for 2004/05 were realistic and achievable, although much, as always, was dependent on their competitors and the general trading conditions.

Andy Mottram has been critically reviewing the level of corporate Head Office costs, which are planned for 2004/05 at around $330 million. The Head Office costs are apportioned and charged to each business unit in accordance with a number of criteria. Andy Mottram considers that the businesses are not generating sufficient profit to sustain the Head Office corporate functions at this level of costs, and is keen to make changes. He is considering decentralising some of the Head Office functions directly into each business unit, for each business unit general manager to control directly.

In order to improve the company's profitability, Andy Mottram is keen to acquire other companies. He has commenced early discussions with several suitable companies.

Mark West has proposed a major corporate marketing campaign and the cost implications were submitted to the corporate planning department for inclusion in the consolidated plans for Homejay. This proposed corporate marketing plan would be *in addition* to the marketing expenditure that is included in each of the business unit's plans for 2004/05. Mark West considered that Homejay should promote its corporate brand and this would have a direct favourable result on the volumes sold by all business units. The proposed marketing campaign was due to be discussed at the next planning review meeting in November 2003.

The forecast incremental effect on the turnover for 2004/05 for each business unit was anticipated to be increases of between 4% and 20%, as shown in the table below. The forecast incremental effect of the proposed corporate marketing campaign on each business unit's gross margin (defined as turnover less all direct variable costs) for 2004/05 has been evaluated. This is also shown in the table below.

	Forecast incremental effect of the proposed corporate marketing campaign on turnover for 2004/05	*Forecast incremental effect of the proposed corporate marketing campaign on gross margins for 2004/05*
	%	*$ million*
Fixitco	+6	+39 to 42
Woodyco	+4	+26 to 28
Electryco	+5	+7 to 8
Cosmetco	+20	+26 to 29
Cardco	+5	+2 to 3
Total Homejay		**+100 to 110**

Mark West is firming up on the cost of the corporate marketing campaign, which would include the use of various media, but it is expected that the increase over the existing corporate marketing budget would be over $80 million.

Appendices 1, 2 and 3 follow

Appendix 1

Note: All data in the Appendices are presented in UK format.

Homejay – Business analysis

(All figures for financial years to the end of February)

		Latest forecast 2003/04 *$ million*	*Actual 2002/03* *$ million*	*Actual 2001/02* *$ million*
Fixitco	Turnover	1,850	1,720	1,650
	NPBI&T	85	78	77
	Capital employed	1,170	1,135	1,110
Woodyco	Turnover	1,500	1,365	1,248
	NPBI&T	70	65	63
	Capital employed	601	594	557
Electryco	Turnover	680	750	713
	NPBI&T	30	41	40
	Capital employed	350	340	330
Cosmetco	Turnover	340	320	276
	NPBI&T	28	21	16
	Capital employed	120	119	105
Cardco	Turnover	140	135	131
	NPBI&T	10	9	8
	Capital employed	90	88	82
Total Homejay	Turnover	4,510	4,290	4,018
	NPBI&T	223	214	204
	Capital employed	2,331	2,276	2,184

Note 1: NPBI&T represents net profit before interest and tax.

Note 2: Net profit before interest and tax for each business unit includes an allocation of head office costs.

Note 3: The capital employed figures include head office net assets which have been apportioned to each business unit.

Homejay – Summary balance sheet

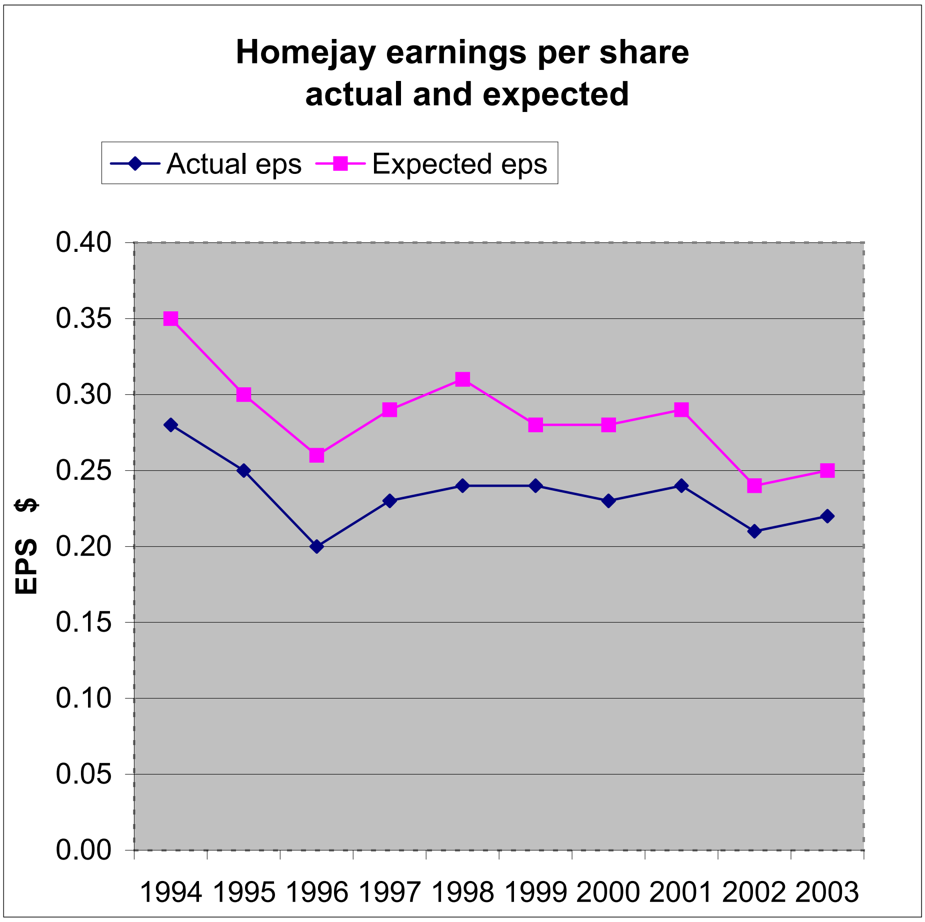
	Actual End February 2003 *$ million*	*Actual End February 2002* *$ million*
Tangible assets (net of depreciation)	**2,075·0**	**2,056·0**
Current assets:		
Stock	411·0	407·0
Debtors	435·0	363·0
Cash and short-term investments	81·0	48·0
Total current assets	**927·0**	**818·0**
Creditors:		
Amounts due within one year	726·0	690·0
Net current assets	**201·0**	**128·0**
Creditors falling due after one year:		
Loans	820·0	780·0
Net assets	**1,456·0**	**1,404·0**
Financed by:		
Called-up share capital	240·0	240·0
Share premium reserve	200·0	200·0
Profit and loss reserve	1,016·0	964·0
Total equity shareholders' funds	**1,456·0**	**1,404·0**

Note: Called-up share capital represents 480 million shares at $0·50 each.

Homejay – Summary profit and loss account

	Actual 2002/03 *$ million*	*Actual 2001/02* *$ million*
Turnover	4,290·0	4,018·0
Total operating costs	4,076·0	3,814·0
Net profit before interest and tax	214·0	204·0
Loan interest (net)	(64·0)	(62·0)
Tax (at 30%)	(45·0)	(42·6)
Net profit	**105·0**	**99·4**
Dividends	53·0	50·0
Amount transferred to reserves	**52·0**	**49·4**

Homejay's actual and expected earnings per share since 1994



Data for earnings per share	*Actual* *$ per share*	*Expected* *$ per share*
Financial year ended February		
1994	0·28	0·35
1995	0·25	0·30
1996	0·20	0·26
1997	0·23	0·29
1998	0·24	0·31
1999	0·24	0·28
2000	0·23	0·28
2001	0·24	0·29
2002	0·21	0·24
2003	0·22	0·25

End of the pre-seen material