

**HKIAAT**

**Accounting and Business Management  
Case Competition 2008-2009**

Secondary School Group

**Every day is a Safety Day  
on the MTR!**



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# Reference

維基百科 (Wikipedia) <http://www.wikipedia.org/>

香港政府一站通 <http://www.susdev.gov.hk/html/en/sd/index.htm>

Answer.com <http://www.answers.com/>

"Making Good Business Sense" by Lord Holme and Richard Watts

# Executive Summary

Social responsibility is essential to every companies including the Mass Transit Railway Corporation (The MTR). It can benefit the company's market positioning, recruitment and relationship with the government. Once the social responsibility is being considered by the company, needs of stakeholders can be fulfilled and thus, the long-term development of firm will be more stable. It is also beneficial if the company concerns about sustainable development, as all stakeholders would prefer knowing about the long-term planning of firm sustainable development. Indeed, concerning sustainable development would be a road leads to success of business. The importance of social responsibility and sustainable development will be explained on [P4-7](#).

Data collected form the MTR 2007 Annual Report shows the strong profit making ability of the company. However, there are still much space in improving the liquidity and asset management ways. The company has to ensure a well utilization on any internal and external advantages and try best in coping with the disadvantages. In general, the MTR needs to put more effort into management in order to maintain investment flow into the firm. The analysis of ratio of the company has been put on [P9-12](#).

Asset management includes the ways of using assets appropriately and control over quality of staff. It is important to the company so a Business Policy Blue Print is suggested for the future development of the MTR, which has been drafted on [P19-20](#). . Some indicators are suggested to access performance of employees, as well as the social responsibilities of the MTR as a franchised public transport operator on [P21](#).

To conclude, the overall performance of the company is satisfactory. However, the company's performance can be greatly improved if the management is done better.

## **Section A: Social Responsibilities of Listed Companies in Hong Kong**

According to Milton Friedman, "the sole responsibility of business is to increase its profit" , which suggests companies to maximize the profit without considering the needs of its stakeholders. Those companies that did not adopt the "responsible" attitudes would face less binding constraints and thus be more competitive in the market place.

Admittedly, the capability of profit making is vital to the survival and continuation of a business, but whether "the sole responsibility of business is to increase its profits" should be in doubt in this modern society, in where corporate social responsibility has become a rising concern.

### **Shareholders' Profit Vs other Stakeholders' Needs: A Delimma or A Complements?**

To maximise shareholders' profits, it is quite often for people to associate with actions taken at the expenses of its other stakeholders such as layoff of workers or making product with poorer raw materials.

However, many recent researches indicate that companies, in the long run, could indeed enjoy a higher shareholders returns by giving a continuing commitment to behave ethically through improving the quality of life of the workforce and their families as well as of the local community and society at large" (L. Holme, R. Watts)

### **Significance of Taking up Social Responsibilities**

Social responsibility is one of the essential components of companies for market positioning, recruitment and maintaining political-social relationships.

- **Market positioning:** It can help the companies' goods and services to be branded as socially responsible and build up a good image in the market.
- **Recruitment:** It can help for hiring and retaining quality and experienced employees for they will be more loyalty to the company when the firm offers good pays and welfare.
- **Political-social relationships:** The MTR is a public utility providing public transport services. She could easily maintain the franchise of operating the rail business when she has social responsibility as a good relationship with the government can be built up.

Maximizing shareholder's profits and considering other stakeholders needs should not be exclusive after all. On the contrary, the two concepts should be regarded as a complement to each other. To illustrate, though MTR have to sacrifice a large proportion of her operating profit for changing the structures of all trains to use hydrogen instead of fossil fuels as fuels to reduce pollution, it helps reducing the social cost by improving the environment and relieving the global warming problem. The company could even build up a good relationship with the government, which could help her in continuing to get the franchise of running railway business. In the contrast, companies that pollute their local communities risk poisoning their customers and the whole society could not remain competitive in longer term.

In conclusion, MTR can operate in a way that maintains a sustainable return for its shareholders as well as shows concern about the needs of stakeholders. To gain trust from the others, treating employees, customers, and business partners fairly during this time of world economic hardship could help in building up goodwill for MTR and thus contribute to the long term growth in its shareholders' returns.

## **Sustainable Development and its Importance**

According to the World Commission on Environment and Development, “Sustainable development is the development that meets the needs of the present without compromising the ability of future generations to meet their own needs” “Sustainable development of Hong Kong means: 1) finding ways to increase prosperity and improve the quality of life while reducing overall pollution and waste; 2) meeting our own needs and aspirations without doing damage to the prospects of future generations; and 3) reducing the environmental burden and helping to preserve common resources.” (Sustainable Department, 2008).

Having sustainability development is one of the important elements that contribute to the success of the MTR, for example,

**To employees:** MTR has held activities like talks on work-life balance, talks on value creation and staff stretching video sharing (2007 Annual Report P.87) so that increase the loyalty and morale of its employees. Besides, trainings were held to increase the working efficiency of workers. Gradually, not only would staff turnover rate be reduced, more experienced and qualified candidates would be attracted to join the workforce of MTR.

**To communities:** By holding activities such as “Race Walking”, “Step to Health Campaign” (2007 Annual Report P.87), MTR can remind the public to have a healthy life and at the same time establish a positive corporate image.

**To environment:** MTR had a water consumptions 3% under budget even with new cooling tower at Admiralty Station and recycled all waste metals and oil. Besides, it has signed “Clean Air Chapter” and adopted the MTR Cooperation Climate Change Policy (2007 Annual Report P.87). By doing so, MTR has shown its commitment to protect the environment and be a socially responsible enterprise and gained public recognition and goodwill on its sustainable development.

## **The Advantages of Preparing Sustainability Report**

Although it is not compulsory for a company to prepare a sustainability report, stakeholders of MTR would be happy to see a sustainability report being prepared because

**As an Investor:** they would like to know how their money invested is spent and thus make further investment decision. A well development plan shown in the report could increase the confidences of existing investors or attract more potential investors.

**As a Staff:** they would like to know the future direction of, development plan on, and new policies over the operation of the company. By having a better understanding on the issues, staff will develop their loyalty towards the company.

**As a Customer:** they will be better informed about the business condition and stability of the company so as to make their consumption decision.

## **Section B: Analysis of MTR's Historical Data**

	Railway Operations and Related Activities		Property Development	
	2007	2006	2007	2006
Return on assets (%)	2.9%	3.0%	47.4%	43.8%
Assets/Total assets(%)	86.4%	86.5%	11.2%	11.0%

## **Corporate Nature of MTR: A Public Utilities or A Property Development Company?**

A public utility company refers to an organization that maintains the infrastructure for a public service, while a property development company refers to an organization aims at generating profits by building and selling properties.

According to the figures of **Return on assets**, MTR has generated a large proportion of profit from the property development, compared with that of railway operations. Then we may say that property development is the major source of revenue of MTR as it is essential for supporting the daily operations of the company.

By comparing the **Assets-to-Total assets** figures, railway operation assets held by MTR take a larger percentage in total assets than the property assets. It is obvious that the firm has spent more resources in providing railway services than developing properties. Railway operations would actually be a significant business of MTR.

From the above figures, we notice that both railway operations and property development show significance to the MTR. Indeed, both of them are inter-related with each other, it is therefore impossible for us to clearly define MTR as a public utility company or a property development company. If MTR is a pure property development company without engaging in railway operations, it can never be succeeded in generating so much profit, as MTR actually gets lands from the government for development in return for financing the construction of railway systems. Stable revenues earned from railway operations can even balance the highly fluctuant revenues generated from property development. Similarly, if MTR just focus on railway operations but neglect development in properties, expenses spent on constructing new railways cannot be covered easily. The healthy financial position will also be difficult to keep, which may even hinder MTR to further develop into various aspects.

In conclusion, MTR actually operates by adopting a **'Rail + Property' model**. It is therefore impossible to for us to treat it solely as a public utility company or a property development company.



## **Ratio analysis Report**

### ***Profitability***

	MTR	A comparable local listed company
<b>Net Profit margin</b>	59.4%	29%

#### **Interpretation and limitations**

The ratio shows that MTR earns \$0.594 by inputting \$1 in the business. By comparing to the ratios of other firm, MTR has a much higher net profit margin which shows the firm has a high profit making ability. The main source of revenues comes from property development (MTR 2007 Annual Report, P.127) as the property market of Hong Kong is blooming in 2007.

<b>ROCE</b>	18.21%	12.5%
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#### **Interpretation and limitations**

By comparing with the other company, the MTR has a slightly higher ratio. This is a sign of “healthy” profitability of the company, as it can utilize less capital in generating same amount of profits.

However, there is no generally agreed definition on the ‘return on capital employed’. Different companies may use different methods to calculate the ratio. This reduces the comparability between companies by using this ratio. The figure may even not be realistic when there is no standard method for calculation.

### ***Liquidity and debts management***

	MTR	A comparable local listed company
<b>Current Ratio</b>	2.41:1	1.8:1

#### **Interpretation and limitations**

MTR has a higher current ratio than the comparable firm. That means the MTR has a higher ability on covering liabilities due in the coming financial year by her current

assets. She also has a better liquidity position which can confidently face emergency financial problems.

Therefore, there is space left for the MTR to borrow loans for carrying out later railway plans.

<b>Interest cover</b>	9.0 times	12 times
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Interpretation and limitations

The ratio shows the profit of MTR can repay the loan interest for 9 times which means it has enough profit to cover all interest on debts.

However, compared with the other company, MTR possesses less profit to cover the interest on debt. Since we know that the profitability of MTR is satisfactory from the above ratios, the lower interest cover maybe due to the great increase in loan interest. As the company borrowed loans from banks for financing the merger with KCRC and the development in the new railway systems, it leads to an increased interest burden of the company.

<b>Debt to Equity Ratio</b>	70.8%	28.4%
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Interpretation and limitations

The MTR has a much higher debt-to-equity ratio than the comparable company. That means the company is too aggressive in financing its growth with loans. The additional interest expense would then lead to a volatile earning. A lower ratio is preferable so the company is advised to control other expenses spent and manage its assets more carefully.

However, the ratio is not standardized. For calculating the Total debts, sometimes only interest-bearing, long-term debt is used instead of total liabilities in the calculation. So, there maybe some misleading causes to the investors.

## **Asset Management**

<b>Debtors' ratio (days)</b>	121.6 days	75 days
<u><i>Interpretation and limitations</i></u> The MTR needs 121.6 day to collect the debts, which is a non-preferable long period of time comparably. Its liquidity is likely to be weaken as most of the debts cannot be collected quickly. It should have a better management over its assets and find ways to improve the ratio. For example: offering more discounts to early repayment.		
<b>Fixed assets turnover</b>	0.08	0.08
<u><i>Interpretation and limitations</i></u> The effectiveness of the MTR in generating the revenue from the fixed assets is satisfactory compared with the other firm as they have the similar ratio. The ratio may be misleading when there is inflation because the sales figure will increases with the cost of materials. This could affect the comparability of the ratio.		

## **Investment appraisal**

<b>Earnings per share</b>	2.72	2.59
<u><i>Interpretation and limitations</i></u> MTR has a slightly higher value of earnings per share than the competitor. That reflects the returns of each share are slightly higher than the other listed company. It is expected that when the development projects in Beijing and London are settled down, the profit of MTR as well as the dividend paid will tend to increase. This would attract more investors to invest into the business.		
<b>P/E ratio</b>	10.56 times	3.26 times
<u><i>Interpretation and limitations</i></u> This higher ratio of the MTR indicates that longer period of time is required to earn back		

same amount of capital invested in its shares.

A higher P/E suggests that investors have more confidence in the company that they are willing to pay higher price for the share.

However, the past P/E ratio cannot show the updated situation until earnings are actually completed.

<b>Dividend cover</b>	6 times	6 times
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Interpretation and limitations

This ratio indicates the extent to which the MTR profit can pay 6 times out as dividends. MTR have the similar ratio with the local comparable company which means it is suitable for investment.

A high dividend cover means that only small amount of profits has been distributed as dividends and a large amount of profits has been retained as reserves which can help to finance the operation of the company, and it can bring higher profits in the future.

A low dividend cover means that a constant amount of dividends is being paid out from decreasing profits in order to meet the expectation of shareholder, and therefore attract more investors into the business.

**SWOT Analysis Report**

**Strengths**

1. Diversification of Business and thus reduce business risk. Diversify the products and services, for instant: advertising, consultancy income and telecommunication income, these provide a wider source of revenue.
2. The idea of 'Rail and Property' brings an appealing profit.
3. The current ratio (2.41:1) shows that the company capable to pay its obligation and the financial position is relatively stable.

4. Apart from the property development, which revenue generated fluctuates according to the economic environment. Railway operation is the basic business for MTR, and because MTR is one of the major transportation in HK, so it can maintain stable revenue to MTR.
5. Well corporate governance system: The MTR consists of over 10 non-executive directors with majority of independent directors come from various aspects such as government, business and education. This is a safety system to ensure there will be a lower chance of having corruption and negative decisions made in the corporation.

#### Weaknesses

1. High total debt to equity ratio (70.8%) indicates MTR has a huge liabilities and it lead to a risk of liquidation or affect the current cash flow.
2. High debtors ratio (121.6 days), increase the risk of bad debts and may worsen short-term liquidity.
3. The merger with KCRC will increase the number of workers rapidly and there is a challenge in keeping up the efficiency.
4. The operation of Ngong Ping 360 does not has well management, and many accidents are happened, so people lack of confidence to travel it.
5. The environment in the car is cramped, customers feel uncomfortable.
6. The safety of platform should be improved, as MTR still has not installed the Automatic Platform Gate in some of the stations.

#### Opportunities

1. The 2012 Olympic Games will be held in London, which could bring huge fare revenue to the London Underground Railway.

2. The increase in taxi fare (from \$16 to \$18) and bus fare, may lead to further increase in patronage.

### Threats

1. The global financial crisis will increase the foreign exchange risk, credit risk and interest risk, which can affect the financial stability of MTR.
2. The financial crisis affected many banks around the world to contract credits towards other parties. It would also be difficult for the MTR to get further finance from bank for development.
3. The profit from property development, which takes a large proportion of the total revenue of MTR, is unstable and will fluctuate a lot. Due to the economic downturn, net profit of the company in the coming few years would be greatly reduced which may hinder the financing of railway development project.

### **Meaning of Synergy**

“It refers to the interaction of two or more agents or forces so that their combined effect is greater than the sum of their individual effects and Cooperative interaction among groups, especially among the acquired subsidiaries or merged parts of a corporation, that creates an enhanced combined effect.” (www.answers.com ,2008)

This term is used mostly in the context of mergers and acquisitions. For example, if Company A has an excellent product but poor distribution system whereas Company B has a great distribution system but poor products, the companies could create synergy by forming a merger. One example is the Citybus became a member company of Merryhill Group Limited in March 2004. It is a comprehensive transport services provider jointly formed by Chow Tai Fook Enterprises Limited and New World Services Holdings Limited.

## **The Synergy Effect of the Merger**

**Revenue Synergy:** It refers to the opportunity of a combination of two companies to generate more revenue than its two companies standing alone would be able to generate. For instance, the properties of the KCRC could be sold with the properties of the MTR together, and so raising revenue can be achieved. Also, the patronage of both MTR and KCRC are add up together, and so more fare income can be secured.

**Cost synergy:** It refers to the opportunity of a combination of two companies to reduce or eliminate expenses associated with running a business. Cost synergies are realized by eliminating positions that are viewed as duplicate within the merged entity. Examples include in the merger of MTR and KCRC, positions were overlapped, a Staff Voluntary Separation Scheme (VSS) is provided to the staff for their voluntary resignation. Besides, with the merger of the two transport giant, it can enjoy further economies of scale on its operation, for example,

- Purchasing (bulk buying of materials through long-term contracts), that is MTR purchase large amount of materials such as tracks for repairing the rail.
- Managerial (increasing the specialization of managers), that is the management team can manage the whole MTR company with more appropriate use of method of production.
- Financial (MTR can obtain lower-interest charges when borrowing from banks and having access to a greater range of financial instruments)
- Marketing (spreading the cost of advertising over a greater range of output in media market).

### **Reasons for MTR to choose Syndicated Loans**

Syndicated Loan is a very large loan in which a group of banks work together to provide funds for one borrower. - It allows the MTR access to a diverse group of financial institutions. In general, MTR can raise funds at a relatively lower interest cost by borrowing from different banks in the syndicated loan market than borrowing the same amount of money through a series of bilateral loans.

- Different financial products can also be obtained from various banks to raise further funds when there is a close contact between the MTR and major banks.

-The MTR can easily get a higher loan value by saving transaction cost such as time and effort on negotiating with each individual bank.

### **Appropriate Options for Raising the additional \$4 billion**

In raising the additional \$4 billion, **method (B)**, i.e. issuing new 4% preference shares with a nominal value of \$1 at \$5.2 each would be a more appropriate option because

1. Preference shareholders do not have voting rights at the board meeting, so no dilution effect is impacted on the power of existing shareholders
2. Since no dilution effect is generated by issuing preference shares, the existing shareholders are not lessened.
3. For each preference shares, share premium of \$4.2 arises. The share premium is going to accumulated as reserves. It gives MTR the flexibility to use the reserves to sustain the cost of developing facilities or making further investments.



### **Reasons for Option (A) and (C) being not preferred**

**For (A)**, right issue is an offering of common stock to existing shareholders who hold subscription rights that entitle them to buy newly issued shares at a discount from the price at which they will be offered to the public later. With the issued rights, existing shareholders have the privilege to buy a specified number of new shares from the firm at a specified attractive price within a specified time.

Assuming all existing shareholders make a right issue according to the original proportional of ordinary share, no dilution effect is occurred. However, if a existing shareholder do not make a right issue, his/her privilege in the board will be weakened. Dilution effect existed.

This leads to an inflow of capital from the shareholders to the business, but there is no change in the shares ratio at last. In fact, all the shareholders have gave out money to the business, but no gain in relative share ratio. Therefore, it is not preferential for MTR 's Board to choose the syndicated loan.

**For (C)**, Debenture is a type of liabilities (Debt). Issuing debentures will increase the total debt to equity (Debt/ Equity). Investors will doubt about the liquidity of the company, and therefore not to invest in the company. Therefore, it is not appropriate to choose method (C).In addition, interest cost is incurred for issuing debentures. The effect of interest cover may leads to the problem of circulating fund.

### **Significance of Development Expenses**

MTR 's development expenses such as railway construction's research, property development's research in mainland china and Europe are important to MTR. Railway

construction & property development expenses including those mainland China railway lines and London Underground Railway.

Development expenses is significant to the MTR because it help the MTR to maintain a competitive position, and expand its brand to the foreign market, such as London Underground Railway will be used as one of the transportation system in 2012 London Olympics, so that profit can be substantially acquired from different aspects.

Another significance of development expenses is it can reduce the unexpected risk of the business decision, so decision being made will be more reliable since appropriate research had been carried out. For example, carry out researches can provide a more realistic picture of the new development project. For examples, the patronage of the Shenzhen Railway can be found out, so the decision-making can be more realistic, because it is based on facts.

Last but not the least, development expense can help exploring more business opportunities for the MTR, such as they submitted bid in Hangzhou, and continue to pursue opportunities in Shenyang, Suzhou and Wuhan.

### **The Implications of the Development Expenses**

**Ups:** Short-term effect: Since the development expenses $\uparrow$ , the profit of the MTR will be $\downarrow$ . Then, the returns on shares $\downarrow$ , earnings per share $\downarrow$ . Finally, the investors incentive to invest is likely to be $\downarrow$ .

Long-term effect: Reduce business risk as it can enhance the image of the MTR with great expansion power and development scheme. And providing a strong competitive power among different railway company such as "European Railway Company".

**Downs:** Short-term effect: On the contrary, since the development expenses↓, the profit of the MTR will be↑. Then, the returns on shares↑, earnings per share↑. Finally, the investment incentive is likely to be↑.

Long-term effect: MTR only develop and operate in a limited way and opportunities in the mainland China and the Europe. It only struggling in the local market in HK. This may leads to a loss of confidence to the investors, as the MTR lack in the thinking of the future opportunities. Furthermore, the risks of the project would not be minimizes. This may raise the risks of the operations and affect the continuity of MTR.

## **Section C: Business Policies and Methods of Performance Evaluation**

### **Proposed Business Policy**

#### ***Marketing***

- Cooperating with other corporations: By joining with plazas and restaurants, we can provide discounts to customers and further promote MTR railway services.
- Further promotion in Octopus card system: The MTR can promote it to large corporations first. Holding seminars about how the system could increase working efficiency or door-to-door retailing are possible ways.

#### ***Product***

- Diversification of investments: MTR can set up or invest different kinds of properties in various places to attract a wide variety of customer classes. For example, shopping malls in South Korea, commercial buildings in Beijing and luxurious resorts in Shanghai. It is a good way to get extra source of income for covering the future large and constant amount of concession and merging fees.

- Making full use of trains: Prepare theme trains for advertisement or lending to others for parties such as birthday and wedding parties. Tai Po and Fo Tan stations are suitable places for the 'party trains' to stay at non-peak hours, as there are 3 tracks with 1 spare.
- Extending Octopus card systems: The mainland is developing a wide rail network. It is a good chance to introduce the convenient Octopus card systems to the mainland.
- Developing renewable source of energy: The MTR can input more resources into development of using hydrogen instead of fossil fuels as fuels or making use of solar energy during daytime. The success of development can raise the social statue of the firm and also greatly reduce expenses spent on energy sources.

### ***Financial***

- Using energy saving lamps: The company can use energy saving lights to replace all existing lamps, especially for the advertisement bulbs. It can help in saving much cost in illumination.
- Setting up cost-reduction plans: The firm can save cost by encouraging employees to set up goals on reducing cost for performance indicator.
- Rearranging timetables of trains: This can make a more efficient use of resources by using limited of resources, which can lead to higher productivity of the firm.

### ***Human Resources***

- Using more technology instead of labour: For instance, staff who is responsible for pointing direction inside the station can be replaced by digital direction boards. It is a long-term way to save wages expenses and reduce average cost.
- Arranging more human resources to the mainland: This can facilitate further development of railways and property of the corporation.

### **Other Performance Measurement Indicators**

- Making assessment: The MTR can set up some criteria such as attitude and achievement of employees to assess their working performance. The assessment can even be done in a more interactive way, which associates and classes of employees can also express their opinions to assess a person. The assessment would then be more objective and reliable.
- Encourage setting up of goals: To assess the departmental achievement, the MTR can encourage every department to set up business goals such as increasing 5% of market shares at the beginning of year. At the end of year, the firm can base on the difficulty in finishing the project and effort of employees put into it as an indicator to evaluate their performance. The higher the difficulty and closer to the goals set would be more preferred.
- Use of data: Comparison of some internal management data such as amount of expenses in different years and the balanced budget can be made for assessing the departmental cost control and revenues generated abilities.

### **Social Responsibilities Indicators**

- Collecting customers' opinions: To keep up the satisfaction of passengers, the MTR can appoint a professional marketing research company to conduct surveys and research on passengers' views towards the firm to collect more objective and reliable result.
- Employees' satisfactory: MTR to pay enough wages and offer suitable welfares to its employees, as they are one of the biggest assets of the company. Thus, the happiness of them needs to be seriously considered.
- Safety and reliability of railway systems: The MTR needs to maintain a safe and dependable service provided to the public. So, a close and careful check on the rate of having faults of railway signals and the rate of delay on the confirmed timetables is needed.