

# P10 – Test of Professional Competence in Management Accounting

Tuesday 4 March 2008

## Instructions to candidates

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| You are allowed three hours to answer this question paper.  |
| You are allowed 20 minutes reading time <b>before the examination begins</b> during which you should read the question paper and, if you wish, make annotations on the question paper. However, you will <b>not</b> be allowed, <b>under any circumstances</b> , to begin using your computer to produce your answer or to use your calculator during the reading time. |
| This booklet contains the examination question and both the pre-seen and unseen elements of the case material.  |
| Answer the question on page 17, which is detachable for ease of reference.  |
| The TOPCIMA Assessment Matrix, which your script will be marked against, is on page 18.   |
| Maths Tables and Formulae are provided on pages 24 to 27.   |
| Your computer will contain two blank files – one Word and an Excel file.<br>Please ensure that you check that the file names for these two documents correspond with your candidate number.   |

| <i>Contents of this booklet:</i>        | <i>Page</i> |
|---|-------------|
| Pre-seen material – Solberri Hotel Case | 2           |
| Pre-seen Appendices 1 - 4               | 11 - 15     |
| Question requirement                    | 17          |
| Assessment Matrix                       | 18          |
| Unseen material                         | 19          |
| Maths Tables and Formulae               | 24          |

TURN OVER

# Solberri Hotel Case

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## Market overview

The holiday industry is a large, varied industry which is very competitive and tourism generates enormous revenues. Branded chains of hotels differentiate from each other according to the level of quality and facilities they offer. The “package holiday” trend started in the 1960’s and concentrated on specific tourist destinations. Since then the holiday industry has changed and matured enormously. Since the early 2000’s, Internet bookings have made a significant impact on the way customers choose to book their holidays. Increasingly, holiday makers have become much more selective and, through the use of a variety of media, they are able to identify facilities available at their chosen hotel. European holiday makers choose particular destinations depending on weather, facilities, value for money and levels of comfort at the chosen hotel. Significant numbers of holiday makers choose to take their holiday in the Peak season. The Peak season in Europe is defined as the months of May to September inclusive.

There are a large number of international hotel chains that offer levels of comfort based on the internationally recognised “star” rating system. There are also many holiday resort hotels which offer a wide range of sports and other facilities to customers within the hotels’ grounds. These often include golf courses and a wide range of sports and water sports. A resort hotel is defined as a hotel that includes a far wider range of facilities on site than a typical hotel. There are increasing numbers of resort hotels around the world. These resort hotels, which are designed specifically for holiday makers, are situated in prime tourist areas at popular destinations.

The hotel industry relies heavily on its employees and its IT systems to deliver the quality of service expected by its customers. Following a downturn in air travel in 2001, many hotels suffered a decline in bookings and were forced to look hard at ways to differentiate themselves in order to attract customers.

The majority of European holiday bookings are still made through established travel companies (whether through travel agent shops or using the travel agents’ websites) although a growing number of bookings are made by the customer with hotels directly.

## The Solberri hotel group

Solberri is a group of mainly resort hotels, all in Europe. It was established in the mid 1980’s by its founder, Richard Berriman. The first two Solberri hotels were located in two different countries around the coast of the Mediterranean Sea. These two Solberri hotels established a high reputation for quality. By the late 1980’s the two Solberri hotels were regarded by many other international hotel chains as the benchmark for the standards to aspire to.

The success of these first two hotels helped to finance the expansion of the Solberri hotel group. This success financed the expansion of new purpose built resort hotels, which included a wider range of facilities on site, including golf facilities, water sports, spas and beauty treatments. To enable the group to expand further, it needed additional finance, rather than relying solely on loan finance. In 1998 the company became listed on a European stock exchange. By the end of 2000 the Solberri group had 10 resort hotels and the original 2 hotels, which have a smaller range of facilities. These 12 hotels are situated in several European countries, along the Mediterranean coast. The 10 Solberri resort hotels were among some of the most prestigious in Europe at that time. The company continues to invest in new facilities and has a rolling refurbishment programme, which ensures that the high standards which customers expect, are met.

## Solberri’s personnel

The career histories of Solberri’s key personnel are shown in **Appendix 1** starting on page 11.

## **Routes to the market**

Solberri hotels have 3 main routes to the market.

- The main route is that bookings are secured as part of a “holiday package” offered by travel agents, where the customer pays a fixed price, inclusive of flights and accommodation, to the travel agent. The revenue generated from bookings made by travel agents is lower than the revenue generated from bookings made by customers who book directly with Solberri, as the travel agents deduct their agreed discount.
- Bookings are made by new customers directly with Solberri using Solberri's website. These customers usually book as a result of Solberri's marketing campaigns and make their own flight arrangements.
- Repeat business. Customers return to Solberri and they book directly with the hotel or by using Solberri's website to secure a repeat business discount.

In the financial year ended September 2007, around 60% of bookings were made through travel agents. Around 30% were made by new customers directly with Solberri. Around 9% were repeat business. There were a small number of bookings from other sources.

## **Difficult market conditions for the Solberri group**

During 2003 to 2005 it became clear, through falling customer numbers and disappointing customer feedback, that the Solberri hotel group had become complacent. The management team had considered that its successful growth and level of profitability would continue.

In 2005, the group made its first ever operating loss and the then Chief Executive resigned in early 2006. The financial year ended September 2006 also resulted in an operating loss. The Solberri Board recruited a new Chief Executive, Johan Alnetti, in September 2006.

## **Pricing changes effective from May 2007**

Solberri's management had previously resisted any change to the pricing structure, although the Board recognised the need to increase its occupancy level. When Johan Alnetti joined Solberri he worked closely with Richard Berriman to review the pricing structures at Solberri hotels in order to boost occupancy levels.

Over the last decade, many competitors in the Mediterranean region have offered “all inclusive” accommodation arrangements. An “all inclusive” room rate is defined as a fixed price for the room inclusive of all meals, most drinks and use of many of the available leisure facilities. The room rate varies depending on features, the location of the room and assumes 2 people sharing. Therefore, there are no additional charges, unless spa treatments or particular sports activities are booked by customers.

Following extensive market research the Solberri Board decided to change the pricing structure effective from the Peak season which commenced in May 2007. This new “all inclusive” price structure is competitive with other “all inclusive” resort hotels. It has also enabled Solberri to market itself as one of the leading “all inclusive” resort hotel groups in Europe.

Prior to the launch of the “all inclusive” room rate for Solberri in May 2007, Johan Alnetti and Piers Lui agreed on which facilities would be included in the “all inclusive” room rate, and which facilities would be charged as extra charges to customers. For example, all of the Solberri hotels have spa facilities including swimming pools, hot tubs, steam rooms and saunas, as well as a range of spa treatments. The use of these spa facilities are not charged as an additional charge. However, all spa treatments which involve the use of highly trained, skilled employees are charged to customers and generate additional revenues. These spa treatments have proved to be very popular with customers and are in high demand. Solberri also has a number of sports activities which generate extra revenues. These extra revenues generated €21 million in the

financial year ended September 2007, which represents an additional 15% of revenue, over and above that which is generated from the “all inclusive” room rate.

Giorgi Kahle launched a major marketing campaign to promote the Solberri brand in early 2007 using a variety of media, including direct marketing, radio and TV advertising and the use of other media. This has proved to be effective as the average occupancy level has shown an increase on the level achieved during the 2006 Peak season, to 74% in the 2007 Peak season (see page 6 in Occupancy levels).

### Summary of Solberri hotels

The 12 Solberri hotels in the group are currently categorised into 3 types depending on the range of facilities they offer. Solberri does not participate in the international star ratings system, but its range of hotels shown in the table below, is comparable to the international star rating system. The table below also shows the number of rooms available and the average price per room for the 2007 Peak season. The average price per room represents the price for 2 people at the “all inclusive” room rate including food, drinks and all of the inclusive activities.

| <b>Solberri hotel category</b>              | <b>Number of hotels (as at September 2007)</b> | <b>Number of rooms at each hotel</b> | <b>Total number of rooms available</b> | <b>Average price per room per night (Peak season 2007 prices)</b> |
|---|--|--------------------------------------|--|---|
| <b>Premier</b><br>(equivalent to 5 star)    | 2  | 250                                  | 500                                    | €<br>650  |
| <b>Superior</b><br>(equivalent to 4 star)   | 7  | 200                                  | 1400                                   | 525   |
| <b>Super plus</b><br>(equivalent to 3 star) | 3  | 150                                  | 450                                    | 350   |
| <b>Totals</b>                               | 12   |                                      | 2,350                                  |   |

The average price per room is substantially lower in the Non-peak season, at around 45% of the Peak season price per room. The average price per room shown above is before deduction of the discount given for rooms booked by travel agents and the repeat business discount.

It should be noted that two of the hotels currently categorised as “Superior” are now being refurbished during the Non-peak season 2007/08. They will then be re-categorised as “Premier” for the 2008 Peak season (see page 5 in Investment and refurbishment programme).

Johan Alnetti is concerned about the three “Super plus” hotels as they offer limited leisure facilities, spa facilities and water-sports, which is reflected in the lower “all inclusive” room rate.

### Growing demand for improved spa facilities

Richard Berriman and Johan Alnetti both agree that the range and luxury of the hotels’ spa facilities is a key factor that affects the customers’ decision as to whether or not to book their holidays with Solberri. Market research has been conducted that confirms that spa facilities are a key selling point. Johan Alnetti would like to extend and enhance the size of the spas at all Solberri hotels and also to extend the range of spa treatments on offer. This would require capital expenditure at all hotels and also necessitate the recruitment of additional skilled employees to provide spa treatments.

Johan Alnetti is confident that if Solberri were to have enhanced spa facilities at its resort hotels then these could generate additional revenues, sufficient to cover all operating costs of the spa, and also be a selling point to improve the level of bookings for Solberri hotels.

## **Investment and refurbishment programme**

Solberri has established world class spa facilities at both of its 2 “Premier” hotels, which has proved very popular. These 2 “Premier” hotels, underwent a thorough refurbishment programme during the Non-peak season in 2006/07, involving the expansion of their spa facilities, as well as refurbishment of other areas around the hotels, costing €6 million each. The improved spa facilities have generated high additional revenues and have made these facilities at the 2 “Premier” hotels profit generating within the first Peak season. These 2 “Premier” hotels have experienced the highest level of accommodation bookings for over ten years and Richard Berriman considers that this is mainly due to the new enhanced spa facilities. The spa facilities at these 2 “Premier” hotels have also generated much favourable publicity for the Solberri group of hotels.

The latest 5 year plan, for the period starting October 2007, was approved in May 2007. It includes plans to continue to invest €12 million annually in the group’s rolling refurbishment programme to bring 2 further hotels each year up to the “Premier” hotel standard. Furthermore, by providing improved spa facilities, additional revenues are generated from customers who book spa treatments. Currently, Richard Berriman considers that only the 2 “Premier” hotels in the group meet the standards to which he wants the Solberri hotels to conform.

During the Non-peak season ending in April 2008, a further 2 “Superior” hotels are currently undergoing a refurbishment, which will include improved accommodation facilities as well as enhanced spa facilities. Therefore by the start of the 2008 Peak season, there will be 4 “Premier” hotels in the Solberri group, which meet Richard Berriman’s desire for “world class” spa facilities. Therefore, there will be only 5 “Superior” hotels from the 2008 Peak season.

Richard Berriman wants to enhance and extend the spa facilities at the remaining 8 Solberri hotels as soon as possible, but is constrained by a lack of finance. Johan Alnetti has stated that these spa facilities should be extended as a matter of urgency as he believes that the investment will be repaid very quickly by higher occupancy level and also additional revenues generated by the spa treatments. However, the timing and financing for this work has not yet been agreed. Antonio Skrip is reluctant to take on additional loan finance for the refurbishment and extension of spa facilities at the remaining 8 Solberri hotels. He considers that this can be done using cash generated from operations over the next few years.

## **Key Performance Indicators**

The Solberri Board uses a variety of key performance indicators (KPI's) to monitor the performance of the group. These KPI's are commonly used in this industry, and include the following:

- Occupancy level. This most important business measure is defined as the proportion of rooms available during the period which were occupied during the period.
- Return on capital employed (ROCE). Solberri defines this KPI in the same way as is the norm for this industry, which is the operating profit generated (after allocated group overheads) divided by Non-current assets at the end of the last financial year.
- Revenue Per Available Room (RevPAR). This is defined as the total revenue generated from room bookings only for the Peak season (that is after the discounts given to travel agents and for repeat business and before additional revenues from extras, such as spa treatments) divided by the total available rooms during the Peak season, expressed as a daily figure.
- Level of repeat bookings. This is defined as the number of bookings made by those customers who have stayed at any Solberri hotel within the last 5 years expressed as a percentage of the total number of bookings.

A summary of the KPI's for the Solberri group for the year ended 30 September 2007 is shown in the table below.

| <b>Hotel Category</b> | <b>Number of Hotels</b> | <b>Occupancy level (Peak season)</b> | <b>ROCE %</b> | <b>RevPAR (Peak season only) €</b> | <b>Repeat bookings</b> |
|-----------------------|-------------------------|--------------------------------------|---------------|------------------------------------|------------------------|
| Premier               | 2                       | 89.5%                                | 10.7%         | 471.8                              | 9.0%                   |
| Superior              | 7                       | 72.0%                                | 7.5%          | 306.6                              | 8.7%                   |
| Super plus            | 3                       | 63.0%                                | 4.0%          | 178.8                              | 10.0%                  |
| Total                 | 12                      | 74.0%                                | 8.1%          | 317.3                              | 9.0%                   |

The RevPAR figures above are shown for the Peak season only and are based on the revenue generated at the average price per room (as shown in the table on page 4) at the average Peak season occupancy level less the proportion of discounts given to travel agents and for repeat business. For example, the RevPAR figure of €471.8 for the "Premier" hotels is calculated on the total revenue, after discounts of 18.9% overall, which was €36.093 million. This amount is divided by 500 (representing the 500 "Premier" rooms), and further divided by 153 (representing the 153 days in the Peak season). This results in the RevPAR figure of €471.8.

The Balance Sheet, Income Statement and Statement of Changes in Equity for Solberri for the last two financial years are shown in **Appendix 2** on page 13.

### **Occupancy levels**

The key driver for profitability is the occupancy level achieved. A low level of occupancy is acceptable to the Solberri management team for the Non-peak season providing it covers the operating costs. However, the overall level of profitability is mainly affected by the occupancy level achieved in the Peak season.

The planned occupancy level for the 2008 Peak season is 85%. Giorgi Kahle has an agreed marketing budget of almost €22 million for the financial year to September 2008 to stimulate demand to achieve this planned higher occupancy level. He has allocated this budget between a number of marketing areas, including marketing literature, direct mail and advertising on radio and television. There was a marketing campaign during the last few months of 2007 and early 2008 and he is currently finalising a further follow-on marketing campaign in order to deliver the planned higher occupancy level in the 2008 Peak season. All of these marketing campaigns will be achieved within the agreed marketing budget of €22 million.

The average period that customers stay at a Solberri hotel is 10 nights, with 50% of customers staying only 7 nights. 37% of customers stay for 14 nights and the remaining 13% of customers stay between 8 and 14 nights.

As far as Solberri's management can establish two of its main competitors managed to achieve occupancy level of around 90% to 95% during the 2007 Peak season. Indeed, some of the enquiries by Giorgi Kahle's market research team have established that some competitors' resort hotels were fully booked (100% occupancy) during some weeks of the 2007 Peak season. It remains a challenge for the Solberri group to try to achieve fully booked hotels during the 2008 Peak season.

The average occupancy level across the 12 hotels in the Solberri group, compared to planned occupancy levels, are shown in the table on page 7.

| Average occupancy level across all 12 Solberri hotels | Non-peak season<br>(7 months:<br>October to April inclusive) |       | Peak season<br>(5 months:<br>May to September inclusive) |       | Overall       |       |
|---|--|-------|--|-------|---------------|-------|
| Financial year ended:                                 | Actual   | Plan  | Actual   | Plan  | Actual        | Plan  |
| September 2006  | 19.0%  | 30.0% | 65.0%  | 75.0% | 38.3%         | 48.9% |
| September 2007  | 25.0%  | 30.0% | 74.0%  | 80.0% | 45.5%         | 51.0% |
| September 2008  | Not available  | 30.0% | Not available  | 85.0% | Not available | 53.1% |
| September 2009  | Not available  | 30.0% | Not available  | 90.0% | Not available | 55.2% |

## Revenue targets

The budgeted revenue target for the financial year ended September 2008 is €193 million. This higher level of revenues is driven primarily by the higher average planned occupancy of 85% for the Peak season. Furthermore, effective from the 2008 Peak season there will be 4 “Premier” hotels, as 2 hotels are being refurbished during the Non-peak season ending April 2008 (as detailed above in Investment and refurbishment programme). The “all inclusive” room rates which were introduced for the 2007 Peak season are budgeted to remain the same, due to pressure from competitors.

During the financial year ended September 2007, the revenue generated from additional charges was 15% of the revenues generated from the “all inclusive” room rate. Additional revenues are generated by customers using facilities which are not included in their “all inclusive” room rate, including all spa treatments, and the tuition fees for a variety of sports. The 2007/08 revenue budget includes a growth in revenue generated by additional charges, to 17% of the revenues generated from the “all inclusive” room rate.

## Operating costs

Each hotel is managed by a General Manager who reports directly to Johan Alnetti, the Chief Executive but has functional responsibility to other Directors. Johan Alnetti has instructed the General Manager of each hotel to re-examine its operating costs and to find ways to make savings without any impact on the quality of service or customer perceptions. Furthermore, all of the General Managers are under pressure to achieve the targets set out in Solberri’s Corporate Social Responsibility report, which is shown in **Appendix 3** on page 14.

Each General Manager is responsible for procurement at the hotel he or she runs, with little interference from Head Office. However, decisions on the range of spa treatments and sports facilities are the responsibility of Piers Lui, who also determines the prices for all spa treatments and sports which are not included in the “all inclusive” price. The operational aspects of the spa and sports facilities are managed by each General Manager.

Following the change in the pricing structure in early 2007 to the “all inclusive” room rate, there was a substantial fall in administration work and most General Managers achieved the agreed planned reduction in the level of administration staff. Together with the introduction of new IT solutions, which will further simplify administration, each hotel is planning to achieve further cost savings.

Solberri has outsourced many of its routine operations, including laundry, property maintenance and maintenance of pool and sports facilities. The companies Solberri has outsourced these operations to have had Service Level Agreements imposed on them. However, the General Managers at some hotels have had difficulty enforcing the agreed quality service levels. There

are still a number of outsourced operations that are not being delivered to the required standard, due to clashes of priorities. For example, a General Manager has insisted that the outsourced maintenance company does not turn off water supplies at certain times to undertake repairs. This has led to the outsourcing company complaining that this has prevented it from carrying out the contracted work in accordance with agreed deadlines.

One of the planned cost savings is the introduction of solar panels at each hotel which it is forecast will be capable of saving around 30% of the electricity costs. However, the required investment for this has repeatedly been delayed. The solar panel proposal is to invest €6 million across the group of 12 hotels. Richard Berriman has delayed the solar panel proposal as he wants all available investment channelled towards improving visible customer facilities.

An analysis of operating costs by main cost categories for the financial year ended 30 September 2007 is as follows:

| Cost category        | Financial year ended<br>30 September 2007 | %    |
|----------------------|---|------|
|                      | € million                                 |      |
| Employee costs       | 62  | 42%  |
| Food and drink       | 21  | 14%  |
| Outsourced functions | 15  | 10%  |
| Marketing costs      | 20  | 14%  |
| IT costs             | 3   | 2%   |
| Depreciation         | 15  | 10%  |
| Other costs          | 12  | 8%   |
| Total costs          | 148                                       | 100% |

### Solberri loan finance

At the end of the financial year ended 30 September 2007, Solberri had loans totalling €33 million, including a loan of €12 million that was due for repayment in December 2007. Antonio Skrip has taken out a new loan for €20 million, which has been secured on 6 specific hotels in the Solberri group including the 2 "Premier" category hotels and 4 of the 7 hotels in the "Superior" category. This new loan is at 10% interest per year and is repayable in December 2014. Therefore, at the end of December 2007, Solberri had loans totalling €41 million.

This new loan for €20 million has been used to repay the loan due for repayment and left €8 million to be used for further capital investment. This €8 million, together with some of the cash generated from operations, will be used to finance the refurbishment and enhanced spa facilities at the 2 "Superior" hotels currently being upgraded to "Premier" status (as outlined above in Investment and refurbishment programme on page 5).

### Improvements to Solberri IT systems

Pietro Heys was requested by the Board to review all of Solberri's IT systems when he was appointed to his role in Solberri in April 2006.

The Bookings Management System (BMS) provides information for the management on room rates and availability. In November 2006, Solberri selected and began implementation of a new BMS system and is paying an annual licence fee for the use of a standard internationally recognised bookings software system. This new BMS system is designed to optimise customer management and hotel occupancy rates. Additional specialised functions include sophisticated availability search facilities, itinerary reservations (for spa, restaurant and sports bookings) and customer accounting and billing. This became operational in November 2007.

The Corporate Information System (CIS) is a management tool to provide information to the senior management team both at Head Office and within each hotel. The CIS consolidates information about each customer such as spending patterns, preferred accommodation and leisure facility requests. Other functions include centralised travel agency booking statistics.



The Business Intelligence (BI) system provides a variety of strategic analysis and planning tools for the entire business, in much the same way as an Executive Information System (EIS) does. It extracts data from other Solberri IT systems to enable data analysis. The BI system produces key industry performance indicators (KPI's) for each of the hotels in the group and for the entire group (see above for KPI's). The BI system produces data on ROCE and Revenue per Available Room (RevPAR) (these terms are defined above in KPI's). These KPI's are produced weekly to closely monitor business performance. It also enables the Board to compare the revenues across each of the hotels in the group, and also to compare its KPI's with published data of its competitors.

The total cost of all the IT investment in hardware and software has been €6 million over the last two years and Pietro Heys is confident that Solberri has now got efficient systems in place. However, Solberri has still some further IT projects to undertake to bring it up to the standards of its competitors, let alone for it to be a market leader. The next phase of development will be to introduce some software, which would allow prospective customers to see typical rooms and hotel views and also the range of facilities on offer at all 12 Solberri hotels. The forecast cost of this development is €5 million and Pietro Heys has requested budget allocation for the entire amount in the financial year 2008/09.

### **Human Resource issues**

Solberri operates a human resources policy which is laid down in its procedures manual. This includes procedures on appointment, customer/employee relationships, code of conduct, leave entitlements, termination of employment and workplace health and safety. In order to meet the latest European standards on employee working conditions and terms of employment, Suzanne De Loore is currently updating the procedures manual. This will now include policies on the prevention of drugs and alcohol misuse, sexual harassment, theft and stress. The revised policies will additionally cover environmental awareness and the use of computers. The updated procedures will be implemented in April 2008. The new HR policy will also set clear guidance for managers on the pay rates and working hours for all employees.

The majority of Solberri's employees are temporary employees who are employed only for the Peak season on short-term contracts. Of these temporary employees, over half work for Solberri for one Peak season only and do not return. These are often young people travelling around Europe, who have limited knowledge of the hotel industry and are only working to earn money to continue their travels. These inexperienced employees are working in a range of positions from housekeeping and catering employees to sports instructors. Suzanne De Loore has raised concerns with Richard Berriman that these short-term contract employees do not have job descriptions setting out their areas of responsibility and sometimes they do not possess the core skills required to perform their duties. She is also concerned that the induction programme is not taken seriously by the employees.

The other half of the short-term contract employees are experienced Solberri employees who return each Peak season, as this is their main source of employment in their local area.

The minority of employees are employed on long-term contracts. Many of these have worked for Solberri for over 10 years. These employees have job descriptions and contracts of employment which set out conditions of work including hours, leave, remuneration, benefits, appropriate use of business assets and confidentiality in respect of Intellectual Property.

### **Customer service and quality management programme**

All short-term contract employees receive two days induction training, which includes all aspects of customer service and issues such as health and safety and hygiene awareness. Whilst the majority of the short-term contract employees are hardworking and polite to customers, there are some who do not provide the standard of service expected at Solberri hotels. Despite providing training to all employees, it is clear to hotel General Managers and Board members that the level of service provided by some of the employees is not up to the standard expected. Richard Berriman has made it clear to all employees, as well as hotel General Managers, that this situation must be improved.

Furthermore, the level of customer service expected by Solberri customers is greater now than ever before, as a result of the increasingly high standards being provided in top luxury international hotels. Many customers choose to return to a hotel based on their experience, which can be positively or negatively affected by the level of customer service received during their stay. Possibly as a result of lower than expected customer service, repeat bookings are anticipated to be lower than previously, at only 7.5% during the forthcoming 2008 Peak season.

Suzanne De Loore and Nik Silva are currently working together to update and implement a rolling training programme for all employees of Solberri. All employees will continue to receive basic customer service training. Those employees dealing directly with the customers, such as waiters, receptionists and sports instructors, will attend specifically tailored customer service training sessions. For those employees on longer term contracts, training will be carried out annually. Other initiatives, which are planned to be introduced by June 2008, include an environmental awareness programme and stress management training, which will be available for senior employees and management.

In order to improve employee focus upon quality issues, Suzanne De Loore introduced a quality management initiative in September 2007. As part of this initiative, all employees are required to participate in quality teams, which meet on a monthly basis. Each team is made up of employees from a variety of jobs and levels and each team is responsible for a particular aspect of quality management in the hotel. These multi-disciplinary teams meet for one hour to discuss issues that have arisen during the month and to suggest ways to improve. However, these quality teams have not been popular with employees, as many have seen little evidence of any change occurring as a result of their suggestions and some employees feel that their input is not valued. A further issue is that attendance at these meetings is compulsory, regardless of whether the employee is scheduled to be working on that day.

The results of the latest customer survey, compared to 2006 results and the target for 2010 is shown in **Appendix 4** on page 15.

### **Solberri shareholders**

The Solberri hotel group was founded in the 1980's and became listed in 1998. The company has 24 million shares of €0.50 each in issue and has a total of 50 million authorised shares. Suzanne De Loore launched an employee share scheme in 2001 and all long-term contract employees receive free shares at the end of each financial year dependent on a range of performance related indicators.

Solberri's shares are owned by a number of institutional investors as well as other shareholders. The shareholdings at the end of the last financial year, 30 September 2007, are as follows:

| <b>Number of shares held<br/>(million)</b> |             |
|--|-------------|
| Institutional investors                    | 9.2         |
| Other shareholders                         | 3.8         |
| Richard Berriman (Chairman)                | 7.2         |
| Directors                                  | 3.6         |
| Employees                                  | 0.2         |
| <b>Total</b>                               | <b>24.0</b> |

Solberri's share price at 31 December 2007 was €4.47. The highest share price for the preceding 12 months was €5.33 and the lowest was €3.57. The highest share price that Solberri has achieved was in 2002 when the shares were traded for over €10.00 per share.

### **Solberri's key personnel**

#### ***Richard Berriman – Chairman***

Richard Berriman, aged 46, grew up in a family which owns and operates a chain of restaurants. He has been involved in the leisure industry for all of his working life. He has no formal qualifications, but has much practical experience at all levels. His ambition was always to operate a small hotel chain and he was very proud when the Solberri group was listed. Since 2006 he has been under much pressure from shareholders to turn the business around. He has recruited an experienced new Chief Executive, Johan Alnetti, who he respects greatly and they work well together.

#### ***Johan Alnetti - Chief Executive***

Johan Alnetti, aged 36, joined the Solberri group in September 2006 following a decline in occupancy level and a substantial fall in group profits over the previous few years. He has previously managed a small chain of hotels and relished the challenge of turning around the fortunes of the Solberri group. He is very decisive, has many innovative ideas and is not afraid of making difficult decisions in order for Solberri to compete effectively.

#### ***Giorgi Kahle - Director of Sales and Marketing***

Giorgi Kahle, aged 40, joined Solberri in late 2004 and has made significant changes in the way that the Group's hotels are marketed. He has raised the profile of many of the resort hotels and has been a keen supporter of the changes being made by the new Chief Executive, Johan Alnetti. He is under much pressure to increase customer numbers and to increase the occupancy level, but has struggled to achieve this in the face of competition, and the need for Solberri to refurbish many of the hotels in the group. Giorgi Kahle is also working with a number of international companies to try to secure bookings as part of their employee reward systems.

#### ***Antonio Skrip - Group Finance Director***

Antonio Skrip has been with Solberri since 1995 and was instrumental in the company achieving a listing. Since then he has been under pressure from its shareholders to deliver the high levels of dividends that they expect. Following the operating losses in the financial years ending September 2005 and 2006, he has worked hard, as part of the management team, to try to improve the finances of the group and to make it once again become a cash generator.

#### ***Pietro Heys - Group IT Director***

Pietro Heys, aged 32, is the youngest member of the Board and joined Solberri early in 2006. He was recruited to improve the quality and timeliness of information available for all twelve hotels and to implement a new Business Intelligence (BI) System. He is continuing to select and implement innovative IT solutions to improve Solberri's ability to compete.

#### ***Dimitri Vitt - Director of Design***

Dimitri Vitt, aged 35, has been involved with design for many years. He was recruited by Johan Alnetti in December 2006, due to his excellent reputation for innovative designs. He has inspected all aspects of all of the hotels in the group and has a long list of changes that he would like to make to improve the ambience and standards of reception areas and bedrooms. He would like to have themed sections for each hotel, with customers being given the choice of room design. He has also worked closely with the group's external architects on the design for the extended spas.

#### ***Piers Lui – Leisure Facilities Director***

Piers Lui was recruited into the Solberri group in 2005, as Richard Berriman considered that the Solberri hotels were not being innovative enough and that this was leading to the decline in the number of customers. Piers Lui had been responsible for the facilities at a world class hotel in Asia and wanted to expand his responsibilities across a hotel group in Europe. He is responsible for the selection and operation of all leisure facilities at Solberri hotels.

***Suzanne De Loore - Human Resource Director***

Suzanne De Loore, aged 38, has worked in the hotel industry all her career and is familiar with the many roles and requirements of the industry. She joined the group in 1997 just before the company was listed. She was initially very pleased with the prestige of the group and the treatment of its employees. However, despite her continued hard efforts to recruit and retain people with appropriate skills, she is now disappointed and rather de-motivated because the group has seen a decline in its popularity. Richard Berriman does not have a good relationship with her, and considers her to be too protective of all employees rather than the reputation of the group. She is admired for her fairness and respected by all employees.

***Nik Silva – Director of Customer Service***

Nik Silva, aged 40, was recruited by Johan Alnetti in early 2007, as Johan Alnetti did not consider that customer service was given the high profile in the group that it required. Previous to his appointment, each of the hotel General Managers was responsible for customer service at the hotels each managed. Nik Silva wants to raise the standard of service provided and to implement best practice across all hotels in the group. He also wants to improve the management training programme, and is working closely with Suzanne De Loore to prepare and implement an improved programme, which will affect all employees, not only customer facing employees, as he considers that only by involving all employees can standards be raised.

***Anna Roet – Director of Property Management***

Anna Roet has worked for the Solberri group for over 22 years and has managed the increased portfolio of properties, from the original 2 hotels, up to the current 12 hotels. She liaises closely with a range of external agencies and construction companies, who undertake all of the routine property maintenance and repair work.

***Hotel General Managers***

The company also employs a General Manager for each of its 12 hotels. They have responsibilities to each of the functional directors, but report directly to the Chief Executive. The Hotel General Managers do not have Board responsibility. They are responsible for the day-to-day operations at each of the hotels in the group. They liaise closely with Nik Silva, the Director of Customer Service, in order to provide feedback from customers and to inform Nik Silva of current problems.

***Non-executive directors***

Solberri has four non-executive directors. The four non-executive directors hold various other directorships in the travel and leisure industry and are based in Europe. Two of the non-executive directors are members of Richard Berriman's family.

## Appendix 2

### Solberri's Balance Sheet, Income Statement and Statement of Changes in Equity

| <b>Balance Sheet</b>                      | <b>As at 30 September 2007</b> |            | <b>As at 30 September 2006</b> |            |
|---|--------------------------------|------------|--------------------------------|------------|
|   | €million                       | €million   | €million                       | €million   |
| <b>Non-current assets (net)</b>           |                                | <b>136</b> |                                | <b>123</b> |
| <b>Current assets</b>                     |                                |            |                                |            |
| Inventory                                 | 14                             |            | 11                             |            |
| Trade receivables and prepayments         | 9                              |            | 7                              |            |
| Cash and cash equivalents                 | 3                              |            | 2                              |            |
|   |                                | <b>26</b>  |                                | <b>20</b>  |
| <b>Total assets</b>                       |                                | <b>162</b> |                                | <b>143</b> |
| <b>Equity and liabilities</b>             |                                |            |                                |            |
| <b>Equity</b>                             |                                |            |                                |            |
| Share capital                             | 12                             |            | 12                             |            |
| Share premium                             | 28                             |            | 28                             |            |
| Revaluation reserve                       | 30                             |            | 10                             |            |
| Retained earnings                         | 18                             |            | 15                             |            |
|   |                                | <b>88</b>  |                                | <b>65</b>  |
| <b>Non-current liabilities</b>            |                                |            |                                |            |
| <b>Loans:</b>                             |                                |            |                                |            |
| Loan at 10% (repayable in December 2007)  | -                              |            | 12                             |            |
| Loan at 8% (repayable in September 2010)  | 6                              |            | 6                              |            |
| Loan at 11% (repayable in June 2012)      | 15                             |            | 15                             |            |
|   |                                | <b>21</b>  |                                | <b>33</b>  |
| <b>Current liabilities</b>                |                                |            |                                |            |
| Bank overdraft                            | -                              |            | 2                              |            |
| Loan at 10% (repayable in December 2007)  | 12                             |            | -                              |            |
| Trade payables and accruals               | 28                             |            | 35                             |            |
| Customers' deposits (for future bookings) | 10                             |            | 8                              |            |
| Tax                                       | 3                              |            | -                              |            |
|   |                                | <b>53</b>  |                                | <b>45</b>  |
| <b>Total Equity and liabilities</b>       |                                | <b>162</b> |                                | <b>143</b> |

Note: Paid in share capital represents 24 million shares of €0.50 each at 30 September 2007

| <b>Income Statement</b>                 | <b>Year ended</b>        | <b>Year ended</b>        |
|---|--------------------------|--------------------------|
|   | <b>30 September 2007</b> | <b>30 September 2006</b> |
|   | €million                 | €million                 |
| Revenue                                 | 159                      | 138                      |
| Total operating costs                   | 148                      | 145                      |
| Operating Profit / (Loss)               | 11                       | (7)                      |
| Finance costs                           | 3                        | 3                        |
| Tax expense (effective tax rate is 32%) | 3                        | 0                        |
| <b>Profit / (Loss) for the period</b>   | <b>5</b>                 | <b>(10)</b>              |

| <b>Statement of Changes in Equity</b> | <b>Share capital</b> | <b>Share premium</b> | <b>Revaluation reserve</b> | <b>Retained earnings</b> | <b>Total</b> |
|---------------------------------------|----------------------|----------------------|----------------------------|--------------------------|--------------|
|                                       | €million             | €million             | €million                   | €million                 | €million     |
| Balance at 30 September 2006          | 12                   | 28                   | 10                         | 15                       | 65           |
| Profit for the period                 | -                    | -                    | -                          | 5                        | 5            |
| Revaluation reserve                   | -                    | -                    | 20                         | -                        | 20           |
| Dividends paid                        | -                    | -                    | -                          | (2)                      | (2)          |
| <b>Balance at 30 September 2007</b>   | <b>12</b>            | <b>28</b>            | <b>30</b>                  | <b>18</b>                | <b>88</b>    |

## Corporate Social Responsibility Report for year ended September 2007

|  | Achievements in year ended September 2007  | Targets for years ended September 2008 to 2010   |
|--|--|--|
| <b>Environmental Policy</b><br>Solberri is committed to its focus on green initiatives, focusing upon green policies, monitoring and reducing consumption levels and converting environmental efforts into cost-reduction and revenue generating opportunities | <ul style="list-style-type: none"> <li>1 hotel won a Bronze Award in the Green Tourism Business Awards 2007</li> <li>90% of employees trained in environmental awareness during induction</li> </ul>   | <ul style="list-style-type: none"> <li>Appointment of an Environmental Director</li> <li>Investigate and implement new technologies to improve efficiency in energy and waste management processes</li> <li>Work with suppliers to encourage them to operate in an environmentally responsible manner</li> <li>Environmental responsibility to become a condition for all suppliers and outsourcing companies.</li> </ul>  |
| <b>Resources</b><br>Solberri intends to reduce its use of water and materials through awareness programmes and through the design of new buildings, equipment and better working practices   | <ul style="list-style-type: none"> <li>Introduction of dual flush toilets in 8 of the 12 hotels</li> <li>2 dedicated recycling units set up</li> <li>Reduced electricity consumption by 0.5% across all hotels</li> <li>Recycling of 80% of plastic, paper, cardboard, glass, waste cooking oil</li> <li>Customers choose to retain 60% of towels each day, and only request that these towels are changed after the second day</li> <li>90% of all light bulbs replaced with energy efficient alternatives</li> </ul> | <ul style="list-style-type: none"> <li>Re-use / donation of all viable furniture and fittings when furniture and fittings are replaced</li> <li>Installation of energy efficient windows and solar panels to improve thermal performance of all new building work</li> <li>Recycling of 90% of plastic, paper, cardboard, glass, waste cooking oil and toner cartridges by 2010</li> <li>To save 90% of towels for changing after second day</li> <li>100% of all light bulbs replaced with energy efficient alternatives</li> </ul> |
| <b>Working with local communities</b><br>Solberri is committed to working with its local communities, to build strong relationships and to encourage partnerships with local business and industry   | <ul style="list-style-type: none"> <li>Sponsorship of local community gardens at 6 locations</li> <li>70% of fresh produce sourced from local suppliers</li> </ul>   | <ul style="list-style-type: none"> <li>To continue to support charitable organisations both locally and internationally.</li> <li>Sourcing of 100% of fresh produce from local suppliers</li> </ul>  |
| <b>Health and Safety</b><br>Solberri continues to apply high standards of health and safety to all employees and customers. The company strives to provide a safe environment.   | <ul style="list-style-type: none"> <li>100% of newly recruited employees trained in Health &amp; Safety issues</li> <li>2% reduction in reported employee accidents</li> </ul>   | <ul style="list-style-type: none"> <li>Provision of annual training programmes in Health and Safety for all employees</li> <li>Further reduction in employee accidents to no more than 5 minor accidents per year and 0 major accidents</li> </ul>   |

## Results of customer feedback survey 2007

The data in this Appendix is based on survey information for the last 2 years. It should be noted that customer feedback surveys are completed for fewer than half of the rooms booked. However, the Solberri Board is committed to improving the percentage of customers that rate the facilities or service as excellent, although it is aware that this is a challenging task.

|   | Actual<br>Year ended<br>September<br>2006 | Actual<br>Year ended<br>September<br>2007 | Target<br>Year ended<br>September<br>2010 |
|---|---|---|---|
| <b>Overall assessment of hotel service:</b>   | Rated as<br>"Excellent" by<br>customers   | Rated as<br>"Excellent" by<br>customers   | Rated as<br>"Excellent" by<br>customers   |
| 1. Level of overall customer service<br>you received in the hotel                         | 15%                                       | 18%                                       | 50%                                       |
| 2. Overall standard of your room  | 16%                                       | 20%                                       | 50%                                       |
| <b>Overall assessment of leisure<br/>facilities:</b>                                      |   |   |   |
| 3. Range of sporting and leisure<br>facilities at the hotel                               | 16%                                       | 19%                                       | 50%                                       |
| 4. Overall standard and quality of the<br>leisure and sporting facilities at the<br>hotel | 16%                                       | 21%                                       | 50%                                       |
| <b>Overall Assessment of the Spa<br/>Facilities:</b>                                      |   |   |   |
| 5. Overall standard of the spa facilities   | 10%                                       | 11%                                       | 60%                                       |
| 6. Range of treatments at the Spa<br>facilities   | 9%  | 12%                                       | 60%                                       |
| 7. Quality of treatments in the Spa<br>facilities   | 10%                                       | 7%  | 60%                                       |

*End of Pre-seen material*

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*[This page is detachable, for ease of reference]*

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Solberri – Unseen material provided on examination day

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Additional (unseen) information relating to the case is given on pages 19 to 22.

Read all of the additional material before you answer the question.

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ANSWER THIS QUESTION

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You are the consultant appointed by the Solberri Board.

Prepare a report that prioritises, analyses and evaluates the issues facing Solberri, and makes appropriate recommendations.

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*Note: The TOPCIMA Assessment Matrix, against which your script will be marked, is on the next page for your reference.*

### March & May 2008 – Assessment Matrix for TOPCIMA – Solberri Hotel Case

| Criterion      | Marks      | Clear Pass   | Pass  | Marginal Pass  | Marginal Fail   | Fail  | Clear Fail  |
|----------------|------------|--|---|--|---|---|---|
| Technical      | 5          | Thorough display of relevant technical knowledge.<br>5                                 | Good display of relevant knowledge.<br>4  | Some display of relevant technical knowledge.<br>3                                       | Identification of some relevant knowledge, but lacking in depth.<br>2                         | Little knowledge displayed, or some misconceptions.<br>1                                      | No evidence of knowledge displayed, or fundamental misconceptions.<br>0     |
| Application    | 15         | Knowledge clearly applied in an analytical and practical manner.<br>13-15              | Knowledge applied to the context of the case.<br>9-12                               | Identification of some relevant knowledge, but not well applied.<br>8                    | Knowledge occasionally displayed without clear application.<br>6-7                            | Little attempt to apply knowledge to the context.<br>3-5                                      | No application of knowledge displayed.<br>0-2                               |
| Diversity      | 5          | Most knowledge areas identified, covering a wide range of views.<br>5                  | Some knowledge areas identified, covering a range of views.<br>4                    | A few knowledge areas identified, expressing a fairly limited scope.<br>3                | Several important knowledge aspects omitted.<br>2   | Many important knowledge aspects omitted.<br>1  | Very few knowledge aspects considered.<br>0                                 |
| Focus          | 5          | Clearly distinguishes between relevant and irrelevant information.<br>5                | Information used is mostly relevant.<br>4   | Some relevant information ignored, or some less relevant information used.<br>3          | Information used is sometimes irrelevant.<br>2  | Little ability to distinguish between relevant and irrelevant information.<br>1               | No ability to distinguish between relevant and irrelevant information.<br>0 |
| Prioritisation | 10         | Issues clearly prioritised in a logical order and based on a clear rationale.<br>9-10  | Issues prioritised with justification.<br>6-8                                       | Evidence of issues being listed in order of importance, but rationale unclear.<br>5      | Issues apparently in priority order, but without a logical justification or rationale.<br>3-4 | Little attempt at prioritisation or justification or rationale.<br>1-2                        | No attempt at prioritisation or justification.<br>0                         |
| Judgement      | 20         | Clearly recognises alternative solutions. Judgement exercised professionally.<br>16-20 | Alternative solutions or options considered. Some judgement exercised.<br>11-15     | A slightly limited range of solutions considered. Judgement occasionally weak.<br>10     | A limited range of solutions considered. Judgement sometimes weak.<br>5-9                     | Few alternative solutions considered. Judgement often weak.<br>1-4                            | No alternative solutions considered. Judgement weak or absent.<br>0         |
| Integration    | 10         | Diverse areas of knowledge and skills integrated effectively.<br>9-10                  | Diverse areas of knowledge and skills integrated.<br>6-8                            | Knowledge areas and skills occasionally not integrated.<br>5                             | Knowledge areas and skills sometimes not integrated.<br>3-4                                   | Knowledge areas and skills often not integrated.<br>1-2                                       | Knowledge areas and skills not integrated.<br>0                             |
| Logic          | 20         | Communication effective, recommendations realistic, concise and logical.<br>16-20      | Communication mainly clear and logical. Recommendations occasionally weak.<br>11-15 | Communication occasionally unclear, and/or recommendations occasionally illogical.<br>10 | Communication sometimes weak. Some recommendations slightly unrealistic.<br>5-9               | Communication weak. Some unclear or illogical recommendations, or few recommendations.<br>1-4 | Very poor communication, and/or no recommendations offered.<br>0            |
| Ethics         | 10         | Excellent evaluation of ethical aspects. Clear and appropriate advice offered.<br>9-10 | Good evaluation of ethical aspects. Some appropriate advice offered.<br>6-8         | Some evaluation of ethical aspects. Advice offered.<br>5                                 | Weak evaluation of ethical aspects. Little advice offered.<br>3-4                             | Poor evaluation of ethical aspects. No advice offered.<br>1-2                                 | No evaluation of ethical aspects. Unethical, or no, advice offered.<br>0    |
| <b>TOTAL</b>   | <b>100</b> |  |   |  |   |   |   |

March 2008

Solberri - unseen material provided on examination day

Read this information before you answer the question

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### **Reduced occupancy levels**

Since November 2007, there have been several unusual weather patterns in the Mediterranean area, with weather forecasters predicting a very cool Peak season for 2008. This appears to have deterred potential customers from making bookings for the 2008 Peak season.

Furthermore, Giorgi Kahle, Solberri's Director of Sales and Marketing has identified, through travel industry research, that there has been a much higher than usual level of holiday bookings outside of the Mediterranean area.

Solberri occupancy is currently forecast to be only 26% overall for the Non-peak season 2007/08. The latest forecast for Solberri is that its 2008 Peak season occupancy will fall far short of its planned level of 85%, and could be as low as 60%. This compares to the actual occupancy level of 74% in the 2007 Peak season.

If the overall occupancy level was to be as low as 60% in the 2008 Peak season then revenue would be €16 million lower than last financial year. This would result in forecast post-tax profits of around €1 million for the year ended 30 September 2008.

Giorgi Kahle has run a variety of marketing campaigns and media events in the last five months in an attempt to secure bookings, and has already spent the entire budget of €22 million for the current financial year ending 30 September 2008. However, Solberri has not secured the expected level of bookings for the 2008 Peak season from these marketing campaigns and media events.

The following two proposals are being considered to stimulate increased occupancy. It is forecast that both of these proposals will cover their costs and will generate additional Peak season bookings which will increase profits.

#### *Proposal A - Direct mail proposal*

Giorgi Kahle has prepared a proposal for the March 2008 Board meeting requesting an additional €10 million in the marketing budget in the current financial year, in order to try to increase the level of bookings. As previous campaigns have not delivered sufficient bookings, the proposal is to undertake a carefully focused direct mail campaign to prospective customers, offering promotional room rates at lower prices. Market research has already established that prospective customers' awareness of Solberri is high. Giorgi Kahle considers that direct mail is the most appropriate way to secure bookings. He has forecast that this direct mail proposal will be profitable.

#### *Proposal B - Joint advertising with HTA*

Currently around 60% of Solberri's bookings are secured as part of a holiday package by holiday travel agents. One of the major European holiday travel agents is HTA, which has shops as well as Internet bookings facilities. HTA has proposed that Solberri contribute towards the cost of a joint advertising campaign, to promote the Mediterranean area in general. If Solberri contributes towards this joint advertising campaign, HTA has stated that it will promote Solberri hotels as its preferred resort hotel. This in turn should boost Solberri's 2008 Peak season bookings. However, the profits forecast from this proposal are approximately half of the profits compared to the direct mail proposal outlined above.

The proposed contribution towards the cost of the joint advertising campaign is €10 million. HTA has asked for a decision by the end of March 2008. If Solberri decides not to contribute towards

this campaign, HTA has stated that it will seek an alternative hotel group in the region as its preferred resort hotel.

Giorgi Kahle is not in favour of this joint marketing proposal and prefers that Solberri's marketing expenditure is managed directly. It is not feasible for the Solberri group to undertake this promotion with HTA as well as the direct mail proposal (as detailed in Proposal A above).

The €10 million which could be spent on either of the two proposals highlighted above is not divisible. Furthermore, the proposals are mutually exclusive and therefore, the €10 million can only be spent on one of these proposals.

### **Problem at one of Solberri's "Superior" hotels**

One of Solberri's "Superior" hotels is located on a cliff top overlooking the Mediterranean. It has a private beach 150 metres below, which can only be accessed by the hotel elevator. This was installed 18 years ago but, in the last two years, the elevator has broken down on several occasions. Each time the elevator has broken down it has taken several days to repair the problem, causing major disruption to customers. The hotel General Manager has been unable to secure funding for the necessary capital expenditure to replace the elevator. In late February 2008, a routine maintenance check by Solberri engineers, identified serious structural problems due to erosion of the cliff face. These engineers have advised that the elevator should be shut down immediately and have estimated that structural repairs will take eight months to complete and will cost €1 million. The General Manager considers that this will severely affect business over the coming 2008 Peak season and he is already under pressure to meet revenue targets. He has therefore decided that work on the elevator will be delayed until October 2008.

There are two other Solberri "Superior" resort hotels in the same country (within a couple of hours travelling from this "Superior" hotel) with sufficient spare capacity. However, the General Manager of this hotel is reluctant to close down the hotel temporarily, and move the customers to either of the two alternative locations.

### **Bookings made by Non-executive directors**

There are four non-executive directors, two of whom are family members of Richard Berriman, and two others, Philip Pascal and Maria Arnot. The General Manager of one of the "Premier" hotels has raised concerns with Giorgi Kahle, regarding recent bookings by Philip Pascal and Maria Arnot and their families in the hotel that he manages. Over the last three years, these 2 non-executive directors and their families have occupied 4 of the best rooms in the hotel, free of charge, for several weeks during the Peak season. Philip Pascal and Maria Arnot have again made it clear to the General Manager that they have no intention of paying for the rooms or for the use of any of the hotel facilities during their stay.

Based on previous stays, the General Manager has estimated that he has been unable to charge revenues of around €0.1 million in the past for these rooms and the additional charges for spa treatments and sports facilities, incurred by these non-executive directors. He is under pressure to meet revenue targets in 2008.

### **Strategic choice for "Super plus" hotels**

At the Board meeting in February 2008, it was agreed that the group should urgently review all 3 "Super plus" hotels as they are achieving a low ROCE of 4.0% and a total of only €0.6 million in operating profit for all 3 hotels. These 3 hotels are generating a positive level of cash from operations, albeit at a low level. Johan Alnetti is in favour of divesting these 3 hotels and he considers that the Board should concentrate on promoting and improving the other 9 resort hotels. His proposal for the bookings already secured for the 2008 Peak season is to provide customers with a choice of an upgrade to a "Premier" or "Superior" hotel at no extra cost. However, the Chairman, Richard Berriman does not want any of the hotels in the group sold.

The net non-current assets for the 3 “Super plus” hotels, in total, is €15 million. Johan Alnetti has prepared a proposal for the March 2008 Board meeting with three strategic alternatives for the 3 “Super plus” hotels, which are:

- Sell to another hotel group. This is forecast to generate around €18 million in total for all 3 hotels. The cost of any refurbishment would be the responsibility of the acquirer.
- Sell to a property development company. A large international property developer, JAC, has indicated that it would like to acquire the 3 hotels, which occupy prime sea front positions, to develop the sites into residential apartments. JAC has indicated that it would not pay more than €16 million.
- Retain the hotels in the Solberri group.

Solberri's current loans are secured on 6 specific hotels, but not on any of the 3 “Super plus” hotels.

### **Proposal by CRUZ to book Solberri accommodation**

Giorgi Kahle has received a proposal from an international cruise ship company, CRUZ, which is considering making a substantial volume of bookings over a three year period effective from the Peak 2008 season. CRUZ would like to use some of Solberri's hotels, which it has already identified, as part of its cruise package to its customers. This would allow CRUZ to offer its customers to stay at a Solberri resort hotel for around 5 to 7 nights at the start or end of their cruise. CRUZ is looking to commit to a three-year contract with Solberri, for the Peak seasons only, for 2008, 2009 and 2010.

CRUZ's Marketing Director has confirmed that it is looking to commit to booking a large volume of rooms, approximately 11% of Solberri's total capacity in 2008, rising to 18% of Solberri's total capacity by 2010. However, the average price that CRUZ is proposing to pay to Solberri for the all inclusive bookings is substantially lower than Solberri's average price per room. Antonio Skrip has stated that he considers that Solberri should not accept the prices proposed by CRUZ.

However, if the proposal were to be accepted, Giorgi Kahle forecasts that additional revenues (not included in the table below) could be generated from spa treatments and other chargeable sports facilities that CRUZ's customers may use. This is conservatively forecast to generate an additional operating profit of around €3 million in 2008, rising to around €5 million by 2010. The forecast financial details of the CRUZ proposal is summarised as follows:

| All figures are pre-tax   | 2008<br>€ million | 2009<br>€ million | 2010<br>€ million |
|---|-------------------|-------------------|-------------------|
| Proposed revenues from CRUZ<br>(for all inclusive accommodation bookings,<br>excluding additional revenue from spa and<br>chargeable sports facilities) | 7.6               | 9.0               | 12.0              |
| Revenues generated at average prices for the<br>same accommodation (that is before travel agents<br>and repeat business discount)                       | 20.0              | 23.4              | 32.2              |
| Solberri direct operating costs   | 6.1               | 7.2               | 9.6               |
| Occupancy levels for CRUZ customers   | 11%               | 13%               | 18%               |

The discount proposed by CRUZ is more than double the current discount rate given to travel agents.

## **Employee complaints**

Last year, a large number of temporary employees complained about the very poor living accommodation offered to them by Solberri. Although accommodation is provided free for employees living on site, the living standards are very poor and the rooms are often dirty, poorly maintained and inadequately furnished.

Also last year, several employees on short-term contracts complained that the induction training was inappropriate for the roles they were expected to undertake. This induction training covered only very general hotel related activities, including a tour of the facilities, general customer care and health and safety issues. Little attention was given to specific training in the various areas where these employees were working. Short-term contract employees felt that they were expected to learn on the job and felt unprepared. As a result they were very stressed and demotivated. There is also some resentment from long-term contract employees who feel that they are being blamed for poor supervision and are being made responsible for "on-the-job" training. They do not see it as their responsibility to train new employees.

## **Richard Berriman on sick leave**

Within the last few days, Richard Berriman has been diagnosed with a serious illness and has required immediate hospitalisation. It is anticipated that Richard Berriman will be on sick leave for at least 6 months.

## **Appointment of a consultant**

At the Solberri Board meeting held at the end of February 2008 it was agreed that a consultant would be appointed to advise the Board on the issues facing Solberri.

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# APPLICABLE MATHS TABLES AND FORMULAE

## Present value table

Present value of 1.00 unit of currency, that is  $(1 + r)^{-n}$  where  $r$  = interest rate;  $n$  = number of periods until payment or receipt.

| Periods<br>( $n$ ) | Interest rates ( $r$ ) |       |       |       |       |       |       |       |       |       |
|--------------------|------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|                    | 1%                     | 2%    | 3%    | 4%    | 5%    | 6%    | 7%    | 8%    | 9%    | 10%   |
| 1                  | 0.990                  | 0.980 | 0.971 | 0.962 | 0.952 | 0.943 | 0.935 | 0.926 | 0.917 | 0.909 |
| 2                  | 0.980                  | 0.961 | 0.943 | 0.925 | 0.907 | 0.890 | 0.873 | 0.857 | 0.842 | 0.826 |
| 3                  | 0.971                  | 0.942 | 0.915 | 0.889 | 0.864 | 0.840 | 0.816 | 0.794 | 0.772 | 0.751 |
| 4                  | 0.961                  | 0.924 | 0.888 | 0.855 | 0.823 | 0.792 | 0.763 | 0.735 | 0.708 | 0.683 |
| 5                  | 0.951                  | 0.906 | 0.863 | 0.822 | 0.784 | 0.747 | 0.713 | 0.681 | 0.650 | 0.621 |
| 6                  | 0.942                  | 0.888 | 0.837 | 0.790 | 0.746 | 0.705 | 0.666 | 0.630 | 0.596 | 0.564 |
| 7                  | 0.933                  | 0.871 | 0.813 | 0.760 | 0.711 | 0.665 | 0.623 | 0.583 | 0.547 | 0.513 |
| 8                  | 0.923                  | 0.853 | 0.789 | 0.731 | 0.677 | 0.627 | 0.582 | 0.540 | 0.502 | 0.467 |
| 9                  | 0.914                  | 0.837 | 0.766 | 0.703 | 0.645 | 0.592 | 0.544 | 0.500 | 0.460 | 0.424 |
| 10                 | 0.905                  | 0.820 | 0.744 | 0.676 | 0.614 | 0.558 | 0.508 | 0.463 | 0.422 | 0.386 |
| 11                 | 0.896                  | 0.804 | 0.722 | 0.650 | 0.585 | 0.527 | 0.475 | 0.429 | 0.388 | 0.350 |
| 12                 | 0.887                  | 0.788 | 0.701 | 0.625 | 0.557 | 0.497 | 0.444 | 0.397 | 0.356 | 0.319 |
| 13                 | 0.879                  | 0.773 | 0.681 | 0.601 | 0.530 | 0.469 | 0.415 | 0.368 | 0.326 | 0.290 |
| 14                 | 0.870                  | 0.758 | 0.661 | 0.577 | 0.505 | 0.442 | 0.388 | 0.340 | 0.299 | 0.263 |
| 15                 | 0.861                  | 0.743 | 0.642 | 0.555 | 0.481 | 0.417 | 0.362 | 0.315 | 0.275 | 0.239 |
| 16                 | 0.853                  | 0.728 | 0.623 | 0.534 | 0.458 | 0.394 | 0.339 | 0.292 | 0.252 | 0.218 |
| 17                 | 0.844                  | 0.714 | 0.605 | 0.513 | 0.436 | 0.371 | 0.317 | 0.270 | 0.231 | 0.198 |
| 18                 | 0.836                  | 0.700 | 0.587 | 0.494 | 0.416 | 0.350 | 0.296 | 0.250 | 0.212 | 0.180 |
| 19                 | 0.828                  | 0.686 | 0.570 | 0.475 | 0.396 | 0.331 | 0.277 | 0.232 | 0.194 | 0.164 |
| 20                 | 0.820                  | 0.673 | 0.554 | 0.456 | 0.377 | 0.312 | 0.258 | 0.215 | 0.178 | 0.149 |

| Periods<br>( $n$ ) | Interest rates ( $r$ ) |       |       |       |       |       |       |       |       |       |
|--------------------|------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|                    | 11%                    | 12%   | 13%   | 14%   | 15%   | 16%   | 17%   | 18%   | 19%   | 20%   |
| 1                  | 0.901                  | 0.893 | 0.885 | 0.877 | 0.870 | 0.862 | 0.855 | 0.847 | 0.840 | 0.833 |
| 2                  | 0.812                  | 0.797 | 0.783 | 0.769 | 0.756 | 0.743 | 0.731 | 0.718 | 0.706 | 0.694 |
| 3                  | 0.731                  | 0.712 | 0.693 | 0.675 | 0.658 | 0.641 | 0.624 | 0.609 | 0.593 | 0.579 |
| 4                  | 0.659                  | 0.636 | 0.613 | 0.592 | 0.572 | 0.552 | 0.534 | 0.516 | 0.499 | 0.482 |
| 5                  | 0.593                  | 0.567 | 0.543 | 0.519 | 0.497 | 0.476 | 0.456 | 0.437 | 0.419 | 0.402 |
| 6                  | 0.535                  | 0.507 | 0.480 | 0.456 | 0.432 | 0.410 | 0.390 | 0.370 | 0.352 | 0.335 |
| 7                  | 0.482                  | 0.452 | 0.425 | 0.400 | 0.376 | 0.354 | 0.333 | 0.314 | 0.296 | 0.279 |
| 8                  | 0.434                  | 0.404 | 0.376 | 0.351 | 0.327 | 0.305 | 0.285 | 0.266 | 0.249 | 0.233 |
| 9                  | 0.391                  | 0.361 | 0.333 | 0.308 | 0.284 | 0.263 | 0.243 | 0.225 | 0.209 | 0.194 |
| 10                 | 0.352                  | 0.322 | 0.295 | 0.270 | 0.247 | 0.227 | 0.208 | 0.191 | 0.176 | 0.162 |
| 11                 | 0.317                  | 0.287 | 0.261 | 0.237 | 0.215 | 0.195 | 0.178 | 0.162 | 0.148 | 0.135 |
| 12                 | 0.286                  | 0.257 | 0.231 | 0.208 | 0.187 | 0.168 | 0.152 | 0.137 | 0.124 | 0.112 |
| 13                 | 0.258                  | 0.229 | 0.204 | 0.182 | 0.163 | 0.145 | 0.130 | 0.116 | 0.104 | 0.093 |
| 14                 | 0.232                  | 0.205 | 0.181 | 0.160 | 0.141 | 0.125 | 0.111 | 0.099 | 0.088 | 0.078 |
| 15                 | 0.209                  | 0.183 | 0.160 | 0.140 | 0.123 | 0.108 | 0.095 | 0.084 | 0.079 | 0.065 |
| 16                 | 0.188                  | 0.163 | 0.141 | 0.123 | 0.107 | 0.093 | 0.081 | 0.071 | 0.062 | 0.054 |
| 17                 | 0.170                  | 0.146 | 0.125 | 0.108 | 0.093 | 0.080 | 0.069 | 0.060 | 0.052 | 0.045 |
| 18                 | 0.153                  | 0.130 | 0.111 | 0.095 | 0.081 | 0.069 | 0.059 | 0.051 | 0.044 | 0.038 |
| 19                 | 0.138                  | 0.116 | 0.098 | 0.083 | 0.070 | 0.060 | 0.051 | 0.043 | 0.037 | 0.031 |
| 20                 | 0.124                  | 0.104 | 0.087 | 0.073 | 0.061 | 0.051 | 0.043 | 0.037 | 0.031 | 0.026 |



Cumulative present value of 1.00 unit of currency per annum, Receivable or Payable at the end of each year for  $n$  years  $\left[ \frac{1-(1+r)^{-n}}{r} \right]$

| Periods<br>( $n$ ) | Interest rates ( $r$ ) |        |        |        |        |        |        |       |       |       |
|--------------------|------------------------|--------|--------|--------|--------|--------|--------|-------|-------|-------|
|                    | 1%                     | 2%     | 3%     | 4%     | 5%     | 6%     | 7%     | 8%    | 9%    | 10%   |
| 1                  | 0.990                  | 0.980  | 0.971  | 0.962  | 0.952  | 0.943  | 0.935  | 0.926 | 0.917 | 0.909 |
| 2                  | 1.970                  | 1.942  | 1.913  | 1.886  | 1.859  | 1.833  | 1.808  | 1.783 | 1.759 | 1.736 |
| 3                  | 2.941                  | 2.884  | 2.829  | 2.775  | 2.723  | 2.673  | 2.624  | 2.577 | 2.531 | 2.487 |
| 4                  | 3.902                  | 3.808  | 3.717  | 3.630  | 3.546  | 3.465  | 3.387  | 3.312 | 3.240 | 3.170 |
| 5                  | 4.853                  | 4.713  | 4.580  | 4.452  | 4.329  | 4.212  | 4.100  | 3.993 | 3.890 | 3.791 |
| 6                  | 5.795                  | 5.601  | 5.417  | 5.242  | 5.076  | 4.917  | 4.767  | 4.623 | 4.486 | 4.355 |
| 7                  | 6.728                  | 6.472  | 6.230  | 6.002  | 5.786  | 5.582  | 5.389  | 5.206 | 5.033 | 4.868 |
| 8                  | 7.652                  | 7.325  | 7.020  | 6.733  | 6.463  | 6.210  | 5.971  | 5.747 | 5.535 | 5.335 |
| 9                  | 8.566                  | 8.162  | 7.786  | 7.435  | 7.108  | 6.802  | 6.515  | 6.247 | 5.995 | 5.759 |
| 10                 | 9.471                  | 8.983  | 8.530  | 8.111  | 7.722  | 7.360  | 7.024  | 6.710 | 6.418 | 6.145 |
| 11                 | 10.368                 | 9.787  | 9.253  | 8.760  | 8.306  | 7.887  | 7.499  | 7.139 | 6.805 | 6.495 |
| 12                 | 11.255                 | 10.575 | 9.954  | 9.385  | 8.863  | 8.384  | 7.943  | 7.536 | 7.161 | 6.814 |
| 13                 | 12.134                 | 11.348 | 10.635 | 9.986  | 9.394  | 8.853  | 8.358  | 7.904 | 7.487 | 7.103 |
| 14                 | 13.004                 | 12.106 | 11.296 | 10.563 | 9.899  | 9.295  | 8.745  | 8.244 | 7.786 | 7.367 |
| 15                 | 13.865                 | 12.849 | 11.938 | 11.118 | 10.380 | 9.712  | 9.108  | 8.559 | 8.061 | 7.606 |
| 16                 | 14.718                 | 13.578 | 12.561 | 11.652 | 10.838 | 10.106 | 9.447  | 8.851 | 8.313 | 7.824 |
| 17                 | 15.562                 | 14.292 | 13.166 | 12.166 | 11.274 | 10.477 | 9.763  | 9.122 | 8.544 | 8.022 |
| 18                 | 16.398                 | 14.992 | 13.754 | 12.659 | 11.690 | 10.828 | 10.059 | 9.372 | 8.756 | 8.201 |
| 19                 | 17.226                 | 15.679 | 14.324 | 13.134 | 12.085 | 11.158 | 10.336 | 9.604 | 8.950 | 8.365 |
| 20                 | 18.046                 | 16.351 | 14.878 | 13.590 | 12.462 | 11.470 | 10.594 | 9.818 | 9.129 | 8.514 |

| Periods<br>( $n$ ) | Interest rates ( $r$ ) |       |       |       |       |       |       |       |       |       |
|--------------------|------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|                    | 11%                    | 12%   | 13%   | 14%   | 15%   | 16%   | 17%   | 18%   | 19%   | 20%   |
| 1                  | 0.901                  | 0.893 | 0.885 | 0.877 | 0.870 | 0.862 | 0.855 | 0.847 | 0.840 | 0.833 |
| 2                  | 1.713                  | 1.690 | 1.668 | 1.647 | 1.626 | 1.605 | 1.585 | 1.566 | 1.547 | 1.528 |
| 3                  | 2.444                  | 2.402 | 2.361 | 2.322 | 2.283 | 2.246 | 2.210 | 2.174 | 2.140 | 2.106 |
| 4                  | 3.102                  | 3.037 | 2.974 | 2.914 | 2.855 | 2.798 | 2.743 | 2.690 | 2.639 | 2.589 |
| 5                  | 3.696                  | 3.605 | 3.517 | 3.433 | 3.352 | 3.274 | 3.199 | 3.127 | 3.058 | 2.991 |
| 6                  | 4.231                  | 4.111 | 3.998 | 3.889 | 3.784 | 3.685 | 3.589 | 3.498 | 3.410 | 3.326 |
| 7                  | 4.712                  | 4.564 | 4.423 | 4.288 | 4.160 | 4.039 | 3.922 | 3.812 | 3.706 | 3.605 |
| 8                  | 5.146                  | 4.968 | 4.799 | 4.639 | 4.487 | 4.344 | 4.207 | 4.078 | 3.954 | 3.837 |
| 9                  | 5.537                  | 5.328 | 5.132 | 4.946 | 4.772 | 4.607 | 4.451 | 4.303 | 4.163 | 4.031 |
| 10                 | 5.889                  | 5.650 | 5.426 | 5.216 | 5.019 | 4.833 | 4.659 | 4.494 | 4.339 | 4.192 |
| 11                 | 6.207                  | 5.938 | 5.687 | 5.453 | 5.234 | 5.029 | 4.836 | 4.656 | 4.486 | 4.327 |
| 12                 | 6.492                  | 6.194 | 5.918 | 5.660 | 5.421 | 5.197 | 4.988 | 4.793 | 4.611 | 4.439 |
| 13                 | 6.750                  | 6.424 | 6.122 | 5.842 | 5.583 | 5.342 | 5.118 | 4.910 | 4.715 | 4.533 |
| 14                 | 6.982                  | 6.628 | 6.302 | 6.002 | 5.724 | 5.468 | 5.229 | 5.008 | 4.802 | 4.611 |
| 15                 | 7.191                  | 6.811 | 6.462 | 6.142 | 5.847 | 5.575 | 5.324 | 5.092 | 4.876 | 4.675 |
| 16                 | 7.379                  | 6.974 | 6.604 | 6.265 | 5.954 | 5.668 | 5.405 | 5.162 | 4.938 | 4.730 |
| 17                 | 7.549                  | 7.120 | 6.729 | 6.373 | 6.047 | 5.749 | 5.475 | 5.222 | 4.990 | 4.775 |
| 18                 | 7.702                  | 7.250 | 6.840 | 6.467 | 6.128 | 5.818 | 5.534 | 5.273 | 5.033 | 4.812 |
| 19                 | 7.839                  | 7.366 | 6.938 | 6.550 | 6.198 | 5.877 | 5.584 | 5.316 | 5.070 | 4.843 |
| 20                 | 7.963                  | 7.469 | 7.025 | 6.623 | 6.259 | 5.929 | 5.628 | 5.353 | 5.101 | 4.870 |

## **FORMULAE**

### **Valuation Models**

- (i) Irredeemable preference share, paying a constant annual dividend,  $d$ , in perpetuity, where  $P_0$  is the ex-div value:

$$P_0 = \frac{d}{k_{\text{pref}}}$$

- (ii) Ordinary (Equity) share, paying a constant annual dividend,  $d$ , in perpetuity, where  $P_0$  is the ex-div value:

$$P_0 = \frac{d}{k_e}$$

- (iii) Ordinary (Equity) share, paying an annual dividend,  $d$ , growing in perpetuity at a constant rate,  $g$ , where  $P_0$  is the ex-div value:

$$P_0 = \frac{d_1}{k_e - g} \text{ or } P_0 = \frac{d_0[1 + g]}{k_e - g}$$

- (iv) Irredeemable (Undated) debt, paying annual after tax interest,  $i(1-t)$ , in perpetuity, where  $P_0$  is the ex-interest value:

$$P_0 = \frac{i[1 - t]}{k_{\text{dnet}}}$$

or, without tax:

$$P_0 = \frac{i}{k_d}$$

- (v) Future value of  $S$ , of a sum  $X$ , invested for  $n$  periods, compounded at  $r\%$  interest:

$$S = X[1 + r]^n$$

- (vi) Present value of £1 payable or receivable in  $n$  years, discounted at  $r\%$  per annum:

$$PV = \frac{1}{[1 + r]^n}$$

- (vii) Present value of an annuity of £1 per annum, receivable or payable for  $n$  years, commencing in one year, discounted at  $r\%$  per annum:

$$PV = \frac{1}{r} \left[ 1 - \frac{1}{[1 + r]^n} \right]$$

- (viii) Present value of £1 per annum, payable or receivable in perpetuity, commencing in one year, discounted at  $r\%$  per annum:

$$PV = \frac{1}{r}$$

- (ix) Present value of £1 per annum, receivable or payable, commencing in one year, growing in perpetuity at a constant rate of  $g\%$  per annum, discounted at  $r\%$  per annum:

$$PV = \frac{1}{r - g}$$

### Cost of Capital

- (i) Cost of irredeemable preference capital, paying an annual dividend,  $d$ , in perpetuity, and having a current ex-div price  $P_0$ :

$$k_{pref} = \frac{d}{P_0}$$

- (ii) Cost of irredeemable debt capital, paying annual net interest,  $i(1 - t)$ , and having a current ex-interest price  $P_0$ :

$$k_{dnet} = \frac{i[1 - t]}{P_0}$$

- (iii) Cost of ordinary (equity) share capital, paying an annual dividend,  $d$ , in perpetuity, and having a current ex-div price  $P_0$ :

$$k_e = \frac{d}{P_0}$$

- (iv) Cost of ordinary (equity) share capital, having a current ex-div price,  $P_0$ , having just paid a dividend,  $d_0$ , with the dividend growing in perpetuity by a constant  $g\%$  per annum:

$$k_e = \frac{d_1}{P_0} + g \quad \text{or} \quad k_e = \frac{d_0[1 + g]}{P_0} + g$$

- (v) Cost of ordinary (equity) share capital, using the CAPM:

$$k_e = R_f + [R_m - R_f]\beta$$

- (vi) Weighted average cost of capital,  $k_0$ :

$$k_0 = k_e \left[ \frac{V_E}{V_E + V_D} \right] + k_d \left[ \frac{V_D}{V_E + V_D} \right]$$


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*P10 – Test of Professional  
Competence in Management  
Accounting*

*4 March 2008*