

XP Actuarial SDM Exam Study Manual Introduction

Hey students, this is Steve. I've been helping students pass SDM for about 6 years now.

First, be sure you have watched the introductory videos on the portal:

- The Reality of SDM
- How XP helps on SDM
- If you previously failed this exam, watch the video on using prior exams BEFORE you look at the SOA solutions for last sitting

OK, so having watched those videos, you should understand now that SDM is a bigger challenge than the other finance track exams because you are competing against almost exclusively students that have already passed 2 written exams. You now have to get into the top 40% of the *really* good students. But be clear, together, we can absolutely do this!

Second, to reiterate, we have found the following things empirically make the biggest differences:

- 1) **Diligent studying** – use your diligent study approach and great time management skills to learn the material, become really familiar with the case study, and stay on schedule.
 - The XP manual and seminar videos are there to help you on this. There are also a number of XP memory tools (ANKI, pdf, audio, key points) that you can select your favorite from.
- 2) **Have more time for additional questions** – this exam challenges you to apply the material in different situations and in different ways ... and often in qualitative ways. To close the gaps between your knowledge and your ability to apply it we've built a lot of medium and some tough questions to ensure you have proper practice across the entire syllabus.
 - The XP Application Questions, XP Practice Exams, and the Business Dynamics Assignment are there to help you in addition to the past SOA questions.
- 3) **Develop "system 1" answering skills** – This is about closing the gaps between your answers and how the graders will score them. The big trick is doing enough practice in the final 2 or 3 weeks so those answering skills improvements are automatic or "system 1". Because SDM has a much higher % of QUALITATIVE questions, HOW you answer SDM questions becomes critical to passing.
 - The XP answering skills videos (specifically for SDM) and specific XP practice exams are there to help develop and test these skills in the last month of your preparation.
 - Also, you get very detailed video feedback from me to help you make sure you are scoring maximum points on HOW you answer. I can guarantee you NO other exam company can provide the feedback we do. (Note: You need to submit something to me for feedback to get a free re-use of the XP material if needed.)

Please keep the above in mind (and maybe print off this page) as the above three things are what have allowed our students to have significantly higher pass rates than non-XP students.

A few important details to note:

- The XP study manual is NOT a replacement for the source material – Instead, it is a more condensed summary and it contains a number of intuitive explanations of the material, additional relevant examples, case study connections, and common student questions. So the manual is there to actually help you learn the material.
- **A few other material notes:** the 12th edition of Strategic Management is absolutely OK to use (there is literally no differences other than examples between the 12th and 13th edition for the material we use); The DMD textbook for Objective 3 is pretty important to have because of its great examples, and I provide you select solutions to end-of-chapter questions.
- ALL of the SOA SDM study notes are linked on the portal. You do NOT need to buy these!
- About every 2 or 3 weeks I send out a short message to students to help guide them along the way – be sure to watch your email for those (my email is steve.scoles@xpactuarial.com)
- **Most of the important tools** – XP Application questions, Business Dynamics assignment, and XP Practice exams **are released in the final 6 to 7 weeks before the exam as we have constantly found that students need to do those closer to the exam.**
- **Note that on the videos**, you can set the **speed** ... some students like to watch the videos a bit quicker than I talk 😊
- The two XP case study tools are released after the case study is updated – usually around mid to late February of each year.
- A lot of the SDM material is really interesting. In fact, this exam is specifically designed to be like a mini-MBA program from MIT, so you will learn a lot of useful stuff for your future career.

As always, feel free to reach out with questions or any ask advice. **Students are always really surprised by how much I am willing to help them directly in getting this exam.**

XP tools aside from the study manual that are all available to you on the portal:

Memory tools:

- **Key point flash cards** – these are the key points from the study manual – very efficient for doing a 20 to 30 minute weekly review of the material to keep on top of your learning.
- **Audio Cards** – flash cards that you can listen too. If these are easy for you to use, you may want to try them as quite a few students find them helpful in the last month when they are tired of reading!
- **Flash cards** – cover the entire syllabus – have both pdf and **ANKI app** flash cards

Seminar Videos – I touch on key points in the material, solve example questions, and relate them to case study and/or real life situations as this is often how the material is actually tested on the exam

Practice Recall Questions – these are memory/recall questions that cover the entire syllabus – these are basically the flash cards but allow you to type your answers for the students that like to do that.

Case Videos – videos on specific questions on the case study companies

Case Study Checklist – about 100 references in the case study that connect with specific syllabus material. This is only intended as an intermediate step before doing SOA and XP questions

XP Application Questions – these are a combination of medium and hard critical-thinking questions – RELEASED about 6 weeks prior to the exam (as we found that students need to do them closer to the exam to properly PEAK for a critical thinking exam).

Business Dynamics Assignment -- Most students have found this to be super-helpful for developing their Business Dynamics skills. The connected videos go through actual good and bad student answers.

Practice Exams – 4 practice exams that simulate the real thing. They have extensive answer commentary that show the typical errors students make with SDM-style questions.

Answering Skills videos – After reviewing hundreds of student’s practices on SDM specifically, we found a number of areas where students unknowingly and painfully lose marks. The key is not only knowing these mistakes, but **practicing enough so they are system 1** under exam time limits. (You’ll learn about system 1 in Objective 5 of the syllabus!)

Personal Video Feedback from the instructor I will give you OBJECTIVE & detailed feedback on HOW you are answering – such as if your justifications are logical and appropriate to score marks for how the graders will look at them. Students are consistently surprised at what I show them in their feedback. You need to get feedback from me on something if you want a free re-use of the study material.

The items in **RED** are released over the final 4 to 8 weeks before the exam as we have found that students should be using them closer to the exam to properly PEAK for exam day. **Basically your goal is to learn the material reasonably well** and then you have the tools in RED to really help in the final month or two.

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Order of Material comments – you don’t need to start with Objective 1

- **Objective 1** (Strategic Management) is the most qualitative
- Start Objective 1 with the Understanding Michael Porter book – it is well-written and has more relevant examples to help build your strategy knowledge and understanding
- **Objective 2** – not too long to get through, but the Valuation material has a lot of things to learn
- **Objective 3** is the quickest to get through – BUT there will still be about 20+ points on the exam and they usually have one *very* challenging optimization-type question every exam – so don’t take this objective lightly!
- **Objective 4** requires lots of practice close to the exam. By the way we have a Business Dynamics assignment for you to work through where you get to see lots of other students’ answers in the accompanying videos.

Objective 1 Material

General Objective 1 Comments:

- In the videos for this objective, we go into many case study and real life examples of the concepts , so it's helpful to at least skim the SDM version of the case study before getting too deep into the videos. The new case comes out each February.
- There are a number of XP Application questions that will help you develop your application of the somewhat general and subjective concepts in this Objective to the case study ... which is like how SDM will test you.

Important Instructor comments about the Understanding Michael Porter textbook and the other readings for this objective:

You should start Objective 1 with reading the Understanding Michael Porter book. This book is well-written and has a lot of great examples – there should be some examples that you can relate to. As well, this is the kind of book you can keep in your office for the rest of your career.

Now for some general comment around learning the strategy material:

You may not have a lot of experience in your current job as to the importance of strategy, but there should be some things that you can relate to.

As a first step, take one or two companies that you know well and try to apply the concepts as you read. For example, take Apple. Apple uses a **differentiation strategy** by having a powerful brand and constantly innovating to bring new features and app capabilities to its products. Because of this strategy, many customers are **willing to pay higher prices** for Apple products, allowing Apple to earn high returns on its investments relative to its competitors. Apple does not try to be the phone for all customers, but it does try to be the **ONLY** phone for **SOME** customers.

Furthermore, Apple has developed a very successful value chain. First, it is able to outsource the production of its iPhones at relatively low cost, but also very high quality. Second, Apple has over many years of continuous strategic effort to develop its own design, branding, marketing, and distribution capabilities that make it a formidable competitive force.

Lastly, customers and suppliers **KNOW** what to expect from Apple because of the **continuity of Apple's strategy over time**. A customer knows that Apple products are cool and have intuitive and friendly design, but also to expect a higher price. A supplier knows that they need to meet high quality specifications for Apple and know that Apple won't accept anything less.

At the same time, many competitors, such as Samsung, have competed aggressively against Apple and have been able to take market share from Apple. Furthermore Apple needs to be concerned about political actions such as foreign governments placing tariffs on its products. These are examples of Apple needing to understand the **five forces of its industry**.

Continuing this example, Samsung, in its efforts to profitably gain customers away from Apple, sometimes **tries to be unique** such as when it was the first to introduce larger screen smartphones. This was risky as it had not been attempted before and thus the results were less predictable. However, once large phones were recognized as a useful feature, Samsung became recognized as an innovative company as well and was able to strengthen its brand and garner many loyal customers

By taking a couple of companies you know, you can start to get a better understanding of how to apply many of these strategy concepts so the concepts become less murky. These companies may be widely-known or may be a small company you have worked a summer job at.

Later on, there will be many opportunities to apply these concepts to the case study through the case study assignment and checklist. Also, and by far most importantly, the XP Application questions have many questions relating the strategy concepts to the case study. And finally, the XP practice exams

have several tough questions to push your ability to apply these concepts really well to very specific situations.

Why do you need a deep understanding of how to apply these concepts in detailed situations? Because that is specifically how you will be tested on this material. The exam graders are always noting that students **lose a lot of marks** because their answers were **not specific to the situation given**. So if all you have done is memorized the lists, you will not do well on this exam! You also need to be able to apply the information deeply ... and accurately.

We can see this in the syllabus learning outcomes: for example, **Assess and recommend** business strategies **under different business situations** and market opportunities, utilizing the **applicable strategic or change management models**. You will have past SOA questions AND XP Application questions and practice exams that WILL test you in this way, so that will be what you have in the last month or so of your preparation to be able to do this well on the exam.

Active Study Tip: For now, write down a couple of companies you are familiar with and make notes on those companies as a way to apply the concepts in this objective's material.

Strategic Management: Competitiveness and Globalization
Chapter 7: Merger and Acquisition Strategies (only 7.1 to 7.4)

Key Points:

- **Reasons for acquisitions:** increased market power, overcoming entry barriers, reduced cost or risk of developing new products, increased diversification, reshape firm's scope, develop new capabilities
- **Problems with acquisitions:** integration difficulties, inadequate due diligence of target, large debt increases, inability to achieve synergies, too much diversification, distraction of managers from core business activities
- **Market Power:** exists when a firm is able to sell its goods or services above competitive levels or when it can buy supplies at lower prices than competitors
- Understand differences between horizontal, vertical, and related acquisitions

Instructor Comment:

For this chapter, you will likely be tested by having to **critique/evaluate acquisitions and make recommendations with logical justification**

- So understand the reasons why different actions are good or bad

Active Study Tip: this chapter could be tested by having to examine a possible acquisition by one of the case study companies – think about each case study company and good & bad reasons for an acquisition and approaches to make those acquisitions

- Why might Frenz NOT want to use acquisition strategies for its expansion
- Which companies would benefit from vertical integration and why?
- this is also a question to ask yourself in the Vertical Integration study note
- Would it make sense for Blue Jay Air to acquire a discount airline? Why?
- Would it make sense for Blue Jay Air to acquire Seaplane? Would it make sense for Darwin to acquire Snappy
- What kind of risks would be present in those acquisitions?
- The XP Application questions and Practice exams have questions like this.

Introduction

- The need to create value for stakeholders is a primary influence on firms decisions to engage in M&A Activity
- M&A does not always lead to the success firms expect
- The main idea of this chapter is to explain how firms can use M&A successfully

7.1 The Popularity of Merger and Acquisition Strategies

- Challenging to implement M&A
- Paying excessive premiums to acquire firms can negatively influence the results a firm achieves through an acquisition strategy

7.1a Mergers, Acquisitions, and Takeovers: What Are the Differences?

- A merger is a strategy through which two firms agree to integrate their operations on a coequal basis
 - But on a practical basis, deciding who will lead the merged firm and how to fuse cultures can be challenging
- An acquisition is a strategy through which one firm buys a controlling or 100% interest in another firm
- A takeover is a special type of acquisition which is “unfriendly” or not solicited

7.2 Reasons for Acquisitions

- Many unique reasons why firms decide to acquire other companies

7.2a Increased Market Power

- **Market Power:** exists when a firm is able to sell its goods or services above competitive levels or when it can buy supplies at lower prices than competitors
- Achieving market power is a major reason for acquisitions
 - E.g. get larger to get economies of scale
 - Market power is derived from size of firm, quality of the resources it uses, and its market share
- Can use horizontal, vertical, and related types of acquisitions to increase market power
- **Horizontal acquisition** – buying a company that is competing in the same industry – e.g. United Airlines buying Delta Airlines
 - Can reduce costs or increase revenue opportunities
 - Best when firms have more similar characteristics: such as strategy or managerial strategies
 - Also requires effective integration to be successful
- **Vertical acquisition** – acquiring a supplier or distributor of one or more of its inputs or products
 - Increases control of value chain
 - Firm can now better control its destiny if it can control a distributor or supplier
- **Related Acquisitions** – acquiring a highly related firm
 - Can increase value by integrating resources and capabilities.
 - E.g. Fed Ex buying a chain of print shops – which allows people to access Fed Ex’s services by going to the print shop while dealing with their other business needs
 - Case study example: Big Ben Bank buying Darwin to offer holistic wealth management

7.2a Overcoming Entry Barriers

- An acquisition can make for a much quicker entry to a market with high barriers to entry
 - E.g. Amazon could buy a well-known grocery store chain rather than try to build a whole new company that sells groceries
- Can also help in acquiring key customers of the acquired business
- Cross-Border Acquisitions – Acquisitions made between companies with headquarters in two different countries
 - Can be higher risk if company is not familiar with the country of the target

7.2c Cost of New Product Development and increased Speed to Market

- Developing new products internally and successfully introducing them into the marketplace requires a very large investment of time and money
- Can use an acquisition of a company to access new products
 - E.g. When google realized online maps were critical to its success, instead of developing its own map programs, it bought a online map company that was already successful (by the way, did you know about 25% of the searches on google are related to maps/directions!)

7.2d Lower Risk Compared to Developing New Products

- Not only can it reduce cost and increase speed to market of new products, but it can also be lower risk in the short-term
- BUT, if a company is reliant on acquisitions for product development, it can lose focus on the importance of R&D and internal innovation skills

7.2e Increased Diversification

- Both related and unrelated diversification strategies
- E.g. Samsung Group has companies in electronics, insurance, construction, and fashion!
- In general, the more related the firm, the more likely the acquisition will be successful

7.2f Reshaping the Firm's Competitive Scope

- Firms that are facing intense rivalry in some areas, may want to expand through acquisitions in other areas to reduce dependence on success in the intense area
- E.g. Campbell's soups acquiring companies that provide fresh soups rather than canned soups

7.2g Learning and Developing New Capabilities

- Firms make acquisitions to acquire capabilities they lack
- E.g. Google buying a successful online maps company
- Ideal is acquiring companies with different, but related capabilities
- E.g. a communications company buying a database company to allow the company to offer services to companies wanting to do data analytics in the cloud

7.3 Problems in Achieving Acquisition Status

7.3a integration Difficulties

- The importance of a successful integration should not be underestimated
- How people are treated during the process is important
- Also challenges in:
 - Merging cultures
 - Merging financial systems
 - Leadership structures

7.3b Inadequate Evaluation of Target

- Due diligence is a process through which a potential acquirer evaluates a target firm
- Examines the quality of the strategic fit and the ability to integrate the target
- Firms can over-estimate the value of synergies or the value of future growth potential and over-pay for the target

7.3c Large or Extraordinary Debt

- Some companies take on a lot of new debt in order to buy another company
 - This could overpower the acquiring company's ability to service it's debt
- This can be worsened if there are bidding wars for companies

7.3d Inability to Achieve Synergy

- Synergies are efficiencies derived from economies of scale and economies of scope
 - E.g. if two insurance companies can merge, they can then have all policies on one admin system saving on the maintenance of the other admin system; or can having one investment division making investments for both companies rather than two
- Private synergy – synergies that can only be created by combining those two specific companies
 - E.g. companies have unique assets that fit together to create new types of services
- Benefits of synergies still need to outweigh transaction and legal costs of the acquisition

7.3e Too Much Diversification

- A lot of diversification can result in reduced success for a firm
- High levels of diversification also lead to:
 - Focus on financial controls rather than strategic goals
 - Which can lead to focus on short-term outcomes, rather than long-term strategic objectives
 - Acquisitions can become substitutes for innovation

7.3f Managers Overly Focused on Acquisitions

- Acquisitions take up a lot of managerial time
- This can divert attention from the regular business

7.4g Too Large

- The new, combined firm, can become too large
- May require too much bureaucracy to manage
 - E.g. imagine two smaller, but nimble firms merging but then losing their nimbleness and losing business and innovation due to bureaucratic controls

7.4 Effective Acquisitions

Attributes of Successful Acquisitions

Attributes	Results
Acquired firm has assets or resources that are complementary to the acquiring firm's core business	High chance of synergy and competitive advantage
Acquisition is friendly	Faster and more effective integration
Acquiring firm conducts effective due diligence to select target firm	Firms with strongest complementarities are acquired
Acquiring firm has financial flexibility to make purchase	Financing is easier and less costly to obtain
Merged firm maintains low to moderate debt position	Lower financing and lower risk
Acquiring firm has an emphasis on R&D	Maintain long-term competitive advantage in markets
Acquiring firm manages changes well and is flexible	Faster and more effective integration achieves synergies

Connections to other Syllabus Material

- The section on vertical acquisitions is covered in more depth and complexity in the Vertical Integration study note (SDM-138-14)

Student Questions

Is Market Power the same as market share?

- No - market power means that a company can sell its goods at higher prices than competitors OR its costs of supplies are lower than a competitor
- For example, if Blue Jay Tire can source tire materials at cheaper prices than its competitors, then BJA has market power relative to its competitors

(Student questions continue on the next page ...)

How are “inability to achieve synergies” and “integration difficulties” different?

- Synergies are often promised (“we’ll combine operations and save millions”) but when it comes to delivering them, they are very difficult (“we couldn’t find a common computer system to merge both organization to”). So “inability to achieve synergies” is the inability to achieve promised financial gains.
- Integration is often more about merging cultures and adopting best practices across the whole combined organization.
- And – if you use these on the exam – you usually need to be specific – e.g. WHY, specifically, will there be integration difficulties in the situation given in the question.