

**OXFORD CAMBRIDGE AND RSA EXAMINATIONS**

**A2 GCE**

**F297/01/CS**

**BUSINESS STUDIES**

**Strategic Management**

**CASE STUDY**

**WEDNESDAY 12 JUNE 2013: Afternoon**

**DURATION: 2 hours**

**plus your additional time allowance**

**MODIFIED ENLARGED**

**OCR SUPPLIED MATERIALS:**

**Insert for Fig. 1**

**READ INSTRUCTIONS OVERLEAF**

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## **CAVENDISH CYCLES LTD (CCL)**

**Cavendish Cycles Ltd (CCL) retails bicycles and related life-style complementary products. Its first shop, 'Maillot Jaune', was opened in the spring of 1981, in Oakford (East Midlands), selling road bicycles and a limited range of accessories. Since then the business has steadily grown with another 'Maillot Jaune' branded shop in nearby Market Harworth (opened in 1992). In addition it has three other outlets selling and hiring bicycles to the leisure and off-road market. These three trade under the name 'Peddlers'. The first Peddlers opened in 1994 adjacent to the sailing club at a local reservoir. In 2001 the second opened outside Market Harworth on the route of a disbanded railway line. The most recent Peddlers is next to a camp and caravan site on the edge of Rockingham Forest. The forestry owners saw all-terrain and adventure sports cycling as a further opportunity to encourage visitors to its site, and knowing of CCL's reputation and integrity, approached CCL with a proposal to open a small, ten year rent free, hire and sales outlet. Hence, in 2011 the third Peddlers opened.**

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**An e-commerce operation, branded as CCL Direct, was opened in 2010.**

**The company is owned and run by the Cavendish family. Founder and Managing Director, Phil Cavendish, has a simple two pronged business philosophy which has enabled CCL to grow in an increasingly competitive market. First, recognising that differentiation through product offering is all but impossible, CCL's focus is on its customers' experience. Hence, whether a customer is thinking of buying an £8.99 drinking bottle or a £3500**

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bicycle, they should be treated with equal respect and made to feel valued. Consequently, all staff receive training in customer care, bicycle servicing and product knowledge. So, even if a customer walks into one of the outlets simply seeking advice, staff are encouraged to see this as the chance to start a new relationship and, all being well, one which may ultimately lead to a sale at some future date. Customer care is, in Phil's view, the only way in which CCL can compete with either national retailers or Internet based firms.

Second, scale matters. Hence, although CCL has grown, Phil strives hard to inculcate amongst all the staff a small business culture. So, all the staff at each store know each other and will 'muck in' and take 'turn and turnabout', whether selling or servicing bicycles. For CCL there is no such thing as 'somebody else's job', rather it is 'everyone's job'. One of Phil's favourite phrases is 'Team; together everyone achieves more'. To further encourage the right culture all staff benefit through an annual bonus triggered by the performance of the whole business, even though each of CCL's six outlets is treated as a profit centre (see APPENDICES 1 and 2).

The average age of the 59 non-administration staff is late twenties. Phil, and the ten strong Accounts, Personnel and Administration staff are on average, older. Aside from working for CCL, a common characteristic amongst the staff is their preference for an outdoor life-style, with many actively participating in cycling competitions. As a service sector business, with direct customer contact, Phil thinks that the staff represent a significant source of competitive advantage and, as such, he is invariably disappointed when someone leaves.

Phil dislikes large businesses, particularly those which seem to see their systems and procedures as more important than their customers' needs.	70
High on his list of dislikes are utility companies and banks. Although he has not been in a classroom for decades, he can still recall his economics teacher extolling the virtues of the 'invisible hand of the market; successful businesses grow and prosper, whilst bad businesses fail'. It seems to Phil that this no longer applies. His views are imposed on CCL to such an extent that it has no bank borrowing and it has been, and will continue to be, zero geared (see APPENDIX 3). Hence, the business' growth has been internally funded. Although this may have resulted in a relatively modest rate of growth for CCL, the shareholders (all of whom are members of Phil's family) felt the benefit during the banking crisis which began in 2008. With no debt, CCL did not have to worry about continued access to long term capital. Further, changes in UK monetary policy have no cost implication for CCL; although it does have an impact on its revenue stream because of customers' confidence and willingness to spend.	75
Other macroeconomic policies and factors do have an impact on CCL and Phil keeps an eye on a variety of indicators; ironically provided in a quarterly economic report published by CCL's bank (SEE TABLE 1).	80
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**TABLE 1 – KEY ECONOMIC INDICATORS**

<b>YEAR</b>	<b>EAST MIDLANDS UNEMPLOYMENT RATE</b>	<b>ANNUAL RATE OF INFLATION (UK)</b>	<b>ANNUAL RATE OF GDP GROWTH (UK)</b>
<b>2009</b>	<b>7.4%</b>	<b>–1.6%</b>	<b>–0.7%</b>
<b>2010</b>	<b>7.4%</b>	<b>5.0%</b>	<b>1.1%</b>
<b>2011</b>	<b>7.9%</b>	<b>5.3%</b>	<b>0.1%</b>
<b>2012*</b>	<b>8.0%</b>	<b>2.4%</b>	<b>0.1%</b>

**\* forecast figures**

**Always mindful of the external environment when establishing CCL's strategy, Phil has agreed with the other shareholders three objectives for 2014 of:**

- 1. bringing the Rockingham Forest 'Peddlers' outlet to break-even by the end of the 2014 peak season** **100**
- 2. increasing the proportion of revenue from e-commerce to 55% by the end of the 2014 financial year** **105**
- 3. becoming the number one bicycle retailer in the East Midlands.**

To achieve the third objective, Phil has asked Bradley Smith, CCL's Marketing Manager, to create a promotional strategy for 2014. After much deliberation Bradley has suggested four possibilities: 110

1. sponsoring a regional bicycle race and so securing naming rights
2. sponsoring a team in that race 115
3. using above-the-line promotion
4. using the marketing budget to subsidise retail prices and so offer targeted discounts on a number of key lines.

If either of the two bicycle race based options are chosen, and the cycling media promise to give the race extensive coverage, then Bradley suggests an additional sponsorship would be sensible. To help explain this to Phil, Bradley sketched out the options as a diagram (SEE FIG. 1 on the insert). Bradley is aware that, at the moment with further research still needed, he cannot complete the diagram; however, he has been able to calculate some of the expected cash inflows and probabilities for good, average and poor returns for each option. 120 125 130

Phil believes that CCL acts ethically in its relationships with all of its stakeholders. However, sometimes there is a fine line between good commercial practice and ethics, with price discrimination being a case in point. Like many businesses which face changes in market demand, both across the year (peak and off-peak) and on a weekly (weekday and weekend) basis, CCL has a pricing structure for its hire business, 'Peddlers', which varies with time (SEE TABLE 2). 135 140



**TABLE 2 – PEDDLER’S 2013 BICYCLE HIRE TARIFF**

	OFF-PEAK			PEAK, EASTER TO AUGUST BANK HOLIDAY		
	2 HOURS	4 HOURS	ALL DAY	2 HOURS	4 HOURS	ALL DAY
<b>TYPE OF BICYCLE</b>						
<b>Mountain</b>	£11.99	£14.99	£21.00	£13.99	£16.99	£21.00
<b>Road</b>	£13.99	£16.99	£24.00	£15.99	£18.99	£24.00
<b>Hybrid</b>	£9.99	£11.99	£18.00	£11.99	£14.99	£18.00
<b>Electric</b>	£17.99	£19.99	£30.00	£19.99	£22.99	£30.00
<b>Tandem</b>	£23.99	£24.99	£37.50	£24.99	£27.99	£37.50
<b>Children’s</b>	£5.99	£8.99	£9.00	£5.99	£8.99	£9.00

In addition, Peddlers offers a family ticket (two adults and a minimum of two children) at a 10% discount. Further, pre-booked groups, spending more than £200, also get a 10% discount. Neither discount is available on peak season bank holidays. 145  
During the peak season the Peddlers outlets open from 8am to dusk. Despite these long opening hours, the bulk of the hires occur between 10am and 6pm, and, especially on warm summer weekends, significant queues for the hire of bicycles can develop. 150

Peddlers used to offer helmet hire for £1. However, last year it was decided to hire helmets for a £1.50 donation to one of two charities; the regional air ambulance or Headway. Despite the increase in fees, Peddlers saw helmet hire rise by 25%. Encouraged by this experience, CCL decided to donate £5 to charity for every helmet sold. An unintended consequence of this decision was some regional publicity for the business. 155  
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In September each year the entire bicycle hire-fleet is serviced and then a proportion is sold at a 50% discount to replacement cost over the following months. This not only keeps the hire-fleet modern, but it can also lead to sales of complementary products. In addition to bicycles, some clothing, such as replica team jerseys and other accessories, is included in the end of year sale. 165

By its very nature, CCL is a business with a low carbon footprint. Recent growth in both sales and hire are, in part, attributable to shifts in society's values. Whereas cycling used to be the preserve of the committed enthusiast or transport for the factory worker, cycling is now very much a mainstream 170



**TABLE 3 – PROJECTED CASH FLOWS**

<b>YEAR</b>	<b>CASH FLOW, NET RECEIPTS, £</b>
<b>0</b>	<b>(40 000)</b>
<b>1</b>	<b>8 000</b>
<b>2</b>	<b>10 000</b>
<b>3</b>	<b>12 000</b>
<b>4</b>	<b>12 000</b>
<b>5</b>	<b>12 000</b>

This possible expansion is but one of the issues facing Phil. Bradley is very keen to merge both brands, ‘Maillot Jaune’ and ‘Peddlers’, into a single identity – ‘Summit Cycles’. Phil, however, thinks that there would be little to be gained by such a move, yet an awful lot to lose. He is more focused on managing the growth in e-commerce sales, and CCL’s other objectives for 2014. With economic growth likely to remain uncertain for some time to come, he is concerned that the outlook for CCL is far from secure, especially as many of CCL’s customers rely on discretionary income to make their purchases. So, whilst life-style remains a key driver for demand, Phil knows it can only continue if customers actually have the cash to spend. Although under no financial threat, Phil feels the growth in CCL’s sales across the last four financial years (2009 £6.8m; 2010 £9.7m; 2011 £11.6m; 2012 £13.3m) may not be repeatable across the next four years.

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**APPENDIX 1 – PROFIT CENTRE PERFORMANCE,  
1 SEPTEMBER 2011 TO 31 AUGUST 2012**

	<b>Maillot Jaune Oakford</b>	<b>Maillot Jaune Market Harworth</b>	<b>Peddlers Reservoir</b>	<b>Peddlers Market Harworth</b>	<b>Peddlers Rockingham Forest</b>	<b>e-commerce</b>	<b>CCL</b>
<b>Manager</b>	<b>Will Farmer</b>	<b>Ben Turnbull</b>	<b>Olivia Tsong</b>	<b>Andrew Jarvis</b>	<b>Sam Tipper</b>	<b>Jo Russell</b>	
<b>Staff</b>	<b>4</b>	<b>4</b>	<b>12</b>	<b>10</b>	<b>2</b>	<b>27</b>	
	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>	<b>£000</b>
<b>Revenue</b>	<b>1640</b>	<b>1458</b>	<b>1495</b>	<b>1415</b>	<b>440</b>	<b>6845</b>	<b>13293</b>
<b>Cost of sales</b>	<b>738</b>	<b>656</b>	<b>598</b>	<b>566</b>	<b>220</b>	<b>3080</b>	<b>5858</b>
<b>Overheads</b>	<b>872</b>	<b>775</b>	<b>795</b>	<b>752</b>	<b>234</b>	<b>3640</b>	<b>7068</b>
<b>Profit</b>	<b>30</b>	<b>27</b>	<b>102</b>	<b>97</b>	<b>-14</b>	<b>125</b>	<b>367</b>

**APPENDIX 2 – MONTHLY PROFIT CENTRE REVENUE,  
1 SEPTEMBER 2011 TO 31 AUGUST 2012**

	<b>Maillot Jaune Oakford</b>	<b>Maillot Jaune Market Harworth</b>	<b>Peddlers Reservoir</b>	<b>Peddlers Market Harworth</b>	<b>Peddlers Rockingham Forest</b>	<b>e-commerce</b>	<b>CCL</b>
	£000s	£000s	£000s	£000s	£000s	£000s	£000s
<b>September</b>	183	172	51	44	28	411	889
<b>October</b>	99	86	28	26	26	384	649
<b>November</b>	140	92	22	14	23	845	1136
<b>December</b>	165	118	59	56	19	368	785
<b>January</b>	72	89	52	39	19	386	657
<b>February</b>	56	54	34	36	24	375	579
<b>March</b>	59	57	35	33	21	381	586
<b>April</b>	68	66	28	29	26	402	619
<b>May</b>	126	130	34	69	30	855	1244
<b>June</b>	206	184	373	354	74	901	2092
<b>July</b>	216	188	393	359	76	879	2111
<b>August</b>	250	222	386	356	74	658	1946

# **APPENDIX 3 – CCL'S BALANCE SHEET AS AT 31 AUGUST 2012**

	£000s	£000s
<b>FIXED ASSETS</b>		
Premises	500	
Equipment	<u>27</u>	
<b>TOTAL FIXED ASSETS</b>		<b>527</b>
<b>CURRENT ASSETS</b>		
Stock	2908	
Debtors	1108	
Cash	<u>175</u>	
<b>TOTAL CURRENT ASSETS</b>		<b>4191</b>
<b>CURRENT LIABILITIES</b>		
Trade creditors		<u>1454</u>
<b>NET CURRENT ASSETS</b>		<b><u>2737</u></b>
<b>NET ASSETS</b>		<b><u>3264</u></b>
<b>EQUITY</b>		
Share capital		100
Profit and loss account		<u>3164</u>
<b>EQUITY SHAREHOLDERS' FUNDS</b>		<b><u>3264</u></b>

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