

Tuesday 22 January 2013 – Afternoon

AS GCE BUSINESS STUDIES

F292/01/CS Business Functions

CASE STUDY

Duration: 2 hours



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H₂Office & Home Ltd (HHL)

Nowadays, most people understand the importance of drinking enough water as an aid to healthy living. H₂Office & Home Ltd (HHL) supplies and maintains water coolers for use in the home, office or factory. Based in Edinburgh, HHL's Managing Director and majority shareholder is Ray McNamara. Other than Ray's wife, Pippa, the only other shareholder is the local water company, which owns 20% of HHL's shares. Since 1993, HHL has grown steadily and has helped thousands of people hydrate, both at work and at home. HHL strives to provide the same sort of personal, local service it gave when the company had only a couple of hundred customers, despite the fact that it is now the largest privately-owned independent company in this industry in the UK. 5

Most of the water which HHL uses comes from a source in the Highlands of Scotland. It leases the site of the source from the local water company. This water is collected by tanker and then delivered to the Edinburgh site, as well as to other depots in Birmingham, Ebbsfleet and Leeds. HHL employs over 160 staff across its four sites (**see Table 1**). 10

Table 1 – HHL's employees (October 2012)

| Location | Management | Administrative staff | Sales people, drivers, warehouse staff |
|---------------------------------|------------|----------------------|--|
| Edinburgh head office and depot | 8 | 10 | 20 |
| Birmingham depot | 4 | 6 | 36 |
| Ebbsfleet depot | 5 | 8 | 32 |
| Leeds depot | 4 | 5 | 26 |

According to medical research, only 60% of the population is adequately hydrated most of the time. This affects a person's concentration and health. HHL uses this evidence in much of its promotional literature. As a result of the current preoccupation with health and safety, a growing number of firms feel obliged to provide free access to cool and healthy water for their workers. To do this as economically as possible, they tend to use firms such as HHL to provide, maintain and restock water dispensers across a firm's office and factory space. HHL's prices vary relative to the size of the customer's business. The package includes one water cooler, an agreed number of large water bottles, plastic cups made from recycled material, and a service and sanitisation visit every three months (**see Table 2**). Larger firms, with more than 15 users, can negotiate a bespoke package with HHL at more favourable rates. 15 20

Table 2 – HHL's workplace packages

| Package | Expected number of staff using the machine | Bottles of water (per year) | Plastic cups (per year) | Price (per week) |
|------------|--|-----------------------------|-------------------------|------------------|
| Hydrate 30 | 1–5 users | 30 | 3000 | £8.99 |
| Hydrate 50 | 6–10 users | 50 | 5000 | £10.99 |
| Hydrate 70 | 11–15 users | 70 | 7000 | £12.99 |

HHL has over 5000 corporate customers and, since its service to private homes began four years ago, around 4000 home customers. Last year, HHL had a turnover of £4.8 million with a net profit margin of 8%. At present, Ray estimates that HHL only has a 5% market share in this industry. 25

Almost all of HHL's profits come from the corporate sector, which has grown steadily year on year. On the other hand, the private home market is barely breaking even, although it has huge potential growth. Ray has, therefore, set a target of 100 000 private home customers within 10 years. This would potentially generate annual revenues of more than £50m. It would also help Ray to achieve another target he has set the business: to increase the net profit margin to 12% within five years. 30

As part of Ray's strategy to increase the number of private home customers, along with his Sales & Marketing Manager, Nicole Lau, he is looking at some data gained from a marketing campaign for the month of July 2012. This campaign used promotional pricing across four different regions of the country (see Table 3). It saw the price of a typical private home package reduced from the normal price of £10 per week. As part of the promotion, customers were given a three month trial period where they could cancel the contract and get their money back if they were not entirely happy. 35

Table 3 – Results of July 2012's promotional pricing campaign

| Region | Promotional price (per week) | Total number of home customers before promotional pricing campaign | New customers acquired during promotional pricing campaign | Percentage of new customers cancelling contract within three months |
|---------------|------------------------------|--|--|---|
| South East | £8.50 | 1170 | 240 | 5% |
| North West | £8.50 | 310 | 100 | 3% |
| Yorkshire | £8.50 | 900 | not available | 16% |
| West Midlands | £8.50 | 620 | 80 | 20% |

"Why don't we have a figure for new customers in Yorkshire?", asked Ray.

Nicole looked concerned. "I don't believe the figure I was given," she replied. "I think it is wrong and the Regional Manager is currently on holiday. I'll get on to him when he returns and check what the correct figure is." 40

"Well, never mind. Let's get on with looking at the three areas we have got the data for," began Ray. "There's certainly not any real pattern across the regions is there? Did we do anything special in the North West to get such a big increase?"

"No," replied Nicole. "You will remember that we wanted to do this quite scientifically, so we tried to do the same in each region. That mainly involved one half-page advertisement a week in local newspapers and four slots a day on local radio in each region." 45

Ray considered the data for a little longer until he opened another file. "My concern is that if we are to realise the planned growth in the private home market, we don't want to do it unprofitably," he said. "I am quite happy to use the profits from the corporate sector to cross-subsidise the private home market for a while, but ultimately it needs to stand on its own two feet." 50

As a private limited company, HHL has to produce a basic set of unaudited accounts annually to conform with the Companies Act 2006. These include a profit and loss account (income statement) and a balance sheet (see Tables 4 and 5). The accounts must be sent to Companies House, an agency of the Department for Business, Innovation & Skills, where they can be inspected for a small charge by anybody. 55

Table 4 – HHL's Balance Sheet extract (as at 31 August 2012)

| | 2012 | | 2011 | |
|--|---------------|----------------|---------------|----------------|
| | £ | £ | £ | £ |
| Fixed Assets | | | | |
| Tangible assets | 571 102 | | 460 802 | |
| Investments (1) | <u>25 000</u> | | <u>25 000</u> | |
| Total fixed assets | | 596 102 | | 485 802 |
| Current Assets | | | | |
| Stocks | 30 003 | | 21 411 | |
| Debtors | 633 108 | | 543 678 | |
| Cash | <u>290</u> | | <u>301</u> | |
| Total current assets | | 663 401 | | 565 390 |
| Creditors: amounts falling due within one year | | <u>730 019</u> | | <u>601 546</u> |
| Net current assets | | -66 618 | | -36 156 |
| Creditors: amounts falling due after one year | | <u>23 982</u> | | <u>25 019</u> |
| Net assets | | <u>505 502</u> | | <u>424 627</u> |

(1) Investment in share capital of Watercoolers Ltd, a supplier to HHL

Table 5 – HHL's Profit & Loss account (Income Statement) extract (year ending 31 August 2012)

| | 2012 | | 2011 | |
|-------------------------|------------------|-----------|------------------|-----------|
| | £ | £ | £ | £ |
| Turnover | 4 801 934 | | 4 419 310 | |
| Cost of sales | <u>3 111 333</u> | | <u>3 021 103</u> | |
| Gross profit | | 1 690 601 | | 1 398 207 |
| Expenses | <u>1 234 417</u> | | <u>930 122</u> | |
| Operating profit | | 456 184 | | 468 085 |

Ray is determined to ensure that the accounts show a true picture of HHL's business activities. This is primarily due to his legal responsibility as a company director but also because he is aware of how many different stakeholders of HHL will be keen to inspect the accounts.

Ray considers the most important stakeholders to be the employees. Many have been with HHL since the birth of the firm; although in recent years the average age of new employees has fallen to the mid-20s. Also, in the last few years, Ray has noticed a growing undercurrent of unrest in the workforce. During the recession at the end of the last decade, HHL managed to maintain growth levels and did not reduce its workforce, unlike many other firms. However, wage rises were only at or below the inflation rate, with pay freezes in 2010 and 2011. Currently, pay rates across the company are, on average, above national rates; however, the work is strenuous and few perks are provided – other than a free water cooler for the home! Ray stresses the importance of teamwork and 'getting on with the job'. He tries to be democratic in his management style, thinking of himself as a 'Theory Y manager'. At a meeting with his Human Resources Manager, Ellen Wilkins, the true level of the mounting problems became apparent.

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“Just look at these trends,” began Ellen. “Labour turnover rates have begun to go through the roof at two of the depots and I am fairly sure there are more resignations in the pipeline”, (see Table 6).

Table 6 – An excerpt from HHL’s employment data

| Location | Labour turnover 2008 | Labour turnover 2009 | Labour turnover 2010 | Labour turnover 2011 | Labour turnover 2012* | Average wage levels at HHL compared to the regional average |
|------------|----------------------|----------------------|----------------------|----------------------|-----------------------|---|
| Edinburgh | 12% | 11% | 13% | 14% | 13% | +19% |
| Birmingham | 15% | 18% | 17% | 24% | 43% | -4% |
| Ebbsfleet | 7% | 10% | 9% | 12% | 25% | -8% |
| Leeds | 8% | 8% | 4% | 2% | 2% | +6% |

* Figures up to the end of October

“Well, this can’t go on”, replied Ray in a shocked manner. “I have big plans for this business and I can do without any problems such as these. I can’t see why there is such a big difference across the four sites. Everyone is paid the same rate for the same job, regardless of where they work and yet our workers are loyal in Leeds but keep leaving in Birmingham. Nothing has changed recently.” 75

One thing which has changed recently is the look of the Ebbsfleet depot. It has had a ‘makeover’ to brighten up the offices and reflect the hydration theme for employees and visitors to the site. The bright blue walls have been decorated with artwork commissioned from a local sixth form college to reflect the healthy hydration message. The layout of the site has also been radically altered, with the office space changed from individual offices to an open plan format. Changes have also been made to the storage and distribution areas of the depot. This has included easier access for the tankers delivering the water from Scotland and greater space so that HHL’s own delivery vehicles can be loaded more efficiently, with two now being able to be loaded at the same time. 80

HHL has also recently invested in new supply chain management and logistics software at the Ebbsfleet depot. This helps to plan the loading of each delivery vehicle and the best route for delivering water and other supplies each day throughout the region served by the Ebbsfleet depot. At present, a customer rings up the customer helpline in order to request supplies or a service call and the administrative staff put the data into the software program. Eventually, it is planned that customers will be able to enter their requests directly via the HHL website. Currently, HHL states in its promotional literature that it expects a customer visit to take place within three working days of a request being made to the customer helpline; something which the new software has helped to achieve when compared to the other three sites (see Table 7). 85 90

Table 7 – HHL’s customer delivery data (October 2012)

| Depot | Customers served within one working day | Customers served within three working days | Customers served within six working days |
|------------|---|--|--|
| Edinburgh | 11% | 68% | 97% |
| Birmingham | 23% | 82% | 100% |
| Ebbsfleet | 52% | 96% | 100% |
| Leeds | 40% | 89% | 99% |

On a recent visit to the Ebbsfleet site, HHL’s Operations Manager, Simon Mbwana, looked at the impact of all the changes with the Depot Manager, Helen Harvey. Simon was particularly looking at the viability of replicating the changes at HHL’s other three sites. 95

“So, how are things going?”, asked Simon. “Everything looks very smart and efficient and there are certainly some obvious operational improvements.”

“I am quite happy with how things have developed so far,” replied Helen. “Things are starting to settle down and the teething problems are being gradually ironed out. Not all the staff have been happy about it, as a few of them have seen their surroundings change and you know how some people don’t like change! In my opinion, we still need to make a few more changes such as introducing more teamworking on the shop floor.” 100

“I’ll gladly support that”, said Simon. “But what about the response from the staff, bearing in mind what you’ve just said? We also need to think about the short-term consequences of such a change. Will there be enough work space to set up these teams? They generally need more room to operate.” 105

“That’s my other point”, answered Helen. “We could do with cutting down our stock levels. We have far too many empty water bottles waiting to be filled and far too many filled bottles. They do take up rather a lot of space and often there is a two month gap between filling the bottles and them actually being dispatched to a customer. Then there’s the stock of the actual water coolers. With the growth in the private home market we are stocking more and more different models to give customer choice but some of them sit in our storerooms for months on end.” 110

“I see your argument”, said Simon. “We just need to remember that the new plastic bottles come from Germany and we never quite know how many empty bottles will be returned on a daily basis from customers. We need to reuse these bottles on both cost and environmental grounds, rather than throw them away. The coolers themselves are a different matter as most of them are manufactured in the UK.” 115

“So you will consider my proposals?”, asked Helen.

“Certainly”, replied Simon enthusiastically. “I am only too happy to consider any proposals which will help to make this company leaner, fitter and more efficient.” 120

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