HTFT PARTNERSHIP

CIMA Operational Case Study

Thomas Fine Teas – Exam Kit

Exam Kit Contents

Chapter 1: Understanding sections illustrated

Chapter 2: Thomas Fine Teas and E1 revision tasks

THOMAS FINE TEAS AND MARKETING

Task 5– Exhibit

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E1-E1 (b) Apply the elements of the marketing mix

Task 5 (Marketing Mix)

From: Fred Thomas

To: Finance Team

Date: 1st August 2018

S**ubject:** Thomas Fine Teas launch new range of healthy and detox teas

Hi FO,

I am pleased to announce that we are launching a new product range of early next year. The initial range will include a lymph cleansing herbal infusion, a complete liver detox infusion and a antioxidant lemon and carrot infusion.

Therefore, I am keen to ensure we get the marketing mix right first time as I want to make sure this launch is successful. Ana and her team are away at a sales conference so I would like you to explain how marketing healthy and detox teas will differ from our current Thomas Fine Teas products such as black and green tea.

Please include in your email your ideas for the marketing of the new range under the four headings of the marketing mix.

Assume you have 14 minutes to complete this tasks

LO E1-E2 (b)

Task 5: Suggested solution

From: Finance Officer

To: Fred Thomas

Subject: Marketing Mix

How marketing healthy and detox infusions will differ from our current Thomas Fine Teas products such as black and green

Product:

The new range of infusions are a **similar product range** to our current offering and must therefore follow the same high quality and fulfil the requirements of the customer. The products will need to be appealing to both the **younger generation** with whom they are popular and **those people trying to lead a healthier life-style** We need to make sure our products are **tasty** and get good reviews whilst **avoiding criticism** that could come our way if we 'over sell' any unproven health benefits. The new **packaging** need to be attractive to the customer i.e. we will need to ensure the packaging reflects a modern and healthy appeal with consideration given to ecological sustainability, materials, colours, etc. Our products need to appeal to both the younger generation who have more disposable income and the better off who want the health benefits.

Price:

Thomas Fine Teas have a **strong brand name** and our customers associate us with a quality product. I believe that the **brand prestige** will extend to the new range of healthy and detox teas and will allow us to have a premium price for the new range. We will need to make sure that we have a price that is competitive with other quality brands in this market however. As usual, **commercial customers** are likely to buy in bulk and suitable discount will be available to them for this. We can consider entering into one of our special pricing arrangements with the supermarkets so they can initially offer a half price or a buy one get one free promotional deal.

Promotion:

We will promote the new range in the same way that the other Thomas Fine Teas products are promoted, using Ben's experience in both TV advertising and his creative background. I expect these traditional marketing methods (TV advertising and media advertising) will need to be used. However we may need to target different journals such as 'Healthy Lives Journal' and 'Slimming World Magazine'. However, I think we should focus more on the social media and web based advertising as many young people do not buy magazines and we need to ensure that our marketing is aimed at the younger generation and those trying to live a healthier lifestyle. The healthy and detox infusions will have different attributes to the other Thomas Fine Teas products so in the early months of the life cycle of the products customers are likely to need more help and guidance than they need for our established product range. In addition to the current promotional techniques we should consider advertising in places where this market are likely to go, such as gyms.

Place:

Our new healthy infusion range will be sold in the same medium as our other Thomas Fine Teas products. The plan is for placing with both the supermarket chains that currently stock our infusions (Forrest and A1) and also the wholesalers (Harper and Deeland). Our corporate clients (Deeair and the national government) should be interested too as health is a big market. We should consider if this is an opportunity to gain a new corporate client – maybe one of the national gym chains would find these products attractive to add to their menus. The market is showing a big demand for ‘monthly gift subscriptions’ delivered each month to the recipient’s door. This healthy range may give us a way in to ‘Gift a months supply of fine tea and infusions, directly through the letterbox’. If it has worked for flower growers then tea bags are easy to post!

Task 15 (The impact on the finance function of supplying directly to small customers)

Today is 1st August 2018 and you receive the following e mail from:

From: Jack Ford (Head of Finance)

To: Finance Officer

Sent: 1st May 2018

Subject: The healthy infusion range and new customers

The marketing campaign seems to have been a big success. Already this morning I've had two more requests from small retailers who don't currently stock our infusions to sell our product directly to them. So far I have redirected them to one of our wholesalers but I am starting to think that maybe we should consider selling directly to small retailers. We only have 9 customers which works well because they are large entities and always pay us (though usually late). Please could you prepare a brief report that I can use at our next management meeting on the implications of taking on direct selling to the small scale customers. In particular can you comment on the practical impact on the finance function of supplying directly to small-scale customers.

Many thanks

Jack

Assume you have 14 minutes to complete this task

LO E1- B2

Task 15 Suggested solution

From: Finance Officer

To: Jack Ford (Head of Finance)

Sent: 1st May 2018

Subject: The healthy infusion range and new customers

The practical impact on the finance function of supplying directly to small scale customers

Credit approval

Currently we are dealing with 9 well known customers (3 x supermarkets, 2 x wholesalers, Deeair and, the Dee land government and 2 x corporate customers) and don't therefore have a **formal credit approval system** for new customers. An increase in the number of customers would significantly increase the administrative burden on the finance function. It would be sensible to recruit an appropriate experienced and **qualified credit controller** to ensure that all new customers are assessed as to their credit worthiness. All potential customers should be assessed as to their creditworthiness prior to being accepted. This might involve purchasing credit agency reports or performing an internal assessment through looking at financial statements.

Credit control

Additional staffing will be required to ensure sound **credit control procedures** are established and that the receivables are monitored and chased for payment as required in a timely manner. In addition there should be procedures in place for the regular monitoring of outstanding debts and for chasing up late payments through telephone calls and letters.

Financing of receivables through factoring

Ultimately to protect against the risk of irrecoverable debt we could at a future date factor our receivables under **a without recourse agreement**. This would in effect mean that we would sell our outstanding debts to a finance company, which would be responsible for recovering the monies and would take on the risk of recoverability. This would have the effect of immediately improving our cash flow, although it would be relatively expensive to implement.

Order processing and invoice processing

The **volume of transactions** will increase significantly which potentially will put pressure on the finance function, unless appropriately staffed. More sophisticated **computer systems** may be required, involving a change in staff skills, investment in training and capital investment in the systems themselves. Outsourcing the function may be worth considering if a sufficient level of transactions is reached.

Chapter 3: Thomas Fine Teas and F1 revision tasks

(IAS 23 Borrowing costs)

Task 32 (IAS 23)

From: Christie Thomas

To: Finance Team

Date: 1st May 2018

S**ubject:** Treatment of finance costs

As you know Thomas Fine Teas has been considering how it will finance its plans to expand our current production facility in Deeland. We are looking to extend the current building to provide an area of production to focus launch on our new infusion products. We intend to complete the build in the next few months. I've been considering how we are going to finance the cost of the construction of production facility. We have decided to take out a medium-term bank loan as our current lenders have indicated that they would support a loan application.

I need to write a briefing paper for our next management meeting about the treatment of the interest costs on the loan. I have been told I might be able to capitalise them but I am sure finance costs should be expensed to the statement of profit or loss.

Task:

Prepare briefing notes for Christie regarding the emails above.

Assume you have 7 minutes to complete this task

LO F1- B2

Task 32: Suggested solution

IAS 23 Borrowing costs

This standard does allow a company to capitalise the finance cost of a loan that relates to the construction of a qualifying assets. A qualifying asset is defined as an asset that takes a substantial period to get ready for its intended use or sale. For the case of Thomas Fine Teas the expansion of the production facility meets the definition of a qualifying asset.

Capitalisation of costs

IAS 23 states that only during construction of the qualifying assets can the finance costs can be capitalised to the statement of financial position, therefore finance costs can be capitalised from the date that Thomas Fine Teas begin to spend money on the expansion project to the date the project is complete and available to use. Once the qualifying asset/ production facility has been completed capitalisation of the finance costs that relate to the load will cease and future finance costs will be expensed to the statement of profit or loss. If for any reason the construction of the production facility is suspended again the finance costs will need to be expensed to the statement of profit or loss.

Chapter 4: Thomas Fine Teas and P1 revision tasks

Task 53 (Decision Trees)

You arrive at your desk this morning and find an email from Fred Thomas (Managing Director)

Private and confidential

From: Fred Thomas

To: Finance Officer

Subject: Decision Trees

Dear FO,

I've recently been liaising with a project management consultancy firm who are advising me on some techniques to use for decision making at Thomas Fine Teas.

The consultancy is only contracted for one day per week and so in their absence, I need some written documentation to explain the diagram that they have created to help me to decide the future of a disused site that we own in Dee-land.

Please prepare notes for me that include:

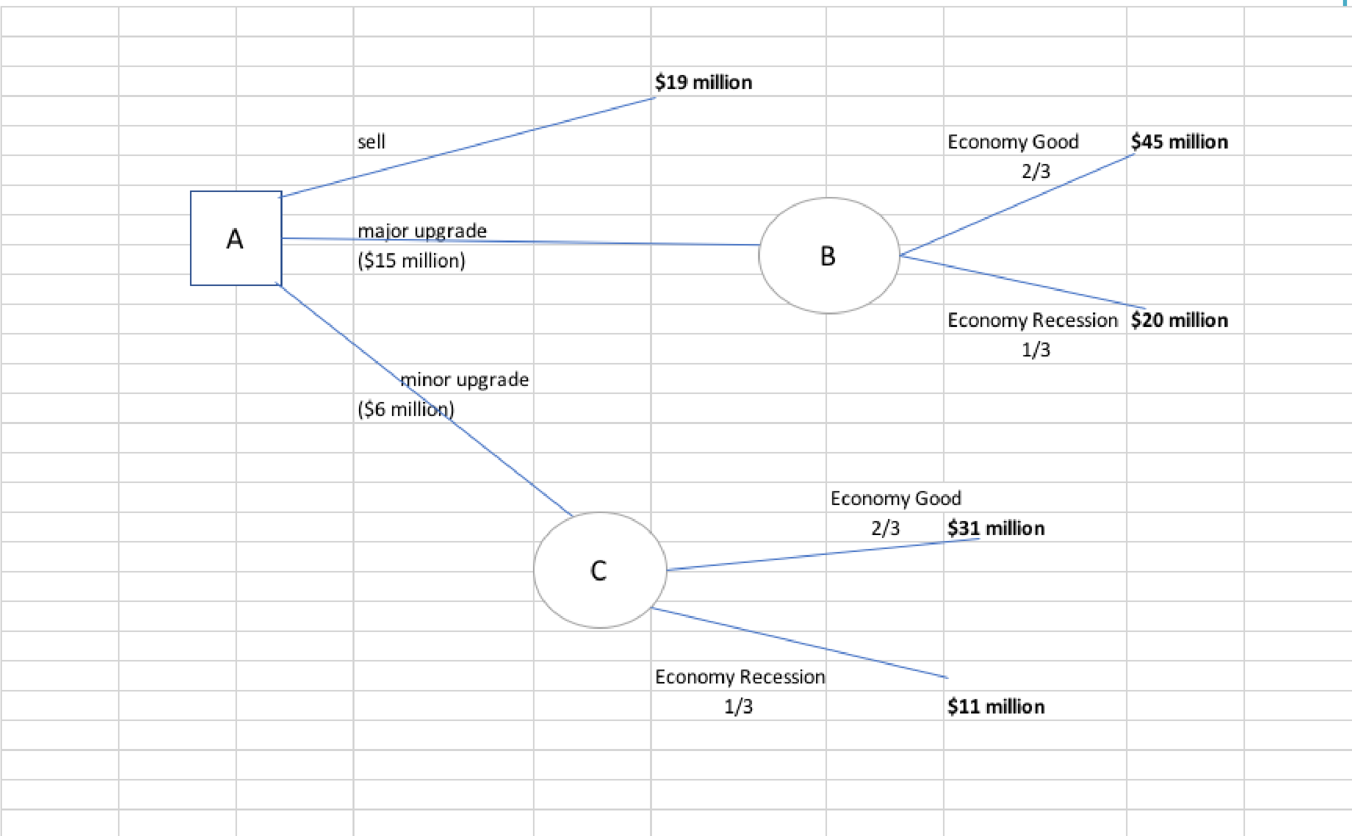
- An explanation of the decision tree (attached) and how the decision tree should be used to make a decision
- Limitations of using a decision tree to make this type of business decision

Many Thanks

Fred

Task 53 – Reference Material

Decision Tree – Future of Disused Site



Notes

Expected Value of major upgrade: (2/3 * 45m) + (1/3 * 20m) =36.67m less 15m costs = D$21.67m

Expected Value of minor upgrade: (2/3 * 31m) + (1/3 * 11m) =24.33m less 6m costs = D$18.33m

Expected Value of selling site: D$19 million

Task 53 - solution

To: Fred Thomas

From: Finance Officer

<u>An explanation of the decision tree and how the decision tree should be used to make a decision</u>.

Overview of decision trees and notation used

Decision tree analysis has been used here to **visually display** the **options and outcomes** which you face regarding the future of the unused site. The decision tree shows which decision you need to make and how the result may be subject to **various factors which affect its future outcome**. The conventional notation is that a **square** is the **decision** to be made and the **circles** are the **outcomes that are not in the Thomas Fine Teas' control.** Here the square represented by A, is the choice regarding the future of the disused site. The options available are described on the lines and show that you have a choice of possible actions in terms of whether you sell the site, undertake a major upgrade or undertake a minor upgrade. The consultancy has estimated the costs of a major upgrade to be D$15 million and the costs of a minor upgrade to be D$6 million. They have also obtained an estimated sales income from disposing of the disused site to be D$19 million. The estimated income associated with each type of refurbishment is written on the end of the branches, however, these are dependent on the state of the future economy.

Probabilities and Risk

The part of our decision which is not known and represents **the risk** is the **future state of the economy.** According to the diagram there is a 2/3 chance that the economy will be good and a 1/3 probability that it will be in recession. When the economy is in recession the value of estimated profits from refurbishments are lower. The future of the economy is not within Thomas Fine Teas' control.

Decision Making Using Diagram

The evaluation of the decision tree is via a method called **Expected Value**. This is a long run weighted average outcome that will be returned if the project is repeated numerous times. The expected value in this case, uses the probabilities of the future economy states and combines them with the associated profit outcomes to get an average value for each decision. The costs of each type of refurbishment need to be deducted from the average profit and then these can then be compared to the selling value of $19 million. The **highest expected value represents the choice** which has the highest long run average net profit. In our case, the **major refurbishment** has the highest expected value of D$21.67m.

<u>Limitations of using a decision tree to make this type of business decision</u>

Simplified Assumptions

There are **various limitations** with using a decision tree for this type of decision. The notation requires choices and outcomes to be clear-cut. There are more than 3 options for this decision – for example you could choose to lease out the disused site or to wait for another year to decide its future. The estimations of the economy outcomes are a little crude and done for **simplification** purposes. In reality, the economy moves gradually between economic states and the associated probabilities and profits under each future state can only be estimated.

Problems with application of expected value method

The method of **expected value** also assumes the decision will be taken multiple times and therefore evaluates the long run average figure. The refurbishment or sale of this disused plant is not likely to be a decision you will take more than once, so expected value could be argued as being an **inappropriate method** to evaluate the options available.

Risk Profile Preferences

Finally, a decision tree is evaluated using **expected value** method. This assumes that Thomas Fine Tea company has a risk profile which is **risk-neutral** and will base decisions on the best long run average result calculated from the probabilities and outcomes, rather than a preference to be **cautious (risk averse)** or take a **gamble (risk seeker)** on the future of the disused plant. For example, you may decide to take a risk and ignore probabilities, in which case you could opt for the major upgrade because of the attraction of receiving the highest potential income of D$45 million. In this particular case, the decision for both a risk seeker and risk neutral profile is to choose to undertake a major upgrade, however these profiles do not always agree on their choices, this is just a coincidence in this particular case.