



The Institute of
Chartered Accountants
of Pakistan

Multi Subject Assessment Stage

5 December 2017
3 hours and 30 minutes
100 marks

Strategic Management – Professional Competence

CENTRALISED REGISTRATION NUMBER (CRN)

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INSTRUCTIONS

Read the instructions carefully before answering the question:

1. Answer all **THREE** questions.
2. Write your Name and Roll Number on the top perforated portion of the **MAIN ANSWER SCRIPT ONLY**. Do not write your Name, Roll Number or any other identification mark on any other portion of the main or supplementary answer script.
3. Answer to each question must begin on a new page and must be clearly numbered. Use both sides of the paper in your main and supplementary answer script.
4. Answer each question in black pen only.
5. Do not write anything on the question paper except CRN.
6. The questions in this paper have been prepared on the assumption that candidates do not have a detailed knowledge of the types of organisations to which they relate. No additional mark will be given to candidates displaying such knowledge.
7. Only **FIVE** original books duly bound shall be allowed.
8. Mathematical tables will be supplied on request.

QUESTION 1

SGC Construction (SGC) is a private engineering and construction company, based in Lahore. It is a well-regarded business, with a recognised brand in the construction market and a reputation for high-quality work with its key government clients. The company's stated aim is to be the 'solutions provider of choice' in engineering and construction in Pakistan.

Its growth over the years has been largely due to the efforts of its founder and Chief Executive Officer, Mohsin Chaudhry. Mohsin Chaudhry is also the company Chairman and owns 50% of the company's equity. His daughter, who owns 10% of the equity, is a qualified lawyer working in Lahore, and his son, who owns 5%, is an ambitious and recently qualified engineer. The remainder of the equity is in the hands of a private equity company, which invested in the company two years ago, encouraged by its historic strong cash generation and perceived growth prospects.

SGC currently operates with a small Board, with the CEO and one other executive director, the Chief Financial Officer (CFO) Mariam Syed. A representative from the private equity company and a long standing friend of Mohsin act as the two non-executive directors. Another friend of Mohsin is the senior partner in the company's firm of external auditors, who also perform internal audit functions.

Originally SGC worked on small and medium sized private sector projects, including residential buildings, but several years ago, the board took a strategic decision to change its focus to larger projects. SGC now specialises as the lead contractor on major infrastructure projects which it wins through a tendering process, working with a range of subcontractors on the building of infrastructure, including roads and bridges using standardised designs. The board still believes that this was an appropriate strategy to pursue, despite the Pakistan government taking measures recently to stimulate the local real estate industry with various incentives that have benefited those of SGC's competitors who have continued to engage in house construction.

The company has a pool of highly-trained and experienced staff who contribute to SGC's ability to deliver on large, unique and complex projects. The Board believes that its project tendering, complex and enormous levels of resources planning and management systems (including monitoring and controlling of work provided by its sub-contractors and suppliers) are among the best in the industry and have helped it to do well in a very competitive market. About two-thirds of its annual revenue, which all arises in Pakistan, comes from government clients for infrastructure projects. SGC is now one of the dominant companies in the market for government contracts, most of which are long term and have a duration of between three to five years.

After several years of strong revenue and profits growth, SGC's business has been adversely affected by economic slowdown. The board decided to reduce the latest annual dividend payment, but considers it a top priority to restore dividend payments to previous levels as soon as possible. Some action has already been taken to investigate where operating costs could be controlled, but the board acknowledges that more needs to be done.

The Board has attributed the poor financial results in 20X7 to the following factors:

- A number of projects (and contracts) were completed in early 20X7, and these have not been replaced with new businesses.
- The government postponed the start of several new infrastructure projects which SGC had planned to tender for.
- There has been a delay in completing two major projects during 20X7, and as a result there has been significant over-spending on them.
- SGC lost out on some projects to competitors and it also had to accept lower margins on certain contracts in order to retain the client.

Major competitors (see Appendix 3) have appeared to perform much better during the previous two to three years, both because their operations are more diverse in the domestic market, and because some of them have construction projects in other countries. However, Mohsin Chaudhry believes that the current problems faced by SGC's business are short term in nature; he expects a 20% recovery in revenues in the next financial year, and he has said that he is prepared to increase SGC's prices if he has to. The Pakistan government is expected to invest in new infrastructure projects to stimulate the construction sector, and Mohsin Chaudhry is confident that SGC should be able to win more contracts. There are numerous infrastructure development projects being proposed, including a large number of flyovers, underpasses, highways, tunnels, dams, roads and industrial projects.

However, the CFO has cautioned against over-optimism and believes that a return to profitability might take much longer.

Report required

You are the senior accountant of SGC. You have been reviewing the summary financial statement data (Appendix 1) and some additional notes on issues currently facing the company (Appendix 2).

The CFO Mariam Syed has asked you to prepare a draft report which addresses each of the following segments.

- (a) The Board of Directors is concerned about maintaining the company's competitiveness, and has requested an assessment of the market environment that SGC operates in, along with an evaluation of the key risks that the company currently faces. **(10 marks)**
- (b) In addition to the environmental analysis, the Directors have requested a review of the main features of the company's recent performance to help them understand where improvements need to be made, or particular strengths to be developed. **(09 marks)**
- (c) Various strategic options for growth have been identified for the company in Appendix 2. For the options identified, explain the potential for the company's growth and make a recommendation to the Board of Directors as to which strategic option should be pursued. **(12 marks)**
- (d) Assume that SGC has decided to opt for the strategic option of overseas markets (Appendix 3) and acquire 100% shareholdings of BKM Building. Discuss the taxability of BKM and the tax implications of the acquisition on SGC (Actual calculations are not required). **(09 marks)**
- (e) With regard to the proposed acquisition of BKM that was discussed in part (d), the CFO has been asked by the board for an estimate of the value of the BKM brand, and suggestions as to how the company might develop a strategy for the BKM brand in Pakistan. (Ignore taxation.) **(10 marks)**

Requirement

Prepare the sections of the report requested by CFO Mariam Syed. Assume the current date is 30 September 20X7.

Total: 50 marks

APPENDIX 1: SUMMARY FINANCIAL STATEMENTS**Summary statement of comprehensive income for the year ended 30 June**

	20X7	20X6
	----- Rs. in million -----	
Revenue	158,559	227,190
Cost of sales	(134,775)	(178,142)
Gross profit	23,784	49,048
General and administrative costs	(28,541)	(37,035)
Operating (loss)/profit	(4,757)	12,013
Net finance costs	(2,784)	(2,763)
(Loss)/profit before taxation	(7,541)	9,250
Taxation	–	(2,960)
(Loss)/profit after taxation	(7,541)	6,290
Dividends paid	(1,500)	(4,545)
Transferred to retained (loss)/profit	(9,041)	1,745

Summary statement of financial position as at 30 June

	20X7	20X6
	----- Rs. in million -----	
Total non-current assets	212,717	200,711
Current assets:		
Inventories	6,390	12,779
Due from customers for contract work-in-progress	31,139	62,277
Trade receivables and prepayments	8,969	17,937
Cash and cash equivalents	9,501	18,896
Total current assets	55,999	111,889
Total assets	268,716	312,600
Current liabilities:		
Due to customers for contract work-in-progress	1,656	2,208
Trade payables and accruals	15,750	37,485
Bank loans	23,566	17,742
Total current liabilities	40,972	57,435
Non-current liabilities:		
Bank loans	55,980	74,360
Equity:		
Share capital and capital reserves	57,595	57,595
Retained earnings	114,169	123,210
Total equity	171,764	180,805
Total equity and liabilities	268,716	312,600

Summary statement of cash flows for the year ended 30 June 20X7

	----- Rs. in million -----	
<i>Cash flows from operating activities</i>		
Loss before interest and taxation		(4,757)
Adjustments for:		
Depreciation		26,830
Operating cash flow before changes in working capital		22,073
<i>Changes in working capital:</i>		
Reduction in inventories	6,389	
Reduction in net amounts due from customers for contract WIP	30,586	
Reduction in receivables and prepayments	8,968	
Reduction in trade payables and accruals	(21,735)	
		24,208
Net cash inflow from operating activities		46,281
<i>Cash flows from investing activities</i>		
Purchase of property, plant and equipment	(38,836)	
Net cash flows used in investing activities		(38,836)
<i>Cash flows from financing activities</i>		
Repayment of loans	(12,556)	
Finance costs	(2,784)	
Dividends paid	(1,500)	
Net cash outflows from financing activities		(16,840)
Net change in cash and cash equivalents		(9,395)
Cash and cash equivalents 1 July		18,896
Cash and cash equivalents 30 June		9,501

APPENDIX 2: STRATEGIC OPTIONS FOR SGC

Extract from a report by the son of Mohsin Chaudhry

Current strategy

Several years ago, the Board of Directors decided to change focus away from small and medium-sized projects in favour of larger public sector ones. However, the focus on large projects may have narrowed the business too much in comparison with competitors.

Having said that, I believe that SGC should continue to strengthen links with the Pakistan government via tendering for new projects and focussing on its core strengths: proven experience, engineering and construction expertise and project management.

Overseas markets

The company could aim to pursue sales in overseas markets. SGC should be able to capitalise on its good reputation by tendering for contracts overseas. One option is to make an acquisition of a local company that will give SGC access both to overseas markets and new sectors, and I have been made aware of a retail construction company based in Pakistan, BKM Building (BKM), which is seeking a buyer. It has significant experience of building large shopping centres in Malaysia and a strong management team. Forecast financial information for BKM for the coming year is attached as an annexure below.

Return to former markets

A return by SGC to small and medium sized housebuilding projects could provide an attractive avenue for revenue growth. As we know, the Pakistan government has taken measures recently to provide various incentives that have benefited house construction companies. With the government moving to stimulate real estate and residential construction, SGC might even consider acquisition of a specialist firm of local architects that could enhance its team and provide bespoke consultancy services to the private residential housebuilding sector.

New technologies

The construction industry has in the past been characterised by strong adherence to traditional methods, but sustainable development is now on the agenda of many businesses, including those in the construction industry. Climate action plans (such as the Paris climate accord) will continue to be a factor in global development. United Nation member states (including Pakistan) have adopted the 2030 Agenda for Sustainable Development, which includes a set of Sustainable Development Goals (SDGs) to tackle climate change by 2030. The modern construction industry is likely to be increasingly characterised by innovation in materials, technologies and practices, and this should be recognised in future SGC strategy in order to differentiate it from competitors.

Annexure**BKM: Forecasted profit and loss statement**

	Forecast
	Rs. in '000
Revenue	81,356
Cost of sales (all variable)	(47,916)
Gross profit	33,440
Fixed costs	(12,000)
Depreciation	(8,000)
Operating profit	13,440
Finance costs	(1,200)
Profit before tax	12,240
Tax	(3,060)
Net profit	9,180

The BKM brand is well recognised in Malaysia as a builder of large shopping centres. Surveys show that its brand is trusted in the construction sector and its 'competitively priced, high-quality' position is one which is generally understood by its clients. However, the brand is comparatively unknown in Pakistan.

The BKM board has claimed, based on market research, that compared to companies whose brand is less well known in Malaysia, construction volumes and revenue are significantly higher at BKM. Specifically, it is estimated that the BKM brand accounts for 15% of its overall sales volume.

BKM has spent significant amounts in recent years on B2B advertising, which has been specifically targeted at brand support and promotion in the Malaysian retail construction sector. It is estimated that for a competitor to establish a similar retail construction brand from a zero base in Pakistan would require many years' advertising expenditure, costing around Rs. 3.2 million per year, with a present value of Rs. 40 million.

A large US construction company, Slab Inc, offered BKM the equivalent of Rs. 10 million in 20X0 to acquire the global rights to the BKM brand outside Pakistan. This offer was rejected by the BKM board.

APPENDIX 3: COMPETITORS

PDY Ltd:

PDY Ltd offers a range of construction services ranging from housing to shopping centres and involvement in government projects. PDY has recently indicated that, as part of its expansion strategy and following a phase of rigorous cost control, it plans to increase its participation in government infrastructure contracts and hopes to erode SGC's market position with planned increase in competitive tender bids.

RTP Ltd:

This company specialises in the construction of warehouses and apartment buildings both in Pakistan and overseas.

IZC Ltd:

Specialises in engineering solutions for skyscrapers and dams around the world, IZC Ltd has seen its revenues grow during 20X7.

APV Ltd:

This company builds sports centres, educational institutions and shopping centres in Pakistan.

QUESTION 2

TTA Airlines (TTA) is a Pakistan based scheduled airline, specialising in long-haul flights from Karachi. It caters for both business and leisure travellers. Established over 30 years ago, when it acquired its initial fleet of aircraft, along with the rights to routes and landing slots at Karachi's Jinnah International Airport, the fleet has since expanded through purchasing and leasing additional aircrafts.

TTA has always operated in the long-haul, intercontinental market with routes from Karachi to America, Asia and Africa. Seats on TTA aircraft are arranged by class in increasing order of price from premium economy to business class and first class. TTA has always prided itself on the level of service that it provides to its first class passengers, and its business class service is gradually becoming highly regarded despite some recent problems with staff, cabin facilities and food quality on some of its routes.

The TTA board has been considering the possibility of TTA operating a new route from Karachi to Sydney, Australia. If the company decides to do this, new aircraft will need to be acquired and these will require financing. The details of the proposal are set out in Appendix 1.

The TTA board has also been reviewing the company's long-term business plan. At a recent meeting, it agreed that the company needed to focus clearly on a limited number of 'strategy drivers' – aspects of the business that should drive the company's strategy in the future. These are set out in Appendix 2.

You are a special projects accountant at TTA, and the financial controller has asked you to help him by preparing some of the sections for a strategic report for the board. He would like you to prepare sections of the report which:

- (a) Calculate the revenue per week, for one aircraft, expected to be generated by each of the two proposed seat configurations. Provide a reasoned recommendation as to which seat configuration would be preferable, taking account of all relevant factors. **(07 marks)**
- (b) Compare the two methods of financing the new aircraft, providing supporting calculations and explanations. Provide a reasoned recommendation. State any further information that would be needed before making a final decision. **(12 marks)**
- (c) Suggest suitable key performance indicators (KPIs) for each of the strategic drivers in the board's draft business plan. **(06 marks)**

Requirement

Prepare the relevant extracts for the report as requested by the financial controller.

Total: 25 marks

Notes

1. Applicable tax rate is 30% payable in the same year. Allowable initial tax depreciation rate on aircraft is 25%. Tax depreciation is allowable on straight line basis.
2. As a working assumption, use an annual discount rate of 10%.

APPENDIX 1: DETAILS OF PROPOSAL TO OPERATE A NEW ROUTE TO AUSTRALIA

Introduction

A new route with landing slots has become available between Karachi and Sydney, Australia. This route would start on 1 October 20X8.

Operating data

The new route would require the acquisition of two new identical aircrafts which are capable of flying all the way from Karachi to Sydney. TTA proposes to operate the route with one flight per day in each direction. Each aircraft will only operate one flight per day.

The proposed prices of seats for a one-way flight are:

	Rupees
Premium economy	80,000
Business class	150,000
First class	300,000

Market research findings

Preliminary market research conducted within the business community in Pakistan has indicated that the number of passengers per one-way flight between Karachi and Sydney, based on the proposed prices and the company's current advertising strategy and brand image, would be as follows:

Day	Premium economy passengers	Business class passengers	First class passengers
Monday	200	100	15
Tuesday	210	70	15
Wednesday	210	80	15
Thursday	220	80	15
Friday	240	90	15
Saturday	240	90	20
Sunday	240	70	20

The above table represents a typical week between Karachi and Sydney. Flights are expected to operate every day of the year.

TTA is confident that the forecast level of demand will remain consistent for the next few years. However, if long-term demand for the new route to Australia is lower than anticipated, then one or both aircraft could be taken out of service from 30 September 20Y1. It is estimated that the fair value of each aircraft will be Rs. 3,400 million at 30 September 20Y1.

Configuring the aircraft seating

The two possible configurations for an aircraft are:

- Configuration 1: 15 first class seats, 90 business class seats and 240 premium economy seats.
- Configuration 2: 20 first class seats, 70 business class seats and 250 premium economy seats.

The seat configuration will be the same in each of the aircraft, and once installed it cannot be changed.

Financing the aircraft

The purchase cost per aircraft is expected to be Rs. 5,500 million, payable on 1 October 20X8. TTA would borrow to finance the aircraft purchase. Each aircraft would have an expected useful life of 10 years, after which time it is forecasted that it could be sold for Rs. 2,000 million.

As an alternative to purchasing, TTA can lease the aircraft for 10 years. Annual lease rentals for each aircraft would be Rs. 700 million and would be payable annually commencing 1 October 20X8. The lease contract would contain a break clause which would permit TTA to cancel the lease after five years, if the route does not prove successful, in return for a penalty payment per aircraft of Rs. 1,900 million on that date.

It is not necessary that both aircrafts are required to be financed in the same way.

APPENDIX 2 – STRATEGY DRIVERS

The TTA board has identified three drivers for the business:

- (1) Geographic expansion
- (2) Promoting the TTA brand
- (3) Selling holiday packages (flight plus hotel deals under a new brand 'TTA Holidays')

A strategic risk for TTA is that competitor airlines will drive their businesses in similar ways, but more successfully. To counter this risk, the board has asked the Chief Executive Officer to set performance targets for each of the strategic drivers, with an appropriate number of key performance indicators (KPIs) for each, to monitor actual performance over the period of the business plan.

QUESTION 3

Paragon Fitness Ltd (PFL) is a company operating in the fitness sector in Pakistan. It provides training space and equipment to its members through its network of fitness centres and has two major revenue streams: monthly membership fee and personal training fee (individually tailored fitness programmes developed for members by personal trainers).

The business was founded 30 years ago by Kashif Malik, who wanted to take advantage of the growing interest in health and fitness. Dreams of expansion have never been realised, largely because of a history of disagreements on the way that the business should develop. Kashif Malik is now the company chairman. The current CEO is his brother, Faisal, who is an ICAP chartered accountant. The executive management team consists of the CEO, CFO Samia Kundi (ICAP Chartered Accountant) and COO Izad Malik (Faisal's son), who is also an ICAP chartered accountant.

Market conditions

In recent years the fitness centre market has become increasingly crowded and competitive, and profit margins have been squeezed. The management team at PFL believes that the current challenges reflected in its latest financial statements are due to a combination of factors, including less willingness to pay high prices for health and fitness services.

Accordingly, PFL has maintained its membership base by keeping its membership fee low, and occupying the lower end of the fitness market when compared with competitors who offer more modern facilities and innovative exercise programs and classes. The company is also reviewing costs, having taken the decision at the end of 20X5 to restrict expenditure on new equipment, keep centre facilities simple and maintain staff numbers at current levels. There has been some concern about maintenance standards and a recent incident has highlighted the problems (Appendix 3).

Membership contracts with PFL require the member to pay monthly membership fee up front, for a minimum of 24 months. Having signed a contract, members must make payments for the full period.

Human resources

Following a report from a human resources consultancy on PFL's problems with staff retention, the company introduced a generous bonus scheme for the achievement of certain targets, aimed at retaining its centre managers, with the result that some of the longer serving managers are now on remuneration packages that are above the industry average.

Each of PFL's 10 fitness centres operates with a centre manager and around 15 members of staff. Many centre managers are saying that the company needs to provide more training to help develop a closer rapport between staff and members, which will encourage members to maintain their memberships. Many members of centre staff have expressed enthusiasm for training in areas such as motivational psychology, as well as disciplines such as yoga or pilates.

Financial performance 20X7

The company is profitable. However profits have been falling since 20X5, and performance in 20X7 is reflective of the challenging market. Despite this, there is optimism that profit growth will be restored if the correct strategy is found, and some options have been put forward (Appendix 2).

Summary financial statements for PFL for the three years ended 30 September 20X7 are shown in Appendix 1.

You are an accountant working in the head office of Paragon Fitness and have been asked by your manager, the Chief Accountant, to accompany him to a meeting with Samia Kundi, CFO, at which various issues are to be discussed. Following the meeting, your manager asks you to draft a report in response to Samia's request for additional information, in separate sections:

- (a) Calculate PFL's working capital between 20X5 and 20X7. As far as the information allows, analyse the probable impact on working capital of each of the strategic options that have been identified, assuming that they are mutually exclusive, and consider how any financing requirements might be met. **(10 marks)**
- (b) With reference to the comments made by the CEO, explain the role that human resources management should play in the acquisition of Prime Performance and which human resources issues need to be addressed. **(08 marks)**
- (c) With reference to the ICAP Code of Ethics, what are the issues presented by the events described in Appendix 3? In your answer, comment upon the appropriate course of action to be taken. **(07 marks)**

Requirement

Respond to the instructions from your manager.

Total: 25 marks

APPENDIX 1: SUMMARY FINANCIAL STATEMENTS FOR THE THREE YEARS ENDED 30 SEPTEMBER 20X7 FOR PARAGON FITNESS LTD

STATEMENT OF PROFIT OR LOSS

Year ended 30 September	20X5	20X6	20X7
	----- Rs. in million -----		
Sales revenue	211.0	220.0	208.0
Staff costs	(24.6)	(26.4)	(26.5)
Personal trainer costs	(20.3)	(21.4)	(19.9)
Occupancy costs	(98.6)	(99.0)	(98.4)
Other operating expenses	(39.0)	(49.0)	(43.0)
Total operating costs	(182.5)	(195.8)	(187.8)
Profit before interest and tax	28.5	24.2	20.2
Interest expense	(1.0)	(1.1)	(1.1)
Interest income	0.4	0.2	0.3
Profit before taxation	27.9	23.3	19.4
Income tax expense	(4.5)	(3.7)	(3.1)
Profit after taxation	23.4	19.6	16.3
Dividends	(14.2)	(11.6)	(11.6)
Retained profit	9.2	8.0	4.7

Note: Occupancy costs consist of rental costs and other operational costs associated with building occupation, such as utilities.

SUMMARY STATEMENT OF FINANCIAL POSITION

Year ended 30 September	20X5	20X6	20X7
	----- Rs. in million -----		
Non-current assets			
Leasehold improvements	87.0	91.7	95.9
Fixtures, fittings and equipment	11.2	9.3	6.3
Total non-current assets	98.2	101.0	102.2
Current assets			
Inventory	1.8	2.1	2.0
Receivables	3.5	3.2	3.4
Cash	8.6	16.0	16.7
Total current assets	13.9	21.3	22.1
Total assets	112.1	122.3	124.3
Current liabilities			
Payables	16.5	15.2	14.0
Advance membership income	9.0	9.5	10.0
Total current liabilities	25.5	24.7	24.0
Non-current liabilities			
Borrowings	25.0	28.0	26.0
Total non-current liabilities	25.0	28.0	26.0
Total liabilities	50.5	52.7	50.0
Equity			
Share capital	10.0	10.0	10.0
Reserves	51.6	59.6	64.3
Total equity	61.6	69.6	74.3
Equity and liabilities	112.1	122.3	124.3

Note: Borrowings represent a Rs. 40 million revolving credit facility from PFL's bankers which has been agreed until 20X9.

EXTRACTS FROM STATEMENT OF CASH FLOWS

Year ended 30 September	20X5	20X6	20X7
	Rs. in million		
Cash generated from operations	38.1	32.1	28.4
Net interest paid	(0.6)	(0.9)	(0.8)
Dividends paid	(14.2)	(11.6)	(11.6)
Income tax paid	(4.5)	(3.7)	(3.1)
Net cash from operating activities	18.8	15.9	12.9
<i>Cash flows from investing activities:</i>			
Acquisition of property, plant and equipment	(25.5)	(11.5)	(10.2)
Net cash used in investing activities	(25.5)	(11.5)	(10.2)
<i>Cash flows from financing activities:</i>			
Increase/(decrease) in borrowings	2.0	3.0	(2.0)
Net cash from financing activities	2.0	3.0	(2.0)
Net increase/(decrease) in cash and cash equivalents	(4.7)	7.4	0.7
Cash and cash equivalents at 1 October	13.3	8.6	16.0
Cash and cash equivalents at 30 September	8.6	16.0	16.7

APPENDIX 2 – STRATEGIC OPTIONS

The three cases below describe significant strategic options which PFL is considering.

1. **Opportunity to manage in-house gyms:** Maira Shah, a friend of the Malik family who is a successful property developer, has offered PFL the opportunity to manage six gyms located within one of her company's newly built apartment complexes. The business model for these gyms would involve PFL managing and operating them in exchange for a fixed monthly fee, receivable six monthly in arrears. PFL would have no responsibility for capital investment, but would need to employ additional staff. Each gym would be approximately half the size of the average fitness centre currently operated by PFL.
2. **Accelerated investment program:** Impact Fitness, a very large and successful international fitness chain has announced that it will enter the Pakistan market. In order to protect PFL's market position against this competitive threat, the COO, Izad Malik, has argued that there is an urgent need to accelerate investment in new equipment in order to maintain profitability and improve the potential for growth in the business.
3. **Acquisition opportunity:** Prime Performance Ltd is a rival fitness centre operator in Pakistan. PFL has been contacted by an investment bank acting as adviser to Prime Performance regarding the sale of its network of premium fitness centres. It is estimated that the cost of these fitness centres would be in the region of Rs. 45–55 million.

Faisal Malik the CEO has said: 'Although I like the idea of the acquisition of Prime Performance, I am a bit concerned about the employment issues which it appears to be having at the moment. Following new investment, costs have been reduced at Prime (as redundancies were made following the introduction of some new operating methods) but not to the extent that management expected. There are ongoing disputes in response to new working patterns for centre staff, and proposed further changes to working practices that staff believe will undermine the premium position that Prime occupies. I don't want an acquisition which makes financial sense to be undermined by human resources issues, and therefore I think we need to give careful consideration to the "people" side of the acquisition as well as the "numbers" aspects of it.'

APPENDIX 3: ETHICAL CONCERNS

One of PFL's most successful fitness centres is extremely popular with local office workers, who visit the centre early in the morning, at lunchtimes and after work. The building in which it is located is relatively old, and PFL is the sole owner and occupier. The board of PFL have been aware for some time that this building (along with other PFL centres) is in need of refurbishment and minor structural improvements, but it has never been regarded as unsafe.

This centre has also had staffing problems. Its previous manager left PFL for a competitor, and while a replacement manager was being sought the centre was being managed by Izad Malik's daughter, Laila. She was appointed by Izad with very little assessment of her suitability, as there was pressure to put an interim manager in place.

Unfortunately, due to the pressures of the role and having to deal with a backlog of customer complaints, Laila failed to tell PFL head office that a neighbouring business had informed her that there was a risk to the structure of the building in which the fitness centre operated, following building works that took place next door. By the time a formal letter on the matter was received at head office, advising of the possible need to vacate the building until it could be investigated, nearly a month had passed without any adverse incident. Without consulting Kashif, the Chairman, and while Izad was on leave, Faisal Malik, the CEO, decided not to take any action. On his return to work, Izad was surprised to hear of this decision, but went along with it on the grounds that the centre concerned had the highest number of visits per week of any of its branches, and so it was important that it be kept open. In any event, nothing had yet happened to indicate that the building was unsafe.

Several weeks after Izad's return to work, part of the ceiling collapsed in the centre, breaking both arms of a member who was using a rowing machine and injuring many others. The neighbouring business has used social media to point out that PFL was warned. In response, PFL has denied that it received sufficiently detailed communication about the potential damage to the building, or any firm indication that there was anything seriously wrong. Laila has been told by Izad not to make any public comment for the time being.

The denials by PFL have limited the damage, with most public anger directed towards the building contractor who undertook the works that appear to have caused the problem. For its part, the building contractor has denied any responsibility for structural damage, suggesting that PFL should be held responsible for not maintaining its properties to a sufficient standard.

A full review has been launched into the affair, and a complete report given to Faisal and Kashif Malik which details exactly what occurred. Faisal and Kashif are considering their next actions; the report is highly critical of PFL's approach to building safety in this instance, and the brothers intend to suppress it as they believe that this portrayal is unfair. Izad Malik has told Faisal and Kashif that he does not agree with them, saying that the best approach is to publish the report and forcefully deny that PFL ever knowingly compromised safety. He has also decided to conduct his own internal review of conditions at each of the fitness centres with a view to proposing a programme of improvements.

(THE END)