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A2 GCE APPLIED BUSINESS

F248/01/CS Strategic Decision-Making

PRE-RELEASE CASE STUDY

JUNE 2018



INSTRUCTIONS TO TEACHERS

- This Case Study **must** be opened and given to candidates on receipt.

INFORMATION FOR CANDIDATES

- You **must** make yourself familiar with the Case Study before you sit the examination.
- You **must not** take notes into the examination.
- A clean copy of the Case Study will be given to you with the Question Paper.
- This document consists of **12** pages. Any blank pages are indicated.

Exclusively Cheese Ltd (*ECL*)

The background

Exclusively Cheese Ltd (ECL) is a retailer of premium quality artisan cheeses. To complement its elite cheeses, *ECL* also sells a range of high quality savoury biscuits, breads, chutneys and olives. Rebecca Holdsworth, the Chief Executive Officer (CEO), founded the company in 1999 at the age of 20. The business idea came to Rebecca while on holiday in Northern Italy. Bra's international cheese festival offered samples of over 1000 types of cheese, none of which were factory-made. It was a cheese lover's paradise and a natural entrepreneur's inspiration. 5

Starting with a single store in Richmond upon Thames, *ECL* grew rapidly. Today, *ECL* has 15 stores in London and a further 35 stores located on major high streets across the UK. *ECL*'s marketing, finance, purchasing, logistics, technical support and human resource functions are all organised centrally at its head office in London. Rebecca believes that *ECL*'s success is primarily due to her insistence on a business philosophy based on excellence. She frequently reminds her fellow directors that *ECL*'s store managers, being ambassadors of excellence, are the most valuable asset the company possesses. 10

The business

ECL's clientele is affluent, well-educated individuals who are socially active and culturally aware. Consequently, *ECL* stocks a wide range of elite artisan cheeses, including those made from cow, goat, ewe and buffalo milk. It also stocks non-dairy cheeses made from soy, coconut, almond and rice milk. The company targets middle-aged professionals who appreciate quality, variety and sophistication. *ECL*'s buyers must constantly seek out handmade cheeses which are new, unusual and of exceptionally high quality to meet the demands of such a discerning market. 15

Where possible, *ECL*'s buyers source stock directly from cheese producers. This enables *ECL* to be certain of the provenance of the cheese, as well as potentially cutting costs. While *ECL*'s buyers source most of the cheeses from within the UK, some cheeses can only be sourced from abroad. Supply costs can be volatile, especially for rarer varieties which cannot be purchased in bulk. Super-premium handmade varieties of Cheddar, Red Leicester, Caithness and Double Gloucester are *ECL*'s best sellers. Dorset Blue Vinney and Oxford Blue are also extremely popular. The most expensive cheese available for general sale at *ECL* is Stilton with flakes of gold. This limited edition cheese commands a price tag of £60 for a 100g wedge. *ECL*'s flagship stores in Belfast, Cardiff, Edinburgh and London also sell two extremely rare cheeses: Moose cheese made from Swedish elk milk at £140 per 100g and Pule cheese made from Balkan donkey milk at £170 per 100g. 20

Even in London, all of *ECL*'s stores are small. Its boutique shopping outlets are designed to accentuate the exclusivity of its products. In store, the cheeses are displayed in refrigerators specially designed to maximise longevity, maintaining the superb flavour and texture of the cheese. All of *ECL*'s stores are open six days a week – Monday to Saturday. Each store is staffed by one store manager and a team of sales assistants. Sales assistants are required to wear traditional uniforms reminiscent of those worn by butlers and housemaids in Victorian times. 25

Store managers at *ECL* are well paid, reflecting the importance of their job role within the company. Store managers must choose, from *ECL*'s stock-list, the varieties of cheese and complementary products to stock in their particular branch, and in what quantities. This is not an easy task. What sells well in one branch does not necessarily sell well in another. Customers frequently buy on impulse and consumer trends are not easy to predict. Although head office sets a price range for each product, the individual store managers can set the price for each 30

product on sale in their particular branch within that range. Store managers need to decide when to offer free samples within their stores. New product lines also need to be introduced into each branch to aid customer retention. Store managers must minimise the wastage of stock by closely monitoring sell-by dates, rotating stock, using special promotions and reducing prices as necessary. In addition, store managers are responsible for the appointment of sales assistants at their branch. They are free to choose the number of sales assistants to employ, the criteria for selection and the conditions of service (including pay rate). Store managers must also train, motivate and manage their sales assistants. 45

Each individual store manager is held accountable for the profitability and performance of their own particular branch. Duncan Morgan, the Finance Director, sets specific and measurable objectives for each of *ECL*'s stores on a monthly basis. As long as the store managers meet their objectives, they may run their branch as they wish. However, any store manager who fails to deliver will be subject to intense scrutiny from head office. 50

Store managers are required to travel to head office one day a month for training. They receive training in financial management, hygiene, health and safety, product provenance and the art of selling. They do not, however, receive training on staff management. The Human Resource Manager insists that the store managers should be free to manage their staff in the way that best matches the individual manager's personality and the needs of their staff. 60

Challenging times

Audited figures for 2016 show an annual turnover of £30 million, with shareholders' equity in excess of £56 million. On the face of it *ECL* is doing well. Indeed, the company has recently been nominated for the Speciality Retailer of the Year award. However, *ECL* has not opened a new store since the Leeds branch in 2010 and closer inspection of the company's accounts reveals a worrying trend: *ECL*'s turnover has fallen by approximately 2% in each of the 2013, 2014 and 2015 financial years. At the start of 2016, convinced that an increase in marketing activity would revive *ECL*'s fortunes, Rebecca authorised a sizeable increase in *ECL*'s marketing budget. Marketing costs in 2016 rose to 11% of net turnover, but sales at all stores continued to disappoint. 65

In addition, the increased marketing costs, coupled with increasing rents (especially for its London stores) and rising cheese costs, have had a significant impact on profit margins. Duncan warns that five of *ECL*'s stores are now on the threshold of viability. 70

Rebecca's thoughts

Before rushing off to the Speciality Retailer of the Year award ceremony, Rebecca turned her thoughts to corporate strategy. She scribbled a brief note to Duncan. 75

Duncan – I want to discuss the following two options at the shareholders' meeting next week. Please prepare capital investment appraisal figures for both options as best you can in the time available. I will be back in three days' time. Any questions, contact me on my mobile, but please do not ring during the ceremony.

80

Option 1 – Online trading

We could upgrade our website and begin selling on the Internet. The e-commerce operation would be run jointly by Technical Support and Logistics. There is plenty of space at head office to accommodate the additional demands of this option, so no worries there.

85

Option 2 – Makeover

We could remain a traditional high street retailer but have a complete image makeover. This would mean realigning ourselves in today's market; hopefully bringing in more customers. We would need to change our branding and marketing, as well as refurbish all of our stores. We could contract out this extra work or use the skills we have in-house.

90

Apologies for the short notice, Rebecca.

Duncan's figures

On Rebecca's return, Duncan presented her with the following figures:

95

	Option 1 Online trading	Option 2 Makeover	
		Contract out	In-house
Estimated capital spend	£700 000	£25 000 000	£15 000 000
Payback period	2 years	3 years 6 months	3 years
ARR (over 5 years)	90%	13%	16%
NPV (discount factor 15%)	£1 634 000	£1 590 000	£2 550 000
Proposed funding method	Company reserves	Bank finance	Bank finance

100

Rebecca thanked Duncan for the figures. Despite *ECL* winning the Speciality Retailer of the Year award Rebecca is worried that something has to be done to secure the long-term success of the company. 105

Further developments

The day before the shareholders' meeting Duncan overheard a conversation which gave him an idea. He immediately emailed Rebecca.

"Rebecca, I have just overheard a conversation between one of our buyers and an independent dairy farmer. The farmer was asking whether *ECL* would be interested in purchasing his range of handmade Greek yoghurt in addition to his white lavender cheese. There may be a third option which we could consider at tomorrow's meeting. 110

Option 3 – Sell yoghurt

In addition to selling artisan cheeses and related products we could sell premium yoghurt. Our temperature-controlled distribution systems and in-store refrigerators should easily be able to cope. Although we would need to do some extensive marketing, taking this option would mean that we would not need to introduce an Internet channel or makeover our stores. 115

Not sure whether I will have time to work out all of the figures in time for tomorrow's meeting, but I will do my best. Duncan."

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Appendix 1

How is the dairy food business?

If you sell natural cheese or Greek yoghurt, then the answer is 'great'.

If you bottle milk or sell ice cream, then the answer might be 'things could be better'.

Cheese. Natural cheese outshines processed cheese. Cheesemakers are innovating with bold flavours such as cinnamon and chocolate. They are blending cheeses into new combinations. Artisan cheesemakers are riding the twin waves churned up by 'foodies' and increased consumer preference for local produce. These consumers appreciate finer foods and are paying for higher quality.

Yoghurt. Yoghurt sales (including frozen yoghurts and smoothies) are increasing year on year according to Mintel, a market research firm. Greek yoghurt is leading this category.

Milk. Processors are being creative in trying to dam the steady drip-drip of annual losses. Milk processors are creating niche formulas by adding functional ingredients, including calcium, omega-3, vitamins and fibre.

Ice cream. Sales of packaged ice cream and novelties have dropped but those of frozen yoghurt have increased. Like milk, ice cream is a product for the young. The population is ageing, so the long-term prospects for ice cream are dim.

Research spotlight on cheese

Key factors which affect retail performance:

- Unemployment. Cheese sales experienced a drop during the recession.
- Household demographics. Households with children consume more cheese than those without children.
- Age demographics. Those aged 25 to 34 are eating more of all types of cheese than they did a year ago and, of all age categories, eat the most speciality cheese.

Appendix 2

Speciality cheese

Artisan cheese has always been something of a standard-bearer for the 'foodie revolution'. As a category, it is approachable enough for newcomers, yet nuanced enough that it can still excite acclaimed chefs. At retail, good merchandising, a good sampling policy and enthusiastic staff can make a cheese department the most exciting area of a store. Once potential customers taste it, if they like it, they will buy it. Even with domestic varieties, if people do not know what it is, and they do not know what it tastes like, then they are certainly not going to go out and spend money on it. Managers should not forget that there is still an art to selling, and still some currency in positioning your staff as experts.

Speciality cheese has a promising road ahead because its growth is really a subset of several bigger trends: the growth of natural and whole foods; the growth of greenmarkets and the popularity of small-batch food production; and the rise of food as a social activism issue among college students. These trends all point to a sharpening focus, especially among young people, on how food is made, where it comes from, how it tastes and how it is best enjoyed.

Interest in cheese remains strong

The International Dairy-Deli-Bakery Association notes trends toward natural, artisan and local cheeses. Consumers have a growing interest in cheeses with a sense of history and tradition – and that is turning them away from processed cheeses and toward products unique to a single region or even a single farm.

The highest rates of cheese consumption occur among suburban families and couples and larger, well-to-do urban families. People with household incomes of £60,000 or more have a much greater interest than others in speciality cheese, as do people who frequently visit supermarket delicatessens, speciality grocers or fine dining restaurants. Cheese consumption drops among the 65-and-older age group.

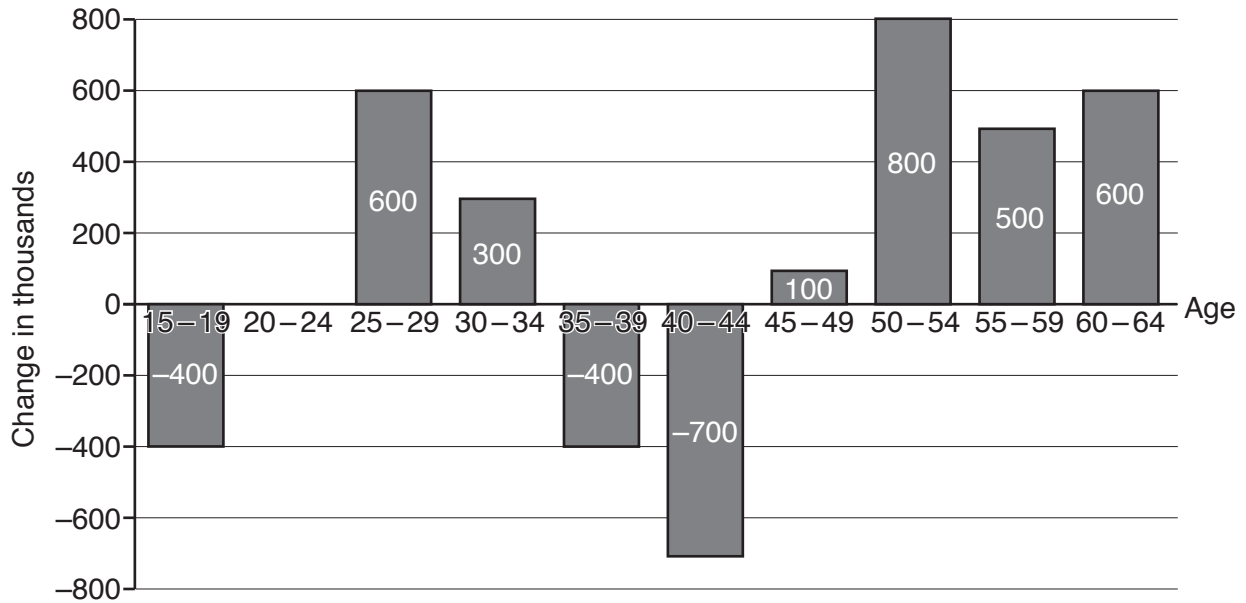
Appendix 3**Factors influencing the purchase of an unfamiliar cheese**

“How likely would the following persuade you to buy a new or different cheese?”	%
An in-store sample	85
I have had it at a restaurant, party or event	83
Recommended by family or friends	81
I have a coupon or discount	78
Featured on a TV cookery programme	54
An advertisement on TV	43
A printed advertisement in a magazine or newspaper	40
An online advertisement	29

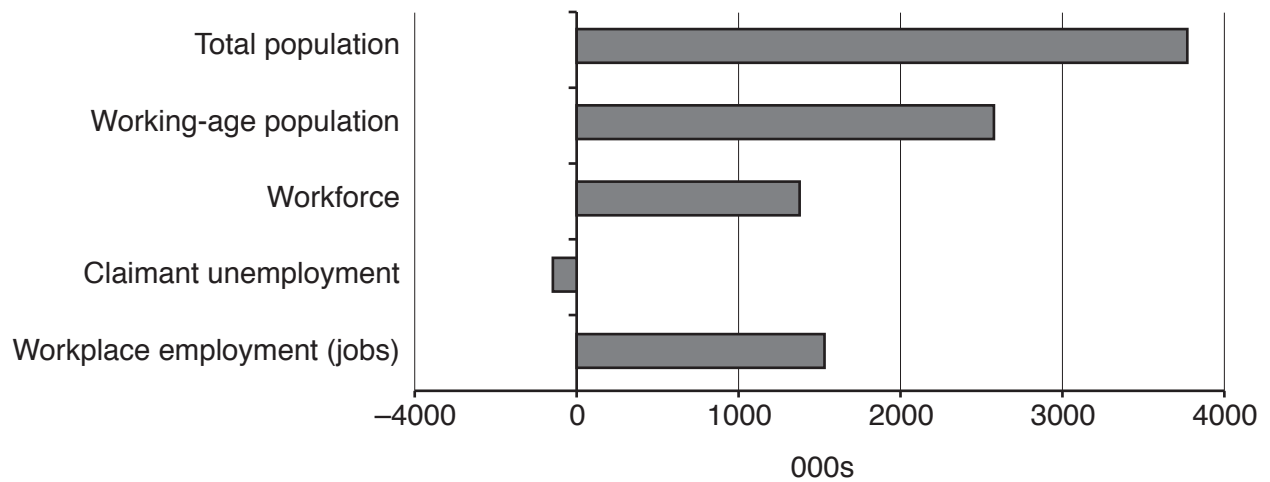
Source: Mintel

Appendix 4

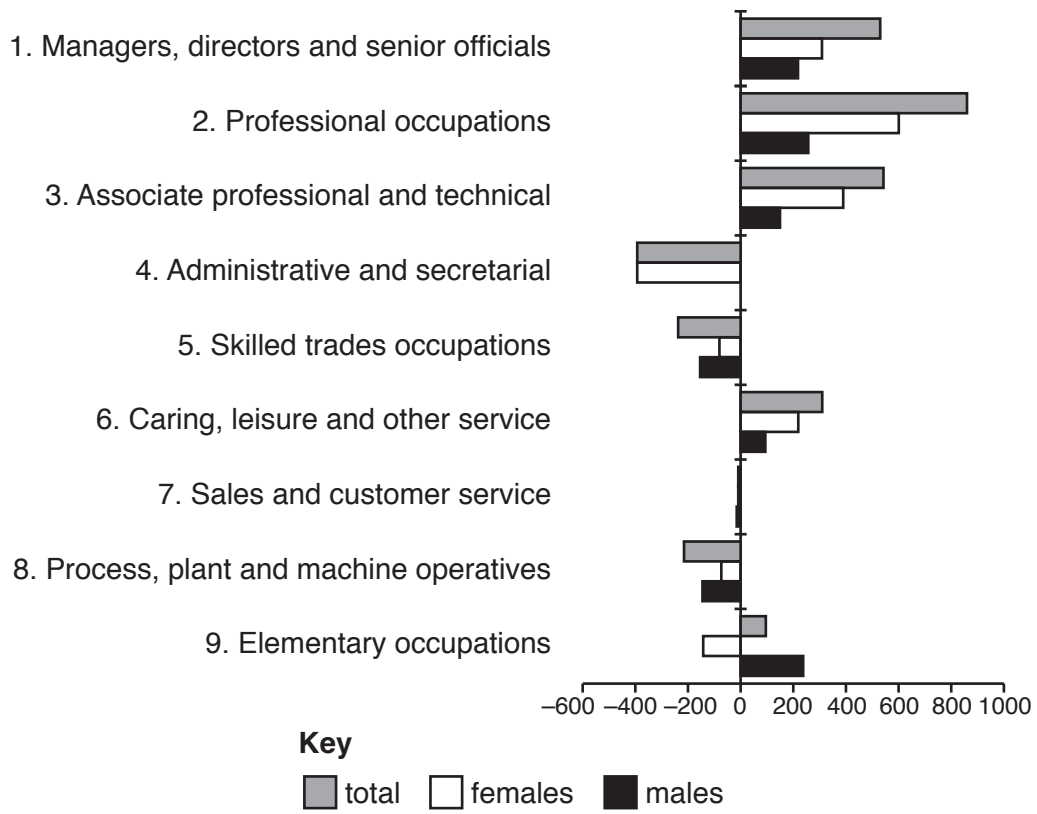
Projected change in age groups 2004–2020 (UK)



Forecasted changes in key labour market indicators, 2010–2020 (UK)



Forecasted occupational change by gender, 2010–2020 (UK)
Total Employment (000s)





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