

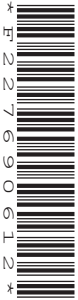
Thursday 21 June 2012 – Morning

A2 GCE BUSINESS STUDIES

F297/01/CS Strategic Management

CASE STUDY

Duration: 2 hours



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Smallbone, Little & Spence Ltd (SLSL)

Smallbone, Little & Spence Ltd (SLSL) is an estate agency. It has three branches, one in each of Oakford, Upham and Stamton. The ownership of the business has changed several times since it was founded in the mid 1980s. Each of the founding shareholders has since sold their equity. The company is now owned by husband and wife, Alistair and Penelope Roley, and Andrew Boddie. Andrew is also the senior partner of Boddie Cooper Solicitors. Andrew bought into SLSL in 2010, buying 10% of the share capital and advancing the firm a loan of £50,000 (with an annual interest rate 3% above the Bank of England base rate as at 31 March each year) repayable in 2015. SLSL used this additional capital to open its Stamton branch which Andrew's daughter, Hanna, manages. In conjunction with Andrew, the Roleys have decided that SLSL's objective for the financial year, commencing 1 April 2012, is an increase in revenues of 4%.

SLSL's market is best described as monopolistically competitive. With barriers to entry remarkably low there is a constant threat of new entrants. However, with barriers to exit also being low, there is a churn of agents opening and closing in the region. Indeed, in the five years the Roleys have owned the firm, five new estate agencies have opened in Oakford, whilst four have closed. At one end of the spectrum is the single outlet agency, which sometimes appears to Alistair as little more than a lifestyle choice for those individuals with an interest in all things property. At the other end of the scale are those agencies which are part of national chains or confederations. Hence, SLSL's market is dynamic from both a competitive and customer position.

Estate agencies, like all agents, do not take title. Rather, they earn their income by bringing vendors and buyers together. Estate agents typically charge the vendor a commission fee which is a percentage of the selling price, often in the range of $\frac{3}{4}\%$ to $1\frac{1}{2}\%$. The actual fee depends on the negotiating skills of both the vendor and the agent, combined with the prevailing market conditions. SLSL's average commission fee is assumed to be 1% for financial planning purposes. Whilst house sales are SLSL's core activity and, hence, commission on sales is its major source of income, it also has several other peripheral income streams. These include commission from the sale of property related services such as building insurance, home buyers' reports and conveyancing. Thus, whilst the sales commission on a typical property sold to a first time buyer might be low, SLSL is often able to guide first time buyers to use a recommended solicitor, e.g. Boddie Cooper, for conveyancing and a favoured surveyor for the home buyer's report.

Alistair is fastidious when it comes to image, believing that the market perception of the business is a key source of competitive advantage. Projecting a professional and confident image is all important. The Roleys work hard to ensure that all staff have effective listening and interpersonal skills; it is important that the two parties, whether buyer or vendor, 'like' the staff and trust their professionalism. All three branches have the same layout: neat, crisp lines with little clutter or distraction. All that is allowed to be on the chrome and glass desks are the latest, leased computers, a telephone and the employee's electronic organiser. Staff have to wear a discreetly logoed uniform; employees buy clothing from Next's business range which SLSL then pays a local seamstress to embroider the SLSL logo onto the jacket. Each office has use of a leased Toyota hybrid vehicle which can be used by any of the staff when visiting a client's property or taking a potential buyer on a viewing. SLSL also spends heavily on marketing. For example, it always takes a weekly double page colour advertisement, which costs £400 each week, in the Oakford Oracle, a newspaper which covers all three branches. Hence, in a recent market research survey, undertaken by the Oracle and used in its promotional campaign to bolster the Oracle's advertising income, SLSL had the highest unprompted awareness, see Table 1.

Table 1 – Public awareness of local estate agents

| | Unprompted awareness | Prompted awareness |
|----------------------------|----------------------|--------------------|
| Smallbone, Little & Spence | 66% | 100% |
| Challoner & Young | 43% | 100% |
| Hodsons | 34% | 95% |
| Castle Estates | 24% | 85% |
| Rural Residences | 23% | 84% |
| Paddock, Wills & McCombie | 17% | 69% |

Macroeconomic influences are a major factor: hence, Alistair regularly monitors data from various sources, including the Bank of England (see Table 2) and The Halifax (see Table 3). However, activity in the property market is also driven by sentiment and confidence. 45

Table 2 – Bank of England data

| | UK Base rates % | Gross Mortgage lending, £bn |
|------------|--------------------|--------------------------------|
| Sept 2010 | 0.5 | 12.4 |
| Oct 2010 | 0.5 | 11.6 |
| Nov 2010 | 0.5 | 11.5 |
| Dec 2010 | 0.5 | 10.5 |
| Jan 2011 | 0.5 | 9.4 |
| Feb 2011 | 0.5 | 9.3 |
| Mar 2011 | 0.5 | 11.3 |
| April 2011 | 0.5 | 10.1 |
| May 2011 | 0.5 | 10.8 |
| June 2011 | 0.5 | 12.6 |
| July 2011 | 0.5 | 12.5 |
| Aug 2011 | 0.5 | 13.1 |
| Sept 2011 | 0.5 | 12.9 |

Table 3 – National housing market data

| | House price index 1983 = 100 | Average house price, £ | House price/ average earnings ratio |
|------------|---------------------------------|------------------------|--|
| Sept 2010 | 524.2 | 161,974 | 4.47 |
| Oct 2010 | 533.9 | 164,949 | 4.54 |
| Nov 2010 | 533.1 | 164,708 | 4.54 |
| Dec 2010 | 526.9 | 162,803 | 4.48 |
| Jan 2011 | 531.3 | 164,145 | 4.49 |
| Feb 2011 | 526.6 | 162,697 | 4.46 |
| Mar 2011 | 526.6 | 162,712 | 4.45 |
| April 2011 | 519.1 | 160,393 | 4.39 |
| May 2011 | 521.2 | 161,039 | 4.40 |
| June 2011 | 528.9 | 163,430 | 4.47 |
| July 2011 | 530.0 | 163,765 | 4.48 |
| Aug 2011 | 524.1 | 161,926 | 4.41 |
| Sept 2011 | 522.3 | 161,368 | 4.39 |

Nearly all residential property is purchased using a mortgage of some kind. Since the ‘credit crunch’ mortgage lenders have been far more cautious in their lending: hence, borrowers are increasingly expected to be able to offer a substantial deposit and to show their credit worthiness. Consequently, new mortgages to first time buyers have declined, despite low interest rates. It has not escaped Alistair’s attention that there has been a commensurate rise in residential letting activity, particularly to young couples unable to access the housing ladder. Further, with low saving rates SLSL has seen a modest rise in properties bought for the buy-to-let market and enquiries from landlords asking whether SLSL offers letting management.

At a local level SLSL’s market often seems to Alistair to behave in a surprisingly irrational manner. For example, the closure of an RAF base six miles from Oakford (due to the government’s 2010 Strategic Defence Review) caused a noticeable drop in market confidence throughout the region. So, in addition to the weekly email Alistair sends to all staff offering an economic briefing, he encourages everyone to keep up to date with local and regional developments and to feed these back to him. For Alistair, information is king, and the more he has the better, particularly if others do not have it. Given that a house is only worth what a buyer is prepared to pay, and a vendor is willing to accept, Alistair is not averse to guiding the two parties to an agreement by lubricating the negotiations with an odd snippet of information now and again. Sometimes this presents him with an ethical dilemma. Aware that SLSL acts on behalf of the vendor, it also has to be remembered that its employees owe a duty of care to the business. As a matter of principle, Alistair will not inflate a valuation simply to gain an instruction.

As SLSL’s income is driven by sales, there is pressure to close sales each month. A poor month would be one in which SLSL did not reach its breakeven revenue, especially given SLSL’s cost structure and consequent high level of business risk. So employees are motivated to make sure that agreements are reached and purchases are finalised. In order to ‘incentivise’ staff SLSL currently pays a quarterly bonus based on the company’s profits. In 2011 the total bonus paid to staff for the year was £53,062. However, some of the staff at both Oakford and Upham are advocating a branch based bonus linked to sales. Penelope is not happy with this proposal, arguing that moving staff between the three branches, to cover for holidays and illness, would become needlessly more difficult.

The nightmare scenario for the Roleys is that, at the ‘eleventh hour’, a sale collapses. In such an instance SLSL will have spent a considerable amount of cash, generating property information and other costs, only to see no corresponding inflow. Indeed, the longer a sale takes from initial agreement through to the eventual legally binding contract the more nervous the Roleys become. This anxiety is compounded when the chain is particularly long. It is against this risk that Alistair has been considering a change to SLSL’s fee structure. Rather than receive the entire commission once title has passed, Alistair is attracted to the thought of staged payments. Hence, on receipt of an instruction, the client would pay 20% of the commission fee negotiated to contribute towards marketing and administration costs. Then, and once the sale is legally finalised, the remainder due to SLSL is payable. In the year just passed SLSL had seen three sales collapse due to changes of mind, twice by the vendor and once due to the buyer. Whilst each instance was something of a personal tragedy for the two parties, for SLSL it represented a fee shortfall of £8,125.

How to speed up the purchase process is something which has exercised greater minds than Alistair’s. One attempt, the creation of Home Information Packs, has been and gone. Penelope keeps a record of how long each sale takes to complete. There is considerable variation in this figure, depending on the complexity of the transaction. Using this completion time as a measure of business efficiency, the Roleys are keen to see it reduced, but as yet they are unsure about how this might be achieved. Table 4 shows completion times and other branch data.

Table 4 – Branch data, 2011

| | Oakford | Upham | Stamton |
|---|----------------|----------------|--------------|
| Instructions Sole and multiple agency | 407 | 218 | 514 |
| Viewings | 726 | 342 | 1,611 |
| Offers | 120 | 64 | 179 |
| Sales, volume | 109 | 54 | 122 |
| Commission, £ | 429,188 | 230,558 | 209,200 |
| Average instruction to offer, days | 78.8 | 67.4 | 101.5 |
| Average offer to completion, days | 64.6 | 61.2 | 78.2 |
| Property awareness | | | |
| 1. Press | 8% | 8% | 11% |
| 2. Website | 84% | 81% | 69% |
| 3. Board | 6% | 8% | 11% |
| 4. Other/ no data | 2% | 3% | 9% |
| Manager | Alistair Roley | Penelope Roley | Hanna Boddie |
| Staff, Full Time Equivalent, FTE | 6 5 | 5 3 | 8 4 |
| Employment costs, Manager’s salary and other costs | 46,000 | 46,000 | 46,000 |
| Staff costs | 80,500 | 48,300 | 64,400 |
| Overheads, £ | 60,000 | 54,000 | 70,000 |

Fig. 1 shows a diagrammatic representation (in days) of a typical sale; Mrs Potter, 6 Jasper Road. 95
 For other vendors, whilst the diagram may be the same, the duration of the various activities may well differ.

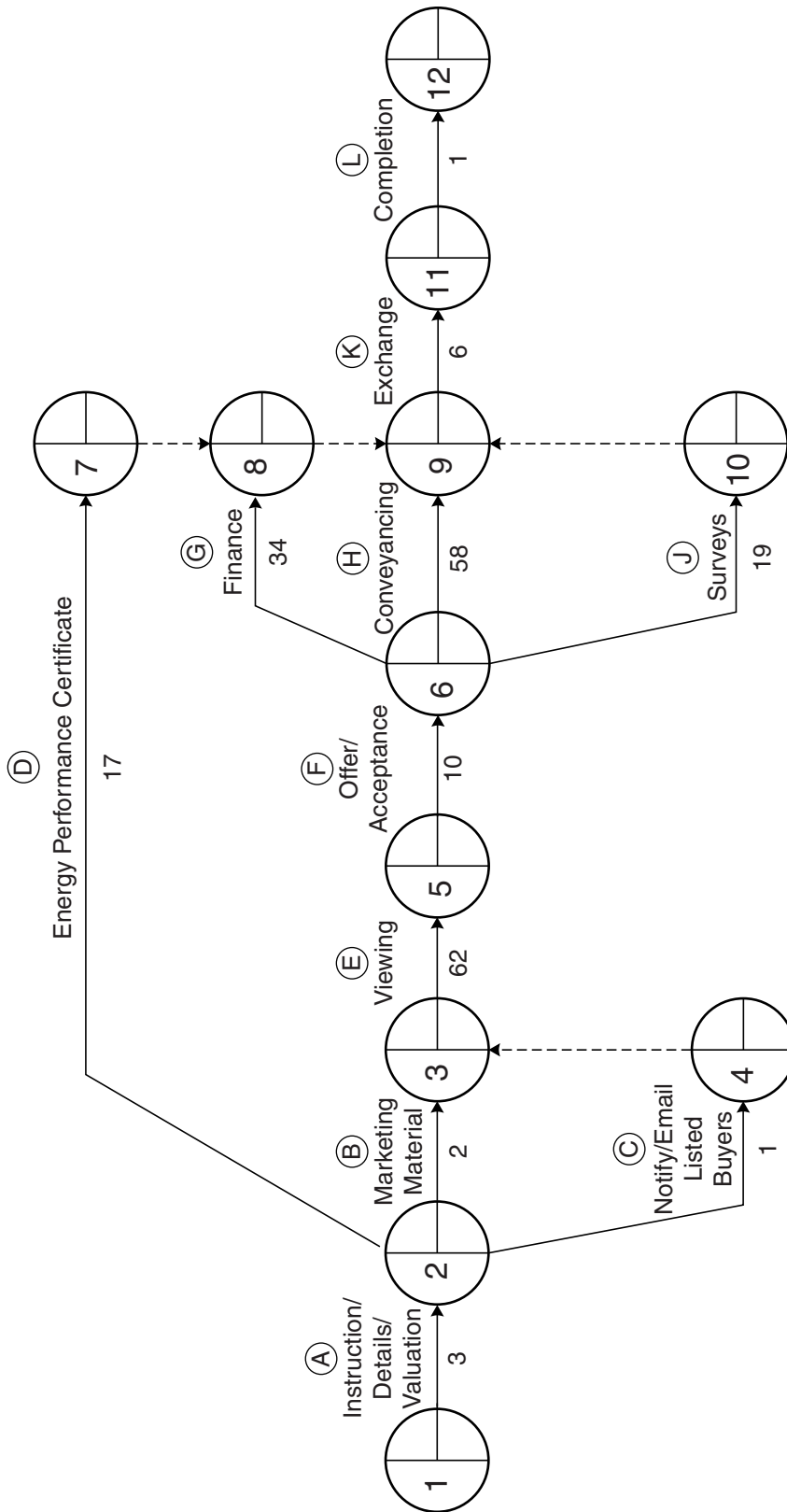


Fig. 1 – Mrs Potter, 6 Jasper Road

In the last four years the Roleys have seen a marked increase in the number of enquiries following a website search, either through SLSL's own site or an associated site such as Rightmove. With the costs of physical premises ever increasing, and having to pay rent on two of the three branches, 100 and the low cost of web based marketing, the Roleys are now considering whether SLSL still needs a physical presence on the high street. In complete contrast, they are also considering whether SLSL should expand into a neighbouring town, Market Harworth. To gauge the feasibility of this, Penelope has had one of the staff at the Upham branch spend an afternoon on the Internet engaged in secondary research (see Table 5). 105

Table 5 – Town Profiles

| | Oakford | Upham | Stamton | Market Harworth |
|---|----------|----------|----------|-----------------|
| Population | 12,000 | 6,500 | 38,000 | 28,600 |
| Households | 4,800 | 1,800 | 18,150 | 7,630 |
| Ave house price, 2011 | £315,500 | £296,500 | £190,000 | £245,000 |
| Projected increase in number of households for next ten years | 8% | 2% | 4% | 15% |
| Number of property sales, 2011 | 436 | 180 | 2,020 | 1,304 |
| Estate agencies | 8 | 4 | 13 | 11 |

Meanwhile Penelope had spent a day at Market Harworth, and had come back with its local paper, the Harworth Times. From their own knowledge, and a quick scan through the paper and the secondary research, the Roleys believe a move into Harworth might make strategic sense. Such a move could be as a fourth branch, or possibly as a replacement for one of the existing branches.

Appendix 1 – SLSL Interim Balance Sheet as at 31 December 2011

| | £000s |
|---------------------------|-------|
| Fixed assets | |
| Premises | 350 |
| Equipment | 20 |
| | 370 |
| Current assets | |
| Stock | 5 |
| Debtors | 13 |
| Cash | 48 |
| | 66 |
| Current liabilities | |
| Trade creditors | 10 |
| Net Current assets | 56 |
| Loan from A Boddie | 50 |
| Net assets | 376 |
| Share capital | 80 |
| Profit and loss account | 296 |
| Equity shareholders funds | 376 |

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