



BUSINESS STRATEGY

This paper 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.

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. Bespoke Oak Beds plc (BOB) is a listed company which manufactures high quality, hand-made wooden bed-frames.

Industry background

Sales of household furniture to consumers were £5,000 million in the UK in 2014. Of this total, bedroom furniture sales were £1,320 million. The market is highly competitive, and is experiencing pressure on profit margins.

A key sales driver in the UK household furniture market is the number of house purchases, which in recent years have been low so sales of household furniture showed zero growth. Increases in the number of house purchases are expected over the next few years and this is a source of optimism for UK household furniture manufacturers.

The bedroom furniture sector comprises two sub-sectors: bed-frames, and other bedroom furniture (ie wardrobes and storage units).

Bed-frame manufacturers typically sell to furniture retailers. Larger manufacturers usually also produce a range of slightly lower quality bed-frames for sale directly to other businesses, such as hotels and house-builders (the contract market).

An important trend in the market is selling full matching sets of bedroom furniture (typically a bed-frame, a wardrobe and storage units).

Company background

BOB is one of the larger upmarket UK manufacturers of bed-frames only. These are hand-made from solid oak, a hardwood. BOB only makes two types of bed-frame: the Classic and the Deco. The two products are made on the same production lines at the same factory, with production runs alternating between the two types of bed-frame according to demand. There are common raw materials and staffing for both products. The Classic is a better quality bed-frame than the Deco, being made with more raw materials and more skilled labour, thereby generating a higher sales price and higher margin. The distribution channels for both of BOB's products are mainly through upmarket furniture retailers.

Oak is sourced from Central America, as this is cheaper than using European oak. BOB has been criticised by environmental groups for contributing to destroying forests in developing nations. Also, hardwoods take far longer to grow than softwoods, so after replanting it takes more time to restore a hardwood forest that has been cut down for commercial use. The BOB board believes that sustainability issues are beginning to damage the company's reputation and it now wishes to improve the company's image.

A board meeting

The finance director, Hannah Zhou, said: "Although currently profitable, the company is in slow decline. I have produced some forecast financial data for the year ending 31 December 2015 (**Exhibit 1**). Unless we develop a new strategy, I expect the results for the year ending 31 December 2016 to be the same as for the year ending 31 December 2015."

Two proposed new strategies were presented to the meeting. Only one of these can be accepted, but it is possible to reject both.

Strategy A

The marketing director, James Jones, spoke next. “There is an increasing trend for consumers to purchase full matching sets of bedroom furniture. As we only sell bed-frames, currently we are not able to offer this choice, so we are losing sales. An overseas manufacturer, Welby East Furniture (WEF), is willing to manufacture sets of oak wardrobes and storage units to match the design of our Deco bed-frames. The WEF furniture is of inferior quality to our own, but it is cheap, so I think the margins will be good. WEF furniture would be sold under the BOB brand. I have provided a briefing paper containing details about a possible arrangement with WEF (**Exhibit 2**).”

Strategy B

The commercial director, Martin Moss, said: “A major house-builder, Linton Housing plc (LH), has started selling its houses fully furnished. I am negotiating to establish BOB as the preferred contract market supplier of bed-frames to LH.

“However, prices for our current products are higher than LH will pay. A possible compromise is to sell our bed-frames to LH in the same designs as the existing Classic bed-frames, but manufactured using Canadian softwood. These would be separately branded as the ‘Quebec’ range. Canadian softwood is significantly cheaper than oak, and it is easier for our craftsmen to work with, so there would also be a saving in labour time. The Quebec softwood bed-frames for LH would be of lower quality than the Classic oak bed-frames for other customers. My briefing paper (**Exhibit 3**) provides further details.

“If this strategy succeeds, then we could consider extending it in future to make all our beds from Canadian softwood, instead of oak.”

An ethical issue

A fault has been detected in one production run of 120 Deco oak bed-frames, all of which have now been sold by BOB. The fault will not immediately be apparent to purchasers, but the typical life of each bed-frame will be four years, rather than the normal ten years or more. BOB products are guaranteed for three years. Disclosure of this fault to purchasers would result, not just in the cost of replacement bed-frames, but also in damage to the company’s reputation. There is a reasonable possibility that, as a consequence, the factory would have to close, necessitating redundancies.

James Jones told the meeting: “We want to be ethical, but there comes a point when the massive commercial and personal consequences for all concerned outweigh what are relatively minor ethical issues regarding the shortened useful life of only 120 bed-frames.”

Requirements

- (a) Using the data provided for the year ending 31 December 2015:
- (i) Compare the financial performance of the Classic and the Deco.
 - (ii) Evaluate and explain the financial and operating performance of BOB.
- Ignore the two proposed new strategies. **(13 marks)**
- (b) For each of the two proposed new strategies:
- (i) calculate the expected contribution that would be generated in the year ending 31 December 2016; and
 - (ii) explain the benefits and risks, including any additional relevant calculations.
- Make a reasoned recommendation as to which strategy, if either, should be adopted. **(17 marks)**
- (c) Without further calculations, explain the merits and problems of BOB changing from using oak to using Canadian softwood for all its future production. **(8 marks)**
- (d) Discuss the ethical issues that arise for BOB from the faulty production run. Set out the actions that BOB should now take. **(8 marks)**

Total: 46 marks

Exhibit 1 – Forecast financial data for the year ending 31 December 2015

	Classic	Deco
Annual sales volume (number of bed-frames)	12,500	18,000
Average contribution per bed-frame	£	£
Selling price	900	720
Variable costs:		
Labour	(250)	(200)
Materials	(200)	(160)
Other	(100)	(100)
Total variable cost	(550)	(460)
Average contribution per bed-frame	350	260

Total fixed costs: £8,170,000

Exhibit 2 – Strategy A: Briefing paper – prepared by marketing director

This strategy is to import from WEF sets of bedroom furniture which match the design of BOB's existing Deco bed-frame. The working assumptions are:

- Deliveries would be under annual contracts, commencing on 1 January 2016.
- Each set purchased from WEF would comprise a wardrobe and two matching storage units.
- WEF would charge a price to BOB equivalent to £480 per set at current exchange rates.
- BOB would sell each full matching furniture set (ie the WEF set plus a BOB Deco bed-frame) to customers for £1,300.
- Based on market research, it is estimated that BOB will sell 2,000 full matching furniture sets in the year ending 31 December 2016. The customers purchasing these 2,000 sets would have purchased 150 Deco beds from BOB in the absence of any contract with WEF.
- The contract would require BOB to purchase a minimum of 1,900 sets from WEF in the year ending 31 December 2016.

Exhibit 3 – Strategy B: Briefing paper – prepared by commercial director

This strategy is to be a contract market supplier of bed-frames for LH, a house-builder. These bed-frames would be branded 'Quebec' and would be identical in design to the current Classic bed-frames, but made of Canadian softwood, rather than oak. The working assumptions are:

- Deliveries would be under a two-year contract commencing on 1 January 2016.
- BOB would charge LH a price of £600 per Quebec bed-frame.
- The costs of raw materials per bed-frame would be 40% lower for the Quebec range compared with the Classic range.
- The costs of labour per bed-frame would be 10% lower for the Quebec range compared with the Classic range.
- Other variable costs per Quebec bed-frame would remain at £100.
- Annual fixed costs would increase by 3% as a result of undertaking this strategy.
- Based on LH's forecast of house sales, LH would require BOB to supply 9,000 Quebec bed-frames in the year ending 31 December 2016 and the same number in the following year.
- The contract would have no minimum or maximum quantities, and demand would be uneven and would peak when each of LH's large housing projects nears completion.
- The contract would require BOB to supply LH within one month of each order.
- Quebec bed-frames would only be available to LH. To keep its existing retail customers happy, as part of this strategy BOB would reduce the price of Classic bed-frames by 2% from 1 January 2016, but the expected sales volume would be unaffected.

2. Drummond & Drew LLP (DD) is a large firm of commercial architects, based in a single office in London.

The industry

Architects plan, design and oversee the construction of buildings for clients. Architects belong to professional bodies and usually operate in professional partnerships or companies.

The scale of architectural projects varies from large commercial buildings (such as offices, shops and factories) to residential housing. Some architect firms specialise in one type of project, others operate across a spectrum of different project types. A project may involve constructing a new building or altering an existing building.

A client's project usually requires two phases of work: the planning and design phase, and the construction phase. Both phases are normally managed by the same architect firm.

The planning and design phase involves the architect ascertaining the client's requirements in detail. The architect then prepares design drawings and graphics which comply with local building and other regulations.

The construction phase requires the administration, monitoring and coordination of the construction process by the architect. This can include, for a large project: site inspections, surveys, procurement of contractors, cost appraisal, certification, valuations and project management. Most aspects of this phase require architects regularly working on site with construction company staff.

Company background

DD's structure and staffing

DD has grown gradually over many years, increasing its revenue and staff, and has built a reputation within the UK as a good quality architect firm specialising in commercial, rather than residential, projects. In recent years, however, DD's UK growth has slowed due to increasing competition from existing firms and new market entrants.

DD has 12 partners (all qualified architects) plus 93 other qualified architects, and a further 77 support staff including managers, IT specialists, chartered surveyors, semi-skilled staff and administrative staff.

The 12 partners together take all the key decisions. Jeff Drummond is the senior partner. The other qualified architects have various levels of seniority and differing specialist skills.

All DD architects are fee-earning other than the technical and regulatory team, comprising three architects, which deals with adherence to technical standards and compliance with regulations.

Additional qualified architect time is sometimes acquired on a short-term contract basis, for both complex projects and more routine work. Using short-term contract architects has helped DD manage capacity where there are variations over time in the number and size of client projects.

Individual DD architects have significant autonomy in the design process and professional decision making, but they report to the partners regarding progress compared to plan, time spent and profitability of each project.

In the design and planning phase, most architects work at the London office, with occasional visits to clients. In the construction phase, most of the architects' time is spent at the construction site, with occasional visits to the London office.

Clients and projects

DD's client portfolio includes large companies requiring the design and construction of offices, factories and other large commercial buildings.

Whilst historically most of DD's projects have been in the UK, over the past five years there has been an increasing number of overseas projects. Almost all of the growth in project numbers has been in Dubai and the other Gulf States, where there is significant commercial construction activity as the region recovers from the recession.

The scale of projects won in the Gulf States has grown as DD's reputation has spread in the region. To date, projects in the Gulf States have been serviced by London-based DD staff, but this has proved increasingly difficult as the number and scale of projects in the region have increased. In 2014, the equivalent of 10 architects spent all their chargeable hours on Gulf State projects. A majority of DD partners believe that many more projects could be obtained in the Gulf States if the firm had an office in the region.

A potential new project in Dubai

To be eligible to bid in January 2016 to provide planning, design and construction services for a major building in Dubai, called the Sunrise, DD must make a commitment to establishing an office in the region from 1 January 2017. It therefore needs now to make an urgent decision about operating an office in Dubai. If the bid is successful, design work on the Sunrise project will start in January 2017.

DD would aim to obtain commissions for additional commercial projects in the Gulf State region during 2016. However, to make the investment in an office in Dubai viable in the longer term, DD would also need to work on smaller projects, especially residential buildings.

The number of architects and support staff required to be located in an office in Dubai is estimated to be:

Projects	Number of Dubai staff		
	2017	2018	2019 and each year thereafter
Sunrise	12	18	0
Other commercial	10	14	16
Residential	5	7	10

If this international expansion does take place, there are two alternative methods: acquire an existing architect firm in Dubai; or set up a new DD office there.

PLEASE TURN OVER

Requirements

- (a) Using appropriate models, explain the nature and suitability of the existing organisational structure of DD as a professional service organisation. Ignore any new development in the Gulf States. **(10 marks)**
- (b) Explain the factors that DD should consider in deciding whether or not to expand internationally by establishing an office in Dubai. Ignore the issue of whether this is by acquisition or by an office being set up by DD. **(12 marks)**
- (c) Assuming DD does decide it needs an office in Dubai, explain the factors that should be considered in determining whether it should acquire an existing architect firm in Dubai or open a new office there itself. **(8 marks)**

Total: 30 marks

3. Mississippi Muzic Ltd (MM) operates four London nightclubs, each with a restaurant. The four clubs are the same size but are located in different areas of London. They all aim to attract a similar clientele and are open every night of the week.

There is a small fee for life-time membership when a person first visits a MM club, but the entrance charge for each subsequent visit by a member is high, and drinks and meals are expensive. The target market is young, high-income professionals who wish to socialise, dine, drink and network with people from a similar background. The high entrance charge is viewed favourably by many club members as it keeps the environment exclusive to professional groups.

MM has attracted a loyal core of members and the clubs are, on average, 95% full on Friday and Saturday nights. The capacity of each club at any one time is 250 people. The clubs are significantly less busy for the remainder of the week as members tend to work long hours.

MM has a database of all its 7,800 current members. The membership grows each week as new members join. However the chief executive of MM, Jane Flinkstein, believes that the company is not making best use of this database for marketing. The core database includes the member's: name; contact details; gender; age; job; and interests. Each member has a membership card with a bar code to be shown at each visit to the club. Data is then recorded so the timing and frequency of each member's visits are held on the database.

MM wishes to increase revenue by marketing its clubs more effectively and has identified two possible strategies, which are not mutually exclusive.

Strategy 1 – MM would encourage existing members to visit the clubs more frequently, and dine in the restaurants more often, by using its database more effectively for relationship marketing purposes.

Strategy 2 – MM would appeal to new types of customer, other than young professionals, in order to fill its spare capacity from Sunday to Thursday.

Requirement

You are a business adviser who has been asked by Jane Flinkstein to prepare a report outlining elements of a marketing strategy for MM:

- (a) Explain how MM can use its database more effectively to market to existing customers (Strategy 1). **(8 marks)**
- (b) Outline and explain the market research that MM should undertake for Strategy 2. **(8 marks)**
- (c) For Strategy 2, identify and explain:
- a segmentation strategy; and
 - a pricing strategy.

(8 marks)

Total: 24 marks