

CIPS Level 5 – Advanced Diploma in Procurement and Supply

Advanced Contract and Financial Management [L5M4]

Sample Answer Guidance

(Q1) – ABC Limited

ABC Limited (ABCL) is a large manufacturer of farming equipment and its range includes (mainly) heavy goods and machinery such as tractors, diggers and farm vehicles. Their turnover is US\$2.5bn with an operating profit of US\$4m.

ABCL currently have an extended supply chain of about 5000 suppliers across the world. They have two key suppliers DEF Limited and GHJ Limited who account for 55% of procurement spend. There are 30 staff in the central procurement team.

The procurement team and systems at ABCL have recently undergone a purchasing audit which looked at strategic and operating operations of the procurement team, including the use of electronic purchasing. The findings were not good with the auditors pointing out that the supply chain operation of ABCL is outdated, lacks innovation and is not fit for purpose.

In addition, the auditors felt that there were poor communications between ABCL procurement department and key functions such as marketing, finance and design. Evidence was also provided by the auditors of poor market and supplier involvement especially in the early part of the procurement cycle (identification of need and specification development were singled out for being particularly poor).

The report concluded with a review of how the procurement unit in ABCL interacts strategically with the supply base when monitoring areas such as quality, price, delivery and sustainability and there was little evidence of any sort of effective “non-contractual” relationships within the supply chain. Within the report, it was highlighted that the assessment of key suppliers was particularly poor with no evidence of modern techniques or financial reporting being utilised. With regard to costs, the auditors were unable to find any evidence of clear financial data on suppliers or any evidence of long term demand planning, especially between sales and procurement.

Question One

Assess a range of measures that the new Procurement Director could utilise to improve the supply chain.

[25 marks]

LO: 1

AC: 1.4

Planning your answer

Command Words

It is important in any constructive response question to understand the Command word used in the question as they tell you exactly what the assessor wants you to do. In this question, the assessor will want you to clearly ‘**Assess** a range of measures that the new Procurement Director could utilise to improve the supply chain’

The Command word in this question is **Assess** which is to “Evaluate or judge the importance of something, referring to the special knowledge of experts where possible. This may involve quoting from other texts.”

Answering the question

A good approach to answering this question would be to have a short introduction that recognises ABCL is barely breaking even with an operating profit of just 0.16% despite having a considerable turnover. If the organisation is to survive it has to rapidly improve how they are operating as a company. And then following on from the introduction perhaps have a short sub-heading

The question is worth 25 marks and good approach would be to assess five measures, heading up each either by bullet point or number.

This approach helps to ensure that you understand the question, recognise the command word and assess a range of measures that could improve the supply chain relative to ABCL.

A good summary/conclusion would be to re-iterate that ABCL is in a pretty dire state and that the measures taken would need to be prioritised and time-phased to accrue some quick wins and benefits. i.e. some of the measures will involve a cultural shift and won't be easy to implement.

The following is suggested answer content rather than a model answer and can include:

Measures to improve the supply chain might be:

- Cross-functional working
- Simultaneous engineering
- Early supplier involvement
- Supplier forums and associations
- Supplier Reduction Programmes
- Improved CM/SRM with key suppliers
- Procurement Training

ABCL could also consider adopting a demand-driven planning and business operating model based on real-time demand insights and demand shaping. ABCL could even build an adaptive and agile supply chain with rapid planning and integrated execution and this would certainly improve supply chain communications. It could also optimise product designs and product management for supply, manufacturing, and sustainability to accelerate profitable innovation.

Another measure could be the triple bottom line of people, profit, and planet. Substantial opportunities exist for sustainability in ABCL supply chain operations:

Embed sustainability as a core strategic component and capability of its supply chain strategy. This means incorporating it as a key requirement across all supply chain processes.

The new Director could focus on the basics to achieve quick wins through real-time visibility and analyses of the energy and resource consumption and resource or material movement. This enables reduction of carbon inefficiencies, minimized energy consumption, less waste with "recycle-reuse-refurbish" materials, and optimized travel and transportation.

The new director could ensure continuous improvement through systemic measurement, audit, and knowledge management. Compliance audits, best practices, and benchmarks provide a governing framework

for sustainable supply chain operations and ensure clarity around the environmental impact of specific actions.

There are clear stakeholder problems in the scenario and the new director must ensure a reliable and predictable supply. Without a reliable supply to customer-facing stakeholders, to meet agreed-upon service levels, ABCL will tend to hold inventory buffers to ensure meeting customer service levels.

Other valid responses will be accepted.

(Q2) – Billway PLC

The data below is taken from the year-end financial accounts of Billway PLC a company who has expressed an interest in becoming a key supplier to your organisation.

	<u>2017</u>	<u>2016</u>
Return on sales	9.1%	13.8%
Return on capital employed	9.4%	12.51%
Gross profit margin	23.9%	28.1%
Return on assets	7.0%	9.4%
Stock turn	151 days	202 days
Debtor days	131 days	148 days
Creditor days	107 days	111 days
Current ratio	1.9:1	2.22:1
Quick/acid test ratio	0.85:1	1.12:1
Gearing	49%	58%

Question Two

From the financial data given, assess, by commenting on all of the ratios, Billway PLCs financial position as a potential supplier.

[25 marks]

LO: 2
AC: 2.1

Planning your answer

Command Words

It is important in any constructive response question to understand the Command word used in the question as they tell you exactly what the assessor wants you to do. In this question, the assessor will want you too clearly '**Assess**, by commenting on all the ratios, Billway PLCs financial position as a potential supplier.

The Command word in this question is **Assess** which is to "Evaluate or judge the importance of something, referring to the special knowledge of experts where possible. This may involve quoting from other texts."

Answering the question

A good approach to answering this question would be to have a short introduction that recognises the importance of conducting a financial appraisal of potential suppliers at an early stage of the sourcing process. As part of the financial due diligence ratio analysis may be used to support an overview of an organisation's financial health. We also need to recognise the limitations of ratio analysis in that among other things the data used is historic and purely numerical and a procurement professional would need to consider the findings alongside other information gathered including for example the competitiveness of the market and the state of the overall economy.

We can then go on to assess Billway's financial health from the data given.

This approach helps to ensure that you understand the question, recognise the command word and assess Billway PLCs financial position as a potential supplier.

The following is suggested answer content rather than a model answer and can include:-

Findings from the data provided reflect that:

Return on sales = Operating Profit/Net Sales

This has reduced and is likely to be due to a decline in sales although it may also be caused by higher sales of lower-margin products and reduced sales of higher-margin products.

Gross Profit margin = Gross Profit/Sales x 100

This has reduced by 4.2% and is likely an indication of higher costs of goods and may be attributable to increased materials costs due to suppliers increasing their prices. May also be an indication of poor negotiation or supplier management capabilities.

ROCE = Earnings Before Interest and Tax (EBIT) / Capital Employed.

This is a measure of how efficiently the company is using the money invested in it to generate profit from day-to-day operations.

ROA = Net Income/Total Assets

Return on assets measures how efficiently your business uses its assets to generate profit.

Both ROCE & ROA have reduced significantly and may reflect the company is operating less efficiently than the previous year.

Debtor days = Trade Debtors/Sales x 365 days

The debtor days ratio focuses on the time it takes for trade debtors to settle their bills. The high figure may suggest general problems with debt collection, the financial position of major customers or poor contractual terms.

In both years they are high but have been reduced in the last year.

Creditor days = Trade Payables/ Sales x 365 days

Creditor days estimates the average time it takes a business to settle its debts with trade suppliers and gives an insight into whether a business is taking full advantage of trade credit available to it. These are also high and may result in a response from suppliers in terms of non-delivery or for Billway to be given lower priority in a buoyant market.

Current Ratio = Current Assets/Current Liabilities

Liquid/Quick Ratio = Current Assets – Stock/Current Liabilities

Both current and liquid ratio slightly reduced but remain above what might be considered acceptable levels.

Stock-turns = Cost of Sales/Average Stock Held

In general guide, the quicker an organisation turns over its inventories, the better but a lot depends on the business and market sector. In both years stock turns are low but have improved since 2016.

Gearing = Total Debt/Total Equity

This focuses on the capital structure of the business reflecting the proportion of finance that is provided by debt relative to the finance provided by equity or shareholders. Shows whether a firm's capital structure is likely to be able to continue to meet interest payments on, and to repay long term borrowing. A gearing ratio higher than 50% is typically considered highly levered or geared. As a result, the company would be at greater financial risk, because during times of lower profits and higher interest rates, the company would be more susceptible to loan default and bankruptcy.

A gearing ratio lower than 25% is typically considered low-risk by investors and lenders.

In this case, Billway appears to be highly geared and is a risk although it has managed to reduce it to just under 50% from 2016.

The findings of a combination of the ratios would suggest that Billway is perhaps not the best-run company in the world with declining sales and profits and inefficiencies in operations, supply chain management and cash management. Perhaps the single biggest issue and concern is the gearing with debt to equity, a potentially serious issue.

However, we can summarise by recognising and repeating the limitations of ratio analysis in the introduction and that a procurement professional would need to consider the findings alongside other information gathered particularly to the market sector Billway PLC is in and the competitiveness of this market and the state of the overall economy.

Other valid responses will be accepted

(Q3)

Question Three

Evaluate a range of approaches that a procurement department could use to assist in the effective funding of working capital.

[25 marks]

LO: 3

AC: 3.1

Planning your answer

Command Words

It is important in any constructive response question to understand the Command word used in the question as they tell you exactly what the assessor wants you to do. In this question, the assessor will want you to clearly: **Evaluate** a range of approaches that a procurement department could use to assist in the effective funding of working capital.

The main Command word in this question is Evaluate “Calculate or judge the value of something; include your personal opinion in your evaluation. Often includes an assessment of strengths and weakness.”

Answering the question

A good approach to answering this question would be to have a short introduction relating to an explanation of the term, e.g. working capital represents money being used to run (or even start) the business on a short term basis’ or ‘working capital = current assets less current liabilities. Having enough working capital means that the company should be able to pay for all of its short-term expenses and liabilities and through proper management of working capital, ensure that a company’s resources are being optimised to help run the business more efficiently.

Having correctly defined working capital, answers should move on to evaluating a range of approaches to assist in the effective financing and management of working capital, in some (if not most) cases in working in conjunction with the finance department.

We need to recognise here that the question is worth 25 marks and we could look to evaluate around five methods in some breadth and depth looking to accrue five marks for each.

This approach helps to ensure that you understand the question, recognise the main command word and “Evaluate a range of approaches that a procurement department could use to assist in the effective funding of working capital”.

The following is suggested answer content rather than a model answer.

A range of approaches that could be used include but not limited to:

The element of most control for procurement could be inventory. A company can have assets, such as premises, cars etc. but be short of liquidity if these assets cannot be converted into cash quickly. Effective use of stock control would be a benefit to working capital with a reduction of stock/inventories held. Answers could also identify when discussing this point the risks involved in the potential failure of JIT stock deliveries.

The extension of creditor days and the reduction of debtor days would improve cash flow and aid the running of the business on a short term basis. Procurement would be a prime mover in dealing with suppliers and negotiating an increase in settlement terms. Answers could look at the alienation of suppliers in increasing settlement days, and also refer to possible loss of profit with the loss of early settlement discount. Settlement of creditors before receipt of debtors is not a formula for cash flow surplus.

Procurement could assist in the use of factoring and invoice discounting in aiding cash flow and working capital, and could also assist in budgeting and forecasting by stringent calculations and advise of any shortfall which would require the use of short term overdrafts.

Procurement could also assist in the management of working capital with the use of leasing instead of outright purchase of fixed assets – thus preserving cash flow and aiding the working capital position. Sale and leaseback of major assets would also assist in the effective financing of working capital.

Other areas could be a cross-functional collaboration, market surveys, supplier rationalisation, early procurement and supplier involvement, centralisation and standardisation, effective supplier selection, cost-beneficial contract terms and overall good communication skills for procurement officers when dealing with external stakeholders.

Note that answers are expected to include items in both current assets and current liabilities.

Other valid approaches and answers will be accepted.

(Q4)

Question 4

Discuss how a balanced scorecard methodology can be applied to the measurement of performance in supply chains.

[25marks]

LO: 4
AC: 4.1

Planning your answer

Command Words

It is important in any constructive response question to understand the Command word used in the question as they tell you exactly what the assessor wants you to do. In this question the assessor will want you to clearly: **'Discuss** how a balanced scorecard methodology can be applied to the measurement of performance in supply chains'

The Command word in this question is **Discuss**, meaning to "Consider something by writing about it from different points of view. Compare with, Argue or evaluate"

Answering the question

A good approach to answering this question would be to first explain the concept of a balanced scorecard (BSC) combining both financial and non-financial measures, thus broadening the scope of information available and increasing the likelihood of organisational objectives being met.

The balanced scorecard approach suggests that organisations view from four perspectives. Each area (perspective) represents a different aspect of the business organisation in order to operate at optimal capacity.

- Financial Perspective - This consists of costs or measurement involved, in terms of rate of return on capital (ROI) employed and operating income of the organisation.
- Customer Perspective - Measures the level of customer satisfaction, customer retention and the market share held by the organisation.

- Business Process Perspective - This consists of measures such as cost and quality related to the business processes.
- Learning and Growth Perspective - Consists of measures such as employee satisfaction, employee retention and knowledge management.

Each perspective may detail objectives, measures, targets and initiatives to provide a measurement system and also a framework that enables organisations to clarify their vision and strategy and translate them into action.

Following on from this short introduction perhaps have a short sub-heading “a balanced scorecard methodology can be applied to the measurement of performance in supply chains in the following ways“

We need to recognise that the question is worth 25 marks and we could look to discuss five ways the methodology could be applied in some breadth and depth to accrue five marks for each. This approach helps to ensure that you understand the question, recognise the command word and discuss around five ways that the scorecard methodology can be applied in relation to performance measurement in supply chains.

The following is suggested answer content rather than a model answer.

Answers should demonstrate that the four perspectives are interrelated since this is the strength of the model therefore, they do not function independently. The advantage of the scorecard is that it presents many of the seemingly disparate elements of an organisation’s agenda in a single report. The scorecard suggests that metrics should be developed and data collected and analysed. It encourages managers to consider all relevant operational measures at the same time.

In real-world situations such as supply chain measurement, organisations may need one or more perspectives combined together or new ones added to achieve its business objectives.

The supply chain measurement aspects can include but not limited to:

An example of a relevant model that has been developed from the Kaplan and Norton is the 'purchasing balanced scorecard' by Cousins et al. This addresses the following questions: (5 Ways)

- How do we look to stakeholders?
- What must we excel at internally?
- How do we manage suppliers?
- How do customers see us?
- How do we learn and innovate?

The main advantage of using this balanced view of measurement is that the supply partners selected for this initiative may give up on one-sided targets but now they might be practising gain sharing and collaborative improvement up and down their supply chains using measurement in all four sections of the card.

These targets should strive for balance in both the effort and benefit for all parties. Without common multi-enterprise target values, the utility of a BSC is massively reduced. As an example answers could suggest typical areas to be highlighted such as learning and growth in tier 1 suppliers.

Reference to Kaplan and Norton’s model is helpful and answers may illustrate this source by including either a diagram or note the key elements of this model.

Reference and inter-connection between the financial perspective, customer perspective, business process perspective and learning and growth – all linked to overall organisational goals is a sound basis to discuss how performance measurement could take place in the supply chain.

Answers may discuss other possible models include The Performance Prism, Cousins et al. the SCOR model or dashboards.

Also, the original balanced scorecard didn't reflect or address the importance of ethical, environmental and sustainability aspects of procurement which could be considered as part of answer content. Refer to the above five bullet points.

Reference to the advantages and challenges of the approach is also relevant (the command word is "discuss"). For example, the quality of data used in the scorecard, time taken to complete or train individuals in its use, or maybe seen as an employee performance monitoring tool and therefore have unintended consequences.

Other valid responses will be accepted.

SAMPLE QUESTIONS