

P5 June 2010 Question 1

- 1 The Superior Business Consultancy (SBC) which is based in Jayland provides clients with consultancy services in Advertising, Recruitment and IT Support. SBC commenced trading on 1 July 2003 and has grown steadily since then.

The following information, together with that contained in the appendix, is available:

- (1) Three types of consultants are employed by SBC on a full-time basis. These are:
- Advertising consultants who provide advice regarding advertising and promotional activities
 - Recruitment consultants who provide advice regarding recruitment and selection of staff, and
 - IT consultants who provide advice regarding the selection of business software and technical support.
- (2) During the year ended 31 May 2010, each full-time consultant was budgeted to work on 200 days. All consultations undertaken by consultants of SBC had a duration of one day.
- (3) During their 200 working days per annum, full-time consultants undertake some consultations on a 'no-fee' basis. Such consultations are regarded as Business Development Activity (BDA) by the management of SBC.
- (4) SBC also engages the services of subcontract consultants who provide clients with consultancy services in the categories of Advertising, Recruitment and IT Support. All of the subcontract consultants have worked for SBC for at least three years.
- (5) During recent years the directors of SBC have become increasingly concerned that SBC's systems are inadequate for the measurement of performance. This concern was further increased after they each read a book entitled '*How to improve business performance measurement*'.

Required:

Prepare a report for the directors of SBC which:

- (i) discusses the importance of non-financial performance indicators (NFPIs) and evaluates, giving examples, how a 'balanced scorecard' approach may be used to improve performance within SBC; (13 marks)
- (ii) contains a calculation of the actual average cost per chargeable consultation for both full-time consultants and separately for subcontract consultants in respect of each of the three categories of consultancy services during the year ended 31 May 2010; (7 marks)
- (iii) suggests reasons for the trends shown by the figures contained in the appendix; (5 marks)
- (iv) discusses the potential benefits and potential problems which might arise as a consequence of employing subcontract consultants within SBC. (6 marks)

Professional marks will be awarded in Question 1 for appropriateness of format, style and structure of the report. (4 marks)

(35 marks)

Appendix
SBC – Relevant actual and forecast statistics

	2010 Actual	2011 Forecast	2012 Forecast
Number of full-time consultants by category:			
Advertising	20	20	20
Recruitment	30	25	20
IT Support	50	50	50
Salaries per full-time consultant (\$):			
Advertising	40,000	40,800	40,800
Recruitment	35,000	35,700	35,700
IT Support	30,000	30,600	30,600
Number of chargeable consultations (total demand):			
Advertising	4,200	4,100	4,000
Recruitment	6,250	5,750	5,000
IT Support	10,250	10,500	10,000
Per cent of chargeable days spent on Business Development Activity (%):			
Advertising	7	8	10
Recruitment	22	22	25
IT Support	12	13	14
Cost per consultation undertaken by subcontract consultants (\$):			
Advertising	300		
Recruitment	220		
IT Support	200		
Other operating costs (\$000):			
Full-time consultants	1,075	1,050	1,270
Subcontract consultants	125	270	182

1 (i) To: The Directors
From: Management Accountant
Subject: The Balanced Scorecard
Date: 11 June 2010

The use of non-financial performance indicators (NFPIs) has become more widespread during recent years to assess performance in organisations. This is largely attributable to the fact that many important aspects of organisational performance cannot be measured in purely financial terms. It follows that if performance measures are restricted to financial measures alone then many important non-financial aspects of organisational performance may be ignored.

Furthermore there is a widely held view that 'what gets measured gets done' and if performance measures are restricted to financial measures alone then the focus of managers will be myopic and consequently they may be motivated by the wrong stimuli. In the past the important measure of performance have been financial in nature, with little or in extreme cases no focus whatsoever, being given to other important aspects of performance. Many commentators have argued that financial measures encourage short-termism to the detriment of the longer-term prospects of organisations.

Many NFPIs are 'lead indicators' insofar as they give an indication of likely future financial performance and therefore their measurement might reveal problems which might be addressed by management in time to take remedial action.

Skill and care must be exercised by management in the selection of NFPIs given the vast number of potential NFPIs in order to avoid an 'information overload' which could be damaging to an organisation.

The increasing attention given to NFPIs was a key factor in the development of Kaplan and Norton's 'balanced scorecard' which proposed that business performance is reviewed from four perspectives, these are:

The financial perspective – How does an organisation appear to the shareholders?

The customer perspective – How does an organisation appear to the customers?

The internal business perspective – What must an organisation excel at?

The innovation and learning perspective – Can an organisation continue to improve and create value?

For each of the four perspectives goals and measures will need to be defined – typically five measures for each perspective. The goals and measures are designed to focus attention on important factors and precipitate improved organisational performance.

The internal logic of the balanced scorecard is that goal-setting originates with customers. Then an organisation must determine what it must excel at in order to satisfy customer expectations. The innovation and learning perspective contains goals which relate to how an organisation will maintain progress and develop its processes, products and services. The results from these three perspectives will be mirrored in the financial perspective.

The directors will need to agree the 'vision' of the organisational strategy with middle management and to ensure that the vision is also shared by all employees within the organisation thereby creating an 'understood environment'. The creation of such an environment should ensure that sufficient attention is focused on all important factors within the organisation's environment which will lead to higher levels of profitability.

The following are possible measures that might feature within a balanced scorecard for SBC:

Customer perspective:

% of sales from new clients

% of clients from whom repeat business is gained

Ratings from client satisfaction surveys

Internal business perspective:

% of client projects completed on time and within budget

% of bids for new clients which are successful

% of employee time billed to clients

Innovation and learning perspective:

% of time used for staff development

% of revenues earned from new products or services

Financial perspective:

Growth in operating cash flow

Gross margin earned from clients

Percentage increase in operating costs

Expected value added (EVATM) generated in relation to the budget.

(ii) Calculation of the cost per consultation is as follows:

		Advertising	Recruitment	IT Support
Number of consultants		20	30	50
Salary (\$)		40,000	35,000	30,000
Total salaries		800,000	1,050,000	1,500,000
Number of consultations per annum	(200 per consultant)	4,000	6,000	10,000
Business Development Activity		(280)	(1,320)	(1,200)
Chargeable days		3,720	4,680	8,800
Demand for chargeable consultations		4,200	6,250	10,250
Subcontractor days		480	1,570	1,450
Cost per subcontractor day (\$)		300	220	200
Cost of subcontractors (\$)		144,000	345,400	290,000
Cost per chargeable consultation (\$)				
Full-time consultants	Total salaries plus operating costs/chargeable days	277.55	286.86	232.95
Subcontractors	= Cost of subcontractors/number of subcontractors	335.71	255.71	235.71

Tutor note:

Any reasonable method for allocating operating costs was given credit. Here, chargeable days have been used but allocating by the number of consultants in each area or the number of consultations (inc BDA) were also accepted.

(iii) The figures contained in the appendix reveal a forecast reduction in level of total demand of 8% over the next two years. Specifically hard hit is the recruitment business with a fall of 20% over this period with the number of recruitment consultants dropping by 33%. The figures also show that salary levels will remain constant from 2011 to 2012. This may be due to reasons such as increased competition or an economic downturn.

The forecast increase 'across all activities' in days spent on Business Development Activity, notwithstanding the projected fall in activity levels in 2011 and 2012, represent an attempt by SBC to broaden and/or retain its existing customer base.

(Additional points such as the increased use of subcontractors (based on answer to part (ii)) were also given credit.)

(iv) Potential benefits which arise from the use of subcontractors by SBC include the following:

- Increased flexibility – the use of subcontract staff where own staff are unavailable helps to avoid situations where SBC might otherwise have to cancel and/or reschedule client activities which might lead to a loss of client goodwill or even worse, the loss of clients
- The use of subcontractors might be necessitated by the lack of a particular expertise among the full-time staff employed by SBC. Thus SBC can avoid being perceived to be 'turning away' business or providing services to clients which are not of the required quality level, both of which might be harmful to its reputation
- The use of subcontractors might reduce the overall costs of SBC as it might well be the case that the number of full-time staff employed within SBC would need to be increased if subcontract staff were not available. Thus the fixed costs associated with a fixed workforce would be higher and it is quite conceivable that some of the full-time staff might have low utilisation ratios, particularly in times of low demand by clients for the services offered by SBC.

Potential problems which arise from the use of subcontractors by SBC include the following:

- The use of subcontract staff might cause resentment by full-time staff within SBC who might view the use of subcontractors as a lost opportunity to develop their own skill bases
- Subcontractors might not identify with the corporate culture of SBC and hence might operate in a way which is inconsistent with ways 'things are done' within SBC. This might create an inconsistent view of the SBC by clients who have received services from both full-time consultants and subcontractors
- The fact that there are two completely different pay schemes operating might prove problematic and cause dissatisfaction among full-time consultants and/or subcontractors. For example full-time staff might consider that the rate paid per day to subcontractors is too high thus giving rise to perceptions of inequity which might damage the morale within SBC.

Tutor note:

Professional marks were given under the following headings: Format, introduction, conclusion, use of subheadings, professional language, clarity. A conclusion was not required as it is difficult to formulate for this diverse report but credit was given where it was reasonably attempted.

		Marks	Marks
1	(i) Importance of NFPIs	Up to 4	
	Balanced scorecard – discussion	Up to 2	
	Balanced scorecard – SBC	Up to 7	13
	(ii) Chargeable days	3	
	Subcontractor days	2	
	Costs per consultation	2	7
	(iii) Comments (on merit)	Up to 2 each 6	Maximum 5
	(iv) Potential benefits	3	
	Potential problems	3	6
	Professional marks	4	4
			Total = <u>35</u>