MARK PLAN AND EXAMINER'S COMMENTARY

The mark plan set out below is that used to mark these questions. Markers are encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks are available than could be awarded for each requirement. This allows credit to be given for a variety of valid points which are made by candidates. The answers provided are more comprehensive than would be possible in the time available for candidates. They have been prepared to accommodate a wide range of possible answers and interpretations by candidates.

Question 1 – Olib ltd

General comments

This question is the mini case.

It is based on a company, Olib, which operates a peer-to-peer platform for buying and selling used clothing – mostly fast fashion – via an app. Users of the app can be both buyers and sellers and Olib earns revenue by taking 10% commission of the sales price of any items sold.

Olib has been very successful in attracting and retaining users, with a user retention rate of 90.1%. This has been achieved through huge investment in technology and skilled staff, with staff interacting with AI to create editorial choices that can be promoted to give an engaging and bespoke user experience.

The growth in users has translated into strong revenue growth. However, Olib is loss-making due to high fixed operating costs and does not expect to be profitable until 2025.

A visualisation showing quarterly revenue for the previous seven quarters is provided alongside detailed financial information for the most recent Quarter 3 ended 30 November 2021 with comparatives. Assumptions were given to produce a forecast for Quarter 4.

Olib has been approached by a fast-fashion retailer, Pablo Inc, to sell its surplus inventory at a discount via the app. This will be the first time Olib will work with a company as a user rather than an individual and it is hoped that it will help Olib become profitable.

1.1

- **Analyse and explain Olib's performance for Quarter 3 ended 30 November 2021 compared with Quarter 3 ended 30 November 2020.**

Note: The figures in red represent calculations a student could perform

Quarter 30th November	2021	2020	% change
	£'000	£'000	
Revenue	1,335	863	54.7%
Cost of sales	193	184	4.9%
Gross profit	1,142	679	68.2%
GP%	85.6%	78.7%	
Operating expenses	2,131	992	114.8%
Operating loss	(989)	(313)	216.0%
OP%	-74.1%	-36.3%	
Operating costs as % of revenue	159.6%	114.9%	
Non-current assets	731	427	71.2%
Non-financial			
Numbers of items sold	4,807,327	2,415,301	99.0%
Number of employees	23	14	64.3%
Active buyers and sellers at start of period	1,880,000	1,340,000	40.3%

New app downloads during quarter	324,000	242,000	33.9%
Active buyers and sellers at end of period	2,018,000	1,390,000	45.2%
Retention rate	90.1%	85.7%	5.1%
Revenue per item sold	0.28	0.36	-22.2%
COS per item sold	0.04	0.08	-47.5%
Gross profit per item sold	0.24	0.28	-15.4%
Revenue per active users (at end of period)	0.66	0.62	6.6%
Gross profit per active users (at end of period)	0.57	0.49	16.0%
Operating expenses per active users (at end of period)	1.06	0.71	47.9%
Operating expenses per employee	92,652	70,857	30.8%
Revenue per £ of NCA/NCA turnover	1.83	2.02	-9.6%
Gross profit per £ of NCA/ Return on NCA	1.56	1.59	-1.8%
Average dwell time (minutes)	5.06	4.76	6.3%
Number of mentions on social media	1800000	900000	100.0%
Average time to first purchase (hours)	18	29	-37.9%
Average time to first sale (hours)	52	72	-27.8%
Average App user rating (out of 5)	4.8	4.1	17.1%

Revenue

- There has been a huge 54.7% increase in revenue in the last year as Olib has built on the growth they had during 2020 due to the rising importance of sustainability
- Olib are both able to attract new users each quarter (324,000 in 2021) and to retain a significant proportion of their existing users, with a retention rate of 90.1%. Having this loyal base of active buyers and sellers means they can consolidate on growth, however it should be remembered that fashion is a fickle industry by its nature and there are no guarantees that user loyalty will continue.
- This fits into the same pattern as the previous year, where there is growth at the start of the year, a dip in sales over the summer and an increase in sales in Q3 in the run-up to the highest sales in Q4. Sales in Q3 2021 are more than that of Q4 2020.
- They have doubled their mentions on social media which means they are able to attract downloads by word of mouth.
- The quality of their app is supported by the non-financial data which shows an increase in dwell time of 6.3% and an increase in user rating from 4.1 to 4.8 out of 5. In addition the falls in average time to first sale and purchase possibly indicate the app has become increasingly user-friendly as the transactions have become much quicker from setting up an account. Alternatively, perhaps buyers and sellers are increasingly confident in using the platform as it is more established.
- As there has been a large increase in active users, the average revenue per active user shows an increase of 6.6% from £0.62 to £0.66 and there is also an increase of 16% in the profit per active user. This shows that Olib can get more revenue and profit per person who has downloaded the app in the last year. Again it is hard to know why this is the case without further information eg, the proportion of buyers and sellers, and the percentage of active users that are both buyers and sellers.
- The revenue per item has fallen from £0.36 to £0.28 which may highlight a trend that, with increased numbers of users, there is a higher proportion of smaller value items being sold. This means for Olib that their future profitability is dependent on the volume of transactions so it must continue to increase their active users, and encourage the buying and selling of multiple items.
- The scenario suggests that items may be purchased on Olib and then resold on Olib very quickly, creating the idea of a circle of buying and selling that is contained in the mission statement. The increase in revenue per user together with the fall in revenue per item might bear this out, as an item re-listed multiple times may fall in value as it is sold and resold, but it would nonetheless bring increased revenue per user.

- Revenue per £ of NCA (asset turnover) has fallen 19p in the year, from £2.02 to £1.83, reflecting the high investment in the year in app development costs. This is a long-term investment in order to attract and retain users which should hopefully increase sales. Therefore, in the short term this metric may decline until the users or the transactions increase.

Cost of sales/margin

- The gross margin continues to be very strong, increasing from 78.6% in 2020 to 85.5% in 2021. It appears that direct costs are low for peer-to-peer selling but that Olib were still able to make some efficiencies in 2021. This might be expected as the company grows and perhaps gets some economies of scale.
- The cost of sales per item sold has a large fall from £0.08 to £0.04 (a fall of 47.3%), suggesting that some of the direct costs of sale are fixed or at least semi-variable. As Olib have a high number of transactions, it is likely that they would obtain better rates from their payment provider, and other costs such as the app hosting costs are likely to be fixed.
- It would be useful to have a breakdown for each year to see the proportion of each of these costs within the cost of sales balance.
- As the trend from revenue appears to be a high number of lower value transactions, the high margins will likely continue because of the elements of fixed and semi-variable costs.
- Gross profit per £ of NCA has fallen 3p from £1.59 to £1.56, which is not by as much as revenue per £ of asset, reflecting the increase in margin as the direct costs associated with the sales have not increased in line with revenue.

Operating expenses

- The operating expenses for Olib are huge, representing 159.6% of revenue in 2021 so they made a large loss of £989,000 in the November 2021 quarter compared with a £313,000 loss in the November 2020 quarter.
- Operating expenses have risen 114.8% in the year, partly due to an increase in staffing of 64.3%. The scenario notes the highly skilled research team and given the use of AI, there is also likely to be a team of skilled software engineers so it is likely that staff at Olib are a major cost. However, this cannot account for all of the cost. Looking at relative measures, expenses per employee show a rise from £70.9k to £92.7k or 30.8%, which reflects the high salaries that highly skilled technology and research teams might command.
- There is likely to be a large cost in the expenses relating to the use of AI ie, amortisation, maintenance. It appears that Olib are spending a lot of money on making the user experience of their app very good in order to attract and retain users at the expense of profit in the short term. This has impacted on their non-financial measures, which show an increase from 4.1 to 4.8 for their app user rating.
- Given their large increase in users it is very likely that Olib have spent money on marketing this year, both to drive increases in sales and to compete against the arrival of the rival app Caper.
- It would be useful to know if these large operating expenses are one-offs or will continue in the future as this will impact on the financial sustainability of the company.

Conclusion

- Olib continue to be loss making but are growing well and increasing their revenue and profit per user. However, significant losses in the long term are not sustainable.
- It appears Olib have invested heavily both in terms of their staff and their assets with the hope that this will see them drive user numbers and therefore revenue in the longer term. This was before Caper's entrance into the UK market. It is unclear what the impact of this will be and if Caper will be able to attract significant numbers of users away from using Olib.

- **Prepare a forecast of Olib's expected gross profit and active users for Quarter 4 ending 28 February 2022. Discuss the validity of the assumptions used from Exhibit 3. Ignore the proposal from Pablo.**

	£	
Revenue	1,802,250	
=1,335,000*1.35		
Cost of sales	259,524	

Gross profit	1,542,726	
=1,802,250*85.6%		
Margin	85.6%	Calculated in first part of Q
Number of active users:		
At start of period	2,018,000	From exhibit
New app downloads	425,000	Assumption (= 21% increase from Q3)
At the end of period	2,221,020	
= (89%*2,018,000) + 425,000		
Retention Rate	89%	assumption

Discussion on validity of assumptions:

- The sales are forecast to be £1.8m which is a growth of 35% from Q3. From Exhibit 2 this looks to be in line with the growth from Q3 to Q4 in 2020/21 and reflects the increased sales for the Q4 peak.
- Reviewing the growth for each quarter in Exhibit 2, this 35% increase does seem supported with the steady rise overall across the last two years. This peaks initially at Q4 in 2020/21 but then starts to grow steadily again to from Q1 to Q3 2021.
- The trend for growth and the seasonality might continue in the market, but it can be questioned however whether Olib will be able to benefit from the growth if competitor apps are available.
- Further information would be useful on how Olib expects to attract the new downloads of 425,000 which would support this increase. For example, it would be useful to know how many people downloaded the app in Q3 vs Q4 2020 in order to see if this 21% increase in downloads is the usual increase they see for the Q4 trading period.
- We can question whether Olib would really see the increase in new downloads given that there is a global competitor (Caper) entering the UK market in this quarter which is likely to attract a significant number of users. However, it might be the case that users download both apps, with revenue being somewhat split between them and therefore the figure to review here might be revenue per user.
- The retention rate for Q4 is lower than Q3 (90.1%) to reflect the impact of Caper but it is still excellent at 89.0% and higher than the 85.7% rate in 2020. Again it could be questioned as to whether this will be maintained. They might find that there are more speculative downloads of the app around the Q4 peak, being people who download but are not active, or possibly who download but then leave very quickly once they have made purchases. It seems more likely that retention would fall in this period.
- Given that there is a new large rival in the form of Caper it is possible that Olib will lose more active users than anticipated. As there is no cost of subscription, many users who are principally buyers are likely to download multiple apps to purchase from. In contrast sellers who buy new then resell may stick to one app to build up a customer base for their used clothes.
- The consistent margin from Q3 does seem reasonable as they are likely to be increasingly efficient and the bulk of their costs are operating costs (employee, AI and marketing costs) rather than direct costs of hosting the sales on the app.
- This is only a forecast for gross profit and does not include a forecast for operating expenses. This is potentially an issue given the large losses; the board should be considering the potential quarterly losses too.

Conclusion:

- Overall, it appears the forecast may be optimistic given the simplistic assumptions that performance will continue as per Q3 and also that they have not taken fully into account the possible impact of Caper and the likely fall-off in active users post the Q4 peak. It would be useful to see the actual figures for the previous Q4 to compare.

Examiner's comments

Analysis of performance
This requirement had the highest average on the paper. It incorporated the more traditional data analysis element and was generally well done.

Given the variety of data given in the exhibit, candidates were expected to give some thought to what calculations to perform to explain the change in performance.

As with past exams marginal candidates simply copied large amounts of data from the exam paper and produced a long list of year-on-year percentage changes. This approach gives very little insight into what is happening and why and as a result only very limited marks are available.

At the top end many candidates produced professional looking, clearly labelled appendices. They performed calculations that combined financial and non-financial information to show relative performance, as well as using the visualisation showing historic quarterly performance to put overall performance into context.

They key point missing from all but the best analyses was that a company making substantial year-on-year losses could not continue to do so indefinitely.

Forecast

Performance on this part of the requirement was more mixed. The numbers were relatively simple and candidates who attempted this part of the requirement were able to get at least some of the marks. However, a number of candidates did not attempt the forecast or discuss the validity of assumptions.

Total possible marks Maximum full marks	**24** **21**

1.2 Explain the extent to which Olib has a sustainable competitive advantage in its market.

- A sustainable competitive advantage (SCA) is generated when a company has a unique resource or competence that is difficult to replicate and sets them apart from their competitors. It means that a company is able to outperform competitors now and in the future.
- It is questionable whether Olib have a sustainable competitive advantage, particularly with many similar apps in the market. The fact that they have never made a profit and do not anticipate doing so for some years reduces their financial stability and their ability to remain competitive
- Olib have invested heavily in their technology, AI and editorial team to give an excellent user experience so they are likely to be thought of as a differentiator giving a high level of service to their users.
- Each of these elements (investing in technology and highly skilled staff) are elements of Olib's value chain which add can add value therefore contribute to its SCA. The extent to which a competitor can copy these elements will impact on its SCA.
- Olib has a competitive advantage as it was one of the first in the UK market to set up a peer-to-peer selling app. Customers who signed up appear to be loyal as there is a strong retention of active users. However, it is likely that some users buy and sell on multiple apps and with a global competitor entering the market the advantage may not be sustained in the longer term.
- It is not clear in the scenario how much commission the other apps, including Caper, charge for the sales. This information would be very useful in assessing the SCA as price-conscious consumers may change to another app quickly as there are no switching costs to them.
- Olib's app is differentiated from other ways to sell as it mimics the features of a social media app. This means it keeps users engaged with a number of similar features like endless scrolling in order to maximise the time the buyers and sellers spend on the app. Again the advantage may be eroded if other apps are able to copy this feature. However, if Olib is able to build a community of users on the app it may have a more sustainable competitive advantage as they will not want to leave their friends/contacts.
- There are questions around the sustainability of the market and fast fashion itself. If the production of fast fashion is reduced the availability of items to be sold would eventually reduce. Given that Olib focusses on fast fashion there is a contradiction inherent in the model of promoting environmental sustainability whilst giving an outlet to selling fast fashion which is part of the problem.
- Olib has a strong human editorial team who work in conjunction with the AI to ensure that recommendations given on the curated homepages are relevant and accurate rather than simply being automated. Again this keeps users engaged and stops them going elsewhere to source

used clothing. However, in the longer term another app may be able to copy these features if they invest enough money, or potentially create new features that draw users. In order to maintain an SCA here Olib need to continually innovate (similarly to social media platforms that bring out updates and features regularly) and this may be expensive.

- Olib has identified a very specific target market, under 25s, and taps into the features they want/need, making the app very easy to use. Linking into existing social media accounts also means someone can open an account instantly. Whilst this has led Olib to grow and attract users easily it is again in the long term something which could be copied by competitors.
- Olib focusses on the quality of their app, making it easy to use as evidenced by the speed at which users first buy and sell on the app. If they are the easiest to use on the market it means they are likely to start to become the 'go to' app for people wanting to buy and sell used clothing. In order to assess whether this is sustainable it would be useful to have data on competitors eg their rating, time it takes to sell etc. However, the increase from 4.1 to 4.8 in user rating does show their excellent user experience.
- The AI collects lots of data about the users which can be harnessed when making deals such as the proposed one with Pablo. This would likely attract more users who are fans of the Pablo brand.
- Overall Olib have tapped into the desire for more sustainability in fashion. As a result it is possible to have a never-ending supply of buyers and sellers of used clothes. However, in order to have a SCA Olib need to continue to differentiate themselves through the quality of their app. They must ensure that their curated homepages are more relevant and specific than those of any competitors and that users stay on the app for a long time by making it like a social media app with an endless scroll of items to view. User loyalty is the key to their SCA.
- The nature of the market means that any competitive advantage gained is likely to be eroded eventually.

Examiner's comments

Answers to this requirement were typically limited in their scope as many candidates did not understand that this question was focussing specifically on sustainable competitive advantage (SCA) rather than on environmental sustainability. Lots of candidates used the SEE (Social, Environmental, Economic) model as a starting point for their discussion which limited the number of marks available. Only a relatively small number of candidates realised that the nature of the market meant that any competitive advantage was likely to be eroded.

Total possible marks	13
Maximum full marks	12

1.3 Explain the factors to be considered by Olib's directors in deciding whether to work with Pablo.

Factors to consider:

- This would be considered market development as per Ansoff as Olib would be providing an existing service to a new type of customer segment (company instead of individual seller). This may give them growth opportunities to work with other large retailers in the same way.
- There is a risk to Olib in working with an unknown third party such as Pablo as any issues with their reputation, eg if they are found to be using suppliers with poor working practices, will reflect badly on Olib for acting as their partner. This is more so than if they are just helping sellers to see used Pablo items as they are now.
- We are not given details of the nature of the relationship with Pablo ie whether there will be a long term contract, an alliance or just an ad hoc arrangement similar to current sellers. Any contractual arrangements would tie the two companies together in a more long-term relationship.
- The relationship with Pablo is potentially changing the nature of Olib's business model, as the seller is now a company rather than an individual.
- Some sellers currently sell used Pablo items so it is likely the partnership would be popular and have a ready audience.
- They would be able to identify the possible audience with the use of AI and target them for higher or quicker sales of Pablo's inventory.
- It is likely to be financially beneficial, as it is indicated that they may be able get more than the usual 10%, although it would be over 10% of items with very reduced prices there would be a large quantity to be sold.
- Olib need to consider what the additional costs would be of getting the AI working for Pablo in the way they desire eg more skilled staff.

- Olib need to consider whether this is really in line with their mission statement. They want to create a circle of buying and selling of used items. Although this is surplus inventory it is not used fast fashion items, so it is not in line with their current sales. This could look bad from a reputational/environmental sustainability point of view. Also, Pablo may start making items specifically for sale on Olib – how can Olib monitor this?
- Olib need to consider if users will be upset with the partnership. Buyers may feel it is against the sustainability values of Olib and sellers, especially those who currently sell their used Pablo items, might be upset if the items being sold are newer and cheaper than they are able to sell.
- There could be some perception of favouritism to Pablo with the use of AI to target buyers en masse if individual sellers do not get the same kind of service level from Olib. However, it can be argued that Pablo would be paying more for this.
- This would move Olib from having millions of individual, very small users to now including a large seller, which would ultimately give Pablo more power than an average user. Olib needs to consider if they are happy with that.
- Pablo however is a global retailer and this could help Olib if they wanted to expand the app overseas as they could attract users with the link to a familiar global brand.
- Olib need to consider if a competitor like Caper, or another new entrant, might work with Pablo (or similar retailers) to sell on this surplus inventory instead as some of its users might switch to their apps as a result.
- Overall Olib should enter the agreement with Pablo. Selling surplus stock is still in keeping with its mission statement and it could help to address the significant and unsustainable losses Olib is currently making.

Examiner's comments

This was the open-ended requirement where students had to consider what factors the directors should consider when working with another company.

It has the lowest average mark for any requirement on the paper. Some candidates struggled with the open nature of the requirement and did not know how to structure their answer without a specific model to rely on. Others produced an unbalanced view of the proposal as either mostly positive or negative without considering a broad range of factors.

To do well in this requirement candidates had to think on their feet and use their business acumen to consider a broad range of relevant points.

Total possible marks	**13**
Maximum full marks	**12**

Question 2 – Pacey Inc

General comments

In this scenario Pacey provides treadmills for use in the home with an integrated tablet which allows the runner to take part in group classes remotely. Pacey currently operates in English-speaking countries only and have live streamed classes available regularly throughout every 24 hours period as well as recorded classes. Customers buy both a treadmill and a monthly subscription to access the classes.

Class instructors are independent contractors who are personal trainers or ex-athletes. They can earn large sums of money from the classes which means Pacey are able to attract the very best instructors.

Pacey launched in the UK in 2020 and persuaded the most popular instructor of Dawson, a rival brand, to deliver classes exclusively for Pacey, as well as recruiting Dawson's marketing director, Joey Lindley. Dawson has since sent Pacey a letter from its solicitors suggesting that Joey Lindley has given Pacey access to Dawson's key contacts.

The board of Pacey are currently considering expanding into Germany via two options:

1. Enter the market interpedently by recruiting German-speaking instructors and establishing a studio in Germany.

2. Using a German agent, Finn Laufer. Finn has contacts in the German fitness industry which would help Pacey to find instructors and arrange a retail space. In return Finn would receive a one-off fee and commission for each treadmill sold.

Candidates were provided with assumptions for the expansion into Germany via each option with probabilities for different outcomes under option 2.

2.1 Using Exhibit 1 and other information supplied, prepare a report for the Pacey board which advises on:

- **Whether to expand into Germany**
- **which option should be adopted, assuming expansion into Germany is agreed. Give reasoned advice and include supporting calculations.**

Report:

To:	**Board of Pacey Inc**
From:	**A Consultant**
Date:	**Today**
Subject:	**German expansion**

Whether to expand into Germany?
Pros

- None of Pacey's direct competitors currently operates in Germany which means Pacey would be the first to the German market. This could mean a significant first mover advantage especially given there are high switching costs of purchasing a new machine.
- This would be market development as per the Ansoff matrix as Pacey are taking its existing product overseas to Germany. Using Lynch's expansion matrix this would either be internal or external international expansion, depending on the option chosen below.
- Pacey are already an established brand/reputation and have existing production infrastructure. This reduces the barriers to entry in the German market. Increasing the volume of sales of the treadmills and the signups to the subscription will spread the fixed costs associated with these and gain some economies of scale for Pacey (although some of these may be eroded with the increased costs associated with the expansion).
- Once expanded into Germany, Pacey can use this as a base to expand further across Europe.
- Germany has a 20% share of the European fitness market by value which means there is a receptive market who have historically spent money on fitness. This is higher than the UK's share of the European market, and Pacey appear to have launched successfully in the UK.

Cons/Risks

- A smaller proportion of the German population go to a gym compared with that of the UK so they may not be as successful as their UK launch. However, some may not be interested in joining a gym but may nevertheless be interested in exercise at home
- The gym goers may not be tempted to buy at home gym-equipment or may be in gym contracts which may be difficult to exit. However, selling to a very small percentage of these gym goers would achieve predicted sales in the first year.
- It is unclear how much market research has been done on the German market; particularly as it will be Pacey's first non-English speaking market, further market research would be useful.
- Pacey may not be able to recruit the right or enough instructors who are at the same standard as their existing instructors, and this might impact on their reputation overall.
- The geographical spread allows Pacey to operate live streamed classes regularly throughout every 24-hour period. However, the German classes are likely to be more restricted so they will not have as broad an appeal.
- Currently all runners can compete with each other and they all speak the same language. It is not clear how this will work in a class with both English and non-English speakers.
- There are foreign exchange risks as customers will be buying in Euros, although Pacey are already exposed to Forex risks given they currently operate in four different currencies so they are likely to be able to hedge their risk.
- It is not clear if there are different technical requirements for operating in Germany or any different rules/regulations to comply with. It would be important to gather this information before making a decision.

On balance, given that Pacey could be the first to enter the German market with an integrated treadmill and tablet they should seize this opportunity. The German market makes up 20% of the fitness market in Europe and Pacey can harness their existing reputation to build up a loyal customer base before other competitors get into the market.

Which option should be adopted, if expansion into Germany is agreed? Give reasoned advice and include supporting calculations.

Year 1 calculations	**Option 1**	**Option 2 (EV)**
Customers	20,000	
Customers (using probabilities: 0.6*26000 + 0.4*20000)		23,600
Treadmill income (customers x 1,500)	30,000,000	35,400,000
Subscription income (customers x 15 x 6 months)	1,800,000	2,124,000
Total income	31,800,000	37,524,000
Gross profit (@41% or 39%)	**13,038,000**	**14,634,360**
Less Finn's fee		(500,000)
Less Finn's commission (treadmill income*5%)		(1,770,000)
Expected profit	**13,038,000**	**12,364,360**

Option 1: Enter market independently

- From the workings above, if they go it alone they are likely to make more profit at £13,038,000 versus an expected value of £12,364,360.
- Option 1 would allow Pacey to retain control as working with Finn means it would run the risks of working with an unknown third party agent who will be in control of much of the contract, including recruiting staff.
- This is organic growth and would likely progress much more slowly than using an agent.
- Pacey appears to have a good track record of expanding in different countries and appears not to have needed to use an agent for this before. It can follow the same model of setting up a studio and recruiting instructors which it has been able to do before.
- There is a higher margin for option 1. Figures are only for year 1, in year 2 there would be the cumulative impact of retained subscribers so figures are likely to be even higher at this increased margin.

- As this option does not have a retail presence it means it would be easier to exit the market should the launch be unsuccessful as all treadmills will be shipped from existing factories in the UK. This may also save on costs required to set up a retail presence.

Option 2: Use Finn

- If Pacey does not work with Finn they may struggle to find and attract the very best instructors which is very important to retain customers. Finn has the connections to personal trainers and athletes which Pacey does not currently have.
- Option 2 would mean having a retail presence straight away, this may be important to showcase the treadmills to potential customers. However, as most sales are made online it might not be a major issue. It would be useful to know the percentage of sales made in store versus online.
- Without Finn there is no potential upside of increasing Pacey's customers to 26,000 in the first year, which could actually mean a potential profit of £13,672,600 ((£41,340k*39%)-£500k-(£39,000k*5%)).
- Figures are only for year 1, in year 2 there would be no one-off fee paid to Finn and there would be the cumulative impact of retained subscribers therefore profit is likely to be significantly higher.
- The assumptions for entering the market independently could be over-optimistic given that Pacey may struggle to attract the right instructors. The fee for Finn is a one-off fee therefore the profit in subsequent years would be higher. It is unclear for how long Finn would attract commission on the sale of the treadmills.
- More information is needed on Finn and Pacey should also verify his contacts in the industry and what they are getting in exchange for the £500k and the commission. The commission Finn earns per sale of each treadmill at 5% gives a large figure and it may be possible to negotiate this figure down.
- Finn gets no commission on the ongoing subscription. Whilst the subscription is a small figure for year 1, with a retention rate of 90% it will grow to be a strong source of revenue for Pacey. In order to maintain this Pacey needs to ensure a good initial launch and access to the right instructors, which Finn could provide.
- The assumption is that the subscribers do so for an average of 6 months in year 1, given the strong retention rates this would be an underestimate. If subscribers subscribed for a longer period this would be additional revenue for Pacey without any commission paid to Finn, so any increases in subscribers he could achieve over Option 1 would add to the profit expected by Pacey. For example if subscribers were to pay for the full 12 months in the first year profit, for Option 2 under the most optimistic scenario would increase to £14,585,200 (an increase of 7%).
- As Pacey would have a retail presence exiting the market under option 2 would be more difficult and expensive, especially given that the one-off fee to Finn is paid regardless of sales.

Advice

- Figures given are for one year only, Pacey need to look at the long term and what will happen in year 2 and beyond. Further research and calculations are required.
- Pacey should use Finn when expanding to Germany as they do not have sufficient local knowledge to recruit the right instructors.
- Despite the risk that, in the pessimistic scenario, the agent does not manage to gain more sales and subscribers than Pacey would if it went in alone, the EV is positive and there is the potential upside to achieve more under the optimistic scenario.
- It may also be that this is the correct long-term decision as the quality of the instructors may be better with Finn's local knowledge and this will mean a strong retention rate. Profit in subsequent years will be higher as although Finn still gets commission there would be no further one-off fee.
- Currently Finn is the only option being discussed as a potential agent. The board should also investigate other potential agents to see if there are any other cheaper or better connected agents they could potentially use for the expansion.
- Pacey should conduct more market research to properly understand the German market and whether it is similar to the UK market, which is their only other European presence.
- Further work should be performed to verify the assumptions for each of the options and confirm how long the commission would be paid to Finn in subsequent years.

Examiner's comments:

This requirement was a report and only a small minority of candidates did not gain this format mark.

This requirement provided bullet points for candidates to structure their answer but specific marks for each one were not broken down. This is similar to previous sittings and allows candidates to demonstrate their higher skills by deciding on the relative importance of each bullet point and what supporting calculations can be chosen.

Overall this requirement was generally very well answered, with the second highest average mark on the paper. Most candidates attempted some supporting calculations with a high proportion using the probabilities given in the requirement to produce an expected value calculation. Even where calculations were incorrect candidates managed to pick up some marks for their attempts and were still able to offer good evaluation on the benefits and risk of independent expansion versus risk-sharing through use of an agent.

The majority of candidates used the bullet point headings in order to structure their answer but some candidates did ignore the initial bullet point on whether to enter Germany at all and thereby missed out on some of the discussion marks.

Reasoned advice was specifically requested in this requirement and most students offered some advice to the client on which option to choose and why.

Total possible marks Maximum full marks	28 24

2.2 Explain the ethical and commercial implications for Pacey of the letter from Dawson's lawyer. Set out the actions the directors should take to address these issues.

Ethical issues
Pacey need to establish the facts: whether any information was shared, and whether any law has been broken or if this just amounts to common industry practice.

Pacey was able to engage one of Dawson's most popular instructors and employ their marketing director which helped them gain contacts in the UK quickly. Whilst the instructors are contractors and therefore likely to move around between different clients, Joey was an employee and may have had clauses in her contract that meant she was not allowed to disclose confidential information.

There is no information about the recruitment process and whether Joey was transparent with Dawson about the fact she was interviewing with and then leaving to go to Pacey, a competitor. It would have been more open and honest for Joey to disclose this as soon as she was approached by Pacey as Dawson may have wanted her to leave without serving her notice due to confidentiality issues.

Pacey need to consider whether they have acted with integrity in firstly employing this member of staff and then asking them to use the contacts they had built up at Dawson. We do not know if Pacey's directors actively encouraged Joey to breach any confidentiality owed to the former employer, if they knew about it or whether this is something Joey was doing herself.

It is possible that the letter from Dawson has no grounds and Pacey's competitor is trying to intimidate them or put them off employing their staff again. We would need to consider how much knowledge Joey had. It is possible that as marketing director Joey had considerable knowledge and contacts in the industry.

Legal issues
As this is a letter from the solicitor there is clearly a legal issue here. It is not clear if Pacey poached Joey Lindley or if she had any kind of confidentiality/non-compete clause in her contract, or indeed whether something of that nature is enforceable.

Pacey's solicitors suggest that the allegations may be difficult to prove in court. However, it is important for Pacey to know if they acted unlawfully regardless of Dawson's accusations as they would not want to be in this position again.

There may be a breach of data protection if Joey has taken names and personal information on clients. These clients gave permission for Dawson to use/store their data but did not consent to Joey/Pacey using the data.

If it is found that they breached any laws or stole any confidential information they could end up with possible fines or have to pay compensation to Dawson.

Commercial issues

It may be bad for Pacey's reputation if it got out that they poached staff from their rival and used these contacts. However, it is unclear whether customers would really be put off by this, as it does not affect the product or the quality of the classes provided. The movement of an instructor from one company to another would presumably be quite common in an industry with contractors like this and most customers cannot quickly change from Dawson to Pacey given the cost of the product. However, a popular instructor leaving may mean their retention rate falls.

This could also impact on Pacey's reputation with existing or potential employees and contracted instructors. They may be put off by a company they think is not acting honestly or legally if it came to light there were issues with Joey's recruitment.

The letter from Dawson received at the end of 2021 is some time after the recruitment of Joey in 2020. It may be that it has only just come to Dawson's attention that Joey may have passed on some contact details however after such a long time it is unclear what Pacey could do about it if they have already used the contacts.

Actions

- Seek legal advice re: contract and data protection issues
- Discuss with Joey Lindley what specific knowledge she shared and establish what clauses were in her employment contract with Dawson
- Review information obtained from Joey when she started at the company
- Review recruitment procedures for instructors and employees
- Respond to Dawson

Examiner's comments

This was the ethics requirement and was reasonably well answered by most candidates.

Weaker candidates still attempt to answer any ethics question using the transparency/effect/fairness framework. This is very limiting as it does not allow them to discuss the specifics of what is happening in the scenario.

Most candidates were able to identify a potential legal issue, either in terms of breaching an employment contract or data protection. However, only the very best candidates offered any kind of nuanced discussion that this may be common practice in the industry or that Joey may not have done what she is being accused of by her former employer.

Candidates were comfortable with the potential commercial implications such as the impact on reputation but again very few questioned whether customers or other staff members would really leave Pacey because of this being made public.

Total possible marks	11
Maximum full marks	10

Question 3 – Baile

General comments

This scenario looks at a Baile city council's plans to become a smart city, including developing the infrastructure needed for all residents, households and businesses in the city to have access to superfast internet within five years.

Details are given about Baile Council, which is located in the country of Inis. It has ten elected members and a mayor who is the chief executive. In running the city, the council must adhere to the principles of governance, set by central government, which are included in its constitution:

- Selflessness
- Accountability
- Openness

In order to roll out superfast internet, the council will partner with a private internet provider which has both the required technical skills and the ability to contribute to the funding of the project.

The council's chosen partner is Luas Inc (Luas), which has been successful in rolling out superfast internet elsewhere in Inis and delivering ongoing maintenance once the roll-out has been completed. The CEO of Luas is a personal friend of Baile Council's Mayor.

3.1. **Discuss the extent to which the decision for Baile to become a smart city, including the choice of partner, fits with the principles of governance included in Baile Council's constitution**. **(10 marks)**

The three principles of governance included in Baile Council's constitution are from the seven Nolan principles of public life.

Selflessness
Selflessness means that holders of public office should take decisions solely in terms of the public interest. They should not do so to gain financial or other material benefits for themselves, their family or their friends.

- The members of the council appear to have been elected on the premise of making Baile into a smart city and in doing so attracting investment to the tune of $20 of economic benefit for every $1 of public money invested. This appears to support the idea that the decision to become a smart city has been taken in terms of public interest. However, Baile should conduct some further studies to confirm the estimate of $20 for every $1 invested.
- The public interest is hard to define and the council should ensure they have taken into account the views of different stakeholders. The key stakeholders here are the residents but will also include local businesses who will use the internet service.
- The project requires a private partnership. This is common in Inis and the council have already chosen Luas Inc. The CEO of Luas is a personal friend of the Mayor, this may directly contradict the principle of selflessness as a personal friend will be gaining a material benefit. This is especially so given that Luas will have the exclusive right to provide internet to all public buildings and services which would result in a large income for Luas.
- However, it could be argued that Luas are the right partner for the project given they have been successful in rolling out superfast internet elsewhere and delivering ongoing maintenance.
- The council need to be seen to be selfless and fair in the award of the contract as well as being fair in the choice of the partner.
- In this case it might be that practically the choice of Luas fits with the principles but it does not look particularly selfless of the Mayor. It may be that the council need safeguards and should have had safeguards during the tendering process to ensure that this was a decision based on who was best for the job not who the mayor knew personally. There is a possible conflict of interest here that needs to be declared.

Accountability
Accountability means that holders of public office are accountable for their decisions and actions to the public and must submit themselves to whatever scrutiny is appropriate to their office.

- The council and Mayor need to be accountable as they are elected officials. They are accountable to the residents of Baile and should make decisions solely in the public interest. At the end of their term they can be voted out by the residents but they should be transparent and open to scrutiny throughout their term in office.
- They are also accountable to the national government as it is they who set the principles of governance. This means the council need to meet the needs of residents while adhering to the principles and any financial constraints from national government.
- As part of accountability the council should ensure they are accountable for all spending on implementation of the smart city (both already spent and going forward), by exercising proper financial stewardship to ensure any money is accounted for and used in the best way on the project.
- The council was elected with the superfast internet as a promise therefore they want to be accountable and ensure this happens within the five year timescale. However, they also need to ensure this is the right way to do this project and also if they are using the right partner.
- All councillors are accountable to the residents who elected them but the Mayor is the chief executive of the council and therefore it is the mayor who has the ultimate decision making authority.
- The private provider is given exclusive access to providing the internet for Baile's public buildings for the next 5 years. There would need to be clauses in the contract to ensure that they were accountable for any connection issues or delays as they are effectively being given a monopoly over internet provision.
- There will be payments to the partner but the nature of these would need to be tied to success and stages of completion so it is transparent why they are receiving public money.
- To ensure the council are accountable they should have proper risk management. When using the private partner the council must ensure there are proper controls in place to manage these risks, resolving any disputes they may have eg over timeframes or if either party wants to exit the partnership before the five year period is over.
- One issue with accountability if a private partner is used is identifying who is in charge. It should be made clear who will take the lead on the project, the council or the private partner. It may be that they are giving too much power/influence to an unelected company.
- It needs to be established who will have oversight, sort out delays etc. It appears there is little movement in the project in the first couple of years so it will be hard to assess progress until year 3 when it might be too late to stop any additional delays.

Openness
Openness means holders of public office should be as open as possible about the decisions and actions that they take. They should give reasons for their decisions and restrict information only when the wider public interest clearly demands.

- Baile council need to be transparent about the decision making and any tendering process and also about the relationship between the mayor and Luas's CEO, especially as they will be using public funds for the project.
- They need to be clear and transparent in the contract about the consequences of failure/delays on the project, including costs.
- The council should ensure they set out their reasons for doing the project and what the aims are/what success looks like.
- It should also be open with residents about the potential for disruption during the works.
- There are issues around sharing data with the private partner. The council need to ensure that it is clear to residents what data is shared and they should be reassured it is all kept confidential and protected.
- It is unclear if they have been open about their choice of partner so far. Any non-disclosure to date could be taken as having something to hide or having failed to conduct the tender on a value for money basis.

Overall the decision to become a smart city appears to fit with the principles set out in the constitution as it is for the public's benefit and the council have been elected on this basis. It could be argued that the use of Luas and the connection between the CEO and the Mayor is not in line with the principle of selflessness as there is a conflict of interest. However, if this is disclosed to the public and Luas are the best private partner available this can still be in line with the principles of governance.

Examiner's comments

This was a very well answered requirement, with many candidates using the principles of governance given to structure their answers. Answers showed a good understanding in the context of the public sector, including taking decisions for the public benefit and being answerable to the electorate. Most were able to discuss the potential issues and conflicts of using a private partner who is a friend of the Mayor but many were less confident in their discussion of whether becoming a smart city met the governance principles.

Weaker candidates ignored the three principles which meant their answer was often very narrow or jumbled.

Total possible marks	11
Maximum full marks	10

3.2 Explain how Baile Council could measure the success of the project, including suggested KPIs. (11 marks)

Measuring success:

- Part of being able to measure success is considering how the council will collect data, this might come in part via Luas and in part via direct feedback from residents.
- The ultimate success for Baile will be every resident and business being connected in five years but in order to assess the progress of the project and ensure it remains on track there needs to be some staging posts.
- The timescale for measurement is tricky as it is very difficult to measure progress in the first two years as the graph shows a very slow start for the households connected. Success will not be easy to measure until year 3 when they are already halfway through the project, which could be difficult to manage and may already be too late to deal with issues.
- There is also the issue around actual connectivity and potential connectivity, the council may make it possible for all 2.8m residents to be connected but if take-up is low then then the project might not be deemed to be a success.
- The council should ensure that they use a range of different measures to review success, not simply financial measures like being on budget. As it is a public sector entity it also has a responsibility to different stakeholders and to meet the governance principles (as above).

KPIs

Possible KPIs could be around value for money: economy, efficiency and effectiveness (3Es):

- Economy is a measure of the actual resources used so the council could look at the cost per household connected.

- Efficiency is a measure of productivity so it could look at the average time to connect each household.

- Effectiveness is a measure of the impact achieved. The council could look at the percentage of residents who have access to superfast internet at each year end of the project. This could be compared to a target set before the project.

Alternatively, they could use a Balanced Scorecard:

- Financial perspective:
  - Actual costs versus budgeted
  - Cost per household connection
  - $ of investment from business

- Customer/resident perspective
  - Level of disruption caused by works
  - Level of complaints about internet service eg is it fast enough?

- Internal business perspective
  - Number of households connected v expected or connections available
  - Percentage of residents using the hotspots

- Learning and growth perspective
  - Number of data breaches
  - Number of crashes/system down incidents

Examiner's comments

Answers to this requirement were mixed. The best candidates offered some interesting discussion on measuring performance, acknowledging this would be focussed differently to a for-profit organisation then using some kind of framework (BSC, EEEs) to suggest a broad range of KPIs.

At the other end of the scale weaker candidates simply listed out a few points, not all of which were KPIs, without any further discussion and this limited the marks available.

Total possible marks	12
Maximum full marks	11