



BUSINESS STRATEGY

This exam consists of **three** questions (100 marks)

1. Ensure your candidate details are on the front of your answer booklet. You will be given time to sign, date and print your name on the answer booklet, and to enter your candidate number on this question paper. You may not write anything else until the exam starts.
2. Answer each question in black ballpoint pen only.
3. Answers to each question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.
4. The examiner will take account of the way in which answers are presented.
5. When the assessment is declared closed, you must stop writing immediately. If you continue to write (even completing your candidate details on a continuation booklet), it will be classed as misconduct.

IMPORTANT

Question papers contain confidential information and must **not** be removed from the examination hall.

DO NOT TURN OVER UNTIL YOU ARE INSTRUCTED TO BEGIN WORK

You **must** enter your candidate number in this box.

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1. Fullerton Office Furniture Ltd (FOF) manufactures office furniture which it sells to UK businesses and schools. It has a single factory, with administrative offices, in Birmingham.

Industry and market background

The office furniture industry manufactures a range of products including desks, chairs and shelving.

The UK market for office furniture in 2017 is expected to be £560 million at wholesale prices (2016: £544 million). The market has grown at 3% per annum for several years and this rate of growth is expected to continue.

There is significant competition, with 900 manufacturers in the UK, but only 300 of these have more than £1 million of annual sales revenue each. In addition to furniture sales, some larger manufacturers offer related services, such as office planning, interior design, project management, finance and storage.

Company background

FOF has two segments – Business and Schools – which operate as separate divisions, serving different markets. All furniture is made from wood and carries the FOF brand. FOF does not deal with retailers because it makes all its sales direct. FOF's existing Birmingham site is a central location for distribution to customers.

Forecast financial and operating data (**Exhibit**) are provided for the year ending 31 December 2017.

The Business Segment

The Business Segment has customers of varying sizes located throughout the UK. Most customers make regular purchases every few years or, in some cases, every year. New Business Segment customers are a major source of long-term growth. However, sales to existing customers make up the majority of sales revenue, so relationship marketing is important. Sales are made either through the FOF website or via a direct sales team. The FOF website currently needs upgrading.

Prior to 2017, sales prices were determined using fixed list prices, and direct sales staff were only paid fixed salaries. However, to increase revenue, from 1 January 2017 FOF started to pay commission to sales staff of 3.5% of the revenue they generate, in addition to salary. Since 1 January 2017, sales staff have also been permitted to offer discounts to all Business Segment customers of up to 5% off the fixed list price.

The Schools Segment

A local education authority (LEA) is the local government department responsible for schools in a given geographical area. An LEA has responsibility for purchases of furniture for schools under its control. Suppliers submit tenders for all school furniture purchases. The chief procurement officer in each LEA evaluates tenders and has significant discretion in deciding which furniture manufacturer is successful. In any one year, a single school has furniture provided by only one supplier.

Due to reductions in government expenditure, the total budget for school furniture purchases made by LEAs was lower in 2017 compared with 2016.

FOF's Schools Segment is headed by Trevor Williams. It has a small number of sales staff, but they are not paid commission. The Schools Segment sells only to the Birmingham LEA, which controlled 475 schools in both 2016 and 2017. In 2017, FOF's Schools Segment won tenders for 125 of the Birmingham LEA's schools (150 schools in 2016).

The Schools Segment's main competitor is Educational Eco-fittings Ltd (EE) which, in 2017, won tenders for 263 of the Birmingham LEA's schools (254 schools in 2016). EE only sells furniture to schools. Ten smaller companies also supply furniture to the Birmingham LEA.

An increasing number of furniture items have been returned to FOF from schools in 2017, compared with 2016. A frequent cause of faults is the wood splitting. FOF's directors fear that the company's reputation is being damaged.

The directors are also concerned that the decline in performance of the Schools Segment is due to increasingly competitive conditions for tenders.

Operations and procurement

Schools Segment furniture differs from Business Segment furniture in style and quality, so they are made on separate production lines. The Business Segment production line uses good quality wood and modern, automated equipment. The Schools Segment production line uses lower quality wood and older production technology.

Wood from all FOF's suppliers is imported into the port of Liverpool, which is 150 kilometres north of the FOF factory, and is then transported by road to the FOF factory. Wood is delivered to FOF monthly. FOF's transport costs from Liverpool are £1,000 per month and are allocated equally between the two segments. FOF's suppliers pay the transport costs by sea to the port of Liverpool.

From 1 January 2017, the Schools Segment started to buy wood from a new Estonian supplier at lower cost.

New premises

FOF has been negotiating to renew the lease for the Birmingham premises, which expires on 31 December 2018. The current annual lease rental is £240,000. However, from 1 January 2019, the owner is demanding a minimum 10-year term for a new lease agreement and a 50% increase in annual lease rentals.

FOF has found suitable alternative premises, but they are in Liverpool. The rentals would be £260,000 per annum for a five-year lease agreement.

The Liverpool premises are larger than the existing Birmingham premises. This would enable FOF to have additional office space and to introduce new design and production technology.

New technology

The new design technology would comprise an upgrade of the existing website plus an additional feature which would allow Business Segment customers to design their office layout and plan their furniture installations online. It would not be possible to charge customers more for this service, but it would enhance sales volumes for the Business Segment. It would also be possible for FOF to analyse and monitor customer activity using the design technology's data analytics package. This would provide data on customer usage regarding the timing and nature of website visits, which could then be used to forecast customers' furniture replacement decisions.

The new production technology would decrease variable costs on the Business Segment production line by £1.50 per furniture item, by reducing wastage and improving operating efficiency.

The additional costs for the new design and production technology together would be £180,000 per annum, excluding any allocation of the lease rental for the new premises.

Potential ethical issues

While visiting the Birmingham LEA on 10 November 2017, Trevor Williams overheard a conversation between two LEA employees. The employees said that they believed the chief executive of EE had been providing free tickets for major sports events to Jayne Oliver, the LEA's chief procurement officer. The employees thought that, as a result, Jayne might have been favouring EE when awarding school tenders.

On 26 November 2017, Trevor questioned Jayne about this issue during a business lunch. Jayne refused to answer his questions and said she would report Trevor to her line manager for attempting to intimidate her. Trevor has not received any further communication on this matter since the business lunch. Jayne is continuing to deal with FOF tenders, but her communications with Trevor are now limited to very formal emails. Previously Trevor and Jayne had been on good terms.

Requirements

1.1 Using the data and other information provided, analyse FOF's forecast performance in 2017 compared with actual performance in 2016 for:

- (a) the Business Segment: and
- (b) the Schools Segment.

Determine and explain, with supporting calculations, the key drivers of the change in operating profit for each segment.

(22 marks)

1.2 Explain the factors to be considered by FOF in deciding between using the Birmingham premises or the Liverpool premises from 1 January 2019.

(10 marks)

1.3 Evaluate whether FOF should invest in the new design and production technology, assuming the company relocates to Liverpool. Provide supporting calculations.

(7 marks)

1.4 Explain the potential ethical issues for Trevor and Jayne arising from the events described. Set out the actions that Trevor should now take.

(8 marks)

Total: 47 marks

PLEASE TURN OVER FOR EXHIBIT

Exhibit – Financial and operating data for FOF

Financial data - years to 31 December

	Business Segment		Schools Segment	
	Forecast 2017 £	Actual 2016 £	Forecast 2017 £	Actual 2016 £
Sales	7,761,600	7,200,000	800,000	960,000
Fixed production costs	3,000,000	2,800,000	240,000	240,000
Variable production costs	3,484,800	2,880,000	240,000	307,200
Sales staff commissions	194,040	-	-	-
Returns inwards - costs	2,000	2,000	10,000	1,000
Administration expenses - fixed	250,000	250,000	100,000	100,000
Distribution costs				
Fixed (inward - wood from Liverpool)	6,000	6,000	6,000	6,000
Variable (outward – furniture to customers)	633,600	576,000	16,000	19,200
Operating profit	191,160	686,000	188,000	286,600

Operating data

	Business Segment		Schools Segment	
	Forecast 2017	Actual 2016	Forecast 2017	Actual 2016
Total number of items sold	79,200	72,000	16,000	19,200
Number of business customers	300	320	-	-
Number of new business customers	12	18	-	-
Total sales to new business customers	£480,000	£756,000	-	-
Number of school tenders won	-	-	125	150
Distribution costs outward per item	£8	£8	£1	£1

Working assumption

Sales revenue and sales volumes in the Business Segment would have been the same in 2017 as in 2016 if the new policy of offering discounts to customers and paying commissions to sales staff had not been introduced.

2. Berlina Kitchen Appliances (BKA) manufactures electrical appliances for use in domestic kitchens.

Company history

BKA was established in 1959 as a government-owned business in Ruritania, Eastern Europe.

For many years, most Ruritanian industries were owned by the government and there was limited international trade. As a result, almost all of BKA's revenue was generated from sales within Ruritania to government-owned retail organisations. These sales were under long-term contracts, which gave financial stability to BKA.

Internally, BKA operated a hierarchical and centralised organisational structure with a rigid control system.

Current operations

BKA has one site in Ruritania where it makes washing machines, tumble dryers, refrigerators and cookers. Each of the four products is made on a separate production line. In total, 1.2 million units are produced annually, in equal proportions for each type of product.

BKA's major competitor, Muskov, sells similar products to BKA. Until the end of 2016 all the sales of both companies were within Ruritania.

Acquisition of BKA

From 2016, following a change of government, there has been a movement towards free market liberalisation of the Ruritanian economy and a desire to open up to international trade by encouraging foreign direct investment into Ruritania.

In May 2017 the Ruritanian government sold BKA's assets to Stigel GmbH (Stigel), an international electrical appliances manufacturer which sells high quality products and is headquartered in Germany. Due to rising production costs in Germany, Stigel's board wanted to acquire a factory in a low-cost environment, but with the ultimate aim of achieving the same high production quality in the acquired factory as in its German factories.

Stigel appointed a new chief executive of BKA, Jurgen Muller. He immediately reviewed BKA's business and operations, and found the following:

- Production technology is old and inefficient.
- All components are purchased from other Ruritanian companies or are made by BKA.
- BKA's sales have fallen significantly since the end of 2016, as many expiring long-term government contracts have not been renewed.
- BKA's existing products are difficult to sell internationally as they are of poor quality and design compared with international standards in the industry.
- Employee wages are about 40% of the amounts typically paid in the industry outside Ruritania.
- BKA's management and factory employees have a continuing culture of resistance to change.

Change management plan

Jurgen drew up a change management plan which includes the following:

- Each of the four products will be operated as a separate division, with more autonomy given to new divisional heads. Divisions' performance will be measured as profit centres.
- To help set achievable goals for the change management plan, a benchmarking exercise will be carried out to compare BKA's processes, products and performance with best practice.
- Following the benchmarking exercise, critical success factors (CSFs) and key performance indicators (KPIs) will be set for a new performance measurement system for BKA. The target for each KPI will change each year to reflect expected improvements (**Exhibit**).
- There will be continuing investment over time to modernise production, but this will be conditional on achieving the KPI targets. Any division not achieving them may be closed.
- The number of units produced per employee will increase significantly.
- The short-term aim will be to use the low-cost Ruritania environment to make products which are capable of being sold internationally under the BKA brand.
- From 1 January 2018, Stigel's German factories will supply BKA with some major components (eg washing machine motors) to achieve an immediate improvement in quality.

The long-term aim, at the end of the change management plan's implementation, will be to have high quality standards so that products manufactured in Ruritania will be of the same quality as those manufactured in Germany. These high-quality products will then be branded with Stigel's trademark and sold internationally.

Jurgen has proposed that the plan should be implemented in stages over a five-year period from 1 January 2018. However, one of his fellow directors has counter-proposed that the whole plan should be implemented rapidly, and should be completed within two years.

Requirements

- 2.1 Identify appropriate types of benchmarks for BKA, providing examples. Explain how BKA may benefit from the use of each type of benchmark. **(9 marks)**
- 2.2 Critically appraise the proposed performance measurement system for BKA (Exhibit), and suggest alternative KPIs, where appropriate, for each CSF. Assume that the CSFs have been agreed. **(11 marks)**
- 2.3 In respect of the change management plan, explain:
- (a) the factors that the board should consider when choosing between staged implementation (over five years) and rapid implementation (over two years); and
 - (b) the cultural and personnel barriers to change that are likely to arise, describing how their effects might be mitigated.

(11 marks)

Total: 31 marks

Exhibit**Performance measurement system for the three years ending 31 December 2019**

Agreed CSFs	KPI	Expected achievement for 2017	Target for 2018	Target for 2019
Customer satisfaction	Proportion of customers responding to questionnaires as overall being 'satisfied' or 'very satisfied'.	72%	90%	95%
Production quality	Proportion of products reported as faulty in the first year after sale.	18%	10%	5%
Penetration of international markets	Proportion of sales outside Ruritania.	2%	10%	30%

Note:

The targets for 2018 and 2019 assume a staged implementation of the change management plan over five years.

3. Cancer Concern Ltd (CC) is a not-for-profit, UK-based charity.

Background information

CC was established in 1995 as a charitable trust. Its board of trustees has ultimate responsibility for governing and managing CC. CC uses available funds to support its two main charitable activities:

(1) Cancer research

CC supports specific research projects in universities and hospitals in the UK which are aimed at the prevention, diagnosis and treatment of cancer. CC awards funds only to established cancer research groups for projects with specific objectives and timescales. Amounts awarded range from £30,000 to £1 million per project. Awarded funds are normally released in stages over the period of the project, and the release of later payments is subject to annual progress reviews. There have been some project successes, but also many failed projects.

(2) Hospices

CC operates 10 hospices which provide expert care for terminally ill cancer patients and support for their families. Hospices are staffed by volunteers and by medical professionals employed by CC.

Restrictions on CC raising funds

CC's income comes from gifts from individuals, events, grants and other types of fundraising. Total income for the year ended 30 September 2017 was £164.2 million (£188.3 million in the year ended 30 September 2016). New government regulations restricting some types of charitable marketing mean this lower level of income is expected to continue in future.

Restrictions on CC's use of funds

When giving to CC, some individuals specify that the funds must be used for a particular activity (eg a specific hospice). These funds are 'restricted' and can be used only for the specific charitable activity specified by the individuals.

Other funds received by CC are 'unrestricted' and therefore trustees have discretion to use these for any projects or causes within the broad activities of cancer research and hospices. CC's policy has been to split the unrestricted funds equally between these two main charitable activities.

A charity's trustees must choose between allocating available funds to current charitable activities or retaining some funds as reserves, to maintain financial stability and to use for future charitable activities.

CC has limited reserves and therefore, given the reduction in income in the year ended 30 September 2017, its trustees must choose how much it allocates to each of its two main charitable activities. It must also choose which specific projects within each of these activities should suffer cuts.

Review of CC's strategy and mission

As a result of the funding reduction and restrictions, the trustees are reviewing CC's strategy and mission, but this has caused conflict amongst trustees and between stakeholders.

CC's current mission statement is: "To find cures for cancer and to care for those suffering from cancer".

All CC trustees agree that this mission statement is too short to be useful and does not help in determining priorities for future fund allocations to be made by CC. In addition, it does not recognise the impact of the financial constraints being faced by CC.

The CC trustees agree that a new and more detailed mission statement must be produced. This will be used to help determine a new strategy and new fund allocation priorities.

Requirements

3.1 Prepare a report for the CC trustees which:

- (a) describes the potential impact on relevant stakeholder groups arising from CC reducing its allocation of funds to its main charitable activities; and
- (b) explains the factors that the CC trustees should consider in deciding how much to allocate to each of its main charitable activities.

(14 marks)

3.2 Prepare a revised mission statement for CC. This should identify CC's key purposes and values. It should also recognise the impact of financial constraints.

Justify your revisions of the existing mission statement.

(8 marks)

Total: 22 marks