

ADVANCED GCE
BUSINESS STUDIES
Strategic Management

F297

Candidates answer on the Answer Booklet

OCR Supplied Materials:

- 16 page Answer Booklet

Other Materials Required:

- Calculators may be used

Tuesday 22 June 2010
Morning

Duration: 2 hours



MODIFIED LANGUAGE

INSTRUCTIONS TO CANDIDATES

- Write your name clearly in capital letters, your Centre Number and Candidate Number in the spaces provided on the Answer Booklet.
- Use black ink. Pencil may be used for graphs and diagrams only.
- Read each question carefully and make sure that you know what you have to do before starting your answer.
- Answer **all** the questions.
- Do **not** write in the bar codes.
- If you use extra sheets of paper, fasten these sheets to the Answer Booklet.

INFORMATION FOR CANDIDATES

- The number of marks is given in brackets [] at the end of each question or part question.
- The total number of marks for this paper is **90**.
- The Quality of your Written Communication will be taken into account when marking your answer to the question labelled with an asterisk (*).
- This is a synoptic paper. When answering each question you must use the knowledge and skills gained throughout the whole A-level course.
- This document consists of **8** pages. Any blank pages are indicated.



**A calculator may
be used for this
paper**

Answer **all** the questions.

- 1 **(a)** Calculate, correct to two decimal places, **four** appropriate profitability ratios for LCL in 2009. **[13]**

 (b) Recommend a strategy which would allow or permit LCL to increase its profitability. **[18]**
- 2 Discuss how a rise in UK interest rates might affect LCL's ability to meet its objectives. **[18]**
- 3 Evaluate how LCL's stakeholders might view the approaching retirement of George Lyte. **[18]**
- 4* Should LCL accept the order from Rupert Doodes? Justify your answer. **[23]**

F N Lyte Cases Ltd (LCL).

George Lyte is, according to most people, a nice person. Ever cheerful and optimistic, he views being in business as fun. George is the major shareholder (with 60% of the company's equity), Chairman and Managing Director of F N Lyte Cases Ltd (LCL). Although he is the "boss", he likes to spend his working days with people. Every day he is more likely to be either walking around the shop floor chatting to the business' highly skilled craftsmen, visiting customers or discussing deliveries with suppliers, rather than being in his office. George prides himself on knowing something about each of the company's 20 staff. Most of the staff feel that LCL is a great place to work, and that George is an enlightened employer. George's philosophy is that businesses are about people. You only get the best out of people by developing trust and respectful relationships. These relationships are not created by memos or emails. Rather they are created by taking the time to get to know people and by listening to their concerns and needs. Without ever having explicitly thought about it, George has created a personal culture at LCL to the extent that he and LCL are intertwined.

LCL designs, engineers and manufactures aluminium flight cases for a wide array of applications. Recent customers have included musicians, IT companies, the aerospace industry, manufacturers of scientific instrumentation and companies which regularly attend exhibitions and trade fairs. In fact, anyone with a delicate and precious product which needs to be protected when being transported is a potential customer. LCL was established nearly 30 years ago to make aluminium cases for the professional and serious amateur photographer. Slowly, and more by accident or good luck than strategy, the business has grown. In 2009 nearly 45% of output (by value) was exported, with the EU, USA and Australasia being LCL's main markets. George would like to see this percentage rise to 50% by 2011 so as to spread risk. With many of LCL's customers becoming more ethically aware George knows that it is important that LCL can show it always acts with integrity and honesty. Further, any suggestion that LCL's standards are open to criticism could result in the loss of customers. These customers insist, for their own CSR compliance, that all suppliers must adhere to their ethical code of practice.

The manufacturing area at LCL has something of the air of an operating theatre about it, both physically and in terms of its atmosphere. The workshop area is spotlessly clean, the CAM machinery is almost new, and materials are carefully and safely stored. The craftsmen work quickly, precisely and carefully. Production is arranged in cells, with each team of three taking responsibility for quality and output. Cases are either made for stock or for order depending on current demand. Over the years the business has built a reputation for quality. Many of the standard cases featured in its on-line catalogue sell steadily throughout the year – with little marketing need.

Each week the senior team (George; Dave Short, Production Manager; Chris Hodder, Marketing Manager; and Shelia Ranger, Finance Director) meet to discuss the coming month's production schedule. In preparation for this meeting, Chris will review the stock levels of finished standard cases. He then advises Dave of what batches need to be made to replenish the stock of finished goods. Once the need for a batch of a particular case is identified, Dave likes to make enough to keep LCL's sales going for a few months. The cheapest product in LCL's catalogue is a "DJ Coffin" with a list price of £175. Chris will also tell the weekly meeting of any bespoke cases which need to be designed, engineered and manufactured. These bespoke cases provide a greater margin than standard cases. They also give everybody at LCL an opportunity for creativity, problem solving and task variety. Once everyone has had their say, George will decide what will be produced.

Although price is important, George believes that quality and product integrity matter far more. George believes that every time a customer interacts with an LCL case they should experience a degree of pride and satisfaction of ownership which lasts long after they have forgotten what they paid for the case. Consequently, he is fastidious about quality, even to the extent that Dave and Shelia feel that some LCL products might be over-engineered. When LCL receives an

enquiry from a potential domestic customer, for a bespoke case, George is anxious to provide the best possible quality of purchase experience. Hence, if the customer is not able to travel to LCL, a team of three from LCL may visit the potential customer – subject to the value of the order. If the order is for export, then the customer will only be visited if the potential value of the order warrants the costs involved. The team comprises one member of the senior team, a member of the design department and one member of the shop floor craftsmen from the cell which will make the order. Together, this team will meticulously diagnose the customer's actual needs rather than rely solely on their initial thoughts. By working with the customer in this way, LCL is often able to delight its customers with imaginative solutions to issues the customer had not even considered when placing the order. Both George and Chris are proud of LCL's customer retention and loyalty.

With the 2012 London Olympics on the horizon, Chris has been targeting media companies. Chris knows that these customers will have to be able to transport expensive and delicate broadcast technology between the various Olympic sites. Thus far, he has not secured any firm orders but he has had lots of expressions of interest. However, his disappointment has been tempered by a visit to the LCL factory from Major (Retired) Rupert Doodles. Major Doodles wants to place an order for 30 bespoke cases of various sizes, to be delivered in three weeks' time. Although he has been reluctant to say exactly what the cases are for, muttering something about medical equipment, he has given Chris the overall dimensions of what they are to protect. One of the design department jokingly said, "You'd get a Stinger anti-aircraft missile in each of the largest ten cases". Chris has had an informal chat with Shelia and Dave. Both are keen to try to win the order, especially as there was a promise of possible future orders – if the delivery date is met. Whilst some of the next three weeks of production capacity is rapidly being assigned to orders, Dave is confident that the order could be completed if he allocates his best cell to the job (see Appendix 1). Shelia has worked out that the order will make a gross margin of 38.7%. This will help LCL reach its objective of increased profitability. However, all three know that the sticking point will be George whose pacifist/anti-military views are well known (and often articulated!). In many ways, LCL is George! Sometimes the other members of the senior team feel his views dominate too much and can, occasionally, hold LCL back.

One issue that George has been forced to face is that of succession. Approaching his retirement, some stakeholders are beginning to question what will happen to LCL if George leaves in two years' time. Amongst these is LCL's bank, as well as some of the minority shareholders. Both of these stakeholders feel George is being unprofessional in not thinking beyond his own personal circumstances. The last time George met with his Business Banking Adviser, Alison Steadman, he was told that the bank would not automatically renew LCL's overdraft facility when it is next reviewed. In effect, the bank is seeking assurances about the long term viability of LCL without George at the helm. George was rather taken aback when Alison produced an analysis of LCL's financial performance (see Table 1). She commented that "Some things don't look too good, especially when compared to recent industry averages".

Table 1 – Comparative financial ratio performance – LCL and industry average

Ratio	LCL – 2008	LCL – 2007	LCL – 2006	Industry average
Return on capital employed	14.23%	15.17%	16.41%	18.79%
Return on equity	17.68%	19.10%	20.97%	19.11%
Net profit margin	2.67%	2.91%	3.25%	3.40%
Gross profit margin	35.47%	35.75%	35.74%	40.15%
Gearing	24.26%	25.97%	27.80%	25.30%
Interest cover	3.25	3.33	3.61	5.20
Current ratio	1.18	1.19	1.19	1.31
Acid test	0.75	0.74	0.72	1.03
Asset utilisation	2.30	2.26	2.23	2.11
Fixed asset utilisation	7.04	7.00	6.61	7.20
Days – stock	61.06	64.78	67.33	52.10
Days – debtors	66.99	67.64	65.14	63.40
Days – creditors	92.06	97.83	95.75	44.80

Alison continued by saying, “We’ve had a few enquiries from your suppliers banks’ about LCL’s liquidity. Whilst they know you’ll ensure that they get paid, they are nervous that someone else might not be as trustworthy. In a nutshell, they worry that LCL is too reliant upon you. With someone else running LCL, well ... they’d be a lot more demanding.”

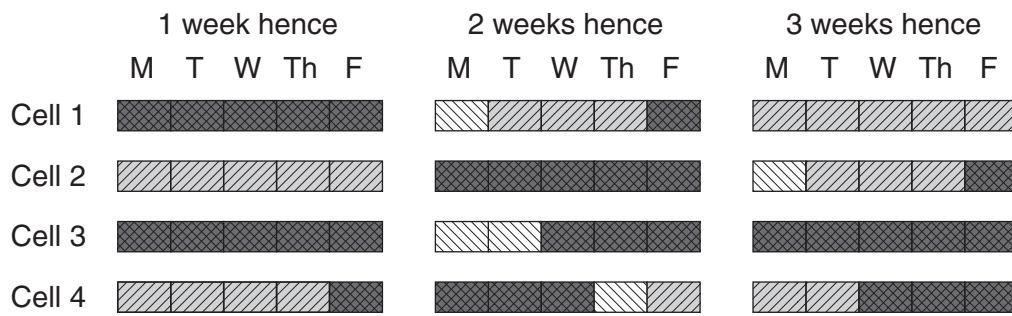
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After his meeting with Alison, George reflected that his idea of what running a successful business means is not universally shared. He is sure his staff prefer being paid by salary. They like the 38 hour week and finishing at lunch time on Friday. Although he has heard a few grumbles about LCL closing for holidays at set times, he knows this is for the best. A few years ago, before he introduced this holiday regime, he had returned from his three weeks at his Spanish villa to find LCL in chaos. In his absence his managers had been reluctant to make any meaningful decisions. Without his clear leadership, and without his “personal touch” with customers, things had not gone well. Alienating hard won customers was too large a risk to run, especially as George had set Shelia a 2012 objective of maximising the book value of LCL (see Appendix 2).

95


100

Appendix 1



Key

Standard cases 

Bespoke cases 

Customer visit¹ 

¹ Visits to potential customers have implications for production (lines 52–58). On a day when a member of a production cell is scheduled to visit a potential customer then, for planning purposes, that cell is regarded as being unavailable for production.

Appendix 2

Profit and Loss Account, year ending 2009

Turnover		638,900
Cost of sales		<u>415,285</u>
Gross profit		223,615

Overheads	181,086	
Marketing	19,169	
Interest expense	<u>6,545</u>	206,800

Net profit		16,815
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Balance Sheet, as at end of financial year, 2009

Fixed assets		92,050
Tangible assets		

Current assets		
Stock	70,800	
Debtors	120,360	
Cash	3,100	
		194,260

Current liabilities		
Trade creditors	108,970	
Overdraft	53,000	
		161,970

Net Current assets		32,290
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Creditors falling due after more than one year		24,000
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Net assets		<u>100,340</u>
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Share Capital	25,000	
Profit and loss account	75,340	

Equity shareholders' funds		<u>100,340</u>
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