ADVANCED LEVEL CASE STUDY EXAMINATION
NOVEMBER 2023
(4 HOURS)

ICAEW
PARTNER IN
LEARNING

ACA MASTERS

Case Study: Mock Exam 1

Guidance:

To obtain maximum benefit, this mock exam should be sat under full exam conditions using the practice exam software which is available from the ICAEW website. You should use the exam technique taught during the 'How to Ace the ACA Case Study' class.

Once you have completed the exam, you should use the marking grids provided to calculate your score.

To improve your grade, you should carefully analyse how the report has been structured and written in the prize-winner model answer.

EXHIBIT 15

EMAIL

From: Ali Fisk
To: Stockard Matelier
Subject: FDM Limited: Draft management accounts and business issues
Date: 8 November 2023

We have just received the latest management accounts from Jai Williamson. Jai would like us to carry out a review of FDM's performance. We also need to address some business issues facing FDM. I am attaching the following:

- A note from Jai Williamson on FDM's management accounts and a request for advice **(Exhibit 16)**
- FDM's draft management accounts for the year ended 30 September 2023 **(Exhibit 17)**
- An email from Jerzel Morales to me regarding Bed Operations Limited (BOL) **(Exhibit 18a),** together with media coverage and extracts from BOL's financial statements **(Exhibit 18b/18c)**
- An email from Brienne Saffire to me about FDM's growth strategy **(Exhibit 19a),** together with an internal document **(Exhibit 19b)** and media coverage **(Exhibit 19c)**

Please draft for my review a report addressed to the FDM board. The report should comprise the following.

1. A review of FDM's performance for the year ended 30 September 2023 in comparison with the year ended 30 September 2022. It should cover:

   - revenue for each client size and in total
   - gross profit for each client size and in total
   - operating profit in total.

   Use the management accounts set out in **Exhibit 17**, incorporating as appropriate the additional information in **Exhibit 16** and FDM's KPIs.

   You should also respond to FDM's request for advice (**Exhibit 16**).

   Based on your analysis, conclude on FDM's performance for the year ended 30 September 2023 and make appropriate recommendations for improving the business.

2. An evaluation of the proposal for FDM to provide digital marketing services to BOL, as set out in **Exhibit 18a**.

   - For each of Alternative A and Alternative B:
     - Calculate FDM's expected annual revenue and gross profit.
     - Calculate the potential lifetime value.
     - Evaluate the estimates and assumptions.
   - Identify and evaluate commercial considerations and risks, including any arising from **Exhibits 18b and 18c**.
   - Recommend, with reasons, which of the two alternatives FDM should propose.

3. An evaluation of FDM’s growth strategy, as set out in **Exhibit 19a**.

    - Calculate FDM’s expected revenue and gross profit for the year ended 30 September 2024 on two bases: (a) FDM pursues a recruit for growth strategy; and (b) FDM pursues a technology-driven growth strategy.
    - Explain and evaluate the strategic, operational and financial issues that FDM should take into account when deciding which strategy to pursue. Incorporate any ethical and business trust aspects.
    - Provide a justified recommendation as to which strategy FDM should pursue.

EXHIBIT 16

Note from Jai Williamson, 8 November 2023: Additional information relating to the draft management accounts for the year ended 30 September 2023 (2023)

Clients

- To support staff development and career progression, we began to staff large and major clients with more junior members. Whilst this was not an issue for most clients, some were not happy with the change in personnel and moved their digital marketing work to another agency.
- Notable client wins in the year included:
  - Supersave, a nationwide grocery retailer. FDM expects to generate annual revenue of £68k.
  - AI-Reach, a management consultancy with global operations. FDM expects to generate annual revenue of £172k.
- Small and medium clients who were only using FDM for SEO work were encouraged to start using paid advertising to boost their website traffic and sales. To increase take up, all paid search management work used performance-based pricing. As FDM's proposed fees were calculated on additional revenue generated by the client, this was sold to clients as a 'no win, no fee' proposal.
- After running a highly successful paid advertising campaign for Compere, the same approach was applied to other clients of a similar size but unfortunately the results were not as good. In some cases, no additional revenue was generated.
- The overall client churn rate was 8.9%. This is broken down by client size below:
  - Major: 21.4%
  - Large: 12.2%
  - Medium: 7.6%
  - Small: 7.9%

Staff

- Headcount increased to 117. This comprised 102 billable staff and 15 support staff.
- A total of 16 staff left during 2023. Of those who left, 7 joined in 2023.
- To support recruitment and reduce attrition, there was an increase in salaries for billable staff and all staff were given the flexibility to work from home for up to four days per week.
- The board decided not to pay a staff bonus because the revenue target was not achieved.

Request for advice

Following recent board discussions, Brienne Saffire has asked me to identify ways to improve the attractiveness of FDM to a prospective purchaser. I will be putting forward the following proposals at the next board meeting.

Proposal 1: allow permanent remote working
By allowing staff to permanently work from a remote location, our need for office space will greatly reduce. Our current short-term lease is due to expire soon so we will be able to rent a considerably smaller space at a much-reduced cost.

Proposal 2: reduce support staff
It is billable staff who generate revenue so reducing the number of support staff will cut costs and increase profit. Instead of relying on support staff, billable staff will be asked to do some of the admin work required for their clients.

Proposal 3: discount for advanced payment
Clients will be offered a 15% fee discount if they pay in advance of work being performed.

Proposal 4: reduce capital expenditure
Capital expenditure will be capped at £160,000 per year. Savings will primarily come from reduced expenditure on IT equipment as we will ask staff to use their own equipment for work.

Proposal 5: staff bonus based on AMFIH
Introduce a staff bonus based on individual AMFIH. This will ensure that the overall AMFIH target is achieved so will enable revenue and profit targets to be met.

Please advise us on

- the impact these proposals would have on operating profit
- any other related issues the board should be aware of
- any actions that should be taken before a final decision is made.

EXHIBIT 17

FDM: Draft management accounts for the year ended 30 September 2023

Statement of profit and loss for the year ended 30 September 2023

	Note	£000
Revenue	1	10,989
Cost of sales	2	(6,611)
Gross profit	3	**4,378**
Administrative and selling expenses		(1,187)
Operating profit		**3,191**
Net finance income		92
Profit before taxation		3,283
Taxation		(821)
Profit for the year		**2,462**

Statement of financial position

	Note	£000
Non-current assets		
Property, plant and equipment (PPE)	4	1,252
		1,252
Current assets		
Trade and other receivables	5	1,350
Cash and cash equivalents		3,223
		4,573
TOTAL ASSETS		**5,825**
Equity		
Ordinary shares		100
Retained earnings		3,503
		3,603
Current liabilities		
Trade and other payables	6	1,401
Taxation		821
		2,222
TOTAL EQUITY AND LIABILITIES		**5,825**

Statement of cash flows

	£000
Cash flows from operating activities	
Profit before taxation	3,283
Adjustments for:	
Loss/(profit) on disposal of PPE	25
Depreciation of PPE	158
Finance income	(92)
	3,374
Change in trade and other receivables	(315)
Change in trade and other payables	169
	3,228
Income tax paid	(454)
Net cash generated from operating activities	**2,774**
Cash flows from investing activities	
Acquisition of PPE	(482)
Proceeds from disposal of PPE	82
Net finance income	92
Net cash generated from investing activities	**(308)**
Cash flows from financing activities	
Dividends paid	(1,000)
Net cash generated from financing activities	**(1,000)**
Net change in cash and cash equivalents	1,466
Cash and cash equivalents at start of year	1,757
Cash and cash equivalents at end of year	**3,223**

Notes to the management accounts

Note 1: Revenue by client size

	£000
Major accounts	2,662
Large accounts	2,617
Medium accounts	2,757
Small accounts	2,953
	10,989

Note 2: Cost of sales by cost category

	£000
Billable staff	4,762
Other costs	1,849
	6,611

Note 3: Gross profit by client size

	£000
Major accounts	775
Large accounts	924
Medium accounts	1,087
Small accounts	1,592
	4,378

Note 4: Property, plant and equipment (PPE)

	£000
Opening carrying amount	1,035
Additions	482
Depreciation charge	(158)
Disposals (carrying amount)	(107)
Closing carrying amount	**1,252**

Note 5: Trade and other receivables

	£000
Trade receivables	1,289
Other receivables and prepayments	61
	1,350

Note 6: Trade and other payables

	£000
Deferred income	708
Other payables and accruals	429
Trade payables	264
	1,401

EXHIBIT 18a

EMAIL

From: Jerzel Morales
To: Ali Fisk
Cc: FDM board
Subject: Bed Operations Limited (BOL)
Date: 7 November 2023

We recently recruited an experienced manager from Bracket who had been the account manager on several of their key clients, including BOL. BOL is a bed retailer with 89 stores across the UK. Before she left Bracket to join us, BOL heavily suggested that they would move their digital marketing work to whichever agency she worked for. As BOL's contract with Bracket has now expired, BOL have contacted us asking that we put forward a detailed digital marketing proposal.

FDM will provide a wide range of services to BOL. This will include setting an evolving marketing strategy, website improvements and content creation, SEO, paid search management and social media campaigns. The overall objective will be to increase BOL's revenue.

When we present FDM's digital marketing plan, we will also need to put forward a pricing proposal:

- **Alternative A**: Billable hours using charge-out rates. FDM's fee will be calculated based on billable hours and FDM's standard charge-out rates.
- **Alternative B**: Performance-based pricing. FDM's fee will be 6% of the revenue attributable to FDM's marketing activities.

Bracket provided BOL with a 20% discount on their standard charge-out rates so we will offer the same if Alternative A is proposed. Under either alternative, payment terms will be 2 months in arrears.

Information provided by FDM

FDM's standard charge-out rates for the year ended 30 September 2024 are set out below.

	Charge-out rate per hour
Director	£240
Manager	£230
Team leader	£100
Team member	£75

The amount of time spent per month will vary, particularly as not all the work is routine, but an estimate of time investment per staff grade is below.

	Expected hours per month
Director	15
Manager	35
Team leader	45
Team member	80

Based on current salaries, FDM’s expected monthly cost of sales are £12,500.

Whilst the initial agreement will be for 12 months, FDM is confident that it will be able to retain BOL as a client for at least 5 years.

FDM’s marketing activities will enable BOL to refresh its image and reach a wider audience. Based on market research and previous experience, FDM has estimated that reach will increase by 500,000 people per month and 10% of those will visit BOL’s website.

Information provided by BOL

The long-term average bounce rate for the BOL website is 45%.

BOL defines a lead as a customer visiting one of its stores. There is some uncertainty about the number of leads that will be generated from each website visit because it is difficult to accurately track how many website visits result in a customer visiting a store. BOL estimates that there is a 55% probability that leads will be 20% of website visitors who do not bounce, a 15% probability that leads will be 25% of website visitors who do not bounce and a 30% probability that leads will be 15% of website visitors who do not bounce.

Over the last three years, BOL has converted 10% of store visits into sales with an average selling price of £650.

EXHIBIT 18b

Try before you buy
(Sleep Easy blog, September 2023)

Online shopping continues to account for an ever-growing share of retail purchases, and beds are no exception. However, given the importance of sleep to our health and wellbeing, we firmly believe that you should always test a mattress before making a long-term commitment. The obvious way to do this is to visit a local retail store so that you can test a variety of beds and find your perfect sleeping partner. Although if you prefer shopping online or cannot access a retail store, you can always try the bed at home as most online companies now offer an exchange or refund if the bed does not suit you.

EXHIBIT 18c

Extracts from BOL's published financial statements

Year ended 30 June	**2023 (£000)**	**2022 (£000)**
Revenue	£31,250	£36,000
Operating profit	£1,625	£2,210
Operating data		
Number of beds sold ('000)	50	56

EXHIBIT 19a

EMAIL

From: Brienne Saffire
To: Ali Fisk
Subject: Growth strategy
Date: 6 November 2023

During recent board meetings, there has been a lot of healthy debate regarding FDM's growth plan. Zizi Zettner and Jai Williamson are of the opinion that any revenue growth targets need to be matched by an increase in headcount. On the other hand, Ron Ashton thinks that we should utilise technology to boost the productivity of our staff. I can see the merits of both and would like your opinion as to which strategy we should pursue.

A: Recruit for growth (views of Zizi Zettner and Jai Williamson)

The strategy of recruiting for growth has enabled FDM to achieve high levels of revenue and profit growth and will continue to do so going forward.

The targeted annual increase in revenue for the year ended 30 September 2024 should be 30% and this growth should come equally from all client sizes.

The headcount target and staff recruitment strategy should be based on AMFIH remaining at £7.8k.

GPM for all client sizes will remain at 2023 levels.

B: Technology-driven growth strategy (view of Ron Ashton)

Several martech applications (including JetStream) should be implemented to boost staff productivity, increase revenue and improve profit margins.

By gathering and analysing large volumes of advertising campaign data, we can increase the effectiveness of future campaigns that FDM runs for its clients. This will result in higher revenue for FDM via performance-based fees and cross-selling other services. We can also analyse confidential operational data that our clients share and build this into a dataset.

The need for staff time will reduce because martech can create, manage and run campaigns. We can restructure the staff hierarchy so that we have fewer team members and more team leaders and managers. The most efficient way to do this is to understaff so that only the best staff stay and fill the new team leader and manager roles.

To improve staff productivity further, we should remove the 15% non-billable allowance so that all staff time is billed to clients.

To reduce costs further, we should relocate the office to Manchester where salaries are lower. London-based staff who stay with FDM can work remotely and collaborate with colleagues and clients via JetStream.

We should aim to implement these proposals by January 2024. As it will take time for the benefits to be fully realised, the targeted annual increase in revenue for 2024 should be 20% (coming equally from all client sizes).

The net effect of the staff changes will be that headcount reduces to 100 in 2024.

Increased productivity and cost savings will result in GPM improvements as follows:

Client size	Increase in GPM from 2023 GPM
Major	4%
Large	5%
Medium	7%
Small	9%

The increase in gross profit margin is greatest for small clients because the higher absolute number of clients in this category means that more data will be gathered on campaigns for small clients.

The profit margin benefit will increase in future years as the data and technology is leveraged and scaled to generate higher revenues and improve productivity.

EXHIBIT 19b

Staff committee meeting notes (October 2023)

Peter Alistair (manager) raised a concern that lots of staff feel stressed because they have too much work. Many are working well in excess of their contractual hours and regularly work at home in the evenings and weekends. He pointed out that most staff he has spoken with said that they like the work and that the job pays well but they are concerned about the long-term impact of long hours on their health and personal lives.

Peter also raised a matter about Brienne Saffire's recent appearance on a popular television chat show where she appeared to imply that her future was away from FDM and would be looking to do more media appearances once she had "sold up". Peter said there are now a lot of rumours among staff that FDM is up for sale.

Zizi Zettner said both these matters would be investigated and followed up at the next meeting.

EXHIBIT 19c

Cloud hacking
(Tech Wizz, July 2023)

As businesses make increased use of cloud services, the risk of those services being hacked also increases. Despite cloud service providers having extensive security procedures in place, sophisticated hackers can find a way through and access highly confidential data. With data being described as 'the new gold', this can prove very valuable to the culprits whilst leaving the victim exposed to the adverse impact of a data breach.

Mock Exam 1 Mark Scheme

OVERALL ASSESSMENT CRITERIA	EXECUTIVE SUMMARY
	R1 - Review of financial performance
(A) Report structure: disclaimer AND from firm AND headings **(B)** Report language: formal AND tactful AND ethical	**(A)** Qualitative comment on total revenue **with fig** **(B)** Qualitative comment on rev by client size **with fig** **(C)** Qualitative comment on GP/GP% **with fig** **(D)** Qualitative comment on OP/OP% **with fig**
	(A) Staff: consult on any changes **(B)** Clients: rebalance mix / win back lost clients **(C)** Request: advises on proposals with reason **(D)** Appropriate summary of report section

R2 - Evaluation of BOL proposal	R3 - Evaluation of strategy
(A) Compares revenue and GP for (A) AND (B) with **figs** **(B)** Evaluates/questions assumptions **(C)** Concludes on main risk **(D)** Get back up for all estimates	**(A)** Gives revenue and GP for both strategies **(B)** Concludes on ethical/business trust issues **(C)** Concludes on main financial/operational/strategic impact **(D)** Headcount strategy gives higher revenue / Martech strategy higher GP/GP%/AMFIH
(A) Concludes on way forward with reason **(B)** Negotiate T&C / DD on BOL / discuss with Sublime **(C)** Consider staff capacity **(D)** Appropriate summary of report section	**(A)** Concludes on way forward with reason **(B)** Prepare longer forecast **(C)** Consult staff on any changes **(D)** Appropriate summary of report section

REQUIREMENT 1 – Review of FDM financial performance and request for advice

ASSIMILATING & USING INFORMATION	STRUCTURING PROBLEMS & SOLUTIONS
Appendix 1 **(A)** Analysis of staff KPIs eg headcount increase, attrition **(B)** Analysis of client churn % **(C)** Analysis of costs	**Financial analysis: Revenue (report)** **(A)** Major: up **£594k / 28.7%** **(B)** Large up **£549k / 26.5%** **(C)** Medium: up **£772k / 38.9%** **(D)** Small: up **£802k / 37.3%** **(E)** AMFIH: down **£7.8k v £8.1k** **(F)** Mix: Major **24.2% v 25.0%** / Large **23.8% v 25.0%** / Medium **25.1% v 24.0%** / Small **26.9% v 26.0%**
AI/CS Exam info (report/appendix) **(A)** Overall revenue: up **£2,717k / 32.8%** **(B)** Overall COS: up **£1,576k / 31.3%** **(C)** Overall GP: up **£1,141k / 35.2% /** GP%: **39.8% v 39.1%** **(D)** Admin: up **£279k / 30.7%** **(E)** OP: up **£862k / 37.0%** / OP% **29.0% v 28.2%**	**Financial analysis: GP/OP (report)** **(A)** Major: GP up **£186k/31.6%** / GP% **29.1% v 28.5%** > **(B)** Large: GP up **£200k/27.6%** / GP% **35.3% v 35.0%** > **(C)** Medium: GP up **£233k/27.3%** / GP% **39.4% v 43.0%** > **(D)** Small: GP up **£522k/48.8%** / GP% **53.9% v 49.7%** > **(E)** Billable: up **£1,482k/45.2%** OR Other: up **£94k/5.4%** **(F)** Admin: up **£279k / 30.7%** >
Business issues / wider context **(A)** Impact of COVID-19 on business / fragile economy / growth in online activity **(B)** Industry averages: CAGR growth >10% **(C)** Attrition: down **10.6% v 11.8%** / **18.8% v 26.5%** / below target **(D)** Headcount: up total **117 v 85 / 37.6%** / above target	**Request for advice (report)** **(A)** Reduced rental expense will increase OP > **(B)** Support staff expense impacts OP > **(C)** Payment in advance is deferred income / no OP impact > **(D)** Lower depr will increase OP > **(E)** Higher AMFIH will help increase OP > **(F)** Bonus will reduce OP >

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<tr><th>APPLYING JUDGEMENT</th><th>CONCLUSIONS AND RECOMMENDATIONS</th></tr>
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Evaluation of revenue analysis

(A) Total revenue: faster growth **32.8%** than last year **22.4%** / **under** target of **35%/£11,167k** / **above 10%** industry CAGR

(B) Major/large: higher churn **with fig** / new client > average / junior staff

(C) Small/medium: cross-selling / performance-based fees / lower churn **with fig** / Compere

(D) Major/large: below target OR Small/medium: above target

(E) Growth due to headcount / headcount above target / AMFIH below target / recruiting ahead of revenue

(F) Client losses compensated with new clients / mix deviated from target

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Draws conclusions (under a heading)

(A) Qualitative comment on total revenue **with fig**

(B) Qualitative comment on COS/GP/GP% **with fig**

(C) Qualitative comment on admin/OP/OP% **with fig**

(D) Qualitative comment on advice request

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Evaluation of GP/OP analysis

(A) Change in COS compared to change in revenue / GP%: client mix impact/lower AMFIH

(B) Major/large: junior staff lower cost

(C) Medium: unsuccessful campaigns / performance-based high risk

(D) Small: higher GP% paid search mgt/performance-based pricing

(E) Billable: avg. cost **with fig** OR Other: recruitment up/fixed cost element

(F) OP% below 30% target

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Makes recommendations

(A) Analyse revenue/GP by client

(B) Clients: rebalance mix / win back lost clients

(C) Focus on improving AMFIH / slow headcount growth

(D) Pricing changes eg performance-based / charge rates

(E) Cross-sell more paid ad mgt / higher value services

(F) Other commercial recommendations

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Evaluation on request for advice

(A) Identify required space / consult staff / find alternative offices

(B) Support staff facilitate billable work / support staff have lower cost / increases billable staff workload / forecast workloads

(C) Will reduce OP as discount results in lower revenue

(D) May be unacceptable to staff / depr’ impact will take time

(E) Will increase pressure on staff / target must be achievable

(F) Forecast overall impact on OP (higher AMFIH and bonus)

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REQUIREMENT 2 – Evaluation of BOL proposal

ASSIMILATING & USING INFORMATION	STRUCTURING PROBLEMS & SOLUTIONS
Appendix 2 **(A)** Numbers clearly derived **(B)** Calculation for alternatives (A) AND (B) **(C)** Sensitivity analysis	**Calc of fee on performance basis (appendix)** **(A)** Leads: 49,500 AND 66,000 AND 82,500 **(B)** Conversions: 4,950 AND 6,600 AND 8,250 **(C)** FDM revenue: £193,050 AND £257,400 AND £321,750 **(D)** FDM GP: £43,050 AND £107,400 AND £171,750 **(E)** LTV: £537,000
Calc of fee on charge-out rates (appendix) **(A)** Charge out rates: £192 AND £184 AND £80 AND £60 **(B)** Hours: 15 AND 35 AND 45 AND 80 **(C)** Total fee: £212,640 **(D)** GP: £62,640 **(E)** LTV: uses 5 / 20% **(F)** LTV: £313,200	**Assumptions** **(A)** Reach: 500k v Sublime: 400k > **(B)** Bounce rate: 45% v Sublime: 50% > **(C)** Questions use of probabilities > **(D)** Average revenue: £650 v Sublime: £600 > **(E)** Revenue will depend on success of BOL business **(F)** LTV depends on churn rate >
Business issues / wider context **(A)** Inflation currently high / future uncertainty **(B)** BOL: store bed retailer / FDM in strong negotiating position **(C)** Risks: failure to win new clients / margin dilution / revenue more important than short-term profitability **(D)** FDM a/cs: revenue target missed / increased churn rate on major clients	**Commercial issues and risks** **(A)** BOL and Sublime are competitors > **(B)** Staff: requires a lot of resource > **(C)** Payment terms: risk for FDM / healthy cash balance **(D)** Knowledge obtained can be used on other clients > **(E)** Performance-based has lower churn > **(F)** BOL revenue declining / Sublime increasing / 50% mattress purchases online >

APPLYING JUDGEMENT	CONCLUSIONS AND RECOMMENDATIONS
Evaluation of calcs **(A)** Comment on relative size / major client / biggest client **(B)** Compares GP% to 2023 / Sublime **(C)** May resist future price increases / costs reduce over time **(D)** Time estimates may be unreliable / SEO straightforward **(E)** Performance-based pricing is higher risk / upside and downside risk / 6% v 5% Sublime **(F)** Any further changes in assumptions will impact calculations eg pay increases, cost of purchase	**Draws conclusions (under a heading)** **(A)** Compares revenue and GP for (A) AND (B) with **figs** **(B)** Evaluates/questions assumptions **(C)** Concludes on commercial issue and risk **(D)** Concludes on way forward **with reason**
Evaluation of assumptions **(A)** Some work takes time to see results eg SEO **(B)** Lower than sector average (50%) **(C)** Performance based higher GP in most likely/70% chance **(D)** Figures provided by BOL / potential bias / BOL a/s suggest lower **with fig** **(E)** No accounting for inflation / staff salaries increase **/** FDM manager charge-out rate high **(F)** Churn rate for major clients is volatile / implies 20% churn / retention may rely on manager staying at FDM	**Makes recommendations** **(A)** Negotiate T&C eg auditor for attributable revenue **(B)** DD on BOL **(C)** Check staff capacity / set timetable for activities **(D)** Get back up for all estimates / marketing claims **(E)** Speak with Sublime **(F)** Other commercial recommendations
Evaluation of commercial issues and risks **(A)** May need non-disclosure agreements / conflicting claims / competing for same advertising space/keywords **(B)** Opportunity for staff development / utilises excess capacity **(C)** May be difficult calculating attributable revenue **(D)** Major clients enhance FDM reputation / brand **(E)** Potential for additional work **(F)** Declining BOL revenue means lower fees for FDM	

REQUIREMENT 3 – Evaluation of strategy

ASSIMILATING & USING INFORMATION	STRUCTURING PROBLEMS & SOLUTIONS
Workings / report **(A)** Numbers clearly derived **(B)** Calculation for alternatives (A) AND (B) **(C)** Uses 2023 figures as starting point **(D)** Sensitivity analysis	**Calc of GP: productivity growth** **(A)** Revenue: £3,194k AND £3,140k AND £3,308k AND £3,544k / £13,187k (accept rounding) **(B)** Headcount: 100 **(C)** AMFIH: £11.0k (accept rounding) **(D)** GP: applies 2023 GP% + 4% AND 5% AND 7% AND 9% **(E)** Overall GPM: 46.2% (accept rounding)
Calc of GP: headcount growth **(A)** Revenue: £3,461k AND £3,402k AND £3,584k AND £3,839k / £14,286k (accept rounding) **(B)** Headcount: 152 or 153 **(C)** AMFIH: £7.8k **(D)** GP: applies 2023 GP% for each client size **(E)** Overall GPM: 39.8% (accept rounding)	**Strategic and operational issues** **(A)** Martech: leverages technology / scalability > **(B)** Management of staff is resource intensive eg management time, development, training > **(C)** Relocation: disruption / cost / major change > **(D)** Changes will impact clients / could increase churn > **(E)** Increased cross-selling **(F)** Impact on staff morale / engagement
Business issues / wider context **(A)** Inflation currently high / future uncertainty **(B)** Risk: not achieving staff targets **(C)** Past strategy: recruit for growth / headcount enabler of growth / overstaffing preferred / revenue growth over profitability **(D)** Martech: Tribalist has proprietary platform / JetStream: remote working/collaboration/cloud-based **(E)** Bank balance: £3,223k	**Comments on ethical/bus trust issues** **(A)** Staff: understaffing will create pressure / reports of stress/overworked > **(B)** Staff: reducing non-billable time / reduces CSR work > **(C)** Data security: risk of data loss / fines > **(D)** Data use: risk of unauthorised use of confidential data > **(E)** Brienne Saffire implied FDM may be sold >

APPLYING JUDGEMENT	CONCLUSIONS AND RECOMMENDATIONS
Financial issues / assumptions **(A)** Headcount strategy gives higher revenue / Martech strategy higher GP/GP%/AMFIH **(B)** Previous forecasting accurate / AMFIH declining / growth without any headcount increase seems ambitious **(C)** Martech: investment / FDM has sufficient cash **(D)** One year forecast not long enough to evaluate this **(E)** Missing costs e.g. change of staff level mix **(F)** Any further changes in assumptions will impact calculations	**Draws conclusions (under a heading)** **(A)** Gives revenue and GP for both scenarios **(B)** Evaluates/questions assumptions **(C)** Concludes on main operational/strategic issue **(D)** Concludes on ethics/business trust issues **(E)** Concludes on way forward with reason
Strategic and operational impact **(A)** Future impact e.g. margin improvement, revenue growth **(B)** Staff costs increasing / upward pressure on wages **(C)** Long-term saving / Manchester digital centre **(D)** Collaboration could help build relationships / reduce churn **(E)** Requires skills to use data effectively **(F)** Short timescale (Jan 2024)	**Makes recommendations** **(A)** Discuss with staff / staff committee **(B)** Negotiate T&C with JetStream **(C)** Prepare longer forecast **(D)** Research alternatives to JetStream / trial use **(E)** Identify other costs eg staff training **(F)** Other commercial recommendations
Evaluation/recs: ethical/business trust **(A)** Ensure expectation fair / work-life balance / plan workloads **(B)** Staff impact / FDM reputational impact **(C)** DD on JetStream / security procedures **(D)** Client agreement / GDPR compliance **(E)** Board to discuss / legal advice / discuss with staff / make decision on future / Ron Ashton suggestions not short term	

Mock Exam 1 Model Answer

A report on FDM

TO: Directors of FDM
FROM: Newell Mast
DATE: 8 November 2023

This report is for the Board of FDM only and should not be distributed to third parties. No liability can be accepted in this event.

Executive Summary

Review of Financial Performance for Year Ended 30 September 2023

Overall revenue increased impressively by £2,717k (32.8%) to £10,989k which is below the target of 35%/£11,167k. AMFIH was £7.8k (3.5% decrease) which is below the target of £8.1k and the previous peak of £8.9k, whereas headcount of 117 (37.6% increase) is above the target of 115 which shows that the revenue target not being achieved was due to AMFIH. Churn has decreased to 8.9% from 15.2%. Major account revenue increased substantially by £594k (28.7%) but is below the target of £2,792k due to new client wins being offset by losses due to some clients not being happy with more junior staff on the team. Large account revenue increased substantially by £549k (26.5%) and is also below the target of £2,792k. Medium account revenue increased impressively by £772k (38.9%) and is above the target of £2,680k due to more paid advertising management work. Small account revenue increased the most by £802k (37.3%) and is above (below) the target of £2,903k.

Overall GP increased impressively by £1,141k (35.2%) to £4,378k with GPM increasing to 39.8% from 39.1% due to a revenue mix shift towards higher margin small/medium clients, a revenue mix shift towards higher margin paid search management work, more work based on performance fee billing and despite an AMFIH decrease due to recruiting ahead of revenue. GPM has continued to increase. Major GP increased impressively by £186k (31.6%), with a GPM increase to 29.1% from 28.5%, due to clients being staffed with juniors who have a lower cost. Large GP increased significantly by £200k (27.6%), with a GPM increase to 35.3% from 35%. Medium GP saw the weakest growth with £233k (27.3%) and a disappointing GPM decrease to 39.4% from 43% due to unsuccessful performance-based pricing campaigns. Small GP saw the strongest growth with £522k (48.8%), with a GPM increase to 53.9% from 49.7%, due to higher margin paid search management. Small accounts for 36.4% (22: 33.1%) which shows the increasing importance of small clients. OP has increased impressively by £862k (37%) to £3,191k, with an OPM increase to 29% (22: 28.2%) which is below the 30% target, due to the revenue mix shift away from demanding major/large clients. OPM has continued to increase.

The reduced rent expense will help increase OP. Staff bonus based on AMFIH will motivate staff and a higher AMFIH will help increase OP. The bonus will be an expense that will reduce OP. Payments in advance are deferred income so this will not increase OP.

RECOMMENDATIONS

Survey staff to identify exactly how much space will be needed.
Introduce performance bonus based on AMFIH target.
Rebalance client mix by targeting large and major clients.
Slow recruitment to reduce risk of over staffing.
Cross-sell more non-SEO work to improve margins.

**highlighted text demonstrates key points to bring to the attention of the directors. These were not included in the conclusions and were added to the Executive Summary.*

EVALUATION OF BOL PROPOSAL

Under Alternative A, annual revenue will be £212,640 and GP will be £62,640, with a GPM of 29.5%. Potential LTV is £313,200. Under Alternative B, annual revenue will be £257,400 (most likely), £193,050 (worst case) or £321,750 (best case). GP will be £107,400 (GPM 41.7%), £43,050 (GPM 22.3%) or £171,750 (GPM 53.4%). Potential LTV is £537,000 on the most likely basis assuming a 20% churn rate. Other than Alternative B in a worst-case scenario, BOL will be largest client (major typically £80-210k) and will deliver more revenue, GP and higher GPM than Sublime (£150k revenue, 29% GPM). Client servicing costs typically reduce over time which will increase margins. GPM under both alternatives is higher than major average (29.1%).

Hours may be higher or lower because the work involves more than SEO so may not be straightforward and accurate to predict. Bounce rate is likely to be higher because it was 50% for Sublime and 50% is the sector average. Churn is likely to be different from 20% because it can be erratic for major clients. Also, lifetime is likely to depend on how long the manager stays with FDM. The calculation uses probabilities which are simplified estimates. The actual outcome is likely to be different. Any further changes to the assumptions will cause the results to change. Adjusting the average selling price to £625 in line with BOL's accounts changes the expected revenue to £247,500 and GP to £97,500 on a most likely basis.

Alternative B has potential for much higher revenue and profits but also downside risk if BOL's revenue is lower than estimated. FDM could make a loss with Alternative B but A is guaranteed to deliver a profit. However, there is a 70% probability that B will deliver higher revenue and profit. Another major client will help maximise staff utilisation and increase AMFIH. However, if there is not sufficient capacity this could increase pressure on staff and detract from other clients. BOL and Sublime are competitors so this creates a conflict of interest for FDM because they will be competing for the same ad space and keywords. Disclosure agreements and separate teams may be required which could increase costs.

BOL should propose Alternative B so that its fees are contingent as this should help build a relationship with BOL and reduce churn.

RECOMMENDATIONS

Due diligence on BOL.
Research to corroborate all estimates.
Ensure staff capacity.
Contact Sublime to ensure acceptable.

EVALUATION OF GROWTH STRATEGY
Recruit for growth forecast revenue is £14,286k and forecast GP is £5,691k (GPM: 39.8%). Technology-driven growth forecast revenue is £13,187k and forecast GP is £6,089k (GPM: 46.2%). Recruiting delivers higher revenue, but technology delivers higher GP and GPM. AMFIH has been declining in recent years and technology will reverse this decline and see it reach a record of £11.0k. Recruiting does not seem to try and improve AMFIH or margins.

The forecast period is too short to make a full assessment. Revenue growth of 20% seems ambitious for the technology option because it will take time for the benefits to have an impact. Any further changes to the assumptions will cause the results to change. If revenue growth is 0% for the technology option, then GP will only be £5,074k (GPM: 46.2%).

Recruiting is lower risk because the strategy is tried and tested. This will help predictability of revenue and profits in the short term. Using less staff and more technology will impact clients and the changes could cause client churn to increase, particularly if account managers leave or clients feel the service is no longer as good. Staff are a resource which require a lot of management time so the technology strategy should free up management time.

Understaffing will increase pressure on staff, some of whom already feel stressed. This could damage their health, increase attrition and reduce productivity. Confidential and valuable data will be held in JetStream and there are reports that cloud services are at risk of being hacked. This could cause business disruption, reputational damage, fines and a loss of clients.

FDM should continue with the recruit for growth strategy in 2024 because it appears the board want to sell in the short term and the technology strategy requires a longer horizon.

RECOMMENDATIONS
Ensure staff workloads are managed to provide a healthy work-life balance.
DD on JetStream with a focus on data security.
Discuss any changes with staff and the committee.
Survey clients about any proposed changes.
Prepare longer forecasts.

APPENDIX 1: Analysis of Management Accounts

	2023	2022	Change (£k)	Change (%)
REVENUE				
Major	£2,662	£2,068	£594	28.7%
Large	£2,617	£2,068	£549	26.5%
Medium	£2,757	£1,985	£772	38.9%
Small	£2,953	£2,151	£802	37.3%
TOTAL	**£10,989**	**£8,272**	**£2,717**	**32.8%**
Mix				
Major	24.2%	25.0%	-0.8%	
Large	23.8%	25.0%	-1.2%	
Medium	25.1%	24.0%	1.1%	
Small	26.9%	26.0%	0.9%	
Headcount	117	85	32	37.6%
Billable	102	72	30	41.7%
Support	15	13	2	15.4%
AMFIH	£7.8	£8.1	-£0.3	-3.5%
Attrition rate (9/85)	10.6%	11.8%	-1.2%	
Left	9	8	1	12.2%
Attrition rate: revised (16/85)	18.8%	26.5%	-7.7%	
Joined and left	7	10	-3	-30.0%
Total left	16	18	-2	-11.2%
Client churn				
Total	8.9%	15.2%	-6.3%	
Clients lost (churn*at start)	31			
Clients at start (approx.)	349			
Major	21.4%	8.3%	13.1%	
Clients lost	3			
Clients at start (approx.)	14			
Large	12.2%	5.7%	6.5%	
Clients lost	5			
Clients at start (approx.)	41			
Medium	7.6%	11.8%	-4.2%	
Clients lost	6			
Clients at start (approx.)	79			
Small	7.9%	19.5%	-11.6%	
Clients lost	17			
Clients at start (approx.)	215			

COS				
Billable staff	£4,762	£3,280	£1,482	45.2%
Other	£1,849	£1,755	£94	5.4%
TOTAL	**£6,611**	**£5,035**	**£1,576**	**31.3%**
% of revenue				
Billable staff	43.3%	39.7%	3.7%	
Other	16.8%	21.2%	-4.4%	
	60.2%	60.9%	-0.7%	
Mix				
Billable staff	72.0%	65.1%	6.9%	
Other	28.0%	34.9%	-6.9%	
Avg. billable staff cost	£46.7	£45.6	£1.1	2.5%
GP				
Major	£775	£589	£186	31.6%
Large	£924	£724	£200	27.6%
Medium	£1,087	£854	£233	27.3%
Small	£1,592	£1,070	£522	48.8%
TOTAL	**£4,378**	**£3,237**	**£1,141**	**35.2%**
GPM				
Major	29.1%	28.5%	0.6%	
Large	35.3%	35.0%	0.3%	
Medium	39.4%	43.0%	-3.6%	
Small	53.9%	49.7%	4.2%	
TOTAL	**39.8%**	**39.1%**	**0.7%**	
Mix				
Major	17.7%	18.2%	-0.5%	
Large	21.1%	22.4%	-1.3%	
Medium	24.8%	26.4%	-1.6%	
Small	36.4%	33.1%	3.3%	
ADMIN AND SELLING	£1,187	£908	£279	30.7%
% of revenue	10.8%	11.0%	-0.2%	
OP	£3,191	£2,329	£862	37.0%
OPM	29.0%	28.2%	0.8%	

Review of Financial Performance for Year Ended 30 September 2023

REVENUE

Overall revenue increased impressively by £2,717k (32.8%) to £10,989k which is below the target of 35%/£11,167k but above the market CAGR which is around 10%. AMFIH was £7.8k (3.5% decrease) which is below the target of £8.1k and the previous peak of £8.9k, whereas headcount of 117 (37.6% increase) is above the target of 115 which shows that the revenue target not being achieved was due to AMFIH. Staff capacity is an enabler of revenue growth, therefore the higher headcount leaves FDM well placed for future growth. The fragile economy may have had a negative impact, so the fact that the rate of growth is increasing (2022: 22.4%) is excellent. Revenue from all client sizes has increased. Many businesses have shifted towards a digital model due to the impact of COVID-19 and this has increased demand for digital marketing. Churn has decreased to 8.9% from 15.2%.

Major account revenue increased substantially by £594k (28.7%) but is below the target of £2,792k due to new client wins being offset by losses due to some clients not being happy with more junior staff on the team. Revenue from AI-Reach (£172k) is expected to be higher than the typical average (£150k). Churn has increased to 21.4% from 8.3% due to clients not being happy with the staff changes. Churn can be erratic because MNCs have low switching costs and there are a small number of clients in this category.

Large account revenue increased substantially by £549k (26.5%) and is also below the target of £2,792k for the same reason as major. Revenue from Supersave (£68k) is expected to be higher than the typical average (£50k). Churn has increased to 21.4% from 5.7% for the same reason as major.

Medium account revenue increased impressively by £772k (38.9%) and is above the target of £2,680k due to more paid advertising management work and a highly successful campaign for Compere. Churn has decreased to 7.6% from 11.8% due to performance-based pricing reducing client churn.

Small account revenue increased the most by £802k (37.3%) and is above the target of £2,903k also due to more paid advertising management work. Churn has decreased to 7.9% from 19.5% because churn for clients on performance-based pricing is lower (estimated at 5%).

Major accounts for 24.2% (22: 25.0%) of revenue, large 23.8% (22: 25.0%), medium 25.1% (22: 24.0%) and small 26.9% (22: 26.0%) which is not in line with the 25% target. A range of client sizes helps staff retention via career progression.

GROSS PROFIT

COS increased by £1,576k (31.3%) due to an increase in all costs but increased slower than revenue which will have a positive impact on GPM.

Billable staff increased by £1,482k (45.2%) due to salary increases and is now 43.3% (22: 39.7%) of revenue. Average billable staff cost has increased by 2.5% to £46.7k (22: £45.6k) which shows that the increase was due to salary increase and headcount. Attrition rate has decreased to 10.6% from 11.8% with the revised rate now 18.8% (22: 26.5%) due to increased WFH and is below the sector average of 30%. There is upward pressure on wages as high-skilled staff are in high demand.

Other costs increased by £94k (5.4%) due to recruitment fees for the increased headcount.

Overall GP increased impressively by £1,141k (35.2%) to £4,378k with GPM increasing to 39.8% from 39.1% due to a revenue mix shift towards higher margin small/medium clients, a revenue mix shift towards higher margin paid search management work, more work based on performance fee billing and despite an AMFIH decrease due to recruiting ahead of revenue. GPM has continued to increase.

Major GP increased impressively by £186k (31.6%), with a GPM increase to 29.1% from 28.5%, due to clients being staffed with juniors who have a lower cost.

Large GP increased significantly by £200k (27.6%), with a slight GPM increase to 35.3% from 35%, for the same reason as major.

Medium GP saw the weakest growth with £233k (27.3%) and a disappointing GPM decrease to 39.4% from 43% due to unsuccessful performance-based pricing campaigns.

Small GP saw the strongest growth with £522k (48.8%), with a GPM increase to 53.9% from 49.7%, due to higher margin paid search management and more work based on performance fee billing. Small accounts for 36.4% (22: 33.1%) which shows the increasing importance of small clients.

OPERATING PROFIT

Admin and selling increased by £279k (30.7%) and increased slower than revenue which will have a positive impact on OPM.

OP has increased impressively by £862k (37%) to £3,191k, with an OPM increase to 29% (22: 28.2%) which is below the 30% target, due to the revenue mix shift away from demanding major/large clients who increase overheads. OPM has continued to increase.

REQUEST FOR ADVICE

The reduced rent expense will help increase OP. The saving will depend on the amount of office space required i.e. number of employees who plan to come to the office.

Reducing support staff will increase the workload of billable staff and this will either result in them working longer hours or doing less billable work (resulting in lower revenue and OP). Support staff are paid less than billable staff so getting billable staff to do support work is not efficient. Fewer support staff will also restrict future growth.

Payments in advance are deferred income so this will not increase OP. In fact, it will reduce OP because the revenue (when recognised) will be 15% lower.

Reduced capex will result in lower future depr so will increase OP. However, the benefit will be over the UEL of assets and not immediate. This may also be unacceptable to staff, and they may expect a pay increase to cover the cost of equipment which will negate any benefit.

Staff bonus based on AMFIH will motivate staff and a higher AMFIH will help increase OP. The bonus will be an expense that will reduce OP.

<u>RECOMMENDATIONS</u>

Survey staff to identify exactly how much space will be needed.
Research alternative office costs.
Forecast workloads to see if any efficiencies can be made.
Do not offer discount for advanced payment as additional cash not needed at present.
Discuss with staff to see if feasible.
Calculate target AMFIH to reach target OP.

<u>CONCLUSIONS</u>

Overall revenue increased impressively by £2,717k (32.8%) to £10,989k which is below the target of 35%/£11,167k. Major account revenue increased substantially by £594k (28.7%) but is below the target of £2,792k due to new client wins being offset by losses due to some clients not being happy with more junior staff on the team. Large account revenue increased substantially by £549k (26.5%) and is also below the target of £2,792k. Medium account revenue increased impressively by £772k (38.9%) and is above the target of £2,680k due to more paid advertising management work. Small account revenue increased the most by £802k (37.3%) and is above (below) the target of £2,903k.

Overall GP increased impressively by £1,141k (35.2%) to £4,378k with GPM increasing to 39.8% from 39.1% due to a revenue mix shift towards higher margin small/medium clients. Major GP increased impressively by £186k (31.6%), with a GPM increase to 29.1% from 28.5%, due to clients being staffed with juniors who have a lower cost. Large GP increased significantly by £200k (27.6%), with a GPM increase to 35.3% from 35%. Medium GP saw the weakest growth with £233k (27.3%) and a disappointing GPM decrease to 39.4% from 43% due to unsuccessful performance-based pricing campaigns. Small GP saw the strongest growth with £522k (48.8%), with a GPM increase to 53.9% from 49.7%, due to higher margin paid search management.

OP has increased impressively by £862k (37%) to £3,191k, with an OPM increase to 29% (22: 28.2%) which is below the 30% target, due to the revenue mix shift away from demanding major/large clients

The reduced rent expense will help increase OP. Staff bonus based on AMFIH will motivate staff and a higher AMFIH will help increase OP. The bonus will be an expense that will reduce OP.

<u>RECOMMENDATIONS</u>

Revenue and profit analysis by client.
Increase charge-out rates.
Rebalance client mix by targeting large and major clients.
Increase use of performance-based pricing for large/major to reduce churn.
Introduce performance bonus based on AMFIH target.
Slow recruitment to reduce risk of over staffing.
Cross-sell more non-SEO work to improve margins.
Exit interviews to identify reasons for leaving.

APPENDIX 2: BOL

A: Billable hours and charge-out rates				
	£ per hour (W1)	Hours pm	PM	PA
Director	£192	15	£2,880	£34,560
Manager	£184	35	£6,440	£77,280
Team leader	£80	45	£3,600	£43,200
Team member	£60	80	£4,800	£57,600
Revenue			£17,720	£212,640
Costs			-£12,500	-£150,000
GP			£5,220	£62,640
GPM			29.5%	29.5%
LTV:				
GP pa	£62,640			
Lifetime (w1)	5			
	£313,200			
Lifetime (w1)				
Churn rate	20%			
	5			
2023 (W1)	80% (20% discount)			
£240	£192			
£230	£184			
£100	£80			
£75	£60			

B: Performance-based pricing				
	Reach	6,000,000	500,000	12
10%	Visitors	600,000		
	Bounce	45%		
55%	Stay	330,000		
		Worst	**Most likely**	**Best**
	Leads probability	**30%**	**55%**	**15%**
	Leads %	15%	20%	25%
	Leads	49,500	66,000	82,500
10%	Conversions	4,950	6,600	8,250
£650	Client revenue	£3,217,500	£4,290,000	£5,362,500
6%	FDM revenue	£193,050	£257,400	£321,750
	FDM costs	-£150,000	-£150,000	-£150,000
	FDM GP	£43,050	£107,400	£171,750
	FDM GPM	22.3%	41.7%	53.4%

Revenue required to match A	£212,640	£3,544,000
	6%	
LTV:		
GP pa	£107,400	
Lifetime (w1)	5	
	£537,000	

Sensitivity				
	Reach	6,000,000	500,000	12
10%	Visitors	600,000		
	Bounce	45%		
55%	Stay	330,000		
		Worst	Most likely	Best
	Leads probability	**30%**	**55%**	**15%**
	Leads %	15%	20%	25%
	Leads	49,500	66,000	82,500
10%	Conversions	4,950	6,600	8,250
£625	Client revenue	£3,093,750	£4,125,000	£5,156,250
6%	FDM revenue	£185,625	£247,500	£309,375
	FDM costs	-£150,000	-£150,000	-£150,000
	FDM GP	£35,625	£97,500	£159,375
	FDM GPM	19.2%	39.4%	51.5%

BOL	2023	2022
Revenue	£31,250	£36,000
Bed	50	56
Avg. price	£625	£643

EVALUATION OF BOL PROPOSAL

CONTEXT

FDM is in a strong negotiating position because BOL wants to work with one of FDM's new employees.

The engagement will involve a range of services so FDM will develop capabilities in different areas.

Failure to win new clients was an identified risk and winning BOL as a client mitigates that risk.

The fragile UK economy may cause BOL's sales to be lower which will reduce FDM revenue. High inflation may increase salaries which will reduce FDM's profit.

RESULTS AND FINANCIAL ANALYSIS

Under Alternative A, annual revenue will be £212,640 and GP will be £62,640, with a GPM of 29.5%. Potential LTV is £313,200.

Under Alternative B, annual revenue will be £257,400 (most likely), £193,050 (worst case) or £321,750 (best case). GP will be £107,400 (GPM 41.7%), £43,050 (GPM 22.3%) or £171,750 (GPM 53.4%). Potential LTV is £537,000 on the most likely basis assuming a 20% churn rate.

Alternative B delivers higher revenue, GP and GPM in all cases except the worst case.

The work will contribute to revenue and profit targets/KPIs being met.

Other than Alternative B in a worst-case scenario, BOL will be largest client (major typically £80-210k) and will deliver more revenue, GP and higher GPM than Sublime (£150k revenue, 29% GPM).

A new major client will help rebalance revenue mix back towards the 25% target.

There is potential to sell more services in the future.

Client servicing costs typically reduce over time which will increase margins.

GPM under both alternatives is higher than major average (29.1%).

Payment terms are unfavourable compared with other clients such as Compere and Sublime. However, FDM has sufficient cash (£3,223k).

ASSUMPTIONS AND SENSITIVITY ANALYSIS

Charge-out rates may be lower because BOL may insist on a bigger discount, particularly the manager rate which is a very large increase from 2022 (£115).

Charge-out rates will be higher in later years because FDM attempts to increase them each year, although larger clients often resist increases.

Hours may be higher or lower because the work involves more than SEO so may not be straightforward and accurate to predict.

Costs may be higher because staff may demand pay rises.

Churn is likely to be different from 20% because it can be erratic for major clients and should be lower for performance-based pricing. Also, lifetime is likely to depend on how long the manager stays with FDM.

Reach is likely to be lower because it was 400k pm for Sublime.

Bounce rate is likely to be higher because it was 50% for Sublime and 50% is the sector average.

BOL revenue is likely to be lower because its revenue is declining, and the average selling price was £625 in 2023. This will cause FDM revenue and profit to be lower.

BOL may have overinflated the estimates to present its performance in more favourable light and make the proposal appear attractive to FDM.

There will be additional costs (e.g. support staff) which need to be considered.

The calculation uses probabilities which are simplified estimates. The actual outcome is likely to be different.

Any further changes to the assumptions will cause the results to change. Adjusting the average selling price to £625 in line with BOL's accounts changes the expected revenue to £247,500 and GP to £97,500 on a most likely basis.

COMMERCIAL CONSIDERATIONS AND RISKS

BOL and Sublime are competitors so this creates a conflict of interest for FDM because they will be competing for the same ad space and keywords. Disclosure agreements and separate teams may be required which could increase costs.

Another major client will help maximise staff utilisation and increase AMFIH. However, if there is not sufficient capacity this could increase pressure on staff and detract from other clients.

Alternative B has potential for much higher revenue and profits but also downside risk if BOL's revenue is lower than estimated. FDM could make a loss with Alternative B but A is guaranteed to deliver a profit. However, there is a 70% probability that B will deliver higher revenue and profit.

Alternative B will help build a better relationship with BOL because the fee is contingent. This helps reduce churn so should increase LTV of B.

It may be difficult to measure attributable revenue because the work does not only involve ad campaigns. This could cause disagreement between BOL and FDM and potentially lower revenue/profit for FDM.

CONCLUSIONS

Under Alternative A, annual revenue will be £212,640 and GP will be £62,640, with a GPM of 29.5%. Potential LTV is £313,200.

Under Alternative B, annual revenue will be £257,400 (most likely), £193,050 (worst case) or £321,750 (best case). GP will be £107,400 (GPM 41.7%), £43,050 (GPM 22.3%) or £171,750 (GPM 53.4%). Potential LTV is £537,000 on the most likely basis assuming a 20% churn rate.

Hours may be higher or lower because the work involves more than SEO so may not be straightforward and accurate to predict. Bounce rate is likely to be higher because it was 50% for Sublime and 50% is the sector average.

Any further changes to the assumptions will cause the results to change. Adjusting the average selling price to £625 in line with BOL's accounts changes the expected revenue to £247,500 and GP to £97,500 on a most likely basis.

Alternative B has potential for much higher revenue and profits but also downside risk if BOL's revenue is lower than estimated. FDM could make a loss with Alternative B but A is guaranteed to deliver a profit. However, there is a 70% probability that B will deliver higher revenue and profit.

BOL and Sublime are competitors so this creates a conflict of interest for FDM because they will be competing for the same ad space and keywords. Disclosure agreements and separate teams may be required which could increase costs.

BOL should propose Alternative B so that its fees are contingent as this should help build a relationship with BOL and reduce churn.

RECOMMENDATIONS

Negotiate on payment terms.
Due diligence on BOL.
Research to corroborate all estimates.
Set timetable for activities.
Ensure staff capacity.
Contact Sublime to ensure acceptable.

APPENDIX 3: GROWTH STRATEGY

A: Headcount growth				
	30%			
	2024 target	**2023**	**Change (£k)**	**Change (%)**
REVENUE				
Major	£3,461	£2,662	£799	30.0%
Large	£3,402	£2,617	£785	30.0%
Medium	£3,584	£2,757	£827	30.0%
Small	£3,839	£2,953	£886	30.0%
TOTAL	**£14,286**	**£10,989**	**£3,297**	**30.0%**
Headcount	153	117	36	30.8%
AMFIH	£7.8	£7.8		
GP				
Major	£1,008			
Large	£1,201			
Medium	£1,413			
Small	£2,070			
TOTAL	**£5,691**			
GPM				
Major	29.1%			
Large	35.3%			
Medium	39.4%			
Small	53.9%			
TOTAL	**39.8%**			
Headcount (W1)				
Revenue	£14,286			
AMFIH	£7.8	12	£93.6	
Headcount	152.6			

	B: Productivity growth				
		20%			
		2024 target	**2023**	**Change (£k)**	**Change (%)**
	REVENUE				
	Major	£3,194	£2,662	£532	20.0%
	Large	£3,140	£2,617	£523	20.0%
	Medium	£3,308	£2,757	£551	20.0%
	Small	£3,544	£2,953	£591	20.0%
	TOTAL	**£13,187**	**£10,989**	**£2,198**	**20.0%**
	Headcount	100	117	-17	-14.5%
	AMFIH	£11.0	£7.8		
	GP				
	Major	£1,058	£775		
	Large	£1,266	£924		
	Medium	£1,536	£1,087		
	Small	£2,229	£1,592		
	TOTAL	**£6,089**	**£4,378**		
	GPM				
4%	Major	33.1%	29.1%		
5%	Large	40.3%	35.3%		
7%	Medium	46.4%	39.4%		
9%	Small	62.9%	53.9%		
	TOTAL	**46.2%**	**39.8%**		

Sensitivity: productivity growth	
	0% rev growth
	2024 target
REVENUE	
Major	£2,662
Large	£2,617
Medium	£2,757
Small	£2,953
TOTAL	**£10,989**
Headcount	100
AMFIH	£9.2
GP	
Major	£881
Large	£1,055
Medium	£1,280
Small	£1,858
TOTAL	**£5,074**
GPM	
Major	33.1%
Large	40.3%
Medium	46.4%
Small	62.9%
TOTAL	**46.2%**

EVALUATION OF GROWTH STRATEGY

CONTEXT

Ron Ashton's operational improvements research paper proposed to invest in martech, focus on profit, understaff and consider relocating. His suggestion on strategy incorporates those proposals.

Headcount and revenue have been strongly linear and forecast revenue based on headcount growth has been accurate and reliable.

Increased costs of the London office was an identified risk and relocating to Manchester would address that risk.

The fragile UK economy may cause revenue to be lower than the forecasts.

High inflation may cause staff to demand an increase in salaries which will increase headcount costs.

RESULTS AND FINANCIAL ANALYSIS

Recruit for growth forecast revenue is £14,286k and forecast GP is £5,691k (GPM: 39.8%).

Technology-driven growth forecast revenue is £13,187k and forecast GP is £6,089k (GPM: 46.2%).

Recruiting delivers higher revenue, but technology delivers higher GP and GPM.

AMFIH has been declining in recent years and technology will reverse this decline and see it reach a record of £11.0k. Recruiting does not seem to try and improve AMFIH or margins.

Technology appears to offer a model which is easier to scale as revenue and profit margins will increase from cross-selling and higher fees rather than having to keep employing more staff.

Technology will have a significant upfront cost and running costs (maintenance and upgrades). Staff have a high cost because wages are increasing for highly skilled staff.

FDM has a large cash balance (£3,223k) which should be sufficient for the technology investment.

ASSUMPTIONS AND SENSITIVITY ANALYSIS

Revenue growth of 20% seems ambitious for the technology option because it will take time for the benefits to have an impact.

The information has been provided by board members in support of their respective views so there could be an element of unintended bias.

There is a lack of detail of exact costs for each option, particularly technology.
The forecast period is too short to make a full assessment.

The timeframes are very challenging because implementing the technology and moving to Manchester by January (in 2 months) is very ambitious.

Any further changes to the assumptions will cause the results to change. If revenue growth is 0% for the technology option, then GP will only be £5,074k (GPM: 46.2%).

STRATEGIC AND OPERATIONAL ISSUES

Recruiting is lower risk because the strategy is tried and tested. This will help predictability of revenue and profits in the short term.

Leveraging technology may enable FDM to obtain a competitive advantage over rivals. However, it appears as though Tribalist already has a platform.

Using less staff and more technology will impact clients and the changes could cause client churn to increase, particularly if account managers leave or clients feel the service is no longer as good.

Staff are a resource which require a lot of management time so the technology strategy should free up management time.

Moving to Manchester will cause a lot of disruption and incur significant cost. Some staff are also likely to be unhappy with the move.

ETHICS

The suggestion to use client's confidential operating data without their permission for purposes other than their digital marketing activities is unethical and potentially illegal. This could result in lost clients, reputational damage and fines. However, if FDM has permission then this is not an issue.

Understaffing will increase pressure on staff, some of whom already feel stressed. This could damage their health, increase attrition and reduce productivity.

Removing the 15% non-billable time will prevent staff doing socially beneficial activities e.g. charity work. This is contrary to Brienne Saffire's belief in social responsibility and will remove the reputational benefits that FDM gets from such work.

It appears the TV appearance has indicated that FDM may be sold. This may cause mistrust between staff and management and the uncertainty may demotivate staff. However, it could be a misunderstanding.

Confidential and valuable data will be held in JetStream and there are reports that cloud services are at risk of being hacked. This could cause business disruption, reputational damage, fines and a loss of clients.

RECOMMENDATIONS

Seek client permission before using their data.
Ensure staff workloads are managed to provide a healthy work-life balance.
Retain some non-billable time so staff can work on ESG projects.

Clarify with staff to avoid any confusion.
DD on JetStream with a focus on data security.

CONCLUSIONS
Recruit for growth forecast revenue is £14,286k and forecast GP is £5,691k (GPM: 39.8%).
Technology-driven growth forecast revenue is £13,187k and forecast GP is £6,089k (GPM: 46.2%).

The forecast period is too short to make a full assessment. Any further changes to the assumptions will cause the results to change. If revenue growth is 0% for the technology option, then GP will only be £5,074k (GPM: 46.2%).

Recruiting is lower risk because the strategy is tried and tested. This will help predictability of revenue and profits in the short term. Staff are a resource which require a lot of management time so the technology strategy should free up management time.

Understaffing will increase pressure on staff, some of whom already feel stressed. This could damage their health, increase attrition and reduce productivity.

FDM should continue with the recruit for growth strategy in 2024 because it appears the board want to sell in the short term and the technology strategy requires a longer horizon.

RECOMMENDATIONS
Obtain full details for costs of technology to factor into calculations.

Discuss any changes with staff and the committee.
Survey clients about any proposed changes.
Prepare longer forecasts.
Research alternatives to JetStream.
Calculate cost savings from moving to Manchester.
Negotiate with JetStream.
Implement any changes in stages.
Set timetable for activities.

ADVANCED LEVEL CASE STUDY EXAMINATION
NOVEMBER 2023
(4 HOURS)

ICAEW
PARTNER IN
LEARNING

ACA MASTERS

Case Study: Mock Exam 2

Guidance:

To obtain maximum benefit, this mock exam should be sat under full exam conditions using the practice exam software which is available from the ICAEW website. You should use the exam technique taught during the 'How to Ace the ACA Case Study' class.

Once you have completed the exam, you should use the marking grids provided to calculate your score.

To improve your grade, you should carefully analyse how the report has been structured and written in the prize-winner model answer.

EXHIBIT 15

EMAIL

From: Ali Fisk
To: Stockard Matelier
Subject: FDM: Draft management accounts and business issues
Date: 8 November 2023

We have just received the latest management accounts from Jai Williamson. Jai would like us to carry out a review of FDM's performance. We also need to address some business issues facing FDM. I am attaching the following:

- A note from Jai Williamson on FDM's management accounts and a request for advice **(Exhibit 16)**
- FDM's draft management accounts for the year ended 30 September 2023 **(Exhibit 17)**
- An email from Zizi Zettner to me about FDM's staffing strategy **(Exhibit 18a),** together with media coverage **(Exhibit 18b)**
- An email from Jerzel Morales to me regarding Biotein **(Exhibit 19a),** together with media coverage **(Exhibit 19b)**

Please draft for my review a report addressed to the FDM board. The report should comprise the following.

1. A review of FDM's performance for the year ended 30 September 2023 in comparison with the year ended 30 September 2022. It should cover:

    - revenue by client size and in total
    - cost of sales by cost category
    - gross profit by client size and in total

    Use the management accounts as set out in **Exhibit 17** and the additional information in **Exhibit 16**.

    You should also respond to the request for advice (**Exhibit 16**).

2. An evaluation of the alternative staffing strategies proposed for the year ended 30 September 2024, as set out in **Exhibit 18a**.

    - For each of Alternative A and Alternative B, calculate FDM's expected revenue and operating profit for the year ended 30 September 2024.
    - Evaluate the appropriateness of the assumptions.
    - Explain and evaluate any other issues that FDM should consider, including any ethical and business trust issues. You should include any issues arising from **Exhibit 18b.**
    - Recommend, with reasons, which staffing strategy FDM should pursue.

3. An evaluation of the proposal for FDM to provide digital marketing services to Biotein, as set out in **Exhibit 19a**.

   - Calculate the LTV of Biotein on two bases: (a) FDM uses billable hours and charge-out rates as the pricing method; and (b) FDM uses performance-based pricing as the pricing method.
   - Evaluate the appropriateness of the assumptions provided.
   - Explain and evaluate the strategic, operational and financial issues related to this proposal. Incorporate any ethical and business trust aspects, including any arising from **Exhibit 19b**.
   - Provide a justified recommendation as to which pricing method FDM should use.

EXHIBIT 16

Note from Jai Williamson, 8 November 2023: Additional information on management accounts

The following relates to the draft management accounts for the year ended 30 September 2023.

Key performance indicators (KPIs)

	2023
Headcount	
Billable staff	100
Support staff	15
Total headcount (including directors)	115
Staff attrition rate	16.5%
Client churn rate	
Major accounts	0.0%
Large accounts	2.4%
Medium accounts	16.5%
Small accounts	22.8%
Overall	18.1%

Business issues

- A summary of charge-out rates for the year ended 30 September 2023 is shown below.

Staff grade	£ per hour
Director	230
Manager	125
Team leader	99
Team member	73

- FDM's experience working with well-known multinational companies helped win the digital marketing work for several more major and large clients, including a popular dog food supplier (DGS). FDM expects to generate revenue of £190k per year from services supplied to DGS. Bigger businesses continue to demand high discounts on charge-outs rates and impose strict time budgets. Nonetheless, FDM's strategy is to win and retain these clients to help raise FDM's profile.

- Homeland Support Group (HSG) was awarded 'Small Charity of the Year' and paid special thanks to FDM and Brienne Saffire on its website and social media pages. Following on from this, FDM has adopted five other small charities as clients. All are on similar terms to HSG.

- Staff recruitment posed several challenges during the year:
  - High demand for senior digital marketing staff prevented FDM being able to recruit enough staff at manager and team leader grade.

- Senior and more experienced staff (directors, managers and team leaders) were directed at servicing the increased number of major and large clients.
- Consequently, this caused team changes on a lot of medium and small clients.
- The lack of appropriate senior supervision caused cross-selling opportunities to be missed because junior staff (particularly new ones) do not always have the necessary commercial acumen to spot opportunities. As a result, 35% of work performed for medium clients during the year was SEO.

Request for advice – staff attrition

Due to an inability to recruit at manager and team leader level, we had to recruit more team members to service our growing client base. However, 18 new recruits had left before the end of the year with 5 leaving less than three weeks after completing their training.

In addition, 12 other experienced team members left during the year. This was a real loss as most of them had been with FDM for several years. Numerous departing staff mentioned to their managers that they had become frustrated by a lack of opportunity to work on FDM's high-profile clients and that they had been offered positions with clearer career progression elsewhere.

Despite our attempts to resist with counteroffers of improved pay, 2 of our experienced managers were poached by a rival agency.

Please advise us on

- the financial and non-financial impact of these issues
- the impact these issues have had on the KPIs
- any actions the board should take.

EXHIBIT 17

FDM: Draft management accounts for the year ended 30 September 2023

Statement of profit and loss for the year ended 30 September 2023

	Note	£000
Revenue	**1**	11,271
Cost of sales	**2**	(7,272)
Gross profit	**3**	**3,999**
Administrative and selling expenses		(1,220)
Operating profit		**2,779**
Net finance income		61
Profit before taxation		2,840
Taxation		(568)
Profit for the year		**2,272**

Statement of financial position

	Note	£000
Non-current assets		
Property, plant and equipment (PPE)	**4**	1,194
		1,194
Current assets		
Trade and other receivables	**5**	1,418
Cash and cash equivalents		2,254
		3,672
TOTAL ASSETS		**4,866**
Equity		
Ordinary shares		100
Retained earnings		3,313
		3,413
Current liabilities		
Trade and other payables	**6**	885
Taxation		568
		1,453
TOTAL EQUITY AND LIABILITIES		**4,866**

Statement of cash flows

	£000
Cash flows from operating activities	
Profit before taxation	2,840
Adjustments for:	
Loss/(profit) on disposal of PPE	14
Depreciation of PPE	132
Finance income	(61)
	2,925
Change in trade and other receivables	(383)
Change in trade and other payables	(347)
	2,195
Income tax paid	(454)
Net cash generated from operating activities	**1,741**
Cash flows from investing activities	
Acquisition of PPE	(390)
Proceeds from disposal of PPE	85
Net finance income	61
Net cash generated from investing activities	**(244)**
Cash flows from financing activities	
Dividends paid	(1,000)
Net cash generated from financing activities	**(1,000)**
Net change in cash and cash equivalents	497
Cash and cash equivalents at start of year	1,757
Cash and cash equivalents at end of year	**2,254**

Notes to the management accounts

Note 1: Revenue by client size

	£000
Major accounts	3,269
Large accounts	2,705
Medium accounts	2,367
Small accounts	2,930
	11,271

Note 2: Cost of sales by cost category

	£000
Billable staff	4,628
Other costs	2,644
	7,272

Note 3: Gross profit by client size

	£000
Major accounts	785
Large accounts	838
Medium accounts	953
Small accounts	1,423
	3,999

Note 4: Property, plant and equipment (PPE)

	£000
Opening carrying amount	1,035
Additions	390
Depreciation charge	(132)
Disposals (carrying amount)	(99)
Closing carrying amount	**1,194**

Note 5: Trade and other receivables

	£000
Trade receivables	1,355
Other receivables and prepayments	63
	1,418

Note 6: Trade and other payables

	£000
Deferred income	301
Other payables and accruals	382
Trade payables	202
	885

EXHIBIT 18a

EMAIL

From: Zizi Zettner
To: Ali Fisk
Subject: Staffing strategy
Date: 6 November 2023

We are in the process of finalising our staffing strategy for the year ended 30 September 2024 and have identified two alternative models.

Alternative A: Recruit for growth

Headcount will increase in line with targeted revenue growth. Revenue growth will be the priority rather than profitability. We will continue to pursue more major and large accounts despite them now accounting for a larger share of the client mix.

<u>Assumptions</u>

- The targeted annual increase in revenue will be 35%.
- Revenue mix will be maintained at actual 2023 mix.
- Total target headcount will be based on AMFIH of £8,200.
- The average payroll cost for billable staff will be £48,000 as we need to recruit additional senior staff to service bigger clients. There will be 15 support staff. There will be no increase to support staff salaries.
- Other costs of sales will be £2,900,000. This includes recruitment and training for new staff, as well as IT costs.
- Advertising and selling costs will £1,500,000. This includes payroll costs for support staff.

Alternative B: Profit focus

New technology will be implemented to improve staff utilisation and productivity. Profitability will be as equally important as revenue growth. We will focus on gaining more small and medium accounts to move client mix back to the target.

We will introduce personalised targets for each staff member. Targets will be based on AMFIH. If they achieve their targets, they will receive a bonus at the end of the year. This will ensure that the best staff are rewarded for rising to the challenge and weaker staff leave.

<u>Assumptions</u>

- The targeted annual increase in revenue will be 25%.
- Revenue mix will be 25% for each account size.
- Total headcount will be 130, including 15 support staff.
- The average payroll cost for billable staff will be £46,000. All staff (billable and support) will be paid a £4,000 bonus if their targets are met. For the purpose of any calculations, assume that all staff meet their targets.
- Recruitment and training costs will be lower than Alternative A because fewer staff will be recruited. The expected saving is £30,000 per recruit.
- The cost to license and implement JetStream, including staff training, will be £160,000.
- Advertising and selling costs will be the same as Alternative A, except for the bonus that will be paid to support staff.

Other considerations

As you know, Big Bison is interested in acquiring FDM and this presents an attractive opportunity for the board as we are all shareholders. Naturally, we will want to receive the highest possible offer from Big Bison so that we maximise our return if we do decide to sell.

Any decisions around staffing strategy need to consider that we are looking to improve results over the short term. One suggestion to improve results has been to increase revenue by recording income from clients earlier. This makes sense to me because a lot of revenue from routine work such as SEO is very predictable and stable. We could also reduce costs by spreading them over several years.

EXHIBIT 18b

Big Bison eyes another acquisition
(The Accountant, September 2023)

It looks like the digital marketing sector is about to see more M&A activity as Big Bison's appetite for acquisitions shows no signs of letting up. It is rumoured that Big Bison has identified two potential targets following its recent acquisition of Collective Link for £23.4m.

Analysts believe that Big Bison is identifying targets who have achieved a CAGR of at least 20% over the last five years and have an operating profit margin of 30%, before submitting an initial offer close to six times current operating profit.

EXHIBIT 19a

EMAIL

From: Jerzel Morales
To: Ali Fisk **Cc:** FDM board
Subject: Biotein
Date: 6 November 2023

I was recently contacted by a former FDM employee, Alison Taylor, who now works in the sales and marketing team at Biotein. Biotein is a company that produces organic food supplements, such as diet drinks and foods fortified with vitamins. As well as using entirely organic ingredients in its products, Biotein claims that its production methods make it the most sustainable food supplement company in the UK and that it regularly donates a share of its profits to animal welfare charities.

Biotein is trying to build awareness and interest in its products and would like FDM to increase its website traffic by redesigning its website and improving its search engine ranking.

Pricing

We need to decide whether the pricing method should be based on billable hours using charge-out rates or performance. Immediately after leaving FDM, Alison went to work for Bracket, so I suspect that she has also contacted Bracket for a quote. We will need to ensure that our pricing is competitive, although I could try and find out from Alison what Bracket are quoting.

<u>Billable hours using charge-out rates</u>

I have included a breakdown of expected hours below, along with charge-out rates for the year ended 30 September 2024:

	Charge-out rate per hour	Expected time per month
Director	£300	1
Team leader	£100	1
Team member	£75	6

FDM's expected GPM is 50%.

Assume that the average churn rate applies.

Payment terms will be an initial three months in advance and then monthly in arrears.

<u>Performance-based pricing</u>

Alternatively, pricing could be performance-based. Allison has indicated that Biotein's priority is to increase the number of potential customers (leads) and that Biotein is prepared to pay FDM £2 for each lead attributable to FDM's work. Biotein defines a lead as a website visitor who spends more than one minute looking at products on its website.

By redesigning the Biotein website (including creating new content for the site) and performing general SEO activities, FDM expects to improve Biotein's search engine ranking so that monthly reach increases by 25,000.

There is some uncertainty about the number of additional website visitors this will generate. FDM estimates that there is a 30% probability that visitors will be 8% of those reached, a 40% probability that visitors will be 10% of those reached and a 30% probability that visitors will be 12% of those reached.

The long-term average bounce rate for the food supplement sector and for Biotein is 40%. Leads are expected to be 20% of those visitors who do not bounce.

Assume that a 5% churn rate applies for performance-based pricing.

Payment terms will be monthly, two months in arrears.

FDM's costs will be the same under either pricing method.

Other information

When I had a look at the Biotein website, I saw a photo of the founder Donovan Daniels being presented with an award for 'Most Sustainable Start Up 2022'. Interestingly, the award was being presented by Brienne Saffire! I spoke with Brienne who said that she is part of the UK's Small Business Sustainability Award Committee and that Biotein was unanimously voted as the 2022 winner. Brienne asked that I include an hour of her time in the budget so that she could catch up with Donovan over lunch.

Biotein will be a great addition as an increasing number of FDM's clients are trying to emphasise their sustainability credentials. This will give our junior staff the opportunity to build skills in targeting conscious customers. With the younger generation being very aware of environmental issues, they will probably happily spend their non-billable allowance doing extra work to make this project a success.

EXHIBIT 19b

Biotein (Eco-warrior, August 2023)

A food supplement company claiming to be the most sustainable in the UK may not be as sustainable as it portrays itself. Biotein, a recent start-up and winner of the prestigious ‘Most Sustainable Start Up 2022’ award, sources a large proportion of the organic dairy used in its protein supplements from Germany. The carbon footprint from shipping tonnes of dairy products through Europe and across the English Channel is certainly not insignificant!

When Biotein was contacted for comment, the CEO and founder explained that “sales growth has meant that our UK supplier is no longer able to supply the quantities needed. Therefore, we have had to purchase some of our organic dairy from Germany until we find a UK supplier with sufficient capacity. Our goal is to produce organic and sustainable products. This has not changed.”

Mock Exam 2 Mark Scheme

OVERALL ASSESSMENT CRITERIA	EXECUTIVE SUMMARY
	R1 - Review of financial performance
(C) Report structure: disclaimer AND from firm AND headings **(D)** Report language: formal AND tactful AND ethical	**(E)** Qualitative comment on total revenue **with fig** **(F)** Qualitative comment on rev by client size **with fig** **(G)** Qualitative comment on COS/GP/GP% **with fig** **(H)** Qualitative comment on KPI **with fig**
	(E) Staff: change recruitment process / bonus / ensure appropriate staff level mix / progression opportunities **(F)** Clients: rebalance mix / reduce discounts **(G)** Request for advice: impact of leavers on business **with reason** **(H)** Appropriate summary of report section

R2 - Evaluation of staffing strategy	R3 - Evaluation of Biotein
(E) Compares revenue and OP for (A) AND (B) with **figs** **(F)** Evaluates/questions assumptions **(G)** Concludes on main ethical issue **(H)** Concludes on other issue eg staff impact	**(E)** Gives LTV for both pricing methods **(F)** Concludes on ethical/business trust issues **(G)** Concludes on main financial/operational/strategic impact **(H)** Evaluates/questions assumptions
(E) Concludes on way forward with reason **(F)** Considers potential sale e.g. BB criteria **(G)** Should not manipulate accounts **(H)** Appropriate summary of report section	**(E)** Concludes on way forward with reason **(F)** Negotiate / DD on Biotein **(G)** Back up for marketing claims **(H)** Appropriate summary of report section

REQUIREMENT 1 – Review of FDM financial performance and request for advice

ASSIMILATING & USING INFORMATION	STRUCTURING PROBLEMS & SOLUTIONS
Appendix 1 **(D)** Analysis of KPIs **(E)** Revenue/GP calculations by client size **(F)** Analysis of cost of sales	**Financial analysis: Revenue (report)** **(G)** Major: up **£1,201k / 58.1%** **(H)** Large up **£637k / 30.8%** **(I)** Medium: up **£382k / 19.2%** **(J)** Small: up **£779k / 36.2%** **(K)** AMFIH: up **£8.2k v £8.1k** **(L)** Mix: Major **29.0% v 25.0%** / Large **24.0% v 25.0%** / Medium **21.0% v 24.0%** / Small **26.0% v 26.0%**
AI/CS Exam info (report/appendix) **(F)** Overall revenue: up **£2,999k / 36.3%** **(G)** Overall COS: up **£2,237k / 44.4%** **(H)** Overall GP: up **£762k / 23.5%** **(I)** Overall GP%: **35.5% v 39.1%**	**Financial analysis: COS/GP (report)** **(G)** Major: GP up **£196k/33.3%** / GP% **24.0% v 28.5%** > **(H)** Large: GP up **£114k/15.7%** / GP% **31.0% v 35.0%** **(I)** Medium: GP up **£99k/11.6%** / GP% **40.3% v 43.0%** > **(J)** Small: GP up **£353k/33.0%** / GP% **48.6% v 49.7%** > **(K)** Billable: up **£1,348k/41.1%** > **(L)** Other: up **£889k/50.7%** >
Business issues / wider context **(E)** Impact of COVID-19 on business / fragile economy / growth in online activity **(F)** Industry averages: CAGR growth >10% **(G)** Churn: up **18.1% v 15.2%** **(H)** Attrition: up **16.5% v 11.8%** **(I)** Headcount: up **115 v 85 / 35.3%**	**Request for advice (report)** **(G)** Significant increase in staff who joined and left in year **(fig)** > **(H)** Revised attrition **37.6% v 26.5%** > **(I)** Recruitment and training costs incurred > **(J)** Staff poaching continues to be an issue > **(K)** Impact on client churn > **(L)** Client mix impacts progression opportunities >

APPLYING JUDGEMENT	CONCLUSIONS AND RECOMMENDATIONS
Evaluation of revenue analysis	**Draws conclusions (under a heading)**
(G) Total revenue: faster growth **36.3%** than last year **22.4%** / **above** target of **35%/£11,167k** / **above 10%** industry CAGR	**(E)** Qualitative comment on total revenue **with fig**
(H) High-profile clients / charity work / charge-out rates / staff changes	**(F)** Qualitative comment on COS/GP/GP% **with fig**
(I) Higher churn for small/medium / lower churn for large/major **with fig**	**(G)** Qualitative comment on KPI **with fig**
(J) Growth due to AMFIH and headcount / headcount at target / AMFIH above target	**(H)** Qualitative comment on advice request
(K) Compares individual client size to target **with fig**	
(L) Mix deviated from target / key risk	
Evaluation of COS/GP analysis	**Makes recommendations**
(G) Discounted charge-out rates / fixed time budgets	**(G)** Analyse revenue/GP by client
(H) GP%: client mix impact / change in COS compared to change in revenue	**(H)** Reduce discounts offered
(I) Less cross-selling due to new inexperienced junior staff / SEO	**(I)** Ensure appropriate staff level mix
(J) Discount for charities / impact of staff changes	**(J)** Cross-selling training / more non-SEO work
(K) Avg. cost **£46.3k v £45.6k**	**(K)** Introduce staff bonus
(L) Recruitment/training increase due to higher headcount/attrition	**(L)** Other commercial recommendations
Eval/Recs on request for advice	
(G) Change recruitment process / identify why staff unsuitable	
(H) Above 30% target / identified risk	
(I) Contract clause to recoup training costs/recruitment fee if staff leave	
(J) Exit interviews / identify competitor offering	
(K) Ensure continuity for clients / consistency in service	
(L) Ensure sufficient development opportunities / rebalance client mix	

REQUIREMENT 2 – Evaluation of staffing strategy

ASSIMILATING & USING INFORMATION	STRUCTURING PROBLEMS & SOLUTIONS
Appendix 2 **(D)** Numbers clearly derived **(E)** Calculation for alternatives (A) AND (B) **(F)** Sensitivity analysis	**Calc of OP for profit strategy (appendix)** **(F)** Revenue: £14,089k **(G)** AMFIH: £9.0k **(H)** Billable staff costs: £5,750k **(I)** Other COS: £2,310k **(J)** OP: £4,469k
Calc of OP for recruit strategy (appendix) **(G)** Revenue: £15,216k **(H)** Headcount: 155 **(I)** Billable staff costs: £6,720k **(J)** Other COS: £2,900k **(K)** Admin: £1,500k **(L)** OP: £4,096k	**Assumptions** **(G)** 35% revenue growth achieved in 2023 > **(H)** Recent changes in client mix > **(I)** Same number of support staff as 2023 > **(J)** Billable staff cost avg. same as 2023 for profit strategy > **(K)** Advertising and selling: compares to 2023 eg as % of revenue v 2023 10.8%
Business issues / wider context **(E)** Inflation currently high / future uncertainty **(F)** Recent strategy: recruit for growth / headcount enabler of growth / overstaffing preference **(G)** JetStream: remote working/collaboration/cloud-based / CL: acquired by BB/growing full-service agency **(H)** Risks: margin dilution / staff recruitment/attrition **(I)** FDM a/cs: OP increase / OPM decline	**Other, ethical, business trust issues** **(G)** Staff: understaffing will create pressure / bonus will motivate > **(H)** JetStream security e.g. client/employee data / GDPR > **(I)** Technology offers scalable growth model > **(J)** Consider impact changes will have on clients > **(K)** Suggestion to manipulate a/cs > **(L)** Compares FDM performance to report/CL **with fig** e.g. CAGR/revenue/OP/OP% >

APPLYING JUDGEMENT	CONCLUSIONS AND RECOMMENDATIONS
Evaluation of calcs	**Draws conclusions (under a heading)**
(G) Recruit: higher revenue / profit: higher OP/OP%	**(E)** Compares revenue and OP for (A) AND (B) with **figs**
(H) Compares to 30% OPM target	**(F)** Evaluates/questions assumptions
(I) FDM has sufficient cash (£2,254k)	**(G)** Concludes on ethical/business trust issue
(J) Timescales for any changes challenging (YE 2024 now)	**(H)** Concludes on way forward **with reason**
(K) BB: both give CAGR>20% / 30% OPM for profit focus/not recruit	
(L) Any further changes in assumptions will impact calculations eg cost increases, pricing changes	
Evaluation of assumptions	**Makes recommendations**
(G) Maintaining high growth challenging	**(G)** Negotiate T&C with JetStream
(H) Will impact GP% / unlikely to be exactly 25%/same as 2023	**(H)** Prepare longer forecast
(I) Support staff facilitate billable work / will need to be higher	**(I)** Check staff capacity / set timetable for activities
(J) Salaries increasing / high demand for senior staff / 2023 recruitment challenges	**(J)** Get back up for all estimates / other costs
(K) No accounting for inflation / additional costs for tech/pitch fees	**(K)** Find alternative prospective purchasers
(L) One year forecast not long enough	**(L)** Other commercial recommendations
Eval/recs: other, ethical and BT issues	
(G) Staff in high demand / attrition increasing / must treat fairly	
(H) DD on JetStream / IT security audit	
(I) Management of staff is resource intensive e.g. mgt time, HR admin, training	
(J) May increase churn / improved service/effectiveness	
(K) Cannot record revenue before service provided / tech costs may be able to be capitalised / legal issues	
(L) Questions source reliability / calcs expected offer using 6x OP / BB wants FDM client base/DM competencies	

REQUIREMENT 3 – Evaluation of Biotein proposal

ASSIMILATING & USING INFORMATION	STRUCTURING PROBLEMS & SOLUTIONS
Workings / report **(E)** Numbers clearly derived **(F)** Calculation for different churn rates **(G)** Sensitivity analysis	**Calc of GP and LTV (Performance)** **(A)** Visitors: 2,000 AND 2,500 AND 3,000 OR 24,000 AND 30,000 AND 36,000 **(B)** Do not bounce: 1,200 AND 1,500 AND 1,800 OR 14,400 AND 18,000 AND 21,600 **(C)** Leads: 240 AND 300 AND 360 OR 2,880 AND 3,600 AND 4,320 **(D)** FDM Revenue: £5,760 AND £7,200 AND £8,640 OR £480 AND £600 AND £720 **(E)** FDM GP: £660 AND £2,100 AND £3,540 **(F)** LTV using churn rate of 5%
Calc of GP and LTV (Hours) **(A)** Charge out rates: £300 AND £100 AND £75 AND Hours: 1 AND 1 AND 6 **(B)** Revenue: £850/£10,200 **(C)** GP: £5,100 **(D)** LTV using churn rate of 18%/20%/22.8%	**Financial, strategic, operational issues** **(G)** Hours higher revenue/GP/GPM / performance higher LTV in most likely/best case > **(H)** Small client / compares to HSG > **(I)** Biotein: sustainable/donations / potential PR benefits for FDM > **(J)** Potential technical/commercial knowledge obtained > **(K)** Suits current staff mix / development opportunity for juniors > **(L)** Payment terms favourable for hours basis >
Business issues / wider context **(F)** Inflation currently high / future uncertainty **(G)** Risk: margin dilution / failure to win new clients **(H)** 2023 client mix: shift to major clients **(I)** Small client churn rates: 18-20% average / 22.8% / 5% performance billing **(J)** FDM approached / good negotiating position	**Comments on ethical/bus trust issues** **(F)** Questionable sustainability practices > **(G)** Self-regulatory code of practice > **(H)** Brienne Saffire: knows Biotein founder / award > **(I)** Former staff member goodwill towards FDM > **(J)** Questions director time/rate > **(K)** Non-billable time should be included / hides true cost of work / impact on staff >

APPLYING JUDGEMENT	CONCLUSIONS AND RECOMMENDATIONS
Evaluation of assumptions **(G)** Questions use of probabilities / LTV ignores discounting / 20 years very long horizon/DM will change **(H)** Leads % has significant impact / SEO takes time / bounce % may reduce after FDM work **(I)** Charge-out rates will increase / wages will increase / time spent may be different **(J)** Content and SEO usually lower margin / 50% may be high **(K)** Cost reduction over time needs to be factored in **(L)** Any further changes in assumptions will impact calculations	**Draws conclusions (under a heading)** **(F)** Gives LTV for both pricing methods **(G)** Evaluates/questions assumptions **(H)** Concludes on main financial/operational/strategic issue **(I)** Concludes on ethics/business trust issues **(J)** Concludes on way forward with reason
Financial, strategic and operational impact **(G)** LTV: lower churn offsets low margin/higher overall profitability / risk eg not multiyear contract **(H)** Future impact e.g. cross selling opportunities **(I)** Brienne Saffire keen to promote FDM as responsible / active on social media **(J)** May help improve performance on other clients / recent increase in churn rate **(K)** Impact on attrition / values may align with young staff **(L)** Payment in advance deferred income / difficulty tracking metrics eg leads	**Makes recommendations** **(G)** Negotiate T&C **(H)** DD on Biotein **(I)** Check staff capacity **(J)** Get back up for all estimates **(K)** Set timetable for activities **(L)** Other commercial recommendations
Evaluation/recs: ethical/business trust **(F)** Investigate facts / speak with Biotein about reports **(G)** Obtain evidence for all marketing claims / comply with code **(H)** Should not be a factor in decision **(I)** Do not ask for inside information/competitor quote **(J)** Time should be spent working for client / director rate v 2023 / client interaction required / v Compere time eg 1.5 hours **(K)** Do not expect staff to use non-billable for client work	

Mock Exam 2 Model Answer

A report on FDM

TO: Directors of FDM
FROM: Newell Mast
DATE: 8 November 2023

This report is for the Board of FDM only and should not be distributed to third parties. No liability can be accepted in this event.

Executive Summary

Review of Financial Performance for Year Ended 30 September 2023

Overall revenue increased impressively by £2,999k (36.3%) to £11,271k which is just above the target of 35%/£11,167k. AMFIH was £8.2k (0.7% increase) which is above the target of £8.1k but below the previous peak of £8.9k, whereas headcount of 115 (35.3% increase) is in line with the target which shows that the revenue target being achieved is due to AMFIH and headcount. Major account revenue increased the most by £1,201k (58.1%) and is well above the target of £2,792k due to winning several more clients. Large account revenue increased substantially by £637k (30.8%) but is below the target of £2,792k which could be due to strict time budgets. Medium account revenue increased the least by £382k (19.2%) and is below the target of £2,680k due to missed cross-selling opportunities. Small account revenue increased impressively by £779k (36.2%) and is above the target of £2,903k due to additional charity work.

COS increased by £2,237k (44.4%) due to an increase in all costs and increased faster than revenue which will have a negative impact on GPM. Billable staff increased by £1,348k (41.1%) due to salary increase and headcount. Other costs increased by £889k (50.7%) due to recruitment and training fees. Overall GP increased by £762k (23.5%) to £3,999k with GPM decreasing to 35.5% from 39.1% due to a GPM decrease in all client sizes and a revenue mix shift towards lower margin major/large clients. This is despite an AMFIH increase. GPM has not continued to increase. Major GP increased the most by £196k (33.3%), with a disappointing GPM decrease to 24% from 28.5%, due to big businesses demanding high discounts on charge-out rates. Large GP increased modestly by £114k (15.7%), with a significant GPM decrease to 31% from 35%, due to more senior staff servicing large clients. Medium GP had the weakest growth with £99k (11.6%) and a disappointing GPM decrease to 40.3% from 43% due to a higher proportion of work being lower-margin SEO (35% v typical 20%). Small GP increased impressively by £353k (33.0%), with a GPM decrease to 48.6% from 49.7%, due to fees for charities being discounted and therefore earning a lower margin.

There has been a significant 80% increase in the number of staff who joined and left in the same year. It causes changes to client teams which can impact the churn rate (which increased to 18.1% from 15.2%). Using Ron Ashton's method, the revised attrition rate is 37.6% (22: 26.5%) which is now above the sector average of 30%. This results in in wasted recruitment and training costs and has contributed to the 50.7% increase in other COS.

RECOMMENDATIONS

Change candidate selection process so only suitable staff are recruited.
Ensure appropriate staff grade and client mix to facilitate junior development.
Implement policies to reduce churn e.g. performance-based pricing, fewer team changes.
Cross-sell more non-SEO work to improve margins.

**highlighted text demonstrates key points to bring to the attention of the directors. These were not included in the conclusions and were added to the Executive Summary.*

EVALUATION OF STAFFING STRATEGY

Under Alternative A, revenue will be £15,216k and OP will be £4,096k, with a OPM of 26.9%. Under Alternative B, revenue will be £14,089k and OP will be £4,469k, with a OPM of 31.7%. Alternative A delivers higher revenue, whereas Alternative B delivers higher OP and OPM. Both strategies result in five-year CAGR meeting BB's reported target criteria of over 20% with A (28.6%) being slightly higher than B (26.6%). Alternative B exceeds the 30% OPM target and BB's reported target criteria but Alternative A does not.

Headcount may be lower because FDM experienced difficulties recruiting senior staff in 2023. Staff costs will be higher because the number of support staff is the same as 2023 despite the planned increase in billable staff and support staff being needed to facilitate billable work. Any further changes to the assumptions will cause the results to change. If Alternative B revenue growth is only 21%, then OP (£4,018k) will be lower than Alternative A and OPM (29.5%) below 30%.

It appears BB will base their offer on OP so Alternative B would be preferable to maximise the offer. A change in strategy is higher risk because it is untested whereas the recruit for growth strategy has been successful in increasing revenue and profit in recent years.

Alternative B implies understaffing which will put pressure on staff. This could damage their health, increase attrition and reduce productivity. However, this is not an issue if staff are happy with any changes. Confidential data will be held in JetStream and there is a risk it could be stolen or lost. This could cause business disruption, reputational damage, fines and a loss of clients. The suggestion to record revenue earlier and defer costs to improve short term results appears contrary to accounting principles and an attempt to manipulate profits. This could result in legal action and fines against the directors. However, capitalising costs such as new technology might be possible.

FDM should proceed with Alternative B to reduce the dependency on recruitment and improve OP and OPM which will help maximise the share value.

RECOMMENDATIONS

DD on JetStream with a focus on data security.
Do not artificially manipulate accounts.
Negotiate with JetStream and find alternatives.
Discuss any changes with staff.
Find other prospective buyers for FDM.

EVALUATION OF BIOTEIN PROPOSAL

Pricing based on hours results in LTV of £25,500 (20% churn), £28,333 (18% churn) and £22,378 (22.8% churn). Pricing based of performance results in LTV of £42,000 (most likely), £13,200 (worst case) and £70,800 (best case). Performance results in higher LTV in all except the worst case. There is a 30% chance of the worst case which is quite high.
There is potential for additional revenue by cross-selling other services e.g. paid ad management. LTV is higher on a performance basis because average churn is only 5% compared with 18-20%.

Reach is likely to be lower initially because it takes time for SEO to have an impact. The calculation uses probabilities which are simplified estimates. The actual outcome is likely to be different. Lifetime is likely to be lower than the 20 years implied by a 5% churn rate because start-ups have a high chance of failure in their early years and digital marketing will change significantly over 20 years. Any further changes to the assumptions will cause the results to change. To make the performance basis at least as attractive in terms of revenue and GP, FDM's work would need to generate 425 leads per month.

Biotein donates to charities and appears to be sustainable. FDM may benefit from being associated with a company that has positive ESG credentials. Small clients such as Biotein give junior staff opportunities. With more junior staff in the hierarchy there is likely to be spare capacity at junior level. More of FDM's clients are focussing on sustainability so the knowledge obtained from this work can be used on other clients. This should help FDM improve the effectiveness of its work and reduce client churn.

There are media suggestions that Biotein is not as sustainable as it claims. This could cause inaccurate claims to be made as part of FDM's digital marketing work which could lead to reputational damage and potential fines if FDM breaches the code of practice. Expecting staff to use some of their non-billable time to do client work may be seen as unfair. This could cause lower staff morale, productivity and even higher attrition. Also, it prevents FDM being able to calculate actual costs involved and track staff time.

FDM should price based on billable hours because the margin on performance-based pricing is very low and a 20-year expected lifetime seems ambitious.

RECOMMENDATIONS

Do not expect staff to use their non-billable time.
Obtain evidence for all marketing claims.
Negotiate with Biotein e.g. a higher payment for each lead.
DD on Biotein and founder.
Prepare longer GP forecasts to include service cost reductions and cross-selling.

APPENDIX 1: Analysis of Management Accounts

	2023	2022	Change (£k)	Change (%)
REVENUE				
Major	£3,269	£2,068	£1,201	58.1%
Large	£2,705	£2,068	£637	30.8%
Medium	£2,367	£1,985	£382	19.2%
Small	£2,930	£2,151	£779	36.2%
TOTAL	**£11,271**	**£8,272**	**£2,999**	**36.3%**
Mix				
Major	29.0%	25.0%	4.0%	
Large	24.0%	25.0%	-1.0%	
Medium	21.0%	24.0%	-3.0%	
Small	26.0%	26.0%	0.0%	
	100.0%	100.0%		
Headcount	115	85	30	35.3%
Billable	100	72	28	38.9%
Support	15	13	2	15.4%
AMFIH	£8.2	£8.1	£0.1	0.7%
Client churn				
Total	18.1%	15.2%	2.9%	
Clients lost	63	40	23	57.2%
Clients at start (approx.)	349			
Major	0.0%	8.3%	-8.3%	
Clients lost	0	1	(1)	(100%)
Clients at start (approx.)	14			
Large	2.4%	5.7%	-3.3%	
Clients lost	1	2	(1)	(50%)
Clients at start (approx.)	41			
Medium	16.5%	11.8%	4.7%	
Clients lost	13	8	5	62.0%
Clients at start (approx.)	79			
Small	22.8%	19.5%	3.3%	
Clients lost	49	29	20	68.6%
Clients at start (approx.)	215			
Director	£230	£215	£15	7.0%
Manager	£125	£115	£10	8.7%
Team leader	£99	£90	£9	10.0%
Team member	£73	£66	£7	10.6%

COS				
Billable staff	£4,628	£3,280	£1,348	41.1%
Other	£2,644	£1,755	£889	50.7%
TOTAL	**£7,272**	**£5,035**	**£2,237**	**44.4%**
% of revenue				
Billable staff	41.1%	39.7%	1.4%	
Other	23.5%	21.2%	2.2%	
	64.5%	60.9%	3.7%	
Mix				
Billable staff	63.6%	65.1%	-1.5%	
Other	36.4%	34.9%	1.5%	
Avg. billable staff cost	£46.3	£45.6	£0.7	1.6%
GP				
Major	£785	£589	£196	33.3%
Large	£838	£724	£114	15.7%
Medium	£953	£854	£99	11.6%
Small	£1,423	£1,070	£353	33.0%
TOTAL	**£3,999**	**£3,237**	**£762**	**23.5%**
GPM				
Major	24.0%	28.5%	-4.5%	
Large	31.0%	35.0%	-4.0%	
Medium	40.3%	43.0%	-2.8%	
Small	48.6%	49.7%	-1.2%	
TOTAL	**35.5%**	**39.1%**	**-3.7%**	
Mix				
Major	19.6%	18.2%	1.4%	
Large	21.0%	22.4%	-1.4%	
Medium	23.8%	26.4%	-2.6%	
Small	35.6%	33.1%	2.5%	
TOTAL	100%	100%		

Headcount	115	85	30	35.3%
Attrition rate (Left / Headcount bf)	16.5%	11.8%	4.7%	
Left (Headcount bf * attrition %)	14	8	6	74.5%
Attrition rate: revised (Total left / Headcount bf)	37.6%	26.5%	11.1%	
Joined and left	18	10	8	80.0%
Total left	32	18	14	77.5%

Review of Financial Performance for Year Ended 30 September 2023

REVENUE

Overall revenue increased impressively by £2,999k (36.3%) to £11,271k which is just above the target of 35%/£11,167k and above the market CAGR which is around 10%. AMFIH was £8.2k (0.7% increase) which is partly due to the 7.0-10.6% increase in charge-out rates and is above the target of £8.1k but below the previous peak of £8.9k, whereas headcount of 115 (35.3% increase) is in line with the target which shows that the revenue target being achieved is due to AMFIH and headcount. Staff capacity is an enabler of revenue growth, therefore the higher headcount leaves FDM well placed for future growth. The fragile economy may have had a negative impact, so the fact that the rate of growth is increasing (2022: 22.4%) is excellent. Revenue from all client sizes has increased. Many businesses have shifted towards a digital model due to the impact of COVID-19 and this has increased demand for digital marketing. Churn has increased to 18.1% from 15.2% due to higher churn on small and medium clients.

Major account revenue increased the most by £1,201k (58.1%) and is well above the target of £2,792k due to winning several more clients. Expected revenue from DGS of £190k is above the typical average for major (£150k). Churn has decreased to 0% from 8.3% due to FDM's strategy to retain major clients to raise its profile. Churn can be erratic because MNCs have low switching costs and there are a small number of clients in this category.

Large account revenue increased substantially by £637k (30.8%) but is below the target of £2,792k which could be due to strict time budgets. Churn has also decreased to 2.4% from 5.7% for the same reason as major.

Medium account revenue increased the least by £382k (19.2%) and is below the target of £2,680k due to missed cross-selling opportunities. Churn has increased to 16.5% from 11.8% due to client team changes caused by the staffing issues.

Small account revenue increased impressively by £779k (36.2%) and is above the target of £2,903k due to additional charity work. Like medium, churn has increased to 22.8% from 19.5% because of staff changes and is now above the average of 18-20%.

Major accounts for 29.0% (22: 25.0%) of revenue, large 24.0% (22: 25.0%), medium 21.0% (22: 24.0%) and small 26.0% (22: 26.0%) which is not in line with the 25% target. A range of client sizes helps staff retention via career progression.

COS AND GROSS PROFIT

COS increased by £2,237k (44.4%) due to an increase in all costs and increased faster than revenue which will have a negative impact on GPM.

Billable staff increased by £1,348k (41.1%) and is now 41.1% (22: 39.7%) of revenue. Average billable staff cost has increased by 1.6% to £46.3k (22: £45.6k) which shows that the increase was due to salary increase and headcount. Attrition rate has increased to 16.5% from 11.8% but is still below the sector average of 30%. There is upward pressure on wages as high-skilled staff are in high demand and this has prevented FDM recruiting enough managers and team leaders.

Other costs increased by £889k (50.7%) due to recruitment and training fees for the increased headcount and higher attrition and are now 23.5% (22: 21.2%) of revenue.

Overall GP increased by £762k (23.5%) to £3,999k with GPM decreasing to 35.5% from 39.1% due to a GPM decrease in all client sizes and a revenue mix shift towards lower margin major/large clients. This is despite an AMFIH increase. GPM has not continued to increase.

Major GP increased the most by £196k (33.3%), but with a disappointing GPM decrease to 24% from 28.5%, due to big businesses demanding high discounts on charge-out rates.

Large GP increased modestly by £114k (15.7%), with a significant GPM decrease to 31% from 35%, due to more senior staff servicing large clients.

Medium GP had the weakest growth with £99k (11.6%) and a disappointing GPM decrease to 40.3% from 43% due to a higher proportion of work being lower-margin SEO (35% v typical 20%).

Small GP increased impressively by £353k (33.0%), with a GPM decrease to 48.6% from 49.7%, due to fees for charities being discounted and therefore earning a lower margin. Small accounts for 35.6% (22: 33.1%) which shows the increasing importance of small clients.

<u>REQUEST FOR ADVICE</u>

There has been a significant 80% increase in the number of staff who joined and left in the same year.

This results in wasted recruitment and training costs and has contributed to the 50.7% increase in other COS.

It causes wasted management time, business disruption and changes to client teams which can impact the churn rate (which increased to 18.1% from 15.2%). Higher churn undermines client wins and winning new clients is expensive.

It masks the true attrition rate. Using Ron Ashton's method, the revised attrition rate is 37.6% (22: 26.5%) which is now above the sector average and target of 30%.

The increase in high-profile major/large clients, fewer senior staff and a lack of focus on medium clients has restricted career progression opportunities for team members.

Poaching continues to be an issue despite pay increases in 2021. It is important FDM does not lose more senior staff when senior recruitment is tough.

<u>RECOMMENDATIONS</u>

Impose contract clauses to recoup recruitment and training fees if staff leave shortly after joining.
Change candidate selection process so only suitable staff are recruited.
Ensure appropriate staff grade and client mix to facilitate junior development.

Exit interviews to identify reasons for leaving and respond with policy changes/pay increases accordingly.

CONCLUSIONS

Overall revenue increased impressively by £2,999k (36.3%) to £11,271k which is just above the target of 35%/£11,167k. Major account revenue increased the most by £1,201k (58.1%) and is well above the target of £2,792k due to winning several more clients. Large account revenue increased substantially by £637k (30.8%) but is below the target of £2,792k which could be due to strict time budgets. Medium account revenue increased the least by £382k (19.2%) and is below the target of £2,680k due to missed cross-selling opportunities. Small account revenue increased impressively by £779k (36.2%) and is above the target of £2,903k due to additional charity work.

COS increased by £2,237k (44.4%) due to an increase in all costs and increased faster than revenue which will have a negative impact on GPM. Billable staff increased by £1,348k (41.1%) due to salary increase and headcount. Other costs increased by £889k (50.7%) due to recruitment and training fees.

Overall GP increased by £762k (23.5%) to £3,999k with GPM decreasing to 35.5% from 39.1% due to a GPM decrease in all client sizes. Major GP increased the most by £196k (33.3%), with a disappointing GPM decrease to 24% from 28.5%, due to big businesses demanding high discounts on charge-out rates. Large GP increased modestly by £114k (15.7%), with a significant GPM decrease to 31% from 35%, due to more senior staff servicing large clients. Medium GP had the weakest growth with £99k (11.6%) and a disappointing GPM decrease to 40.3% from 43% due to a higher proportion of work being lower-margin SEO (35% v typical 20%). Small GP increased impressively by £353k (33.0%), with a GPM decrease to 48.6% from 49.7%, due to fees for charities being discounted and therefore earning a lower margin.

Using Ron Ashton’s method, the revised attrition rate is 37.6% (22: 26.5%) which is now above the sector average of 30%. This results in in wasted recruitment and training costs and has contributed to the 50.7% increase in other COS.

RECOMMENDATIONS

Revenue and profit analysis by client.
Reduce discount on charge-out rates.
Rebalance client mix by targeting small and medium clients.
Implement policies to reduce churn e.g. performance-based pricing, fewer team changes.
Introduce performance bonus based on AMFIH target.
Slow recruitment and focus on quality over quantity.
Cross-sell more non-SEO work to improve margins.
Introduce more performance-based billing to improve margins.
Obtain breakdown of ‘Other COS’ and investigate reasons for increase.
Consider relocating to reduce costs.

APPENDIX 2: STAFFING STRATEGY

		35%				MIX	
		2024 target	**2023**	**Change (£k)**	**Change (%)**	**2024 target**	**2023**
	REVENUE						
	Major	£4,413	£3,269	£1,144	35.0%	29.0%	29.0%
	Large	£3,652	£2,705	£947	35.0%	24.0%	24.0%
	Medium	£3,195	£2,367	£828	35.0%	21.0%	21.0%
	Small	£3,956	£2,930	£1,026	35.0%	26.0%	26.0%
	TOTAL	**£15,216**	**£11,271**	**£3,945**	**35.0%**		
	Headcount	155					
	AMFIH	£8.2					
	COS						
44.2%	Billable	-£6,720					
19.1%	Other	-£2,900					
	TOTAL	**-£9,620**					
	GP	**£5,596**					
	GPM	36.8%	35.5%				
9.9%	**A&S**	**-£1,500**					
	OP	**£4,096**					
	OPM	26.9%	24.7%				
	Headcount						
	Revenue	£15,216					
	AMFIH	£8.2	12	£98.4			
	Headcount	154.6					
	Rounded up	155					
	Billable		Support	Total			
	Avg.	48					
	Headcount	140	15	155			
		£6,720					

	CAGR		
	2024	£15,216	
	2019	£4,331	
	2024/2019	351.4%	
	^0.2 (1/5)	128.6%	0.20
	-1	28.6%	
	OP x6		
	6	£24,575	

		25%				MIX	
		2024 target	**2023**	**Change (£k)**	**Change (%)**	**2024 target**	**2023**
	REVENUE						
	Major	£3,522	£3,269	£253	7.7%	25.0%	29.0%
	Large	£3,522	£2,705	£817	30.2%	25.0%	24.0%
	Medium	£3,522	£2,367	£1,155	48.8%	25.0%	21.0%
	Small	£3,522	£2,930	£592	20.2%	25.0%	26.0%
	TOTAL	**£14,089**	**£11,271**	**£2,818**	**25.0%**		
	Headcount	130					
	AMFIH	£9.0					
	COS						
40.8%	Billable	-£5,750					
16.4%	Other	-£2,310					
	TOTAL	**-£8,060**					
	GP	**£6,029**					
	GPM	42.8%	35.5%				
11.1%	**A&S**	**-£1,560**					
	OP	**£4,469**					
	OPM	31.7%	24.7%				
	Billable						
	Avg (salary + bonus)	£50	£46	£4			
	Headcount	115	15	130			
		£5,750					
	Other	-£2,900					
	Recruit, train, IT saved	£750	25	£30			
	JetStream	-£160					
		-£2,310					
	A&S	-£1,500					
	Bonus - support	-£60	15	£4			
		-£1,560					

CAGR		
2024	£14,089	
2019	£4,331	
2024/2019	325.3%	
^0.2 (1/5)	126.6%	0.20
-1	26.6%	
OP x6		
6	£26,813	

		21%				MIX	
		2024 target	**2023**	**Change (£k)**	**Change (%)**	**2024 target**	**2023**
	REVENUE						
	Major	£3,409	£3,269	£140	4.3%	25.0%	29.0%
	Large	£3,409	£2,705	£704	26.0%	25.0%	24.0%
	Medium	£3,409	£2,367	£1,042	44.0%	25.0%	21.0%
	Small	£3,409	£2,930	£479	16.4%	25.0%	26.0%
	TOTAL	**£13,638**	**£11,271**	**£2,367**	**21.0%**		
	Headcount	130					
	AMFIH	£8.7					
	COS						
42.2%	Billable	-£5,750					
16.9%	Other	-£2,310					
	TOTAL	**-£8,060**					
	GP	**£5,578**					
	GPM	40.9%	35.5%				
11.4%	**A&S**	**-£1,560**					
	OP	**£4,018**					
	OPM	29.5%	24.7%				

EVALUATION OF STAFFING STRATEGY

CONTEXT

Ron Ashton's operational improvements research paper proposed to invest in martech and focus on profit. Alternative B incorporates those proposals.

Headcount and revenue have been strongly linear and forecast revenue based on headcount growth has been accurate and reliable.

Margin dilution was identified as a key risk and Alternative A's proposal of not moving the revenue mix back to the 25% target will likely result in lower margins.

The fragile UK economy may cause revenue to be lower than the forecasts.

FDM is in a strong negotiating position because BB has approach FDM.

RESULTS AND FINANCIAL ANALYSIS

Under Alternative A, revenue will be £15,216k and OP will be £4,096k, with a OPM of 26.9%.

Under Alternative B, revenue will be £14,089k and OP will be £4,469k, with a OPM of 31.7%.

Alternative A delivers higher revenue, whereas Alternative B delivers higher OP and OPM.

Both strategies result in five-year CAGR meeting BB's reported target criteria of over 20% with A (28.6%) being slightly higher than B (26.6%).

Alternative B exceeds the 30% OPM target and BB's reported target criteria but Alternative A does not.

Both will help reverse the recent decline in OPM (23: 24.7%, 22: 28.2%).

Alternative B will result in AMFIH reaching a record of £9.0k. Alternative A does not seem to try and improve AMFIH.

FDM's large cash balance (£2,254k) is sufficient for the technology investment.

ASSUMPTIONS AND SENSITIVITY ANALYSIS

Growth may be lower than 35% (or 25%) because it will be challenging to maintain such a high growth rate as the business matures. However, 35% was achieved in 2023 which suggests this is reasonable.

Revenue mix is unlikely to be exactly the same as 2023 (or exactly 25%) because it is hard to manage the number of new clients and the revenue generated from them exactly. Deviations will impact profit margins.

Headcount may be lower because FDM experienced difficulties recruiting senior staff in 2023.

Alternative B AMFIH could be lower because recent years ('21-'23) have been £8.1-8.3k and any changes will take time to have an effect.

Billable staff costs may be higher for Alternative B because it assumes an average of £46k when 2023 was £46.3k. Also, staff are in demand and inflation is high which will increase costs.

Staff costs will be higher because the number of support staff is the same as 2023 despite the planned increase in billable staff and support staff being needed to facilitate billable work.

Staff costs may be lower in Alternative B because it is unlikely that all staff will meet their targets.

Other COS is likely be higher because it is only 19.1%/16.4% of revenue compared with 23.5% in 2023.

The expected recruitment and training cost saving of £30k per employee looks high.

Admin is likely be higher for Alternative A because it is only 9.9% of revenue compared with 10.8% in 2023.

There will be additional costs (e.g. technology security and maintenance) which need to be considered.

The forecast period is too short to make a full assessment.

The timeframes for Alternative B are very challenging because implementing the technology takes time and the financial year ended 2024 has already started.

Any further changes to the assumptions will cause the results to change. If Alternative B revenue growth is only 21%, then OP (£4,018k) will be lower than Alternative A and OPM (29.5%) below 30%.

OTHER ISSUES

It appears BB will base their offer on OP so Alternative B would be preferable to maximise the offer.

A staff bonus is likely to motivate staff which should help increase AMFIH and reduce attrition.

A change in strategy is higher risk because it is untested whereas the recruit for growth strategy has been successful in increasing revenue and profit in recent years.

Using less staff and more technology will impact clients and the changes could cause client churn to increase.

ETHICS

Alternative B implies understaffing which will put pressure on staff. This could damage their health, increase attrition and reduce productivity. However, this is not an issue if staff are happy with any changes.

Confidential data will be held in JetStream and there is a risk it could be stolen or lost. This could cause business disruption, reputational damage, fines and a loss of clients.

The suggestion to record revenue earlier and defer costs to improve short term results appears contrary to accounting principles and an attempt to manipulate profits. This could result in legal action and fines against the directors. However, capitalising costs such as new technology might be possible.

RECOMMENDATIONS
Ensure staff workloads are managed to provide a healthy work-life balance.
DD on JetStream with a focus on data security.
Do not artificially manipulate accounts.

CONCLUSIONS
Under Alternative A, revenue will be £15,216k and OP will be £4,096k, with a OPM of 26.9%.
Under Alternative B, revenue will be £14,089k and OP will be £4,469k, with a OPM of 31.7%.

Staff costs will be higher because the number of support staff is the same as 2023 despite the planned increase in billable staff and support staff being needed to facilitate billable work.

Any further changes to the assumptions will cause the results to change. If Alternative B revenue growth is only 21%, then OP (£4,018k) will be lower than Alternative A and OPM (29.5%) below 30%.

It appears BB will base their offer on OP so Alternative B would be preferable to maximise the offer.

The suggestion to record revenue earlier and defer costs to improve short term results appears contrary to accounting principles and an attempt to manipulate profits. This could result in legal action and fines against the directors.

FDM should proceed with Alternative B to reduce the dependency on recruitment and improve OP and OPM which will help maximise the share value.

RECOMMENDATIONS
Negotiate with JetStream.
Research alternatives to JetStream.
Research/corroborate all estimates.
Prepare longer forecasts.
Discuss any changes with staff.
Survey clients about any proposed changes.
Find other prospective buyers for FDM.
Set timetable for activities.

APPENDIX 3: BIOTEIN

A: billable hours and charge-out rates				
	£ per hour	Hours pm	PM	PA
Director	£300	1	£300	£3,600
Team leader	£100	1	£100	£1,200
Team member	£75	6	£450	£5,400
Revenue			£850	£10,200
Costs			-£425	-£5,100
GP			£425	£5,100
GPM			50.0%	50.0%
LTV:				
GP pa	£5,100	£5,100	£5,100	
Lifetime (w1)	4.4	5.0	5.6	
	£22,378	£25,500	£28,333	
Lifetime (w1)	2023	Small avg.	Small avg.	
Churn rate	22.8%	20%	18%	
	4.4	5.0	5.6	

	B: Performance-based pricing			
	Reach	25000		
		30%	40%	30%
		Worst	Most likely	Best
		8%	10%	12%
	Visitors	2000	2500	3000
	Bounce	40%	40%	40%
60%	Do not bounce	1200	1500	1800
20%	Leads	240	300	360
£2	FDM revenue pm	£480	£600	£720
	FDM revenue pa	£5,760	£7,200	£8,640
	FDM costs	-£5,100	-£5,100	-£5,100
	FDM GP	£660	£2,100	£3,540
	FDM GPM	11.5%	29.2%	41.0%
	LTV:			
	GP pa	£660	£2,100	£3,540
	Lifetime (w1)	20	20	20
		£13,200	£42,000	£70,800
	Lifetime (w1)			
	Churn rate	5%		
		20		

	Sensitivity			
	No. of leads pm to match hours basis:	Revenue:	£850	425
			£2	
			Check	
	Leads pm		425	
£2	FDM revenue pm		£850	
	FDM revenue pa		£10,200	
	FDM costs		-£5,100	
	FDM GP		£5,100	
	FDM GPM		50.0%	

EVALUATION OF BIOTEIN PROPOSAL

CONTEXT

Biotein has approached FDM and FDM has a relationship with one of Biotein's staff. This puts FDM in a good negotiating position.

The key risk of margin dilution occurred in 2023 due to client mix shifting towards major clients. Winning Biotein as a client will help move the mix towards smaller clients.

The risk of failing to win clients was previously identified but offering Biotein a competitive pricing method will help reduce this risk.

The fragile UK economy may cause leads (and therefore FDM revenue) to be lower than expected.

High inflation may cause staff to demand an increase in salaries which will reduce profit and LTV.

RESULTS AND FINANCIAL ANALYSIS

Pricing based on hours results in LTV of £25,500 (20% churn), £28,333 (18% churn) and £22,378 (22.8% churn).

Pricing based of performance results in LTV of £42,000 (most likely), £13,200 (worst case) and £70,800 (best case).

Performance results in higher LTV in all except the worst case. There is a 30% chance of the worst case which is quite high.

Revenue will be £10.2k pa on an hours basis which is in line with the small client average (£10k). Revenue will be between £5,760 and £8,640 on a performance basis which is lower than the average and worst case is even lower than HSC (£6k).

There is potential for additional revenue by cross-selling other services e.g. paid ad management.

Client servicing costs reduce over time, so GP is likely to be higher in later years.

GPM will be 50% on an hours basis which is in line with small client average and slightly higher than 2023 (48.6%). GPM will be between 11.5% and 41.0% on a performance basis which is lower than the average and worst case is even lower than HSC (25%).

LTV is higher on a performance basis because average churn is only 5% compared with 18-20%.

Payment terms are preferable on an hours basis but as the amounts are small in the context of FDM's cash balance (£2,254k) this is not a major consideration.

ASSUMPTIONS AND SENSITIVITY ANALYSIS

Charge-out rates and wages will be higher in later years because there will be increases.

The director rate may be lower because £300 seems very high compared to 2022 (£230) and 2021 (£215) so Biotein may negotiate this lower.

50% GPM may be lower because the work involves SEO and content creation which are typically lower margin.

Reach is likely to be lower initially because it takes time for SEO to have an impact.

The calculation uses probabilities which are simplified estimates. The actual outcome is likely to be different.

Leads and bounce rates are likely to be different because round numbers and averages have been used.

Lifetime is likely to be lower than the 20 years implied by a 5% churn rate because start-ups have a high chance of failure in their early years and digital marketing will change significantly over 20 years.

Any further changes to the assumptions will cause the results to change. To make the performance basis at least as attractive in terms of revenue and GP, FDM's work would need to generate 425 leads per month.

STRATEGIC AND OPERATIONAL ISSUES

Biotein donates to charities and appears to be sustainable. FDM may benefit from being associated with a company that has positive ESG credentials.

Small clients such as Biotein give junior staff opportunities. With more junior staff in the hierarchy there is likely to be spare capacity at junior level. This should help reduce the attrition rate which increased in 2023.

More of FDM's clients are focussing on sustainability so the knowledge obtained from this work can be used on other clients. This should help FDM improve the effectiveness of its work and reduce client churn.

It may be difficult to measure attributable revenue because the work does not involve ad campaigns. This could cause disagreement between Biotein and FDM and potentially lower revenue/profit for FDM.

ETHICS

The suggestion to obtain Bracket's pricing quote from the former FDM employee may be unethical if the information is confidential or it puts pressure on the former employee. This could cause FDM to lose the work. However, if the information is forthcoming then this may not be an issue.

Brienne Saffire was involved in the award given to Biotein so will have some familiarity with the CEO. Whilst this is not an issue in itself, this probably should not be a factor for FDM when deciding whether to take Biotein as a client.

Including an hour of Brienne Saffire's time every month to have lunch with the client may be excessive. This could cause higher fees payable by Biotein and may be challenged by Biotein if they become aware of this. However, relationship management is usually undertaken by senior staff so this can be justified.

Expecting staff to use some of their non-billable time to do client work may be seen as unfair. This could cause lower staff morale, productivity and even higher attrition. Also, it prevents FDM being able to calculate actual costs involved and track staff time.

There are media suggestions that Biotein is not as sustainable as it claims. This could cause inaccurate claims to be made as part of FDM's digital marketing work which could lead to reputational damage and potential fines if FDM breaches the code of practice.

RECOMMENDATIONS

Do not pressure the former employee to provide information.
Do not consider Brienne Saffire's relationship with CEO when deciding how to proceed.
Include Brienne Saffire's time to the extent that it is related to FDM work.
Do not expect staff to use their non-billable time.
Verify the facts with Biotein.
Obtain evidence for all marketing claims.

CONCLUSIONS

Pricing based on hours results in LTV of £25,500 (20% churn), £28,333 (18% churn) and £22,378 (22.8% churn). Pricing based of performance results in LTV of £42,000 (most likely), £13,200 (worst case) and £70,800 (best case).

Reach is likely to be lower initially because it takes time for SEO to have an impact.

Any further changes to the assumptions will cause the results to change. To make the performance basis at least as attractive in terms of revenue and GP, FDM's work would need to generate 425 leads per month.

Biotein donates to charities and appears to be sustainable. FDM may benefit from being associated with a company that has positive ESG credentials.

Small clients such as Biotein give junior staff opportunities. With more junior staff in the hierarchy there is likely to be spare capacity at junior level.

There are media suggestions that Biotein is not as sustainable as it claims. This could cause inaccurate claims to be made as part of FDM's digital marketing work which could lead to reputational damage and potential fines if FDM breaches the code of practice.

FDM should price based on billable hours because the margin on performance-based pricing is very low, and a 20-year expected lifetime seems ambitious.

RECOMMENDATIONS

Negotiate with Biotein e.g. a higher payment for each lead.
DD on Biotein and founder.
Research/corroborate all estimates.

Prepare longer GP forecasts to include service cost reductions and cross-selling.
Set timetable for activities.
Ensure staff capacity.

ADVANCED LEVEL CASE STUDY EXAMINATION
NOVEMBER 2023
(4 HOURS)

ICAEW PARTNER IN LEARNING

ACA MASTERS

Case Study: Mock Exam 3

Guidance:

To obtain maximum benefit, this mock exam should be sat under full exam conditions using the practice exam software which is available from the ICAEW website. You should use the exam technique taught during the 'How to Ace the ACA Case Study' class.

Once you have completed the exam, you should use the marking grids provided to calculate your score.

To improve your grade, you should carefully analyse how the report has been structured and written in the prize-winner model answer.

EXHIBIT 15

EMAIL

From: Ali Fisk
To: Stockard Matelier
Subject: FDM Limited: Draft management accounts and business issues
Date: 8 November 2023

We have just received the latest management accounts from FDM. Jai Williamson would like us to carry out a review of FDM's performance. We also need to address some business issues facing FDM. I am attaching the following:

- A note from Jai Williamson on FDM's management accounts and a request for advice **(Exhibit 16)**
- FDM's draft management accounts for the year ended 30 September 2023 **(Exhibit 17)**
- An email from Jerzel Morales to me regarding Cosy Furniture **(Exhibit 18a),** together with an extract from Cosy Furniture's website **(Exhibit 18b)**
- An email from Zizi Zettner to me about FDM's staffing strategy **(Exhibit 19a),** together with media coverage **(Exhibit 19b)** and an online forum post **(Exhibit 19c)**

Please draft for my review a report addressed to the FDM board. The report should comprise the following.

1. A review of FDM's performance for the year ended 30 September 2023 in comparison with the year ended 30 September 2022. It should cover:

   - revenue by client size and in total
   - cost of sales by cost category and in total
   - gross profit by client size and in total
   - administrative and selling expenses
   - operating profit

   Use the management accounts set out in **Exhibit 17**, incorporating as appropriate the additional information in **Exhibit 16** and FDM's KPIs.

   You should also respond to FDM's request for advice (**Exhibit 16**).

2. An evaluation of the proposal for FDM to provide digital marketing services to Cosy Furniture, as set out in **Exhibit 18a**. You should:

   - Calculate FDM's expected annual gross profit, covering all relevant services provided under the contract.
   - Evaluate the appropriateness of the estimates and assumptions.
   - Explain and evaluate the wider commercial and financial considerations relating to the contract, including those arising from a potential long-term relationship with Cosy Furniture. Take into consideration any issues arising from **Exhibit 18b**.
   - Recommend, with reasons, how FDM should proceed.

3. An evaluation of FDM's staffing strategy, as set out in **Exhibit 19a**.

   - For each of Alternative A and Alternative B, calculate FDM's expected operating profit for the year ended 30 September 2024.
   - Explain and evaluate the strategic, operational and financial issues that FDM should take into account when deciding which strategy to pursue. Incorporate any ethical and business trust aspects, including any arising from Exhibits 19b and 19c.
   - Provide a justified recommendation as to which staffing strategy FDM should pursue.

EXHIBIT 16

Note from Jai Williamson, 7 November 2023: Additional information relating to the draft management accounts for the year ended 30 September 2023 (2023)

- Following an increase on 1 October 2022, charge-out rates for the year ended 30 September 2023 were as follows:

Staff grade	£ per hour
Director	240
Manager	130
Team leader	100
Team member	75

- FDM won several clients during the year. These included:
  - Bed Operations Limited, a national bed chain with stores across the UK. Expected monthly revenue is £10,800.
  - Fresh Foods, a rapidly expanding online grocery delivery business. Expected monthly revenue is £2,200.
  - Shelter, a UK charity providing temporary housing for homeless people. Expected monthly revenue is £600.

- The increase in charge out rates was fiercely resisted by major and large clients. Despite continuing to offer substantial discounts, FDM lost three major clients and four large clients during the year.

- The overall client churn rate was 16.3%.

- Whilst SEO work continued to provide a steady revenue stream, clients are increasingly focussing on paid advertising to boost their digital presence. Approximately 50% of revenue in 2023 was from paid search management.

- All staff were paid a bonus under the discretionary bonus scheme. The amount paid varied by individual based on their grade, seniority, role and performance. The total bonus paid to all staff was £80,000.

- Additional information on staff is set out below.

	2023
Headcount	
Billable staff	94
Support staff	16
Total headcount (including directors)	110
Leavers who were in headcount at start of year	11
Leavers who joined in 2023	13
Average payroll cost per member of staff (billable and support staff, including bonus)	£47.1k

Request for advice: Sublime

In March 2023, Sublime appointed a new marketing director and there has been a notable change in the working relationship since. Previously, Sublime were happy for FDM to take the lead on setting the digital marketing strategy and deciding how the paid advertising budget was spent. However, the new marketing director constantly challenges and overrules FDM staff. This has resulted in suboptimal decisions being made which has led to a decline in Sublime's search engine ranking and paid advertising campaigns generating less revenue than expected.

Sublime's marketing director believes FDM is to blame for this decline in digital marketing performance and has refused to pay FDM's fees for SEO work performed between May and August 2023. They also claim that the two most recent social media campaigns that FDM ran for Sublime did not result in any additional revenue for Sublime and therefore no fees are payable to FDM.

The total fees outstanding from Sublime are £26,000. This includes an estimate of FDM's fees for paid search management work.

Please advise us on the matters that FDM should consider when dealing with this issue and any actions that FDM should take.

EXHIBIT 17

FDM: Draft management accounts for the year ended 30 September 2023

Statement of profit and loss for the year ended 30 September 2023

	Note	£000
Revenue	**1**	10,705
Cost of sales	**2**	(6,363)
Gross profit	**3**	**4,342**
Administrative and selling expenses		(1,078)
Operating profit		**3,264**
Net finance income		48
Profit before taxation		3,312
Taxation		(829)
Profit for the year		**2,483**

Statement of financial position

	Note	£000
Non-current assets		
Property, plant and equipment (PPE)	**4**	1,397
		1,397
Current assets		
Trade and other receivables	**5**	1,544
Cash and cash equivalents		3,131
		4,675
TOTAL ASSETS		**6,072**
Equity		
Ordinary shares		100
Retained earnings		3,524
		3,624
Current liabilities		
Trade and other payables	**6**	1,619
Taxation		829
		2,448
TOTAL EQUITY AND LIABILITIES		**6,072**

Statement of cash flows

	£000
Cash flows from operating activities	
Profit before taxation	3,312
Adjustments for:	
Loss/(profit) on disposal of PPE	30
Depreciation of PPE	178
Finance income	(48)
	3,472
Change in trade and other receivables	(509)
Change in trade and other payables	387
	3,350
Income tax paid	(454)
Net cash generated from operating activities	**2,896**
Cash flows from investing activities	
Acquisition of PPE	(642)
Proceeds from disposal of PPE	72
Net finance income	48
Net cash generated from investing activities	**(522)**
Cash flows from financing activities	
Dividends paid	(1,000)
Net cash generated from financing activities	**(1,000)**
Net change in cash and cash equivalents	1,374
Cash and cash equivalents at start of year	1,757
Cash and cash equivalents at end of year	**3,131**

Notes to the management accounts

Note 1: Revenue by client size

	£000
Major accounts	2,355
Large accounts	2,569
Medium accounts	2,676
Small accounts	3,105
	10,705

Note 2: Cost of sales by cost category

	£000
Billable staff	4,462
Other costs	1,901
	6,363

Note 3: Gross profit by client size

	£000
Major accounts	682
Large accounts	908
Medium accounts	1,172
Small accounts	1,580
	4,342

Note 4: Property, plant and equipment (PPE)

	£000
Opening carrying amount	1,035
Additions	642
Depreciation charge	(178)
Disposals (carrying amount)	(102)
Closing carrying amount	**1,397**

Note 5: Trade and other receivables

	£000
Trade receivables	1,486
Other receivables and prepayments	58
	1,544

Note 6: Trade and other payables

	£000
Deferred income	942
Other payables and accruals	408
Trade payables	269
	1,619

EXHIBIT 18a

EMAIL

From: Jerzel Morales
To: Ali Fisk
Subject: Cosy Furniture
Date: 7 November 2023

We were recently approached by Cosy Furniture who are looking for a new digital marketing agency as they are currently unhappy with recent changes at their existing provider, Collective Link. Cosy are an online retailer of sofas and living room furniture which are made and sold in the UK.

Scope of the work
Cosy require an agency to provide SEO and paid search management services because their internal marketing team do not have the required technical capabilities. The initial contract will be for 12 months and will then move to a one-month rolling basis.

The objective of the SEO work is to ensure that Cosy maintains its ranking for keyword searches on Google. The nature of Cosy's business and FDM's experience means that this work will be routine and predictable. Most of the work can be carried out by junior staff with manager and director input mainly for supervision and client interaction.

Expected time per month and charge-out rates are set out below. These are normal charge-out rates and do not include any discount. The estimated gross margin for the SEO work before any discount is 35%.

	2024 charge-out rate per hour £	Expected time per month hours
Director	250	1
Manager	150	3
Team leader	100	8
Team member	75	20

Paid search management work will involve short-term social media campaigns. The objective is to increase sales of Cosy's products by building brand awareness and reaching a larger number of potential customers.

Depending on the success of the SEO and paid search management work, Cosy has indicated that it would like to outsource website development and strategy formulation in the future.

Pricing and payment
Cosy have informed FDM that Collective Link provides them with a 30% discount on normal charge out rates for SEO work and fees for paid search management are calculated as 4% of attributable revenue. Cosy requires the same pricing terms from whichever agency it decides to use.

Payment for SEO work will be two months in advance and then monthly. Payment for paid search management will be 60 days after each campaign.

Social media campaigns
Cosy runs one social media campaign each quarter with campaigns currently taking place in January, April, July and October. FDM may experiment with different dates to see if this can improve results but there will still be four campaigns per year for the time being. FDM will also experiment with different social media platforms to identify which platform is the most effective for reaching Cosy's target market.

Based on experience, each campaign is expected to be viewed by 250,000 potential customers with 10% visiting Cosy's website. Cosy's bounce rate is 30% and leads are 25% of those who remain on the site. Due to the current challenging economic conditions, there is some uncertainty over the number of leads that will convert into paying customers. The most likely case (50% probability) is that 10% of leads will convert into paying customers. However, there is a 20% probability that only 8% of leads will convert and a 30% probability that 12% of leads will convert.

Cosy's average revenue per sale is £450.

FDM's costs for billable staff are expected to be £4,000 per campaign.

Other information
The historic average gross margin for clients of this size is 35% and the average churn rate is 6%. However, when performance-based pricing is used for at least some of the services provided then the average churn rate is 3%.

EXHIBIT 18b

Extract from www.cosyfurniture.co.uk

We are a family run business and the UK's leading supplier of sustainably sourced sofas and furniture. Our mission is simple: we aim to supply top quality products that are sustainably manufactured at competitive prices.

All our products are designed, manufactured and distributed with the environment in mind. Everything we supply is made from sustainably sourced materials and all manufacturing takes place in the UK to reduce our carbon footprint.

We have a wide range of sofas which can be tailored to your exact specifications. You can view our sofa product range here.

We also supply living room furniture made entirely from reclaimed wood. You can view our furniture product range here.

EXHIBIT 19a

EMAIL

From: Zizi Zettner
To: Ali Fisk
Subject: Staffing strategy
Date: 6 November 2023

Recruitment in 2023 focussed on increasing headcount at team member grade. The current staff hierarchy is below.

Grade	Total headcount
Team member	84
Team leader	12
Manager	9
Director	5
Total	**110**

The increased number of staff at team member grade has created several challenges. Firstly, team leaders and managers have spent more time dealing with staff issues. This has taken away from the time available to spend on client work and client surveys have shown a marked decline in service quality. Secondly, almost all team members are working remotely two days per week which is making it difficult to supervise and monitor them.

We are now in the process of finalising our recruitment plans for 2024 and have identified two alternative staffing strategies.

A: Recruit team leaders and managers

All recruitment will be at team leader and manager grade. This will help improve client service and maximise cross-selling.

All staff will be permitted to work remotely as often as they wish. Having more managers and team leaders will enable proper supervision and development of existing team members and employee monitoring technology will be introduced for all team members who work remotely. JetStream will be implemented to facilitate remote working, boost productivity and optimise workflow planning. As a result of the reduction in required office space, a smaller office premises will be sought.

<u>Assumptions</u>

- The annual increase in revenue for the year ended 30 September 2024 will be 30%.
- 25% of revenue will come from each client size.
- AMFIH will be £9.0k.
- All new staff will be billable (the number of support staff will remain at 2023 levels).
- Average cost for all billable staff will be £65,000.
- Recruitment costs will be £10,000 per recruit. Staff will pay all training costs.
- The cost to implement JetStream will be £100,000.
- Other cost of sales will be £1,500,000.
- Advertising and selling costs will remain at 2023 levels.
- Cost savings from the office relocation will be £500,000.

B: Recruit team members

The majority of recruitment will continue to be at team member grade to help control staff costs. The market is continuing to grow as more businesses realise the importance of digital marketing, so FDM will not have any difficulty finding new clients if some existing clients leave due to lower service quality.

All staff will be required to work from the existing London office five days per week to enable proper supervision.

Assumptions

- The annual increase in revenue for the year ended 30 September 2024 will be 40%.
- The mix of revenue from each client size in 2024 will remain at the 2023 mix.
- AMFIH will be maintained at 2023 levels.
- Gross profit margins will remain at 2023 levels.
- Advertising and selling costs will remain at 2023 levels.

Other issues

There has been a lot of disagreement at recent board meetings as to the future of FDM. Some of us are questioning whether this is the right time to sell our shares, whereas others are keen to get a sale agreed as soon as possible so they can pursue other opportunities. This has caused a delay in deciding what our staffing strategy should be for 2024 as the decision will be affected by the planned timing of the disposal of our shares.

EXHIBIT 19b

Financial Chronical
(October 2023)

It has been reported that Big Bison has instigated legal action against Collective Link's former directors following its acquisition of Collective Link in August 2023. Big Bison is said to be unhappy about the state of Collective Link's client portfolio and staff relations. Big Bison claims that the former directors, who were also the shareholders, made misrepresentations during the negotiation process knowing that Big Bison would rely upon those representations.

When we approached Big Bison for comment, a spokesperson for the company said that they were unable to comment on ongoing legal matters. Collective Link's former directors were unavailable for comment.

EXHIBIT 19c

Online forum
(October 2023)

User387: Hey, can anyone who works at FDM shed some light on what it's like to work there?

User 048: Hey, yeah I have been here 6 months. It's pretty good pay and you can take as much holiday as you want (provided that you get your work done). You also get a 15% time 'allowance' which you can do whatever you want with - most people just say they are working from home and spend it getting on with their own personal stuff!

Mock Exam 3 Mark Scheme

OVERALL ASSESSMENT CRITERIA	EXECUTIVE SUMMARY
	R1 - Review of financial performance
(E) Report structure: disclaimer AND from firm AND headings **(F)** Report language: formal AND tactful AND ethical	**(I)** Qualitative comment on total revenue **with fig** **(J)** Qualitative comment on rev by client size **with fig** **(K)** Qualitative comment on COS/GP/GP% **with fig** **(L)** Qualitative comment on admin/OP/OP% **with fig**
	(I) Below target due to headcount / AMFIH achieved target **(J)** Clients: rebalance mix / staff: reduce attrition **(K)** Sublime: financial impact / major clients lost/major churn % up **(L)** Appropriate summary of report section

R2 - Evaluation of Cosy proposal	R3 - Evaluation of staffing strategy
(I) Gives annual GP **(J)** Evaluates/questions assumptions **(K)** Concludes on commercial/financial issues **(L)** Get back up for all estimates	**(I)** Gives OP for both alternatives **(J)** Concludes on ethical/business trust issues **(K)** Concludes on main financial/operational/strategic issue **(L)** B gives better short-term results / links to planned sale
(I) Concludes on way forward with reason **(J)** Negotiate T&C / DD on Cosy **(K)** Consider staff capacity **(L)** Appropriate summary of report section	**(I)** Concludes on way forward with reason **(J)** Board to agree on future **(K)** Discuss with staff / staff committee / resolve client service issues **(L)** Appropriate summary of report section

REQUIREMENT 1 – Review of FDM financial performance and request for advice

ASSIMILATING & USING INFORMATION	STRUCTURING PROBLEMS & SOLUTIONS
Appendix 1 **(G)** Analysis of revenue **(H)** Analysis of COS/GP AND admin/OP	**Financial analysis: Revenue (report)** **(M)** Major: up **£287k / 13.9%** **(N)** Large up **£501k / 24.2%** **(O)** Medium: up **£691k / 34.8%** **(P)** Small: up **£954k / 44.4%** **(Q)** AMFIH: **£8.1k** **(R)** Mix: Major **22% v 25%** / Large **24% v 25%** / Medium **25% v 24%** / Small **29% v 26%**
AI/CS Exam info (report/appendix) **(J)** Overall revenue: up **£2,433k / 29.4%** **(K)** Overall COS: up **£1,328k / 26.4%** **(L)** Overall GP: up **£1,105k / 34.1% /** GP%: **40.6% v 39.1%** **(M)** Admin: up **£170k / 18.7%** **(N)** OP: up **£935k / 40.1%** / OP% **30.5% v 28.2%**	**Financial analysis: GP/OP (report)** **(M)** Major: GP up **£93k/15.8%** / GP% **29.0% v 28.5%** **(N)** Large: GP up **£184k/25.4%** / GP% **35.3% v 35.0%** **(O)** Medium: GP up **£318k/37.2%** / GP% **43.8% v 43.0%** **(P)** Small: GP up **£510k/47.7%** / GP% **50.9% v 49.7%** **(Q)** Billable: up **£1,182k/36.0%** OR Other: up **£146k/8.3%** > **(R)** Admin: ex. staff up **£30k / 9.1%** >
Business issues / wider context / KPIs **(J)** Impact of COVID-19 on business / fragile economy / growth in online activity **(K)** Industry averages: CAGR growth >10% **(L)** Attrition: up **12.9% v 11.8%** / **28.2% v 26.5%** / below 30% **(M)** Headcount: total up **110 v 85 / 29.4%** / below target **(N)** Client churn: **16.1%** v **15.2%**	**Request for advice (report)** **(M)** Sublime major client / previous work a success > **(N)** Lower FDM revenue for performance-based pricing work / disagreement as to who is to blame > **(O)** Uncertainty over attributable revenue > **(P)** Financial impact: £26k / comment on size as % of TR/revenue / increase in TR days / cash impact > **(Q)** New director appears domineering/bullying > **(R)** Working with BOL may create further issues >

APPLYING JUDGEMENT	CONCLUSIONS AND RECOMMENDATIONS
Evaluation of revenue analysis **(M)** Total revenue: faster growth **29.4%** than last year **22.4%** / **under** target of **35%/£11,167k** / **above 10%** industry CAGR **(N)** Client churn: major/large higher **with fig** **(O)** Impact of new clients on relevant category e.g. BOL large / FreshFoods medium / Shelter small **(P)** Major/large/medium below target / small above target **(Q)** Growth due to headcount / AMFIH maintained/achieved target **(R)** Mix deviated from target / key risk	**Draws conclusions (under a heading)** **(I)** Qualitative comment on total revenue **with fig** **(J)** Qualitative comment on COS/GP/GP% **with fig** **(K)** Qualitative comment on admin/OP/OP% **with fig** **(L)** Qualitative comment on advice request
Evaluation of GP/OP analysis **(M)** Change in COS compared to change in revenue **(N)** GP%: impact of change in client size mix / impact of services **with fig** **(O)** GP%: charge out rate increase > staff cost increase / major clients resisting increases/discounts **(P)** OP% above 30% target **(Q)** Billable: avg. cost up **£47.5k v £45.6K / 4.2%** OR Other: recruitment up/fixed cost element **(R)** Support staff: avg. cost increase **with fig**	**Makes recommendations** **(M)** Analyse revenue/GP by client **(N)** Clients: rebalance mix / win more major clients **(O)** Staff: change bonus scheme / reduce attrition **(P)** Pricing changes eg charge rates **(Q)** Consider relocating **(R)** Other commercial recommendations
Eval/recs on request for advice **(M)** Risk of losing another major client **(N)** Compare recent performance to before new director appointed / speak with alternative contact at Sublime **(O)** Independent review / obtain evidence **(P)** May require write off / provision **(Q)** Consider if FDM wants to keep working with Sublime / staff impact **(R)** Inform Sublime / non-disclosure agreements / separate teams	

REQUIREMENT 2 – Evaluation of Cosy proposal

ASSIMILATING & USING INFORMATION	STRUCTURING PROBLEMS & SOLUTIONS
Appendix 2 **(G)** Numbers clearly derived **(H)** Calculation for total GP **(I)** Calculates GP for different outcomes	**Calc of paid ad mgt fee / totals (appendix)** **(K)** Leads: 4,375 **(L)** Conversions: 350 AND 438 AND 525 **(M)** FDM revenue: £6,300 AND £7,875 AND £9,450 **(N)** FDM GP: £2,300 AND £3,875 AND £5,450 **(O)** Total FDM revenue: £50,400 AND £56,700 AND £63,000 **(P)** Total FDM GP: £11,000 AND £17,300 AND £23,600
Calc of SEO fee (appendix) **(M)** Charge out rates: £250 AND £150 AND £100 AND £75 **(N)** Hours: 1 AND 3 AND 8 AND 20 **(O)** Revenue: £2,100 / £25,200 **(P)** COS: £1,950 / £23,400 **(Q)** GP: £150 / £1,800	**Assumptions** **(L)** Reach: 250k v Sublime: 400k / Leads: 25% v 20% > **(M)** Bounce rate: 30% v Sublime: 50% > **(N)** Questions use of probabilities > **(O)** Time spent may be different / v Compere > **(P)** Leader and member charge out rates same as 2023 > **(Q)** Revenue will depend on success of Cosy business / expected lifetime seems very long
Business issues / wider context **(J)** Inflation currently high / future uncertainty **(K)** 2023 client mix: shift to small clients **(L)** Risks: failure to win new clients / margin dilution **(M)** Cosy: online furniture retailer / currently with Collective Link	**Commercial issues** **(M)** Large clients lost in 2023 > **(N)** SM campaigns may require overtime/weekend working > **(O)** SEO upfront payment / deferred income > **(P)** Experimentation may increase costs / knowledge obtained can be used on other clients **(Q)** Potential for more work if successful > **(R)** Claims to be environmentally sustainable >

APPLYING JUDGEMENT	CONCLUSIONS AND RECOMMENDATIONS
Evaluation of calcs **(M)** Comment on relative size / identifies as large client **(N)** Compares to large client average revenue/GP%/LTV **(O)** Client serving costs reduce over time / 12m contract may not be extended/one month notice **(P)** Calculates and comments on estimated LTV **(Q)** Performance-based pricing has upside/downside risk / 4% v 5% Sublime **(R)** Any further changes in assumptions will impact calculations eg pay increases, lifetime/churn rate	**Draws conclusions (under a heading)** **(I)** Gives annual GP **(J)** Evaluates/questions assumptions **(K)** Concludes on commercial and financial issues **(L)** Concludes on way forward **with reason**
Evaluation of assumptions **(M)** Will be variation between campaigns **(N)** Similar sector / lower than sector average (50%) **(O)** Actual outcome likely to be different / calculates EV **(P)** SEO generally straightforward and accurate / questions 35% GPM v large avg./discounts/SEO low margin **(Q)** Large clients resist increases **(R)** No accounting for inflation/salary increase/other costs	**Makes recommendations** **(M)** Negotiate T&C **(N)** DD on Cosy **(O)** Check staff capacity **(P)** Get back up for all estimates / marketing claims **(Q)** Set timetable for activities **(R)** Other commercial recommendations
Evaluation of commercial issues **(M)** Churn % increase **/** will impact LTV **(N)** Opportunity for staff development / progression **(O)** Difficulties calculating attributable revenue / Sublime issues / compares payment terms with Compere/Sublime **(P)** Large clients enhance FDM reputation / brand **(Q)** Potential higher margins / performance pricing reduces churn **(R)** Claims must be supported by evidence	

REQUIREMENT 3 – Evaluation of staffing strategy

ASSIMILATING & USING INFORMATION	STRUCTURING PROBLEMS & SOLUTIONS
Workings / report	**Calc of OP: Alternative B (accept rounding)**
(H) Numbers clearly derived **(I)** Calculation for alternatives (A) AND (B) **(J)** Uses 2023 revenue as base **(K)** Sensitivity analysis	**(F)** Revenue: £3,297k AND £3,597k AND £3,747k AND £4,346k / £14,987k **(G)** Headcount: 154 **(H)** GP: 40.6% OR 29.0% AND 35.3% AND 43.8% AND 50.9% **(I)** Admin and selling: £1,078k **(J)** OP: £5,001k
Calc of OP: Alternative A (accept rounding)	**Strategic and operational issues**
(F) Revenue: £13,917k **(G)** Headcount: 129 **(H)** Billable staff: £7,345k **(I)** Recruitment costs £190k AND JetStream £100k **(J)** Office saving: £500k **(K)** OP: £4,204k	**(M)** JetStream: productivity / scalability > **(N)** Management of staff is resource intensive eg management time, development, supervision > **(O)** Relocation: disruption / cost / major change > **(P)** Clients service declining > **(Q)** Major changes unnecessary if plan is to sell
Business issues / wider context	**Comments on ethical/bus trust issues**
(K) Inflation currently high / future uncertainty / growing market **(L)** Identified risks: client mix / staff targets / office costs / data / strategic goal of award-winning service / engaged staff **(M)** Past strategy: recruit for growth / headcount enabler of growth / overstaffing preferred / revenue growth over profitability **(N)** JetStream: remote working/collaboration/cloud-based **(O)** Bank balance: £3,131k / attrition/churn 2023 increase	**(L)** Inappropriate use of 15% allowance by staff > **(M)** Staff to pay training costs > **(N)** Disagreement/tension between directors > **(O)** CL director misrepresentations > **(P)** Stop WFH for team members / monitoring / morale impact / ‘quiet quitting’ / younger staff want flexibility > **(Q)** JetStream data security: inappropriate access/use / reputational damage / fines

APPLYING JUDGEMENT	CONCLUSIONS AND RECOMMENDATIONS
Evaluates financial issues **(M)** B gives higher revenue/GP/GP%/OP/OP% / A higher AMFIH/profit per employee **(N)** 2022 and 2023 missed target / targets seem ambitious / previous forecasting broadly accurate / AMFIH flat in 2023 **(O)** JetStream investment covered by office saving / FDM has sufficient cash **(P)** B better short-term results/links to planned sale/short termism **(Q)** Mix will not be exact / identifies missing costs / one year forecast not long enough if sale not soon **(R)** Any further changes in assumptions will impact calculations	**Draws conclusions (under a heading)** **(K)** Gives OP for both scenarios **(L)** Concludes on main financial/operational/strategic issue **(M)** Concludes on ethics/business trust issues **(N)** Concludes on way forward with reason
Strategic and operational impact **(M)** Future impact e.g. margin improvement, revenue growth **(N)** Costs increasing / upward pressure on wages / more team members means more supervision **(O)** Long-term saving / reduced fixed cost **(P)** Client acquisition costs / churn impact / large/major require experienced staff **(Q)** Short timescale for major changes (2024 now)	**Makes recommendations** **(M)** Discuss plans with staff / staff committee **(N)** Negotiate T&C with JetStream / research alternatives **(O)** Find alternative office locations **(P)** Address client service issues / speak with clients **(Q)** Get back up for all estimates / identify other costs **(R)** Other commercial recommendations
Evaluation/recs: ethical/business trust **(L)** Process to monitor how time is used / verify claims **(M)** Positive recruitment tool / some rivals make staff pay **(N)** Ensure effective management of business / agree on way forward re sale **(O)** Obtain legal advice on any 'pump and dump' strategies / personal consequences for directors **(P)** Discuss working arrangements with staff / monitoring may create legal issues so seek advice **(Q)** DD on JetStream / security audit/procedures	

Mock Exam 3 Model Answer

A report on FDM

TO: Directors of FDM
FROM: Newell Mast
DATE: 8 November 2023

This report is for the Board of FDM only and should not be distributed to third parties.
No liability can be accepted in this event.

Executive Summary

Review of Financial Performance for Year Ended 30 September 2023

Overall revenue increased impressively by £2,433k (29.4%) to £10,705k which is below the target of 35%/£11,167k. AMFIH remained at £8.1k (target), whereas headcount of 110 (29.4% increase) is below the target of 115. The revenue target not being achieved was due to headcount. Major account revenue increased modestly by £287k (13.9%) but is below the target of £2,792k due to increases in charge out rates being resisted by clients. Churn has increased to 21.4% from 8.3% due to the loss of three clients. Large account revenue increased reasonably by £501k (24.2%) and is also below the target. Medium account revenue increased impressively by £691k (34.8%) and is just below the target of £2,680k despite the acquisition of Fresh Foods. Small account revenue increased the most by £954k (44.4%) and is above the target of £2,903k because small clients mostly accept charge out rate increases.

COS increased by £1,328k (26.4%) due to an increase in all costs but increased slower than revenue which will have a positive impact on GPM. Billable staff increased by £1,182k (36.0%) due to the £80k staff bonus. Attrition rate has increased to 12.9% from 11.8% with the revised rate now 28.2% (22: 26.5%) (below sector average of 30%). Overall GP increased impressively by £1,105k (34.1%) to £4,342k with GPM increasing to 40.6% from 39.1% due to a revenue mix shift towards higher margin small/medium clients and higher margin paid search management work. Major GP has the lowest growth with £93k (15.8%) but still saw a slight GPM increase to 29.0% from 28.5% despite clients resisting price increases and average staff costs increasing. Large GP increased significantly by £184k (25.4%) with a slight GPM increase to 35.3% from 35.0%. Medium GP increased impressively with £318k (37.2%) and had a strong GPM increase to 43.8% from 43%. Small GP saw the strongest growth with £510k (47.7%), with a GPM increase to 50.9% from 49.7%, due to increases in charge out rates being accepted by clients and being higher than the cost increase for average billable staff. Admin and selling increased by £170k (18.7%) and increased slower than revenue which will have a positive impact on OPM. OP has increased impressively by £935k (40.1%) to £3,264k, with an OPM increase to 30.5% (22: 28.2%) which is above the 30% target, due to the revenue mix shift away from demanding major/large clients.

The new Sublime director appears aggressive and domineering. This is restricting FDM's creatively and will result in lower revenue for Sublime and FDM (when fees are performance based). The £26k fees outstanding are 17.3% of average revenue from Sublime (£150k) so are a substantial part of work performed in 2023. Working with BOL may create further issues because they are competitors.

RECOMMENDATIONS

Engage independent party to verify attributable revenue.
Speak with alternative director at Sublime e.g. MD to explain issues.
Rebalance client mix by targeting major clients.
Improve pay, conditions and career progression opportunities to reduce attrition.

**highlighted text demonstrates key points to bring to the attention of the directors. These were not included in the conclusions and were added to the Executive Summary.*

EVALUATION OF COSY PROPOSAL

GP will be £17.3k (most likely), £11k (worst case) or £23.6k (best case). GPM will be 30.5% (most likely), 21.8% (worst case) or 37.5% (best case). LTV is estimated at £576.7k (most likely), £366.7k (worst case) or £786.7k (best case) and is higher than the large client average of £291.7k. All cases are lower than overall GPM (40.6%) but the best case is above large GPM (35.3%). The work will contribute to revenue and profit targets/KPIs being met and will help rebalance the client mix after a loss of four large clients in 2023. Using performance pricing will help reduce churn. Any further changes to the assumptions will cause the results to change. Adjusting the paid ad management fee to 5% in line with Sublime increases GP to £25.2k (GPM 39%) on a most likely basis and this is higher than large client average.

Bounce rate is likely to be higher than 30% because it was 50% for Sublime and 50% is the sector average. Although a slightly different market, there are a lot of similarities so would not expect such a big difference. Hours may be higher at the start because of initial time spent on research and experimenting with different SM platforms. A 3% churn rate implies a 33.3-year engagement life which is incredibly long for a rapidly changing industry and when the contract is only for 12 months.

Cosy claims to be sustainable but FDM will need to verify claims so as not to be complicit in greenwashing or risk breaching the code of practice. Performance pricing has potential for higher revenue and profits but also downside risk if Cosy's revenue is lower than estimated. FDM could potentially make a loss with performance pricing. Managing SM campaigns can be very resource-intensive for staff so may cause excessive pressure and damage morale and their welfare.

FDM should proceed because a large client will reduce the impact of 2023 client losses and help achieve growth targets.

RECOMMENDATIONS

Negotiate and perform due diligence on Cosy.
Research to corroborate all estimates.
Ensure staff capacity.
Verify all sustainability claims before running campaigns.

EVALUATION OF STAFFING STRATEGY

Financially, Alternative A OP is £4,204k with an OPM of 30.2%. Alternative B OP is £5,001k with an OPM of 33.4%. Alternative B delivers higher revenue, GP, GPM (40.6% v 34.4%), OP and OPM so makes FDM appear more attractive to a potential purchaser. Both deliver OPM higher than the 30% target but only Alternative B is higher than 2023 OPM (30.5%).

The timeframes are very challenging because implementing the technology and moving office will take time and the YE 2024 has already started. Revenue growth of 30/40% seems ambitious because it was 29.4% and below target in 2023. Any further changes to the assumptions will cause the results to change. If revenue growth is also 40% for Alternative A, then OP will be higher than Alternative B at £5,274k.

Strategically, reducing service quality is contrary to FDM's goal of providing award-winning service levels. This will damage FDM brand and increase client churn which is a key risk. Major changes seem unnecessary if the board is considering selling in the short term.

Operationally, having more staff will increase the amount of time managers and leaders spend dealing with staff issues. This may further reduce service quality.

In terms of ethics, FDM's directors could be subject to legal action if they make misrepresentations to potential purchasers. This could result in fines and compensation to the purchaser. This could be an issue if short term focussed strategies which result in a decline in service quality and staff relations are chosen. Employee monitoring technology may be considered invasive and a breach of privacy for some staff. This could reduce staff morale and productivity. However, it will depend on the exact form that monitoring will take.

If the board plan to sell their shares in the short term, then Alternative B should be chosen to improve short-term results.

RECOMMENDATIONS

Discuss any changes with staff and the committee.
Obtain legal advice throughout sale process and do not make misrepresentations.
Get back up for all estimates.
Negotiate with JetStream.
Find purchasers for FDM and identify their valuation criteria.

APPENDIX 1: Analysis of Management Accounts

	2023	2022	Change (£k)	Change (%)
REVENUE				
Major	£2,355	£2,068	£287	13.9%
Large	£2,569	£2,068	£501	24.2%
Medium	£2,676	£1,985	£691	34.8%
Small	£3,105	£2,151	£954	44.4%
TOTAL	**£10,705**	**£8,272**	**£2,433**	**29.4%**
Mix				
Major	22.0%	25.0%	-3.0%	
Large	24.0%	25.0%	-1.0%	
Medium	25.0%	24.0%	1.0%	
Small	29.0%	26.0%	3.0%	
	100.0%	100.0%		
Headcount	110	85	25	29.4%
Billable	94	72	22	30.6%
Support	16	13	3	23.1%
AMFIH	£8.1	£8.1	£0.0	0.0%
Attrition rate	12.9%	11.8%	1.1%	9.7%
Left	11	8	3	37.1%
Attrition rate: revised	28.2%	26.5%	1.7%	
Joined and left	13	10	3	30.0%
Total left	24	18	6	33.2%
Client churn				
Total	16.3%	15.2%	1.1%	
Clients lost (approx.)	57	40	17	41.9%
Clients at start (approx.)	349			
Major	21.4%	8.3%	13.1%	
Clients lost	3	1	2	197.2%
Clients at start (approx.)	14			
Large	9.8%	5.7%	4.1%	
Clients lost	4	2	2	100.5%
Clients at start (approx.)	41			
Director	£240	£215	£25	11.6%
Manager	£130	£115	£15	13.0%
Team leader	£100	£90	£10	11.1%
Team member	£75	£66	£9	13.6%

COS				
Billable staff	£4,462	£3,280	£1,182	36.0%
Other	£1,901	£1,755	£146	8.3%
TOTAL	**£6,363**	**£5,035**	**£1,328**	**26.4%**
% of revenue				
Billable staff	41.7%	39.7%	2.0%	
Other	17.8%	21.2%	-3.5%	
	59.4%	60.9%	-1.4%	
Avg. billable staff cost	£47.5	£45.6	£1.9	4.2%
GP				
Major	£682	£589	£93	15.8%
Large	£908	£724	£184	25.4%
Medium	£1,172	£854	£318	37.2%
Small	£1,580	£1,070	£510	47.7%
TOTAL	**£4,342**	**£3,237**	**£1,105**	**34.1%**
GPM				
Major	29.0%	28.5%	0.5%	
Large	35.3%	35.0%	0.3%	
Medium	43.8%	43.0%	0.8%	
Small	50.9%	49.7%	1.2%	
TOTAL	**40.6%**	**39.1%**	**1.4%**	
Mix				
Major	15.7%	18.2%	-2.5%	
Large	20.9%	22.4%	-1.5%	
Medium	27.0%	26.4%	0.6%	
Small	36.4%	33.1%	3.3%	
	100%	100%		
ADMIN AND SELLING	£1,078	£908	£170	18.7%
% of revenue	10.1%	11.0%	-0.9%	
Avg. payroll cost	47.1	45.4	£1.7	3.7%
Total staff costs	£5,181	£3,859	£1,322	34.3%
Billable staff	£4,462	£3,280	£1,182	36.0%
Support staff	£719	£579	£140	24.2%
As % of revenue	6.7%	7.0%	-0.3%	
Avg. support staff cost	£44.9	£44.5	£0.4	0.9%
Total ex support	£359	£329	£30	9.1%
As % of revenue	3.4%	4.0%	-0.6%	
OP	£3,264	£2,329	£935	40.1%
OPM	30.5%	28.2%	2.3%	

Review of Financial Performance for Year Ended 30 September 2023

REVENUE

Overall revenue increased impressively by £2,433k (29.4%) to £10,705k which is below the target of 35%/£11,167k but above the market CAGR which is around 10%. AMFIH remained at £8.1k which is the target, but it is still below the previous peak of £8.9k, whereas headcount of 110 (29.4% increase) is below the target of 115. This shows that the revenue target not being achieved was due to headcount. The fragile economy may have had a negative impact, so the fact that the rate of growth is increasing (2022: 22.4%) is excellent. Revenue from all client sizes has increased. Many businesses have shifted towards a digital model due to the impact of COVID-19 and this has increased demand for digital marketing. Churn has increased to 16.3% from 15.2%.

Major account revenue increased modestly by £287k (13.9%) but is below the target of £2,792k due to increases in charge out rates being resisted by clients and substantial discounts being offered. This is despite acquiring BOL with expected annual revenue below the average and Sublime (£129.6k v £150k). Churn has increased to 21.4% from 8.3% due to the loss of three clients. Churn can be erratic because MNCs have low switching costs and there are a small number of clients in this category.

Large account revenue increased reasonably by £501k (24.2%) and is also below the target of £2,792k for the same reason as major. Churn has increased to 9.8% from 5.7% due to the loss of four clients.

Medium account revenue increased impressively by £691k (34.8%) and is just below the target of £2,680k despite the acquisition of Fresh Foods with expected annual revenue slightly above the average and Compere (£26.4k v £25k).

Small account revenue increased the most by £954k (44.4%) and is above the target of £2,903k because small clients mostly accept charge out rate increases (increases of between 11.1%-13.6% in 2023). Expected revenue from Shelter is below the average (£7.2k v £10k) but higher than HSG (£6k).

Major accounts for 22.0% (22: 25.0%) of revenue, large 24.0% (22: 25.0%), medium 25.0% (22: 24.0%) and small 29.0% (22: 26.0%) which is not in line with the 25% target. A range of client sizes helps staff retention via career progression.

GROSS PROFIT

COS increased by £1,328k (26.4%) due to an increase in all costs but increased slower than revenue which will have a positive impact on GPM.

Billable staff increased by £1,182k (36.0%) due to the £80k staff bonus and is now 41.7% (22: 39.7%) of revenue. Average billable staff cost has increased by 4.2% to £47.5k (22: £45.6k) which shows that the increase was due to pay increase and headcount. Attrition rate has increased to 12.9% from 11.8% with the revised rate now 28.2% (22: 26.5%) but is still below the sector average of 30%. There is upward pressure on wages as high-skilled staff are in high demand.

Other costs increased by £146k (8.3%) due to recruitment fees for the increased headcount.

Overall GP increased impressively by £1,105k (34.1%) to £4,342k with GPM increasing to 40.6% from 39.1% due to a revenue mix shift towards higher margin small/medium clients and a revenue mix shift towards higher margin paid search management work which now accounts for 50% (typically 40%). GPM has continued to increase.

Major GP has the lowest growth with £93k (15.8%) but still saw a slight GPM increase to 29.0% from 28.5% despite clients resisting price increases and average staff costs increasing.

Large GP increased significantly by £184k (25.4%) with a slight GPM increase to 35.3% from 35.0%.

Medium GP increased impressively with £318k (37.2%) and had a strong GPM increase to 43.8% from 43%.

Small GP saw the strongest growth with £510k (47.7%), with a GPM increase to 50.9% from 49.7%, due to increases in charge out rates being accepted by clients and being higher than the cost increase for average billable staff (11.1%-13.6% v 4.2%). Small accounts for 36.4% (22: 33.1%) which shows the increasing importance of small clients.

OPERATING PROFIT
Admin and selling increased by £170k (18.7%) and increased slower than revenue which will have a positive impact on OPM.

Support staff increased by £140k (24.2%) due to the bonus and is now 6.7% (22: 7.0%) of revenue. Average support staff cost has increased by 0.9% to £44.9k (22: £44.5k) which shows that the increase was due to pay increase and headcount.

Excluding support staff, costs increased by £30k (9.1%) and are now 3.4% (22: 4.0%) of revenue showing that they have been well controlled. However, this is lower than average marketing spend by digital marketing companies which is 4.3% of revenue and as this helps maintain reputation, win new clients and reduce churn, this could have a negative impact on churn and growth.

OP has increased impressively by £935k (40.1%) to £3,264k, with an OPM increase to 30.5% (22: 28.2%) which is above the 30% target, due to the revenue mix shift away from demanding major/large clients who increase overheads. OPM has continued to increase.

REQUEST FOR ADVICE
Sublime has been a client since 2016 and prior work has been successful, but the disagreement may cause FDM to lose another major client.

The £26k fees outstanding are 17.3% of average revenue from Sublime (£150k) so are a substantial part of the work performed. However, they are only 0.24% of total revenue and 1.7% of trade receivables so not significant to FDM overall.

Determining attributable revenue can present challenges but it should be possible to verify the impact of the campaigns.

The new Sublime director appears aggressive and domineering. This is restricting FDM's creatively and will result in lower revenue for Sublime and FDM (when fees are performance based).

This will also impact staff morale and staff may not want to work on the Sublime account.

Working with BOL may create further issues because they are competitors.

<u>RECOMMENDATIONS</u>

Compare Sublime DM performance before and after appointment of new director.
Engage independent party to verify attributable revenue.
Consider need to write off TR / make a provision.
Ensure FDM staff are not bullied.
Increase seniority/experience of FDM staff on account.
Inform Sublime about BOL and use separate teams/confidentially agreements if required.
Obtain legal advice.
Speak with alternative director at Sublime e.g. MD to explain issues.

<u>CONCLUSIONS</u>

Overall revenue increased impressively by £2,433k (29.4%) to £10,705k which is below the target of 35%/£11,167k. Major account revenue increased modestly by £287k (13.9%) but is below the target of £2,792k due to increases in charge out rates being resisted by clients. Large account revenue increased reasonably by £501k (24.2%) and is also below the target of £2,792k. Medium account revenue increased impressively by £691k (34.8%) and is just below the target of £2,680k despite the acquisition of Fresh Foods. Small account revenue increased the most by £954k (44.4%) and is above the target of £2,903k because small clients mostly accept charge out rate increases.

COS increased by £1,328k (26.4%) due to an increase in all costs but increased slower than revenue which will have a positive impact on GPM. Billable staff increased by £1,182k (36.0%) due to the £80k staff bonus. Overall GP increased impressively by £1,105k (34.1%) to £4,342k with GPM increasing to 40.6% from 39.1% due to a revenue mix shift towards higher margin small/medium clients. Major GP has the lowest growth with £93k (15.8%) but still saw a slight GPM increase to 29.0% from 28.5% despite clients resisting price increases and average staff costs increasing. Large GP increased significantly by £184k (25.4%) with a slight GPM increase to 35.3% from 35.0%. Medium GP increased impressively with £318k (37.2%) and had a strong GPM increase to 43.8% from 43%. Small GP saw the strongest growth with £510k (47.7%), with a GPM increase to 50.9% from 49.7%, due to increases in charge out rates being accepted by clients and being higher than the cost increase for average billable staff.

Admin and selling increased by £170k (18.7%) and increased slower than revenue which will have a positive impact on OPM. OP has increased impressively by £935k (40.1%) to £3,264k, with an OPM increase to 30.5% (22: 28.2%) which is above the 30% target, due to the revenue mix shift away from demanding major/large clients.

The new Sublime director appears aggressive and domineering. This is restricting FDM's creatively and will result in lower revenue for Sublime and FDM (when fees are performance based). The £26k fees outstanding are 17.3% of average revenue from Sublime (£150k) so are a substantial part of work performed in 2023.

RECOMMENDATIONS

Revenue and profit analysis by client.
Rebalance client mix by targeting major clients.
Implement policies to reduce churn e.g. more performance-based pricing.
Introduce performance bonus based on AMFIH target.
Focus on increasing AMFIH, not just headcount.
Improve pay, conditions and career progression opportunities to reduce attrition.
Exit interviews to identify reasons for leaving.
Continue to cross-sell more non-SEO work to improve margins.
Consider relocating to reduce costs.

APPENDIX 2: COSY

SEO: billable hours and charge-out rates					
				70%	
	£ per hour	Hours pm	PM	Discount 30%	PA
Director	£250	1	£250	£175	
Manager	£150	3	£450	£315	
Team leader	£100	8	£800	£560	
Team member	£75	20	£1,500	£1,050	
Revenue			£3,000	£2,100	£25,200
Costs			-£1,950	-£1,950	-£23,400
GP			£1,050	£150	£1,800
GPM			35.0%	7.1%	7.1%

Paid Ad Mgt: Performance-based pricing				
	Reach	250,000		
10%	Visitors	25,000		
	Bounce	30%		
70%	Stay	17,500		
25%	Leads	4,375		
		Worst	Most likely	Best
	Conversion probability	**20%**	**50%**	**30%**
	Conversion %	8%	10%	12%
	Conversions	350	437.5	525
£450	Client revenue	£157,500	£196,875	£236,250
4%	FDM revenue	£6,300	£7,875	£9,450
	FDM costs	-£4,000	-£4,000	-£4,000
	FDM GP	£2,300	£3,875	£5,450
	FDM GPM	36.5%	49.2%	57.7%

<u>**Total**</u>			
	Worst	**Most likely**	**Best**
Revenue			
SEO	£25,200	£25,200	£25,200
Paid search mgt (4x pa)	£25,200	£31,500	£37,800
	£50,400	**£56,700**	**£63,000**
COS			
SEO	-£23,400	-£23,400	-£23,400
Paid search mgt (4x pa)	-£16,000	-£16,000	-£16,000
	-£39,400	**-£39,400**	**-£39,400**
GP	**£11,000**	**£17,300**	**£23,600**
	21.8%	30.5%	37.5%
LTV:			
GP pa	£11,000	£17,300	£23,600
Lifetime	33.3	33.3	33.3
	£366,667	£576,667	£786,667
Churn rate	3%	3%	3%
	33.3	33.3	33.3

	Large average:	
	Revenue	£50,000
35%	GP	£17,500
	Churn rate	6%
	GP pa	£17,500
	Lifetime	16.7
	LTV	£291,667

Sensitivity				
Paid Ad Mgt: Performance-based pricing				
	Reach	250,000		
10%	Visitors	25,000		
	Bounce	30%		
70%	Stay	17,500		
25%	Leads	4,375		
		Worst	Most likely	Best
	Conversion probability	**20%**	**50%**	**30%**
	Conversion %	8%	10%	12%
	Conversions	350	437.5	525
£450	Client revenue	£157,500	£196,875	£236,250
5%	FDM revenue	£7,875	£9,844	£11,813
	FDM costs	-£4,000	-£4,000	-£4,000
	FDM GP	£3,875	£5,844	£7,813
	FDM GPM	49.2%	59.4%	66.1%

Sensitivity			
Total			
	Worst	**Most likely**	**Best**
Revenue			
SEO	£25,200	£25,200	£25,200
Paid search mgt (4x pa)	£31,500	£39,375	£47,250
	£56,700	**£64,575**	**£72,450**
COS			
SEO	-£23,400	-£23,400	-£23,400
Paid search mgt (4x pa)	-£16,000	-£16,000	-£16,000
	-£39,400	**-£39,400**	**-£39,400**
GP	**£17,300**	**£25,175**	**£33,050**
	30.5%	39.0%	45.6%

EVALUATION OF COSY PROPOSAL

CONTEXT

FDM is in a strong negotiating position because Cosy approached FDM and is looking to leave Collective Link.

The engagement will involve a range of services so FDM will develop capabilities in different areas.

Failure to win new clients was an identified risk and winning Cosy as a client mitigates that risk.

The fragile UK economy may cause Cosy's sales to be lower which will reduce FDM revenue. High inflation may increase salaries which will reduce FDM's profit.

RESULTS AND FINANCIAL ANALYSIS

GP will be £17.3k (most likely), £11k (worst case) or £23.6k (best case). GPM will be 30.5% (most likely), 21.8% (worst case) or 37.5% (best case).

All cases are lower than overall GPM (40.6%) but the best case is above large GPM (35.3%).

Revenue will be £56.7k (most likely), £50.4k (worst case) or £63k (best case) so Cosy will be a large client and higher than the large average (£50k) in all cases.

The work will contribute to revenue and profit targets/KPIs being met and will help rebalance the client mix after a loss of four large clients in 2023. Using performance pricing will help reduce churn.

There is potential to sell more services in the future and some of these will be higher margin so will improve GPM.

A lot of staff time is required which could be spent on higher margin small/medium clients, although FDM currently prioritises client size diversification and revenue growth over short-term profitability.

Client servicing costs typically reduce over time which will increase GPM.

LTV is estimated at £576.7k (most likely), £366.7k (worst case) or £786.7k (best case) and is higher than the large client average of £291.7k.

Payment terms are favourable for SEO as there will be an initial cash inflow. Although this is not as favourable as Compere (four months in advance). Payment terms for paid ad management are not as favourable as Sublime (30 days after campaign). However, FDM has sufficient cash to fund any outflows (£3,131k).

ASSUMPTIONS AND SENSITIVITY ANALYSIS
Charge-out rates look low for leader and member because they have not increased from 2023.

Hours may be higher at the start because of initial time spent on research and experimenting with different SM platforms. However, SEO estimates are likely to be accurate because work is routine and predictable.

It may be possible to negotiate a lower discount if FDM can demonstrate it will deliver better results than CL.

Costs may be higher because of pay rises and bonuses.

The starting GPM of 35% for SEO looks high because it is low margin work and large clients demand discounts.

Bounce rate is likely to be higher than 30% because it was 50% for Sublime and 50% is the sector average. Although a slightly different market, there are a lot of similarities so would not expect such a big difference.

Leads may be lower than 25% because this is higher than Sublime (20%).

The source of estimates is not clear, and Cosy may have overinflated estimates such as average revenue to make the proposal appear attractive to FDM.

There will be additional costs such as IT and support staff will need to be factored in.

The calculation uses probabilities which are simplified estimates. The actual outcome is likely to be different.

A 3% churn rate implies a 33.3-year engagement life which is incredibly long for a rapidly changing industry and when the contract is only for 12 months.

Any further changes to the assumptions will cause the results to change. Adjusting the paid ad management fee to 5% in line with Sublime increases GP to £25.2k (GPM 39%) on a most likely basis and this is higher than large client average.

COMMERCIAL CONSIDERATIONS
Cosy claims to be sustainable but FDM will need to verify claims so as not to be complicit in greenwashing or risk breaching the code of practice.

Performance pricing has potential for higher revenue and profits but also downside risk if Cosy's revenue is lower than estimated. FDM could potentially make a loss with performance pricing.

Managing SM campaigns can be very resource intensive so may cause excessive pressure and damage staff morale and their welfare.

Another large client will help maximise staff utilisation and increase AMFIH. However, if there is not sufficient capacity this could increase pressure on staff and detract from other clients.

It may be difficult to measure attributable revenue which could cause disagreement between Cosy and FDM as it did with Sublime in 2023.

Large clients help enhance FDM reputation and brand.

CONCLUSIONS

GP will be £17.3k (most likely), £11k (worst case) or £23.6k (best case). GPM will be 30.5% (most likely), 21.8% (worst case) or 37.5% (best case).

LTV is estimated at £576.7k (most likely), £366.7k (worst case) or £786.7k (best case) and is higher than the large client average of £291.7k

Bounce rate is likely to be higher than 30% because it was 50% for Sublime and 50% is the sector average. Although a slightly different market, there are a lot of similarities so would not expect such a big difference. Any further changes to the assumptions will cause the results to change. Adjusting the paid ad management fee to 5% in line with Sublime increases GP to £25.2k (GPM 39%) on a most likely basis and this is higher than large client average.

Cosy claims to be sustainable but FDM will need to verify claims so as not to be complicit in greenwashing or risk breaching the code of practice.

FDM should proceed because a large client will reduce the impact of 2023 client losses and help achieve growth targets.

RECOMMENDATIONS

Negotiate fee and discount.
Due diligence on Cosy.
Research to corroborate all estimates.
Set timetable for activities.
Ensure staff capacity.
Verify all sustainability claims before running campaigns.

APPENDIX 3: STAFFING STRATEGY

A: Leaders and Managers					
	30%				
	2024 target	**2023**	**Change (£k)**	**Change (%)**	**Mix**
REVENUE					
Major	£3,479	£2,355	£1,124	47.7%	25.0%
Large	£3,479	£2,569	£910	35.4%	25.0%
Medium	£3,479	£2,676	£803	30.0%	25.0%
Small	£3,479	£3,105	£374	12.0%	25.0%
TOTAL	**£13,917**	**£10,705**	**£3,212**	**30.0%**	
Headcount	129	110	19	17.3%	
AMFIH	£9.0	£8.1	£0.9	10.9%	
COS					
Billable	-£7,345	-£4,462	-£2,883	64.6%	
Other	-£1,790	-£1,901	£111	-5.8%	
TOTAL	**-£9,135**	**-£6,363**	**-£2,772**	**43.6%**	
GP	**£4,782**	**£4,342**	**£440**	**10.1%**	
	34.4%	40.6%			
A&S	**-£578**	**-£1,078**			
OP	**£4,204**	**£3,264**			
	30.2%	30.5%			
Headcount					
Revenue	£13,917				
AMFIH	£9.0	12	£108.0		
Headcount	128.9				
rounded	129				
Billable		Support	Total		
Avg	£65.0				
Headcount	113	16	129		
	£7,345				
Other	-£1,500				
Recruit	-£190	19	£10		
JetStream	-£100				
	-£1,790				

A&S	-£1,078				
Office saving	£500				
	-£578				

	<u>**B: Members**</u>					
		40%				
		2024 target	**2023**	**Change (£k)**	**Change (%)**	**Mix**
	REVENUE					
	Major	£3,297	£2,355	£942	40.0%	22.0%
	Large	£3,597	£2,569	£1,028	40.0%	24.0%
	Medium	£3,747	£2,676	£1,071	40.0%	25.0%
	Small	£4,346	£3,105	£1,241	40.0%	29.0%
	TOTAL	**£14,987**	**£10,705**	**£4,282**	**40.0%**	
	Headcount	154	110	44	40.0%	
	AMFIH	£8.1	£8.1	£0.0	0.0%	
	GP					
29.0%	Major	£955	£682			
35.3%	Large	£1,271	£908			
43.8%	Medium	£1,641	£1,172			
50.9%	Small	£2,212	£1,580			
	TOTAL	**£6,079**	**£4,342**			
		40.6%	**40.6%**			
	A&S	**-£1,078**	**-£1,078**			
	OP	**£5,001**	**£3,264**			
		33.4%	30.5%			
	Headcount					
	Revenue	£14,987				
	AMFIH	£8.1	12	£97.3		
	Headcount	154.0				

Sensitivity	A: Leaders and Managers					
		40%				
		2024 target	**2023**	**Change (£k)**	**Change (%)**	**Mix**
	REVENUE					
	Major	£3,747	£2,355	£1,392	59.1%	25.0%
	Large	£3,747	£2,569	£1,178	45.8%	25.0%
	Medium	£3,747	£2,676	£1,071	40.0%	25.0%
	Small	£3,747	£3,104	£642	20.7%	25.0%
	TOTAL	**£14,987**	**£10,705**	**£4,282**	**40.0%**	
	Headcount	129	110	19	17.3%	
	AMFIH	£9.7	£8.1	£1.6	19.4%	
	COS					
	Billable	-£7,345	-£4,462	-£2,883	64.6%	
	Other	-£1,790	-£1,901	£111	-5.8%	
	TOTAL	**-£9,135**	**-£6,363**	**-£2,772**	**43.6%**	
	GP	**£5,852**	**£4,342**	**£1,510**	**34.8%**	
		39.0%	40.6%			
	A&S	**-£578**	**-£1,078**			
	OP	**£5,274**	**£3,264**			
		35.2%	30.5%			

EVALUATION OF STAFFING STRATEGY

CONTEXT
Ron Ashton's operational improvements research paper proposed to invest in martech and consider relocating. Alternative A incorporates those proposals.

Increased costs of the London office was identified as a risk and relocating would address that risk.

Previous revenue forecasts based on headcount growth have been reasonably accurate and reliable.

The fragile UK economy may cause revenue to be lower than the forecasts.

High inflation may cause staff to demand an increase in salaries which will increase staff costs.

RESULTS AND FINANCIAL ANALYSIS
Alternative A OP is £4,204k with an OPM of 30.2%. Alternative B OP is £5,001k with an OPM of 33.4%.

Alternative B delivers higher revenue, GP, GPM (40.6% v 34.4%), OP and OPM. This will help catch up on revenue missed due to being below target in 2022 and 2023.

Alternative B does not rebalance the client mix, and this contributes to higher margins. This is contrary to the aim of having 25% from each account size.

Alternative A will improve client service and cross-selling which will help increase future revenue.

Both deliver OPM higher than the 30% target but only Alternative B is higher than 2023 OPM (30.5%).

AMFIH will be higher under Alternative A due to more senior staff, cross-selling and use of technology. Alternative B does not seem to try and improve AMFIH.

Alternative A appears to offer a model which is easier to scale rather than having to keep employing more staff.

Technology will have additional running costs e.g. maintenance and upgrades.

FDM has a large cash balance (£3,131k) which is sufficient for the JetStream investment.

ASSUMPTIONS AND SENSITIVITY ANALYSIS
Revenue growth of 30/40% seems ambitious because it was 29.4% and below target in 2023.

Client mix will be different because it will not be exactly 25%/the same as 2023. This will impact margins.

Similarly, other COS/GPM and A&S will not be exactly the same as 2023 because there are likely to be other costs e.g. training and increases due to inflation.

Admin costs are likely to be higher because additional support staff will be needed to facilitate additional billable staff/work.

The timeframes are very challenging because implementing the technology and moving office will take time and the YE 2024 has already started.

The forecast period is too short to evaluate a strategy (unless the business will be sold in 2024).

Any further changes to the assumptions will cause the results to change. If revenue growth is also 40% for Alternative A, then OP will be higher than Alternative B at £5,274k.

STRATEGIC AND OPERATIONAL ISSUES

Reducing service quality is contrary to FDM's goal of providing award-winning service levels. This will damage FDM brand and increase client churn which is a key risk.

Having more staff will increase the amount of time managers and leaders spend dealing with staff issues. This may further reduce service quality.

Implementing technology will require training for staff and will cause some initial disruption.

Moving office will require a lot of management time and cost.

Employees want flexibility and requiring them to work in office every day may cause a lack of engagement and commitment to FDM. This could reduce AFMIH and increase attrition.

Major changes seem unnecessary if the board is considering selling in the short term.

Alternative B has higher revenue and profit which makes FDM appear more attractive to a potential purchaser.

ETHICS

Employee monitoring technology may be considered invasive and a breach of privacy for some staff. This could reduce staff morale and productivity. However, it will depend on the exact form that monitoring will take.

Requiring new staff to pay training costs could make recruitment more challenging. However, other agencies make staff pay for training.

Disagreement between directors may prevent effective management of FDM. This could have a negative impact on performance and results.

FDM's directors could be subject to legal action if they make misrepresentations to potential purchasers. This could result in fines and compensation to the purchaser. This could be an issue if short term focussed strategies which result in a decline in service quality and staff relations are chosen.

There are reports that staff do not spend their non-billable allowance on activities that benefit FDM. This is a cost to FDM because they are paying staff. However, the claim is on a forum so may not be reliable.

Confidential and valuable data will be held in JetStream and there is a risk of unauthorised use and data loss. This could cause business disruption, reputational damage, fines and a loss of clients.

RECOMMENDATIONS

Discuss with staff and explain reasons for monitoring.
Research impact on recruitment.
DD on JetStream and audit security ecosystem.
Agree on plans for sale of FDM.
Obtain legal advice throughout sale process and do not make misrepresentations.
Implement processes to monitor non-billable time.

CONCLUSIONS

Alternative A OP is £4,204k with an OPM of 30.2%. Alternative B OP is £5,001k with an OPM of 33.4%. Alternative B delivers higher revenue, GP, GPM (40.6% v 34.4%), OP and OPM.

Revenue growth of 30/40% seems ambitious because it was 29.4% and below target in 2023. Any further changes to the assumptions will cause the results to change. If revenue growth is also 40% for Alternative A, then OP will be higher than Alternative B at £5,274k.

Reducing service quality is contrary to FDM's goal of providing award-winning service levels. This will damage FDM brand and increase client churn which is a key risk. Having more staff will increase the amount of time managers and leaders spend dealing with staff issues. This may further reduce service quality.

Employee monitoring technology may be considered invasive and a breach of privacy for some staff. This could reduce staff morale and productivity. However, it will depend on the exact form that monitoring will take.

If the board plan to sell their shares in the short term, then Alternative B should be chosen to improve short-term results.

RECOMMENDATIONS

Get back up for all estimates.
Negotiate with JetStream.
Discuss any changes with staff and the committee.
Improve client service.
Prepare longer forecasts.

Compare suitable office locations.
Find purchasers for FDM and identify their valuation criteria.
Research alternatives to JetStream.
Implement any changes in stages.
Set timetable for activities.