Pre-Workshop Materials

Workshops 1 and 2

Case Background

Overview

Platin Hotels Limited ('Platin') is a long-established company whose shares are listed on the Hong Kong Stock Exchange. It operates a chain of luxury hotels, competing at the premium end of the market with the top international hotel groups.

It currently has one hotel in Hong Kong; four in other Asian countries and Australia and three in the USA. It also has a 50% share in a joint venture that operates another hotel in mainland China. These hotels are located in prime city-centre locations.

All Platin hotels currently hold awards from business associations for the best business hotels in their city or geographical region.

The head office of the company is located in Hong Kong.

The premium hotel business

The premium hotel market is very competitive. All major city centres have several five-star hotels which compete to attract guests. They do not compete on price. Instead they try to attract customers by offering excellent facilities. All Platin hotels have indoor swimming pools and fitness centres or spas for their staying guests, and they employ highly-rated chefs in their restaurants.

In order to compete successfully, hotels need to spend extensively on renovation work each year to maintain or improve luxury standards. Capital spending on renovations is the main element in the annual capital spending programmes of most hotel groups. At Platin, capital spending in the year to 30 June 2012 was 5.6% of total revenue for the year, and the board of directors is concerned that this was insufficient.

With the economic downturn in Europe and the USA, occupancy rates at all premium hotels have been low throughout 2011 and the early part of 2012. Many companies have been cutting back on business travel and using conference calls more extensively, with the result that number of 'business' guests has been static and may have even declined slightly. There has also been only a small rise in the number of tourists using premium hotels.

Like all premium hotels, Platin earns its revenue from providing accommodation ('rooms'), its restaurant services and bars ('food and beverage') and other revenue-generating activities such as the hire of rooms for conferences and meetings. Some Platin hotels also earn income from renting retail space to luxury retailers ('commercial' revenue).

A large proportion of revenue from the restaurants comes from staying guests, particularly business guests, although some hotels are more successful than others in attracting 'external trade' from the general public.

The hotel industry is global and many business customers come from large international companies. These companies recognise global brand names in hotels, and often use the same hotels in all the cities that their senior executives visit. The fact that Platin has just eight hotels worldwide may put it at a strategic disadvantage to some of its major competitors.

Economic conditions in the year to 30 June 2012

The past two years have been difficult for the premium hotel business, due to the global economic recession. In the year to 30 June 2012, total revenue for Platin was just 4% higher than the previous year, and EBITDA and earnings per share increased by less than 1%.

A major earthquake occurred in one of the Asian cities where Platin has a hotel, causing huge damage and disruption to the city and its business. As a consequence, the hotel in this city lost a considerable amount of business and also suffered a small amount of structural damage. The poor performance of this hotel during the year to 30 June 2012 is attributed to the time it has taken the city to restore itself to normal working.

Occupancy rates at most of the company's hotels was disappointing. Several years ago, the company was achieving an average occupancy rate of about 70%, but in the year just ended it was about 60%.

Profitability and other aspects of performance

In the past the company has relied on revenue growth for growth in its profits. As a consequence of the slowdown in revenue growth, combined with a lack of attention to cost control, profitability in the year to 30 June 2012 was disappointing. Revenue of HK$4,403 million was only 4% higher than in the previous year and earnings per share, at 49.8 Hong Kong cents, were roughly the same as the previous year.

The company experienced a volatile year in the stock market. Its share price ranged between a high of $15.50 and a low of $9 during the year. It currently stands at $11, valuing the company's equity at HK$4,400 million.

A summary income statement, statement of financial position and statement of cash flows is shown in Appendix 1.

The company values its hotels in the financial statements at cost less depreciation and impairments. A professional market valuation of the hotels estimates their current market value at 15% above their cost model value.

The financial performance of each hotel is measured individually. Performance has been monitored mainly in terms of revenue. The profitability of each hotel is measured by charging attributable direct costs to each hotel and an apportioned share of head office operating costs.

A statement of the revenue and operating profit of each hotel is shown in Appendix 2.

The main measures of performance for each hotel have been average revenue room per day (ARR) and revenue per available room per day (RevPAR). These are shown in Appendix 3.

Platin has a 50% interest in a hotel in a major city in mainland China. This was established only two years ago and is currently making a loss. Platin has also provided substantial financial investment in this project, including additional loans during the year to 30 June 2012. Although this hotel is loss-making, revenue is growing quickly and there are strong indications that the hotel will move into profit next year and could be a very successful investment.

Board of directors and senior management

The board of directors of Platin consists of 11 members.

The chairman Charles Scott has been with the company for many years, and is a major shareholder in the company. Although he is now quite old, he retains a keen interest in the company and its future development. He is non-executive.

There are three executive directors:

- James Wu: Chief Executive Officer (CEO)
- Penny Chow: Chief Operations Officer (COO)
- Lee Stevens: Chief Finance Officer (CFO)

There are seven other non-executive directors in addition to the chairman. One of these, Peter King, is a lifetime friend and business associate of Charles Scott. The other six non-executive directors are independent, to the satisfaction of the Hong Kong Stock Exchange.

James Wu, a Hong Kong CPA, is a recent appointment to the position of CEO. Aged 37, he already has extensive experience in the hotel industry, and believes that substantial changes are needed to restore the company to strong growth.

Although the company has a CEO and COO, a large amount of authority is delegated to the hotel managers. As stated above, the performance of each hotel is measured individually. Each manager is given extensive freedom to develop their hotel and its activities, and they have a major influence on decisions about renovation and improvements, subject to spending limits in the renovations budget. Each manager is personally accountable for the performance of their hotel.

James Wu suspects that although hotel managers have the authority to make decisions for their hotel, many of them are reluctant to innovate. This is because they are aware that if they take an initiative that is unsuccessful, they will be held personally accountable.

A management committee meets every four months. This consists of the CEO, COO, CFO, chief accountant and the hotel managers.

Corporate social responsibility

The Platin board promotes the concept of corporate social responsibility (CSR) within the company. CSR is seen as a combination of promoting sustainability and environmental issues, being a fair and considerate employer; and engaging with local communities in the cities where the hotels are located.

Employment policy is decided at head office, but responsibility for other CSR initiatives is delegated to hotel managers and as a consequence Platin does not have an integrated company-wide CSR policy.

Last year one of the hotels in the USA attracted publicity by announcing an exclusive supply arrangement with an ISO 14000-certificated seafood supplier for the supply of fish to the hotel from sustainable sources.

Corporate social responsibility (CSR) and sustainability management policies are in place, or are currently being adopted, by most of the large global hotel chains. Global hotel chains, such as Radisson and Marriott International are industry leaders in this area. For example, the Marriott international policy sets out the specific steps in six key areas which are water; waste and energy; supply chain efficiencies; green building development; rainforest protection, and guest engagement.

The Platin group has not yet developed a CSR policy and this has now become a high priority to the business due to pressure from the competition, the operating environment and the consumer. The board has identified five key areas for their future company-wide policy:

- Sustainable food sourcing and management
- Water management
- Community partnership
- Guest engagement
- Waste and energy management
- Rainforest protection

The board has decided to introduce some CSR measures into the Platin Hong Kong as a trial before developing a wide-ranging company policy and implementing it across the group.

The Platin HK is currently trialling three CSR initiatives:

1 Sustainable food supply practices – the Platin HK is only serving sustainable seafood and is advertising this on all menus and relevant marketing material

2 Water management – the Platin HK is requesting guests indicate whether they want new linen on a daily basis and advertising this as a water-saving measure in all the rooms

3 Community partnership – the Platin HK is running a promotional month where 10% of all proceeds from their ‘Oxfam High Tea’ is being donated to workers on tea plantations through Oxfam International

Strategies for the future

James Wu has persuaded Charles Scott that the board should review the company’s business strategies for the future. He doubts whether the current strategy of slow expansion in the premium hotel business is appropriate. Except for the joint venture in mainland China, it is five years since Platin opened a new hotel. The damage to business from the earthquake in the Asian city also alerted the board to the fact that its business is exposed to environmental risks such as this.

James, supported by CFO Lee Stevens, believes that Platin has the capacity to raise new finance for a business expansion strategy. The cost of debt is currently about 3% (gross) and the board believes that the joint venture in China will not require any further loan support from Platin.

James has suggested that four strategies should be researched, with a view to presenting a paper for discussion to the board. The four strategies that he has recommended for research are as follows:

- A strategy of focussing on the existing hotels in the company and improving the quality of the facilities and services so that Platin hotels are seen as the best quality hotels in the premium hotel sector. This strategy will require substantial additional spending on renovations and other developments. At the same time, more attention should be given to cost management in order to improve the narrow profit margins at the hotels.
- A strategy of developing the company by opening new hotels in other major international cities. New hotels would have to be in prime locations, and in cities that are expected to be major centres for business and tourism in the future.
- Another strategy is to develop a new range of lower-standard hotels (three star hotels), initially in Hong Kong. This strategy would be targeted mainly at attracting high-spending tourist business. James thinks that tourism in city centres will grow in the future, especially in Asian cities, with demand coming from high-spending tourists from the Middle East, USA, Europe and some countries of South America.
- A fourth strategy is to diversify into a different business area in order to supplement Platin’s hotel business and leverage off the Platin brand. James believes a strong possibility is to open a number of country clubs and golf clubs in Asia, to meet the growing demand for luxury sports centres in countries with rapidly expanding economies.

Dividends, cash and treasury policy

Platin is a profitable company but it does not have large cash resources. This is partly because a substantial investment has been made in the recent joint venture, financed mainly from the company’s cash resources. In addition, the company had a high dividend policy until several years ago, when it recognised the need to retain profits and cash and as a consequence reduced dividend payments to shareholders.

At the time shareholders reacted adversely to the reduction in dividends and the share price fell. Since then the share price has been quite volatile, due more to economic conditions than dividend policy. The board believes that shareholders are now reasonably satisfied with the level of dividend payments, although they will expect growth in both earnings and dividends in the future.

In the year to 30 June 2012, the earnings per share were 49.8 Hong Kong cents and dividends totalled 23 cents per share – an interim dividend of 7 cents and a final dividend of 16 cents. This is the same as in the previous year. Dividend cover is 2.2 times.

The final dividend for the year to 30 June 2012 has not yet been paid.

Although the company has cash resources, it also has borrowings in several currencies. The company’s policy has been to take advantage of low interest rates on debt to reduce the company’s overall cost of capital. Borrowing requirements are not seasonal.

The board has approved a treasury policy of maintaining a ratio of fixed rate debt to floating rate debt of between 40:60 and 70:30, with a long term target of 50:50. At 30 June 2012 the ratio of fixed to floating rate debt was about 45:55.

The company controls treasury policy from head office, and uses interest rate swaps and cross currency interest rate swaps to manage its interest rate risk. It also uses forward exchange rates to manage some foreign currency risks. However the company makes extensive use of natural hedging of foreign currency risks, matching currency income with expenditures in the same currency.

Appendix 1: Summary financial statements for year to 30 June 2012

Platin Hotels Limited

Summary income statement for the year ended 30 June 2012

(All figures are in HK$ millions)		
Revenue		4,403
Operating costs		
Materials, inventories	459	
Staff and related costs	1,680	
Other costs	1,558	
		(3,697)
EBITDA		706
Depreciation		(370)
Operating profit		336
Net financing costs		(48)
		288
Share of loss of 50%-owned joint venture		(51)
Profit before tax		237
Taxation		(38)
Profit after taxation		199

Platin Hotels Limited

Summary statement of financial position at 30 June 2012

(All figures are in HK$ millions)		
Fixed assets		34,701
Long-term investment		2,738
Financial derivatives		42
Cash		658
Other current assets		589
Total assets		38,728
Bank overdraft	21	
Borrowings	2,353	
Financial derivatives	220	
Other liabilities	1,412	
Total liabilities		(4,006)
Net assets		34,722
Share capital and premium (400 million shares)		4,935
Retained profits		29,787
		34,722

Platin Hotels Limited

Summary statement of cash flow for the year ended 30 June 2012

(All figures are in HK$ millions)

EBITDA		706
Change in working capital		(75)
Tax paid		(39)
Fixed asset purchases		(247)
Loan to joint venture		(600)
Finance cost payments		(73)
Dividend payments		(92)
		(420)
Interest income	25	
Net new bank borrowings	300	
		325
Net cash flow		(95)

Appendix 2: Hotels: revenue and profitability

An analysis of the revenues, costs and profit of each hotel is shown in the following table. All figures are in HK$ millions. The hotels are identified by letters, not their city location.

	Analysis of Revenue						
Platin Hotel	Rooms	F&B	Commercial	Other revenue (Note 2)	Total revenue	Costs	Operating profit
Hong Kong	427	363	370	65	1,225	1,132	93
Rest of Asia							
Hotel A	169	80	140	20	409	377	32
Hotel B (Note 1)	107	77	3	18	205	196	9
Hotel C	206	289	33	25	553	510	43
Hotel D	200	152	4	28	384	345	39
USA							
Hotel E	384	116	36	49	585	550	35
Hotel F	300	231	–	61	592	545	47
Hotel G	310	103	–	37	450	412	38
Total	2,103	1,411	586	303	4,403	4,067	336
50%-owned joint venture							
Hotel H	261	207	–	30	498		

Notes:

1 Hotel B is the hotel in the Asian city damaged by the earthquake.

2 ‘Other revenue’ includes revenue from chargeable hotel services, the provision of conference rooms and meeting rooms, charges for wedding receptions and also recognised income from non-returnable room deposits *(explained in the workshop).

Appendix 3: Hotel performance measures

Hotel	Rooms revenue	Number of rooms available	Occupancy rate	ARR (Note 1)	RevPAR (Note 2)
	HK$m		%	HK$	HK$
Hong Kong	427	310	75	5,032	3,774
Rest of Asia					
Hotel A	169	350	48	2,756	1,323
Hotel B	107	180	45	3,619	1,629
Hotel C	206	300	52	3,618	1,881
Hotel D	200	325	70	2,409	1,686
USA					
Hotel E	384	240	75	5,845	4,384
Hotel F	300	320	60	4,281	2,568
Hotel G	310	340	65	3,843	2,498
Total/average	2,103	2,365	61.3	3,974	2,436
50%-owned joint venture					
Hotel H	261	350	50.0	4,086	2,043

Notes:

1 **ARR = Average revenue per room per day. This** is the revenue from accommodation (rooms revenue) divided by the average number of rooms occupied and divided by 365 days.

Average number of rooms occupied = total number of rooms available multiplied by the occupancy rate.

2 **RevPAR** = Revenue per available room per day. This is the revenue from accommodation (rooms revenue) divided by the total number of rooms available occupied and divided by 365 days.

RevPAR may also be calculated as ARR average revenue per room multiplied by the occupancy rate.

Workshop 1 Session 1

Pre-workshop exercise 1 (Ethics in Business)

Ethical scenario

Platin commenced operations in 1912 with one hotel, the Platin Hong Kong. This is the group's flagship hotel; its most successful and the 'diamond' in the brand. It has been operating as one of Hong Kong's leading five-star hotels since 1912 and its continued success is integral to the Platin global brand. The group is currently heavily promoting the hotel's centenary celebrations.

Last year, the manager of the Platin Hong Kong retired after 30 years in charge. The new manager, Cindy Scott, has been operating the hotel for nine months and was appointed by the Board of Directors. Cindy has over 20 years' experience in hotels, and has been with the Platin group for her entire career. She has proved herself as a competent hotel operator, and was manager in one of the USA hotels for three years prior to this appointment. Cindy is also the daughter-in-law of Charles Scott (company director and major shareholder).

All Platin hotels run a luxury day spa with massage treatments, beauty treatments, spa, steam room and relaxation area. Company policy is that this is currently only available for use by hotel guests. Hotel guests are given vouchers to use the spa services. Company-wide policy states that these vouchers are only for hotel guests and are not to be given away or sold to the general public.

When Cindy was hotel manager in the USA hotel, Cindy suggested to James Wu (CEO) that the day spa service be packaged and sold to the general public. This strategy is used to raise revenue and marketing profile by many five star hotels across the world. James Wu and the management considered her suggestion but decided to keep the spa services exclusive to hotel guests at this stage. In fact, they were so worried about the luxury and exclusivity of the spa service being diluted by this suggestion, that they sent out a company email stating that it was strictly against company policy to open up any spa services to the general public or to be used as a 'perk' for family and friends.

In direct contravention of this policy, Cindy has been giving free vouchers for the day spa to a broad group of friends to use at the Platin Hong Kong. This has been going on for the nine months since Cindy started managing the hotel. She has given out a total of 30 vouchers in that time.

Amy Lui, Hong Kong CPA, has been the Platin Hong Kong's hotel accountant for 12 years and was good friends with the previous hotel manager. She enjoys her position and has the trust of management. She is a relatively quiet person who does not like to 'make a fuss' and performs her job efficiently. Six months ago, she noticed the improper use of the hotel vouchers when preparing her month-end figures. She has taken no action.

In the last month, three of Cindy's friends have now tried to use the vouchers at other Platin hotels, two in Australia and one at the joint venture hotel in mainland China. These vouchers have been rejected by the hotels concerned. The voucher holders have now returned to Hong Kong and demanded compensation from the Platin Hong Kong for the fact that the voucher was not honoured.

Yesterday, on Cindy's day off, the hotel duty manager received this request for compensation, which was quickly followed up by two hotel guests complaining to reception that spa packages were being used by individuals who did not seem to be guests of the hotel.

The duty manager immediately went and reported this information to Amy Lui, who was in the office. They decided to immediately report the misuse of the vouchers to the Platin group COO, Penny Chew. At this point, Amy informed Penny that she had been aware of the misuse but was too scared of Cindy to report it. Today, Penny informed James Wu of the misuse of the vouchers.

James then immediately informed Charles Scott and has proposed that they meet shortly to discuss the situation.

Group discussion

In your group, you will be asked to consider this scenario from the viewpoint of **one** of the following persons:

- Cindy Scott, hotel manager at the Platin Hong Kong
- Amy Lui, hotel accountant at the Platin Hong Kong (and Hong Kong CPA)
- Charles Scott, Chairman and major shareholder of Platin
- James Wu, CEO of the Platin group (and Hong Kong CPA)

In each individual group discussion, consider the following:

(a) Note down the key considerations of your allocated person in the scenario by analysing the scenario from their perspective.

(b) With reference to the HKICPA Code of Ethics, what does the group consider to be the ethical issues faced in this scenario? This should be assessed from the perspective of the group's allocated person and as a CPA.

(c) Broadly following the American Accounting Association (AAA) Model, what does the group consider to be the best solution or action taken to address the situation? This should be assessed from the perspective of the group's allocated person and as a CPA.

Refer back to the information in the Case Background on Platin's corporate social responsibility (CSR) policy.

(d) In each individual group, discuss three **benefits** of implementing a comprehensive CSR policy across the Platin chain, highlighting how each benefit could specially impact on the group.

Note: It is recognised that there may be many more than three benefits of implementing a CSR, and that acceptable answers may vary in content.

Workshop 1 Session 3

Pre-workshop exercise 2 (Executive Management)

Lee Stevens, CFO, has asked you to attend a monthly management committee meeting. In this committee meeting you will be asked to evaluate **four possible strategic options** and decide on the **appropriate strategy** to be taken by Lee and the other members of the management committee to take up to the Board of Platin Holdings Limited.

They will certainly raise a lot of questions to you after your presentation to the management committee. You are very pleased to take on this opportunity to impress Lee and the team.

Required

(a) Carry out a comprehensive **market analysis** of the luxury hotel industry in which Platin operates, using **Porter's five forces model.** Conclude whether the power of each force is high, medium or low. Identify at least six points for each of five forces. In your analysis also consider the sixth force – complementarity – and list at least six complementors.

Note: It is recognised that there may be many more than six possible items for each force, and that acceptable answers may vary in content.

(b) Bring your completed Porter's five forces to the Workshop as a tool to assist you in evaluating the **strategic options** presented.

Workshop 1 Session 4

Pre-workshop exercise 3 (Management Reporting)

James Wu, the CEO of Platin, is dissatisfied with the lack of management information about the financial performance of the hotels. He is discussing his concerns with Lee Stevens, the CFO, and May Wong, the chief accountant.

They have been looking at the annual results to 30 June 2012 for one of the US hotels, which are as follows. (The figures are in HK$ millions, not US dollars.)

Revenue		
Rooms		300
Food and beverage		231
Other revenue activities		61
		592
Costs		
Materials, inventories	57	
Labour and related costs	237	
Other costs attributable to hotel	170	
Apportioned head office costs	30	
Depreciation	51	
		(545)
Operating profit		47

The hotel consists of 320 rooms. 32 of these are elegant suites for which the rate per night is about HK$11,000 and the rest are standard rooms for which the rate per night is about $3,500. The occupancy rate was 60% in both suites and standard rooms.

During the year, 75% of staying guests were business people and the others were tourists. It has also been established that 80% of the income from sales of food and beverage came from staying guests, and the other 20% came from non-residents.

The hotel has an indoor swimming pool, a fitness centre and a games room, and guests are not charged for using these. Some hotel services such as treatments in the hairdressing and beauty salon are chargeable, and the revenue from these activities is included in ‘other revenue’.

The materials costs include costs of replacing broken items, such as broken tableware, and the cost of ‘inventories’ is the cost of food and beverage items consumed. Labour costs are a major proportion of total costs. Most employees work a fixed number of hours each week and they receive additional pay for overtime working.

Every hotel is charged a share of head office costs. Based on budgeted costs and revenues for the year, this overhead was apportioned at the rate of 5% of hotel revenue.

James Wu would like to receive more detailed information about the costs of hotel activities, such as the costs of operating the hotel desk and lobby, room cleaning and room service, and so on.

Lee Stevens suggests that a system of activity-based costing could be considered, although he is not sure what benefit this cost information would have for management.

Required

Using the information provided in the case study and the information in this document, you should:

(a) Assess the profitability of the entire company for the year to 30 June 2012.

(b) Suggest:

   (i) how the company might introduce a system of activity based costing into its hotels, and

   (ii) whether and how a system of ABC might provide valuable cost information for management.

Workshop 2 Session 6

Pre-workshop exercise 4 (Treasury Operations)

James Wu and Lee Stevens are discussing the company's cash flows and working capital.

The company is cash positive in its operations, but it has also been using up a large amount of cash. In the most recent financial year, Platin made a loan of HK$600 million to its joint venture, and the money came from the company's cash resources. Net new borrowings in the year were HK$300 million.

There are plans to develop the business strategically. Although most of the funding to develop the business will come from new sources, James and Lee agree that improvements in cash management will reduce the amount of new funding required. They are discussing whether improvements in working capital management will help to reduce the need for cash, and they have been analysing the company's cash flows and the working capital position.

The working capital of the company as at 30 June 2012 was as follows, excluding positions in financial derivatives. (All figures are in HK$ millions.)

Current assets

Inventory	109
Trade receivables	242
Payments in advance	54
Short-term investments	184
Cash	658
	1,247

Current liabilities

Overdraft		21
Other bank borrowings repayable within 12 months or on demand		516
		537
Trade payables (note 1)	575	
Commercial tenants' deposits	116	
Guest deposits (note 2)	74	
Accruals	82	
Tax payable (note 3)	38	
		885
		1,422

Notes

1 Trade payables are creditors for purchases of materials and inventories and for other operating expenditures of the hotels.

2 Guest deposits included non-returnable room deposits of HK$15 million that would soon be recognised in revenue as realised income.

3 Other liabilities in the end-of-year summary statement of financial position (Appendix 1) were HK$1,412 million. In addition to the HK$885m above, these liabilities included deferred taxation of HK$527 million.

James and Lee are aware that both revenues and operating costs were 4% higher in the year to 30 June 2012 than in the previous financial year. Working capital increased by HK$75 million between 30 June 2011 and 30 June 2012.

Required

Using the information available (including the information in the case study material) and making any assumptions you consider appropriate, you are required to:

(a) measure the working capital cycle of Platin

(b) assess whether and to what extent improvements in working capital management could reduce the need of the company for additional cash for its operations

(c) assess whether the company has serious cash flow problems.

Workshop 2 Session 7

Pre-workshop exercise 5 (Corporate Finance)

The board of Platin are considering the company's investment in the 50%-owned joint venture in China. They agree that the longer-term business prospects for this hotel are very good, but they are concerned about the current financial position of the business. They are also worried that the development of the hotel may be held back by inefficient management by their joint venture partner, which is currently in charge of day-to-day operations at the hotel.

There is a risk that if the business grows slowly, it will take a very long time before Platin recovers its investment and makes a good return.

A summary income statement for the joint venture for the year to 30 June 2012 is shown below, together with a summary balance sheet as at 30 June 2012.

Summary income statement for the year to 30 June 2012

All figures are in HK$ millions	
Revenue	498
Operating expenditure excluding management charges and depreciation (note 1)	(364)
Management charges	(60)
EBITDA	74
Depreciation	(112)
Financing costs	(64)
Operating loss	(102)

Summary statement of financial position at 30 June 2012

All figures are in HK$ millions	
Non-current assets	7,030
Current assets	110
Current liabilities	(3,484)
Non-current liabilities (note 2)	(1,820)
Equity (note 3)	1,836

Notes:

1 The operating expenditure includes HK$60 million of management and administration charges by the joint venture partner.

2 The non-current liabilities consist entirely of loans to the joint venture by Platin. These are long-term loans on which interest is payable.

3 The joint venture has been established as a company, and each joint venture partner owns 50% of the equity shares.

Following a meeting of the management committee, James Wu is preparing a document for discussion by the board of directors about:

- a financial restructuring of the joint venture operation, which is urgently in need of more capital
- a possible reorganisation of the management structure of Platin.

Financial restructuring of the joint venture

A financial restructuring of the joint venture is considered essential – and urgent – because the operation has insufficient working capital. More cash must be put into the business, and Platin's management agree that the joint venture partner must contribute some of the extra funds. Platin has lent enough money to the business already.

Organisation and management restructuring

Senior management consider that the current management structure within Platin will not be appropriate if the company diversifies and expands into commercial property development in the USA or the development of golf clubs and country clubs in parts of Asia. As new business operations are established, there will be too many direct reporting lines to senior management in Hong Kong.

The proposal under consideration is to create three divisions within the company, organised on the following geographical basis:

- Hong Kong and Australasia
- Rest of Asia
- USA.

Each division should have its own divisional manager, supported by administrative staff and management, who would be responsible for all business operations within their geographical area. Hotel managers and other business managers within the division would report to and be accountable to the divisional manager. The divisional manager would report to and be responsible to senior management at head office (the COO and CEO).

Required

(a) Identify the key issues that must be considered in a planned financial reconstruction of the joint venture.

(b) Suggest how the market may react to information about a proposed financial reconstruction of the joint venture company.

(c) Identify the probable reasons for the restructuring of the company into divisional units and suggest what the strategic and financial implications of restructuring might be.