PROFESSIONAL LEVEL EXAMINATION

WEDNESDAY 10 DECEMBER 2014

(2½ hours)

BUSINESS STRATEGY

This paper consists of **THREE** questions (100 marks).

1. Ensure your candidate details are on the front of your answer booklet.
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.

The questions in this paper have been prepared on the assumption that candidates do not have a detailed knowledge of the types of organisation included in the paper. No additional credit will be given to candidates displaying such knowledge.

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.

1. Confo plc (Confo) is a listed company, operating in the packaged confectionery products (boxes of sweets) industry.

Confo was established in 1968, manufacturing boxes of sweets in its factory and selling them in its own shops throughout the UK. Since 1983, some of the 240 shops have been operated under exclusive franchise arrangements, while the remainder are still owned by Confo. All products sold at Confo shops (both owned and franchised) are produced in Confo's factory. The company was structured as two separate divisions, Manufacturing and Retail, until 30 September 2013 (**Exhibit 1**).

Recovery plan

After a difficult period of trading, a new board was appointed in December 2012 and, following a detailed review, it implemented a radical three-year recovery plan from 1 October 2013. The recovery plan included: the closure of 70 owned shops; the opening of 30 franchised shops; and the creation of two new sales channels, commercial sales (to UK supermarkets) and export sales (to overseas retailers). As a result, Confo now has two additional divisions, Commercial and Export, and a revised system for pricing transfers (**Exhibit 2**).

Following preparation of the management accounts and operating data for the year ended 30 September 2014 (**Exhibit 3**), a board meeting was called to review progress in implementing the three-year recovery plan, and to consider whether any changes to the plan are needed.

Board meeting

The chief executive complained: "This year's results are disastrous. This was supposed to be a recovery plan, but performance seems to have got worse, not better. Profit has fallen compared with last year."

The marketing director disagreed: "I believe that we have great potential for future growth from the commercial and export sales that we started this year. However, we need to give them time to get established and show their potential. You cannot judge performance on one year's figures."

An ethical issue

From 1 October 2013, the sales manager of Confo's Commercial Division, Kirsty Keller, met regularly with John Drake, the procurement manager of a large customer, Lenton Supermarket (Lenton). In November 2013, John asked if he could have two small boxes of sweets for his family for Christmas. This type of small gift to customers' staff is common in the sweets industry. In December 2013, Kirsty delivered some Confo sweets, with a total value of £10, to John's home as a gift to promote good relations between Confo and Lenton. She informed Confo's commercial director about what she had done and he was happy with this action.

From January 2014, John made further requests for gifts of sweets, gradually increasing in both value and frequency. In order to keep a good business relationship with John, Kirsty continued to provide these gifts, but she stopped disclosing them to the commercial director in March 2014 when the value of the gifts reached £30 per week. In July 2014, when John started asking for gifts valued at £100 per week, Kirsty refused.

In September 2014, Lenton stopped purchasing from Confo. Kirsty never made any personal gain from the gifts and there is no documentary evidence relating to them.

Requirements

(a) Compare and evaluate Confo's pricing of transfers before and after the changes made by implementing the recovery plan on 1 October 2013. Suggest and justify alternative methods of pricing transfers that Confo could have adopted on 1 October 2013. **(9 marks)**

(b) Analyse and evaluate the performance of the Manufacturing Division and the Retail Division in the year ended 30 September 2014 compared with the year ended 30 September 2013. Highlight any problems in comparing the data and set out any additional information that would assist your analysis. **(15 marks)**

(c) As part of the appraisal of the first year of the recovery plan, write a report which:

(i) Reviews the strategies adopted by the Export Division and the Commercial Division, and evaluates their performance. Include any relevant strategic models in your appraisal.

(ii) Evaluates the success of the recovery plan for Confo to date.

(15 marks)

(d) Explain the ethical issues for Kirsty, and for Confo, arising from the matters occurring with Lenton and John Drake. Set out, and justify, the actions that Kirsty and Confo should now take. **(7 marks)**

Total: 46 marks

Exhibit 1: Company structure and pricing of transfers – pre 30 September 2013

Up to 30 September 2013, both Confo divisions, Manufacturing and Retail, were profit centres. The factory's output was transferred by the Manufacturing Division to all Confo shops (owned and franchised) at the same price, full cost plus 20%. In addition to the Retail Division's profits from the owned shops, Confo also earned a total of £1.2 million annually from the fixed fees it charged to franchisees for use of the Confo brand name and for operational and management support.

Consumers are charged the same list prices at all Confo shops. Franchisees are also required to charge these list prices in order not to undercut the prices charged by owned shops, and to avoid cheapening the Confo brand.

The setting of the same prices for transfers from the factory to both owned and franchised shops caused some internal debate. The Retail Division management claimed that prices for transfers to owned shops were too high and should be lower than the prices charged to franchisees. They also believed that the annual fixed fees paid to Confo by franchisees were too low. Confo products are unique and valid comparison with the prices charged by rival manufacturers and retailers cannot be made easily.

Exhibit 2: Company structure and pricing of transfers – post 1 October 2013

Since the commencement of the recovery plan on 1 October 2013, Confo has operated with four divisions: Manufacturing, Retail, Commercial and Export.

Changes in the Manufacturing Division

From 1 October 2013, the Manufacturing Division became a cost centre. It transfers all its output at full cost to the Retail Division, to franchisees, and to the new Commercial and Export Divisions. The reduction in the price of transfers was, in part, intended to increase the volume of sweets purchased by existing franchisees and to encourage more franchises to be taken up. To offset the lost revenue, Confo increased the fixed fee charged to each franchisee. These fixed fees now total £2.5 million.

Changes in the Retail Division

Confo continues to make UK retail sales via owned and franchised shops. The Retail Division still comprises owned shops and remains a profit centre. The review by the new board identified that many owned shops in the retail network were under-performing. On 1 October 2013, as part of the recovery plan, 70 poorly performing owned shops were closed. Of these closed shops, 30 were immediately reopened under the management of new franchisees.

The new Commercial and Export Divisions

The Commercial and Export Divisions were opened on 1 October 2013 as separate profit centres.

The Commercial Division makes sales to UK supermarkets. The products are all made in Confo's factory, but are packaged by Confo in the client's brand and wrapping (ie 'own labelled') in order to minimise the loss of sales at Confo shops, and to make price comparisons by consumers more difficult. Prices charged by the Commercial Division are negotiated separately with each client. The supermarkets sell the products at retail prices that are lower than the list prices in Confo's owned and franchised shops.

The Export Division sells only Confo branded products, in bulk, to overseas retailers. It has taken some time to establish relationships with new clients and develop brand awareness, but sales have started to grow.

Exhibit 3: Management accounts and operating data

Confo: Management accounts for the year ended 30 September 2013

	Manufacturing £'000	Retail £'000	Total £'000
Transfers to franchised shops by Manufacturing Division	8,100	-	8,100
External sales	-	24,000	24,000
Divisional transfers	18,000	(18,000)	-
Variable costs	(13,050)	(2,400)	(15,450)
Fixed costs	(8,700)	(4,000)	(12,700)
Divisional profit	4,350	(400)	3,950
Fixed franchise fees			1,200
Operating profit			5,150

Confo: Management accounts for the year ended 30 September 2014

	Manufacturing £'000	Retail £'000	Commercial £'000	Export £'000	Total £'000
Transfers to franchised shops by Manufacturing Division	7,500	-	-	-	7,500
External sales	-	14,400	4,320	1,760	20,480
Divisional transfers	13,000	(9,000)	(3,000)	(1,000)	-
Variable costs	(12,300)	(1,080)	(720)	(320)	(14,420)
Fixed costs	(8,200)	(3,000)	(300)	(240)	(11,740)
Divisional profit	0	1,320	300	200	1,820
Fixed franchise fees					2,500
Operating profit					4,320

Confo: Operating data for the years ended 30 September

	2013	2014
Number of boxes of sweets sold externally:		
Retail Division (owned shops) (000s)	12,000	7,200
Franchised shops (000s)	5,400	6,000
Commercial Division (000s)	-	2,400
Export Division (000s)	-	800
Total products sold externally	17,400	16,400
Number of Confo shops:		
Owned shops	150	80
Franchised shops	90	120

2. Radar Traditional Radios Ltd (RTR) is a family-owned company which manufactures high quality portable radios at a factory in the UK. The particular styling of the radios, which appeals to UK market tastes, means sales are made in the UK only.

Radio broadcasting

In the UK, radio stations broadcast radio programmes via two main platforms:

- Analogue, using traditional analogue frequencies (AM/FM)
- Digital, using newer digital audio broadcasting (DAB)

Digital broadcasting was publicly launched in the UK in 1995. The broadcasting industry is encouraging digital radio broadcasting as it offers a wider choice of radio stations than analogue, is easier to use, and is resistant to localised signal interference.

However, on the negative side, the overall audio quality on digital is poorer than analogue, and digital reception is restricted in certain areas of the UK, so a lower percentage of the population can receive digital, compared with analogue. Digital reception was available to 80% of the UK population in 2004 and to 90% by 2014. Analogue reception is available to 99% of the UK population.

Radio listening

In 2013, 35% of radio listening hours in the UK were on digital, 60% on analogue and 5% on other platforms.

Radio programmes that are broadcast on the analogue platform can be listened to only on analogue radios. Digital radio broadcasts can however be listened to on a variety of devices. The devices used to listen to digital audio broadcasts in the UK in 2009 and 2013 were as follows:

Radio listening to digital broadcasts by device	**2009**	**2013**
	%	**%**
Digital television	25	27
Digital radios	23	25
Internet	15	22
Smartphones	10	20
Other devices	27	6

In 2009, there was significant optimism about the future of digital radio broadcasting. The UK government predicted that it would switch off the analogue platform in the UK by 2015. As a result, in 2011 a major UK electrical retailer announced that it would shortly stop selling analogue radios. In spite of this early optimism, however, growth in sales of digital radios has been much lower than anticipated. Digital radios are currently owned by a little less than half of UK households.

The government is now expected to require the switch-off of analogue radio frequencies in the UK by 2019, at the very earliest. Some industry analysts believe that digital may take many years to overtake analogue due to the modest levels of ownership of digital radios.

Radio manufacture

The manufacture of radios is a global industry with some multinational companies producing radios as part of a wide range of consumer electrical products. There are however many small national companies, like RTR, specialising in radio manufacture only for their home markets. Some companies have stopped making analogue radios. Most companies in the industry, however, currently manufacture both analogue and digital radios, though some have plans to greatly reduce, and then cease, the production of analogue radios, as analogue is being switched off in an increasing number of countries.

The price of radios to consumers in the UK varies widely. Analogue radios are significantly cheaper than digital radios, retailing from around £25. The cheaper digital radios retail at £35, and mid-market digital radios are typically £50 to £100, while top-of-the-range models are considerably more expensive.

With advances in technology, some radio manufacturers are adding additional features to digital radios including, for example, internet access. They have also added 'Bluetooth' technology, which allows the user to stream music wirelessly through a digital radio from other devices such as MP3 players and smartphones.

Company information - RTR

RTR manufactures both digital and analogue radios. Its radios contain up-to-date technology and are known for their quality, but they deliberately feature old-fashioned styling. This gives RTR a niche market, but there is continued pressure in the industry to keep the technology up-to-date to compete, not just with other radios, but also with the other devices, such as smartphones, which can receive digital broadcasts.

RTR radios are only distributed through upmarket stores in the UK, and are at the top end of the market. RTR's analogue radios sell for an average of £150 and their digital radios average £200. Over the past few years, RTR's annual sales volumes have remained constant at 100,000 radios, as follows:

RTR sales (units)	**2009**	**2013**
Analogue radios	65,000	60,000
Digital radios	35,000	40,000

RTR has always had a policy of investing in research and development (R&D) to ensure its radios are innovative in function, as well as being distinctive in style. Recently it has added Bluetooth to one model in its digital range, but further investment is needed to introduce Bluetooth across the digital range and develop additional technology features.

It has become difficult for RTR to compete with larger manufacturers given rapidly advancing technology, both in radio broadcasting and in listening devices. RTR needs to decide whether to cease R&D and marketing expenditure on analogue radios, effectively phasing out their production over the next two to three years, so that all the R&D and marketing budgets can be focussed on digital radios. A board meeting was arranged to discuss these issues.

Board meeting

The R&D director was pessimistic: "We are a small company in a big industry. We need to focus our R&D expenditure on digital products or the budget will just be spread too thin."

The marketing director disagreed: "We cannot abandon analogue, which is still our largest market. I agree we need to focus our resources. However, I would try to focus marketing expenditure at our target consumer groups for both analogue and digital radios, not just concentrate on one type of product. I agree the digital radio market is more challenging, so I have provided some data (**Exhibit**) to help us decide on a marketing strategy for digital radios."

Requirements

(a) Using Porter's Five Forces Model, explain the impact on competitiveness in the radio manufacturing industry, for the UK market, of the following TWO forces only:

- substitutes
- competitive rivalry amongst existing firms **(10 marks)**

(b) Explain how market segmentation can be used by RTR to identify target groups of consumers for its digital radios, and discuss how each of the components in the marketing mix (4Ps) can be used by RTR to promote its digital radio product range to these groups. **(12 marks)**

(c) Discuss and evaluate the factors to be considered by the RTR board in determining whether, and if so when, it should decide to abandon the manufacture of analogue radios to focus resources on developing and selling only digital radios. **(9 marks)**

Total: 31 marks

Exhibit – Analysis of UK consumers for digital radios

	UK industry average	**RTR radios**
Age of consumer	45	55
Average annual income	£23,000	£37,000
Gender	60% male	45% male

3. The Norgate Bank plc (NB) is a bank whose customers are small businesses and individuals living in either the UK or France. It has no physical branches for customers to visit. Internet banking is therefore important to NB, but also its telephone call centres are key to communication and to building customer relationships.

Until last year, NB had only one telephone call centre, which was near London and served all its existing customers. Call operators included fluent French speakers to serve French customers. In December 2013, a major new investment was made in a new call centre in Vietnam, where some of the local population speak French. At that time, Ron Terry was appointed as the director in charge of all call centre operations.

Under the new arrangement, the UK call centre serves only UK customers. French customers are served by the call centre in Vietnam, where call operators are from the local, French-speaking population. Property costs and staff costs are much lower in Vietnam than in London. At both call centres there are two groups of call operators: one for business customers and one for individual customers.

Ron wants to conduct a post-implementation review of both call centres to ensure that physical and human resources are being used efficiently. Over the past year, Ron has used three Key Performance Indictors (KPIs) to measure call centre performance (**Exhibit**). These are:

- Average time taken to answer a customer call
- Average length of a customer call
- Scores from customer satisfaction surveys for handling calls (where: 1 = poor; 5 = excellent)

Ron is concerned about the validity of these KPIs, and he is unsure whether they are the most appropriate means of measuring performance. He is also unsure how they might be utilised to improve the efficiency of the call centres.

Wendy West, a senior manager reporting to Ron, used to work at a call centre in a large insurance company. She believes that NB's KPIs are poor by comparison to those of her previous employer.

Requirements

(a) Evaluate the validity of the three KPIs used for measuring the performance of NB's call centres and suggest alternative measures. **(12 marks)**

(b) Explain the benefits and problems of NB using benchmarking to evaluate performance, and to improve efficiency, in its call centres. Refer to different types of benchmark and use the data in the Exhibit where relevant. **(11 marks)**

Total: 23 marks

Exhibit – data for the year ended 30 November 2014

	UK call centre (UK customers)		**Vietnam call centre (French customers)**	
	Business	**Individuals**	**Business**	**Individuals**
Number of calls in the year (000s)	120	1,200	90	600
Number of call operators	20	100	12	30
Time to answer a call (minutes)	2	2	1	1.2
Length of call (minutes)	10	4	8	3
Average customer satisfaction score	3.9	4.1	3.1	3.3