

Wednesday 12 June 2013 – Afternoon

A2 GCE APPLIED BUSINESS

F248/01/CS Strategic Decision-Making

CASE STUDY

Duration: 2 hours



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Magic Metal Ltd

The business

Magic Metal Ltd, founded in 1992, manufactures rings for the UK jewellery market. The rings, plain metal bands adorned with simple motifs such as hearts, stars, butterflies and skulls, are made in a range of sizes. The motifs are decorated with heat sensitive resin. When worn, the motif on the ring changes colour in response to the body temperature of the wearer. The chemical properties in the resin change from black to brown, then to yellow, green, blue and purple as the temperature rises. Being fun and ingenious, the rings appeal primarily to young consumers. 5

In its relatively short lifetime, the company has seen many directors come and go. Pearce, one of the three current directors, is the only remaining founding director. Pearce, now in his early sixties, hopes to retire soon. He is an obsessively hard worker who demands the same from the workforce. He always accepts orders, believing that all orders contribute to profit. The other two directors are Pearce's children – Freya and Oliver. Freya, having worked in banking for a few years, joined the company five years ago at the age of 24. She lives on her own and has just taken on a mortgage to buy her first home. Freya has a naturally cautious personality. Oliver, on the other hand, is willing to give anything a go. He joined the company straight from school after his 'A' levels two years ago, and is full of fresh ideas and youthful enthusiasm. He lives with his girlfriend in rented accommodation. The three directors have very different aspirations for the business. Whilst Pearce now sees the company solely as a route to a comfortable retirement; Freya wants to improve the company's flagging reputation by developing a high fashion designer brand for the jewellery; whilst Oliver wants rapid, expansion favouring quantity rather than quality. 10 15 20

The three directors are the only shareholders in the company. Pearce, being the major shareholder and senior director, takes a salary of £125 000 per annum. Freya and Oliver each receive an annual salary of £50 000. Whilst Pearce is generally responsible for production, none of the directors have specific job roles within the business. The company is currently worth £1.5 million and over the last few years has struggled to achieve a modest return on capital employed of around 9% per annum. 25

Changing fortunes

At its inception in 1992, *Magic Metal Ltd* produced innovatively designed gold rings with colour-changing motifs mainly for independent jewellers. Output levels were low but, because the rings were made out of gold, profit margins were high. Over the years the company has drifted into the costume jewellery market, ditching gold, and supplying larger quantities of batch produced silver rings, instead of gold, to mainstream retailers. Operating in the highly competitive costume jewellery sector, the company has, at times, struggled to break-even. The recession which started in 2008 hit the business very hard. With consumer confidence in decline, the company was forced to supplement its product range with even cheaper rings made of nickel. Today the revenue received by the company is almost evenly split between that obtained from supplying rings made out of silver and that obtained from supplying rings made out of nickel. The silver colour-changing rings retail in shops at £15–£25, with nickel rings selling for considerably less. Indeed, some of *Magic Metal Ltd's* mass produced children's rings, aimed at the pocket money market, retail for as little as 99p. Born out of necessity, none of the changes in strategic direction which *Magic Metal Ltd* has gone through have ever been properly planned. As a consequence, the company has never put together an integrated marketing strategy. 30 35 40

Challenging times

Currently *Magic Metal Ltd* employs 32 workers, the majority of whom are semi-skilled. Whilst the metal bands and motifs are now produced on an automated production line, the motifs are still attached to the bands by hand. This, together with the manual application of the heat sensitive colour-changing resin, needs considerable patience and skill. *Magic Metal Ltd* pays its trained production staff slightly more than the national minimum wage in an attempt to retain their skills within the business. 45

Given the way in which the company is run, it is amazing that it continues to make a profit. Production is not planned in advance and no budgets are set. The volatility of silver prices has already taken the directors by complete surprise on at least three occasions in the last six months, causing embarrassing cash-flow difficulties. The company's bank account is currently close to its overdraft limit and the directors have yet to realise this, never mind apply for an increase in the overdraft limit. 50

Magic Metal Ltd relies on special orders to reach its break-even point. However, time and time again Pearce has accepted orders which push the company beyond 100% capacity utilisation. Rushing to complete orders increases the number of faulty rings being made which, due to the way in which the colour-changing resin binds with the metal, have to be scrapped. Pearce, in typical autocratic management style, complains when wastage levels rise. 55

Late in 2012, Pearce accepted, at very short notice, an offer to supply a large order of 60000 nickel rings to be used as novelties in Christmas crackers. Without consultation with production supervisors, or even his fellow directors, Pearce instructed the workforce to work late and to do overtime at weekends. He even demanded that certain workers cancel the holidays which they had booked. Not surprisingly, employer-employee relations were pushed to their limits. As a result, many of the staff decided to join a leading trade union. There is now talk of the trade union members threatening a go slow or even a strike if similar, unreasonable, demands are placed on them in the future. 60
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Pearce would be first to admit that, when large orders are being produced, the factory is a little cramped. A couple of years ago he had plans drawn up to extend the factory. The first planning application was rejected and Pearce has not got round to submitting any amendments to the planning application. 70

The proposal

Oliver, who has recently become a father to twins, has discovered a new use for the heat sensitive colour-changing properties which *Magic Metal Ltd* utilises in its rings. Never seeming to be able to tell if his two sons are warm enough in their cold flat, he has seen a gap in the market for baby clothes which constantly monitor a newborn's temperature. His idea is to produce a range of babygrows with two small heat sensitive panels which are located one on the back and one on the front of the garment. The panels, with chemical properties similar to those used in the rings, would change colour indicating if the baby was too hot or too cold. He has sourced a suitable fabric from Algeria. Oliver's proposal is that *Magic Metal Ltd* should enter the baby clothes market, making and supplying babygrows with heat sensitive colour-changing panels to baby clothes retailers across the whole of the European Union. By targeting more than its current UK market, Oliver believes that the proposal will lead to high returns and fast growth. 75
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The proposal would require a major increase in the scale of *Magic Metal Ltd's* current operations. A larger factory capable of housing several automated production lines would be required. If planning permission could not be obtained to extend the factory building on the current site, then the company would need to relocate. Whilst no staff would be made redundant, several new staff would need to be appointed. At an estimated cost of £11 million, such a large investment 85

could only be funded by going through the lengthy and costly process of re-registering the business as a public limited company and floating on the stock exchange. In the meantime, prototypes of the babygrows would need to be put through extensive safety testing, incurring significant sunk costs which would need to be funded through borrowing. 90

Oliver is very keen for the company to enter the baby clothes market. He sees this as just the first step in a move by the company to exploit the need for heat sensitive colour-changing products in the baby care market. Spurred on by his two young sons, he is already working on a baby's bottle with a heat sensitive colour-changing panel designed to ensure that bottle fed babies are served their milk at exactly the right temperature. 95

Freya wishes to research further the proposal to enter the European baby clothes market. In particular, she wants to study the financial implications for the company of entering this market. Pearce, on the other hand, cannot help but think of all of the effort and upheaval this proposal would bring at his time of life. 100

All three directors have agreed to give the proposal serious consideration over the coming weeks. The proposal will be tabled at their next board meeting.

Appendix 1

The Jewellery Market in the UK

The watches and jewellery market has not been immune to the economic climate and the whole industry suffered in late 2008 and in 2009 as consumer confidence fell and people became more cautious about their spending.

- The overall jewellery and watches market has grown by 10% since 2005 to reach £4.8 billion in 2010 and Mintel forecasts 11% growth for the jewellery and watches market over the following five years.
- Rocketing gold prices and the recession have led many consumers to buy silver jewellery instead of gold, with almost one in five people wearing more silver jewellery than gold, rising to nearly three in ten women, particularly young people aged 15–24.
- Costume jewellery is the smallest sector of the watches and jewellery market, but has grown at the fastest rate. The market is expected to grow further, thanks to people buying pieces for accessorising more frequently and as young people under-25 continue to spend.
- The affordability and disposability of many costume jewellery items means that customers are more willing to experiment and try new looks without denting their bank balances. Almost a third of women buy costume jewellery in different styles and colours to complement their outfits.

Appendix 2

Managing your baby's temperature

Babies are unable to regulate their body temperature in the way adults do. When adults are cold they shiver, and when hot, they sweat. It is important to keep your baby neither too hot nor too cold. The following suggestions are given to help you keep your baby's temperature within the normal range (36.6°C to 37.2°C):

- Try to keep the room temperature between 16–20°C – this temperature is comfortable for most adults wearing short sleeves.
- Use the right amount of clothing and bedding – during the day your baby should wear the same amount of clothes as you wear, plus an extra layer. For example, if you are wearing a shirt, baby should wear a babygrow or t-shirt or dress and a cardigan. Babies should wear hats in summer to stop them becoming sunburnt and in winter to stop them getting cold. At night babies should wear a nappy, vest and babygrow or gown, plus a sheet and a couple of blankets. If the room is cooler than 16°C then three to four blankets will be necessary; if the room is warmer than 20°C then only one blanket or perhaps only a sheet will be needed.
- If your baby seems restless or fussy and its skin is flushed and feels hot, remove a piece of clothing or blanket. It is normal for babies to have cool hands and feet but if they feel cold and look blue and blotchy, add mittens, socks/booties, a hat and a cardigan or blanket. Remember to take off baby's outdoor clothes when you get inside.

Appendix 3

The baby clothing and nursery equipment market in the UK

Since 2005 there has been a baby boom, with higher birth rates helping fuel demand for baby clothes and equipment. But, over the next five years, the number of babies born each year is forecast to stabilise.

Baby clothes market

- The childrenswear sector enjoyed only modest growth in sales in 2010, driven by a 1.6% rise in newborns and infants.
- The growing influence of supermarkets and value retailers has depressed the prices of baby and children's clothing, making it harder for other retailers, particularly independent childrenswear stores, to compete.
- Infantswear has continued to be the best performing sector, boosted by the growing number of newborns and under-5s.
- Fewer people are shopping at specialist baby stores, with just under a quarter purchasing baby clothes and children's clothes from these specialist retailers in the 12 months to November 2010 compared to nearly a third in the previous year.
- Most parents do not rely on hand-me-downs and, therefore, continue to buy new clothes for their children.
- A host of fashion designers are moving into the childrenswear market and expanding their children's clothing ranges.

Nursery equipment market

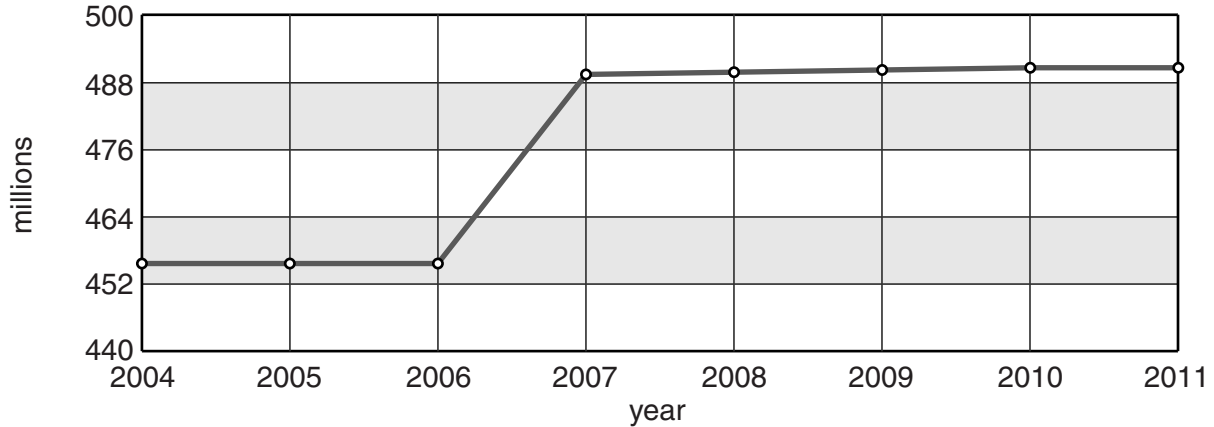
- Consumer spending on baby and nursery equipment grew by a third over 2005–10 to reach £753 million. This translates into an average spend of £780 per year for every child aged 0–4 in the UK.
- The extended family plays a huge role in funding the spending spree. Research found that for more than four in ten parents of 0–4s, grandparents and close relatives had contributed to the cost of buying baby and nursery equipment.
- Increasing the level of competition, Tesco, the UK's largest grocery retailer renowned for everyday low prices, has announced that it will roll out an in-store chain of nursery shop-in-shops.

Today's web-savvy parents have more information at their fingertips than ever before. Mintel's research shows that the Internet is seen as a source of good advice for 38% of parents of 0–4s.

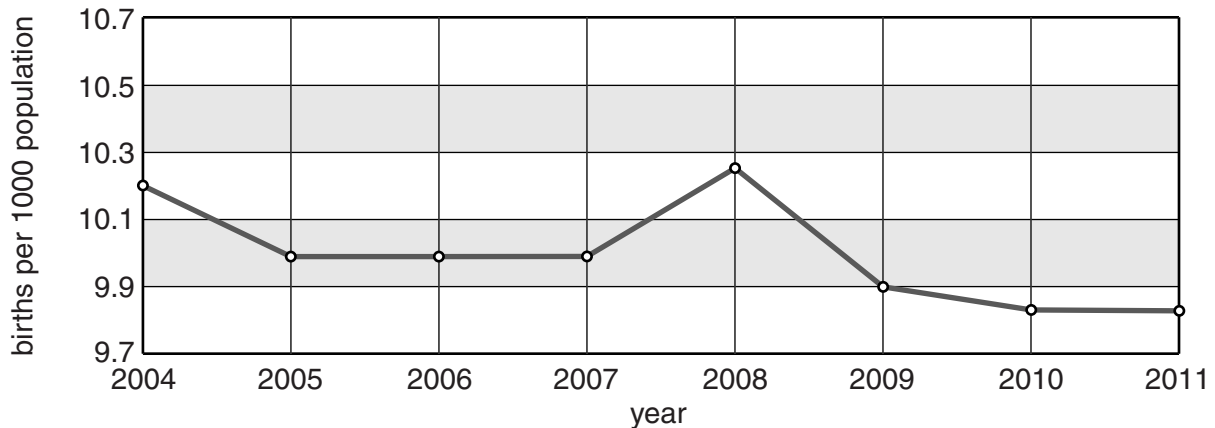
Appendix 4

European Union population and birth rate 2004–2011

Population of the European Union



Birth rate in the European Union



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