Specimen coursework assignment

M92 – Insurance business and finance

The following is a specimen coursework assignment including questions and indicative answers.

It provides guidance to the style and format of coursework questions that will be asked and indicates the length and breadth of answers sought by markers. The answers given are not intended to be the definitive answers; well-reasoned alternative answers will also gain marks.

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Coursework submission rules and important notes

Before commencing work on, or submitting, your coursework assignment it is essential that you fully familiarise yourself with the content of *Mixed Assessment Candidate Guidelines*. This includes the following information:

- Answers to a coursework assignment should be between 5,000 and 10,000 words in total depending on your writing style.
- Arial font and size 11 to be used in your answers.
- Important rules relating to referencing all sources including the study text, regulations and citing statute and case law.
- Penalties for contravention of the rules relating to plagiarism and collaboration.
- Six month deadline from enrolment date for the submission of coursework answers.
- The total marks available are 200. You need to obtain 120 marks to pass this assignment.
- Do not include your name or CII PIN anywhere in your answers.

Top tips for answering coursework questions

- Read the Learning Outcome(s) and related study text for each question before answering it.
- Ensure your answer reflects the context of the question. Your answer must be based on the figures and/or information used in the question.
- Ensure you answer all questions.
- Address all the issues raised in each question.
- Do not group question parts together in your answer. If there are parts (a) and (b), answer them separately.
- Where a question requires you to address several items, the marks available for each item are equally weighted. For example, if 4 items are required and the question is worth 12 marks, each item is worth 3 marks.
- Ensure that the length and breadth of each answer matches the maximum marks available. For example, a 30 mark question requires more breadth than a 10 or 20 mark question.

The coursework questions link to the Learning Outcomes shown on the M92 syllabus as follows:

Question	Learning Outcome(s)	Chapter(s) in the Study Text	Maximum marks per answer
1	Learning Outcome 1	Chapter 1	10 marks
2	Learning Outcome 2	Chapters 2 & 3	20 marks
3	Learning Outcome 3	Chapter 4	20 marks
4	Learning Outcome 4	Chapter 5	20 marks
5	Learning Outcome 5	Chapter 6	30 marks
6	Learning Outcome 6	Chapters 7 & 8	10 marks
7	Learning Outcome 7	Chapter 9	20 marks
8	Learning Outcome 8	Chapter 10	10 marks
9	Across more than one Learning Outcome	Across more than one chapter	30 marks
10	Across more than one Learning Outcome	Across more than one chapter	30 marks

M92 specimen coursework questions and answers

Question 1 - Learning Outcome 1 (10 marks)

TC plc, a UK-based commercial property owner, has a portfolio of small offices in the UK, which are insured on a traditional risk transfer basis. TC plc is currently negotiating to purchase a high value office block in the UK. TC plc's UK-based insurance broker needs to place the high value office block with a suitable insurance organisation.

Explain, with justification, **two** types of insurance organisation that the insurance broker might consider suitable to cover this risk. (10)

Answer to question 1 (Learning Outcome 1)

There are many forms of insurance organisation in the UK, but not all are appropriate to this scenario. The key issue for the insurance broker would be the high value of the new office block; some companies do not have capacity to insure such high values. It may even be possible to continue with the current insurers.

Proprietary companies

These are the traditional form of insurer and they are funded by the issue of stock (CII study text, M92 Insurance business and finance, 2016, P1/2). This type of insurer could be considered as many have a high degree of capacity. The capacity comes from having the financial security to underwrite large values themselves and because they are able to take out reinsurance on individual or class specific risks i.e. able to transfer part of the risk. The broker is likely to have extensive experience in this market. Examples of such companies include Aviva and AXA.

Lloyd's

Lloyd's is made up of a large number of syndicates who are made up from individual or corporate members (CII study text, M92 Insurance business and finance, 2016, P1/4). They operate by having managing agents who deal with the underwriting and administration of the insurance risks. Lloyd's are known for their ability to take on high indemnity values and therefore would be a consideration. They may be able to take on the whole risk, or it may be that a number of syndicates will take 'lines' so that the full insurance value is reached. The broker would need to be a registered Lloyd's broker or have access to one, to deal with syndicates.

These are the main insurance organisations to be considered as mutuals, captives, self-insurance and Takaful are unlikely to be suitable in this scenario.

Question 2 - Learning Outcome 2 (20 marks)

SD plc, a UK-based insurer, has offices located in twelve countries. Its innovative approach and exceptionally good performance has led to rapid expansion.

Competitors are now targeting SD plc's customers and this has led to a reduction in SD plc's operating performance. SD plc has recognised this competitive environment and has therefore decided to recruit a new chief executive officer (CEO) to drive the business forward.

(a) Identify, with justification, the most appropriate management style the new CEO, of SD plc, might use. (5)

(b) Analyse **two** advantages and **three** disadvantages of the style that you have identified for SD plc, given the scenario above. (15)

Answer to question 2 (Learning Outcome 2)

(a) When looking at management styles, it is important to understand the current business and its strengths, weaknesses, opportunities and threats (SWOT), as it is these which will influence the choice of management style. Management style is an essential element of the corporate culture.

SD plc would want to counteract the external threats in a uniform and consistent manner, but at the same time maintain its innovative style. The style of management which seems most appropriate in this instance is open door, which promotes team work and a common cause which encourages innovation (CII study text, M92 Insurance business and finance, 2016, P2/11).

The new CEO needs to keep the innovation which has made the company a success, whilst confronting the attack on its customers. Open door allows the management team to benefit from the experience of the team members from the varying countries. SD plc have demonstrated that they have an exceptionally good performance and open door style allows employees to continue to feel valued and assist the further development of SD plc. The open door style gives the employees independence but support when needed.

(b) The following are the two advantages and three disadvantages of open door style:

<u>Advantages</u>

- As a multi-national company it is hard to keep close control of the team. Therefore, this style of management fosters openness but gives an element of autonomy to staff, allowing them to respond appropriately to customer demands. This ensures that innovation remains alive and employees have the freedom to develop their ideas.
- This style helps develop a contented and productive workforce. The CEO is likely to create more loyalty, through an open door policy, as well as fostering a positive working environment. This means that there will be less staff turnover which again keeps the intellectual property within SD plc. This also helps keep costs to a minimum as recruiting can be very expensive and can have a negative impact on the business.

<u>Disadvantages</u>

- If the open door style is fully embraced, individuals may become isolated, especially with the geographic differences. This means that regions may be pursuing more country specific objectives rather than those which best suit SD plc. Without any regular contact there is a possibility of diverging objectives which could have a negative impact on the business. Harmony among objectives is important.
- There is a concern that the CEO may not know what is going on in each region. Information may not be shared and issues may be hidden. Although open door is intended to enhance innovation and personal responsibility, if control and checking is not maintained then there is significant risk of divergence between the twelve countries. Trust has to be built up and any variance in this can lead to diverging objectives.

- There is limited sharing of knowledge as countries work independently so the opportunity for exploiting best practice is reduced. Unless there is a forum for sharing best practice and information there can be problems with information sharing, which in the long-term can add to significant long-term issues.

Question 3 - Learning Outcome 3 (20 marks)

CB plc, a UK-based insurer, is experiencing very high levels of customers' complaints across its underwriting and claims departments. CB plc currently use the three lines of defence risk management approach.

This risk management approach needs to be improved as it is not preventing the high levels of customer complaints.

(a) Explain the **six** most important actions that could be taken to reduce customers' complaints when considering **each** of the three lines of defence. (12)

(b) Identify, with justification, **two** management controls that the underwriting department could use and **two** management controls the claims department could use to contribute to the prevention of future complaints from customers. (4)

(c) Identify, with justification, **two** management controls that the claims department could use to contribute to the prevention of future complaints from customers. (4)

Answer to question 3 (Learning Outcome 3)

(a) **Three lines of defence**

Risk management is a critical aspect for all businesses. Whilst individual complaints can be dealt with, it is essential for long-term success that CB plc identifies and deals with the issues which are causing these complaints. This should be done via a risk management strategy which is embedded into everyday business life - the three lines of defence model (CII study text, M92 Insurance business and finance, 2016, P4/11). This model acknowledges that different personnel have different roles to play within CD plc.

First line of defence

These are the people who have day-to-day responsibility for ensuring that the risk management strategy is implemented. It would be their responsibility to deal with customers on a day-to-day basis.

- The first action would be a review of recent complaints so that the key areas for concern could be identified. For example, if there are a number of complaints relating to the timely settlement of claims there could be issues with backlogs or ‘sign off’ of payments.
- Secondly, once these issues are identified, the team can have these as key risk indicators and monitor them on a regular basis. They will then be able to identify quickly when service levels are starting to falter.

Second line of defence

The majority of organisations have their own risk management team (CII study text, M92 Insurance business and finance, 2016, P4/11) and they form the second line of defence.

- Firstly, the team need to monitor and advise the people within the first line of defence, which can sometimes be a difficult role. It is essential that they develop a positive working relationship.
- The Board must understand their responsibility to ensure that the employees understand the importance of co-operating and working together with this team. This team are able to ensure that the focus remains strong.

Third line of defence

This line is even further removed. It would consist of internal and external audit functions, as well as regulators (CII study text, M92 Insurance business and finance, 2016, P4/11).

- The regulators role is to ensure that everything is being completed in accordance with published guidelines. If this is the case, they can confirm this and give peace of mind or, if not, they can comment on areas for improvement. As an example, the Financial Conduct Authority (FCA) maintains a complaints log for each company and this could be monitored. This is the final check and if the other two lines of defence are working well, no major issues should be identified. It is critical that findings from any internal audit function are used to improve service.
- Finally, regulators will audit from time to time and can offer improvements and developments which may not otherwise be known to CB plc.

On a regular basis the risk management model can be checked in order that any remedial action necessary can be administered. More specifically, key risk indicators can be used for the immediate or urgent concerns and these would then be monitored individually on a regular basis.

(b) **Underwriting departments**

The following management controls could be used within the underwriting department:

Critical success factors (CSF)
CB plc would define the objectives which are important to the success of their underwriting function. These would be strategic rather than tactical and may include something such as the reduction of staff turnover by 50%. Whilst this does not have a direct impact on underwriting, it filters through as new or poorly qualified staff are more likely to make mistakes (CII study text, M92 Insurance business and finance, 2016, P3/4).

Key performance indicators (KPI)
These are the actions required to meet the CSF. These will be specific and measurable and if they are not achieved they give a good indication of where things are going wrong, so remedial action can be taken (CII study text, M92 Insurance business and finance, 2016, P3/4).

(c) **Claims departments**

Key risk indicators (KRI)
This monitoring system establishes what is not acceptable within a business and ensures that it is monitored regularly. For example, if claims cannot be processed as the IT system keeps going down, this could be a KRI. It makes it easier for trends to be spotted and action can then be taken (CII study text, M92 Insurance business and finance, 2016, P3/5).

Benchmarking
This is where CB plc measures itself against someone else. If the claims department are concerned with a certain area, they could look at the industry average and measure themselves against this (CII study text, M92 Insurance business and finance, 2016, P3/6).

Question 4 - Learning Outcome 4 (20 marks)

EC plc, a UK-based insurer, has an objective of profitable growth by maximising the contribution of each of the following functions contained within its business:

- Underwriting.
- Claims.
- IT/data management.

(a) Explain, with justification, the contribution that **each** of the **three** functions could make to profitable growth. (14)

(b) Identify **two** actions for **each** function which could contribute to the objective of profitable growth. (6)

Answer to question 4 (Learning Outcome 4)

(a) There are many aspects to an insurer, such as EC plc, and they can all have a direct impact on its profitability.

Underwriting

If EC plc wishes to grow profitably, then it needs to select the correct risks at the correct premium and ensure it understands the exposure the policy wording brings. The aim of underwriting is to obtain sufficient premium to settle claims plus expenses, leaving an element over for profit. The senior managers would normally agree the level of risk that is acceptable to EC plc and this would be cascaded down the underwriting team. Lower down the hierarchy there would be limited autonomy – rates would be driven by a published manual and cover would be formulaic. As the underwriters become more senior there is greater flexibility and also greater risk. Audits would be required to ensure that risks underwritten fall within the level of risk set by the senior managers.

Claims

It is essential to maintain the loyalty of the insureds. This is achieved by being fair in all claims dealings, from coverage to settlement. There are many areas however, where profitability can be driven. This comes from the efficiency aspects of the service such as the absence of claims leakage and the quick settlement of claims. These elements will be set out in EC plc's claims philosophy and there will also be specific policies with regard to various claims activities such as reserving and the handling of fraudulent claims. Savings and therefore profitability can also be promoted through the use of certain suppliers.

IT/data management
EC plc needs effective and efficient technology to collect and use data, as well as to collect premiums and pay claims. All insurers want an IT strategy that will enable them to deliver a competitive advantage.

Depending on the class of business, the internet is becoming an increasingly important sales tool. Having an efficient internet capability allows a cheaper and quicker quotation and policy issue system which will have a direct impact on profitability. IT also plays an important role in the sharing of information with other insurers, including helping to reduce fraud.

It is important to use the information to target customers appropriately. This can cut down considerably on marketing costs.

Overall, it is essential for EC plc to realise that all functions have an impact on the business and that by getting them to work together, at their optimal level, helps it achieve its profitability targets.

(b) Actions which could contribute to profitable growth are:

Underwriting
- Monitor authority levels on a quarterly basis and ensure that underwriters have enough flexibility in order to write profitable business.
- Audit underwriters to ensure that they are remaining within their agreed authority limits.

Claims
- Encourage claimants to use authorised repairers only, thereby obtaining a saving on the total cost.
- Audit claim files on a monthly basis to check for leakage. Identify trends and implement any training required.

IT/data management
- Develop a user friendly internet capability which will lead to a decrease in acquisition costs.
- Use fraud databases to minimise the exposure to fraudulent activity. This will directly reduce the income lost to fraud.

Question 5 - Learning Outcome 5 (30 marks)

CG plc, a UK-based insurance broker, is evaluating a manufacturing company as a potential long-term customer, using the manufacturing company's financial statements for last year. This evaluation is focused on the income statement/profit and loss account, balance sheet and cash flow statement.

The manufacturing company reported an annual profit of £400 million in 2015, with a net cash outflow of £250 million in the same period. The company has expanded its business in the last six months, in an environment where products become obsolete quickly. It responded to this fast changing environment, by acquiring £150 million of new production machinery in 2015. The company gives its customers considerable time to pay their bills.

(a) Analyse the potential risks to CG plc if the manufacturing company becomes their customer, based on the above information. (20)

(b) Identify, with justification, **five** additional items of financial information that CG plc would find helpful in arriving at a final decision. (10)

Answer to question 5 (Learning Outcome 5)

(a) From first glance, the manufacturing company's profit looks healthy but this could be a misleading conclusion as you need all three major statements, income statement (profit and loss account), balance sheet and cash flow statement, to truly interpret a business. A one-off profit figure does not give a wide enough view to decide if the manufacturing company is truly profitable. For example, what happens if the company has one main contract which is due to expire next year?

The cash outflow seems high, given the level of profit, therefore liquidity is poor. There appear to be two main issues – firstly they have bought new production machinery and secondly they are not collecting monies they are owed in a timely fashion. Profit can be misleading, as it does not account for the inflow and outflow of monies. Lack of cash is more likely to cause a company to cease trading rather than a lack of profit. In this scenario they are paying for the machinery, which has a relatively short life. Does this mean that they will need to buy new machinery in a year or two? Is it an on-going cost which needs to be accounted for? They are also funding their clients' purchases by offering exceptionally good credit facilities. These good credit terms directly impact on accounts receivable. CG plc needs to ensure that the manufacturing company is sound as they wish to be paid in the first instance and then to maintain a relationship with this company, as there are significant upfront costs associated with taking on a new client.

The purchase of the new equipment will normally have the cost deferred over the lifetime of the machinery (depreciation) to ensure that there is evenness in the accounts when a large capital purchase is made. This leads to greater stability in the accounts and a clearer view of its financial position. We do not know whether this has happened in this instance. This could significantly impact the profitability of the company.

It is therefore more essential that they look at the available cash (cash flow statement) rather than the profitability.

As a potential customer, you are not only interested in their financial position. In an ideal world, customers would be selected who have good housekeeping skills and run their business efficiently and effectively. This is important as it is indicative of how you will be treated as a supplier. Currently, they seem somewhat disorganised as they are waiting so long for the money that is owed to them. Is this just one department or the whole company? This would give a clear indication of where the issue lies.

As the broker, I would be concerned that they could pay their immediate fees and would therefore want to see what their cash flow projections over the next 12 months. I would also wish to ensure that they had sufficient longevity potential as a client, to ensure they would be profitable to take on.

Furthermore, the business may feel increasing financial pressure and the resulting pressure on survival may make the manufacturing company neglectful of various aspects such as risk management.

Although the broker would consider all of the above points, insurance broking is a highly competitive market and they may therefore find that they need to take on clients who are not as well run or financially stable as they would like.

(b) As already discussed above, one year’s accounts do not allow you to truly understand a business. The additional information that would be useful in any decision making process can be found below along with the justification.

Five pieces of financial information could be:

- Income for the year and projections for year end – this would give an indication of how the business is developing and any growth potential. It shows how the business is currently performing.

- Previous years' financial reports – through the use of historical accounts, trends can be identified and a true understanding of the manufacturing company can be achieved. Ratio comparisons can then be used to understand the current state of the business.
- Details of its accounts receivable – an understanding of the reason for this delay in collection would give an insight into the control mechanisms surrounding this element of the business. Do they only have a few major customers who like a long credit period or are there many small customers who are difficult to manage? How do contracts differ? Historically how do collection figures differ?
- Understanding of the 'fast changing environment' – by understanding the market they are operating in, the longevity of the business can be established. This will give an insight into the need for new machinery and how often this is likely to be needed. Will the new machinery be obsolete in a few years?

(CII study text, M92 Insurance business and finance, 2016, P6/8 and P6/9).

<u>Question 6 - Learning Outcome 6 (10 marks)</u>

MG plc is a UK-based general insurer. An actuarial review has revealed that MG plc's claims reserves are inadequate. The key finding of the review was that long-tail claims had been accounted for at their paid cost only.

Explain how MG plc might rectify this key finding in relation to reserving, identified in the actuarial review. (10)

<u>Answer to question 6 (Learning Outcome 6)</u>

It is critical that MG plc reserve accurately as this is a legal and regulatory requirement. Reserving is a difficult process and has a lot of uncertainty around it, as it is hard to predict the development of existing claims. However, in this instance there appears to have been an error, as the long-tail claims have only had paid costs accounted for, whilst outstanding elements of claims have not been reserved. Long-tail claims, by their very nature, are not settled early and therefore making judgements about the likely outcome of claims is an integral part of the claims department's work (CII study text, M92 Insurance business and finance, 2016, P8/2).

The claims team need to identify all claims which have been affected by this error and collate the related claims files. The claims team has a range of methodologies which it can use to help it with its assessment of the claims potential. There are some methodologies which are more suitable for long-tail claims and these will be considered in turn. If this issue is important, then there may be some merit in placing a provisional claims reserve on the balance sheet to ensure all regulatory requirements are met. The main methodologies they might consider are (CII study text, M92 Insurance business and finance, 2016, P8/5 and P8/6):

Projection of paid claims
This method is straightforward as it is an extrapolation of settled claims, with or without an adjustment for inflation.

Projection of incurred claims
This is generally seen as more accurate, as it is based on incurred claims in that class (and category), so long as there have been no significant changes in the claims handling process or level of awards.

Loss ratio method
This is a useful tool for long-tail liability claims however is usually used in tandem with another method. It is used when the early years' claims estimates are much lower than the eventual expected claims.

Bornheutter-Ferguson
This combines loss ratio and projection methods. It uses these methods to arrive at a more accurate long-term projection. This is most appropriate for long term claims.

Depending on the size of the problem, external actuaries may be employed to assist in calculating claims reserves. This work will ensure that sufficient reserves are maintained to meet outstanding liabilities and that the accounts reflect a 'fair and true' picture for all stakeholders.

Question 7 - Learning Outcome 7 (20 marks)

You are the Finance Director of XY plc, a UK-based insurance broker. XY plc is considering the acquisition of a specialist insurance broker who has an 80% market share in their specialist market.

As part of the acquisition process, you undertake an analysis using various financial ratios. You have obtained the specialist insurance broker's report and accounts for the last two complete financial years. You do not have any information on the current year.

(a) Explain the limitations of relying on financial ratio analysis in the possible acquisition of the specialist insurance broker. (14)

(b) Identify, with justification, **three** additional items of financial information that will be required to enable XY plc to fully consider the acquisition. (6)

Answer to question 7 (Learning Outcome 7)

(a) The key business consideration for the proposed acquisition arises because the specialist insurance broker has an 80% market share in their particular market. Ratios are a very useful tool and are at their best when they can be used to compare different companies. As this is a specialist market, the ability to compare is compromised. How can you compare, when you are the main holder of the available business? There is the possibility to compare your own performance year on year and perhaps against other specialist organisations in other specialist areas. This limitation is therefore the success of the specialist insurance broker, as they have such a high proportion of the available business.

You do not have any partial year financial information for the current financial year. The ratio analysis which has taken place therefore only concerns itself with the past two years. Ratios are a useful tool when comparing companies but realistically we cannot do this as no other company has such a large share of the market. For an insurance broker there are a number of ratios which can offer the widest view of the company – these could be expenses, commission, return on capital employed and gearing. The current year figures help to develop trends and, in turn, an understanding of the business.

In this scenario we would be interested in seeing any trends in the business over the last two years. This is particularly important given the proposed acquisition's penetration of its specific market. If XYZ plc is considering buying it, they may need to take into account that the broker may have achieved its maximum penetration rate and therefore make allowance for this in the relevant ratios. Understanding the market, its competitors and the position it holds are critical. However, the current performance is not necessarily an indicator of the future performance of the business.

There are other limitations with ratios which would also need to be considered. With the majority of accounts, judgements need to be made concerning key financial information and these judgements need to be understood to make meaningful comparisons. This is also linked to accounting standards. As companies compile information differently, it is essential that this possible influence on the acquisition procedure is understood and the implications arising from it are taken into account. The limited number of years does not give a clear indication of trends.

Finally, whilst ratios can tell us many things, they are not able to provide links to the more qualitative issues such as staff morale and sustainability of earnings.

(b) Other financial information which would prove useful:

- The current year's figures and budget to date, as this will give a clear understanding of how the company is performing this year, its expectations and how it explains any variances. It will also help identify any trends which are in place or developing.
- Three years' historical financial accounts, which would help in spotting any trends so giving a possible indication of its future performance.
- If there are any future capital requirements. This would enable XY plc to understand what needs to be spent to keep the business running profitably, to maintain their market share.

Question 8 - Learning Outcome 8 (10 marks)

JM plc, a UK-based insurer, has recently had its credit rating downgraded from BBB- to BB+ by Standard and Poor's.

Identify, with justification, **five** potential business implications of this downgrade for JM plc. (10)

Answer to question 8 (Learning Outcome 8)

Insurers use rating agencies, such as Standard and Poor's, to provide an opinion of financial strength and this strength is graded, with AAA being the highest (CII study text, M92 Insurance business and finance, 2016, P10/2). Customers, when they buy insurance, are buying a promise from the insurer. For some classes of business, this promise can be short-term, whilst for others, e.g. employers' liability, it will remain in place for many years. It is therefore essential that the customer has confidence that insurance liabilities can be met in the future. By choosing an insurance company with a higher financial strength rating, the customer can be more confident that it is taking out cover with a financially strong insurer.

JMG plc will likely suffer from this downgrade from BBB- to BB+, as potential and existing customers will begin to have concerns over JMG plc's ability to honour its debts and liabilities. It begins to cast doubt over its ability to deal with catastrophes and also whether this downgrade is a trend which could worsen.

Some brokers and companies will only deal with insurers who have a rating of A or above and so JMG plc will be automatically excluded from certain clients. Those clients, who will still consider them, would expect a reduced premium for the additional risk that they are taking on. For example, if you put a quotation enquiry to two insurers, where one insurer had an AA rating whilst the other was BB+, you would expect the BB+ rated insurer to provide a lower-cost quotation.

So at a time when they are trying to increase their financial strength they will actually be under pricing pressure.

Borrowing costs may also increase as JMG plc is seen as a less attractive choice; they may even struggle to acquire capital. It may also have a negative impact on possible investors.

Question 9 - Across more than one Learning Outcome (30 marks)

You work in the Finance Department of JB plc, a UK-based insurer, and use financial ratio analysis as part of your investigations to determine if JB plc should conduct business with BU plc, a UK-based insurance broker.

BU plc provides the following financial statements:

Income statement for the year ending 31 December 2015	
Income	**£000's**
Broking commissions and fees	181,330
Investment income	18,000
Expenses	
Salaries and associated expenses	(103,660)
Other expenses	(68,340)
Operating profit	27,330
Finance costs	(4,000)
Profit before taxation	23,330
Taxation	(7,780)
Profit for the year	15,550

Balance sheet as at 31 December 2015	
	£000's
Non-current assets	
Properties	74,000
Office equipment	22,000
Vehicles	3,670
Subsidiary companies etc.	20,670
Current assets	
Trade receivables	299,670
Cash and cash equivalents	163,340
Other items	43,330
Current liabilities	
Insurance broking creditors	(385,000)
Other items	(97,670)

Non-current liabilities	
Borrowings	(34,330)
Provisions for liabilities and charges	(27,670)
Net assets	**82,010**
Shareholders' equity	
Ordinary shares	26,670
Retained earnings	55,340
Total shareholders' equity	**82,010**

Note: Figures in brackets are negative

(a) Analyse, **showing all your workings,** whether JB plc should conduct business with BU plc, making use of **one** profitability ratio, **one** productivity ratio, **one** liquidity ratio and **one** gearing ratio. (16)

(b) Explain, with justification, the implications of your calculations on whether JB plc should conduct business with BU plc. (14)

Answer to question 9 (Across more than one Learning Outcome)

(a) Financial ratio analysis is a useful comparison tool and therefore JB plc can use common insurance ratios to establish which brokers it should be doing business with. On paper, this particular broker looks to be in good shape. By the use of ratios, we can establish whether it fits within certain industry norms.

Profitability

Profitability can be examined in a number of ways and in this instance we have focused on return on equity (ROE).

ROE = profit after tax/shareholders equity x 100 = 15,550/82,010 x 100 = 18.96%

The ROE appears to be a good return. Usually, an investor would wish to see at least 2.5 times the profit they could make by leaving the money in the bank, because there needs to be an acceptance that they require an increased return for a higher level of risk. BU plc is seemingly making a good return for its investors and appears to be in a strong position (CII study text, M92 Insurance business and finance, 2016, P9/3).

Productivity

These measurements help to show how efficiently a business operates relative to its costs and sales. They have more application in a business which produces tangible goods but for a broker it is useful to examine the collection of debt. Collection of debt is a source of cash flow and therefore by being slow in its collection, it can increase the cost of capital.

Trade receivables (debtors)/sales x 365 days = 299,670/181,330 x 365 = 603 days

It should be noted that fees and commissions have been used as a proxy for premium which makes this figure look very bad. Unless the broker takes all premiums in and then passes them onto the insurer, as there is no other option. (CII study text, M92 Insurance business and finance, 2016, P9/4)

Liquidity

There are two measurements for this – the current and quick ratios. They are useful measures of how well the company can meet its financial demands. As there is extremely limited amount of inventory, the current ratio would be appropriate for this scenario.

Current ratio = current assets/current liabilities, where current assets are trade receivables plus cash and cash equivalents plus other items and current liabilities are insurance broking creditors plus other items = (299,670+163,340+43,330)/(385,000+97,670)
= 506,340/482,670
=1.05

This looks to be good as there are enough assets to cover the liabilities but it should be monitored. This is not always the case. Liquidity does not necessarily have to mean cash, if the company can borrow quickly they can also rely on access to such borrowing (CII study text, M92 Insurance business and finance, 2016, P9/4 and P9/5).

Gearing

This ratio examines the ratio of long-term borrowings to the shareholder equity. This helps to show how much of the business is reliant on borrowings. Borrowings can be a significant commitment as it requires interest to be paid on them and if too high can be an appreciable drain on the business (CII study text, M92 Insurance business and finance, 2016, P9/6).

Gearing = long-term borrowings/shareholder equity x 100 = 34,330/82,010 x 100= 41.9%

(b) It would appear that BU plc is not taking on enough business risk as the gearing ratio is so low. It would be worth finding out why this is and to look to see if there is potential to increase capital investment and expand the business. As with most ratios, this cannot be considered in isolation; the business environment will play an important part in any decision to borrow money. For example, if the business is at saturation point in its market/s there may be no need to invest further to expand. It is therefore important to understand the market and competition before making any further decisions.

BU plc looks to have a good liquidity position as they are able to meet the demands for cash. Holding cash is not always necessary as the company may have other sources of income which can be relied upon, e.g. overdrafts.

This broker appears to be trading on a basis of extended periods of credit, which is not a financially attractive position. This looks to be a critical flaw in the business and would require further investigation. It would be useful to understand how many clients BU plc has, if they all had the same credit periods or if there is one large client who has more credit. Conversely, there may be an issue with BU plc whereby outstanding account payments are not actively managed and pursued. This would need to be investigated further.

Overall, the company looks to be profitable and reasonably healthy. It may be that the company is a well-established one, hence the high profitability and low gearing, offset in part by the tardy collection of monies. More investigation is needed. However on the face of it, BU plc is profitable and liquid.

Question 10 - Across more than one Learning Outcome (30 marks)

You have recently been appointed as a senior manager of DJ plc, a UK-based insurer, providing commercial and personal insurances.

The price of DJ plc's shares has been declining steadily. You believe that this fall in shareholder value has been influenced by issues arising in the non-financial perspectives (quadrants) of the balanced scorecard.

These issues are as follows:

1) Learning and growth perspective
   - Staff training and development is not comprehensive.
   - Some managers do not have time to provide on-the-job training and development for their staff.

2) Internal perspective
   - Planning processes and procedures are not regularly updated.
   - Delivery of plans is not adequately monitored.

3) Customer perspective
   - Customers are mostly satisfied. However, customer service level agreements are not always adhered to.
   - Service levels are currently acceptable, but are declining slowly. This could be linked to staff-turnover.

(a) Explain the **six** most significant actions that you would take to address the issues above. (12)

(b) Explain, for **each** of the six actions you have explained in (a) above, how it should be measured and monitored. (12)

(c) Identify, with justification, which department should take the lead in implementing **each** of the six actions you have explained in (a) above. (6)

Answer to question 10 (Across more than one Learning Outcome)

(a) The balanced scorecard system aims to measure performance on a wider, more holistic basis, taking into account the four key perspectives: internal perspective, customer perspective, learning and growth and financial perspective (CII study text, M92 Insurance business and finance, 2016, P3/6).

The new senior manager of DJ plc has identified that its decreasing shareholder value is due to three perspectives of the balanced scorecard. The most significant actions that can be used to address the issues include:

Learning and growth perspective
There is a Financial Conduct Authority (FCA) requirement that staff are trained to complete their jobs properly. This can be assessed by the audit function by:

- Developing individual training programmes which are integrated in the staff performance and review process. This means they will be reviewed formally on a regular basis, with appropriate action taken to address issues arising.
- If not already available, hiring a head of learning. This focuses the attention of other mangers on the importance that DJ plc has on improving the skills and competencies of its staff.

Internal perspective
This aspect of the balanced scorecard looks at how the whole company can innovate and build its strategic capabilities, in order that it can provide an efficient and effective process for customers. Currently, DJ plc is not regularly updating its processes and procedures and not monitoring its plans. This can be addressed by:

- Having a project management team who manage and supervise all projects. This will ensure focus through the use of regular updates and plan variance analysis.
- Arranging weekly review meetings for projects in order that plans can be updated. This will ensure key stakeholders understand the progress (or lack of) for projects.

Customer perspective
DJ plc will only survive if it can meet the needs of its customers. It currently has declining service standards, which if continued could become a serious issue. It should therefore:

- Monitor service level agreements at monthly review meetings and make them an integral part of management information. Appropriate remedial action can then be identified and implemented.
- Complete employee satisfaction surveys to understand the dynamics of the workplace and use the results from the surveys to develop employee retention and development strategies.

(b) Control is an essential part of business management. If DJ plc is to succeed it needs to ensure that it is meeting the objectives, actions and targets which have been set at Board level and cascaded down. For the six actions identified above the following controls could be used:

(1) Develop individual training programmes which are integrated into the HR review system. This would be monitored via individual key performance indicators (KPIs) within the formal appraisal process.

(2) Hire a head of learning – the success of this action would be monitored via critical success factors (CSF) as these are best when considering more strategic goals.

(3) Project management team – key risk indicators (KRI) would be a good measure here as ensuring that the projects run smoothly is vital. KRI highlight when things are not going as planned.

(4) Project review meetings – an effort orientated KPI would be useful here as projects on target could be monitored.

(5) Monitor service levels – this could be monitored via benchmarking. DJ plc could benchmark against their competitors to ensure that they are, at minimum, offering as good a service as their competitors.

(6) Staff satisfaction – this might be best managed via management by objectives. This control measure ensures that the objectives are cascaded through the whole workforce from top to bottom and this ensures consistency and focus.

(c)

(1) Individual training programmes – these would be the responsibility of the Board and senior management as they have to cascade all the way down DJ plc. They need to be regarded as an integral part of the business development.

(2) Head of learning – The HR Director would be responsible for this as they would report directly to him/her. If learning is to become integrated, then the head of learning needs to report to the HR Director, who deals with all aspects of development and remuneration.

(3) Project management team might report to the Strategy team or director. This is because a high percentage of the projects will be concerned with delivering the future plans of the business.

(4) Project review meetings – the project owners would have responsibility for this as they have vested interest in their success.

(5) Monitor service levels – the Operations Director and the operations team would need to have responsibility for this as they can directly influence the results.

(6) Staff satisfaction – this would be the responsibility of the HR Director as they have the necessary influence over the management team, as well as the ability to influence the areas which are causing dissatisfaction.

Reference list

CII study text, M92 Insurance business and finance, 2016

Question deconstruction and answer planning

The following three plans are based on 10, 20 and 30 mark questions respectively.

Question 1 - Learning Outcome 1 (10 marks)

TC plc, a UK-based commercial property owner, has a portfolio of small offices in the UK, which are insured on a traditional risk transfer basis. TC plc is currently negotiating to purchase a high value office block in the UK. TC plc's UK-based insurance broker needs to place the high value office block with a suitable insurance organisation.

Explain, with justification, **two** types of insurance organisation that the insurance broker might consider suitable to cover this risk. (10)

Question deconstruction

- Review learning outcome 1 in the course material and the relevant information in the study text.
- Highlight the instructions within the question (which are circled in red above).
- What is the <u>context</u>? UK-based and high value office block.
- The question asks for two types of insurance organisations. This means that you should spend an equal amount of time and effort in your answer in relation to each type of insurance organisation.

Answer plan

- Explain your two likely organisations. For example, a proprietary insurer who has or can get reinsurance and a Lloyd's syndicate who can share the risk if appropriate.
- Discuss each organisation and how they would each be able to cover the risk.
- As this is a 10 mark question, your answer should be shorter than the answers to either a 20 or 30 mark question.

Question 2 - Learning Outcome 2 (20 marks)

SD plc, a UK-based insurer, has offices located in twelve countries. Its innovative approach and exceptionally good performance has led to rapid expansion.

Competitors are now targeting SD plc's customers and this has led to a reduction in SD plc's operating performance. SD plc has recognised this competitive environment and has therefore decided to recruit a new Chief Executive Officer (CEO) to drive the business forward.

(a) Identify, with justification, the most appropriate management style the new CEO, of SD plc, might use. (5)

(b) Analyse **two** advantages and **three** disadvantages of the style that you have identified for SD plc, given the scenario above. (15)

Question deconstruction

- Review learning outcome 2 in the course material and the relevant information in the study text.
- Highlight the instructions within the question (which are circled in red above).
- Consider the context which includes the planned appointment of a new CEO, historic innovation and growth; and recent competition.
- The 15 marks in part (b) are awarded for relevant advantages and disadvantages which are clearly linked to the chosen management style.

Answer plan

- Part (a): You need to **identify** and **justify** the most appropriate style. This needs to be linked to the scenario so that the style chosen is appropriate for SD plc.
- Part (b): For the style listed above you now need to analyse in depth two advantages and three disadvantages. You must make reference to the scenario when looking at these. Marks are allocated for the advantages and disadvantages (which are justified), followed by a brief conclusion.
  As this is a 20 mark question, your answer should be longer than the answer to a 10 mark question but shorter than the answer to a 30 mark question.

Question 5 - Learning Outcome 5 (30 marks)

CG plc, a UK-based insurance broker, is evaluating a manufacturing company as a potential long-term customer, using the manufacturing company's financial statements for last year. This evaluation is focused on the income statement/profit and loss account, balance sheet and cash flow statement.

The manufacturing company reported an annual profit of £400 million in 2015, with a net cash outflow of £250 million in the same period. The company has expanded its business in the last six months, in an environment where products become obsolete quickly. It responded to this fast changing environment, by acquiring £150 million of new production machinery in 2015. The company gives its customers considerable time to pay their bills.

(a) Analyse the potential risks to CG plc if the manufacturing company becomes their customer, based on the above information. (20)

(b) Identify, with justification, **five** additional items of financial information that CG plc would find helpful in arriving at a final decision. (10)

Question deconstruction

Review learning outcome 5 in the course material and the relevant information in the study text.

- Highlight the instructions within the question (which are circled in red above).
- Consideration of the context which is the long-term financial viability of a potential customer. The scenario also tells you the following limited information relating to 2015:
  - Profit of £400m in 2015.
  - Cash outflow of £250m in 2015.
  - Expanded business in the last 6 months, but products becoming obsolete quickly.
  - Acquired £150m of new production machinery in 2015.
  - Customers have considerable time to pay bills.

Answer plan

- Part (a) is worth 20 marks and part (b) is worth 10 marks, so each needs to be answered accordingly in length and depth.
  In part (a) each of the profit, cash outflow, expanded business, new machinery acquisition and customers' bill payment needs to be analysed in detail. Make conclusions about the potential risks.
- In part (b) identify with justification the additional financial information required. There should be a sentence or two for each justification. The financial information should fill the gaps from the scenario.
  As this is a 30 mark question, your answer should be longer than the answers to 10 and 20 mark questions.

Glossary of key words

Analyse

Find the relevant facts and examine these in depth. Examine the relationship between various facts and make conclusions or recommendations.

Describe

Give an account in words of (someone or something) including all relevant, characteristics, qualities or events.

Discuss

To consider something in detail; examining the different ideas and opinions about something, for example to weigh up alternative views.

Explain

To make something clear and easy to understand with reasoning and/or justification.

Identify

Recognise and name.

Justify

Support an argument or conclusion. Prove or show grounds for a decision.

Recommend with reasons

Provide reasons in favour.

State

Express main points in brief, clear form.