



CPA

CHARTERED
PROFESSIONAL
ACCOUNTANTS
CANADA

CPA Common Final Examination

BOARD OF EXAMINERS' REPORT

PART B — The Day 1 Report

September 2019 and September 2020 Examinations

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See Part A for full report on Day 2 and Day 3 simulations and marking guides.

THE BOARD OF EXAMINERS' REPORT ON THE SEPTEMBER 2020 COMMON FINAL EXAMINATION

OBJECTIVES OF THE REPORT

The objective of this report is to explain the Common Final Examination (CFE) process and to assist the profession in improving the performance of candidates on the CFE.

The report sets out the responsibilities of the Board of Examiners, the methods used for guide setting and marking the CFE, and the results of the marking process. The report also includes recommendations to candidates from the Board of Examiners.

The September 2020 CFE Report is presented in two parts: Part A is the Day 2 and Day 3 Report and Part B is the Day 1 report.

The appendices provide more detailed information on the design, guide setting, and marking of the CFE, as well as the board's expectations of candidates on the simulations. Readers are cautioned that the marking guides were developed for the entry-level candidate and that, therefore, all the complexities of a real-life situation may not be fully reflected in the content. The CFE report is not an authoritative source of GAAP.

RESPONSIBILITIES OF THE BOARD OF EXAMINERS

The Board of Examiners (BOE or the board) comprises a chair, two vice-chairs, and sixteen members appointed by the provincial bodies.

The board's responsibilities, as set out in its terms of reference, include the following:

- Setting the CFE in accordance with the *CPA Competency Map* (the *Map*) and other directions from the Professional Education Management Committee;
- Submitting the CFE and the marking guides to the provincial bodies for review;
- Marking the candidates' responses and recommending to the provincial bodies the pass or fail standing that should be given to each candidate; and
- Reporting annually on the CFE to various CPA committees and the provincial bodies, in such form and detail and at such time as is satisfactory to them.

The chair is responsible for the supervision of the evaluation process. A CFE subcommittee, made up of nine members of the board, is actively involved in the preparation of the CFE simulations, the preliminary marking guides, and the setting of the initial passing profile. Selected members of that subcommittee participate in the Preliminary Evaluation Centre where the marking guides are tested against candidate responses and finalized, and in the start-up of the marking centre. The BOE chair and vice-chair provide oversight throughout the entire marking process. The full board is responsible for equating the difficulty of the examination to prior years' examinations and determining the passing standard.

THE CFE

Preparation and Structure of the CFE

The board staff works in conjunction with authors to ensure that simulations presented to the board achieve the overall intent and design objectives set by the board, while adhering to the competencies and the proficiency levels specified in the *Map*.

The full board provides guidance as to the content and nature of simulations to be included on the examination. The CFE subcommittee reviews and refines these simulations that make up the three-paper evaluation set.

Nature of the Simulations

The CFE comprises a set of simulations that are both essential and effective in evaluating the candidates' readiness to enter the profession:

Day 1 – The first paper is a four-hour examination consisting of a single simulation that is linked to the Capstone 1 group case. There are two versions of the linked cases. Version 1 is linked to the most current Capstone case and is written by first time writers and by repeat writers who chose to attempt the new case rather than Version 2 of the previous Capstone case. Version 2 is written by repeat writers and candidates who deferred and are writing Version 2 as their first attempt.

Day 2 – The second paper is a five-hour case, with four different roles and requirements. Additional information tailored to each role is provided in four separate appendices.

Day 3 – The third paper, is a four-hour paper, consisting of three multi-competency area simulations.

Assessment Opportunities

The board applies competency-based marking procedures that enable it to decide which candidates demonstrate readiness to enter the profession.

Assessment Opportunities are designed to answer the question, “What would a competent CPA do in these circumstances?” To attain a pass standing, candidates must address the issues in the simulations that are considered significant.

Appendix A contains a comprehensive description of the evaluation process.

Marking Guides

Marking centre leaders and assistant leaders provide valuable input during the testing and setting of the marking guides, before live marking begins. The board chair, the vice-chair, selected member(s) of the CFE subcommittee and senior evaluations staff hold meetings with the leaders and their assistants during both the guide-setting and the marking processes. See **Appendices B to F** for the MARMANI Day 1 simulations and related capstone case, MARMANI marking guides, and MARMANI sample responses. **Appendix G** contains the marking results by assessment opportunity, and **Appendix H** contains the BOE comments. A copy of the Day 1 V1 (DHC), Day 2 and Day 3 simulations can be found in **Part A** of the CFE Report. The marking guide and detailed BOE commentary for the DHC Day 1 simulation will not be published until version 3 is written on the September 2021 CFE¹.

Day 1 – The marking guide is designed to assess the candidate on the stages of the CPA Way: 1) situational analysis; 2) analysis of the major issues; 3) conclusions and advice; and 4) communication. Based on these four summative assessments, the candidate’s response is then holistically judged to be either a passing or a failing response.

Day 2 and Day 3 – Marking guides are prepared for each simulation. Besides identifying the Assessment Opportunities, each marking guide includes carefully defined levels of performance to assist markers in evaluating a candidate’s competence relative to the expectations set out by the board when developing the passing profile for a competent CPA.

Five categories of performance are given for each Assessment Opportunity. The candidate’s performance must be ranked in one of the five categories:

- Not Addressed
- Nominal Competence
- Reaching Competence
- Competent
- Competent with Distinction

¹ Due to the cancellation of the May 2020 CFE, the profession decided to offer Version 2 of DHC on the May 2021 CFE rather than the September 2021 CFE. A Version 3 of DHC will be offered in September 2021

Setting the Passing Standard

The board chair and vice-chair participate in the monitoring of live marking. Near the completion of the marking process, the CFE subcommittee satisfies itself that the markers applied the marking guides as intended by the board.

In determining which candidates pass the CFE, a candidate is judged in relation to the board's pre-established expectations of an entry-level chartered professional accountant. Any changes to the initial profile that were made throughout guide-setting and the marking centre are ratified by the full board. In setting the passing profile, the board considers the following:

- The competency area requirements described in the *Map*
- The level of difficulty of each simulation (set using a scale: Easy, Easy to Average, Average, Average to Hard, or Hard)
- The level of difficulty of each Assessment Opportunity (set using a scale: Easy, Easy to Average, Average, Average to Hard, or Hard)
- The design and application of the marking guides
- Comments from leaders and assistant leaders regarding any marking difficulties encountered or any time constraints noted
- Possible ambiguity of wording or of translation
- Input on critical decision factors from an independent board (i.e., those BOE members not on the CFE subcommittee and therefore not directly involved) who review the fair pass package

The Decision Model

The purpose of the CFE is to assess whether candidates possess the competencies required of an entry-level CPA through a written evaluation that is common to all CPAs. Each day of the CFE is unique and is designed specifically to assess different skills:

- Day 1 is linked to the Capstone 1 group case work. It assesses the candidates' ability to demonstrate professional skills. It is independent from Day 2 and Day 3.
- Day 2 is the **depth** test. It assesses technical **depth** in one of four unique roles (that reflect the four CPA elective choices) and provides **depth** opportunities in the common core competency areas of Financial Reporting and/or Management Accounting. Candidates pre-select one role and respond from that role's perspective.
- Day 3 supplements the **depth** test in the common core areas of Financial Reporting and/or Management Accounting. It is also the **breadth** test for all common core competency areas.

Candidates must pass all three days in order to qualify for entry to the profession. Those seeking licensure must obtain depth in Financial Reporting and in the Assurance Role.

Day 1

Day 1 is assessed independently from Day 2 and Day 3. A pass or fail decision is made based on a holistic assessment of the candidates' performance in applying the CPA Way to demonstrate essential professional skills.

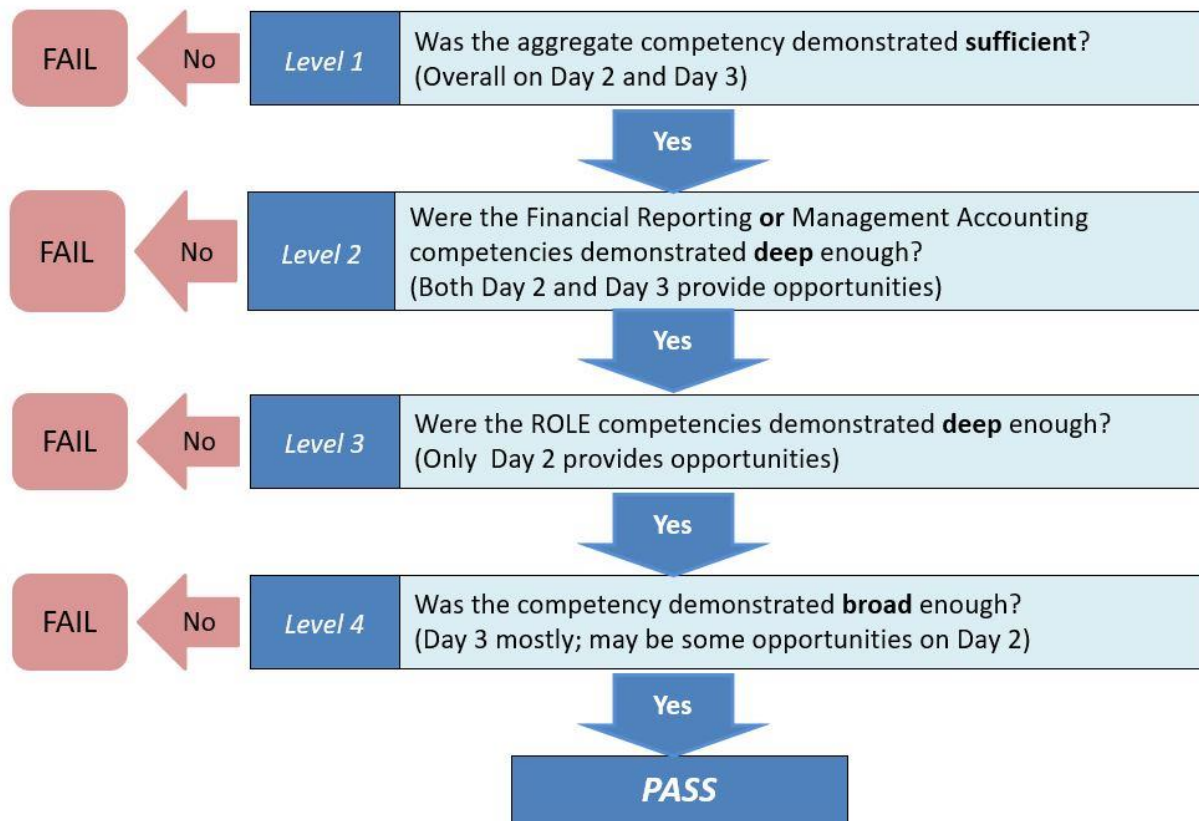
Day 2 and Day 3

The decision model used by the board is presented in Exhibit I. Four key decision points, or levels, are applied in reaching a pass or fail decision, as follows:

1. The response must be **sufficient**; i.e., the candidate must demonstrate competence in the Assessment Opportunities presented on Day 2 and Day 3 (Level 1).
2. The response must demonstrate **depth** in the common core area of Financial Accounting or Management Accounting (Level 2).
3. The response must demonstrate **depth** in the pre-selected elective role (Level 3).
4. The response must demonstrate **breadth** across all competency areas of the *Map*, at a core level, by not having avoided a particular technical competency area (Level 4).

The BOE is responsible for equating the results from one examination to another to ensure that candidates have an equal chance of passing whichever examination they write. The BOE uses the factors listed above under setting the passing standard, in order to equate the examinations.

EXHIBIT I
DAY 2 AND 3 PASS/FAIL ASSESSMENT MODEL



Approving the Results

The CFE subcommittee reviews and approves the marking results for each simulation. Day 1 is assessed separately from Day 2 and Day 3.

Day 1 – The CFE subcommittee discusses the profiles for both the marginally passing and marginally failing candidates to confirm that the board's pre-established passing profile has been appropriately applied by the markers.

Day 2 and Day 3 – As part of the development process, the CFE subcommittee sets preliminary requirements for the three levels (tests of depth and breadth) being assessed on the Day 2 and Day 3 simulations. After the marking is completed, the board reviews and finalizes those requirements. The board establishes the Level 1 (sufficiency) requirement for the combined Day 2 and Day 3 simulations.

During the approval process, the board continues to consider whether the results could be affected by any inconsistency in the evaluation or the board's processes.

Reporting

In reaching its decision, the board determines which candidates pass on a national basis only, without regard to provincial origin or language. Similarly, the detailed comments are based on analyses of the performance of all candidates.

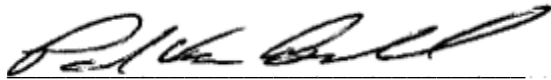
The board reports the following information by candidate number:

- Overall pass/fail standing and pass/fail standing for each of Day 1 and of Day 2 and Day 3 combined.
- A pass/fail standing for Day 1.
- A pass/fail standing for Level 1, Sufficiency. A decile ranking is provided for failing candidates.
- A pass/fail standing for Level 2, Depth in Financial Reporting and/or Management Accounting.
- A pass/fail standing for Level 3, Depth in Role.
- A pass/fail standing for Level 4, Breadth in all technical competency areas.

Thank You

All board members wish to express their warm and sincere appreciation for the outstanding energy, support, and commitment of the Board of Examiners staff members whose dedication and talent contributed in large measure to the achievement of our objectives and the fulfilment of our responsibilities.

We also wish to acknowledge the contributions made by the provincial reviewers, markers, authors, translators, and editors. The commitment, energy, and skill demonstrated by all the markers were outstanding, resulting in the sound application of marking procedures and producing an appropriate evaluation of the candidates. Everyone's commitment to the quality and fairness of the process is appreciated.



Paul Van Bakel, CPA, CA
Chair
Board of Examiners

A MESSAGE TO CANDIDATES

To attain a pass standing, candidates needed to achieve a “Pass” on Day 1, and on Day 2 and Day 3 combined, demonstrate sufficient competence in all areas, plus meet the two depth standards and the breadth standards.

Introduction

The September 2020 CFE Report, Part A and Part B combined, presents detailed information on all candidates' performance for all the examination cases, except for the Day 1 linked case, DHC Version 1. The CFE Report on DHC will only be provided after Version 3 is written in September 2021¹. The simulations, marking guides, marking results and Board of Examiners' (BOE) comments on the remainder of the examination are found in this document (Part A of the CFE Report). Similar information on Day 1 (Marmani Version 1 and Version 2) can be found in Part B of the CFE Report.

The intent of this message from the BOE is to help candidates improve their performance on future CFEs by drawing their attention to the most common detracting characteristics observed in candidate responses to the September 2020 CFE. The BOE's comments are based on the feedback of the marking teams, who see the entire candidate population, and reflect the broad themes noted by the markers. More detailed, AO by AO commentary on candidates' performance can be found in the BOE's comments in Appendix F of Part A, or Appendix H of Part B, of the CFE Report.

Nature of the CFE

The design of the CFE is such that each day of the examination allows candidates to demonstrate a different skill set. Day 1 allows candidates to demonstrate their high-level professional skills, such as analysis that is relevant and critical to strategic decision-making, professional judgment and ability to synthesize. Day 2 allows candidates to demonstrate their technical competence in the common Financial Reporting and Management Accounting competencies and in their chosen role, which ties to one of the four elective areas. Day 2 typically, but not always, directs candidates to the work to be done and is not designed to be time constrained, allowing candidates to demonstrate depth. Day 3 allows candidates to demonstrate depth in the common Financial Reporting and Management Accounting competencies, and provides multiple opportunities to demonstrate breadth in all the core technical competency areas. It is also time constrained, requiring candidates to prioritize their time per issue. Both Day 2 and Day 3 require candidates to integrate the information found in the case in order to demonstrate competence. All three days require candidates to clearly communicate their thought process.

¹ Due to the cancellation of the May 2020 CFE, the profession decided to offer Version 2 of DHC on the May 2021 CFE rather than the September 2021 CFE. A Version 3 of DHC will be offered in September 2021

Strengths and Weaknesses

Time management

With a few exceptions, time was well managed on the three days of the CFE. There was a normal amount of evidence of time constraint on the last AO of Day 3, Simulation 3. The BOE was pleased to see less AOs being “skipped over”, as the majority of candidates attempted all the AOs.

Neither Day 1 Version 1 or Version 2 was meant to be time constrained in any way, and most candidates managed their time well. In particular, the amount of time devoted to their situational analysis was better balanced with the rest of their response. Whereas previously the BOE often noted that candidates spent too much time preparing a full situational analysis, responses were focused more on the relevant changes from Capstone. Those who did experience time management issues on Day 1 generally spent too much time on their quantitative analyses, aiming to perform more complex calculations than were required. For example, on DHC Version 1, candidates often tried to recalculate Holiday’s income figures. On Marmani Version 2, some candidates spent too much time analyzing the financing alternatives, which was the first issue to appear in Version 2 this year. Most candidates addressed the issues in the order in which they appeared in the case, and while candidates are free to address the requireds in the order they prefer, the financing alternatives happened to be the issue of least strategic consequence. These candidates tended to spend their time analyzing the operational aspects of refinancing Ray’s loan compared to converting his debt to equity in Marmani. For those candidates who did not take the time to rank the issues, this resulted in their having insufficient time to fully address the more important strategic issues.

On Day 2, the teams noted fewer rushed, or very short, responses in the role section as compared to the prior year. In 2019, the BOE noted that candidates spent an inordinate amount of time on the common AOs in Day 2, to the detriment of the role AOs. This was likely due partly to candidates spending excessive time on the quantitative Management Accounting AOs, failing to balance and manage their time per AO properly. Candidates appear to have better managed their time per AO, with many candidates appearing to have set a time limit for addressing the six common AOs. This was evidenced by some candidates stopping their discussion partway through AO#6 (convertible debt) in order to move on to the role AOs. There also appeared to be a good balance between the amount of time spent on the quantitative and qualitative elements of the common AOs.

Because success on the depth-in-role test is only achievable on Day 2, it is important to manage the amount of time spent on the common AOs, to ensure that enough time remains to be able to address the role AOs in sufficient depth. Candidates are encouraged to continue to balance the time spent on the common AOs and the role AOs, and on each individual AO, as spending too much time on any one AO can hurt performance on another AO.

Clarity of communication / Unsupported discussions

The BOE noted an overall improvement in the clarity of communication, with fewer very short, point form and generic responses that are hard to interpret. However, some candidates continue to list case facts without elaborating on why those points were relevant, or explaining the relationship to the point being argued. For example: on Day 2, Common, AO#2 (Airport bid – qual), candidates listed several potential benefits and risks of the airport contract but did not explain the specific impact of each point to ECI; on Day 2, Assurance role, AO#8 (Audit plan critique), some candidates listed risk factors without explaining how they would impact the overall financial statement risk; on Day 2, Finance role, AO#10 (Ride-sharing – qual), candidates provided a list of case facts without explaining why these were advantages or disadvantages of either option; on Day 2, Taxation role, AO#12 (Employee benefits), candidates often provided a table or list of the different benefits, stating very briefly whether they were taxable or deductible without explaining why; on Day 2, Performance Management role, AO#12 (Drivers' compensation), candidates often listed case facts with no explanation of why these were advantages or disadvantages of either option; and on Day 3, Simulation 3, AO#3 (Growth options – qual), candidates listed pros and cons of each option without linking them to the company's goals and values. For additional examples of where added support made the difference in the quality of the response, see the BOE's detailed comments.

In the past, the BOE noted instances where candidates copied information from the Handbook but did not apply that information to the case facts. This year, what appeared to be more prevalent was candidates listing requirements or criteria, typically Handbook or Income Tax Act guidance, and labelling them "met" or "not met," without providing an explanation to support why. Candidates are reminded that the role of the CPA is to advise clients on the application of standards and other requirements. Without that explanation, it is impossible to know what logic was applied, and therefore, the BOE is unable to assess the degree of competence. This pattern was noted on several of the financial reporting AOs, including Day 2, Common, AO#5 (Lease), and on Day 3, Simulation 2, AO#6 (SwiftPay accounting treatment). It was also evident on Day 2, Performance Management role, AO#9 (Fit of ECI's strategy with Policy), in the second part of the required, where some candidates mentioned the government's criteria and then labelled each one as being "met" or "not met," with no support for this assessment. A similar approach was taken on Day 2, Taxation role, AO#13 (QSBC shares), where candidates copied and pasted the relevant section from the Income Tax Act, and then concluded that the criteria were met without explaining why.

Candidates are reminded of the importance of answering the questions, "Why?" or "So what?" when making any point using case facts, and including that in their response. Repeating case facts without further explanation, even if it is in a logical format, such as a list of pros and cons, is insufficient. Additionally, stating whether the requirements or criteria are met without explaining why is also not enough. The BOE is interested in understanding a candidate's logic, and is looking for evidence of the analysis and professional judgment that has been applied in reaching a conclusion. For the Financial Reporting AOs in particular, the BOE is interested in seeing the application of the accounting principles as evidence of a candidate's understanding of the decision-making elements that were considered. There is more value in a discussion of the fundamental, underlying accounting principles, and how they apply, than with a "cut and paste" of the Handbook that has no supporting explanation. Candidates are reminded that the Handbook is only a resource tool, to be used to help explain their position.

Combining technical knowledge and enabling skills

As has been the pattern for the past few years, candidates generally performed better on the more straightforward and routine issues presented throughout Day 2 and Day 3 of the CFE. For example, they performed well on Day 2, Common AO#5 (Lease), Day 3, Simulation 2, AO#1 (Recoverable cost allocation), Day 3, Simulation 3, AO#1 (Ratio analysis), and on Day 3, Simulation 1, AO#6 (Control weaknesses). It was also noted that, within some of the AOs, candidates correctly addressed the easier elements. However, the more unusual and harder issues presented a challenge for many, with some candidates avoiding those entirely.

The BOE consciously includes more challenging and unique topics (such as convertible debt in the Common AOs, stock compensation plans or the reliance on the QC team in the Assurance role, the point of indifference between the two business models in the Performance Management role, the conversion value of the Class B shares in the Finance role, and the QSBC share discussion in the Taxation role) in order for candidates to use the tools available to them to find the applicable technical knowledge, demonstrate their ability to draw on first principles and use their judgment to work through an issue they perhaps have never seen before. Although there is no doubt that success on the CFE requires demonstrating strong foundational knowledge, the ability to handle new and difficult issues is also critical. With technical knowledge changing at an ever increasing pace, it is important that candidates know how to look up relevant standards, draw on first principles, explore alternatives and use their professional judgment and common sense to tackle the issues presented. The BOE will continue to present new and challenging topics on the CFE, and encourages candidates to use their enabling skill set to respond to the issues.

In addition to the above-noted areas not being as well performed, the BOE noted that candidates had difficulty with many of the Management Accounting AOs that required relevant costing or incremental costing to be applied as a technique. Many lost sight of which basis they were using and ended up comparing figures that were calculated on different bases. For example, on Day 2, Common, AO#1 (Bid price – quant), candidates often mixed their calculations of ECI's existing costs, which were on a per-kilometre basis, with their calculations of the airport contract costs, which were on a per-trip basis, adding these together to determine their bid price. As a result, their conclusions often became unreasonable, such as recommending a minimum bid price in the millions of dollars, or pennies per trip. On Day 2, Performance Management role, AO#7 (Indifference point between two business models), many candidates were internally inconsistent in their calculation, calculating some costs on a per-month basis, some on a per-car basis and others on an annual basis. Also on Day 2, Performance Management role, AO#11 (Maintenance options), some candidates made conceptual mistakes in the calculation of the annual cost of the in-house option, such as adding recurring costs to one-time costs, ignoring the initial one-time costs altogether or including irrelevant or sunk costs in their analysis. On Day 3, Simulation 3, AO#2 (growth options – quant), many performed an incremental analysis for the permanent location and wrongly compared it to what the net income would be for the Gogo booth option, without any adjustments for lost revenue or incremental savings. Others included both incremental components and net income components within their analysis of one option, resulting in their individual calculation not being internally consistent.

In terms of the more straightforward AOs noted above, there were some surprising technical weaknesses. On Day 2, Common, AO#5 (Lease), a number of candidates thought there was a bargain purchase option, even though the case stated that \$5,000 was the estimated fair value at the time, and a number of candidates had errors in their present value calculations, such as using an incorrect number of periods or an inappropriate interest rate. Many candidates did not integrate information from ECI's draft financial statements in Appendix I, which would have allowed them to approximate the useful life of the leased assets; as a result, they concluded that there was not enough information to be able to assess the Handbook criteria regarding the lease term. On Day 3, Simulation 2, AO#6 (SwiftPay accounting treatment), a significant number of candidates failed to identify that there were different components that required different accounting treatments, even though the amounts were laid out separately in the case (\$65,000 for tablets, \$75,000 for software licence and \$5,000 for testing/software tailoring). These candidates often treated all components of SwiftPay as one asset, usually as PP&E.

Finally, the BOE noted that candidates' ability to perform an NPV and WACC has improved (see Finance BOE comments). However, it was also noted that candidates sometimes attempted to apply this technique where it was inappropriate to do so. For example, in Day 1, Version 2, which was intended to focus on the contribution margins, many candidates attempted to calculate the net present value of the contribution margin, and then concluded that the project was positive and should be pursued. These candidates failed to consider many of the costs that were relevant, and therefore, their conclusion was based on false information. On Day 3, Simulation 1, AO#4 (Cash flow projection), some candidates used a net present value calculation to conclude on whether the project was profitable. This type of analysis did not address the client's request, as they could not answer whether the franchising operations would require additional funding.

Misinterpretation of the required / Irrelevant or unrelated discussions

Similar to past exams, there were instances of candidates providing irrelevant discussions, either as a result of misinterpreting or misreading the requireds or as a result of failing to consider the specific case facts presented in an integrative manner. This issue may have been somewhat more prevalent this year, due to the exam being slightly less directive, and the level of integration required for some issues being slightly higher.

The BOE believes it is an essential CPA skill to be able to analyze and integrate the information presented in order to identify what is, and isn't, relevant to the issues raised in the case. The BOE intentionally reduced the level of direction on some of the issues, and placed certain case facts in different places, to increase the required integration. This may have resulted in some candidates having more difficulty identifying the correct issue and relevant case facts to include in their discussions. Candidates are reminded to take the time necessary to read the required carefully, and to use their judgment to decide whether a discussion is pertinent to the issues at hand or to their role.

Following are some examples of where candidates misinterpreted the requireds or failed to integrate information that was presented in different parts of the case.

On Day 2, Common, AO#3 (Licence impairment), there were two instances where candidates failed to integrate the information presented. First, many candidates were aware that ASPE requires a cash flow test for recoverability and often suggested doing one. However, although most of the information the candidates used for this AO was presented in Appendix II (Common), the information needed to perform the recoverability test was found in Appendix IV (Common), which many candidates failed to integrate. Second, some included lengthy discussions on whether the licences were an intangible asset, apparently thinking they were addressing the required, since they were discussing the stated required, “the accounting treatment for the licences.” However, additional key information was presented in Appendix II (Common), where Jen specifically wonders whether ECI’s licences are impaired due to changing market conditions. Integrating this information into the required would have pointed candidates to the right discussion, that is, whether there was impairment.

On Day 2, Performance Management role, AO#7 (Indifference point between two models – quant), a large number of candidates misinterpreted the required and thought they needed to calculate the number of trips that Ruby would need to make under the ECI business model in order to have the same net income that it currently generates (\$250,000 for a two-month period), rather than the number of trips it would require in order to earn the same net income if it kept its current business model. Some misread the required, and did the calculation for the wrong company, and calculated the number of rides ECI (instead of Ruby) would have to generate to have the same net income as Ruby does currently. Others calculated Ruby’s breakeven number of trips using the ECI business model, without incorporating a profit component in the calculation.

On Day 2, Finance role, AO#10 (Ride-sharing – qual), some candidates misinterpreted the required, which was to provide a qualitative assessment of both Ryde Green and EcoCab, and instead discussed whether ECI should pursue ride sharing in general. On Day 2, Taxation role, AO#13 (QSBC), some candidates seem to have misread the required, which stated, “ECI’s shares might no longer qualify as qualified small business corporation shares,” and thought that ECI’s shares *would* no longer qualify. Instead of explaining why the shares would or would not qualify, these candidates instead tried to remedy the situation, often providing inappropriate tax planning measures as a result.

On Day 3, Simulation 1, AO#4 (Cash flow projections), some candidates lost sight of the required after performing their calculation of the royalties, and did not integrate that calculation with the other financial information in order to answer the client’s question about whether additional funding was required. On Day 3, Simulation 1, AO#3 (Variance analysis), some candidates limited their use of the information to what was provided within the notes of the draft income statement, rather than integrating the relevant information found throughout the case in order to analyze the variances between budget and actuals. On Simulation 3, AO#2 (Growth options – quant), many candidates included the cost of goods sold in their calculation of the Gogo option, since the gross margin percentage was provided in the appendix with all of the other information on Gogo, but did not take into account the cost of goods sold in the permanent location option, as that information was not provided directly in the permanent location appendix, failing to integrate the information from the various appendices.

The BOE also noted on Day 2 and Day 3 that, as was the case in 2019, some candidates tried to insert discussions that were not relevant to the case. Many of these discussions appeared to come from previous CFEs, suggesting that candidates are trying to fit the answers from practice exams into the current year's exam. On Day 2, Assurance role, some candidates discussed performing audit procedures to test whether ECI was a going concern, which was an issue on the 2019 CFE. While ECI has been operating at a loss, it has a healthy current ratio and cash available in the current year, and Jen and the silent angel investors are willing to inject more funds if required. On Day 2, Taxation role, some candidates discussed intercorporate loss planning, which was an issue on the 2019 CFE. On Day 2, Performance Management role, some candidates performed a full situational (SWOT) analysis at the beginning of their response, as was required on the 2018 CFE.

A contributing factor this year seems to be the use of a certain approach being applied by some candidates. For some issues, even though it was clear from the case facts that certain aspects were not relevant, candidates seemed to feel it necessary to discuss every aspect of a topic in an effort to cover all their bases, thereby spending unnecessary time on these discussions. For example, on Day 2, Common, AO#4 (Investment in Ruby), candidates often discussed whether Ruby was a business acquisition. However, the case clearly identified that Ruby's shares were acquired 100% by ECI; therefore, the focus of the discussion should have been on the options for accounting for the acquisition (cost, equity, consolidation) and not on whether Ruby was acquired. This also occurred on the Day 2, Common, AO#3 (Impairment licences), where some candidates included a lengthy discussion of whether the licences were an intangible asset. Similarly, on Day 2, Taxation role AO#11 (Drivers become employees), some candidates spent time applying the tests for determining whether the drivers would be employees or contractors, even though the case very explicitly stated that they would be employees. On Day 3, Simulation 2, AO#1 (Recoverable costs allocation), some candidates described the ABC allocation method at length before performing the allocation, when the added value was in explaining why it was a better method to use in this case.

Another template that is seen often, and was again sometimes misused on the 2020 CFE, is the weakness-implication-recommendation (WIR) template. For example, on Day 2, Assurance role, AO#11 (Royalty controls), the required was to discuss how the Ruby drivers may be avoiding paying the full amount of royalties owed, and to recommend internal controls that should be in place. While this required has many similarities to other internal control weakness AOs that have appeared in past CFEs, where the WIR template would apply, the specific required for this case was discussing the "how," and providing recommendations. By using a WIR format, many candidates instead stated that the implication of the weaknesses they identified was that Ruby would not receive the full amount of royalties, and did not go beyond this, which provided limited value and often caused candidates to not discuss the "how" portion of the required in sufficient depth. In addition, on Day 2, Assurance role, AO#13 (Reliance on QC team), the use of the WIR template resulted in candidates discussing the weaknesses found in the team and their processes, the implications of those weaknesses and recommendations to address them, but this approach did not address a significant part of the required, which was to determine whether

external auditors could rely on the work of the QC team. And on Day 2, Performance Management role, AO#10 (EEEEV's proposal), some candidates presented their response in a WIR format, which was not the best approach, given the required. Making recommendations for each clause of the proposal was not appropriate in this context, as the client simply wanted an opinion on the governance implications of the proposal, not suggested modifications to it. Also on Day 2, Performance Management role, AO#11 (Maintenance options), the use of the WIR template proved again to be detrimental to the quality of the qualitative responses of some weaker candidates, who made recommendations within each option on how to improve current operations, even though the options had not yet been implemented.

While it is good to practice writing cases, and to know different approaches to use, candidates are advised to not automatically assume the task is the same as in previous years, even though the wording may appear similar. The facts presented are unique to each case and require integration of the pertinent case facts, to fully understand what the relevant issues are for a particular case, and to decide what form of analysis is appropriate. Rarely is an issue identical. Candidates are encouraged to pause and take the time necessary to ensure that they have clearly identified what is most relevant, based on the particular set of circumstances presented, before beginning their response.

For more detailed commentary, see Appendix F of Part A, or Appendix H of Part B, of the CFE Report.

Additional Comments Specific to Day 1 DHC (Version 1)

A majority of candidates dedicated the first section of their response to a relevant situational analysis. Most used that analysis later in their response, making relevant links back to the company's situational analysis when analyzing the specific strategic issues that were presented, and within their conclusions. Candidates generally identified the major changes from Capstone and identified the fact that DHC had limited financial resources to invest. They also highlighted DHC's primary objectives, that of concentrating on the company's core hotel business, improving the occupancy and average daily rate, earning a minimum of 12% on any strategic investments made and having an adequate level of cash in order to once again pay dividends. A few candidates chose not to provide a situational analysis and proceeded directly to their issue analysis. As a result, some missed key elements of the situational analysis within their discussion of the issues.

There were four major issues to analyze from a strategic perspective: 1) whether to purchase 100% of Holiday Tours or to split ownership 40/60% with KGI; 2) whether to convert the Northern Ontario hotel to a Global franchise; 3) whether to offer cooking retreats in Northern Ontario with Chef Norman; and 4) whether to proceed with the revised management contract in connection with HHH's proposed conference centre. In addition, candidates were expected to identify a potential conflict of interest between Patrick, Derek and KGI.

Most candidates did a good job of analyzing the major issues. There were three main differentiating factors that separated strong responses from weak responses. First, strong responses tended to recognize the more important decision factors for each of the issues and focused their discussion on the strategic implications of those factors. Important decision factors included: the possible conflict between Derek and KGI in conjunction with the decision to purchase some or all of Holiday in Issue 1; the significant change in business structure that would result if Northern Ontario became a Global franchise in Issue 2; the role and dependence on Chef Norman in Issue 3; and Martha's lack of cooperation in Issue 4. Second, strong candidates clearly explained the implications of the relevant case facts within their analysis, appropriately linking to their situational analysis. Third, strong candidates provided calculations that were clear and on point, avoiding overly complicated and unnecessary calculations. This was important, given that, when compared to some prior Day 1 cases, few calculations were required for DHC Version 1. The required calculations on DHC Version 1 were quite simple, and the main quantitative skill being assessed was the candidate's ability to critique the calculations provided.

Most candidates approached their response in a coherent and organized fashion. Only a few candidates struggled to effectively communicate their ideas. These candidates tended to use poor sentence structure, confusing syntax and an unorganized approach to their response.

APPENDIX A

**EXAMINATION DESIGN, MARKING GUIDE DEVELOPMENT, AND MARKING
OF THE COMMON FINAL EXAMINATION**

CFE Design

Day 1 is one four-hour case that is linked to the Capstone 1 case, which is worked on in groups for eight weeks prior to the CFE. When writing the Day 1 case, candidates are allowed access to their Capstone 1 case but not their group's answer or any sample response. The Day 1 case is designed to assess the enabling (professional) skills. Candidates are directed to target a "board room and senior management" level of discussion, with high-level analytics. There are two versions of the Day 1 case. Candidates pre-select the version they will write.

Day 2 is one four-hour case that candidates are given five hours in which to respond. The extra hour gives candidates time to filter and find the information that they need to answer *their* role requirements from within the common information presented. Day 2 is designed to assess the technical competencies in **depth** (Level 2 and Level 3). Candidates pre-select a role (Assurance, Finance, Taxation, or Performance Management). All candidates work with the same case — it has a common section and four sets of appendices containing additional information applicable to each of the four unique roles. The required tasks, regardless of the role, are clearly directed unless there is an undirected/enabling issue in the case that the board expects candidates to identify on their own. Day 2 evaluates the competencies listed in the *CPA Competency Map* mostly in the elective area and in common Financial Reporting and/or Management Accounting areas in **depth**. The role **depth** test (Level 2) may also include coverage of other competency areas from the common core.

Day 3 is a four-hour examination containing a mix of small cases (60 to 90 minutes each) that evaluate the common core competencies only. The Day 3 cases provide additional opportunities for **depth** in Financial Reporting and Management Accounting and all the **breadth** opportunities for all the technical competency areas. Cases are time constrained, and they are designed to cover different competency areas within each case. A higher level of integration and judgment is required on Day 3 of the CFE than in the core modules, although the technical competencies are tested at the common core level of expectation.

The assessment opportunities on the Day 2 case are given mark values such that each of Day 2 and Day 3 are weighted equally.

The Development of Marking Guides and the Provincial Review Centre

Approximately two months prior to the Common Final Examination booklets being published, provincial reviewers meet to examine the simulations and the preliminary marking guides. The provincial reviewers' comments are then considered by the board when it finalizes the examination set and again when the senior markers review the marking guides in the context of actual responses at the Preliminary Evaluation Centre.

The September 2020 CFE Marking Centre

The 2020 CFE Evaluation Centre was 100% remote due to Covid-19. From the marker applications received, approximately 280 individuals were chosen to participate in the September 2020 CFE marking centre. The criteria for selection included marking experience, motivation, academic achievement, work experience, personal references, and regional representation. The marking was supervised by the CPA Canada Evaluations and International Assessment full-time board staff.

The Day 1 Version 1 linked case was marked by a team of 30 people from October 8 to October 20, 2020. The Day 1 Version 2 linked case was marked by a five-member team from September 18 to October 1, 2020.

The Day 2 Common assessment opportunities were marked by a separate team from the role teams. Day 2 Common was marked by a team of 60 people from October 5 to 18, 2020. Day 2 Assurance was marked by a team of 54 people from October 6 to October 19, 2020. Day 2 Performance Management was marked by a team of 19 people from October 6 to October 19, 2020. Day 2 Finance was marked by a team of 8 people from October 10 to October 19, 2020. Day 2 Tax was marked by a team of 7 people from September 26 to October 5, 2020. All three Day 3 cases were marked from October 9 to October 26, 2020. The Day 3 simulations were marked by a total of 94 people.

In advance of the marking centre, the members of the CFE subcommittee, staff, leaders, and assistant leaders participate in a five or six-day preliminary evaluation centre (PEC). Participants reviewed the marking guides, applied them to randomly selected candidate responses, and made necessary revisions to the marking guidelines, taking into account the comments on the marking guides received from provincial reviewers.

At the beginning of the marking centre, the leaders and assistant leaders presented the marking guides to their teams, while staff, the BOE chair, and a selected subcommittee member supervised. The teams undertook a two-phase test-marking procedure prior to actual marking. Phase one consisted of marking guide familiarization, during which markers applied the marking guide to copies of candidates' responses and collectively reviewed their results. Phase one thus ensured that all markers understood the issues in the marking guide and the basis on which to apply each expectation level. Phase two consisted of an expanded test marking of several responses to establish marker congruence.

After the training and test-marking phases, and only when marker congruence was achieved, live marking commenced. All teams, for all days, had a leader, and anywhere from one to eight assistant leaders, and had both French-speaking and English-speaking markers. Each team had one or more markers who marked in both languages.

The board strives for the highest possible marking consistency and quality control. Leaders and assistant leaders, therefore, devoted much of their time to cross-marking and other monitoring activities. Control papers are automatically fed into the system daily to check markers' consistency. Markers' statistics were reviewed to ensure that marking remained consistent throughout the centre. Based on analysis of the statistics, leaders reviewed and, if necessary, re-marked papers to ensure that the assessment opportunities were marked fairly for all candidates. Bilingual markers marked papers in both languages, and their results were compared to ensure that the marking was consistent in both languages. Additional audits were performed at the end of marking on any large differences between markers, or language differences.

Borderline Marking (Day 1)

Each candidate's paper was marked once. All candidates' responses that were assessed as clear fail, marginal fail, and marginal pass were marked a second time by the team leader, an assistant team leader or a senior marker. Clear pass results were also audited to ensure accuracy of marking.

Double Marking (Day 2)

Each candidate's Day 2 paper was marked independently by two different markers. If the two initial markings differed on any assessment opportunity, an arbitrator (the leader, the assistant leader, or a senior marker) compared the two initial markings and determined the final result.

As an added measure to ensure that markers were consistently applying the marking guide, a two-day rule exists that results in the second round of marking not beginning until two days have elapsed since the first marking. Adherence to this rule ensures that any movement in the application of the marking guides due to marker interpretations during the first two days of live marking are stabilized before the second marking and arbitration process begin.

Borderline Marking (Day 3)

Day 3 was marked using a borderline model. All Day 3 responses were marked once and then the Day 2 and Day 3 results were combined. All failing candidates who passed the Day 2 role test, had their Day 3 response marked a second time by an independent marker, and any differences between the first and second markings were arbitrated by a leader or senior marker.

Subsequent Request for Remark of Results and Request for Performance Analysis

Failing candidates may request a remark of their examination results and/or a performance analysis for either Day 1, or Day 2 and Day 3, or for all three days.

Review and Remarking Approach

Great care is exercised in the original marking and tabulating of the papers and results. The following review and marking procedures are applied to all three papers constituting the Common Final Examination.

Under the supervision of the chair of the Board of Examiners, as well as CPA Canada Evaluations and International Assessment staff, the responses are reviewed by the leaders and assistant leaders who did the original marking. The leaders and assistant leaders read the responses and compare them to the marking guides used at the marking centre. In reviewing candidates' results, two aspects are considered. First, it must be determined that the basis of marking the papers has been consistent with that accorded other candidates who wrote the examination. Second, all responses reviewed are subjected to a careful check to ensure the markers have indicated that consideration has been given to all material submitted by the candidate.

The results are tabulated and the decision made regarding whether any candidates have been treated unfairly and should be granted a pass on the examination.

The results are then forwarded to the provincial bodies for notification of the candidates.

APPENDIX B

**CAPSTONE 1
MARMANI BACKGROUND CASE**

Capstone 1

Marmani Inc. — Case

(All dollars are Canadian dollars unless specifically stated otherwise.)

It is May 9, 2019, and you, CPA, have recently been hired as the corporate controller at Marmani Inc. (Marmani). Previously, you were employed at Tomkins, Klein, and Associates LLP (TKA) as a member of the small business financial services group, providing consulting and business services to many clients. Roberto Marmani, the company founder, made the decision to outsource processing of Marmani's payroll transactions and month-end adjustments to TKA in 2009. You had been assigned to Marmani for the last two years, working closely with Roberto and his staff for an average of eight days per month, bringing some much-needed financial stewardship to Roberto's business. Your role was to help with payroll transactions and reporting, the timely completion of bank reconciliations, general ledger maintenance, and tax compliance, allowing Roberto to spend more time on operations.

More recently, Roberto recognized the need to focus more on developing the strategic direction of Marmani, which led to hiring you as the corporate controller. The partners at TKA had been very pleased with your job performance over the years and were happy for you to take this next step in your career path. Roberto realized that if Marmani is going to take advantage of any of the growth opportunities presented, then he must lead the company in a new, more professional direction. You have been tasked with performing a strategic analysis and recommending which direction Marmani should take, as well as addressing numerous operational issues that have been highlighted.

While you have gained familiarity with the company over the last two years, you have been provided with the following information to review and analyze in order to refresh and expand on your understanding of the company, and to assist you in your new role.

Company overview

Marmani, a Canadian privately held company located in Toronto, Ontario, is a medium-sized retail specialty line apparel company. Italian-born designer Roberto Marmani founded the company in 1994. Marmani currently operates in the adaptive apparel industry. Its main product is the SIDEAWAY Pant, a flexible alternative to the traditional hospital gown. The SIDEAWAY Pant has experienced continuous demand from health care, long-term care, and retirement facilities in Canada. More detail on this product can be found in Appendix I.

Industry information

Fashion

Fashion is a US\$1.2 trillion global industry, with more than US\$250 billion spent annually on fashion in the United States.¹ On a per-capita basis, Canadians spend the second-highest amount on apparel, averaging US\$831 annually, topped only by Australians who spend an average of US\$1,050 annually.² Many apparel companies offer their products for sale through online venues as well as through retail stores, and there has been a significant increase in consumers making online apparel purchases.

While Canadians are spending a significant sum on apparel, the Canadian fashion industry itself is struggling, as Canadian fashion brands face fierce global competition combined with the challenge of selling within a smaller domestic marketplace.³ Statistics Canada data show that the total value of apparel made in Canada continues to decrease while apparel imports increase. Since 2011, apparel imports have increased by \$3.4 billion, or an average of 8.3% annually, to total \$12.5 billion in 2015.⁴

Within the apparel industry, diversification is key to success. Once a company has an established brand and product base, it is critical for it to expand to multiple sources of revenue by offering additional products and product lines or by expanding its customer base, in order to drive future growth. The industry is sensitive to shifts in trends and consumer perceptions and preferences, and the ability to respond to these shifts and/or having multiple product lines to absorb a decrease in popularity of one line can be crucial to a company's continued success. Creating a desirable brand in an underserved niche and then effectively marketing that brand — coupled with efficient distribution, constant innovation of the design process, control over the supply chain, expansion into other products, and consumer involvement — is imperative to success in this industry.⁵

Consumers in this industry can also be very sensitive to prices — whether they be too high, too moderate, or too low. Some consumers are interested in a more exclusive product and are attracted to the elitism that comes with a product that is priced quite high and is known for being better quality (a designer-type product). These consumers would shy away from products that are reasonably priced. Other consumers are more price-conscious and are looking for a good-quality product at a reasonable price. Still others are more focused on the bottom line and are willing to sacrifice a bit of quality for getting a lower-cost product. It is important that companies price products appropriately for their target consumer. It is also possible for companies to have a few different

¹ <http://www.newmobility.com/2017/03/adaptive-clothing-shakes-up-world/>

² <http://wwd.com/business-news/financial/apparel-spending-list-10203626/>

³ http://www.huffingtonpost.ca/greg-hewitt/canadian-fashion-brands_b_6120858.html

⁴ https://ic.gc.ca/eic/site/026.nsf/eng/h_00070.html

⁵ <http://smallbusiness.chron.com/important-factors-competition-clothing-market-81643.html>

product lines, offered at the various price points, to cater to a wider range of consumers.⁶

Pricing and quality are not the only variables. Consumers may also be sensitive to how environmentally friendly or socially conscious a company is, considering where the products are made, and from what materials and how they are made, in making a purchase decision.

There have also been many technological advances within the industry that have helped to reduce the costs of inputs and increase quality. The ability of companies to capitalize on these technological advances and achieve more control over the supply chain — either in their own production processes or by purchasing the inputs at a lower cost from suppliers that utilize advanced technology — can be an important factor in the companies' continued success. Employing an experienced and versatile labour force that is adaptable to new manufacturing techniques can also help a company remain competitive in this industry. Digital technology adoption is increasing, with Canadian apparel manufacturers taking a multi-channel approach to sales.⁷

Adaptive clothing

A small and lesser-known facet of the fashion industry is the adaptive clothing segment. Adaptive clothing “refers to clothing designed for people with physical disabilities, the elderly, and the infirm who may experience difficulty dressing themselves due to an inability to manipulate closures, such as buttons and zippers, or due to a lack of a full range of motion required for self-dressing.”⁸ Examples of adaptive apparel include open-backed blouses and sweaters that can be put on without wearers having to raise their arms, open-backed pants, and extra-wide slippers for wearers with swollen feet.⁹

The adaptive clothing industry is a unique segment of the apparel industry in that it may not be as sensitive to changing trends and whims of the consumers, and constant innovation may not be as critical to future growth. It is estimated that by 2024, persons aged 65 years and older will account for 20.1% of the Canadian population.¹⁰ The aging population, combined with the increased proportion of the senior demographic, can lead to a natural increase in the consumer base for adaptive apparel.

To date, very little money spent in the fashion industry has been focused on adaptive clothing or the needs of people with disabilities.¹¹ However, this segment of the fashion

⁶ Ibid.

⁷ https://ic.gc.ca/eic/site/026.nsf/eng/h_00070.html

⁸ http://www.apparesearch.com/definitions/clothing/adaptive_clothing.htm

⁹ <http://business.financialpost.com/entrepreneur/help-us-tailor-a-solution-for-adaptive-clothing-maker-silverts/wcm/616ec3e6-ac1f-491c-9d78-be83575eaf6c>

¹⁰ <http://www.statcan.gc.ca/daily-quotidien/150929/dq150929b-eng.htm>

¹¹ <http://www.newmobility.com/2017/03/adaptive-clothing-shakes-up-world/>

industry is starting to gain more traction and there is increasing competition, domestically and especially globally.

Snap and zippered closures are still the most commonly used closures. However, magnetic buttons for clothing are emerging for those with diminished dexterity. Magnets are placed behind decorative buttons and are strong enough to stay closed on shirts, pants, dresses, and skirts.

There is a continuing transformation occurring in Canada related to adaptive clothing. In the summer of 2014, the Royal Ontario Museum unveiled “Fashion Follows Form: Designs for Sitting,” an exhibition honouring a well-known Canadian fashion designer who created “a revolutionary line of fashionable and functional clothing for the growing demographic of men and women who use wheelchairs.”¹²

Adaptive clothing for special needs or people with disabilities is an evolving industry. “The right fit is not only important when it comes to looking good; it also helps people feel good. Studies show that feeling comfortable in certain clothing or fashion pieces can significantly boost confidence and self-esteem.”¹³ However, often the alternatives for people who use wheelchairs or have other disabilities are unattractive and/or uncomfortable clothing options.¹⁴ Adaptive clothing attempts to address these issues with the appearance of traditional clothing.

There is limited competition in adaptive clothing in Canada. “There have been several small companies that have attempted to address the fashion needs of people with disabilities, but their success has been sporadic at best.”¹⁵ According to one designer, “finding the right pants is so hard for someone in a wheelchair... There’s length, if it cuts into your hips, risk of pressure sores if pants have back pockets with rivets, and on top of all that, finding the right fit.”¹⁶

While many trends come and go in the fashion world, only a few have been focused on the needs of people with disabilities. However, more designers are beginning to develop adaptive fashion solutions and bring adaptive fashion into the public’s view.¹⁷

Company background

Roberto moved to Canada with his family in the late 1980s and became a Canadian citizen. After graduating from a fashion college in Oakville, Ontario, in 1991, Roberto worked as a creative director at a large Canadian sporting goods retailer. However, Roberto always knew that he wanted to run his own business, and in his spare time he focused on developing his own designs. Three years later, in 1994, Roberto had the

¹² <https://www.rom.on.ca/en/exhibitions-galleries/exhibitions/past-exhibitions/fashion-follows-form>

¹³ <http://www.newmobility.com/2017/03/adaptive-clothing-shakes-up-world/>

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ Ibid.

¹⁷ Ibid.

design idea that would enable him to leave his job and start the business of his dreams — one with a culture of creativity and a healthy spirit of co-operation.

The company began when Roberto designed one key item, the ICON Tearaway Pant (ICON Pant), for both men and women. This style quickly became a leader in the field of fitness performance training wear. What made this item special was the unique “dome” snaps that went down the outside of each leg of the pant. Roberto outsourced the manufacturing of this innovative design and high-quality pant to a technologically advanced industrial production facility located in Toronto.

For six years, Marmani enjoyed doing business as a successful wholesale startup, selling the ICON Pant to the majority of the large North American sporting goods retailers, and the product flew off the shelves. Steady year-over-year growth drove double-digit annual sales increases to a high of \$20 million at Marmani’s peak in the year 2000.

By 2007, the Canadian active wear industry had clearly begun to change, moving more toward velour track suits and yoga pants. Sales of the ICON Pant had consistently decreased each year since 2000 due to this shift in demand by consumers, and while Marmani was still marginally profitable, cash flow was becoming an issue. The cash balance began to fluctuate monthly between negative and marginally positive. As a result, Marmani had to cut many marketing and public relations initiatives.

In order to increase sales and profitability, Roberto and his team needed to find a way to create new demand for the pant. With a mandate to expand the use of the ICON Pant, Marmani focused on the value proposition of the item: its adaptability and convenience. After much research, Roberto and design manager Sonya Valencia became convinced of the importance of producing well-designed, attractive, and functional clothing for people with limited mobility. Roberto saw the opportunity with adaptive clothing to change the world of health care by serving the common good of hospital patients, the elderly, and people with disabilities, as well as their caregivers and the medical community at large, by providing high-quality apparel — all while making a profit and expanding his business with a team of people he valued greatly. Roberto and Sonya realized that by lowering the technical quality of the ICON Pant, the innovative design could be used to make cost-effective pants for the health care industry.

Roberto and Sonya spent much of 2007 and 2008 focused on creating, researching, designing, and developing the new product. In 2009, Marmani was ready to relaunch its product under the name “SIDEAWAY Pant.” Marmani then engaged TKA to help develop a financially sound selling strategy to market directly to health care facilities such as hospitals and rehabilitation centres, and to long-term care facilities. The response was overwhelming, and by 2009 the SIDEAWAY Pant was selling as a functional alternative to a hospital gown. The focus then shifted toward growing sales via a network of sales agents and marketing the SIDEAWAY Pant in this new market segment: health and wellness.

From 2009 to now, the SIDEAWAY Pant has become a popular standard outfit of hospital patients, people with disabilities, and the elderly. It provides independence in dressing and undressing, as well as allows wearers to feel clean, fresh, and well-groomed, which helps keep them in a more positive state of mind. This new and improved dignified patient clothing has received overwhelming praise from the medical community and caregivers. Marmani's experience in technical athletic design provides the attention to detail that these garments require in order to meet the special needs of these customers.

Along with the SIDEAWAY Pant, Marmani also designed, developed, and produced the Flexible T, a T-shirt that utilizes the same snap technology as the SIDEAWAY Pant to provide its wearers with more movement and flexibility. This product, while not as popular as the SIDEAWAY Pant, was still a success and continues to sell well.

Current operations

By 2018, Marmani was well known for its SIDEAWAY Pant, which is in constant demand by various health care, long-term care, and retirement facilities. Marmani's sales for 2018 were almost \$41 million, a milestone for the entrepreneurial company. Continued success led Marmani to purchase its own 15,559-square-foot industrial warehouse and production facility, in the building located adjacent to its current office and warehouse space in the north end of Toronto. Roberto funded the purchase by taking a loan from his cousin for \$6.6 million. Marmani also purchased three state-of-the-art programmable laser-cutting and assembly machines for use in the production facility, totalling \$1.2 million. This purchase was also funded with an additional \$1 million loan from the same cousin and the remainder with cash reserves.

The move away from outsourcing production resulted in higher fixed expenses and the need to hire additional staff, but Roberto believed this would pay off. Marmani now has control over the entire process, from production through to sales, including more oversight over the important aspects of product quality and timing. There is currently excess capacity at the production facility and 3,500 square feet of the space is unused. Utilizing this area could increase production by 10,000 direct labour hours. Labour continues to be Marmani's constraining resource, as the new equipment does not currently complete all stages of production and skilled employees are difficult to find.

Raw materials continue to be purchased from the same vendors Marmani has been working with for years. All products are produced using ethical production practices, an important consideration for Roberto. Soft, machine-washable fabrics in a variety of cheery colours are sourced from a well-known ethical supplier in southern China that uses sustainable manufacturing practices. Roberto has resisted the temptation to decrease the quality of the fabrics used in making his apparel. While this would save money, Roberto's passion for quality simply won't allow him to make that move.

Currently, all of Marmani's sales occur through sales agents, who interact with the customers on behalf of Marmani. The company does not have any online presence.

Maximizing profitability is now largely driven by how efficiently the production facility has been able to operate by specializing in one line of business. However, Roberto realizes that he needs to explore how to best utilize the excess capacity of the production facility, with a continued focus on efficiencies and profitability. Roberto is averse to business risk, as he wants to avoid the hard times that Marmani went through, but realizes that the best way to do this is by exploring new opportunities and growing the company in a diversified manner.

Vision statement

“Our vision is to be a leader in the apparel industry by creating products that perform beyond expectation for our customers and make people’s lives better.”

Mission statement

“We accomplish our vision by designing and selling technical clothing that offers optimal functionality while still being attractive.”

Marmani has not updated its vision or mission statements since 2009, when the SIDEAWAY Pant was launched.

Values

Marmani’s and Roberto’s current core values and beliefs include:

- passion for everyone to stay active and lead a healthy lifestyle
- quality, a high level of service, and value for customers
- innovative clothing designs and production practices
- ethical and environmentally sustainable operations

Company structure

Marmani is owned 100% by Roberto Marmani, who incorporated the company in 1994 and is the current CEO. Roberto is compensated solely by salary. Marmani’s poor cash flows in 2007 significantly impacted his family finances and it is now his preference to keep his personal finances separate from the company’s. Since 2010, he has not advanced Marmani any shareholder loans. Roberto would like to limit his investment to the original amount invested when Marmani was incorporated.

Marmani has no formal board of directors, though TKA has provided some business advice in the past, primarily related to the launch of the SIDEAWAY Pant in 2009. Most decisions must flow through Roberto, and the other members of the management team have very little control or decision-making power.

Management team

Marmani's management team is composed of the following individuals:

Sonya Valencia, design manager

Sonya has been with Marmani since 1999. She joined mainly to learn from Roberto, given his reputation as a highly creative designer with a great ability to see the finished product, even before he puts it on paper. Sonya is confident in her own drawing and sewing skills, but realizes that she needs to be more of a team player in order to capitalize on the talents of others in expanding the adaptive clothing product line. She hopes Roberto remembers her contributions to making the SIDEAWAY Pant successful — specifically, she was responsible for selecting the fabrics and sourcing the materials; she wants to remain valued and needed.

Sonya feels strongly about continuing in the adaptive clothing industry, and has been devoting much of her time to developing a more diversified collection of designs. She has a family member who was recently moved into a long-term care facility and she has seen first-hand the difficult job caregivers have, including the limitations and risks associated with dressing patients. This has increased her passion to turn her design ideas into reality.

Karen Zenkovic, communications and marketing manager

Karen joined Marmani in 2004 with a mandate to help drive sales of the ICON Pant. She came from a very structured working environment at a public relations agency, and has had a difficult time working for an entrepreneur. Roberto makes important decisions quickly and with little information. Karen has been trying to set out a clear marketing strategy, but with a very small marketing budget. She is still trying to make the company a customer-centric organization. Karen has requested an investment in IT infrastructure to support a digital marketing strategy, but Roberto has not agreed to it.

Karen's role has evolved over the years, and she now spends a lot of time overseeing the sales agents, serving as their first point of contact. Karen tries to get as much detailed customer data as she can, but the agents aren't quick to share too much and the IT system doesn't capture sufficient data on customer inquiries and orders to support a detailed analysis. She has been tasked by Roberto to review and approve all press releases, press interviews, and customer communications; however, he often forgets to include her in pertinent meetings. She wants to support Roberto, but she sometimes wonders how her day-to-day work has drifted so far away from her true area of expertise.

Don Baker, supply chain manager

Don has been with Marmani since its inception, being the first employee hired. He is very loyal to his boss, and tries to help out with whatever needs to get done. With the

move to the new production facility, Don feels he has taken on many more shipping and receiving duties than before. He tries to keep to himself, and not get too much in Roberto's way, so he is fine with his employees getting their answers directly from Roberto.

Wayne Croxton, production manager

Wayne recently joined the company, with the primary responsibility to oversee the production facility and its workers. Previously, he worked in a large apparel factory in Montreal and he has been trying to set up a costing system at Marmani similar to the one he used there. However, the machines purchased by Marmani are brand new and very high-tech compared to the old machines he was used to. They need to be programmed, especially the laser cutter, which only needs one worker to attend to it. He is not confident in his costing analysis. Data on garment specifications, when programmed, can be integrated with other software to facilitate procurement of raw materials and production scheduling, but the IT system would need to be upgraded to capture this information. This level of IT system expertise is beyond Wayne's capabilities.

Ronald Wu, accountant

While not a management member, Ronald has been a key employee. He has been with Marmani for 19 years, and is now reporting to CPA, the new corporate controller. Ronald has worked independently on the day-to-day accounting tasks related to banking, calling customers for payment when they are overdue, and paying vendors, both by cheque and letter of credit, as required. He has worked closely with CPA in the contract work performed by TKA, and felt relieved when CPA was hired.

The company's current organizational chart is included in Appendix II, along with the company head count.

Other stakeholders

Ray Cirello, Roberto's cousin, has been financing the growth of Marmani off and on over the past 20 years. Ray made his own entrepreneurial success in the beauty and cosmetics industry with a very lucrative distribution business. He started out by securing exclusive rights to a high-end hair care line out of the United States and brought it into Canada, selling to hair salons across the country. Ray has since travelled the world to find other exclusive brands, continuing the same business model of bringing these global brands into Canada and selling them to salons and other beauty retailers. Ray has always encouraged Roberto to follow in his footsteps of entrepreneurship and find his own niche, so he was willing and able to provide financing, as needed, with fair and reasonable terms.

Financing and banking

Initially, Roberto started Marmani with his own money, which he had been saving since his first part-time job in the hopes of opening his own business one day. Over the years, he has received several loans from his cousin, Ray, and repaid all or some of the outstanding balance when he felt that Marmani had enough cash. The most recent increase in the loan was for \$7.6 million in 2018, used to finance the purchase of the production facility and equipment. There are no covenants or security required. Marmani pays Ray annual interest at 4% on the outstanding loan balance.

Historically, Roberto's belief was that growth should only be financed by internally generated funds combined with financing from family members, and he has always been hesitant to take on debt. Roberto knew he could always rely on Ray for financial help, and, for a long time, he was content to grow Marmani at a very slow pace, with minimal risk. Marmani went through sharp cash fluctuations when the demand for the ICON Pant diminished, beginning in 2001. Due to the lack of diversification of his business, Roberto was lucky Ray was there for him, providing Marmani with cash as needed. Marmani made principal repayments when it could until Ray agreed that any loan repayments would not be needed until he retired. The responsibility of owing money to a family member has been a lot for Roberto to deal with.

Late in 2018, Ray advised Roberto that he had decided to retire within the next two years, and would be requiring repayment of all loans to begin in 2020. Marmani will need to make principal repayments to Ray in the amount of \$200,000 per month, in addition to the annual interest payments, until all loans and interest have been paid. These terms have been verbally agreed upon.

For the last 25 years, Marmani has banked with Hurley Bank of Canada (Hurley). Marmani has always been pleased with the banking services provided. Marmani has four bank accounts, and deals with foreign exchange letters of credit for the raw materials it buys overseas.

Now that Marmani cannot rely on Ray for financing and must begin to make loan repayments, Roberto wants to proceed with obtaining a \$600,000 operating line of credit from Hurley to ensure Marmani has access to funds as needed, for future expansion or as a safeguard against sales fluctuations.

In his recent meetings with Hurley, Roberto has been told that any short-term borrowing would need to be secured by Marmani's accounts receivable and inventory, along with a personal guarantee from the shareholder. Hurley recommended a \$600,000 revolving credit facility, and requested the following information to determine Marmani's credit worthiness:

- a complete set of financial statements, prepared in accordance with accounting standards for private enterprises (ASPE), reviewed or audited (preferably audited)

- a strategic business plan for the next five years, including forward-looking financial projections incorporating the impact of any planned strategic objectives
- complete details of the accounts receivable and inventory accounts for the current year
- other personal financial information from Roberto

The interest rate would be 6%. The banking agreement would also include a covenant requiring a minimum return on assets of 8% (calculated using after-tax income and the year-end balance of total assets).

Financial reporting and budgeting

A few years into operations, Roberto hired Ronald Wu, an accountant, to keep the records. Ronald would create simple reports for Roberto to understand how the company was doing. Initially, all reports were prepared primarily in Microsoft Excel, as the company did not use any formal accounting software. Roberto managed the finances and what was spent by the company on a cash basis, using an Excel daily cash report Ronald prepared for him. This helped them decide when to release cheques and when to pay the bills. Even though payments were sometimes made late, Marmani's vendors always knew they would get paid. Marmani has therefore built up an honourable business reputation within the vendor community.

In 2010, following TKA's recommendation to improve monthly reporting, Marmani purchased an off-the-shelf accounting software package, but Ronald only ever used the general ledger module and continued to operate on a cash basis. Over the years, shipping, procurement, receiving, and production have automated some functions and generate various reports (such as raw materials requisitioned). There is no integration of these reports with the accounting software. Ronald posts entries to the general ledger weekly.

Ronald is not an expert in preparing payroll, tax returns, or government compliance filings. While he has done his best, his efforts have resulted in Marmani paying late penalties and interest to the government from time to time. In 2009, Marmani engaged TKA to assist with payroll, provide tax advice, and prepare corporate federal, provincial, and GST (now HST) tax returns and filings, in addition to providing strategic advice related to the new SIDEAWAY Pant. Marmani's corporate income tax and government compliance filings have all been made accurately and on time ever since. TKA has also taken over Roberto's personal tax work, providing him with personal tax advice and estate planning.

Marmani has never prepared any formal financial statements beyond minimal compilation work needed for tax purposes, since Ray was its only lender and has never asked to see any company financial information. Over the years, TKA has recommended budgeting or forecasting be done. Roberto has resisted this, however, since he has been involved in every facet of the company and felt he had a good-

enough understanding to make any necessary decisions. Since Roberto is involved in most areas of the company, there has been very little attention to developing effective internal controls.

Management meeting

Roberto held a meeting with his management team on May 7, 2019, explaining this was to be a strategic planning session for the business, looking forward to the next five years, as well as an opportunity to address some important operational issues.

Excerpts from the discussions that took place follow:

Roberto: Thanks to all of you for being here and welcome to CPA, who is attending our management meeting for the first time!

Management team: Welcome, CPA!

Roberto: You are all aware of the increasing competition we are facing in our current industry. While I am comfortable that the sales levels that we have now achieved are sustainable into the near future, I am concerned that, given the increased competition, Marmani will not be able to realize any substantial growth going forward if we stay small and focused on only a limited line of products. Therefore, it is important that we proactively seek out solutions to ensure the company's continued growth and profitability. The last 25 years, while enjoyable, have been difficult and stressful at times. I don't want to remain stagnant and I would like to achieve annual revenue growth of 8% to 10%. Current industry long-term growth is projected to be 4% per year. There are a number of strategic alternatives for us to consider.

Don: I am not looking forward to making changes. I have always loved working here, and we're busy with new orders. We make great products, and we always have!

Roberto: I hear what you're saying Don, but we don't want to face another situation like we did back in 2007, where demand for our main product was declining and we had to scramble to find a new direction. We are in a good financial position and demand for our products remains strong, so now is an opportune time to proactively think about where we want the company to go in the future. CPA will be performing the analysis of all of the options we discuss here, and will prepare a report outlining the best strategic alternatives for Marmani to take. I agree that Marmani is known for its high-quality products, so whatever direction we decide to pursue, it is important that we maintain our commitment to quality.

One potential strategic option is to consider selling Marmani. I was recently approached by Witherspoon's Mobility Ltd. (Witherspoon's) about the possibility of selling Marmani. It is a large, U.S. retailer of medical supplies, and they are impressed by our adaptive clothing designs. I know everyone is shocked by this option, but it could be a means to an end. I have provided more details about the offer (see Appendix III). Frankly, I'm

shocked by the selling price proposed. I didn't think Marmani was worth that much! I would like CPA to perform an analysis of the offer and evaluate the selling price for my shares based on the value of the company. Maybe Marmani is worth even more? I have promised to get back to Witherspoon's soon, as I know they are interested in completing a sale by the end of June.

Don: This June? That seems really quick.

Roberto: Yes, this June. They also mentioned something about needing to complete due diligence, which I didn't quite understand. CPA, would you be able to explain what this means and what it could entail for Marmani? As well, I wasn't sure if there would be any tax implications that I should personally consider before deciding whether to move ahead with the sale. I have not claimed any capital gains exemptions to date related to the sale of small business shares.

CPA: Yes, I would be happy to include this information in a separate report for you.

Karen: What would happen to our jobs?

Roberto: Well, there could be an option to negotiate for some or all employees to stay on. If I can net \$25 million on the selling price of my shares after tax, I would consider taking the money to start another business. Essentially, I would be continuing to build on my initial investment in Marmani.

Sonya: We have been so successful in the adaptive apparel industry, enjoying a favourable margin, and there is still such growth potential. I don't really see the point of moving into a different industry where we don't have any experience.

Roberto: It would actually be an industry that is very similar to the one Marmani started out in — athletic apparel. I have continued to follow the athletic apparel industry and there is a new trend developing called "athleisure." One of my former classmates, who is now the head designer for a high-end apparel retailer, called me up to talk seriously about this up-and-coming trend. He wanted to know if I would be interested in designing, producing, and selling wholesale athleisure products to the large North American sporting goods and clothing retailers. Some of the retailers are the very same that sold our ICON Pant. My friend also expressed interest in coming to work for Marmani as a designer, should Marmani move in this new direction. We have both already come up with some designs. My primary area of interest has always been the athletic fashion world and it is intriguing to consider moving back in that direction. I'm excited to see if I would be able to design and develop another "runner" apparel product as a pure-play athleisure brand with the same success as our original ICON Pant!

I have provided some preliminary background information about the athleisure industry (Appendix IV). Even if I don't sell my shares of Marmani, there is the option of adding an athleisure division alongside adaptive apparel to utilize our excess capacity. I have pulled together some financial details about the possibility of moving in this direction

using our manufacturing data and my preliminary designs (see Appendix V). Wayne provided the facility information, as diversification into athleisure would require more production capacity than our current plant. I have also researched outsourcing production. CPA, I would like you to perform an analysis of this option to include in your report.

Sonya: There is so much we don't know about the athleisure industry. Is this a trend or fad, or could this be a mega-trend in fashion that is here for a long time? Who are the key competitors? Who are the target customers and how do we best sell to them? I think there is more to consider than just the financial results.

Roberto: You are right, Sonya. It is important we think carefully before moving in this direction. CPA will perform some additional research about this industry and consider some of these qualitative points before providing a recommendation. I know how passionate you are about the work we are doing with adaptive clothing.

Sonya: Yes, I think everyone knows athleisure is a big deal right now, but I feel the bubble is going to burst pretty soon. My heart is in designing products to truly improve the quality of the lives of our current customers. Marmani is developing clothing that is making a real difference, and I think that is where our success lies. I think there is a lot of potential within our current industry and there are many improvements we could make to our current operations that will have a significant positive impact on future results. One area that we need to understand better is how to maximize our sales volume. We are in a growing industry as people age and as people with disabilities become more aware of our products. And we haven't made many changes to our marketing recently.

Karen: I have to agree; there is potential to expand and change our marketing strategies. I have documentation for CPA on some sales options to better connect us with our customers (Appendix VI), and I would like CPA's advice on both of these issues. CPA should proceed under the assumption that both issues are strategic and that Marmani is not sold, regardless of whether the athleisure expansion occurs. First, we need to decide whether to continue with our strategy of using sales agents to sell our products or to hire our own sales force. In listening to Roberto's expansion ideas, it occurs to me that there may be significant differences between adaptive clothing and athleisure apparel when it comes to our target market and how we reach them. Second, there is also an opportunity to reach smaller health care facilities that our sales agents currently do not visit by developing some digital marketing for Marmani. Aside from many other benefits, reaching more customers could increase our existing product revenue by 1% per year.

Roberto: We would be selling wholesale to the athletic retailers, so I don't see the need to waste valuable financial resources on digital marketing. The products should speak for themselves, just as the ICON Pant did.

Karen: No matter how we sell our products, we need to continue to build the Marmani brand by understanding our consumers. I am wondering whether there are other marketing initiatives that Marmani should adopt? I haven't devoted any time to new marketing strategies, given how much time I spend interacting with the sales agents. CPA, as part of your report, can you also address this issue and let me know where I should start on the marketing and branding of the company?

CPA: I can definitely look into these issues and provide my findings.

Roberto: Sonya, I believe you had mentioned there was a strategy you wished to present?

Sonya: I believe the best way to grow Marmani and increase profitability is to concentrate our collective efforts in our current industry. We can increase market share by introducing new products and selling more adaptive clothing to our existing customer base.

I wanted some specific feedback about the designs I have been developing for clothing with back snaps, shoulder-opening clothing, side-opening pants, front-zipper dresses, diabetic shoes, and other footwear. I am also working with the latest mineral-based technology that allows clothing to improve stability and balance. I ran several focus groups with target customers about the importance of wearing clothing that made dressing effortless instead of a chore to see how successful my new design ideas may be. I have provided the results of the customer focus groups (Appendix VII).

Roberto: This is very exciting, and I am impressed with your initiative, Sonya. The development and formulation of new designs could turn into an entire collection.

Sonya: Definitely! But, at this point, we are not ready to move forward with most of the new designs — they are still in the research stage. We would need to think of our production capacity if we decide to develop and produce more items. However, there are also existing products that we can purchase and resell to our customers, such as sandals, slippers, and orthopedic footwear, that would not impact our capacity. Wayne and I have done some preliminary analysis regarding the two products I would like to begin selling over the next year: adaptive sleepwear and medical compression socks (Appendix VIII). For now, we have estimated revenues based on selling to our existing customer base. I am not sure how to make a decision on which products to make or buy, considering our limited capacity.

Wayne: Yes, I think expanding our current product line is the way to go. The products proposed could be made and stocked using our excess space and capacity. We could test the market to see if the product line can be expanded. We are familiar with the products and it would secure all of our jobs.

Karen: Both sleepwear and socks would be of interest to consumers whom we could market to directly, instead of only selling to health care, long-term care, and retirement

facilities. These products would allow us to grow by tapping into new customer segments we have not previously sold to. Once our assortment is large enough, we could eventually even consider new sales channels like online marketplaces such as Amazon.

Sonya: Our sales agents have been critical to the adaptive clothing line's success. Their presentations really show the benefits of our products to patients and staff. It is helpful for buyers in health care, long-term care, and retirement facilities to feel, touch, and try the various products. And the buyers appreciate the knowledge and personal contact of the sales agents.

Roberto: Sonya, your passion for our business is wonderful. Let's start by asking CPA to review and further analyze the information you've gathered and make some recommendations. I would like this analysis performed regardless of the recommendations made on other strategic options, as I am not sure what direction I will end up taking and am curious about the results. I agree that there is the potential to expand our current product line, especially given the excess capacity we have at our production facility. As well, if volume gets too high, we can always explore outsourcing some of the production back to the third-party factory Marmani has always dealt with, though this could result in higher costs than if we produced it internally. I know our loyal customers would be interested to see what other products and designs we can come up with.

Sonya: Great!

Roberto: CPA, as you know, I am looking into obtaining a bank operating line of credit, now that my cousin will no longer be in a position to advance Marmani any additional funds. In addition to a five-year projection, the bank has requested either reviewed or audited financial statements. What does this mean? Which would be better for us and why?

I am also wondering if there are other financing alternatives available to us and if we should be pursuing these instead of, or in conjunction with, the operating line of credit. I'm not sure how much funds we will need to complete the strategic initiatives we have discussed here. Could you let us know how much financing would be required, given your recommendations, and also present some financing options? Taking on bank long-term debt might be one option. I don't like the idea of taking on a lot of new debt — I'm just not comfortable with it, especially given that we have to repay Ray. Are there any equity options?

CPA: I will be happy to provide this information, in addition to the five-year projection requested by the bank. I will be sure to incorporate the impact of my recommendations into the projection to present a complete picture of the expected future of the company.

Roberto: Does anyone have any other issues they'd like to address?

Wayne: I do. I'm concerned about the accuracy of the cost of sales I have provided to Ronald weekly for posting to the general ledger. The machines used in the production process are able to gather data to better allocate indirect costs. I have never allocated the costs to this level of detail before. I have prepared some details on our current job costing system and other cost data (Appendix IX).

Roberto: Production is entirely new to me and most of our staff, so it is important that we fully understand the cost of manufacturing different products and orders, as it can impact what our selling prices should be. CPA, could you please have a look at the information Wayne provided and let us know if there are any issues with our current costing process and any recommendations for improvement?

CPA: Of course!

Roberto: I have a few other concerns I would like to address. Most of you have been with the company for quite some time, and most of our employees are quite long-term. I understand it has been difficult for you to be effective managers because all the staff come directly to me with their questions. This is mostly my fault, as I have liked to be involved in every aspect of the business and encouraged employees to come to me. However, as we move forward and continue to grow and embark on new initiatives, it will become increasingly important for me to take on much more of an oversight role and focus on strategic planning and monitoring our financial results. I would also like to be able to evaluate how the company is progressing toward the strategic goals we are now developing. I want to be in a position to be alert to any operational changes that need to be made, but the ongoing operations should be run by this management team. Our organizational chart needs to be updated to reflect better reporting lines and roles and responsibilities, to help create a more professional and formal organizational and reporting structure.

CPA: I can take care of this for you.

Roberto: Thanks. I am also interested in learning more about the value of creating a board of directors. I will always remain the CEO and founder of Marmani, but Ray has mentioned to me many times all the benefits he realized in his business once he had a formal board in place. TKA had suggested a board too, but I really need to see the value for my business. Could you please explain what some of these benefits are for Marmani given our planned strategies, who the board should be comprised of, and what the board would be responsible for? If you notice any other governance issues that we should be addressing, please discuss them in your report as well.

CPA: Certainly.

Wayne: I notice that we are talking about making a lot of potential changes. But what does all of this mean for us as managers? If we are taking on more work, will we be compensated accordingly?

Don: I'm concerned about this as well. Right now, I do a bit of everything, not just what is in my job description. It would be nice to be recognized for everything I do around here, especially if I'm going to be taking on new work as a result of any of these new strategic initiatives.

Roberto: These are valid concerns. I would like to offer a better compensation scheme to reward all employees for their loyalty and hard work. I am happy that Marmani has such low employee turnover, particularly within the management team. Most of the employees feel like family to me! However, it is important that any bonus motivates employees to achieve the goals and strategic objectives of the company.

CPA: Sounds good. I will provide some advice on performance measures and incentive plans for employees.

Karen: One other thing I've noticed is that we've always emphasized and marketed Marmani as a "steward of the environment." However, I've noticed limited sustainability formally incorporated into the day-to-day business operations. I know there is a lot of information on the internet on this subject, and I'm wondering whether we could formalize policies that provide clear direction to employees and perhaps other stakeholders.

CPA: I can perform some research on this topic and let you know. It may be possible that some sustainability initiatives will positively affect the production facility.

Roberto: CPA, I know that our accountant Ronald is very happy to have you on board. He has mentioned you have already set up a few more modules to integrate with the general ledger that he has been using in the accounting software package.

CPA: Yes, I did, but there is more work to do. It is important that Marmani have an accounting system to accurately track transactions and prepare important reports that can be used to analyze performance. I was able to create a draft set of financial statements for 2018 with comparatives from the prior year. I used these financial statements to build some projections based on the current operations (see Appendix X). I have also included some industry metrics for both the retail and wholesale apparel industry in Canada (Appendix XI). As you can see from the cash flow projections, it may be difficult to meet the repayments to Ray and sustain our expected capital expenditures if we are considering other expansion opportunities as well. These projections will need to be updated to reflect the recommended initiatives and operating issues.

Roberto: Our current IT system is quite old. Should we consider upgrading our IT and accounting systems, now that we are focused on future growth? If so, then why? And what are some elements that would be important to consider?

CPA: Yes, this would be a good idea, as we can leverage technology to obtain more information and be more efficient in our business processes. I will provide you with some details on this in my report.

Roberto: Thanks, everyone, for your input. It's time to focus on our future!

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Appendix I
Press release on the SIDEAWAY Pant
Provided by Sonya Valencia

FOR IMMEDIATE RELEASE

The SIDEAWAY Pant

Marmani Inc. Enters the Healthcare Market with its First Innovation in Patient Apparel

Toronto, Canada, June 30, 2009: Earlier this year, Marmani Inc. introduced a brand new product called the “SIDEAWAY Pant” designed to transform the patient experience, making hospital wear more dignified. It is more comfortable, flexible, and convenient than that dreaded hospital gown. The lightweight pant comes in a variety of colours, features snaps down the outside of the leg and allows for freedom of movement.

That hospitals should avoid insisting on the gowns when possible was the overwhelming sentiment of the many physicians Marmani consulted when designing the innovative new product. One doctor described the standard-issue hospital gown as the hospital’s version of a prison jumpsuit.¹⁸

The thinking in the past was that the design of the standard hospital gown was a necessary evil. Not only do they provide doctors and nurses easy access to the patient’s body, but the one-size-fits-all garments are easy to launder and reasonable to purchase, noted Dr. Todd Lee, the internal medicine specialist at Montreal’s Royal Victoria Hospital.¹⁹

These facts were seriously considered by Roberto Marmani, founder and CEO. “Marmani’s goal is to improve the comfort and convenience for patients with a lightweight and cheery garment that can easily fit almost any patient because of the built-in snap flexibility,” he says. “The pant comes in unisex sizes from small to extra large.”

With the help of physicians at hospitals in Vancouver, Toronto, Montreal, and Halifax, a total of 154 patients in various departments were interviewed. “The doctors treating them deemed that 57% were eligible to wear lower-body garments, and almost all the patients said that would be their preference. Yet only 11% were doing so, with the rest wearing the classic open-back gowns, though some hospitals have recently adopted more modest designs.”²⁰

¹⁸ <http://nationalpost.com/health/the-dreaded-hospital-gown-described-as-health-cares-prison-jumpsuit-often-imposed-on-patients-needlessly-study/wcm/5f64fe86-0803-4cc0-93bb-383997ad682e>

¹⁹ Ibid.

²⁰ Ibid.

Appendix I Press release on the SIDEAWAY Pant (continued)

“Alies Maybee does not need to be convinced of that argument. She spent three days in hospital after an operation two years ago and could see “no earthly reason” why she had to wear a flimsy, open-backed hospital gown the whole time. After all, the surgery she underwent was on her elbow.”²¹

“The SIDEAWAY Pant is also perfect for rehabilitation centres, long-term care facilities, and other health facilities. The pant still allows surgeons, doctors, and nurses easy access to the body, while preserving the patients’ dignity when they are walking around. The pant also makes a great staple for senior citizens, as it addresses restrictions in their daily lives,” says Roberto.

Features and benefits of the SIDEAWAY Pant include the following:

- made of high-quality, soft material that is durable and easily washable, with easy-snap technology down the outside of the leg
- designed for men and women in unisex sizes, striking a perfect balance of function and form
- available in multiple cheery colours
- can be paired with patients’ own T-shirts
- perfectly comfortable to wear with dignity and modesty

Marmani Inc. is headquartered in Toronto, Canada, with the ability to sell around the globe.

For more information, contact:

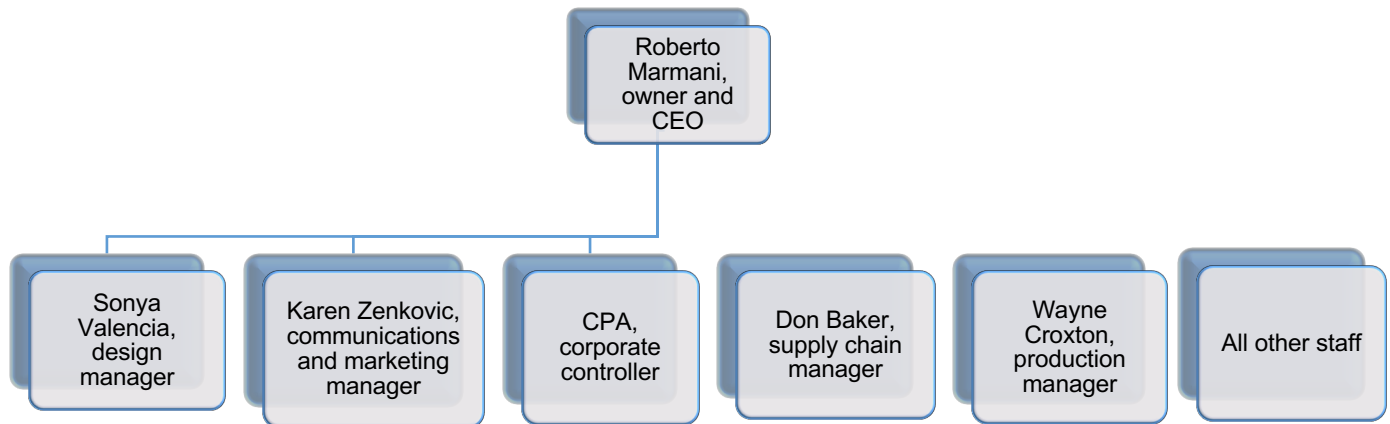
Marmani Inc.

Karen Zenkovic, communications and marketing manager

416-123-4567; kzen@marmani.ca

²¹ Ibid.

Appendix II Organizational chart and company head count



Head count as of April 2019:

Department	Employees
Management	6
Administrative support	2
Accounting and finance	1
Information technology	2
Human resources and payroll	2
Marketing and communications	1
Production (pattern layers, cutters, sewers, and so on)	16
Graphic design	2
Shipping/receiving	2
Quality control	2
Total	36

Salary details:

- Roberto's salary is \$425,000.
- Other members of the management team earn \$105,000 with no other incentives.
- The average salary for all other employees is \$63,000.

Appendix III
Offer to purchase Marmani
Prepared by Roberto Marmani

Witherspoon's is a large U.S. retailer of medical supplies that has been in business for 35 years. It specializes in providing home care equipment at an affordable cost for those dealing with wellness or mobility issues who wish to retain a level of independence. Witherspoon's is known for its high-quality products and excellent customer service. Its mission is to support "active independent living." It has retail stores throughout the United States and some parts of Canada.

Witherspoon's has been considering expanding outside the medical supplies industry and sees the adaptive apparel industry as a logical next step. It is interested in acquiring an apparel company in order to produce its own private-label line of adaptive apparel. As Witherspoon's has no previous business experience in design or production of apparel, it is interested in acquiring the experience and expertise it lacks. The CEO of Witherspoon's, Jeff Powell, believes that owning apparel factories and investing in technology is the best way to make better apparel and thus meet the needs of the highly valued customers to whom he feels a genuine responsibility.

The following are some highlights of Witherspoon's:

- It is a public company with a reputation for strong corporate governance and corporate social responsibility, and this is a reflection of management's values.
- Its board of directors foster the highest levels of ethics and integrity.
- It has maximized its market share penetration in North America's mass-market retail channel for its products.
- It is a full product line supplier of:
 - health and medical supplies
 - bedroom and sleeping accessories
 - exercise and fitness products and aids
 - wheelchair and walker accessories
- All products are manufactured in a co-owned, high-tech facility in Shanghai, China.
- It has made several successful acquisitions in the past, which has involved moving members of its own management team into the companies to help facilitate a smooth transition. Typically, some employees have been laid off.
- It has high demand from existing customers to expand its product line into adaptive apparel, but has proceeded slowly into this new line of business due to the technical design complexities of adaptive apparel. However, Witherspoon's does have an extensive network that would enable it to produce apparel in Asia if it so chooses.

Appendix III Offer to purchase Marmani (continued)

Witherspoon's has approached me to discuss the potential acquisition of Marmani, and wishes to purchase my shares as opposed to just Marmani's assets. Witherspoon's has suggested a value of \$26 million as a starting point for negotiations. It is particularly interested in Marmani given our proven innovation, advanced technology, skilled design team, and niche products. Witherspoon's would want to retain me as an advisor for at least a year to help expand Witherspoon's current business and to help it transition into this new industry. Witherspoon's would pay me \$200,000 annually in exchange for my agreement to provide them with services for 30 hours per week. Witherspoon's would also require a non-complete clause to be included in the agreement.

I have discussed the potential acquisition with TKA, who has provided the following information for consideration:

- TKA suggests that a discounted cash flow approach should be used, based on the projected 2019 through 2023 results, and offered to perform the valuation. Given the increasing volumes, I think annual working capital investment will be required as CPA forecasted (see Appendix X).
- After some research and discussion, TKA determined that an appropriate weighted average cost of capital for Marmani is 10%.
- TKA has calculated the present value of the existing tax shield to be \$250,000.

Appendix IV
Background information on the athleisure industry
Prepared by Roberto Marmani

Athleisure refers to casual clothing designed to be worn for exercising and general use, and is about wearing clothing that is comfortable enough to work out in but also fashionable enough to wear for other aspects of one's life.²² Athleisure is often about looking stylish while exercising, as there is now commonly a social element to fitness.²³ The look is overall sporty, such as leggings, yoga pants, and muscle T-shirts, and often uses performance materials and fabrics, including sweat-wicking and anti-odour materials.

The growth in athleisure attire is the result of two shifts in fashion: the casualization of attire and cultural shift in the workplace (such as the emergence of a "casual Friday" and the acceptance of wearing sneakers and sweatpants to the office) and the increased health consciousness of consumers.²⁴ "Sports apparel and footwear sales have jumped 42% to [US]\$270 billion between 2007 and 2015. It's the kind of winning streak that raises ... investor skepticism. Is the sportswear sector due for a fall? In fact, prospects for growth are getting stronger, not weaker, as health and fitness trend for adults and sports participation for youth goes global, according to a recent report from Morgan Stanley Research, 'Global Athletic Wear: Very Bullish Five-Year Outlook' ... The report estimates that the industry could add [US] \$83 billion in sales by 2020, or more than 30% growth."²⁵

²² <https://www.scmp.com/magazines/style/fashion-beauty/article/1983046/brand-new-lifestyle-luxury-fashion-brands-are>

²³ Ibid.

²⁴ <https://www.forbes.com/sites/greatspeculations/2016/10/06/the-athleisure-trend-is-here-to-stay/#2dae748128bd>

²⁵ <http://www.morganstanley.com/ideas/global-athletic-wear-geared-for-growth>

Appendix V
Athleisure division/company expansion
Prepared by Roberto Marmani

There is the potential to begin an athleisure division within Marmani or, if I sell my shares in Marmani, begin a new company focusing on athleisure attire. I believe the high-potential markets for athleisure attire are in Western Canada and the western United States. I have identified three possible alternatives for the production of athleisure attire:

New production facility — Richmond, British Columbia

By focusing selling efforts and having a sales presence in Western Canada, I believe Marmani could realize \$4 million in incremental sales in 2020, with the potential to increase by 3% in the subsequent year as recognition of the Marmani brand grows. Sales are then projected to increase with inflation each year.

Marmani contracted with a property management firm in British Columbia to source and evaluate several location options, and then negotiate with the landlord. I feel that the fee of \$30,000 we paid for the report and expertise was worth the expense and saved valuable management time. There is the potential to lease a 20,000-square-foot facility in Richmond, British Columbia, for a fixed cost of \$4.50 per square foot, per month, with a five-year lease term. This building has a fair market value of \$8 million. The property management firm negotiated with the landlord to waive the first and last months' rent as an incentive to sign the lease. I'm not sure if this has any accounting implications, but I always like to get a good deal!

We would need to spend approximately \$450,000 on improvements to the facility to tailor it to our specifications/requirements, and another \$100,000 to purchase new manufacturing equipment to equip the facility. Working capital would be required to initially stock the facility with the materials to use in production, prior to operations. Based on our operations in the current Toronto facility, I estimate we would need initial inventory equal to the equivalent of half a month of revenue. Another \$15,000 would be required to furnish and equip the rest of the facility, plus \$20,000 for an IT system to ensure compatibility and functionality with our headquarters in Toronto.

An additional 12 employees would need to be hired at a total cost of \$600,000 per year, and other costs of production would equal 35% of revenues. Shipping costs would approximate 3% of revenues. Marketing costs are estimated at \$50,000 in the first year, decreasing to \$20,000 in 2021. Other selling, general, and administrative expenses are estimated to be 10% of revenue. Except as otherwise noted, costs are expected to increase with inflation, which is forecasted at 1.5% each year.

Appendix V Athleisure division/company expansion (continued)

At the end of the lease term, Marmani would be responsible for returning the premises back to its original condition, which is estimated to cost \$50,000 at that time. The equipment is not expected to have any residual value. There is currently no renewal option included in the lease, but the lessor has indicated it may be possible to renegotiate at the end of the lease, depending on the terms.

Existing production facility — Toronto, Ontario

Alternatively, it is possible for Marmani to negotiate good shipping terms and service the Western Canada and U.S. market from the existing Toronto facility. This option would utilize the excess capacity of the current production facility; however, half of the production would still need to be outsourced.

Internal production costs for 2020 would be approximately \$500,000; this amount would only increase with inflation, as there would be no further excess capacity to accommodate increased sales volume. Outsourcing production costs would approximate 25% of revenue for 2020; this would increase to 26% of revenue for 2021 and 27% of revenue for 2022, levelling out for subsequent years.

\$20,000 in shelving and other miscellaneous furniture would need to be purchased, along with some small parts costing \$50,000 that are needed to modify the current manufacturing equipment to accommodate the athleisure product line. In order to handle the additional workload, we would need to add a shift with about five more employees at a similar cost per employee as the Richmond option.

The shipping cost would be double for the Toronto option. However, with no sales presence out west, the expected revenue would be about half what was estimated for the Richmond facility and marketing expenses would be at least 30% higher. Inventory and selling, general, and administrative expenses are expected to be proportional to the estimates prepared for the Richmond expansion. Except as otherwise noted, costs are expected to increase with inflation.

Outsourcing all production

If I sold Marmani and I wanted to stay located in Toronto, then I could rent warehouse space in Toronto and go back to outsourcing 100% of the production. Office and warehouse space of approximately 4,000 square feet in Toronto could be rented for a fixed cost of \$10 per square foot, per month, on a month-to-month basis. Rent would increase with inflation. Approximately 75% of the space would be warehouse.

Appendix V
Athleisure division/company expansion (continued)

As with the Toronto facility, with no sales presence out west, the expected revenue would be about half what was estimated for the Richmond facility. Shelving would cost \$30,000, office equipment and furniture \$20,000, and computer system equipment \$12,000. Outsourcing production costs would be 51% of revenue annually. As with Marmani's Toronto location, shipping would be double the cost estimated for the Richmond expansion, marketing costs would be 30% higher, and other selling, general, and administrative expenses would be 10% of revenues.

TKA suggested a discount rate of 15% would be appropriate for this analysis.

Appendix VI Sales options

Prepared by Karen Zenkovic

Current sales strategy

Marmani's default sales strategy has always been the use of sales agents. These sales agents are independent and often represent several different companies, as long as the companies are not Marmani's competitors. I work closely with these agents and know which are the most effective. The best sales agents are those who work very closely with me, providing important customer insights, since the agents are the ones dealing directly with the health care, long-term care, and retirement facilities that will purchase wholesale and in larger volumes.

This feedback from customers assists me in preparing the marketing material packages that I provide to the agents to assist in their selling presentations. The feedback is also useful for Sonya's designs and material choices. However, I often have to request information repeatedly from the sales agents and then I receive the details in bits and pieces, which is very time consuming and doesn't always provide me with the complete picture I need.

For the last few years, most of the sales agents have been requesting regular increases to their commissions. Currently, they are paid a commission of 5% of gross sales, but most are asking for at least 8%. If we want to retain our sales agents, we will most likely need to increase the commissions to 8%, though this is not reflected in my current projections. If we agree to increase the commission percentage, it will need to be for all agents, as word will get out.

Hire our own sales team

Given the possibility of expanding our adaptive clothing line, we could hire our own sales team instead. With additional products, we will need a committed sales strategy to introduce the products to the customers and obtain their feedback. We could pay each member of the sales team a salary plus commissions. Marmani could consider hiring the best sales agents on a full-time basis and make one of them the sales manager. I have already approached Rory Shain, whom I consider the most successful agent, with the proposal to come on board as sales manager and help Marmani grow its sales. He offered his services on a full-time basis for \$135,000 per year. The salespeople at market value today would get \$40,000 base salary plus 2% commission. We currently use nine sales agents.

Appendix VI Sales options (continued)

Digital marketing strategy

Digital marketing includes internet marketing, text messaging, social media, display advertising, search engine marketing, and any other form of digital media.²⁶ Studies have shown that technology will continue to impact traditional retail operations and result in a shift in consumer purchasing habits, driven by the emergence of eCommerce and mobile technology. Other studies show that online retail sales are already outpacing the traditional retail channels.

Depending on which products Marmani chooses to offer, the marketing department may need to evaluate how Marmani should best connect with its target customers. Marmani could integrate its marketing strategies using the latest technological tools. As a starting point, Marmani should use digital strategies to foster product awareness and engage customers directly to provide any additional information required about the products. If customers are able to interact with Marmani digitally, then there is the opportunity to use web analytics to obtain more information about customer demographics. In addition, we could add quick surveys for customers, similar to the focus group work Sonya has conducted to gather design information. To promote consistency, the same message should be provided both digitally and by Marmani's sales agents or salespeople. Interacting with customers digitally also requires safeguards for the protection of the privacy of consumer data. A breach of consumer data would negatively impact the Marmani brand.²⁷

Marmani's current information system will not support the move to the digital marketing environment. The key deficiency is that our systems all operate independently and are not interfaced. In making new IT investments, Marmani should consider how sales will integrate through all back-end systems such as manufacturing systems, warehouse management, and distribution. Marmani lacks the IT personnel resources to support a digital strategy. While CPA will be helpful in determining the impact on other business processes, Marmani will require more expertise to ensure our enterprise architecture supports all operations.

²⁶ <http://lexicon.ft.com/Term?term=digital-marketing>

²⁷ <https://blog.centrify.com/breaches-negative-impact-brand-reputation/>

Appendix VI Sales options (continued)

I recommend that we hire a consultant to:

- help establish a digital marketing vision
- work with CPA to understand the current business processes and identify ways to adapt them to a digital strategy
- prioritize IT initiatives to support the development of digital marketing strategies
- develop an initial mobile app
- lead the selection process for required hardware, system software, and customer relationship management software for data analytics
- facilitate future app development as required

I believe Marmani would see sales impacts beginning in Year 3. My research on preliminary cost estimates and timing is provided below:

	Expenditure	Timing	Amount
Consultant		Year 2	\$ 75,000
		Year 3	25,000
		Years 4-6	10,000
IT server		Year 1	60,000
System software		Year 1	15,000
Computer hardware — workstations		Year 1	12,000
Furniture and equipment		Year 1	8,000
Website development		Year 1	25,000
Customer relationship management software		Year 2	13,000
	Ongoing costs all adjusted annually with inflation		
Website hosting, domain, and ongoing software licence costs		Years 2-6	7,000
Additional IT staff (3)		Years 2-6	210,000
Additional marketing staff (1)		Years 2-6	70,000

Appendix VII

Customer focus group results

Prepared by Sonya Valencia

Background

Marmani markets the SIDEAWAY Pant to consumers and also to hospitals, long-term care facilities, and rehabilitation centres. Occupational health and safety studies show that the use of adaptive clothing has proven to be effective in both reducing the risk of injury to caregiver staff and the time spent dressing residents of care facilities. Fastening snap closures, for example, is accomplished without rolling or lifting residents. When adaptive clothing is used, there is less movement required of residents' joints, increasing the ease of dressing.

Summary of project

The aim of this project is to better understand the shared experiences of the target market that buys adaptive clothing and accessories. This knowledge will enable Marmani to determine the potential strengths it possesses to service this demand by leveraging its past experiences in the athletic business, and to design additional products to better serve this component of the health and wellness industry.

Participant demographics:

- patients from hospitals, long-term care facilities, and rehabilitation centres
- the infirm, the elderly, and people with disabilities
- caregivers, doctors, and nurses

Outcomes

Outcome 1:

- Garments must be easy to care for.
- Fabrics need to be long-lasting to withstand rigorous usage and cleaning.
- Water- and oil-repellent coatings should be used to help prevent obvious signs of spills and stains, to help people feel more secure and hygienic.

Appendix VII Customer focus group results (continued)

Outcome 2:

- It must be affordable — quality clothing at competitive prices; however, people are willing to pay more for good value.
- It should provide easy dressing and comfortable living, but still look like traditional clothing.
- The clothing shouldn't stand out as being "different," but should still be versatile enough to meet a range of mobility restrictions.

Outcome 3:

- The garments must promote independence in dressing and personal care by having the right fabric features. The garments must also be comfortable.
- Adaptive clothing does not only entail adding some extra zippers, Velcro straps, or snaps — it needs to be more involved than that.
- It's all about adjusting the design of the garments to address the problems that the elderly and people with disabilities face every day.

Conclusions

This segment of the consumer market has been largely neglected in terms of apparel that meets their needs related to fashion, comfort, and functionality, and that is of good quality, durable, and a reasonable price.

Appendix VIII
New product line extension proposal
 Prepared by Sonya Valencia

Adaptive sleepwear and medical compression socks both complement our current product line and are desired by our customers. Therefore, I recommend these products as the best two options to begin expanding our adaptive clothing line.

We have the option of either buying these new products and reselling them or making them in our production facility. We have the necessary expertise to manufacture both products. Unfortunately, due to capacity constraints, we cannot produce both new products at this time. As well, although it is possible, I do not think that Marmani should pursue buying medical compression socks and reselling them. Many wholesalers already do this and we would not have a competitive advantage or the opportunity to make much, if any, profit from this alternative. I have an innovative sock production design that will allow Marmani to attract customers and also demand a higher price should we produce the medical compression socks ourselves. There is a high demand for adaptive sleepwear, so this is a viable option whether we make the sleepwear or buy it.

Below are the projected revenues and current costs for manufacturing adaptive sleepwear and medical compression socks. For reference, we achieve a contribution margin of approximately \$11 per unit on the existing products.

	Adaptive sleepwear	Medical compression socks
Financial projections (in '000s)		
Revenues	\$2,050	\$2,400
Direct materials cost	530	900
Direct manufacturing labour	425	450
Variable manufacturing	100	165
Other variable costs	65	210
Fixed manufacturing costs	100	50
Production estimates		
Units	41,000	60,000
Direct labour hours, annually	12,300	13,200

If Marmani purchases sleepwear from a third party, then the total cost for 41,000 units would be \$992,000. Volumes are expected to increase by 5% annually.

If we choose to manufacture the socks, we will need to purchase an additional machine at a cost of \$45,000. If we manufacture the sleepwear, we'll require two different machines for a total of \$70,000. Shelving and furniture required for all options will cost \$20,000. Selling, general, and administrative expenses, including marketing, will be 8% of revenues.

Appendix IX Cost of sales data

Prepared by Wayne Croxton

The current job costing system we use has two direct cost categories: direct materials and direct manufacturing labour. It also has one indirect cost pool: manufacturing overhead, which is allocated to each job based on direct labour hours. The indirect cost allocation rate of the current system was \$62.50 per direct labour hour for 2018. I'm not sure if there is a more accurate way to allocate costs for each job — I'm concerned we aren't reflecting costs properly, which could be negatively impacting how we price our products.

I have spent a bit of time looking at the production process and have summarized the different activities that I think directly attribute to the cost of a job, in addition to direct materials and direct labour, which replace the indirect manufacturing overhead. However, I'm not quite sure how to use this information or whether it is relevant:

Activity area	Cost driver	Cost allocation rate
Materials handling	Number of parts	\$0.10 per part
Pre-production	Number of turns	\$0.05 per turn
Laser cutting	Machine hours	\$5.00 per hour
Assembly	Number of parts	\$0.20 per part
Quality control testing	Number of units per order	\$2.66 per unit

Marmani's production equipment is very technologically advanced and is able to gather all of the data necessary related to each of these activities. It makes tracking very easy and increases our ability to rely on the numbers produced. I have provided a summary of the data gathered for two representative orders recently produced in our facility:

	Order #71	Order #89
Direct materials cost	\$2,425.00	\$32,438.60
Direct labour cost	\$690.30	\$9,495.40
Direct labour hours	23.01	316.51
Parts per order	1,085	15,038
Turns per order	5,000	15,000
Machine hours per order	37.5	262.5
Units per order	350	4,820

I have heard about activity-based costing and am wondering about the impacts on Marmani of adopting this costing method, using Order 71 and Order 89 as examples, compared to our current costing system.

Appendix X
Draft financial statements and projections
Prepared by CPA

Marmani Inc.
Income statement
For the year ended December 31
(In C\$'000s)

	Notes	Draft 2017*	Draft 2018	Based on current operations Projected				2023
				2019	2020	2021	2022	
Revenue								
Bottoms — SIDEAWAY Pant		30,113	31,923	33,200	34,528	35,909	37,445	38,939
Tops — Flexible T's		<u>8,393</u>	<u>9,065</u>	<u>9,450</u>	<u>9,900</u>	<u>10,350</u>	<u>10,700</u>	<u>11,150</u>
Total revenue		<u>38,506</u>	<u>40,988</u>	<u>42,650</u>	<u>44,428</u>	<u>46,259</u>	<u>48,145</u>	<u>50,089</u>
Cost of sales		<u>24,413</u>	<u>23,763</u>	<u>24,500</u>	<u>25,710</u>	<u>26,743</u>	<u>27,808</u>	<u>28,907</u>
Gross margin		<u>14,093</u>	<u>17,225</u>	<u>18,150</u>	<u>18,718</u>	<u>19,516</u>	<u>20,337</u>	<u>21,182</u>
Expenses								
Selling, general, and admin.	[1]	12,171	12,911	13,632	14,185	14,755	15,343	15,949
Other		105	114	200	200	300	300	400
Depreciation		<u>121</u>	<u>425</u>	<u>700</u>	<u>600</u>	<u>600</u>	<u>500</u>	<u>400</u>
Total expenses		<u>12,397</u>	<u>13,450</u>	<u>14,532</u>	<u>14,985</u>	<u>15,655</u>	<u>16,143</u>	<u>16,749</u>
Operating income		1,696	3,775	3,618	3,733	3,861	4,194	4,433
Interest expense	[2]	<u>(148)</u>	<u>(300)</u>	<u>(452)</u>	<u>(404)</u>	<u>(308)</u>	<u>(212)</u>	<u>(116)</u>
Income before taxes		1,548	3,475	3,166	3,329	3,553	3,982	4,317
Income taxes (25%)		<u>387</u>	<u>869</u>	<u>792</u>	<u>832</u>	<u>888</u>	<u>996</u>	<u>1,079</u>
Net income		<u>1,161</u>	<u>2,606</u>	<u>2,374</u>	<u>2,497</u>	<u>2,665</u>	<u>2,986</u>	<u>3,238</u>

* Derived from the 2016 and 2017 financial results

Appendix X
Draft financial statements and projections (continued)

Marmani Inc.							
Balance sheet							
As at December 31							
(In C\$'000s)							
Notes	Draft 2017*	Draft 2018	2019	Based on current operations Projected			
			2020	2021	2022	2023	
Assets							
Current assets							
	129	2,145	4,216	4,113	4,178	4,464	4,952
	4,816	5,652	6,000	8,200	10,000	11,100	12,600
	4,347	5,023	6,400	8,300	9,900	13,100	15,400
	[3] 50	500	500	500	500	500	500
	9,342	13,320	17,116	21,113	24,578	29,164	33,452
	[4] 2,159	10,134	10,034	10,034	10,034	10,134	10,334
	11,501	23,454	27,150	31,147	34,612	39,298	43,786
Liabilities							
Current liabilities							
	5,311	6,998	8,250	12,100	15,250	19,300	22,900
	[5] 770	830	900	950	1,000	1,050	1,100
	[2] —	—	2,400	2,400	2,400	2,400	1,700
	6,081	7,828	11,550	15,450	18,650	22,750	25,700
	[2] 3,700	11,300	8,900	6,500	4,100	1,700	—
	9,781	19,128	20,450	21,950	22,750	24,450	25,700
	[6] 100	100	100	100	100	100	100
	1,620	4,226	6,600	9,097	11,762	14,748	17,986
	1,720	4,326	6,700	9,197	11,862	14,848	18,086
	11,501	23,454	27,150	31,147	34,612	39,298	43,786

* Derived from the 2016 and 2017 financial results

Appendix X
Draft financial statements and projections (continued)

Marmani Inc.
Cash flow statement
For the year ended December 31
(In C\$'000s)

	Draft 2017*	Draft 2018	Based on current operations Projected				2023
			2019	2020	2021	2022	
Operating activities							
Net income	1,161	2,606	2,374	2,497	2,665	2,986	3,238
Depreciation	121	425	700	600	600	500	400
Change in working capital							
Receivables*	(628)	(836)	(348)	(2,200)	(1,800)	(1,100)	(1,500)
Inventories*	(589)	(676)	(1,377)	(1,900)	(1,600)	(3,200)	(2,300)
Accounts payable*	451	1,687	1,252	3,850	3,150	4,050	3,600
Customer deposits*	(100)	60	70	50	50	50	50
Other current assets*	(100)	(450)	—	—	—	—	—
Cash flow from operations	316	2,816	2,671	2,897	3,065	3,286	3,488
Investing activities							
Capital expenditures	(226)	(8,400)	(600)	(600)	(600)	(600)	(600)
Cash flow from investing activities	(226)	(8,400)	(600)	(600)	(600)	(600)	(600)
Financing activities							
Net borrowings	—	7,600	—	(2,400)	(2,400)	(2,400)	(2,400)
Cash flow from financing activities	—	7,600	—	(2,400)	(2,400)	(2,400)	(2,400)
Net cash flow	90	2,016	2,071	(103)	65	286	488
Beginning-of-year cash balance	39	129	2,145	4,216	4,113	4,178	4,464
End-of-year cash balance	<u>129</u>	<u>2,145</u>	<u>4,216</u>	<u>4,113</u>	<u>4,178</u>	<u>4,464</u>	<u>4,952</u>

* Derived from the 2016 and 2017 financial results

Appendix X
Draft financial statements and projections (continued)

Notes:

1. Included in selling, general, and administrative expenses are the 5% commissions paid to sales agents. Fixed costs comprise 85% of the remainder of selling, general, and administrative expenses (after deducting the commission cost), with the remaining 15% being other variable costs.
2. Interest expense relates to the loan from Ray Cirello, a related party to the shareholder. The loan is unsecured and bears interest at 4%. For fiscal 2017 and 2018, there were no fixed terms of repayment. Monthly principal payments of \$200,000 are required beginning January 1, 2020.
3. Other current assets consist of marketable securities with a net realizable value of \$500,000, net of taxes and selling costs.
4. The annual expected expenditures on capital equipment is estimated to be \$600,000 for 2019 onward.
5. Customers are charged a deposit of 10% of the order total on all orders exceeding \$100,000. It is deducted from the final invoice when the order is shipped.
6. The amount for common shares is the price Roberto paid for the common shares when he incorporated Marmani in 1994.

Appendix XI
Industry metrics
Prepared by CPA

	Textile, clothing, and footwear merchants, wholesaler	Other clothing stores, retailer
Gross margin	27.8%	41.2%
Return on assets	5.9%	9.5%
Current ratio	2.0	1.6
Collection period for accounts receivable (days)	58.2	23.3
Accounts receivable turnover	6.3	17.0

APPENDIX C

**THE COMMON FINAL EXAMINATION
DAY 1 MARMANI VERSION 1 BOOKLET – SEPTEMBER 11, 2019**

**COMMON FINAL EXAMINATION
SEPTEMBER 11, 2019 – Day 1**

Case (MARMANI-Version 1)

(Suggested time: 240 minutes)

It is now June 18, 2022, and you, CPA, continue to work as Marmani's corporate controller. Currently, Marmani is thriving. Roberto ultimately decided against the sale of the company and operations were instead expanded into the athleisure apparel industry. To accommodate the additional production demands of the new Athleisure product line, Marmani purchased a new production facility in Richmond, British Columbia. Marmani now operates with two divisions: Adaptive and Athleisure.

The introduction of a digital marketing campaign for Athleisure resulted in rapid growth in that division. The formation of a dedicated, in-house sales force for the Adaptive division has also proven successful.

Marmani secured a long-term debt agreement with Hurley Bank of Canada with the terms and covenant that were first discussed with them. Combined with Marmani's strong earnings and cashflows, Marmani is in a more secure financial position than it has ever been. Marmani's goal remains to increase annual revenues by between 8% and 10%. The management team remains the same.

Marmani revised both its vision and mission statements to emphasize its dedication to quality and environmental sustainability.

"Our vision is to be a leader in the apparel industry by creating products that, through sustainable business practices and a commitment to quality, perform beyond the expectations of our customers and make people's lives better."

"We accomplish our vision by designing and selling functional and attractive clothing with materials and production practices that adhere to the tenets of long-term sustainability and quality."

The athleisure industry segment has grown considerably in the past three years and industry experts are forecasting a high growth trend for at least the next five years. However, competition within the segment has become fierce. The popularity of online shopping has led many companies to offer an online marketplace in order to remain competitive. Based on industry research, the online market for athleisure clothing currently generates \$800 million in annual revenue globally, having grown at an exceptionally rapid pace compared to other retail segments. The current growth rate of 15% per year for online sales is predicted to continue for the next five years.

With a large portion of the Canadian population being 65 or older, the adaptive clothing industry is also growing, and this is expected to continue. Only a few of Marmani's competitors have started to recognize this opportunity. As a result, competition within this market is slowly growing.

The Canadian economy is strong and consumer confidence is high.

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APPENDIX I
TRANSCRIPT OF MANAGEMENT MEETING – JUNE 18, 2022

Roberto: Thank you for joining me today. I called this meeting because, like most of you, I am overwhelmed. I just cannot believe the rapid growth we have experienced. Who would have thought that our athleisure products would be so popular? I am so proud of all of you and thank you for your hard work. However, we have some major decisions to make. First, what is our next step with the adaptive apparel line? Sonya, can you give us an update?

Sonya: Well, Roberto, to be honest, I have been spending so much time on the designs for Athleisure that I haven't had the opportunity to do much on Adaptive.

Wayne: I can attest to the same thing, Roberto. The Athleisure division has absorbed all our attention, and because of that, the Adaptive division is in a decline. Products are still selling but we are nowhere near our annual revenue growth target. This past month, adaptive apparel sales have decreased for the first time. I am starting to become concerned. We need to do something to reverse this trend.

Roberto: Witherspoon's is still interested in Adaptive and has again submitted an offer to purchase the division. They have increased the offer and I want to reconsider it. Their offer seems reasonable. When we were securing financing through Hurley in November 2020, Hurley's valuers assessed the value of Adaptive, as a stand-alone division, to be approximately \$28.5 million.

Sonya: Roberto, you know my passion lies in adaptive apparel. If we were to sell Adaptive, I would reconsider my future with Marmani. I want to work on designs that make a difference in people's lives.

Roberto: We would hate to lose you, Sonya, as you are such an important part of our management team. And if we sell to Witherspoon's, most of our Adaptive employees may be terminated, which is hard for me to accept. But I am not sure there is another viable option.

Sonya: My preference is to stay. I believe adaptive apparel still presents an opportunity to increase Marmani's revenue. We could expand our adaptive apparel product line. We need to develop new designs and offer new products. If we refocus our attention on the Adaptive division, I have no doubt that we can turn it around while also making a real difference.

APPENDIX I (continued)
TRANSCRIPT OF MANAGEMENT MEETING – JUNE 18, 2022

CPA: I will look at the options for the Adaptive division. By the way, what was done regarding the sales staff issue? While doing some analysis of Adaptive's sales, Ronald found a large increase in returns for one salesperson. He said he informed the sales manager, Rory, so that he could deal with it. I assume Rory told you, Karen, about the issue and how he resolved it.

Karen: He did, but he gave me the impression he took care of what he considered to be a minor issue, so I didn't investigate any further. CPA, could there be concerns of a broader nature here?

CPA: I'll review Rory's email more closely and let you know .

Roberto: Karen, prior to our meeting, you mentioned that you wanted to discuss something.

Karen: Yes. I want to explore the idea of offering our athleisure products online. We are overlooking a huge opportunity. Sonya, I'm sorry, but I think Marmani would be far better off directing more resources towards Athleisure than towards Adaptive. I would even suggest that we focus all our attention on Athleisure.

As the largest growth segment of the apparel industry, the athleisure segment is flourishing. If our objective is growth, why not focus on this segment? The research clearly supports higher growth in it than in the adaptive apparel segment.

In addition, Marmani's digital presence has expanded since we adopted a digital marketing strategy. Athleisure has become a recognized brand online. We could increase revenue even more with online sales, which our customers now expect. If we are to compete in today's world successfully, we need online sales!

Roberto: What kind of earnings do you expect from an online marketplace for our athleisure wear?

Karen: The potential is huge. According to the expert I have been working with, our market share could be anywhere between 1% and 4.5% of the global market. We could maybe get around 3% of the market share.

APPENDIX I (continued)
TRANSCRIPT OF MANAGEMENT MEETING – JUNE 18, 2022

Roberto: Karen, you know I am conservative and 3% seems aggressive to me, especially since we would be competing with some of the biggest brands in the segment.

Karen: I am surprised that you would doubt the potential of our Athleisure brand, especially after the explosive growth we have been experiencing. Admittedly, there is risk because of how competitive the marketplace has become, making it impossible to be more definitive with our market share estimate.

Sonya: And what about our IT situation? We upgraded for digital marketing, but we lack the infrastructure to support online sales. I hear about disasters with online sales all the time on the news. We could be putting clients' confidential, personal information at risk, for example.

Roberto: CPA, please analyze Karen's proposal. Although it may be unrealistic, the ideal would be to both rejuvenate Adaptive and expand into online sales of athleisure wear.

Wayne: That would be difficult. We would risk overextending ourselves. Ever since the Athleisure division was created, we have been overworked. Personally, I am exhausted. I think we can all agree that we need to lighten our workload.

Sonya: I agree with you, Wayne. We cannot keep up this pace. Roberto, what was the name of the guy you met a couple of weeks ago at that business conference, the one you were so impressed by?

Roberto: His name is Matthew Mondoux. I was really impressed by his self-confidence and his interest in Marmani. He seemed willing to come work for us and even proposed bringing in a whole managerial team for the Athleisure division. He was confident that he could find the right people very quickly, using his many contacts in the industry. He promised to present some proposed plans for Athleisure. I just received them but haven't had a chance to consider them yet.

Sonya: I think expanding our management team could really help us.

Karen: I agree, and our earnings in Athleisure are fantastic, so we can certainly afford to hire additional staff.

APPENDIX I (continued)
TRANSCRIPT OF MANAGEMENT MEETING – JUNE 18, 2022

Wayne: Just because we can afford it does not mean it is a good idea. The success of Marmani is a direct result of the decisions made by us. Bringing in a new team makes me nervous. If the new manager and the new team we hire do not perform to our expectations, it could undo Marmani's hard-earned success. What do we know about Matthew?

Roberto: Matthew's online profile speaks for itself. He has extensive experience and a proven record, which should reduce the risk. And the reality is that we need help now. The timing of his offer to help seems perfect. If we hire him, the current burden being placed on all of you would be lifted.

Karen: I agree that we need more help, but we should be cautious. Our Athleisure brand is built on quality and sustainability. I worry about Matthew maintaining our quality standards. I did an online search after you first mentioned his name, and I discovered a few things.

Roberto: Really? What did you find?

Karen: Well, does Matthew plan to expand Athleisure by outsourcing our production to Vietnam? If he uses the same overseas facility that he has in the past, we may have a problem. That facility has previously used questionable business practices.

Roberto: Matthew has been so successful! I can't believe he would jeopardize that in any way. CPA, please look at Matthew's profile and plans for Athleisure and at Karen's findings, and provide your opinion.

CPA: Of course.

Roberto: We have a lot more to consider than I thought and the decisions we make cannot be made in isolation. To ensure Marmani's future, we must have a coherent strategy. Let's reconvene next week. With CPA's input, we should be better able to make good decisions about the issues we are facing.

APPENDIX II
NOTES ON WITHERSPOON'S OFFER

Prepared by Roberto Marmani

Witherspoon's has expressed renewed interest in acquiring the Adaptive division. The offer is for \$30 million. The only other change to the offer is that my commitment to stay with the company after the sale has been reduced to three months.

Because Witherspoon's does not want a long, complex process, the deal is structured so that the sale of the Adaptive division would be simple and quick. The offer expires in two weeks.

APPENDIX III ADAPTIVE APPAREL EXPANSION

Prepared by Sonya Valencia

If we refocus our attention on it, the Adaptive division can be so much more successful than it is now. We have not released new designs or products in years. I have some new designs ready, and am working on other plans for new, innovative product designs that I am confident will revive Adaptive's sales.

Expanding our product line will most likely require our management team to be dedicated full-time to the project. The biggest obstacle at this point is the production facility in Toronto.

We can only expand our product line and continue to meet our high-quality standards efficiently if we put state-of-the-art equipment in Toronto, like we did in Richmond. I think that equipment is largely responsible for Athleisure's success. In order to produce and quickly change our designs, we will need to invest an estimated \$5 million in specialized, advanced production equipment, a new design lab and a new IT system.

Realistically, it will take a year to make these changes. Once we introduce our new products, I expect annual revenue from them to be \$9 million. Following that, I expect our total revenue will increase by at least 5% per year, which is a conservative estimate. I also have other design ideas, and after the upgrade to our production facility, Adaptive will produce some truly innovative products. Therefore, there is even greater growth potential!

With the upgrade to our production facility, our gross profit percentage should increase significantly.

After the upgrades are completed, my estimates translate into an after-tax operating cash flow of approximately \$70 million in total for the Adaptive division for five years of operation, and a net present value of approximately \$35 million for that period, net of the initial \$5 million investment. I used the 15% discount rate that we typically apply.

**APPENDIX IV
EMAIL FROM SALES MANAGER (RORY)**

June 10, 2022

To: Ronald
Re: Sales staff member
From: Rory

Thanks for making me aware of a potential issue with one of our new internal salespeople. I have since discovered that this salesperson has been artificially inflating their earned commission by making sales to retailers that they knew would be returned. I discovered three orders, coincidentally made with the same retailer, that came back shortly after the product was sold.

Our current compensation policy does not deduct returns from a salesperson's earned commission of 2% on the value of each contract that they conclude between Marmani and any retailer. Returns are common in this industry. I strongly believe it would be unreasonable to penalize our sales staff, who work very hard to secure business for us, each time a product is returned.

I don't think we should overreact to this isolated incident. At this point, it appears to be limited to one salesperson. I spoke to the person in question, which should suffice.

All my attention has been on supporting our new sales team, to ensure its success. Let's keep the focus on that, and consider this issue resolved.

APPENDIX V
POTENTIAL ONLINE MARKETPLACE FOR ATHLEISURE WEAR

Prepared by Karen Zenkovic

Competition online is fierce. I know it is a risk, but based on the strength of our brand, I believe that we can successfully compete in the world of online sales. Marmani has never been in direct competition with the big, global brands, but Marmani's size could work to its advantage. Consumers are increasingly looking for unique styles, which we can provide. Our products are of higher quality and are more exclusive. This exclusivity allows us to target niche markets that the big brands, who mass produce their products, cannot reach effectively.

Because Athleisure's current production facility is nearing capacity, we will need an additional facility to service an online marketplace. I have assumed that we will lease and renovate that facility to meet our needs, at an estimated total cost of \$4.25 million, including information technology development and infrastructure.

I have assumed that our margins will be lower; based on my research, variable costs of 60% should be achievable. We will make up the decline in margin with more volume in sales, resulting in higher profits. Our fixed costs should be about \$750,000 per year.

APPENDIX VI

SUMMARY ON MATTHEW AND HIS PLAN FOR ATHLEISURE

Prepared by Roberto Marmani

Matthew's online profile is impressive. Here are some highlights I noted:

- Matthew has managed three separate apparel brands, each time achieving financial success.
- In only three years, Matthew took a company from having virtually no sales or brand recognition to being valued at over \$500 million. That company's success is attributed to its online sales.
- Matthew was able to take an unprofitable apparel company from losing market share to once again being a successful company. In this case, his strategy was to drastically reduce costs. He outsourced the brand's production to an overseas facility in Vietnam (Viet BDG) and was able to reduce the cost of materials by changing suppliers.

One of Matthew's references described him as a "natural born leader," "tenacious and confident" and "tech savvy."

Here are some of the key items from the plan that Matthew submitted:

- Given that the Richmond facility is nearing capacity, all new production demands will be outsourced to Asia. Matthew has suggested moving all Athleisure production to Asia. According to Matthew, the more that Athleisure utilizes his connections in Asia, the more that production costs will be reduced.
- Matthew suspects that Marmani is currently paying too much for the fabrics that it uses for Athleisure products. Matthew has contacts within the textile industry and would likely change suppliers.
- Matthew's plan includes the introduction of many new products that will appeal to a wider consumer market, thereby increasing sales.
- Matthew's colleagues include a designer who has extensive experience in the apparel industry. This designer's products are mass produced and sold all over the country. He expects this designer will join the Athleisure division.
- Based on outsourcing production and changing suppliers, total production costs should decrease by nearly 30%. At the same time, given an expanded product line and aggressive expansion into new markets, revenue is projected to increase by 40% annually.
- While he does not outline the details, Matthew recommends stock option plans for all senior managers, enabling them to purchase shares based on the increase in revenue.

APPENDIX VII
KAREN'S FINDINGS

Prepared by Karen Zenkovic

Viet BDG has a very poor reputation and has been accused of serious violations. Two years ago, Viet BDG was reprimanded for its facility being an unhealthy workplace. Apparently, the facility has since improved, but I couldn't find anything to confirm or deny any improvements.

Although Matthew has indeed successfully managed several apparel companies, those companies all manufactured products that we would expect to see in department stores: low-quality, low-priced clothing.

One of the companies Matthew worked for is being sued by a designer for copyright violations.

It appears that Matthew has frequently changed employers, and that his colleagues often follow him.

APPENDIX D

**DAY 1 (MARMANI VERSION 1) – SEPTEMBER 11, 2019
MARKING GUIDE AND SAMPLE CANDIDATE RESPONSE**

**DAY 1 MARKING GUIDE
MARMANI INC. (MARMANI)
VERSION 1**

Summative Assessment #1 – Situational Analysis (Update)

For Summative Assessment #1, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate used a reasonable situational analysis when analyzing the major issues facing Marmani.

Unsure – The candidate attempted to use a reasonable situational analysis when analyzing the major issues facing Marmani.

No – The candidate clearly did not use a reasonable situational analysis when analyzing the major issues facing Marmani.

Competencies

2.3.2 Evaluates the entity's internal and external environment and its impact on strategy development

Enabling:

2.1.1 Defines the scope of the problem.

2.1.2 Collects and verifies relevant information.

2.1.3 Performs appropriate analyses.

Competent candidates should complete an appropriate level of situational analysis. The focus should be on describing the factors that have changed since Capstone 1 that will affect the decisions to be made (e.g., updated athleisure industry direction). Recapping parts of the mission/vision and relevant KSFs, and presenting relevant elements of the SWOT, is appropriate.

Mission and Vision Points

Marmani's mission and vision statements have been updated to reflect a dedication to quality and environmental sustainability.

Values (from Cap 1)

Marmani's and Roberto's current core values and beliefs include:

- Passion for everyone to stay active and lead a healthy lifestyle
- Quality, a high level of service, and value for customers
- Innovative clothing designs and production practices
- Ethical and environmentally-sustainable operations
- Valuing of staff
- An aversion to risk (Roberto)

Key Objectives

From Cap 1:

- Annual revenue growth of between 8% and 10%

From Day 1:

- Develop a coherent strategic plan for Marmani's future
- Reduce stress and improve work conditions for Marmani's management staff

Key Success Factors for Industry (from Cap 1)

- Securing multiple sources of revenue (diversified product lines and/or customer base), to drive growth once demand plateaus for current products
- Pricing product lines appropriately
- Using technology to improve efficiency and effectiveness of the production process and the multichannel approach to sales
- Brand development in an underserved niche
- Effective marketing and distribution channels
- Continual innovation through the design and introduction of new and appealing designs
- Customer involvement and target market demographic research

Strengths, Weaknesses, Opportunities and Threats (SWOT) Analysis (updated from Cap 1)

Strengths

- Marmani's Athleisure brand has built strong recognition with digital marketing and a successful in-house sales force; the product line's success has exceeded expectations.
- Through its digital marketing campaign, Marmani has significantly increased its online presence.
- The company has never had stronger cash flow and earnings and is financially secure.
- Marmani has secured long-term financing from Hurley; per Cap 1, the terms are 6% interest and an ROA debt covenant of 8%.
- Athleisure's brand is built on high-quality products that appeal to a niche market; this could allow Athleisure to compete more effectively with the bigger brands, who tend to target a wider market.

Weaknesses

- Marmani currently does not allow customers to purchase products through their website, which is only used for marketing the brand.
- Marmani's IT environment, which was already noted as being outdated, has still not been updated.
- Marmani still does not have a Board of Directors, to help provide direction or help with decisions.
- The Adaptive division has not met its annual revenue growth target.
- Management is overworked and at risk of burnout; there are also signs of conflict and differing objectives.

Opportunities

- As Matthew and his colleagues are available to begin work for Marmani, a new management team could possibly be hired.
- Matthew's plan to produce more products within Athleisure, with production outsourced overseas, provides an opportunity to expand sales and reduce costs.
- Witherspoon's, the company interested in purchasing Adaptive, has resubmitted the offer from Cap 1, with an increase in the offer amount and a reduction in the time length of Roberto's involvement; the offer expires in two weeks.
- Sonya has multiple, promising designs for products that could help grow the Adaptive line.
- The fashionable athletic wear industry has grown considerably and this growth is projected to continue for at least five years.
- Online shopping has become very popular and this growth is forecast to continue.
- Given the large number of people near and over the age of 65 within Canada, Marmani's adaptive apparel line is projected to grow.
- As the Canadian economy is strong and consumer confidence is high, it could be a good time to expand the company.

Threats

- Marmani is at risk of losing Sonya, a key member of the management team, who wishes to design products that make a difference in people's lives (Marmani's goal in Cap 1).
- Athleisure's Richmond facility is approaching capacity and any major increases in production would require the purchase of another production facility.
- The Adaptive product line has been neglected over the last two years; without a renewed focus, this segment of Marmani is unlikely to survive.
- Competition within the adaptive apparel industry is slowly growing and may become more active or more of a threat.
- Matthew's business practices and plans for Marmani may not align with the company's mission/vision; if issues with quality and environmental sustainability arise, harm may be done to the Athleisure brand.

Quantitative Analysis

None required.

Summative Assessment #2 – Analyzes the Major Issues

For Summative Assessment #2, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate completed a reasonable assessment of the major issues facing Marmani.

Unsure – The candidate attempted to complete a reasonable assessment of the major issues facing Marmani.

No – The candidate clearly did not complete a reasonable assessment of the major issues facing Marmani.

Competencies

2.3.3 Evaluates strategic alternatives

Enabling:

2.1.3 Performs appropriate analyses.

2.1.4 Integrates information to investigate each potentially viable solution or conclusion.

This summative assessment is based on Assessment Opportunities #2 to #5.

Assessment Opportunity #2 (Strategic Issue #1 – Sell Adaptive division or refocus on it)

Candidates are expected to analyze the options for Adaptive: sell to Witherspoon's or refocus on Adaptive, adding new products and investing in facilities.

Candidates are provided with the offer amount and a valuation amount. They should assess the valuation based on the date it was done and consider the changes (value may have declined if candidate integrated lack of management attention or value may have increased based on potential expansion opportunity) that have occurred in the division since that date. Candidates are provided with the expected results of refocusing on Adaptive and are expected to interpret that information.

Candidates are expected to qualitatively analyze the options, tying into the elements of SWOT. Candidates are expected to compare the two options and make a recommendation.

Option 1: Sell the Adaptive Division

Quantitative Analysis

Candidates are to provide a quantitative analysis of the Witherspoon's offer to purchase the Adaptive division.

- The Witherspoon's offer of \$30 million to purchase the Adaptive division appears to be fair, given Hurley's valuation. The original offer in Cap 1 was \$26 million.
- Hurley's valuation of \$28.5 million is 18 months old. As Adaptive has been stagnant recently, it might be worth less than when the original valuation was performed; therefore, the Witherspoon's offer may now be even more financially attractive.
- However, the offer does not consider the potential increase in Adaptive's sales if the situation can be improved, which would suggest that Adaptive's value could be higher.

Qualitative Analysis

- The current Adaptive division is not hitting the annual revenue growth target (link to objectives) and sales have decreased for the first time, which is likely due to the lack of attention provided by management. The sale of the Adaptive division would alleviate the burden on Marmani's current management team because Marmani would then consist of only one business unit, Athleisure (link to threat).
- The sale would allow Marmani to focus all its attention on Athleisure, which is the business segment that is projected to grow the most (link to trends).
- The sale would provide cash to invest in Athleisure, although, as the company is in sound financial condition, this may be unnecessary.
- Expanding the product line is key if the division is kept; this will require investment in Adaptive's production facility, which is not technologically advanced. If sold, Marmani would not need to address this issue.
- Witherspoon's may release many of the existing staff members from Adaptive if the sale is made; as he has a strong loyalty to his staff, Roberto is opposed to this (link to Marmani's values).
- Sonya would consider leaving Marmani if the line is sold; as a long-time employee and key part of management, she may be difficult to replace. Also, with Marmani's current staffing issue, retention of managers is even more essential.
- As Roberto's preference is to retain Adaptive as well as expand Athleisure, options for achieving this should be explored.
- If sold, Marmani could not take advantage of the growth projected to occur within the adaptive apparel industry.
- Because Adaptive has been neglected, its value may be lower than it could be.
- The option to sell Adaptive may not be available in the future; the Witherspoon's offer expires in two weeks so there is pressure to make a decision.
- We should confirm whether some of the other terms were adjusted, such as the option to negotiate that some or all employees remain employed.

Option 2: Refocus on the Adaptive Division

Quantitative Analysis

- The management team has experience in the industry, which should mean more knowledge and more accuracy in estimates.
- The experience of the company and management team lowers the risk.
- We should consider whether the 15% rate is appropriate relative to the risk level.
- With the expansion, the NPV for the division is \$35 million.
- An after-tax operating cash flow of \$70 million is provided but it is the NPV of \$35 million that is relevant.
- A project NPV can be calculated by assuming a certain gross margin that is factored into the \$9 million additional revenue provided by the project.
- As maintaining the status quo does not appear to be an option, the investment cannot be easily separated from the division.
- A change in the interest rate used will significantly change the NPV.
- Given the lower risk, a lower rate may be appropriate, which will improve the NPV.
- Sonya's estimates are conservative (as she stated, and as supported with possible further growth).

Qualitative Analysis

- Consumer confidence is high within Canada and Sonya has numerous ideas for innovative products; there is the potential to expand Adaptive beyond current expectations. If Marmani rejuvenates Adaptive, the company will have aligned with a key success factor in the industry: new, innovative and diverse products. Marmani could take advantage of the growth projected within the adaptive apparel industry (good growth is expected, but not as strong as for Athleisure).
- Competition, although slowly increasing, is not as strong as in the Athleisure segment, and Marmani already has a competitive advantage over newcomers in that its brand is well known. However, there is the risk that the competition is just becoming aware of this market segment. It is unknown what will happen if competition increases in the next year, before Marmani can capitalize on its brand with new products.
- The production facility requires improvements; as it will take a year to start producing more products and sales are already showing signs of a slump, this would need to be addressed immediately.
- It is unknown how long it will take to turn around Adaptive and get new products to market; Sonya estimates a year, but it could take longer.
- Sonya and the rest of Adaptive's staff would be retained, which is preferable to Roberto (link to values).
- The estimated growth revenue is below the target of 8% to 10%.
- The managerial staff at Marmani are already overstretched; to add an additional, major project may be more than the current team can handle.

Conclusion

After the expansion, the NPV of the division is approximately \$35 million, which is more than the Hurley valuation or the Witherspoon's offer. Using these estimates, the increase in value is \$5 million.

The offer from Witherspoon's is more than the Hurley valuation, which may indicate that it makes financial sense to sell. The fact that the Hurley valuation is 18 months old, and that we have started to notice a decline in sales, reinforces this.

However, as the expansion increases Adaptive's value, based on what Sonya states are conservative estimates, we would profit from the expansion.

In making a decision, it is key that Roberto's personal goals are considered—if he is committed to providing products that improve people's lives, it makes sense to expand the division. Success of the expansion will depend on Marmani's ability to hire new management.

The recommendation should be integrated with other recommendations and the constraint of management time. For example, candidates may recommend to sell Adaptive considering the lack of management time that can be devoted to the division or a recommendation could be made to hire additional management to assist with this division since it is clear the existing management team is overstretched.

Assessment Opportunity #3 (Strategic Issue #2 – Online sales platform for Athleisure)

Candidates are expected to quantitatively and qualitatively analyze whether Marmani should offer an online sales platform for its Athleisure product line.

Quantitative Analysis

Given the fierce competition within the athleisure industry, Karen and the expert she is working with are unable to provide a reliable or exact estimate of Marmani's potential market share, which is projected to be anywhere between 1% and 4.5%. The inability to produce a reliable projection presents a risk to Marmani.

Karen suggests that 3% of the market is attainable. Calculations assuming 3% market share are as follows:

Year	0	1	2	3	4	5	Total
15% discount rate							
Initial investment (cash out)	(4,250,000)						
Ongoing cash flows							
Revenue		24,000,000	27,600,000	31,740,000	36,501,000	41,976,150	
Variable costs		(14,400,000)	(16,560,000)	(19,044,000)	(21,900,600)	(25,185,690)	
Fixed costs		(750,000)	(750,000)	(750,000)	(750,000)	(750,000)	
Total	(4,250,000)	8,850,000	10,290,000	11,946,000	13,850,400	16,040,460	
Discount factor	1	0.8696	0.7562	0.6576	0.5718	0.4972	
Net present value	(4,250,000)	7,695,960	7,781,298	7,855,690	7,919,659	7,975,317	34,977,924

Calculations at different market shares are as follows:

15% discount rate	Market Share			
	@ 4.5%	@ 3%	@ 2%	@ 1%
Initial costs	\$ 4,250,000	\$ 4,250,000	\$ 4,250,000	\$ 4,250,000
Ongoing cash flows				
Revenue	156,533,336	104,355,558	69,570,372	34,785,186
Variable costs	(93,920,002)	(62,613,335)	(41,742,223)	(20,871,112)
Fixed costs	(2,514,300)	(2,514,300)	(2,514,300)	(2,514,300)
Net present value	\$ 55,849,035	\$ 34,977,924	\$ 21,063,849	\$ 7,149,774

Based on a sensitivity analysis, as market share declines, the net present value of the expansion drops significantly. However, even at 1% market share, Marmani is forecast to earn a significant NPV on online sales.

The estimated level of investment of \$4.25 million may change if:

- the market share achieved is higher or lower than 3%; and
- the size of the market (\$800 million) is incorrect; and
- the actual growth rate differs from the estimated rate (15%).

Calculation of Payback Period

	1%	3%	4.50%
Revenue	\$ 8,000,000	\$ 24,000,000	\$ 36,000,000
Variable costs at 60%	\$ (4,800,000)	\$ (14,400,000)	\$ (21,600,000)
Fixed costs	\$ (750,000)	\$ (750,000)	\$ (750,000)
Cash flow	\$ 2,450,000	\$ 8,850,000	\$ 13,650,000
Initial investment	\$ 4,250,000	\$ 4,250,000	\$ 4,250,000
Payback period in years	1.73	0.48	0.31

From the above analysis, the payback period for the initial investment is less than two years even under a conservative scenario where 1% of the Athleisure market is achieved. Candidates can add value to their analysis by performing this calculation.

Calculation of Breakeven

Fixed costs	\$ 750,000
Margin	40%
Break even	\$ 1,875,000
Percentage of market	0.23%

The breakeven market percentage that is required to be achieved is 0.23% indicating that this is a viable project from a quantitative perspective. Candidates could consider including depreciation on the initial \$4.25 million investment in their fixed costs.

If this is a decision to either expand Adaptive or Athleisure, the investment is close to the same, at \$5 million versus \$4.25 million, and the return here is much higher; however, the risk is also much higher.

Marmani could potentially invest in both Adaptive and Athleisure expansions; this will depend on acquiring additional management support.

Qualitative Analysis

- The move to online sales is an unknown area for Marmani; given the uncertain estimated market share and the high, and increasing, level of competition, risk is high. This is not in line with Roberto’s conservative nature.
- Marmani can leverage its online presence to generate additional or new Athleisure sales (online is arguably a different segment of customers/ target market relative to its current customers); however, this may cannibalize sales through existing channels.
- Marmani’s brand recognition has grown due to the company’s digital marketing campaign, which should help facilitate the expansion into online sales.
- This option would increase management’s workload; additional management would likely need to be hired.
- As Athleisure’s current facility is near capacity, additional sales will require additional production capacity, which will further burden Marmani’s management staff.

- The company's IT infrastructure is still questionable and an online sales platform could pose security risks to customer data. An IT upgrade would be necessary for online sales, the cost of which is included in the \$4.25 million quantitative analysis. A breach would potentially impact Marmani's reputation.
- The trend towards online sales has built momentum in recent years and is projected to continue, and consumers expect the ability to purchase online. If Marmani does not expand into online sales and customers are unable to purchase the products online, the brand could lose relevance. Timely implementation is important.
- Athleisure will be forced to compete against the biggest brands in the industry; however, Marmani serves a smaller niche market that the big brands cannot effectively target. Within Marmani's target market, competition is less fierce (links to Cap 1 – target market discussion).
- The athleisure industry is projected to grow significantly in the coming years; by providing the option to purchase online, Athleisure can increase sales significantly (more than Adaptive sales).
- The projected growth (15%) is forecast to surpass the revenue growth target of 8% to 10% (link to goals).
- The Canadian economy is strong and consumer confidence is high, and the economy favours an expansion into online sales (link to trends).
- If Marmani decides to sell outside of Canada, it may have a hard time competing on a global scale due to its smaller size.

Conclusion

Based on the most conservative market share potential of 1%, financial results suggest pursuing the option of online sales. To remain competitive in this market, moving into online sales is necessary. Therefore, unless Marmani is considering getting out of Athleisure to concentrate on Adaptive, online sales need to be pursued. It also appears to provide significant financial benefit to Marmani. However, the financial benefit is highly dependent on the brand's ability to capture market share; therefore, this is not a low risk option.

Before the expansion takes place, the IT system must be upgraded, to ensure that online sales can be handled successfully and that all customer data collected is kept safe.

The recommendation should be integrated with recommendations in other areas, including management time and expertise, and the potential hire of Matthew or other new management. Alternatively, mitigating strategies such as staggered implementation of the Adaptive and Athleisure expansions could be recommended to ensure that management time is appropriately allocated.

Assessment Opportunity #4 (Strategic Issue #3 – Expand management by hiring Matthew and his team to manage the Athleisure brand, or search for an alternative)

Candidates should support Marmani's need for additional management and should evaluate Matthew as a potential candidate for leading a new Athleisure managerial team. Candidates are expected to acknowledge that Matthew's vision and plans for Athleisure's expansion may not align with the company's mission and vision, and that Matthew's plans may pose a threat to the company.

Quantitative Analysis

None required.

Qualitative Analysis

The meeting dialogue clearly indicates that the management team is overstretched and cannot deal with the company in its current state, and expansion will only increase the pressure.

Sonya has not been able to do much work on Adaptive as her time has been taken up with Athleisure, and Wayne says that they have been overworked and he is exhausted.

It appears clear that additional management support is needed. Hiring Matthew Mondoux, and potentially his team, has been presented as an option.

Matthew's profile and plans show potential:

- He has experience in the apparel industry, managing brands and achieving financial success.
- He is technologically proficient and has successfully helped another company become an online merchant.
- He has built a brand from essentially nothing into a product that is available across the country.
- Athleisure's production facility is currently near capacity; with Matthew, outsourcing production to Asia could be done instead of expanding the production facility.
- Matthew's plans include a projected increase in revenue of 40% and a reduction in production costs of 30%.

However, there are also indications that Matthew might not be a good fit with Marmani's vision, mission and goals, or with existing management.

Outsourcing to Asia may create quality issues. Marmani holds quality as an important value. The Adaptive division initially outsourced production but brought it in house to improve control of the product quality. This may indicate that outsourcing is not a good idea (link to Cap 1).

The information that Karen presented indicates that Matthew used Viet BDG, which may have a poor reputation. Viet BDG has been reprimanded for its unhealthy work conditions. Using Viet BDG may not align with Marmani's mission and vision of sustainability and quality business practices (link to mission/vision and values).

Matthew's experience in the apparel industry appears to be with mass market, low-cost apparel rather than in the segment of the market in which Marmani operates. His approach may not work in the specialty-apparel, high-quality segment of the market.

The fact that Matthew has used production facilities that appear beneath Marmani's standards may be indicative of his way of operating, in that he may not properly research, and select, companies to deal with.

The reduction in fabric expense is suspect; these new materials might not meet Marmani's quality requirements (link to Roberto being unwilling to compromise quality in Cap 1).

The companies that Matthew has worked with previously produce lower-quality, higher-volume brands, which does not align with Marmani's business model of niche markets; if Matthew is hired, the Athleisure brand may be put at risk.

There is also the issue of a company being sued for patent infringement with respect to product design. If this happens at Marmani, its reputation would be negatively impacted.

Additionally, Matthew may be too focused on revenue versus profit—he suggests that stock options be tied to revenue. He has also changed companies often, as has his team. The existing managers at Marmani have been with the company a long time, are passionate about the company and its products, and are dedicated to achieving long-term success. They are loyal to Marmani and to Roberto.

Matthew appears to focus on short-term results—he doesn't stay long at any of the companies he has helped, and his team tends to go with him. If Marmani hires Matthew and his team and they do not stay, Marmani would presumably have to hire again, which would cause more instability and change. This is quite different from the long-term management team in place at Marmani.

Conclusion

As the current management team is overworked, Marmani clearly needs additional help within the management team. Maintaining the current status quo is not an option; Marmani cannot continue with both Adaptive and Athleisure without additional management staff. This would put Marmani in a better position to keep Adaptive and still expand Athleisure. Given the projected growth of both the athleisure and adaptive clothing markets, the company could expand to meet its revenue growth target, but only if Marmani expands its management team.

Matthew and his team are available to start soon. Matthew's profile is his success in the online area. This is a strong point; however, if the information that Karen discovered is true, there could be serious consequences for Marmani. Matthew and his plans may not be a suitable fit for Marmani, based on mission/vision and values. Athleisure is built on quality and sustainability and appeals to a niche market; Matthew's work history and current plans for Athleisure do not adhere to these business practices. At this point, it would be a huge risk for Marmani to hire Matthew and his management team.

If Matthew is not hired, it is important to find an alternative. See further discussion on this recommendation later. If Matthew is hired, the potential cost of stock options needs to be considered.

Assessment Opportunity #5 (Strategic Issue #4 – Other – Sales team compensation issue)

Candidates are expected to discuss the seriousness of the recently discovered inflated commission by a salesperson. Candidates should discuss the fact that both Rory, the sales manager, and Karen, the communications and marketing manager, discounted this as a minor issue. Candidates should identify the fact that Marmani's current compensation plan for its new, in-house sales team may be promoting unsustainable, and potentially unethical, sales practices.

Quantitative Analysis

None required.

Qualitative Analysis

With the current compensation formula, sales staff have an incentive to sell as much product as possible, regardless of whether that product is returned, indicating a possible problem with the formula.

It appears that one salesperson may have formed a kickback agreement with clients, to purchase large amounts of Marmani's product and return it at a later date. This will need to be investigated further. The three orders at issue are all with the same vendor.

The commission incentive for the sales team may be causing a higher product-return rate than what it would be otherwise, which may be impacting financial results.

This is a serious situation. Marmani needs to determine whether the problem is isolated to one salesperson or if others are doing the same.

If not dealt with appropriately, and if revealed publicly, such activity would harm the company's reputation.

That Rory treated the issue as a minor or insignificant issue may be a sign of inexperience, lack of time to deal with ad hoc items as they arise due to the existing high stress levels, or this may represent a bigger, governance issue. Karen seems to have relied upon Rory, which may not be appropriate until he gains more experience. The management and staff of Marmani may require training in ethics.

This type of issue should be brought to Roberto's attention on a timely basis.

Recommendations and Next Steps

To remove this motivation, consideration should be given to changing the compensation formula; one potential fix would be to increase the commission rate and apply it to net, rather than gross, sales.

If further investigation into this incident suggests fraud, Marmani should consult a lawyer to ensure that proper procedures are followed before formally dismissing the employee, and should perhaps attempt to get the funds back. Until the situation is fully understood and documented, the employee should be put on paid leave.

Ethics training may be a good idea for the entire management team.

Summative Assessment #3 (Conclude and Advise)

For Summative Assessment #3, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate provided reasonable conclusions for each major issue. The recommendations recognized the management team time constraint and provided a consistent overall response.

Unsure – The candidate attempted to provide reasonable conclusions for each major issue. The constraint related to management time was not clearly recognized and/or the recommendations were not consistent with the constraint.

No – The candidate clearly did not provide reasonable conclusions for each major issue.

Competencies

*Enabling 2.1.4 Integrates information to investigate each potentially viable solution or conclusion.
Enabling 2.1.5 Recommends and justifies a solution or conclusion based on an integrative view of information for the situation.*

Competent candidates will provide recommendations consistent with their analysis. It is essential for candidates to integrate the recommendations in the different areas and deal with the management time-constraint issue.

Strategic decisions to be made are as follows:

1. Should Marmani sell the Adaptive division? If not, should it invest the \$5 million to expand the division?
2. Should the company proceed with the \$4.25 million investment and sell Athleisure online?
3. Should Marmani hire Matthew and his team, or find an alternative, to add to the management of the company?

The decision regarding Adaptive is likely an either/or. The dialogue suggests that the options of expanding Adaptive and Athleisure may be mutually exclusive because of the management time constraint. Depending on the recommendation made with respect to the management team, expanding Adaptive and Athleisure may be feasible. The dialogue also suggests that Athleisure must sell online or it will be unable to compete.

The main problem facing Marmani is that the current management team cannot handle any additional work. The phenomenal growth of Athleisure took the company by surprise and Marmani has not been able to stabilize the company or prepare it for further growth. For the management team to be able to manage the company properly, Marmani needs to either stop growing, and even cut back, or it needs to expand its management team.

I recommend that Marmani expand its management team, and perhaps hire an entirely new management team for Athleisure. Based on my review, Matthew does not appear to be the right person for the job, and neither he nor his team should be hired. Instead, Marmani should immediately begin to search for a qualified team that better fits with the company's current vision, mission and values.

If Marmani can establish an organized and effective management team, both expansion options could be pursued. On the other hand, if help cannot be found or if Roberto decides not to hire an outside team, Marmani faces a much harder decision and may have to choose between the further pursuit of Adaptive and Athleisure; management would be unable to handle the additional effort required to turn Adaptive around and at the same time expand Athleisure into online sales.

Although there is potential growth in both segments, the higher growth is in Athleisure. To meet the revenue growth objective of 8% to 10%, this is likely the better option to pursue. Athleisure needs to expand into online sales in order to be competitive in this market segment; however, there is risk in doing so. This market segment is highly competitive and Marmani may get squeezed out by the competition.

There is likely less risk in Adaptive, but the expected market growth is less than the 8% to 10% revenue target. There is currently less competition and the Marmani brand is already established in that niche market. The question is whether one year is sufficient time to get new, innovative products to market. It may take longer or be too late in terms of the increased competition, putting more pressure on Marmani in this segment as well.

In terms of choosing one option over the other, there is no easy or obvious answer. There is value in both product lines, and in my view, both should be retained if possible. Roberto has expressed a desire to keep both, although he feels that it may not be possible.

The ideal solution would be to find additional management team members as soon as possible, which would provide both product lines with the resources they need for growth.

Other recommendations are acceptable if consistent with the candidate's analysis and if integrated – e.g., if recommend selling Adaptive, will have resources necessary for the other proposals and will likely not need to hire an additional manager, with the possible exception of Sonya, if she leaves.

Candidates should also recognize the seriousness of the issue with the salesperson and recommend appropriate action. They may discuss the potential weaknesses in the design of the compensation arrangement that led to this behaviour.

Summative Assessment #4 (Communication Hurdle)

For Summative Assessment #4, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate adequately communicated his/her response.

No – The candidate did not adequately communicate his or her response.

Insufficient communication in a candidate's response would generally include some of the following:

- The response is difficult to understand.
- The reader needs to re-read sections several times in order to gain an understanding.
- It is not clear what point the candidate is trying to make.
- The quantitative analysis does not make sense because of illogical ordering or a lack of labelling.
- There is an excessive amount of spelling and grammatical errors.
- The language used is unprofessional.

Summative Assessment #5 (Overall Assessment)

For Summative Assessment #5, the candidate must be assessed in one of the following, based on their overall performance:

Clear Pass – Overall, the candidate provided an adequate response, clearly meeting the minimum standards for each of the summative assessments above.

Marginal Pass – Overall, the candidate provided an adequate response, with some errors or areas of omission, but including the underlying key concepts.

Marginal Fail – Overall, the candidate provided an attempt at a response, with several errors or an incomplete analysis.

Clear Fail – Overall, the candidate did not provide an adequate response because the response was deficient in multiple areas.

To be assessed a Pass, candidates are expected to perform adequately in all the summative assessments and demonstrate that they addressed the issues of importance in a cohesive, professional manner.

In making their overall assessment, markers were asked to consider the following:

1. Did the candidate step back and see the bigger picture, and then address the broader issues identified?
2. Did the candidate prioritize the issues by discussing the major and minor issues in appropriate depth?
3. Did the candidate use both quantitative (when available) and qualitative information to support their discussions and conclusions?
4. Did the candidate use the appropriate tools to perform quantitative analysis?
5. Did the candidate use sufficient case facts (current case and Cap 1 case) about the external and internal environment to support their discussions?
6. Did the candidate communicate their ideas clearly, integrating and synthesizing the information?

SAMPLE RESPONSE – MARMANI VERSION 1

Below is an actual passing candidate response.

To: Roberto, Marmani

From: CPA, Controller, Marmani

Date: June 18, 2022

Situational Analysis

Mission:

This has been updated to include "materials and production practices that adhere to the tenets of long-term sustainability and quality". This reflects Marmani's focus on long-term sustainable products that are produced through environmentally friendly work behaviours.

Vision:

This has been updated to include "through business practices and a commitment to quality". This updated vision focuses on environmentally friendly business practices with still staying true to producing high quality products.

Key Success Factors (KSF)

- Multiple streams of revenue (diversification)
- Ethical and environmentally friendly initiatives
- Experienced and versatile work force
- Control over the supply chain
- High-quality products
- pricing products appropriately for our target market
- Creating a desirable brand in an undeserved niche

Values

- Increase annual revenues by 8-10%
- Coherent strategy

SWOT Analysis

Strengths

- Marmani's digital presence has significantly expanded since the marketing strategy was initiated. This resulted in rapid growth in the Athleisure division. This has also allowed Marmani to capitalise on online sales for adaptive apparel.

- A new production facility in Richmond, BC has allowed for more in-house production of athleisure and adaptive apparel. This has enabled us to keep control of the supply chain while monitoring and ensuring only high-quality products are generated. This has helped us stay successful in the past couple of years.

Weaknesses

- There has been so much focus by management on the new athleisure division that the adaptive apparel division is facing repercussions as it is starting to decline. This was noted by Wayne who mentioned that sales are not as high as they used to be, and are not meeting the targets. Sonya also openly admitted to her not having the time to develop new designs for the adaptive apparel. This is a weakness because the focus is on one product and not both. This is not staying true to the KSF of diversification. To continuously diversify both product lines should grow.
 - In the month of June the adaptive apparel sales have decreased for the first time. This is concerning as this division has always been successful.
 - New designs or products of the adaptive apparel division have not been released for months. The lack of new products could leave the current customer base frustrated. This could reduce revenues and we could lose key customers.

Opportunities

- The current growth rate of the online market is growing at 15%. This is expected to continuously grow at 15% for the next five years.
 - This indicates that we have the ability to continuously expand through its digital marketing and possible attract new customers through the means of the inter web.
 - Athleisure has become a recognised brand online and industry research indicates that the online market for athleisure is currently generating \$800M annually. The 15% growth will allow for sales in this division to continuously grow, which could help broaden the target market. This would also help meet the target revenue growth that you are concerned with.
- The athleisure segment has grown considerable in the past couple of years and experts are forecasting a high growth trend for the next five years.
 - The continuous growth of this trend will continue for the next five years which provides us the opportunity to continuously market to this target market. This will allow for steady and constant sales for the athleisure division.
- The Canadian economy is strong and consumer confidence is high. This indicates that there is continuous opportunities amongst Canada to market to for both lines of apparel. This would also allow the sales to be local.

Threats

- The market for adaptive apparel has been quite slow. This has led to Marmani being the leader in this type of apparel. However, competitors are starting to realise that there is an opportunity in this apparel industry and are starting to make this market grow. This is a threat to Marmani because there will be more adaptive apparel on the market, which will give customers substitutes for Marmani's apparel. This could possibly decrease revenues.

Quantitative

- Marmani has had continuous strong earnings and cash flows and is in a more secure financial position than it ever has been.

Constraints

- Time/Direct Labour Hours - management has noted that they are exhausted ever since the athleisure division was opened due to having to work for both the adaptive and athleisure division. They have noted that they are being overworked.
- Capacity - there is no room in the current production facility to expand with any type of in-house production.

Strategical Analysis

Sale to Witherspoons

Witherspoons has approached us yet again and has revised his offer. His offer has also changed from obtaining Marmani to just obtaining the adaptive apparel division.

Qualitative

Pro's

- Incremental profit would be earned on the transaction. The \$30M could also provide additional funds for us to use in the future for growth of the athleisure division. Roberto, you do not overly like external funding so this would provide you the opportunity to grow the business without acquiring additional debts from the bank or another external source.
- Witherspoons is known for their strong corporate governance and corporate social responsibility. This sale would then be in-line with our KSF of having ethical and environmentally friendly operations. This is still important as this is the brand that you developed from nothing Roberto. Therefore you would want the products to still be successful as the existing customers would continue to purchase the products and would hope that it would remain consistent. This may result in the customers being loyal and perhaps purchasing athleisure apparel, if able.

Con's

- The offer expires in two weeks. This does not give us enough time to complete due diligence. Although we already completed some due diligence in the past (when the

original offer was made) there could be changes or significant events that could occurred in the meantime. This could negatively impact us and the athleisure division.

- Our focus as a company is to help make people's lives better, and that is the sole purpose of the adaptive apparel division. By selling the division we would no longer be meeting our vision statement. This is not inline with our values either as it reduces our multiple sources of revenue and limits them to just athleisure wear.
- In the prior agreement Witherspoon required that you stay on as a business adviser for one year. This has been changed to three months. Although this requires less involvement for you there is a concern that this time frame may not be enough to help Witherspoon get the division up and running, and have a smooth transitions. This may result in defective apparel, or unsatisfactory apparel, which would leave consumers unhappy. This would not be in-line with our KSF of producing high-quality products. Although the division would no longer be associated with Marmani, it was started up through you and therefore would still possible reflect you and our current business.
- There is the potential to lose our main designer Sonya. Sonya has a passion for adaptive apparel, and if we were to sell it she would reconsider her future with Marmani. This loss of key personnel would be very detrimental to us as she is the main designer for the athleisure division as well. You even mentioned that Sonya is an important member of the management team. This would result in us requiring a new designer. This would be a business risk, and you are not very risk averse Roberto. This is also not in-line with our KSF of having a experienced and versatile work force and we would lose our versatility and would need to hire a new, possible less experienced designer.

Based on the above analysis it would not be recommended to go ahead with the offer.

Quantitative

Assumption

- The bank valuation is accurate and that the division is indeed worth \$28.5M on a stand-alone price. This is a large assumption, especially since the valuation was completed in November of 2020. It has been approximately 1.5 years since the valuation. This valuation may be overstated or understated. The division has declined in the past year which may have caused the value to decline. In this cause further incremental profits would be earned on the sale. It is also possible that the value of the division may have increased. This would cause a decrease in incremental profit.

Our current bank evaluated the adaptive apparel division as a stand-alone division and came up with a valuation of \$28.5M. Currently Witherspoon is offering \$30M. This is \$1.5M greater than what the division is valued at. This would result in incremental revenues from the sale.

Witherspoons original offer was for \$26M, and his current offer exceeds this by \$4M. It should be noted that in the past the offer was for Marmani's entire business so although the offer has increased it does not take into account the positive reputation that Marmani has built. It should also be noted that tax implications are not taken into consideration for this offer and that after-tax proceeds received would reduce the funds available. For example, if the highest corporate tax rate of 52% was used it would result in proceeds of \$14.4M.

Based on quantitative analysis alone it would be recommended to go ahead with this as it offers incremental cash flows.

Conclusion

Although this offer would provide additional funding which could help us grow in the future, it would not be recommended to go through with as it goes beyond our vision of making people's lives better, and does not help us generate multiple streams of revenue, and would result in a loss of key personnel which effects our experienced workforce. The after-tax proceeds may also not be enough to fund any future growth.

Adaptive Apparel Expansion

Sonya has made a proposal that we refocus our attention on the Adaptive apparel division.

Qualitative

Pro's

- This would allow for the expansion of the adaptive apparel division. This division has a main focus to help make people's lives better by providing them with technically functional apparel that is attractive. By expanding the division we would be in-line with our mission, and vision statement as we have greater growth potential. This could allow us to provide our current customers with additional products and could possible attract new consumers depending on what the new designs entail. This would help increase revenue's and would diversify our products. This is in-line with your expectations Roberto as you want to see a consistent increase in revenue.
 - Also in the expansion a new state-of-the-art equipment would be purchased. This would help ensure that only high-quality products are efficiently made. This is in-line with our KSF of producing high-quality products which helps make consumers happy. This is also in-line with the mission of making staying true to our commitment of quality.
- A new IT system would also be purchased in this expansion. It was noted that we lack infrastructure to support online sales. This system could possible provide the support that we lack. The system would be built into the \$5M initial investment cost and therefore we would not incur additional costs for it. This could help solve one of our operating issues all while strategically putting Marmani in a better position for the future.

Con's

- This would require that the management team be dedicated full-time to the expansion project that is estimated to take a year to complete. This would take away from time spent on the athleisure division which is currently booming.
 - Operationally this is a flaw as we are still operating two divisions simultaneously. Both the divisions are assumed to be profit centre's with the goal of incurring profit, and therefore by reducing time spent on athleisure we would be limited the possible profit that could be generated. This is not in-line with our KSF of diversification, and having multiple streams of revenue because we are focusing on expanding one stream of revenue.

- o This is also a con because the staff has mentioned that they are overextending themselves and are being overworked. They would like a lightened workload and if anything this would increase their workload. This could leave management unhappy. By being overworked it could also negatively impact the quality of our products if the employee's are too exhausted.

Based on the above information it would not be recommended to go ahead with this option as it is not in the best interest of Marmani as a whole.

Quantitative

Assumptions

- The discount rate of 15% is used. It is believed that this is accurate, but this may be outdated as it was used years ago. If this were to fluctuate it would negatively or positively effect the NPV. For example if a lower discount rate was used than a higher NPV would be incurred, and if a higher discount rate was used than a lower NPV would be incurred.
- The estimate of revenues of \$9M is also significant. If revenues are not incurred as expected it would reduce the NPV. If the NPV is continuously reduced it could result in negative cash flows.
- Increase of 5% per year in revenues. This estimation is based on the growth trend. If revenue does not indeed grow this could reduce our NPV.
- The fact that it will take a year to make these changes. If it takes longer than a year it could negatively impact the athleisure division even more as full-time dedication is required by management for this expansion. If it were to take less time it would be beneficial to the athleisure division.

The estimation that is given by Sonya is that \$70M for the next five years of operations will be generated by this expansion. If time value of money is taken into consideration (cash flows change in the future due to inflation and deflation) than \$35M would be generated. This is assuming that upgrades would be taken into consideration in this calculation.

As per Exhibit I a quick calculation was completed solely for the initial investment and revenues. This resulted in a NPV of \$27M. This calculation excludes costs of producing the new designs and products that Sonya has in mind for the future. Further information should be required for Sonya to determine the true financial impact that this would incur.

Based on quantitative analysis alone it would be recommended to go through with this option(once assumptions are further analysed) as it incurs a positive NPV.

Online Market - Athleisure

There was mention by Karen that the exploration of the increase in online sales for the athleisure vision be taken into consideration as the online market provides a huge opportunity for the division to grow.

Qualitative

Pro's

- Consumers have expressed their desire for clothing with unique styles. Marmani is known for our high-quality, beyond expectation products. Sonya is known to have unique designs that are optimal and functional, all while looking good. The products we offer are also more exclusive and more pricey. This creates a desire for our product.
 - This meets various KSF as we are pricing products appropriately for the target market, we would be offering our high-quality products, and we would be creating a desirable brand for our global market.
 - The big brands often product mass products that are cheaper and of lower quality, and therefore we would be able to better serve the needs of this target market as our brand is more desirable for their needs. This is inline with the vision statement of being a leader in the apparel industry by creating products that perform beyond expectation.
- Marmani's digital presence has expanded since the adoption of the digital marketing strategy. Due to this the athleisure apparel brand has become recognised online.
 - This indicates that this division already has notable success online, and that there is potential to increase it in the global market. This would be increasing our streams of revenue, which is a KSF.
 - This could also meet your needs of incurring 8-10% of revenue growth as anticipated revenues are to grow 15%.
- In the expansion would be included information technology development. There has been mention that the current IT department is weak. This system could possible provide the support that we lack, all while not incurring additional costs.

Con's

- Additional It support may be required for the online sales. With online sales comes the risk of a breach of confidential data. This could result in client's information being put in jeopardy. If customer data is obtained by hackers it could result in unhappy customers which could potentially lose us business in the future as those consumers would no longer trust us. This could reduce revenues, and would not be a good business practice.
- Online competition is continuously growing and is quite fierce and Marmani would be competing against some of the biggest brands. The world of online sales expands globally and has a large market. The big brands are reputable and have experience in a global market and have been successful. This would therefore be a risky growth opportunity. Roberto you are not risk averse so this may be concerning.
- The expert working with Karen noted that there could be market share value between 1-4.5%. Estimating an average of 3%. You believe that this is a bit aggressive of an estimate.

- o The marketplace is very competitive which makes it quite difficult to estimate the market share value.
- o This aggressive estimate may be inflated by Karen as she is very passionate about this option. This causes concern regarding the other information that she has provided (i.e. fixed costs, and variable costs, etc.). Further research should possible by done.
- There already has been mention that the staff is being overworked and is exhausted. This new offer would incur an additional facility. To effectively operate this new facility new staff members would have to be hired. This would generate additional costs for this option as well.
 - o This is also a con because the staff has mentioned that they are overextending themselves and are being overworked. They would like a lightened workload and if anything this would increase their workload. This could leave management unhappy. By being overworked it could also negatively impact the quality of our products if the employee's are too exhausted.

Based on the above information it would not be recommended to go ahead with this option as it is not in the best interest of Marmani as a whole.

Quantitative

Assumptions:

- Fixed costs remain consistent at \$750K per year. If fixed costs increase it would reduce net income, and if they were to decrease it would increase net income.
- Revenue is based on the current \$800M with 15% increase each year. If the increase is not as expected that revenue could be overstated. If the percentage of increase is lower it would result in lower income which would reduce net income. If the percentage was higher it would result in higher income and would increase net income.
- Variable costs are 60% of revenue. If this is higher it would result in higher costs and reduced net income, if the costs were lower than it would result in lower costs and increased net income.
- It was assumed that half of the lease and renovation costs would be for yearly leasing.

As per calculations in Exhibit I you can see that this initiative would incur an NPV of \$1.59 billion dollars. This is based on the various assumptions noted above.

Based on quantitative analysis alone it would be recommended to go through with this option as it incurs a positive NPV.

Adaptive apparel expansion and online sales

Assess the situation

Roberto, you have made it clear that it may be unrealistic but you would like to look into the opportunities of rejuvenating adaptive apparel and expanding into online sales of athleisure simultaneously. The implications have been analysed below.

Analyse the situation

Qualitative

Currently both the adaptive apparel expansion and online sales solely focus on their specific divisions. The expansion would require a hands on approach by all of management for one year while the online sales would require that all the focus possible be towards athleisure. This would not be inline with your goals Roberto, as neither of these strategies would not be coherent. They would not be in the best interest for the company.

Currently Sonya and Karen have strong views about both the athleisure division and the adaptive apparel division. When two divisions are working simultaneously they should have congruent goals. The main objective should be that Marmani is successful as a whole. Currently it does not seem as though the two individuals have this in mind.

Quantitative

Both divisions would require a large upfront investment of \$9.25M however these investments would be recovered through the next five years as the NPV of both initiatives would be \$1.6 billion dollars. Financing options should be considered for this option. Although Marmani has been successful and has had positive cash flows this is a large investment. Further financing from Hurley should be examined. External resources should also be considered.

Conclude

Implementing both of these initiatives simultaneously could be very strenuous on staff members. Management has already noted that they are overworked. Therefore, it should be determined if Marmani has sufficient funds to implement both operations simultaneously. If not it would be recommended to complete the adaptive apparel expansion first as this is the division that is currently on the decline, after this the online marketplace could be put into implementation. For the implementation of both of these plans further assistance should be acquired as staff members are already notable exhausted and overworked. The staff members could be temporary or permanent.

Matthew and his Management Team - Athleisure

Matthew Mondoux and his managerial team are willing to come work for us in the Athleisure division. This would take the workload of the existing management team and would be able to free up time for the adaptive apparel division.

Qualitative

Pro's

- Matthew has a good reputation. He has managed three separate brands and has generated financial profit and success for all of those brands. He has experience turning companies around and helping them incur more profits, and increase the value of the business.
 - This indicates that he could successfully and easily manage the athleisure division as he has prior experience.

- The athleisure division is already successful and Matthew is used to working with struggling companies. This could result in additional profit than what is expected.
- This could meet your goals of 8-10% revenue growth Roberto.
- The management staff has mentioned that they are overextending themselves and are being overworked. They would like a lightened workload. This would be providing management with the additional support that they require. This would reduce the work that the management staff is currently incurring which would make them happier. It would also be better for the health of the staff as they would no longer feel as though they are being overworked. Being overworked could lead to injuries and reduced quality of work. This option would be mitigating this risk.
 - This is in-line with the vision statement of having business operations that have a positive effect.

Con's

- Matthew has a stock option plan that could be an incentive for employees. The plan allows senior managers to purchase shares based on the increase in revenue. This would reduce your ownership in Marmani Roberto, which is not in-line with your goals.
- Matthew wants to outsource all new production demands and athleisure products to Asia. This is because Matthew believes that we are paying too much for fabrics. Marmani and its apparel is known for its unique textile and fabrics. The purpose of the apparel is to perform beyond expectation, and is to offer and design clothing that is functional and attractive. By switching the current fabrics that we use it could be detrimental to our existing sales and customers may be unhappy with this sudden and large change.
- Matthew wants to outsource all new production demands and athleisure products to Asia. This outsourcing would be completed in Vietnam (Viet BDG). Viet BDG has a very poor reputation and has been accused of serious violations. Its also known for an unhealthy workplace as two years ago it was reprimanded for such. Since then they argue that they have made improvements but there is not proof. It was also noted that the items that are manufactured at low-quality and low-priced.
 - This is against our KSF of Ethical and environmentally friendly initiatives as they have a poor reputation and violations for their employees. They do not operate in ethical manners and do not treat their employees right.
 - This would also result in a loss of control over the supply chain. This would result in us not being able to guarantee the quality of production in Asia. If the materials being produces are not meeting expectations it could result undesirable products which would leave customers unhappy. The low-quality products would also leave customers dissatisfied as we are well known for our above quality products. This is not meeting our KSF.
 - Another KSF is pricing products appropriately for our target market. We sell unique, high quality products and therefore price them accordingly. We would not be able to do this with production that is occurring in Viet BDG. Low quality

products would result in us having to drop prices. This would be less desirable to our potential global market and existing customers.

- Matthew has frequently changed employees in his operations. This would result in high employee turnover. We believe in an experienced and versatile workforce and this would not be meeting expectations. Continuous employee turnover would result in additional training costs, and would also leave us with inexperienced members with athleisure apparel. There would also be a lack of versatility as Matthew often hires his colleagues.
 - His colleagues include a designer who is experienced, but has the idea of mass production over the country. We are known for our unique products and therefore this would not meet our expectations.
- Matthew would like to introduce new products that will appeal to a wider consumer based.
 - Companies that Matthew has worked for have been sued for copyright violations, so there is a risk that the new products that Matthew brings in may be violating copyright of other designers. This could incur litigation and lawyer fees in the future. We have a well known reputation and this could tarnish it.

Based on the above analysis it would not be recommended to go ahead with this option as it is not in-line with our mission, vision, and multiple key success factors.

Quantitative

This would result in a decrease of production by 30%, and an increase of revenue by 40%. This does not include the incremental costs of hiring this new management team. Further information would be required to determine the net incremental cost.

It is estimated that incremental cash flows would be generated, however further details are required to determine the financial implication.

Overall it would not be recommended to go ahead with this option because there are some severe issues noted with Matthew's suppliers in Asia. The working conditions and operations of the facility in Vietnam would not meet our standards. Although this would be a great way to reduce stress on employees a different option should perhaps be examined to obtain additional staff members.

Current Commission Structure

Assess the situation

It was noted that there was a salesperson who had been inflating their commissions. This was done by making sales to retailers that the salesperson knew would return items. The current compensation policy does not deduct returns from the salespersons commissions as it does not seem fair as returns are quite common in the industry. Although this was limited to one salesperson there is the risk that this could occur again.

Analyse the situation

There is a moderate probability that a salesperson could act in bad faith and make a deal with a supplier to make a sale and incur commissions with the sales being returned. This would

negatively impact the financial statements as the commission expense would increase, and returns would increase. This would result in a reduction of net income.

There are two different options that could be approached:

1. Change the current structure so that returns are reflected in the commission calculation.

Although it may seem unfair to employees the commissions that they receive are an incentive and are an additional benefit that they receive. What could be done is that a spreadsheet could be made to examine each employees sales and returns. The total sales amount would be accurately reflected to reduce the sales by the returns that were made in the year.

- PRO: This would give the most accurate representation of a commission expense. This would help ensure there is no manipulation or bad faith behaviour. It would also result in accurate costs which is a good business practice.
- CON: However, this may leave employees upset which may result in a loss of employees. We are fond of our experienced and versatile workforce so this would not be in-line with our KSF.

2. Determine a new incentive structure - balanced scorecard.

Currently the structure focuses on increased revenues which is inline with your expectations Roberto. Increased revenues of 8-10% are desired on a yearly basis. However, other items could also be examined. A balanced scorecard ensures that incentives are motivated by well rounded areas of a business. i.e. refer to Exhibit III for details. The different areas allow us to ensure that we are doing well financially all well savings costs, and keeping the customers happy.

- PRO: This type of incentive would be more fair, well rounded and relate to different aspects of the business. This could be beneficial in reducing costs in production, increasing customer satisfaction, etc.
- CON: A new incentive structure would have to be implemented which would require time (that we do not necessarily have), and potential costs.

Conclude

It would be recommended to implement the balanced scorecard as it could be beneficial for us in all aspects of our business. This will help ensure we have effective business practices all while having a happy sales team that can continue to grow and be successful amongst our organisation.

IT Infrastructure

Assess the situation

Digital marketing was implemented but the IT infrastructure was noted to be lacking. There is a lack of infrastructure to support online sales, which could be troublesome in the future.

Analyse the situation

Online sales have been quite successful for us, especially in the growth of the athleisure market as a large portion of our sales are made through the online function. There is a risk that there may be a hacker, or breach of information and customer data may be leaked. This would result in unhappy customers and would negatively impact our current reputation.

We are going to go ahead and implement the adaptive apparel expansion and the online market for athleisure right after. Both of these strategies include the development of IT technology and infrastructure. Both of these should be further examined to determine what each encompasses. It should also be ensured that the same development of functions is not completed, and that they are done all in one.

Conclude

Examine the current IT systems that are going to be installed with the adaptive apparel expansion and the online market for athleisure. If these are not sufficient then the systems and developments should be revamped. It should be determined if the technology will be sufficient to protect us against hackers, or breach of information. If not the systems that are obtained through the strategically implementation should be modified accordingly.

An IT member could also be hired to keep track of the current system to ensure that no issues occur in the future.

Overall conclusion

There were various strategical and operational issues that were noted. It was also noted that there is a time constraint and capacity constraint. Taking all factors into consideration the sale to Witherspoons would not be recommended. Instead the adaptive apparel expansion would be put into action right away. Additional funding and staff members would have to be hired for this. Once completed, the online market for athleisure should be expanded. The same staff members that were hired for the previous project could be used for this project. Incremental cash flows from the adaptive apparel expansion could be used to help fund the online market, however, additional cash flows would also be most likely be required. Matthews management team should not be hired but other options should be examined as hiring a management team for athleisure could be quite beneficial and could decrease the stress and current overload of current staff members. Finally by implementing a balanced scorecard it could result in increased gross profit, sales, customer satisfaction, reduced costs and increased training which would overall benefit the business as a whole.

Exhibit I

Purpose:

To determine the financial implications of expanding the adaptive apparel division and the online marketplace.

Adaptive Apparel Expansion

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Initial investment	-	5,000,000.00				
Additional Revenues		9,000,000.00	9,450,000.00	9,922,500.00	10,418,625.00	10,939,556.25
	-	9,000,000.00	9,450,000.00	9,922,500.00	10,418,625.00	10,939,556.25
Discount Rate	1.00	0.87	0.76	0.66	0.57	0.50
	-	7,826,086.96	7,145,557.66	6,524,204.82	5,956,882.66	5,438,892.86
NPV		27,891,624.95				
Total CF		44,730,681.25				

Online Marketplace

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Initial Investment	-	4,250,000.00				
Anticipated Revenue		920,000,000.00	1,058,000,000.00	1,216,700,000.00	1,399,205,000.00	1,609,085,750.00
Fixed Costs	-	750,000.00	750,000.00	750,000.00	750,000.00	750,000.00
Variable Costs	-	552,000,000.00	634,800,000.00	730,020,000.00	839,523,000.00	965,451,450.00
Net Cash Flow		367,250,000.00	422,450,000.00	485,930,000.00	558,932,000.00	642,884,300.00
Discount Rate	1.00	0.87	0.76	0.66	0.57	0.50
PV	-	319,347,826.09	319,432,892.25	319,506,862.83	319,571,185.07	319,627,117.45

NPV 1,593,235,883.68

Both Options

	Year 0	Year 1	Year 2	Year 3	Year 4	Year 5
Initial Investment	-	9,250,000.00				
Revenue		929,000,000.00	1,067,450,000.00	1,226,622,500.00	1,409,623,625.00	1,620,025,306.25
Fixed Costs	-	750,000.00	750,000.00	750,000.00	750,000.00	750,000.00
Variable Costs	-	557,400,000.00	640,470,000.00	735,973,500.00	845,774,175.00	972,015,183.75
Net Cash Flow		370,850,000.00	426,230,000.00	489,899,000.00	563,099,450.00	647,260,122.50
Discount Rate	1.00	0.87	0.76	0.66	0.57	0.50
PV	-	322,478,260.87	322,291,115.31	322,116,544.75	321,953,938.13	321,802,674.59

NPV 1,601,392,533.66

Conclusion: The NPV of the adaptive apparel expansion on its own would be \$27.8M
 The NPV of the online marketplace on its own would be \$1.59 billion.
 The NPV of the combined initiatives would be \$1.60 billion.

Purpose: **Exhibit III**
 To provide an alternative bonus structure.

Area	Goal	Measure	Incentive
1 Financial	Gross Profit of 42% and increased sales of 8%.	Reviewed Financial Statements	1% bonus
2 Customer	1 day customer response time, Satisfactory customer survey	Online sales site, Marmani's emails.	1% bonus
3 Internal	Reduction in costs per defects	Costing system	\$1K bonus
4 Employee	25 Training hours	Training hours as noted by HR	\$1K bonus

Conclusion: The above bonus structure should be implemented.

APPENDIX E

**THE COMMON FINAL EXAMINATION
DAY 1 MARMANI VERSION 2 BOOKLET – SEPTEMBER 9, 2020**

**COMMON FINAL EXAMINATION
SEPTEMBER 9, 2020 – Day 1**

Case (MARMANI-Version 2)

(Suggested time: 240 minutes)

It is March 12, 2021. You, CPA, continue to work for Marmani as corporate controller. Alain Pepin was recently hired as Marmani's COO. A consultant with six years of experience in financial and operational management and strategic planning, Alain advised mid-sized clients on expansion into global markets and on maximizing the use of technology.

Roberto did not sell Marmani to Witherspoon's. In 2019, an Athleisure division was created and a new, state-of-the-art design and production facility was opened for this division in Richmond, British Columbia. Adaptive clothing design and production remains in Toronto, Ontario. Roberto remains as CEO but has renewed his interest in designing Athleisure wear and now spends most of his time in Richmond. Roberto delegated responsibility for strategic planning, finance, production and information technology to Alain. A standalone accounting system, a customer relationship management system (CRM) and an e-commerce site were implemented to sell Athleisure products, which are only sold online.

Sonya left Marmani in late 2019. Rory Shain was hired to manage the full-time employees hired in Toronto to replace the Adaptive contracted sales agents. Rory, who reports to Karen, has become the new advocate for the Adaptive clothing division. Adaptive's sales department now consists of 11 salespeople who each have their own geographical territories across Canada and the U.S. The sales staff have built good relationships with their customers, those being hospitals, seniors' homes, rehabilitation centres and other long-term care facilities, resulting in strong recurring sales.

Marmani's mission statement was updated to reflect the added division, and in late 2020, Marmani formed a five-member Board of Directors (board), with Roberto as one of the members. The other members have strong backgrounds in: law (Jay Ting); finance and accounting (Chris Lieberman); online, retail media and advertising (Chuck Stevens); and the fashion industry (Mira Putnam). Alain has provided you with excerpts from the first board meeting.

Roberto asks Alain to prepare a strategic plan to present to the board on May 1, 2021, that will address the issues identified at the first board meeting. Roberto tells Alain that he must find ways for the company to meet its growth targets. Alain expects that his strategic plan will therefore need to be aggressive. Because you have more history with the company, Alain asks you to recommend which course of action Marmani should take, and to discuss any additional issues you identify. To help prepare your response to Alain, you spoke with some of the managers about the recent changes.

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APPENDIX I
EXCERPTS FROM FIRST BOARD MEETING

The board's first meeting begins with a presentation of Marmani's 2020 year-end income statement.

Alain: The combined revenue for Adaptive and our new division, Athleisure, fell short of the targeted 8% to 10% annual growth rate.

Chris: The apparel industry only averages about 4% annual revenue growth, so why such an ambitious growth rate target?

Roberto: The growth target that I set was based on my sales projections, which I still think can be met.

Mira: Global competition from large athleisure brands is now a factor and prices are declining as discounters join the competition. To grow Athleisure, Marmani must cope with high demand, keep up with the latest fashion trends and contend with the industry becoming highly competitive, putting more pressure on pricing and margins.

Roberto: True. Luckily, the Adaptive division's gross margin was higher than expected, enough to offset the much lower-than-expected gross margin in the Athleisure division. I am worried that our margins are being squeezed.

Chris: In that case, higher sales in Athleisure could have caused the division's gross margin to worsen. We will need to keep a close watch on it.

Roberto: I received a request from my cousin Ray that could affect our decisions. Ray wants to convert his debt to equity and become an active shareholder and board member. Ray wants at least one-third of the common shares after conversion. We must either accept his proposal or repay the balance of his loan by the end of June. Hurley Bank is still offering financing.

Let's continue our discussions but bear in mind Ray's request and the possible need for refinancing. A formal valuation will be arranged later.

Chuck: Can we talk about the Adaptive division a bit more? Roberto, is Marmani working toward offering a more diversified collection of designs? What other plans are there for Adaptive?

APPENDIX I (continued)
EXCERPTS FROM FIRST BOARD MEETING

- Roberto: This segment of the industry continues to evolve. Honestly, we have not had a lot of time to spend on it recently. In fact, we have not yet replaced Sonya, our design manager, and she left over a year ago! Fortunately, our strong reputation within the health and wellness industry is sustaining us. Our relatively new sales department has managed to increase sales volumes and Rory is doing a great job of maximizing our selling prices, which is what contributed to the higher margins.
- Mira: This division is doing well. The adaptive clothing market is much larger than I thought and is growing. We know the population is aging. Shouldn't we be servicing this niche market by offering new products? Instead of focusing so much on athleisure wear, why aren't we taking advantage of this growth?
- Roberto: Adaptive clothing is not just for the elderly. We have been approached by a prominent doctor to produce a mass market line of adaptive clothing that I think has the potential for high growth. We have information on the proposal, with some input from our sales department.
- Chuck: Adaptive is providing a steady cash flow, which Marmani needs, but I think the higher growth potential is in Athleisure. I am convinced that, with the ongoing pursuit of healthy and active lifestyles, it will grow more than Adaptive and its profits will be sustainable.
- Alain: I agree with Chuck. I think Athleisure has greater potential than Adaptive. I want to expand Athleisure sales on the global market as soon as possible.
- Chuck: The fastest way to achieve global expansion is to sell online through Amazon as a professional seller in their Athleisure category. Amazon has a loyal customer base in over 180 countries. Marmani could easily reach a wider audience. Amazon's processes are so straightforward that Marmani can start receiving sales orders as soon as its account is approved and the products are listed on-line. The principle is simple: although Amazon will take a percentage of sales, the more you sell, the more money you make.
- Alain: In my experience, this option promises to generate sales quickly. However, it is important to continue to feed off that momentum. Since customer loyalty can be inconsistent, a lot of effort will need to go into keeping up with trends. Frequently refreshing the products available is usually essential for maintaining sales.

APPENDIX I (continued)
EXCERPTS FROM FIRST BOARD MEETING

Roberto: Industry experts predict high demand for street luxury brands, which inspired my designs for three new summer collections: “Fresh,” “Flow” and “Cool.” These designs should position us to successfully compete. Based on our experience in the Canadian market, I provided Alain with preliminary estimates of sales we can expect on Amazon. They might need to be adjusted but let’s work with them for now.

Alain: Selling on Amazon can help us meet our revenue growth target quickly. We will simply make up the lower margin with an increase in sales volume. The increase in volume will also create enough demand to enable continual production of new and appealing designs. I have prepared cost estimates to go along with Roberto’s sales estimates.

Mira: You know as well as I do that generating more sales without a sufficient profit margin makes no sense. Our margins are already being squeezed. In the long term, I am not sure Amazon is the best sales channel for us. We need to grow our brand profitably by finding new markets that strengthen our current brand.

Roberto: Having never sold outside of Canada and the U.S. before, selling all three collections on Amazon may be too ambitious. I suggest we start with the collection that will provide the best financial results. Considering the increased competition, we need to price it carefully.

Alain: Let’s get CPA to suggest which collection to offer and at what sales price, and to provide further analysis and commentary on pursuing this option.

Jay: I have a completely different sales idea. I joined this board to help Marmani benefit from my network. Recently, a lawyer I know well talked to me about one of his clients, a professional athlete. This athlete, whose name is being concealed for now for confidentiality and privacy reasons, currently partners with an athletic shoe brand and an energy drink. The lawyer disclosed that the athlete is known as being unpredictable and prone to outbursts of anger. He is apparently also a perfectionist, with high standards for himself and those around him.

The celebrity athlete wants us to design and supply a line of men’s streetwear bearing his name. The first item of the line is a slim-cut athletic sweatshirt. He wants Roberto to be the creative director and they would co-design all the items. I have prepared a summary of the proposal.

APPENDIX I (continued)
EXCERPTS FROM FIRST BOARD MEETING

Roberto: I am excited about the idea of designing new and creative items for men. It would tie in with some of my new product ideas. I want to share the highlights of an article I read a few months ago, discussing the direction in which the athleisure trend is heading. If this arrangement works out, it could lead to others, with different celebrity athletes. My only concern is how much of my time it will require.

Jay: According to the lawyer, the celebrity athlete is wealthy and is willing to include a guarantee of \$2 million dollars in sales of product annually, for the next five years, at a gross margin of 25%.

Mira: I don't like it. Celebrity partnerships can be risky. Some celebrity deals have gone horribly wrong and social media notices it quickly. We don't even know which celebrity athlete we are dealing with!

Roberto: I think the proposal offers significant advantages. Let's ask CPA to take a closer look at it.

Alain: This proposal does not align with my vision for Marmani or your growth objectives, Roberto. My vision is to have the entire company marketing through social media and selling online, through our own website and through Amazon. If we target our marketing to our repeat customers and obtain new customers globally, imagine the potential sales growth. Marketing through social media also provides data that we can use for designing new products.

Karen is satisfied with the information she is getting from the new CRM and strongly believes that the reports she is creating with the available data are sufficient. She is reluctant to change. She fails to understand that Marmani needs to grow globally, not just in North America. In order to do this, we need to be able to react quickly to changes in the marketplace, which requires real-time information. The CRM is just a starting point. Using data analytics to understand customer needs and then offering products to meet those needs is how big companies succeed.

Karen may no longer fit with the management team at Marmani. If she does not see the need for these changes, she should be replaced.

Roberto: Karen has been a valuable member of management for a long time. Alain, I expect you to work collaboratively with our existing management team.

APPENDIX I (continued)
EXCERPTS FROM FIRST BOARD MEETING

Chuck: Roberto, your business has grown quickly and is more complex than when you started it. Alain may be right about the need for Marmani to change in order to reach its growth potential.

Roberto: Let's start by determining which options will provide the growth of the Marmani brand that we seek based on both our strategic and financial goals. We also need to decide quickly on financing, ensuring that the choice fits with our strategic plans.

We will make decisions about these issues at a follow-up board meeting. Alain, please have a full report ready for us.

APPENDIX II
INCOME STATEMENT

Marmani Inc.
For the years ended December 31
(in thousands of Canadian dollars)

	2019		2020	
	Projected	Actual	Projected	Actual
Revenue				
Adaptive	\$42,650	\$43,503	\$46,100	\$45,800
Athleisure	0	0	4,000	3,800
Total revenue	42,650	43,503	50,100	49,600
Cost of sales – Adaptive	57.4% 24,500	57.2% 24,900	57.5% 26,508	56.5% 25,877
Cost of sales – Athleisure	0	0	60.0% 2,400	77.0% 2,926
	57.4% 24,500	57.2% 24,900	57.7% 28,908	58.1% 28,803
Gross margin	42.6% 18,150	42.8% 18,603	42.3% 21,192	41.9% 20,797
Expenses				
Selling, general and administrative	13,632	14,041	14,985	14,800
Other	200	240	370	420
Depreciation	700	700	670	670
Total expenses	14,532	14,981	16,025	15,890
Operating income	8.5% 3,618	8.3% 3,622	10.3% 5,167	9.9% 4,907
Interest expense	452	452	404	404
Income before taxes	3,166	3,170	4,763	4,503
Income taxes (25%)	792	793	1,191	1,126
Net income	5.6% \$ 2,374	5.5% \$ 2,377	7.1% \$ 3,572	6.8% \$ 3,377

APPENDIX III REFINANCING OPTION

Refinancing of Ray's Loan

Terms of the long-term loan are as follows:

- The maximum amount is \$10 million.
- Repayment of principal and interest will be over 10 years.
- The rate is prime plus 2%.
- A personal guarantee from Roberto is required.
- Audited financial statements must be submitted.

The bank agreement contains the same covenant as in the past, requiring a minimum return on assets. If the covenant is breached, all payments to shareholders will require the pre-approval of Hurley Bank and may be limited.

APPENDIX IV ADAPTIVE MASS MARKET LINE

The availability of adaptive clothing for people with physical disabilities is limited, and is often expensive and unfashionable. We have an opportunity to co-develop a lower-priced, more appealing and widely accessible line of clothing with Dr. Irving, a highly respected physician who specializes in treating people with physical disabilities.

Offered at a lower price point, the line will allow us to reach a new market. The items will focus on fitness wear designed for people with physical disabilities.

In order to access the mass market, we will sell to a large retailer with whom we have never done business. Because the price points of our current lines are typically too high for this market, our sales prices will be lower but so will our costs, allowing us to achieve a gross margin of 40%. Based on information from Dr. Irving, we can expect sales of \$2 million in the first year, \$3.5 million in the second year, and growth of 5% to 10% thereafter.

Once our products become better known, demand should increase, which should give us access to other large retailers. We can then consider various production options: in-house, if we have the capacity; or outsourcing production to manufacturers we are familiar with and who will maintain our quality standards.

Dr. Irving is willing to work with us for no personal compensation. Instead, we will provide an upfront donation of \$25,000 to a charity that supports people with disabilities and an ongoing, annual donation to the same organization of 1% of gross revenue from this mass market line.

APPENDIX V SELLING ON AMAZON

Sales Estimates (provided by Roberto, based on Canadian sales)

Probability of Sales in 2021 (in units)				
Collection	Low	Medium	High	Weighted Average
	45%	35%	20%	
Fresh	12,000	15,000	20,000	14,650
Flow	19,000	20,000	21,250	19,800
Cool	18,000	22,000	27,500	21,300

Cost Estimates (provided by Alain)

Estimated total costs, which include Amazon's fee as well as production, shipping, customs, payment transfers and variable overhead allocation costs, are as follows.

Collection	Cost Estimate	Amazon Base Price
Fresh	\$43	\$50
Flow	\$32	\$45
Cool	\$53	\$65

We need to identify the collection that can be sold on a global scale and set the price appropriately. Based on Amazon's data analytics, to generate strong sales volumes while remaining competitive, the prices we set should not exceed 120% of the above noted Amazon base price. In order to sell on Amazon, I think we will have to accept a reduction in margin. Let's work with a margin of 35% for our pricing.

Advice from Amazon, for Amazon Sellers:

First time Amazon sellers must rely on their own retail experience and their product knowledge. Most importantly, they should follow the industry trends in pricing and keep up to date on competing products that may affect their sales.

APPENDIX VI CELEBRITY ATHLETE PARTNERSHIP PROPOSAL

The celebrity brand must reflect a high fashion sense with attention to cut and fit, using good-quality materials and with street luxury brand elements.

Design Requirements

- Roberto will be paid a \$25,000 annual design fee.
- Roberto and the celebrity athlete will co-design the line(s); however, the final design approval will be given by the celebrity athlete. Design revisions will continue until the celebrity athlete is satisfied and approval is given.
- For the first year, the line will include six men's styles, consisting of three tops and three bottoms, each in three colours, for a total of 18 pieces, to be sold to large retailers.
- The existing line will be updated and/or a new line will be added annually.
- The celebrity athlete will retain ownership of all designs. Marmani is prohibited from manufacturing similar items under its own brand.
- The Marmani name will be on all co-designed lines.

Production Requirements

- Marmani will produce and ship the finished goods to the celebrity athlete's warehouse facility. Payment will be made on delivery.
- Marmani must be flexible enough to accommodate changes in the production and delivery schedule requested by the celebrity athlete.
- Marmani must guarantee that it can consistently and reliably supply product, without exception, or the agreement can be terminated at any time by the celebrity athlete for non-performance.

Sales and Distribution Requirements

- The scheduling, filling and outbound transportation for the final customer orders will not be Marmani's responsibility.

APPENDIX VII
ARTICLE HIGHLIGHTS SHARED BY ROBERTO

- Athleisure wear for men is one area that continues to gain momentum.
- Lululemon Athletica, the pioneering yoga-wear retailer, now generates 20% of its total sales from menswear.
- Sales of men's pants increased by 20% over last year.
- Retailers already competing on Amazon fear that Amazon.com is planning to partner with Nike to produce its own athleisure wear label.
- By 2021, sales on Amazon are expected to account for 16.2%, or \$62 billion, of apparel sales.

Source: How Many More Laps Are Left for The Athleisure Trend, Apparel News, September 7, 2020

APPENDIX VIII NOTES FROM DISCUSSIONS WITH MANAGERS

Most of the managers are under the impression that Alain's only focus is on revenue growth at all costs. He is highly critical of how things are currently being done, which in their view is creating a climate of negativity, undermining the positive corporate culture created by Roberto.

Managers are still upset over not being given shares in Marmani as part of their compensation package and are now dealing with Alain being controlling. There is also a rumour circulating about another possible shareholder. They noted that the work atmosphere has changed and there is talk of some employees leaving.

Don expressed concern that, during Alain's recent tour of the production facility, his comments were focused on cost cutting. Alain seemed to think the process could somehow be streamlined, to reduce production costs. Don was mystified by how Alain could determine this. Alain did not seem interested in understanding the impact that changes to the processes could have on the quality of the final products.

Since the new CRM was implemented, Karen has provided an enormous amount of customer data to the managers, who feel overwhelmed with information. Rory, in particular, said the sales team is not actively using the CRM data, nor has he personally made use of it.

Rory thinks the demand for fashionable adaptive clothing remains strong. There is enough capacity in the Toronto facility to produce additional products, but the designers seem totally focused on Athleisure; ideas gathered from an important customer on ways to improve the Adaptive product designs are being ignored. Rory believes this is due to a lack of understanding of the differences between Adaptive and the new division, Athleisure.

APPENDIX F

**DAY 1 (MARMANI VERSION 2) – SEPTEMBER 9, 2020
MARKING GUIDE AND SAMPLE CANDIDATE RESPONSE**

**MARKING GUIDE
MARMANI INC. (MARMANI)
VERSION 2**

Summative Assessment #1 – Situational Analysis (Update)

For Summative Assessment #1, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate used a reasonable situational analysis when analyzing the major issues facing Marmani.

Unsure – The candidate attempted to use a reasonable situational analysis when analyzing the major issues facing Marmani.

No – The candidate clearly did not use a reasonable situational analysis when analyzing the major issues facing Marmani.

Technical Competencies

2.3.2 Evaluates the entity's internal and external environment and its impact on strategy development.

Enabling Competencies

1.2.2 Performs work competently and with due care.

2.1.1 Defines the scope of the problem.

2.1.2 Collects and verifies relevant information.

2.1.3 Performs appropriate analyses.

2.1.4 Integrates information to investigate each potentially viable solution or conclusion.

A competent candidate should complete a sufficient and appropriate situational analysis. The focus should be on describing the factors that have changed since Capstone 1 that will affect the decisions at hand (e.g., updated athleisure industry predictions and direction). The candidate should also identify and describe the apparent operational and strategic concerns that have recently arisen at Marmani, given the hiring of Alain Pepin. There is also the opportunity to comment on the relative performance of Marmani's two divisions. The essential aspect is for the candidate to use the SWOT analysis in their discussion of the issues presented, as well as in their conclusions and recommendations.

Keep in mind that the Alain is the one asking CPA to provide the strategic plan input. Issues related to Alain should be addressed in a separate memo to Roberto.

Mission/Vision

Vision statement (from Capstone)

Our vision is to be a leader in the apparel industry by creating products that perform beyond expectation for our customers and make people's lives better.

Mission statement (from Capstone)

We accomplish our vision by designing and selling technically designed clothing that produces optimal function while still being attractive.

Since Capstone, the mission statement has been updated to reflect the addition of the new Athleisure division.

Values (from Capstone, that are still relevant for this case)

Marmani's and Roberto's current core values and beliefs include:

- a passion for everyone remaining active and leading a healthy lifestyle.
- a high level of service, good quality and value for customers.
- innovative designs and production practices.
- ethical and environmentally sustainable operations.

While the candidate is not expected to recap KSFs or provide a detailed SWOT, they may draw upon these various elements in their Day 1 case analysis.

Financial Goals

Roberto's financial target remains at 8% to 10% annual revenue growth.

Key Success Factors (KSFs) for Apparel Industry (from Capstone, that are still relevant for this case)

In the apparel industry, once demand plateaus for current product offerings, diversification of those offerings and/or customer base is a KSF.

Other KSFs of the apparel industry include:

- launching a product line at a price appropriate for the target market.
- using technology to improve efficiency and effectiveness in the production process, which controls costs, and a multi-channel approach to sales, which increases revenues.
- creating a desirable brand in an identified "underserved" niche.
- effectively marketing and distributing products.
- continually producing new, appealing and innovative designs.
- performing market research in order to determine customer needs.

Strengths (*from Capstone, that are still relevant for this case*)

- Marmani has successfully launched two separate product lines and innovative brands.
- Marmani has a strong brand reputation and recognition within the health and wellness industry, which can lead to increased sales as customers recognize and purchase Marmani products.
- Marmani has made a strong commitment to purchasing quality materials and producing quality products, which can lead to customer loyalty and increased sales.
- There has been very low employee turnover, particularly within the management team, which demonstrates that Marmani has very loyal employees. Low turnover can lead to an increased efficiency of operations, reducing costs and increasing profit margins.

Strengths (*new info in Day 1 case*)

- The sales trend in the Adaptive division is positive. The sales manager and in-house sales staff appear to be two important aspects that allowed for the increase in sales and profit margin.
- The new COO, Alain, has six years of experience in financial and operational management and strategic planning, and in maximizing the use of technology, which should remove some pressure from Roberto (*link to Capstone*), who wishes to delegate more.
- The new Board of Directors appears strong, and should be able to provide expertise and guidance for establishing growth strategies.
- Marmani recently opened its own production facility to produce Athleisure wear, which allows it to control the quality and timing of production and distribution.
- If used properly, the most up-to-date technology (e.g., the CRM) can help generate increased sales by providing more, and better, information.

Weaknesses (*new info in Day 1 case*)

- The Athleisure sales have fallen short of projections and have a lower gross margin percentage relative to Adaptive.
- Based on employees' negative comments about Alain, Marmani's historically low employee turnover may be at risk, which could affect Marmani's culture and values.
- Marmani has been slower than its competition to adopt new digital technologies. Marmani upgraded its IT system to support a digital marketing strategy but the company might still not be reaching as many new customers as it could.
- Marmani is a mid-sized business that is attempting to compete with larger businesses as it grows; the company recently went through a large expansion and is still adjusting.
- Sonya has not yet been replaced and there are challenges with design.
- Roberto and Alain both appear to be committed to growing the sales of the smaller Athleisure division, and could therefore be losing focus on Adaptive, the main revenue generator of Marmani.

Risks (*new info in Day 1 case*)

- The world is moving at a faster pace in general, and there is a technology risk; Marmani must keep pace with digital advancements in order to compete.
- Marmani needs to manage its online brand reputation.
- To continue to expand, Marmani must continue to innovate and offer the right products at the right price.

Opportunities (*new info in Day 1 case*)

- Due to athleisure wear's popularity, Marmani can capitalize on industry growth and possibly globalize sales.
- Marmani can build on its industry reputation in health and wellness, and adaptive clothing, and encourage further growth rather than just steady sales.
- There is a mass market opportunity for Adaptive.
- There is a celebrity athlete design and supply opportunity for Athleisure.
- Marmani can build on successful implementation of the CRM in order to move into digital marketing.

Threats (*new info in Day 1 case*)

- There is increased global competition within athleisure wear, putting pressure on prices and margins.
- Large players and discounters, who tend to have more resources available to compete, are entering the market.
- If Marmani continues to neglect the Adaptive division, the company's performance may start to decline. Marmani's reputation may also be harmed by this if the company no longer produces high-quality products.

Quantitative Analysis

Simple financial statement trend analysis, comparing 2019 and 2020 projections and actual figures, show some concerning negative trends that can be identified as weaknesses within SWOT.

2020 Sales:

- Adaptive – Sales are up by 5%, which is in line with industry growth but less than the projection of 8% to 10%.
- Athleisure – Sales are less than projected (stated in case).

Gross margin percentage:

- Overall, gross margin percentage is down, from 42.8% in 2019 to 41.9% in 2020.
- Adaptive – Due to Rory managing prices and margins well since taking on the role of Adaptive’s advocate, profit margins were higher than projected.
- Athleisure – Profit margins were much lower than projected. This decline in margin should be investigated further. (Was there pressure on prices and/or was it a cost control issue?)

Expenses:

- Expenses were higher in 2020 than in 2019, but were lower than was projected for 2020.

Net income:

- Net income was a bit higher than was projected for 2019; it increased in 2020 but was lower than was projected for 2020.

Overall, financial performance was good, mostly because of Adaptive’s contribution. In its first year, Athleisure did not perform as well in terms of sales or gross margin. This needs to be investigated further; however, one main contributing factor appears to be an increase in competition, which has squeezed Athleisure margins.

Summative Assessment #2 – Analyzes the Major Issues

For Summative Assessment #2, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate completed a reasonable assessment of the major issues facing Marmani.

Unsure – The candidate attempted to complete a reasonable assessment of the major issues facing Marmani.

No – The candidate clearly did not complete a reasonable assessment of the major issues facing Marmani.

Technical Competencies

2.1.1 Evaluates entity’s governance structure (policies, processes, codes).

2.3.3 Evaluates strategic alternatives.

Enabling Competencies

2.1.1 Defines the scope of the problem.

2.1.2 Collects and verifies relevant information.

2.1.3 Performs appropriate analyses.

2.1.4 Integrates information to investigate each potentially viable solution or conclusion.

This summative assessment is based on Assessment Opportunities #2 to #6.

Assessment Opportunity #2 (Strategic Issue #1 – Adaptive mass market line)

A competent candidate will evaluate the business opportunity to co-develop and sell a mass-market, adaptive clothing line for people with physical disabilities with a highly respected physician. The candidate should quantify the potential financial benefit and qualitatively discuss the pros and cons of the option. They should recognize that there are few calculations to perform as the key measure in the case is the gross margin.

Conclusion: The candidate should consider both the quantitative and qualitative analyses when drawing conclusions and making recommendations.

Quantitative Analysis

- A gross margin of 40% is expected, which is similar to Marmani’s current products and targets.
- Year 1 – Sales of \$2 million are anticipated (a gross margin of \$800,000).
- Year 2 – Sales of \$3.5 million are anticipated (a gross margin of \$1.4 million).
- Thereafter, annual sales growth of 5% to 10% is anticipated.

This appears to provide a higher gross margin percentage relative to Athleisure’s current margin. In addition, this option also provides a greater margin than the celebrity athlete option and the Amazon option (depending upon the sales price that Marmani is able to achieve on Amazon).

The growth of 5% to 10% may be less than the desired expected rate, but there also appears to be less risk here, given that Marmani has more experience in this area and because there appears to be less competition in this segment of the industry.

Qualitative Analysis

Revenue:

- Starting to sell to the mass market, which has lower price points, could lead to many growth opportunities, and to sales not just to people with physical disabilities.
- If entry into the market is successful, this would lead to a growth in demand for Adaptive’s products.
- To be able to grow in the future, Marmani must get comfortable with new market demographics, and identify customer needs based on their buying habits.
- Adaptive’s expansion into the mass market presents Marmani with the opportunity to create a multi-channel approach to sales of adaptive clothing; this assumes that Marmani also continues to sell adaptive clothing via its current methods.
- This mass market line could also potentially be sold online, further expanding the reach and market of the Adaptive division.

Pricing and gross margin:

- To be competitive and maximize selling volumes and profits (*a Capstone KSF*), Marmani must ensure that products are launched at the appropriate prices (*a Capstone KSF*). To generate strong sales volumes, the mass retailer's price needs to be very low, so Marmani will need to watch its margins closely.
- Gross profit is a key to success in retail and will need to be closely monitored.
- Providing donations (1% of gross revenue plus \$25,000 upfront) to an organization related to people with disabilities is potentially a good source of publicity. However, this means a 1% reduction in the bottom line. It is not clear if this has been factored into the projected gross margin of 40%. In Year 1, a 1% donation of \$2 million equals \$20,000; in Year 2, it equals \$35,000.

Risks:

- As a new line, it is uncertain which products will appeal to the marketplace; however, Dr. Irving can provide these insights in order to help ensure success.
- Other retailers may not become involved as suggested.
- Growth may not be as high as expected; projections may be overly optimistic.
- These mass-produced goods may demand a level of production capacity that Marmani does not have; as a result, the company may need to outsource this function or build a new production plant. (These extra complications could make the project more costly and time consuming than originally projected.)
- Without a replacement for Sonya, there is no designer dedicated to the Adaptive division; therefore, there is the risk that Marmani will not be able to fulfill the design requirements for a mass market line.

Other:

- This option supports the mission and vision to produce innovative, adaptive clothing in order to make people's lives better.
- This option focuses on diversifying the offerings of Adaptive, which is currently outperforming Athleisure, which may mean there is less risk in this option.
- It is a business opportunity with a highly respected physician, which could draw more attention to Marmani.
- It meets the company value of having a passion for everyone remaining active and leading a healthy lifestyle.
- It meets the company value of providing good value to customers; however, the quality might be compromised in order to appeal to the mass market.
- Marmani typically targets niche markets and therefore, a mass market may not be the right fit; perhaps Marmani should target the aging population niche.

Conclusion

This option is relatively low risk, has good growth potential and good margins; overall, it looks attractive.

Assessment Opportunity #3 (Strategic Issue # 2 – Selling athleisure products on Amazon)

The candidate is expected to complete both a quantitative and qualitative assessment of whether Marmani should begin to sell athleisure products on Amazon.

Quantitatively, a competent candidate should calculate the potential financial benefit of each product being considered for Amazon (Fresh, Flow and Cool) and compare those results to the other strategic options Marmani currently has available, as well as the results of its existing product lines, focusing on the contribution margin.

Qualitatively, a competent candidate should discuss the pros and cons of this strategic option. The candidate should recognize that this option provides a significant opportunity to increase sales but that there is also a significant amount of risk, given Marmani’s lack of experience in this area and the increasing level of competition for these products on Amazon. Therefore, it is appropriate to question whether Amazon is the right channel for Marmani in the longer term.

Conclusion: The candidate should consider both the quantitative and qualitative analyses when drawing conclusions and making recommendations. They should recommend which product (Fresh, Flow or Cool) to offer for sale on Amazon.

Quantitative Analysis

Amazon Product Selection	Cost Estimate	Amazon Base Price	120% of Amazon Base Price
Fresh	\$43	\$50	\$60
Flow	\$32	\$45	\$54
Cool	\$53	\$65	\$78

	Probability of Sales in 2021 (in units)			Weighted Average
	Low	Medium	High	
	45%	35%	20%	
Fresh	12,000	15,000	20,000	14,650
Flow	19,000	20,000	21,250	19,800
Cool	18,000	22,000	27,500	21,300

Cool has the highest gross margin as well as the highest volume. Flow has the least variation in sales, which implies that it may be the least risky option.

Calculation of Sales Price Using 35% Margin

		Fresh	Flow	Cool
Sales price	100%	\$66.15	\$49.23	\$81.54
Cost of product	65%	43.00	32.00	53.00
Gross margin	35%	\$23.15	\$17.23	\$28.54
Max. price recommended – 120% of Amazon base price		\$60.00	\$54.00	\$78.00
Sales and margin, using 35%				
Expected sales (units)		14,650	19,800	21,300
Expected sales (\$)		\$969,154	\$974,769	\$1,736,769
Expected margin		\$339,204	\$341,169	\$607,869

Sales and Margin Using 120% of Amazon Base Price

	Fresh	Flow	Cool
Expected sales (units)	14,650	19,800	21,300
Expected sales price	\$60.00	\$54.00	\$78.00
Expected sales (\$)	\$879,000	\$1,069,200	\$1,661,400
Expected margin (per unit)	\$17.00	\$22.00	\$25.00
Expected margin (\$)	\$249,050	\$435,600	\$532,500
Expected margin (%)	28%	41%	32%

Observations:

- Only Flow has a price, at a 35% margin, that is less than the recommended price from Amazon, that of 120% of the base price. If Marmani is unwilling to accept a lower margin percentage, Flow should be chosen.
- Flow has the least variation in sales at the low, medium and high estimates and therefore may be the least risky.
- Flow could potentially be sold at the higher price of \$54.00, which is 120% of the base price and would provide a higher margin percentage (41%) and therefore a total contribution of \$435,600.
- Cool has the highest price and the highest sales volumes, so this option would provide the highest total contribution.
- If Marmani is willing to accept a lower margin percentage than with Flow, it should select Cool, as it provides the highest total contribution: \$532,500.

Notes:

- These calculations assume that volume does not change with a change in price, which is likely unrealistic.
- Estimates are based on the Canadian market and will likely need to be adjusted for other markets.
- As the market will be larger, the adjustment will likely be to increase sales.

Based on the estimates, selling on Amazon appears to provide significant incremental revenue. Once selling on Amazon begins, a more detailed analysis, using actual selling data, should be completed.

Other considerations:

- If there is pressure on price and profit margins, is there a risk of reducing product quality in order to be profitable?
- How far is Marmani willing to reduce the margin percentage in order to increase its sale volumes?
- Is there a risk of cannibalizing Athleisure's current sales and earning a lower margin?
- Are financing and/or capacity a constraint?

Qualitative Analysis

Revenue:

- As barriers to entry are low, this is the simplest way to sell products globally.
- This option provides an opportunity to quickly grow sales, to help meet Roberto's revenue growth targets for 2021. It also meets Alain's personal objective of increasing revenues in order to meet revenue growth targets.
- Because Amazon is in over 180 countries, it will expand Marmani's customer base.
- Assuming that Marmani wants to compete on a larger scale in the future, it must start getting comfortable with global customers, and identify customer needs based on their buying habits.
- Assuming that Marmani continues to sell using its current methods, this will create a multi-channel approach to sales of athleisure wear.
- Because Marmani has no experience in sales outside of Canada and the U.S., and as the sales figures are based on the Canadian market, there is a risk that the global market does not react in the same way.

Pricing and gross profit margin:

- Industry data suggests that global competition is from large, established brands and, as a result, profit margins are being squeezed; therefore, Marmani needs to consider whether it can compete with large companies that have more resources.
- This option will deliver incremental, positive gross profit margin.

- To generate strong sales volumes, prices need to be within 120% of the Amazon base price. As the competition increases, more price drops could occur; therefore, Marmani will need to watch prices more closely.
- Is 35% the right margin? Are the prices set correctly? Before moving forward, more work should be done to ensure that the right prices are set.
- Pricing competitively (a KSF) will be critical. There is already pressure on prices and margins as discounters enter the market. Marmani will need to consider how that affects prices and therefore margins.

Risks:

- As Roberto is conservative in his decision-making and averse to both financial and business risk, he might be uncomfortable moving in this direction. He has expressed concerns about being too aggressive. (Launching only one product is the more conservative approach that he suggests.)
- As it is a highly competitive marketplace, and Marmani does not yet have a strong brand in athleisure wear with which to compete, this is a higher risk opportunity.
- As Amazon's processes are so easy and there are few barriers to entry, there could be further increases to competition to contend with in the future.
- There is a risk that the products Marmani decides to offer on Amazon will have little demand, either because the "street luxe" trend, or Roberto's product designs, are not popular.
- There is a risk that Marmani will hurt its reputation of providing quality products if pricing and gross margin pressures require the sacrifice of quality.
- Marmani will need to determine the logistics, such as responsibility for shipping and for dealing with the complexities of exporting to other countries. Amazon has clarified that there is little support to retailers.
- The pricing estimates were provided by Alain, who is focused on growth and expansion. There is a chance that these estimates are optimistic and should be confirmed for accuracy.

Other:

- Finding cost-effective ways to expand the market for Marmani's products makes sense (a KSF is to manage costs).
- Alain and the board want to move Marmani into the digital world and this is a way to gain access to a large digital market with many potential customers.
- It is uncertain which products will appeal to the global marketplace, and no real research has been done into the most appropriate price to be charged.
- Marmani needs to ensure that it can produce enough inventory to meet what could be high demand.
- This option seems to be a big step for Marmani and Athleisure, which may take even more attention from the flagship adaptive clothing line, which is performing better and providing most of the company's current profit. Will this option provide the opportunity to make the gains required in Athleisure without taking more attention away from Adaptive?

- Marmani will need to deal with foreign jurisdictions and foreign currencies, and it has no expertise in this area.
- Is the arrangement with Amazon permanent? If Marmani so chooses, how easily can this business be moved to the company's own platform?
- Because a good feedback rating is critical to success, products must arrive on time and as specified (high quality). Karen or the designers will need to monitor this factor.
- Inconsistent customer loyalty could be a reason to launch only one item initially. Marmani could consider relying mostly on the quantitative analysis and launch Cool first (which was projected to provide the highest overall contribution to the gross margin).
- Alain suggested that Marmani take advantage of the momentum while it lasts. Does this suggest that this is a short-term channel that is better suited to short-term trends?
- There is a suggestion that product offerings need to be refreshed often. Is Marmani ready and equipped to do this?

Key points from Capstone that could be integrated:

This option would allow Marmani to meet certain KSFs of the apparel industry:

- Competitive prices for launched products will ensure that Marmani maximizes sales volumes and profits.
- If executed properly, Amazon's e-commerce platform will provide additional marketing and distribution of Marmani's product lines.
- The quick delivery of products supports the core value of providing a high level of service to customers.
- This option is in line with the current mission statement and simply expands the geographic reach for selling the company's existing products.

Conclusion

Using the sales estimates provided by Roberto, the option to sell athleisure products on Amazon could substantially increase the company's revenue. To maximize its revenue and overall gross margin, Marmani should lower its desired gross margin to 32% and select Cool. However, margins are already being squeezed. The accuracy of the unit sales estimates provided by Roberto is critical; if these sales volumes are not realized in the Amazon marketplace, price reductions may be required in order to make the products more attractive.

In the short term, this may help Marmani meet its financial targets. Longer-term opportunities could materialize as a result of learning how to compete in the global marketplace. If pursued, and as suggested by Amazon, the board will need to closely monitor financial performance, since circumstances can change quickly. Product offerings and product pricing will both need to be closely managed, and any necessary revisions to product offerings will need to occur regularly.

Roberto will need to decide whether this option fits with the company values, that of providing high quality products and exceptional customer service. It appears that it might not. Is this the right option to take when considering the best way to promote Marmani's long-term growth? Before proceeding, further discussion is required.

Assessment Opportunity #4 (Strategic Issue #3 – Celebrity partnership deal to sell athleisure wear)

The candidate is expected to complete both a quantitative and qualitative assessment of whether Marmani should partner with the celebrity athlete in order to sell more athleisure products.

Quantitatively, the candidate should recognize that the projected gross margin of the partnership, although greater than the Athleisure division's current margin, is less than the other options that are currently available to Marmani.

Qualitatively, a competent candidate will assess the celebrity proposal and discuss the risks and benefits of the deal presented. They should also recommend changes to the initial offer that will benefit, or reduce the risk to, Marmani. They should recognize that, because this option requires the design of new product lines and celebrity approval before going into production, it may take longer than the Amazon option to realize an increase in sales revenue.

Conclusion: The candidate should consider both the quantitative and qualitative analyses when drawing conclusions and making recommendations.

Quantitative Analysis

The gross profit margin of the project is projected to be 25%. This is higher than the gross profit margin of 23% currently earned on athleisure wear, but less than the expected margin of 35% on Amazon sales and the projected margin of 40% on Athleisure sales.

The celebrity athlete has guaranteed purchases of \$2 million per year for five years and a 25% gross margin of \$500,000 per year, plus a \$25,000 annual design fee.

Qualitative Analysis

Revenue:

- As sales are guaranteed, this option will help meet Marmani's revenue growth targets; however, the timing is unclear and designs must be approved by the celebrity athlete before production and sales can begin.
- This could provide a new and exciting sales channel.
- Based on the article that Roberto provided, this fits with the market trend toward more growth in men's, and "street luxe," athletic clothing.
- It would provide a guaranteed source of revenue for five years.

- It could lead to more partnership deals, with celebrities or otherwise, in which Roberto is the creative director.

Pricing and gross margin:

- If products and styles are chosen according to trends, this could be a way to build longer-term, desirable brands in niche design areas that are likely to have higher profitability (*link to Capstone*).

Risks:

- The non-compete clause could restrict Marmani's future growth.
- Roberto and the celebrity athlete might disagree on final designs. Marmani should clarify the dispute resolution process.
- Roberto expressed concern over the time this project will require, as it could limit his time spent on creating designs of other products. Further, if this project becomes time consuming, the Adaptive division might not get the attention that it needs.
- The proposed deal has strict stipulations that must be met, particularly around supply. There is a risk that Marmani cannot fill the orders.
- The items will bear the celebrity athlete's and Marmani's names. This celebrity athlete might not be the right fit for Marmani. Perhaps Marmani should seek out a more appropriate individual to endorse Marmani's products. Given the rumours of his behaviour, there might be a reputational risk through association with this celebrity. Perhaps Marmani is better off not having its name on the products; this could be a point to negotiate.

Other:

- This option meets Roberto's personal desire to design products for men and to focus more on the design process.
- The co-design arrangement could be challenging for Roberto, given that he likes to control most decisions (from Capstone); the loss of full creative control might not appeal to Roberto.

Key points from Capstone that could be integrated:

- A KSF is to diversify the company's sources of revenue and indirect product offerings, that of designing new, different products for others to sell; this option would help achieve this.
- A trend (noted by Roberto in Day 1) that this option meets is diversification of the customer base into the men's apparel business.
- Because of the co-design arrangement and potential loss of control over the entire creative design process, the value proposition that products be attractive and have optimal functionality may be in question.
- The core value of providing quality and customer value is likely met by this option.
- The core value of having ethical operations might not be met by this option.

Conclusion

This proposal could be appealing as it will likely increase profits by a minimum of \$525,000 (25% of \$2 million gross margin plus \$25,000 design fee) per year for the next five years, which helps Marmani meet its financial targets, and provides a guaranteed source of revenue. As Marmani must manage its reputational risk, the identity of the celebrity athlete will need to be disclosed before any deal is completed.

Should the board investigate other celebrity partnership opportunities in the future, they will need to be closely reviewed, to determine whether they fit with Marmani's mission, vision and core values.

Before pursuing this proposal, it is key to:

- learn the name of the celebrity athlete and investigate whether he would fit with the company's brand.
- get additional details on the non-compete clause, to avoid limiting future growth in Marmani's own brands.
- ensure that design time is not unlimited and there is a mechanism for resolving any disputes. (Given that the celebrity athlete is known to be temperamental and a perfectionist, this is especially important.)
- ensure that the promised sales and margin are included in the contract.

Assessment Opportunity #5 (Strategic Issue # 4 – Finance decision)

A competent candidate should assess the alternatives of either converting Ray's debt to equity or refinancing with Hurley Bank, considering both quantitative and qualitative factors, such as the impact on the strategic objectives and fit with mission/vision and KSFs. Taking expansion plans into consideration, the candidate should consider which option is the best strategic fit.

Note: As it affects the equity/ownership of Marmani, this issue could be addressed to Roberto separately. It was important to focus on the strategic consequences of the options, and not simply on the pros and cons of the financial decision.

Quantitative Analysis

- As at June 30, 2021, the required repayment date, the balance on Ray's loan is \$7.7 million. The \$10 million financing available is therefore more than sufficient.
- Marmani must compare Ray's interest rate (4%) to Hurley's interest rate (prime + 2%).
- Valuations from Capstone 1 can be compared to the current outstanding loan balance to determine whether converting the outstanding loan balance to equity is a reasonable offer (which it is not, given that the valuations are dated).
- If debt is converted to common shares, Marmani should consider the dollar value of the dividends that may need to be issued to Ray. As no dividends have been paid previously, the amount might be zero.

- Roberto needs to consider the cost involved in sharing the future growth of Marmani's value.

Qualitative Analysis

- Roberto is conservative by nature (as clearly demonstrated in Capstone), and bank debt with a variable interest rate is not in line with his nature.
- As debt would incur interest, adequate cash flow is needed to pay both the interest and principal components of the loan. (However, Marmani appears to be fully capable of doing so.)
- Because of Adaptive's success, Marmani currently has the cash needed to finance the business.
- If Ray's debt is refinanced, this may limit borrowing capacity for future expansion options.
- If the Amazon option is pursued, Marmani will likely need funds to expand; however, rapid turnover could potentially self-finance the large volume of product required.
- Financing needs will be dependant on how Marmani chooses to expand.
- Offering shares to Ray will result in a major change in ownership. Roberto currently owns 100% of the shares and has the final word on all decisions.
- Ray will have voting power, which could impact decisions made, especially regarding Marmani's mission, vision, goals and strategic focus. Roberto would most likely want to retain full control of the business.
- Roberto does not need to make this decision alone; he can seek the advice of Marmani's board.
- Perhaps Marmani should make counter-offers to Ray and Hurley Bank, to ensure that these are the best terms that each party is willing to offer.
- If Ray's loan is converted to equity, he will be entitled to share in Marmani's future growth. This amount could be significant, and therefore, the true cost of converting this debt to equity is impossible to know at this point.

Conclusion

Sufficient financing can be obtained to repay Ray through the available Hurley Bank loan. The maximum loan from Hurley Bank is \$10 million and the loan balance is \$7.7 million. I recommend that Ray be repaid. Roberto is used to being the sole shareholder and there is no indication that he would like to change this. Marmani is doing well financially and there does not appear to be excessive risk associated with the bank financing.

Concluding that Ray's debt should be converted is an acceptable alternative, provided that it is supported.

Assessment Opportunity# 6 – (Strategic Issue #5 – Governance issues)

A competent candidate is expected to recognize the developing HR issue concerning Alain as a disruptor with his digital ideas and suggestion of firing Karen, and from comments made by the managers. They are also expected to recognize that Marmani's aggressive growth targets may result in the company's straying from its core values. The candidate is also expected to identify, and comment on, Marmani's apparent shift in focus toward the Athleisure division, even though the Adaptive division is the company's main revenue generator. They could also offer suggestions for dealing with the apparent discontent of the employees.

Note: This issue is more appropriate to address with Roberto rather than with Alain.

HR Issues

Alain, the new COO, is critical of actions that Roberto and others have taken, and seems to have left a negative impression on the company's managers and employees. As his management style is different from Roberto's, Alain's approach appears to conflict with the company's existing corporate culture; however, if these issues go unresolved, Marmani's culture may change for the worse as employees become further embittered. When Roberto controlled the decisions, employees had no voice, and they continue to be unheard under Alain's management, who has his own vision and does not appear interested in others' ideas.

Roberto has delegated authority to Alain but appears to be having difficulty accepting Alain's more aggressive recommendations. Alain's suggestions are mostly technological, which is an area that Roberto is already uncomfortable with (CRM in Capstone, etc.). Roberto feels that Alain is too quick to suggest replacing Karen.

Alain appears to offer some value to Marmani; however, he also appears to be a disruptor. If left unchecked, his actions could have a negative, long-term impact. For example, according to one manager, Alain appears to favour cost-cutting measures above all else; if this is true and if Alain gets his way, Marmani's products may start to deteriorate in quality. This could lead to further issues.

Alain also appears to be overlooking the Adaptive division's contributions to Marmani in terms of sales growth and consistent profit, and as the main products behind the Marmani brand. Alain may be pushing for even less focus being put on Adaptive in favour of the currently underperforming Athleisure division, which may jeopardize the performance of the adaptive product line, and ultimately the company. In addition, since Roberto is focused on athleisure wear designs, and Sonya left and has not been replaced as the Adaptive division's designer, there is a growing risk that the Adaptive division will begin to suffer from this lack of focus.

Governance Issues

I suggest that Marmani make use of the expertise of the new board.

In addition, the declining employee morale increases the risk of losing employees and needs to be addressed. Employees seem to be upset regarding Alain's new approach, as well as their current compensation levels. To ensure that employee morale does not continue to decline, Roberto should address the conflict that some managers currently have with Alain.

Alain's leadership and management of Marmani's employees needs to improve. To encourage success in Karen's evolving role, she needs to be trained and coached by Alain. If this training does not produce an improvement in her performance, she will need to be replaced with a more digitally knowledgeable employee.

As Roberto's and Alain's roles evolve, Marmani must determine how organizational decision-making will change. It will be important to convey to Alain that the company was built on a strong core mission and strong values, which has resulted in the success of the Adaptive division. It is also important that Alain understands that the Adaptive division is responsible for most of the company's current profitability, both in gross margins and volume of revenue. It is very important that Marmani hire a new design manager for the Adaptive division and ensure that the division is not overlooked, as it could be a strong contributor to the growth targets that have been set.

To balance the aggressiveness of Marmani's growth targets, Marmani should consider changing its approach to risk management. Given the industry average of 4% annual growth, perhaps 8% is too aggressive. A target of 4% for Adaptive, and a higher target for Athleisure, is probably more realistic.

Summative Assessment # 3 (Conclude and Advise)

For Summative Assessment #3, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate provided reasonable conclusions for each major issue.

Unsure – The candidate attempted to provide reasonable conclusions for each major issue.

No – The candidate clearly did not provide reasonable conclusions for each major issue.

Enabling Competencies

2.1.4 Integrates information to investigate each potentially viable solution or conclusion.

2.1.5 Recommends and justifies a solution or conclusion based on an integrative view of information for the situation.

A competent candidate will provide logical conclusions that are consistent with their analysis. It is essential for them to recognize the need to maintain the Adaptive clothing line, as it is a stable source of cash flow and revenue. The candidate should also explore ways to grow Athleisure while assessing the overall risks and benefits.

A competent candidate will conclude the following:

- *AO2 Adaptive mass market line – yes (unless they present a good reason not to).*
- *AO3 Selling on Amazon – yes or no (likely yes, given the low cost of entry and the potential for high growth).*
- *AO4 Celebrity athlete partnership – likely no, given the risk to Marmani’s reputation.*
- *AO5 Refinancing option – likely refinance with Hurley Bank, given the apparently high value of Marmani relative to the outstanding value of Ray’s loan.*
- *AO6 Governance issues – the candidate should conclude that these issues need to be addressed and resolved, to ensure the long-term health of the company.*

Conclusion

Marmani has a difficult strategic decision to make. The current focus appears to be on Athleisure. Given that Marmani’s financial success, including the majority of the company’s revenue and cash flow, is being provided by Adaptive, this appears risky. It is also contrary to Roberto’s low risk tolerance.

There are arguments both for and against each strategic alternative presented. Each of the options presented is viable on its own. However, understanding the importance of Adaptive is key to maintaining Marmani’s overall financial success. In reaching a conclusion, the goals and objectives of the key stakeholders should be considered.

Although new, the board members have valuable expertise and should be listened to—by both Roberto and Alain. The board members are providing Roberto and his team with objective advice and support, which should be used to establish a prudent strategic direction and help address risk management issues. For example, they support a digital transformation in order to stay competitive.

Recommendations

I recommend that more attention be paid to Adaptive. More than just providing steady cash flow, it has growth potential, and efforts should be made to grow what was—and still is—a core part of the business. Adaptive is a key part of fulfilling Marmani’s mission and vision. There is no information to indicate that adaptive clothing is coming to the end of its life cycle. In fact, there is evidence of further growth potential. Revenues have been stable and there are indications that they could grow. Marmani should not jeopardize its strong brand reputation and recognition within the health and wellness industry. Marmani should continue to sell to its existing customer base for adaptive clothing. To ensure the overall success of Marmani, more attention and resources should be directed to this area. If executed effectively, it is likely that Adaptive’s performance will improve. It is also likely that Marmani could create a wider market for Adaptive’s products, which could help Marmani meet its aggressive growth targets.

The quantitative analysis of each strategic option available indicates that positive incremental gross profit is likely from each option.

Comparison of Gross Margins

	<u>Year 1</u>	
Adaptive mass market line (40%)	<u>\$ 800,000</u>	5% growth predicted
Selling on Amazon		
Flow (35%)	<u>\$ 341,169</u>	
or		
Cool (32%)	<u>\$ 532,500</u>	with lower margin and maximum profit
Celebrity athlete partnership (25%)	\$ 500,000	
Design fee	<u>25,000</u>	
	<u>\$ 525,000</u>	

The quantitative analysis, on its own, does not provide enough differentiation between pursuing the Amazon or celebrity athlete partnership options. Depending on which line is selected, the margins could be in the same \$500,000 range. Whereas the sales and margin for the celebrity deal are guaranteed, an assumption needs to be made about how much incremental growth is available with Amazon sales over the next five years. Product innovation that will continue to satisfy Amazon customers will be a key to generating annual revenue and gross margins. Product innovation will also be important for the celebrity athlete partnership but less so than for the Amazon sales.

Assuming that Marmani is confident it can effectively compete on Amazon, while still providing a high-quality product, I recommend pursuing the Amazon option. This strategy is a good way to gain experience with global sales and potentially grow sales quickly. However, Marmani must be cautious with this new endeavour, given the high level of competition and the inconsistent loyalty of the customers who shop online.

Given the apparent erratic behavior of the celebrity athlete, as well as the currently unfavourable terms contained in the partnership proposal, I do not recommend proceeding with the celebrity athlete partnership option. Marmani may be able to renegotiate the terms of the proposal in order to make it less restrictive for Marmani but there is no control for the risk that the celebrity's behavior could harm Marmani's reputation.

I recommend obtaining financing from Hurley Bank and repaying Ray rather than converting his debt to equity. This will allow Roberto to continue to have full control of Marmani and to benefit from 100% of its future increases in value.

Marmani needs to address the conflicts that are developing within the management team as a result of hiring Alain as the new COO.

Roberto and the board should review Marmani's goals and objectives because, unless Marmani takes on additional risks, the stated goal of 8% to 10% growth is likely unrealistic.

Summative Assessment #4 (Communication Hurdle)

For Summative Assessment #4, the candidate must be assessed for reasonableness of attempt:

Yes – The candidate adequately communicated their response.

No – The candidate did not adequately communicate their response.

Insufficient communication in a candidate's response would generally include some of the following:

- *The reader needs to re-read sections several times in order to gain an understanding.*
- *It is not clear what point the candidate is trying to make.*
- *The quantitative analysis does not make sense because of illogical ordering or a lack of labelling or formatting.*
- *There is an excessive amount of spelling and grammatical errors.*
- *The language used is unprofessional.*

Summative Assessment #5 (Overall Assessment)

For Summative Assessment #5, the candidate must be assessed in one of the following, based on their overall performance:

Clear Pass – Overall, the candidate provided an adequate response, clearly meeting the minimum standards for each of the summative assessments above.

Marginal Pass – Overall, the candidate provided an adequate response, with some errors or areas of omission, but including the underlying key concepts.

Marginal Fail – Overall, the candidate provided an attempt at a response, with several errors or an incomplete analysis.

Clear Fail – Overall, the candidate did not provide an adequate response because the response was deficient in multiple areas.

To be assessed a Pass, the candidate is expected to perform adequately in all the summative assessments, and demonstrate that they addressed the issues of importance in a cohesive and professional manner.

In making their overall assessment, markers consider the following:

- 1. Did the candidate step back and see the bigger picture, and then address the broader issues identified?*
- 2. Did the candidate prioritize the issues by discussing the major and minor issues in appropriate depth?*
- 3. Did the candidate use both quantitative (when available) and qualitative information to support their discussions and conclusions?*
- 4. Did the candidate use the appropriate tools to perform quantitative analysis?*
- 5. Did the candidate use sufficient case facts (Day 1 and Capstone 1 case) about the external and internal environment to support their discussions?*
- 6. Did the candidate communicate their ideas clearly, integrating and synthesizing the information?*

SAMPLE RESPONSE – MARMANI VERSION

Below is an actual passing candidate response.

Situational Analysis

Vision

Our vision is to become a leader in adaptive and the athleisure industry by selling products that perform beyond expectation and helps improve people's lives.

Mission

We accomplish our vision by selling and designing technical clothing that performs as promised.

Core Values

- Passion for healthy and active lifestyles
- High Quality, High service and value to customers
- Ethical and environmentally sustainable operations
- Innovative design and manufacturing practices

KSF

- Multiple sources of revenue
- Creating a brand in an underserved niche
- Control over supply chain, enabling control of cost and quality of inputs
- Employing an experienced and versatile labor force that is adaptable to changes in manufacturing processes.
- Multi-channel approach
- Effective marketing and sales distribution
- Getting customers involved and researching their needs
- Constant innovation
- Using technology to improve efficiency and effectiveness in manufacturing process
- Transparency in supply chain
- Demonstrating corporate social responsibility, environmental stewardship and charitable giving.
- Having High quality products

SWOT

Strengths

- Adaptive divisions gross margins are higher than expected
- Strong reputation within health and wellness industry
- Increase in sales volumes, from strong sales team.
- Adaptive division is providing steady cash flow.

Weaknesses

- Lower than expected margins on Athleisure division
- Sonya the design manager has not been replaced. Resulting in less innovative designs for the adaptive division.
- Roberto's focus is on the athleisure division, which may result in there being less oversight on the adaptive division.
- Management lacks focus on all product lines. (Specifically Adaptive)
- Management's disagreement between direction of company.

Opportunities

- The athleisure division is demanding the latest fashion trends.
- The population is aging, and the athleisure division is growing with it.
- Increase sales through online selling like amazon.
- Selling through amazon will allow marmani to reach a wider audience. (180 countries)
- Frequently refreshing products available to maintain sales.
- Use of social media and data analytics to help drive more sales.
- High Fashion clothing

Threats

- Global competition from large athleisure brands , forcing prices to decline as discounters join the competition
- Highly competitive industry, which forces marmani to keep up with the latest fashion trends , putting pressure on pricing and margins
- Amazon may partner with Nike to produce its own athleisure wear label.

Quantitative analysis:

- Adaptive division's sales remain strong and steady
- Weaker margins on athleisure division
- Steady year over year margins. (Above 40%)

Financial targets

- 8 to 10% annual growth rate

Bank Covenant

- Min return on assets

To: The Board of directors

From: CPA

Strategic issues

Refinancing option

Ray he requested that he wants to convert his debt to equity and become an active shareholder and board member. Ray wants at least one of third of the common shares after conversion. I have completed an analysis on whether we should accept his proposal or repay the balance of his loan by end of June.

Quantitative Analysis

As seen in exhibit 1, the annual repayment would be \$1,260,683, if marmani was to refinance 10 million to repay Ray. This is based on a 10 year term, and the payment includes principal and interest. In this calculation I made the assumption that the current prime rate is 2.45% and that the rate would have been 4.45% (2+2.45%). In order to have this loan Marmani will need to submit audited financial statements, have a personal guarantee from Roberto and also maintain the same covenant where a min return on assets is required. The Fair market value of Marmani has not be evaluated, so the value of 1/3 of the company being issued to Ray has not been quantified.

Qualitative analysis:

I have completed a qualitative analysis for repaying Ray.

Pros

- By repaying Ray, there will be no change in the company's ownership. This will allow marmani to continue to operate with the same strategic direction and allow marmani to not have any changes in its management. It is a key success factor, to employ experienced and versatile employees, which Marmani has maintained over the years.
- Marmani's adaptive apparel line continues to have strong and steady cash flow. As mentioned in the situational analysis, the strong and steady cash flow from the adaptive apparel line can help pay for this repayment.
- Will clear the debt owed to Ray.

Cons

- This annual payment will have a significant impact on Marmani's cash flow.
- By repaying Ray, and not offering him a position on the board, does not help improve the weaknesses that were indicated in the situational analysis. Marmani is not focused on the adaptive apparel industry, having an additional board member who can provide oversight on this division, would be beneficial for the growth of marmani.
- Additional work required, as Marmani will need to provide audited financial statements.
- Roberto will also need to provide a personal guarantee.

I have completed a qualitative analysis for switching Ray's debt to equity.

Pros

- Ray would bring his business acumen to the board and help Marmani focus on the adaptive division. As indicated earlier, Marmani's weakness is that there isn't much focus on the adaptive division. Having Ray who has seen Marmani grow with the adaptive division, would help improve oversight and direction.
- No annual payments, allowing Management to focus on growing both the adaptive and athleisure division. Seeing as there is an opportunity to improve athleisure sales by keeping up with fashion trends, this free cash flow can be used to design new fashionable products which in turn would improve profitability.

Cons

- Ray would have a significant amount of control. Where he could influence the direction and the structure of the organization. As mentioned before Marmanis key success factor is having an experienced and versatile workforce, any changes to the team could impact Marmanis ability to operate successfully.
- Ray may have conflicting views of how the organization is ran. This can impact the decisions that are made at marmani.

Recommendation:

As seen in exhibit 1, the annual repayment to refinance rays loan would be \$1,260,683. As seen in the situational analysis, Marmani has strong and steady cash flows from the adaptive line which can support this annual payment. By repaying Ray, it ensures that Roberto continues to have full ownership of the company. This will allow Roberto to continue to employ the same experienced workforce. (A KSF in this industry) and will also allow Marmani to continue to operate in the same strategic direction. However as mentioned, one of marmani's weaknesses is that management is not focused on all of the product lines, and that the adaptive clothing line seems to be neglected especially now that Sonya has left. I recommend that Marmani repays the loan to Ray, as Ray may bring in more oversight, but may also disrupt the organizational direction and structure, which is a key success factor. (Employing an experienced and versatile labor force) However Marmani does need more oversight on all of its products, especially the adaptive division. Seeing as Ray has a strong business background and has seen marmani grow through the adaptive division, offering Ray a position on the board can help Marmani refocus on the adaptive apparel division.

Adaptive Mass Market line

Dr. Irving is a highly prominent doctor, who has provided marmani will a proposal for an adaptive mass market line. This product will be a lower price point, product that will focus on fitness wear and is designed for people with disabilities. I have completed an analysis of this opportunity below.

Quantitative analysis

As seen I exhibit 2, this opportunity is extremely profitable. Using a discount rate of 4.45%, I have calculated a positive NPV of \$2.4M. It should be noted that in this analysis I have only used a 3 year timeline. If we extend the time line to 5 years with a growth rate of 5% per year (Using the lower and conservative number provided to us) we should still have a positive NPV. Additional scrutiny of the numbers is recommended to ensure that all costs are identified and accurate. We need to consider the qualitative factors.

Key assumptions

- Borrowing rate of 4.45% was used as discount rate, as the WACC is not available.
- 3 year time line is used as there were estimated sales growth provided to us by Dr. Irving.
- 5% growth in year 3 is used, as it is the lower and conservative growth figure.
- 40% Margins will be maintained every year.

Qualitative

Pros

- The lower price point product will help increase the audience Marmani is currently facing. It will also help customers lives improve which is aligned with the company vision and core value which is to offer a product that improves lives and to have a passion for healthy and active lifestyles.
- There is significant growth opportunity in the adaptive apparel industry, due to the aging population, by offering this lower priced product, we would be able to take advantage of this opportunity.
- Multiple sources of revenue if a key success factor. This will allow Marmani to increase profitability by offering more diversified products.
- There is an option to produce these in-house as there is excess capacity. Having the ability to create this in house will allow Marmani to have control over the supply chain, enabling control of costs and quality of inputs. (KSF for the industry)
- By producing in house, Marmani can be sure that the products quality is still being maintained, which is a KSF.
- The donations are aligned with the KSF, demonstrating corporate social responsibility and charitable giving.
- This will help drive growth, which is targeted for 8% to 10%

Cons

- If this product is outsourced marmani will lose the ability to have control over the supply chain, which is a key success factor.
- The lower priced product may not be aligned with the Marmani brand, it may give the perception that the quality of the product has decreased. It is a key success factor for Marmani to sell high quality goods, and the perception of quality is key for the reputation and the success of the company.

- This product seems to not have a clear line between adaptive and athleisure, this can create operational confusion at marmani.
- This is an athleisure product that is marketed to adaptive apparel customers. Marmani needs to ensure that the technology is performed as promised, which is part of the mission statement. This product may give the image that there is a technical promise, when it simply is just an athleisure product marketed as an adaptive apparel.

Recommendation:

As previously mentioned additional scrutiny is required to ensure that all costs are identified and accurate. Assuming that the information provided to us is accurate, financially this opportunity makes sense. This product will reach a much wider audience, and will help Marmani gain an additional revenue stream, and also help improve the lives of the people wearing it. By selling this product marmani also gets to demonstrate charitable giving which is a value to the target demographic. As mentioned before this product seems to be more of an athleisure product but is designed for adaptive customers. There is a risk that the customer may believe that this product is supposed to make their lives easier, when in reality those facts may be limited as it is just another athleisure product. This confusion can damage the marmani brand. I recommend that marmani goes forward with this product, as it is another source or revenue, and that the product itself should be marketed more as an athleisure fitness product than an adaptive apparel product. This will help mitigate any risk where customers may feel that the clothing does not have any technical feasibility for someone who may have physical disabilities.

Selling on Amazon

I have completed an analysis on the three summer collections and have identified the product and the price point of the product we should sell on Amazon.

Quantitative

As seen in exhibit 3, only one product would have a min margin of 35% after increasing the selling price by the maximum of 120% as recommended by Amazon. This is the Flow product. The flow product should be priced at \$54 a unit. Which would have a 41% margin after the price increase. The total Margin for the year, assuming that the projected sales volumes are met would be 435k.

Key Assumptions

Roberto's sales figures are reasonable.

Amazon analytics are correct about setting prices at 120% above amazons base price.

Qualitative

Pros

- This is taking advantage of the opportunity to sell High fashioned clothing.
- This opportunity allows marmani to have an additional product line. Which is aligned with the KSF, multiple sources of revenue.
- This distribution channel will help reach over 180 countries. This is KSF, Mutli channel approach.
- Uses Amazon, a technology to help improve its sales distribution. (KSF for the industry)

- This will help achieve the targeted annual growth of 8 to 10%

Cons

- High fashion, is something management does not have much experience in. Management's time would be constrained on this product. As mentioned in the situational analysis, Marmani already suffers from management's lack of oversight on the adaptive product line.
- High Fashion does not offer any technical promises or improves people's lives, or promotes a healthy and active lifestyle. This is not aligned with the company's mission and vision. This product line may also lack clear strategic direction from the board.

Recommendation:

Adding high fashion will help take advantage of the trend for high fashion. This will help marmani add another product to their diverse product line. This is a KSF for marmani. By selling on Amazon, Marmani also gets to take advantage of this sales channel which is also another KSF for Marmani. However it should be noted that High fashion is not aligned with any of the mission or vision statements. It should also be noted that Management's focus has been on athleisure and other product lines such as adaptive have been neglected. This product will help improve profits and also help take advantage of this great sales channel. I recommend that Marmani goes forward with selling the flow collection line, at \$54 per unit. This will ensure margins of at least 35% as suggested by Alain. I also recommend that Marmani goes forward with this opportunity and hires more management to help focus on this product line, and not distract management from the adaptive and athleisure product line.

Celebrity Athlete partnership Proposal

I have completed an analysis on the partnership proposal below.

Quantitative

As seen in exhibit 4, based on the numbers provided to us by the lawyer, annual profits would be 375k. In addition Robert would be paid 25k every year. I have not considered Roberto's payment as income to Marmani. Additional scrutiny of these numbers are required in order to ensure that all costs have been identified and costs are accurate.

Key assumptions

- 25% Margin
- 2M in annual sales
- 5 year time line
- No additional costs from redesigning, accommodating production and delivery schedule.

Qualitative

Pros

- This product would be aligned with the high fashion product line that was previously recommended, which takes advantage for the growing opportunity in the high fashion industry.

- It uses high quality products, which is a KSF for marmani
- Marmani would be producing the product which is aligned with the KSF, Controlling the supply chain enabling control of costs and quality of inputs.
- This sales growth would help marmani reach the 8 to 10% annual growth target.

Cons

- The ownership of all designs are retained by the celebrity. Marmani has always had full ownership of all of its designs.
- The athlete is unpredictable and prone to outbursts of anger. This can damage Marmani's reputation.
- Design revisions will continue until the athlete is satisfied. This will take up a lot of management's time, which is currently already being divided by athleisure and the adaptive division.
- Marmani's margins have been relatively consistent at 40%, this product only has a 25% margin.

Recommendation:

In this analysis we can only see that marmani is expected to make \$375k a year. This will help Marmani reach the targeted sales growth of 8 to 10%, however the margins are at 25% which is lower than the 40% gross margin % Marmani had in 2020. We can see that in this arrangement Marmani will be producing the product in house, which is a KSF, control over the supply chain, enabling costs and quality of inputs. It is able to sell a high quality product and increase its multiple sources of revenue.

However as mentioned this celebrity's actions and opinions may affect marmani reputation. Also the celebrity has many conditions setup on the agreement that are unfavorable to Marmani. Marmani has no rights or ownership to the designs, has to keep changing designs as asked and has to guarantee and accommodate changes in production and delivery schedules. Marmani's management is already too focused on athleisure and neglecting the adaptive division, this would make management lose even more focus on the key products. I do not recommend going forward with this proposal, as it distracts management, the 25% margin would be even lower after considering all the additional costs for redesigning and accommodating changes in the production and delivery schedule. Marmani would also be faced with reputational risk as well as additional strain on management, if this option was proceeded with.

Operational issues

Lack of focus on Adaptive apparel

Roberto's focus seems to be strictly on the athleisure division. As Rory has pointed out, demand for the fashionable adaptive clothing remains strong. With Sonya leaving the company and no one replacing her the adaptive appeal line has been neglected. As it is a KSF for constant innovation, it would make sense for marmani to hire a new design manager so that they can continue to produce products in this product line that has high margins and continues to be a steady stream of income to Marmani.

Differentiating between adaptive and athleisure

As noted in my analysis of the adaptive wear mass market proposal, there does not seem to be a clear understanding of the difference between athleisure and the apparel industry. This has resulted in confusion with management, and may also lead customers to be confused with the value proposition the product has. I recommend that there are clear guidelines created, to ensure that the two product lines are differentiated. This will help with strategic planning of the products and also ensure Marmani's strong reputation in health and wellness is maintained.

Alain Pepin

Alain has joined the company and is involved around many aspects of the company. His focus has been revenue growth at all costs. He has impacted the positive corporate culture of marmani. As seen in many of the proposals, Alain is focused on increasing sales but does not consider how these products are aligned with marmani's vision and core values. Alain has also openly mentioned that Karen should be replaced in a board meeting. This is rather unprofessional and should not have been done. Alain's behavior towards employees, have negatively impacted morale. I recommend that Alain reviews the vision, mission and core values of Marmani, and has a discussion about this behavior with other employees. Alain should also consider the impact of cost cutting measures, as having a high quality products is a KSF for Marmani.

CRM

It appears that the CRM Data Karen is providing is not being used by management. Karen should spend time refocusing the data into meaningful information. That way the information can actually be used to help improve operational efficiencies. Using technology to help improve efficiency and effectiveness in the manufacturing process is a KSF for Marmani.

Summary

Marmani has successfully expanded into the athleisure brand. I have provided a summary of all the strategic options below.

Refinancing for Ray

I recommend that we refinance the loan to Ray. Marmani has sufficient cash flows coming from the adaptive appeal line to pay for this. This will ensure that Roberto retains complete ownership, and that no management or employee is effective by Ray taking over the company. Which is a KSF,

employing an experienced workforce. However offering Ray a position on the board, may help with more oversight on the adaptive division.

Adaptive Mass market line

Assuming that additional scrutiny of the numbers have been done, I recommend that we go forward with this option, as it allows the products to reach a wider audience, and also is another source of revenue to Marmani. (KSF). It also allows marmani to demonstrate charitable giving, As Mentioned in my analysis, this product needs to be explicitly marketed as an athleisure product, to ensure that customers are not promised false value propositions.

Selling on amazon

I recommend that we go forward with the opportunity to sell on amazon. As mentioned before we should hire more management to help oversee this high fashion product line, as management's attention has been lost in the athleisure division. This is a great way to expand into another sales channel, which is a KSF.

Celebrity proposal

I do not recommend going forward with this opportunity as the margins are at 25%, before considering additional costs for redesigning, and accommodating production and delivery schedules, it also has a lot of reputational risk and attention that is required from management. As management is already not focused on all the product lines, I do not recommend going forward with this.

Other operational issues

Lastly, I wanted to point out that Management has been focused on the athleisure line which has resulted in the adaptive apparel line being neglected. As it is a key success factor to constantly innovate, a new design manager should be hired immediately. Additional management figures would also help improve oversight of the company as a whole. Additional board members such a Ray could help oversee the adaptive apparel division, which is a driving division for marmarnis success.

It also appears that again as COO as failed to help keep the strategic direction of marmani inline. I recommend that Alain Reviews the mission, vision and core values of marmani, and not focus strictly on increasing revenue, and it has created a strain on management to focus on the top line. Alain should also not speak to employees in a negative way as it has impacted morale.

The CRM data that is being shared does not seem to be used properly. I suggest Karen consolidate the data into more meaningful points to help improve strategic operations, as using technology to help improve efficiency and effectiveness is a KSF for Marmani.

Through these recommendations, I see Marmani continuing to grow and expand into an even more profitable company

Exhibit 1
 Amount of loan 10,000,000
 Term 10
 Rate 4.45%
 Annual Payment 1,260,683.22

*Rate is 2 plus prime. Assuming prime rate is around 2.45%

Annual payments would be 1,260,683 a year. If Marmani chooses to refinance rays loan.

Exhibit 2

	Year 0	Year 1	Year 2	Year 3
Sales		2,000,000	3,500,000	3,675,000.00
COST		(1,200,000.0)	(2,100,000.0)	(2,205,000.0)
GM		800,000.0	1,400,000.0	1,470,000.0
1% Donation		(20,000.00)	(35,000.00)	(36,750.00)
Net Income		780,000.00	1,365,000.00	1,433,250.00
Income Tax		(195,000)	(341,250)	(358,313)
Net Income after tax		585,000	1,023,750	1,074,938
Discount Rate (4.45%)		0.957395883	0.916606877	0.877555651
PV		560,076.59	938,376.29	943,317.48

Initial Donation (25,000.00)

NPV 2,416,770.36

This is profitable venture. I have completed a NPV calculation using a discount rate of 4.45% the assumed borrowing rate. As no WACC was provided.

Key Assumptions

Discount rate at 4.45%, as no wacc was provided

The timeline is only 3 years, with more years the NPV would be even more positive

Assumption that 40% margins will be achieved every year.

Exhibit 3

Collection	weighted average sales	Cost	Amazon Base price	Margin%	Selling price at 120% of ama	Margin% after
Fresh	14,650	43	50	0.14	60	28%
flow	19,800	32	45	0.29	54	41%
Cool	21,300	53	65	0.18	78	32%

The Flow would have a min Margin % of 35 percent after a 120% price increase from the amazon base price.

Total Revenue 1,069,200
 Total Margin 435,600
 Total Margin would be 435.6K

Exhibit 4

	1	2	3	4	5
Year	Year	Year	Year	Year	Year
Sales	2,000,000	2,000,000	2,000,000	2,000,000	2,000,000
GM	500,000	500,000	500,000	500,000	500,000
Tax	(125,000)	(125,000)	(125,000)	(125,000)	(125,000)
After Tax Income	375,000	375,000	375,000	375,000	375,000

Annual net income would be 375k

APPENDIX G

**RESULTS BY SUMMATIVE ASSESSMENT OPPORTUNITY FOR
DAY 1 VERSION 1 AND VERSION 2**

Results by Summative Assessment Opportunity

Marking Results – MARMANI Version 1

Indicator	Papers (normal population)	Did not meet standard¹	Marginal¹	Yes, met standard
Situational Analysis	5770	.26	1.09	98.65
Analysis	5770	1.06	16.24	82.70
Conclude and Advise	5770	1.42	16.93	81.65
Communication	5770	0.12		99.88

Marking Results – MARMANI Version 2

Indicator	Papers	Did not meet standard¹	Marginal¹	Yes, met standard
Situational Analysis	1092	1.37	7.05	91.58
Analysis	1092	10.44	60.07	29.49
Conclude and Advise	1092	7.23	19.41	73.35
Communication	1092	0.0		99.45

¹Clearly failing were marked twice. All marginally failing or marginally passing papers were marked a second time to determine which ones met the passing standard. The clear passes were marked only once, however, they were audited.

APPENDIX H

**BOARD OF EXAMINERS' COMMENTS ON DAY 1 SIMULATION
VERSION 1 AND VERSION 2**

**BOARD OF EXAMINERS' COMMENTS ON DAY 1
(MARMANI VERSION 1 AND MARMANI VERSION 2)**

Paper/Simulation: Day 1 – Linked Case, MARMANI Version 1
(on Sept 2019 CFE)

Estimated time to complete: 240 minutes

Simulation difficulty: Average

Competency Map coverage: N/A; Enabling Skills

Examiners' comments by Summative Assessment Opportunity (SO)

SO#1 (Situational Analysis)

Candidates were expected to highlight the internal factors, such as the change in Marmani's mission and vision, and external factors, such as industry trends, that would influence both Marmani's strategic direction and the decisions that Marmani was considering. Any significant changes that had taken place since Capstone 1 should have been noted. In the simulation, Roberto emphasizes the importance of having a coherent strategy; given that Marmani has entered into the Athleisure market since Capstone 1, a strong situational analysis provided a balanced and integrated discussion that considered both the Athleisure and the Adaptive division. Candidates were rewarded when they made links to the situational analysis within their analysis in SO#2, and within their conclusions in SO#3.

Strong candidates made links within their analysis back to Marmani's revised mission and vision, and the industry trend information that was provided within the case. Strong candidates also noted the management time constraint as an issue that could seriously threaten Marmani's ability to successfully expand either division.

Weak candidates simply listed case facts within a SWOT analysis without highlighting the crucial points or explaining the implications of the case facts listed. Weak candidates tended to make generic links back to the situational analysis that were either irrelevant or incorrect. For example, some candidates recommended selling Adaptive in order to fund Athleisure, even though the company's financial position was described as strong. Candidates are reminded that making links back to the situational analysis is a crucial part of a strong response but those links must make sense and be relevant in order to have value.

SO#2 (Analysis of the Issues)

There were three major issues that candidates were expected to analyze from both a strategic and operational perspective. There was one additional, minor issue that candidates should have also discussed, but in less depth. Candidates were expected to provide an in-depth, qualitative discussion of each of the major issues while also showing an acceptable level of numeracy skill in their discussion of these issues.

In the simulation, Roberto mentions that Marmani cannot make the required decisions in isolation and must instead form a coherent strategy. Throughout the case, Roberto and his team continually mention the need for additional management, given how busy and overworked the current team is. Candidates were expected to identify this management time constraint and consider how it affected each decision, and how each decision would affect Marmani on a more holistic level.

Major Issue #1: Sell or Expand Adaptive?

Marmani is facing a crucial decision relative to the Adaptive division: sell it or refocus on the division and expand it. Marmani has received a revised offer from Witherspoon's (Appendix II), who was interested in purchasing the division from Marmani in Capstone 1. Sonya, on the other hand, presents a plan and projection for the division's expansion (Appendix III). Candidates were expected to analyze both options and provide a recommendation.

With respect to the option to sell Adaptive, strong candidates recognized that it would alleviate the need for management to manage two different divisions. Given that the management time constraint was highlighted as a major issue throughout the case, this point was especially important. Strong candidates also highlighted that the sale could be made quickly, which would mean that Marmani's already overstretched management team would not be further burdened by the sale proceedings. Strong candidates also identified that selling Adaptive would likely mean that Sonya would leave the company. Given Marmani's commitment to its employees, strong candidates realized the importance of this point. Strong candidates also linked to, and discussed, differences between the offer made by Witherspoon's in Capstone 1 and the current offer.

Weak candidates tended to simply compare the Witherspoon's offer to the division's valuation without analyzing whether the sale aligned with Marmani's future. Weak candidates also tended not to link this decision to the company's management time constraint, and tended to have an unbalanced qualitative discussion, often emphasizing the cons of selling.

With respect to the option to expand Adaptive, strong candidates recognized that the expansion of the Adaptive division aligned with the company's stated mission and vision. Strong candidates also emphasized that expanding Adaptive would allow the company to retain key employees and would make the company's management time constraint issue even worse. Strong candidates also recognized the difference between a divisional NPV and a project NPV and did not get lost in the various numbers and projections provided.

Once again, weak candidates provided an unbalanced discussion, this time only looking at the pros of this option. Weak candidates often failed to recognize that the expansion would mean an additional burden on management's time. In addition, weak candidates often tended to spend too much time with the quantitative aspects of the decision. For instance, some weak candidates attempted to calculate the project NPV with the stated \$9 million in revenue even though no information on the project's expenses was provided.

Major Issue #2: Expand Athleisure into Online Sales?

Marmani's new Athleisure brand has experienced significant growth and success since its launch, and Marmani is now considering whether to expand into online sales (Appendix V). Since Capstone 1, Marmani has launched a successful digital marketing strategy and has become a recognizable brand online. The projected growth of both online sales and athleisure products point toward a major opportunity to expand the division.

Strong candidates highlighted the potential for significant growth while also questioning whether the stated assumptions were accurate, given that they appear somewhat "too good to be true." Strong candidates also linked this decision to the management time constraint and recognized that this expansion would further burden the current management team. Some strong candidates also linked their discussions of Adaptive's expansion and Athleisure's expansion together, to point out that both expansions would likely be impossible without additional support for the existing management team. Strong candidates also highlighted the IT risk of expanding into online sales, such as, for example, the potential for data leaks. Quantitatively, strong candidates were able to provide a coherent NPV of the project with a sensitivity analysis for the various levels of potential market share that Marmani might achieve.

Weak candidates provided generic pros and cons and made links back to the situational analysis that were either irrelevant or incorrect. For instance, some candidates suggested not expanding Athleisure given that the management team could not handle the additional work; while this is correct, these candidates did not recognize that Marmani could hire additional staff. Weak candidates also tended to recommend expanding into online sales without considering how this would impact the Adaptive division or the management time constraint. In other words, weaker candidates tended to have difficulty integrating their analysis of each required into a coherent strategy. Quantitatively, many weak candidates failed to recognize the projected \$800 million in annual revenue for the online athleisure market and were therefore unable to provide a meaningful analysis of the project's profitability.

Major Issue #3: Hire Matthew and his Team to Manage the Athleisure Division?

Given Marmani's recent growth as well as the expansion opportunities being considered, Marmani needs to hire additional management to alleviate the burden on the current management team. Matthew and his team are being considered for heading the Athleisure division. Candidates were provided with a profile of Matthew and his work history as well as his plans for the Athleisure division in Appendix VI, and with findings from Karen about Matthew in Appendix VII. Candidates were expected to assess both Matthew's suitability for the management position and his plans for the Athleisure division.

Given that the simulation provided many case facts that could have been discussed, most candidates did a good job of analyzing this issue.

Strong candidates provided a separate assessment of Matthew's fit within Marmani and of his plans for the Athleisure division. Relative to Matthew's fit within Marmani, strong candidates recognized that Matthew's business practices, such as the use of Viet BDG, might conflict with Marmani's revised mission/vision, and more specifically, with the emphasis that Marmani places on environmental sustainability. Strong candidates also recognized that Matthew's history seemed to lean toward mass-produced, and therefore lower-quality, products whereas Marmani's intention was to focus on high-quality, niche products. Relative to Matthew's plan, strong candidates realized that Matthew's projected cost savings would likely reduce the quality of Marmani's products, going against Marmani's mission and vision.

Weak candidates tended to only focus on Matthew's plan for Athleisure's expansion, simply accepting Matthew as the right person. Weak candidates also failed to tie their analysis into the other issues that Marmani was grappling with, such as the effect of not hiring Matthew and his team on Marmani's opportunities to expand both divisions.

Minor Issue #1: Sales Team Compensation Issue

In Appendix IV, candidates learned that Marmani recently discovered that a member of their sales staff may have made sales that they knew would be returned with the aim of inflating their sales commission. The sales manager expressed that this was a minor issue and that no further work was required. Candidates were expected to assess the severity of the incident, make suggestions that would be helpful in preventing it from happening again and suggest how to resolve the issue with the offending member of the sales staff.

Strong candidates discussed the operational aspects, such as, for example, potential revisions to the sales commission structure, as well as the ethical considerations of the recent incident, such as, for instance, whether the offending sales staff member should be let go. Some strong candidates insightfully connected this issue to the management time constraint, in that the issue might have occurred because the management team has been so busy managing Marmani's growth. Some strong candidates also recognized that there could be more occurrences and suggested further investigation.

Weak candidates provided only a superficial discussion of this issue and did not provide any helpful recommendations. Instead, weak candidates tended to highlight the issue and recommend that something be done about it without providing any potential remedial actions. Some weak candidates correctly recommended that the member of the sales staff be let go but did not provide further explanation or analysis of the issue.

Overall

Most candidates did a good job of analyzing the required issues that were presented in the case. Within this summative assessment opportunity, there were three main differentiating factors that separated strong candidates from weak candidates. First, strong candidates tended to provide balanced discussions for each issue analyzed whereas weak candidates tended to lean toward either the pros or the cons of each issue. Second, strong candidates provided the implications of the case fact that they included within their analysis. Weak candidates tended to simply list case facts without providing the “so what?” Third, strong candidates highlighted and discussed the qualitative points that were most critical to the decision at hand, such as, for example, the management time constraint. Strong candidates recognized this critical issue and assessed how each decision would affect the constraint. Weak candidates did not give priority to the qualitative points that were most pertinent and instead listed case facts in a more haphazard manner.

SO#3 (Conclude and Advise)

Candidates were expected to conclude on each issue analyzed. These conclusions and recommendations were expected to be consistent with the analysis performed. Candidates were also required to make an overall, integrated conclusion that would alleviate the company's current management time constraint.

Most candidates realized that it was not realistic for Marmani to expand either Adaptive or Athleisure, let alone both, if the company did not hire additional management. Most candidates recognized that Matthew and his team were not a good fit for Marmani and therefore recommended against hiring Matthew and his potential management team. Instead, many candidates recommended expanding both divisions, since both expansions aligned with the company's mission and vision and appeared to be lucrative, and hiring additional management to alleviate the current team.

Weak candidates failed to step back and integrate their conclusions, failing to understand how their conclusions would affect the company as a whole. For instance, weak candidates tended to recommend that Marmani expand both divisions and not hire Matthew and his team but did not mention or recommend hiring a different management group. Because this recommendation would have greatly worsened Marmani's management time constraint, this was considered a “fatal flaw” error.

SO#4 (Communication)

Most candidates approached their response in a coherent and organized fashion. Only a few candidates struggled to effectively communicate their ideas. These candidates tended to use poor sentence structure, confusing syntax and an unorganized response approach.

SO#5 (Overall Assessment)

Overall, candidates were expected to meet the minimum acceptable standards in each of the four assessment opportunities listed in this report in order to obtain a “Pass” on the Day 1 linked case. Candidates also had to demonstrate a minimum level of numeracy skill. For each major issue, the board expected an in-depth analysis before candidates proceeded to a reasonable conclusion. Candidates were also expected to recognize the management time constraint and to make a recommendation that would alleviate this constraint. The board also sought evidence of candidates having incorporated information from Capstone 1, and the major considerations that were identified, in their situational analysis.

BOARD OF EXAMINERS' COMMENTS ON DAY 1 (continued)

Paper/Simulation: Day 1 – Linked Case, Marmani Version 2 (on Sept 2020 CFE)

Estimated time to complete: 240 minutes

Simulation difficulty: Average

Competency Map coverage: N/A; Enabling Skills

Examiners' comments by Summative Assessment Opportunity (SO)

SO#1 (Situational Analysis)

Candidates were expected to highlight the internal factors, such as the addition of Alain Pepin, the company's new COO, and external factors, such as industry trends, that would influence both Marmani's strategic direction and the decisions that Marmani was considering. Any significant changes that had taken place since Capstone 1 should also have been noted. In the simulation, Marmani had set aggressive growth targets that were well above the industry standard, and it appeared that Marmani had somewhat neglected Adaptive, the more successful division, in order to focus on the growth of Athleisure. Although these entity-level strategic issues were undirected, a strong situational analysis typically identified some of these issues. Candidates were rewarded when they made links back to the situational analysis within their response in SO#2 and within their conclusions in SO#3.

Within their situational analysis, strong candidates identified the various entity-level strategic issues that were presented in the case. For example, strong candidates identified Alain's management and operational approach as a risk to Marmani's established processes or how the aggressive growth targets that had been set might lead Marmani away from its key success factor of producing high-quality products.

Weak candidates commonly restated basic information about Marmani within their situational analysis (for example, items such as mission, vision and key success factors, which came directly from Capstone) and often failed to identify all the main strategic elements of the case e.g. missing the governance issue. Weak candidates also tended to make links that were less applicable or even irrelevant to the issue being discussed, whereas stronger candidates recognized the important issues and made links that clearly demonstrated their understanding of Marmani's business and the industry's landscape.

SO#2 (Analysis of the Issues)

There were four major issues that candidates were expected to analyze from a strategic perspective. They were expected to provide an in-depth, qualitative discussion of each of the major issues while also showing an acceptable level of numeracy skill in their discussion of these issues. Although not requiring the same amount of depth as the major issues, there was one additional issue that candidates were expected to address.

Major Issue #1: Expand the Adaptive division into the mass market?

Marmani is considering expanding the Adaptive division into a new, mass-market product line that would be co-developed with a respected physician, Dr. Irving. In Appendix IV, candidates were provided with more information about the option, and some financial projections provided by Dr. Irving. Quantitatively, candidates were expected to provide a basic gross margin calculation and an interpretation of that calculation, such as how the projected gross margin of the option compares to that of the other options that Marmani is considering, or to the company's current gross margin figures. Qualitatively, candidates were expected to discuss how Adaptive was currently being neglected despite its significant contribution, which should have led them to consider expanding the Adaptive line. Candidates could have compared the risk of expanding Adaptive to that of expanding Athleisure, considering, for example, the higher competition or lower margins with Amazon.

Strong candidates converted the financial information in Appendix IV into a gross margin figure and compared those results to the other strategic options that were available, or to Marmani's current results. Strong candidates also discussed how Adaptive would require a new design manager, given that Adaptive's old design manager was no longer with the company. In addition, strong candidates identified Adaptive as the main income provider for Marmani and suggested that the company refocus a certain amount of energy and resources on this division, to ensure that it did not become neglected. Stronger candidates also sometimes touched on the potential for a production capacity issue, should the sales of Adaptive grow rapidly.

Weak candidates typically calculated a gross margin figure for the project, but then simply concluded that the option appeared profitable without any sort of further analysis or comparison. Weak candidates often calculated an NPV alongside their basic gross margin calculation, which was not appropriate or useful, as it omitted many of the costs that were needed to be considered for a complete analysis. Qualitatively, weaker candidates would focus on the more superficial links to SO#1, such as how this option would allow Marmani to diversify its revenue stream, which is a key success factor. This point was valid, however, there were more meaningful points to discuss.

Major Issue #2: Begin to sell Athleisure on Amazon?

Marmani is considering selling its Athleisure products on Amazon and is trying to determine which product line to offer first. In Appendix V, candidates were provided with some estimates pertaining to the potential sales of each product line (Fresh, Flow and Cool), as well as some pricing information. Quantitatively, candidates were expected to use that data to analyze which product to offer on Amazon, and at what price. Candidates were also expected to analyze the Amazon option from a qualitative perspective. The main qualitative points were that: Amazon represents a global marketplace and this option therefore presented a huge potential for growth, which might allow the company to meet its aggressive growth targets; this option had a higher projected gross margin percentage relative to the celebrity athlete's option; this option could be very time consuming and could therefore lead Adaptive to be further neglected; and Marmani may be forced to compromise on product quality in order to earn a sufficient margin on these products.

Almost all candidates attempted to perform the quantitative analysis that was expected of them. There were two main elements: 1) determining which of the three products had the best sales price within the parameters provided by Amazon; and 2) determining which product would provide the greatest increase to the company's gross margin, based on the projected sales figures for each product.

Strong candidates correctly determined at least one of the above elements and usually recommended either one or two of the products, based on the results of their analysis.

Weak candidates appeared to have a harder time interpreting the information in Appendix V and then converting it into a meaningful analysis. They attempted the necessary product line calculations; however, most failed to consider the floor price or incorrectly calculated the product markup. Many weak candidates performed a calculation based on the provided figures but failed to recommend a product based on that analysis, which was directly asked for in the case.

Qualitatively, many candidates performed well on this AO. There were a multitude of case facts and discussion points that candidates could have included in their response. Strong candidates noted that, although selling Marmani's products on Amazon represented an opportunity for quick returns, the option also presented risks to Marmani. Strong candidates identified the more important aspects of the decision, such as the higher degree of competition and the pressure of the company's already squeezed margins, and were therefore more able to provide an in-depth and meaningful response. Strong candidates sometimes noted that the implementation time of this project was much shorter when compared to the other options, allowing Marmani to improve the results for Athleisure, to meet its targets. Many weak candidates provided more basic and superficial links to SO#1, such as how this option aligned with Marmani's new mission statement.

Major Issue #3: Partner with a celebrity athlete to sell Athleisure products?

Marmani has an opportunity to partner with a celebrity athlete, to co-design and sell Athleisure wear. In Appendix VI, candidates were provided with the specifics of the partnership proposal. This issue was considered the easiest of the issues. Qualitatively, candidates were expected to recognize that, although the market for men's athleisure was trending upward (Appendix VII), the celebrity athlete presented a significant amount of risk because of his apparent erratic behavior, which could compromise Marmani's reputation. Other important qualitative points were that: the celebrity had full control over the design process, which could result in the option being very time consuming, leaving less time for other projects; the option provided Marmani with guaranteed sales; and the agreement with the celebrity appeared to be very restrictive. Quantitatively, similar to the Adaptive mass market issue, candidates were to provide a simple gross margin calculation and then interpret and compare that result to the other options available, and/or to Marmani's existing results.

Strong candidates provided the basic gross margin calculation and used that figure to compare it to other options available, and to Marmani's existing operations. Weak candidates often only noted the gross margin, without providing any sort of comparison.

There were many case facts that candidates could incorporate into their qualitative discussion. Strong candidates tended to recognize the more important issues. They often also suggested revisions to the proposed partnership agreement, to reduce Marmani's risk exposure. Weak candidates tended to list the most obvious pros, such as how this option would help diversify the company's revenue streams, and cons, such as that the celebrity's name not being disclosed. Again, many weak candidates made superficial links back to their situational analysis, stating, for example, how this option would conform to Marmani's new mission, which now included Athleisure.

Major Issue #4: Governance

Throughout the board dialogue (Appendix 1) and the notes from the discussion with managers (Appendix VIII), there were suggestions of bigger, underlying issues that needed to be addressed. First, there were hints that Alain, the company's new COO, might be disrupting the company; a manager complained that Alain seems only focused on cost reduction, which could compromise the quality of the company's products (producing quality products was a KSF of the company), and Alain threatens to fire a long-standing employee. The second issue is evident from Alain's comments, where he argues that Marmani should focus its attention on Athleisure's growth. Candidates were expected to recognize, based on the financial information presented in the case, that Adaptive is the main income generator for Marmani, and should not be neglected. Candidates were expected to address, at a strategic level, at least one of the variety of operational and strategic issues that were undirected yet apparent in the case by discussing how the issue could affect the overall direction and future of Marmani.

Strong candidates discussed the strategic, rather than the operational, issues. For example, they discussed how Marmani seemed to be losing focus on Adaptive, even though that division was the main income generator. Weak candidates tended to focus on the more operational aspects of the issues that were presented, such as how Marmani's managers should be trained on how to use the CRM system, or whether Karen should be replaced. Some other weak candidates offered a discussion that emphasized helping Marmani improve its management team's communication style. Although these points were all relevant to the case, they were operational and less consequential to the company on a global and immediate level.

Minor Issue #1: Finance decision

Although this issue was presented first in the simulation, it was considered a minor issue. This is because Marmani's financial position was not weak and clear options existed to refinance its loan with Ray. In Appendix III, candidates were provided with information about a new loan that could be obtained if Marmani decided to forgo converting Ray's existing loan to equity in the company. Candidates were expected to compare the two available options in a way that linked the decision back to what was important to Roberto, for example, by estimating Marmani's value and comparing that to the loan currently outstanding with Ray, and discussing the impact on Roberto's ownership percentage. Candidates were expected to recognize that, if Marmani converted the loan to equity, Ray would become a voting shareholder and would be entitled to all future growth of the company. As Roberto had stated in the Capstone case that he preferred to retain full control of the company, this was a major drawback.

Most candidates spent more time than necessary on this issue and therefore did well on it. Most candidates provided a separate analysis for each option. Strong candidates provided more meaningful quantitative comparisons between the two options. For instance, by providing a rough valuation calculation of Marmani, strong candidates determined that converting Ray's debt to shares did not make much sense, given the approximate value of the company. Strong candidates also accurately determined that Marmani would easily be able to service the payments of the new loan. Most candidates also recognized that converting Ray's loan to equity would mean giving up a certain amount of control in the company. Fewer candidates touched on how the future growth of the company would also have to be shared with the new shareholder. Some candidates discussed how converting the loan to equity would improve the company's debt-to-equity ratio and therefore enable Marmani to access additional financing in the future. Although valid, it was not considered as strong a point, given Roberto's preference to retain full control (expressed in Capstone 1) and the fact that Marmani did not appear to require any more additional financing. Weak candidates often focused on the more operational aspects, for example, discussing how the new loan contains certain covenants and the added cost of audited financial statements, and how the variable interest rate could potentially increase the cost of the new loan if interest rates were to increase.

Overall

The focus of this case was on candidates' ability to provide depth and breadth in the qualitative elements of their response, to do a reasonable quantitative analysis for the strategic issues presented and to identify that there were broader strategic issues around Alain. Most candidates were able to discuss the pros and cons of each option, to link those back to their situational analysis and provide evidence of numeracy skills. Where they typically fell short was in seeing the broader strategic issues.

In terms of their analysis of the issues, strong candidates usually discussed the more important and relevant aspects of each issue whereas weak candidates tended to provide more superficial responses, often listing the case facts as pros and cons, and little else. Strong candidates not only demonstrated strong numeracy skills but also interpreted their quantitative analysis, in this case comparing the margins or product line results and recommending appropriate options for Marmani. Weak candidates had a much harder time connecting their quantitative analysis to Marmani's objectives. They often provided only one calculation, and did not relate it back in any way to the objectives. Finally, strong candidates were better at moving beyond the operational aspects of all the issues, and saw some of the undirected strategic issues in the case, such as that Alain's suggestions for Athleisure went against the evidence that Adaptive could be a better option to invest in for the future.

SO#3 (Conclude and Advise)

Candidates were expected to conclude on each issue analyzed. These conclusions and recommendations were expected to be consistent with the analysis performed. Most candidates who did a good job in SO#2 also did a good job in SO#3. Candidates who did not meet the requirements in this summative opportunity were almost always deficient in other aspects of their response (SO#1 and/or SO#2), and therefore, SO#3 was not a major differentiating factor for this case.

SO#4 (Communication)

Most candidates approached their response in a coherent and organized fashion. Only a few candidates struggled to effectively communicate their ideas. These candidates tended to use poor sentence structure, confusing syntax and an unorganized response approach.

SO#5 (Overall Assessment)

Overall, in order to obtain a “Pass” on the Day 1 linked case, candidates were expected to meet the minimum acceptable standards in each of the four assessment opportunities listed in this report. For each major issue, the board expected an in-depth analysis, which was largely qualitative in this case, before candidates proceeded to a reasonable conclusion. However, candidates also had to demonstrate a minimum level of numeracy skill. Candidates were also expected to address the undirected strategic issues that were present in the case. The BOE also sought evidence of candidates having incorporated information from Capstone 1, and the major considerations that were identified, in their situational analysis.

APPENDIX I

CPA COMMON FINAL EXAMINATION REFERENCE SCHEDULE

CPA COMMON FINAL EXAMINATION REFERENCE SCHEDULE

1. PRESENT VALUE OF TAX SHIELD FOR AMORTIZABLE ASSETS

Present value of total tax shield from CCA for a new asset acquired before November 21, 2018

$$= \frac{CTd}{(d+k)} \left(\frac{2+k}{2(1+k)} \right) = \frac{CdT}{(d+k)} \left(\frac{1+0.5k}{1+k} \right)$$

Present value of total tax shield from CCA for a new asset acquired after November 20, 2018

$$= \frac{CdT}{(d+k)} \left(\frac{1+1.5k}{1+k} \right)$$

Notation for above formula:

C = net initial investment

T = corporate tax rate

k = discount rate or time value of money

d = maximum rate of capital cost allowance

2. SELECTED PRESCRIBED AUTOMOBILE AMOUNTS

	2019	2020
Maximum depreciable cost — Class 10.1	\$30,000 + sales tax	\$30,000 + sales tax
Maximum depreciable cost — Class 54	\$55,000 + sales tax	\$55,000 + sales tax
Maximum monthly deductible lease cost	\$800 + sales tax	\$800 + sales tax
Maximum monthly deductible interest cost	\$300	\$300
Operating cost benefit — employee	28¢ per km of personal use	28¢ per km of personal use
Non-taxable automobile allowance rates		
— first 5,000 kilometres	58¢ per km	59¢ per km
— balance	52¢ per km	53¢ per km

3. INDIVIDUAL FEDERAL INCOME TAX RATES**For 2019**

<u>If taxable income is between</u>			<u>Tax on base amount</u>	<u>Tax on excess</u>
\$0	and	\$47,630	\$0	15%
\$47,631	and	\$95,259	\$7,145	20.5%
\$95,260	and	\$147,667	\$16,908	26%
\$147,668	and	\$210,371	\$30,534	29%
\$210,372	and	any amount	\$48,718	33%

For 2020

<u>If taxable income is between</u>			<u>Tax on base amount</u>	<u>Tax on excess</u>
\$0	and	\$48,535	\$0	15%
\$48,536	and	\$97,069	\$7,280	20.5%
\$97,070	and	\$150,473	\$17,230	26%
\$150,474	and	\$214,368	\$31,115	29%
\$214,369	and	any amount	\$49,644	33%

4. SELECTED INDEXED AMOUNTS FOR PURPOSES OF COMPUTING INCOME TAX

Personal tax credits are a maximum of 15% of the following amounts:

	2019	2020
Basic personal amount	\$12,069	\$12,298
Spouse, common-law partner, or eligible dependant amount	12,069	12,298
Age amount if 65 or over in the year	7,494	7,637
Net income threshold for age amount	37,790	38,508
Canada employment amount	1,222	1,245
Disability amount	8,416	8,576
Canada caregiver amount for children under age 18	2,230	2,273
Canada caregiver amount for other infirm dependants age 18 or older (maximum amount)	7,140	7,276
Net income threshold for Canada caregiver amount	16,766	17,085
Adoption expense credit limit	16,255	16,563

Other indexed amounts are as follows:

	2019	2020
Medical expense tax credit — 3% of net income ceiling	\$2,352	\$2,397
Annual TFSA dollar limit	6,000	6,000
RRSP dollar limit	26,500	27,230
Lifetime capital gains exemption on qualified small business corporation shares	866,912	883,384

5. PRESCRIBED INTEREST RATES (base rates)

<u>Year</u>	<u>Jan. 1 – Mar. 31</u>	<u>Apr. 1 – June 30</u>	<u>July 1 – Sep. 30</u>	<u>Oct. 1 – Dec. 31</u>
2020	2	2		
2019	2	2	2	2
2018	1	2	2	2

This is the rate used for taxable benefits for employees and shareholders, low-interest loans, and other related-party transactions. The rate is 4 percentage points higher for late or deficient income tax payments and unremitted withholdings. The rate is 2 percentage points higher for tax refunds to taxpayers, with the exception of corporations, for which the base rate is used.

6. MAXIMUM CAPITAL COST ALLOWANCE RATES FOR SELECTED CLASSES

Class 1.....	4%	for all buildings except those below
Class 1.....	6%	for buildings acquired for first use after March 18, 2007 and \geq 90% of the square footage is used for non-residential activities
Class 1.....	10%	for buildings acquired for first use after March 18, 2007 and \geq 90% of the square footage is used for manufacturing and processing activities
Class 8.....	20%	
Class 10.....	30%	
Class 10.1.....	30%	
Class 12.....	100%	
Class 13.....		Original lease period plus one renewal period (minimum 5 years and maximum 40 years)
Class 14.....		Length of life of property
Class 14.1.....	5%	For property acquired after December 31, 2016
Class 17.....	8%	
Class 29.....	50%	Straight-line
Class 43.....	30%	
Class 44.....	25%	
Class 45.....	45%	
Class 50.....	55%	
Class 53.....	50%	
Class 54.....	30%	

The CPA certification program prepares future CPAs to meet the challenges that await them. For more information on the qualification process, the common final examination (CFE), and the specific education requirements for your jurisdiction, contact your provincial/regional CPA body.

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