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# BUSINESS STRATEGY

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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.

**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.

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1. Forsi Ltd (Forsi) provides forensic science services to private clients and UK public sector organisations, such as the police and HMRC.

### **Industry information**

Forensic scientists examine materials and provide scientific evidence to assist in an investigation or court proceedings. As well as criminal cases, forensic science is used in private disputes concerning accidents, medical negligence, insurance claims and product liability.

Until 2009, the government-owned Forensic Science Service (FSS) accounted for 60% of the total forensic science market in the UK and handled the majority of the public sector work. However, in 2010 a decision was taken to reduce the activities of FSS, leading to its complete closure in 2013. As a result there have been several new entrants to the market, which is now very competitive.

Forsi was founded in 2010 by four scientists who previously worked for FSS. Forsi and one other key competitor now dominate the UK market. Both offer a wide range of forensic science services to all types of client. A number of smaller providers have also emerged which typically specialise in one particular scientific field e.g. fire investigation, toxicology or genetics. Various UK police forces also have their own in-house forensic science laboratories but there is no national police policy, so many police forces outsource work to businesses such as Forsi.

### **Company information**

From the outset, Forsi has operated with an informal structure, to minimise bureaucracy and focus on technical expertise and scientific analysis. The original founders spend little time on administration and management tasks, and instead concentrate on attracting clients and undertaking analytical work. Many support functions (including payroll, accounting and human resources) are outsourced.

As a result of the founders' reputations and technical expertise, and the range of forensic science services provided, Forsi has experienced steady growth. It now employs 40 scientists and five administrators. Work is organised on a project basis, with an appropriate project team created for each specific client request. On smaller projects, scientists may work alone. When they are not working on projects, Forsi's scientists are expected to undertake research to develop new scientific techniques or more efficient processes.

Although Forsi does undertake one-off projects for clients, most of its business is on a repeat basis, e.g. a succession of accident investigations for an insurance company. Obtaining such clients is key to revenue growth. Once Forsi has been confirmed as a client's approved supplier, client retention becomes important. Depending on the client and the nature of the work, some projects are negotiated at a fixed price and some are priced on a cost-plus basis. Increasingly clients prefer fixed-price projects so that they can avoid unexpected increases in costs. All dealings and discussions with clients are handled by the four founders.

As a result of the increased competition, Forsi's informal structure has started to present some difficulties and threatens to inhibit its growth. There has been a lack of collaboration between staff, with scientists preferring to work independently on each project, and Forsi has not maximised opportunities for shared learning.

Often, requirements change during the course of a project and delays have arisen whilst one of the founders renegotiates with the client, leading to client complaints. There are few in-house financial controls and although a budgeted cost is established for each project before work starts, this is often exceeded. As a result of these issues, Forsi's profits have fallen (**Exhibits 1 and 2**). It has started to lose some potential projects to competitors and has also had to accept lower margins on repeat business in order to retain clients.

### **A possible new owner**

Recently, Forsi has been approached by an Australian multi-national, Aussi Ltd (Aussi), which undertakes work for global private and public sector clients. Aussi consists of several divisions, each offering a different scientific service (e.g. pharmaceutical research, forensic science, aerospace). All support services are provided by a centralised head office function.

Aussi's forensic science division is the market leader in Australia and Asia. In 2013 it spent £4.4 million on research and development and £9 million on marketing, and it generated sales revenue of £220.3 million (all figures translated from Australian dollars into £ sterling).

Aussi wants to acquire Forsi to further its expansion in Europe. However, it does not want to destroy Forsi's research-centred culture as it acknowledges that Forsi's success to date has been driven by the founders' knowledge and contacts, and by the skill of the scientists it employs. If the founders agree to sell their shares, Aussi will either allow Forsi to operate autonomously as a separate subsidiary company or integrate it within Aussi's forensic science division.

Whichever structure is chosen, Forsi will be required by Aussi to achieve a target return on capital employed (ROCE) of 15%. It will also have to comply with Aussi's formal project screening process whereby:

- all new projects are required to meet an expected minimum 20% gross margin, and
- the final agreed project price has to be signed off by Aussi's central finance department.

In 2013, Aussi's forensic science division generated a gross margin of 25% and ROCE of 18% on net assets of £183.5 million. Exhibit 2 sets out additional operating data for Aussi.

### **Requirements**

- a) Using the data in the Exhibits and the other information provided, analyse the performance of Forsi, contrasting it with Aussi's where appropriate. Suggest other non-financial information that may be useful in ascertaining the causes of the deterioration in Forsi's performance. **(16 marks)**
- b) Discuss the appropriateness of Forsi's existing structure, referring to relevant models. **(7 marks)**
- c) Assuming Forsi's founders do **not** agree to be taken over by Aussi:  
explain why knowledge management is important to Forsi and recommend the steps that Forsi could take to implement a knowledge management strategy. **(8 marks)**
- d) Assuming Forsi's founders **do** agree to be taken over by Aussi:
  - (i) discuss whether Forsi should be operated as a subsidiary of Aussi or as part of Aussi's forensic science division; and
  - (ii) recommend how Aussi should manage the change when the takeover is announced. **(14 marks)**

**Total: 45 marks**

**Exhibit 1: Financial data for Forsi for the years ended 31 December**

	<b>2012</b>	<b>2013</b>
	<b>£000</b>	<b>£000</b>
Sales revenue	5,400	5,088
Direct costs	<u>(4,175)</u>	<u>(4,165)</u>
Gross profit	1,225	923
Research & development	(254)	(260)
Marketing	(108)	(90)
Other operating expenses	<u>(268)</u>	<u>(270)</u>
Operating profit	<u>595</u>	<u>303</u>
Net asset value	4,020	3,910

**Exhibit 2: Operating data for Forsi and Aussi**

	<b>Forsi</b>	<b>Forsi</b>	<b>Aussi forensic science division</b>
	<b>2012</b>	<b>2013</b>	<b>2013</b>
Number of employees	45	45	2,000
Number of projects undertaken in year	108	106	2,448
% of projects completed on time	83%	76%	89%
% of projects completed within budgeted cost	72%	65%	92%
Sales value of projects awarded, but not yet undertaken, at year end	£1,350,000	£855,000	£65,080,000

2. ToyL Ltd (ToyL) is a start-up business. It intends to provide educational toys for children, which will be sold to individual customers and educational establishments.

ToyL has been founded by a husband and wife team, Pavel and Rosemary Bochev. They have prepared the first draft of a business plan to attract additional funding from private investors (**Exhibit**).

You are a consultant in a firm of business advisers that is assisting ToyL. Your manager has undertaken an initial review of the draft business plan and has some concerns about its structure and content. Rosemary and Pavel have never prepared a business plan before and lack financial expertise. Your manager is also concerned that they may have been over-enthusiastic in their desire to present the business in the best possible light to attract potential investors.

### **Requirements**

- a) Write a report for Pavel and Rosemary which critically assesses the content of the draft business plan and makes recommendations as to how the document may be improved. As part of your appraisal indicate the nature of any missing information and any additional sections of the plan that would be relevant to a prospective investor. **(15 marks)**
- b) Explain the benefits of outsourcing as a production model for ToyL. **(6 marks)**
- c) Assume that ToyL successfully raises the necessary finance. Explain how the information requirements of Pavel and Rosemary as managers will be different from the information requirements of the additional private investors, once the business is operational. **(9 marks)**

**Total: 30 marks**

## Exhibit

### DRAFT BUSINESS PLAN: ToyL Ltd

#### Contents

1. Executive summary
2. Introduction and management team
3. Products
4. Marketing
5. Competition
6. Strategy and operations

#### 1. Executive summary

Will be completed after the remainder of the business plan is finalised.

#### 2. Introduction and management team

ToyL Ltd (ToyL) will sell educational toys for young children. It is owned and managed by Pavel, an information technology (IT) specialist and his wife, Rosemary, an educational consultant.

Pavel will be in charge of operations, including the one-off manufacture of product prototypes. He has a computer engineering degree. Pavel started his career in the product development department of a large IT company, before moving to a consumer electronics company, where he was responsible for developing hand-held games.

Rosemary will be responsible for marketing and sales. She studied for a Master of Education degree and then spent several years developing educational tools for teachers of pre-school children.

Together Rosemary and Pavel's backgrounds have helped them design products that combine opportunities for learning with the fun aspects of a game.

#### 3. Products

ToyL has developed three distinct educational toys for young children, aged three to five years. These toys use interactive technology to teach numeracy and literacy.

- NumberToy: emits lights and sounds when the child touches a stylus on the appropriate number. In addition to teaching number skills, it also helps with hand-eye co-ordination.
- AlphabetToy: similar to NumberToy, but it teaches the child the alphabet and appears to improve their attention span.
- PhonicToy: an interactive toy that looks similar to a miniature laptop. It contains speech recognition software which allows the child to have a spoken conversation with a cartoon character. The character teaches word pronunciation and reads stories aloud. This is the most expensive product and is designed to help the child read and develop a vocabulary.

Although the toys are currently prototypes, they are functionally complete and ready for manufacture. The prototypes have been tested widely and were well received. Part of the testing has included Rosemary and Pavel observing a variety of children as they interact with the toys.

All products will be designed and initially manufactured in-house. However once a toy design has been tested and approved for sale, its on-going production will be outsourced to suppliers either in the UK or Eastern Europe. ToyL's product range is expected to grow over time as ideas for new toys are generated.

#### **4. Marketing**

ToyL has identified two target market segments:

- (i) individuals, such as parents or grandparents, who will purchase the product for a particular child. We think this market segment currently has about 3.3 million prospective customers and is growing at around 8% pa. Typically these customers are well-educated and have higher disposable incomes. They are keen for the children to develop and believe they are getting value-for-money if the toys have educational as well as entertainment value.
- (ii) educational organisations, such as pre-schools, day care centres and nurseries, which will buy products to use within their institutional environment. Typically they care for children in groups of between 7 and 25 in number. We believe that this market segment contains about 0.7 million prospective customers and is growing annually at around 10%.

ToyL has decided to sell direct to both groups. Its key marketing tool will be its website. Its marketing strategy will recognise the fact that there are two distinct groups that must be attracted.

#### **5. Competition**

The UK toy industry is a fragmented market, with many different toy manufacturers. Within the toy industry there is a niche of educational toy manufacturers which is dominated by two global market leaders (Knowall and Brightkidz). These companies sell toys under a range of different brand names to cover several price points. There are also several smaller, regional manufacturers of educational toys.

In addition, educational toy providers compete with the wide range of electronic products produced by the large game manufacturers.

We believe ToyL's competitive advantage comes from products that are superior to those already available in the marketplace. This quality will allow ToyL to achieve market penetration. ToyL will use its educational and engineering expertise to produce toys that are fun to use and which at the same time teach important skills for children. By recognising and exploiting its core competencies, ToyL will quickly gain market share as well as develop a reputation for making effective educational toys.

#### **6. Strategy and operations**

The company is in its first year. It has incurred set-up costs of around £24,000 but has not yet produced a finished product or made any sales. ToyL hopes to generate sufficient revenues to break-even by the end of year one and then expects strong sales growth for several years. Rosemary and Pavel anticipate sales of £367,000 in year two and £475,000 in year three.

Pavel and Rosemary have invested capital of £60,000 in the business (through personal borrowing) but to develop more products ToyL is seeking additional equity capital of £40,000 from one, or more, private investors.

ToyL has identified three critical success factors (CSFs) that will be instrumental in the sustainability of its business:

- (i) the ability to develop creative, educational, engaging toys
- (ii) the need to listen to customers and create a feedback mechanism for new product development and existing product improvement
- (iii) the implementation of strict financial controls

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3. “Water On Tap” (Ontap) is a small social enterprise operating in central London. A social enterprise is a business which meets social and environmental aims by trading in a profitable and sustainable way.

Ontap’s specific aim is “to provide a cheaper and more sustainable alternative to bottled water.” Its founder, Nala Delmar, a keen athlete, founded Ontap because she was frustrated by the large amount of money she was spending on bottled drinking water.

Ontap’s operations need to be financially viable because it relies on its business activities, not donations, for funding. 70% of Ontap’s profits are donated to fund clean water projects in India. Remaining funds are reinvested in the business or used to raise awareness of the damaging effects of bottled water on the environment.

### **Bottled water industry in the UK**

The retail market for bottled water in the UK is worth approximately £1.6 billion, by annual sales revenue. Industry statistics show that the average consumer drinks 33 litres of purchased bottled water per annum.

Despite legislation that requires any establishment serving alcohol to have free tap water available, it has become the social norm to purchase bottled water in such establishments. This has reduced the acceptability of asking for free tap water in restaurants, cafes and bars. It has also created a huge increase in plastic bottle waste. An estimated 18 billion plastic bottles are consumed annually in the UK, of which 75% are not recycled and therefore end up in landfill. The packaging and transportation involved means that bottled water also has a much higher carbon footprint per litre than tap water.

In 2012 several UK supermarkets were criticised for selling a product that should have been free, when it became apparent that some of their own-brand bottled water was simply filtered, purified tap water. Some multi-national bottled water companies have also attracted adverse publicity for spending huge sums on advertising in an attempt to make their brand fashionable and appear to offer variety for what is essentially an homogenous product.

### **About Ontap**

The Ontap concept involves a re-fillable water bottle made from recycled aluminium foil, which carries the Ontap logo. Once purchased from Ontap, at a cost of £8, the bottle can be taken to a range of participating cafes and shops (currently only in central London) and re-filled with tap water. These businesses provide their re-filling services for Ontap’s customers free of charge, in the hope they will purchase additional products. The Ontap website and free mobile app provide a list of refill sites, all of which prominently display the Ontap logo.

### **Plans for expansion**

In London, Ontap has been a success and proved popular with athletes, commuters and students plus the participating cafes and shops. Ontap has received lots of social media coverage and the brand is currently very fashionable. Nala is keen to expand her original concept.

She is considering two possible options for expansion:

- (i) A corporate sales scheme. Nala would like to persuade companies to buy water bottles to replace the plastic cups typically found beside water coolers in most offices. She has read a recent survey reporting that, on average in such offices, each employee throws away four plastic cups a day. Instead, the company would bulk purchase Ontap bottles for their employees, which would then be co-branded with the company's own name.
- (ii) Geographical expansion. This would necessitate finding cafes and shops outside the central London area which would be willing to be Ontap partners.

### **Requirements**

- a) Discuss the extent to which Ontap is a sustainable enterprise. **(7 marks)**
- b) Compare and contrast the ethics of the marketing activities of Ontap with its competitors in the bottled water industry. **(8 marks)**
- c) Discuss the problems Ontap will face in any expansion of the business and evaluate the two proposed options. **(10 marks)**

**Total: 25 marks**