

Wednesday 10 June 2015 – Morning

A2 GCE APPLIED BUSINESS

F248/01/CS Strategic Decision-Making

CASE STUDY



Duration: 2 hours

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155 Ltd – a cue for change?

Alec and Sue Myton, a married couple in their late fifties, are on holiday in Gran Canaria. Despite luxury accommodation and delightful weather, they are finding it difficult to relax. This is because the company which they own in the UK is constantly on their minds.

Their company, *155 Ltd*, manufactures a range of snooker cues for the discerning British sports market. It employs 35 people at its factory in Evesham and it uses traditional methods of manufacture. Despite having an enviable reputation for quality, and an annual turnover in the region of £2.4 million, *155 Ltd* is in trouble. Profits over recent years have plummeted to unsatisfactory levels. The latest set of accounts to be filed at Companies House show a profit of only £10 000. This year the company is struggling to breakeven.

Given that *155 Ltd* is not experiencing cash-flow problems, and that the factory seems as busy as ever, the owners cannot understand why the company's profitability has fallen so dramatically. One thing is for certain, the long-term survival of the company depends on it making a significant profit, not least because Alec and Sue wish to use the profit to fund their retirement.

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A historical perspective

Alec's father was an avid viewer of the World Snooker Championship on the BBC. When colour television was introduced, Alec, then aged 10, also became interested. Given this interest, Alec's father took him to a local snooker club, and from there a lifelong love of the game was born.

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At age 16, Alec secured a carpentry apprenticeship at a local cabinet makers. There he served his time and gained permanent employment making bespoke furniture out of oak. It was whilst working at the cabinet makers that Alec made his first snooker cue, using the cabinet maker's tools in his lunch hour. The players at the local snooker club were impressed with the quality of Alec's cue. Alec bought his own hand tools, and began making cues to order in his spare time. Every cue he made increased his confidence and skill level. In 1981 Alec left the cabinet makers and set up *155 Ltd*, manufacturing his own brand of snooker cues. He and Sue were the only shareholders.

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The mid eighties saw a boom in the popularity of snooker in the UK and the company did well, recording profits in excess of £250 000 per annum. In the early nineties, however, the popularity of snooker in the UK began to wane, threatening *155 Ltd*'s previous profit levels. Sue, realising that the company's sales and marketing efforts needed improving, joined the company as co-director in March 1994. Using her excellent communication and interpersonal skills, she managed to secure orders greater than those in previous years and has continued to do so ever since.

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An outline of the present

155 Ltd currently produces hand-finished snooker cues in a range of lengths, weights, tip sizes and tapers. Its range is designed to meet the needs of amateur club players who, dissatisfied with the poor quality rack cues provided by their club, wish to maximise their chances of success with a quality cue. Good quality snooker cues rely on well seasoned, carefully selected timber and meticulous workmanship.

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While it is a constant struggle to find reasonably priced timber, Alec prides himself on sourcing wood of the highest quality. All of the cues in *155 Ltd*'s range are made of ash imported from North America, a far superior timber to the cheaper maple alternative used by many manufacturers. In addition, all of the cues in *155 Ltd*'s range are decorated with ebony – an exotic hardwood imported from West Africa. While in extreme circumstances a different hardwood could be used

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to decorate the cues, the ash is essential to production. Consequently, Alec insists that the factory holds large stocks of ash, for fear of not having enough when needed. The storage of large quantities of timber is expensive, not only because it takes up a lot of space, but because the atmospheric conditions have to be carefully controlled. Any ash which becomes stressed or warped is not suitable for the production of high quality snooker cues and has to be discarded.

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The production process is more complex than it at first appears. The cues are made in two parts – the shaft and the butt. The butt, or handle, of the cue is cut from ash and elaborately decorated with inlaid pieces of ebony. A custom-built bonding oven is used to harden the adhesive used to secure the designs. The shaft, also cut from ash, is precision-tapered using specialist lathes and carefully fitted with a tip. All fittings are made of solid brass and all cues are lacquered by hand. Every cue which bears the *155 Ltd* logo is checked for weight, balance, straightness and visual effect. Those which pass Alec's quality inspection are labelled and packaged; those which are defective are either modified or scrapped. Alec feels certain that an ever-increasing number of cues are having to be scrapped. He is also concerned about the reliability of the bonding oven over the last few months and the recent increase in the number of machinery breakdowns, in particular the lathes and grinders. In addition, he is convinced that the amount of time production staff seem to be idle, awaiting resources or hindered by bottlenecks in production, is increasing.

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Of the 35 staff which *155 Ltd* currently employs, 30 are directly involved in production. All 30 of these production staff are employed on full-time, permanent contracts working 9am to 5pm, Monday to Friday. While some production workers are skilled in two or three operations, most are not. Due to this lack of flexibility, production workers are required to give one week's notice for holidays and are not allowed to book half days off. The company has paid all of its production workers, including the production supervisors, £12 per hour for the last five years. The company has been unable to afford to give any of its workers a pay rise during this period.

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Low profit levels have led Alec and Sue to postpone the maintenance of staff facilities. In the kitchen the fridge is not working, the worktops need replacing and the extractor fan is broken causing mould to grow on the walls. In the staff room the free drinks vending machine is broken and, ironically, the baize on the pool table is ripped. The toilets, while serviceable, are in desperate need of updating. More worryingly, perhaps, Alec has delayed acting on health concerns voiced by Mandip, one of the production supervisors. Mandip thinks that wood dust from the grinders might be causing respiratory problems amongst the staff. One of the longest serving workers, who regularly operates a grinding machine, has been absent from work with breathing difficulties for over two months. Workers also report that the lacquer is causing skin irritation and are worried about the long-term effects of this toxic substance being absorbed through the skin. Alec insists that these issues are currently too expensive to solve.

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Alec and Sue have overheard workers discussing whether redundancies might be necessary. Job security is a major concern. The production staff, seeing the decline in British manufacturing, fear they might have to join the service sector or face long-term unemployment. Last year, in an attempt to improve profitability, Alec had a clock card machine installed on the factory floor. The machine, designed to improve the punctuality of the workforce, requires every production worker to clock in and out at the beginning and end of the day. Far from making matters better, it appears to have made things worse. Alec and Sue are now very concerned about the motivation levels amongst the production staff. Sue feels that a softer human resource management approach might help. Alec thinks that the production supervisors need to be more autocratic in their management style when dealing with the production staff.

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The company sells its cues direct to sports shops in the UK. It does not use wholesalers nor does it sell direct to the public. The snooker cues retail in the shops for between £80 and £160. None of its current range is exported. Sue, who used to work in IT, keeps a database of contacts and uses video conferencing and Skype to keep down the cost of talking to retail buyers when she can. She attends trade shows throughout the year and negotiates with buyers on an individual basis. Given that Sue continues to secure orders close to the factory's maximum capacity of

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72 000 cues per year, and that annual sales revenue continues to rise, albeit at a rate lower than inflation, she is convinced that the key to the company's profitability lies with its costs. If only she could persuade her husband to use a spreadsheet to record company spending. Alec insists that he is too close to retirement to learn new skills, especially IT skills given his dislike of computers and all things automated.

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The couple know that the company cannot continue as it is. Profit levels are woefully inadequate. The company must make more profit; enough profit to fund their retirement as they have no pension provision of their own.

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A change of strategic direction is required, but what? The economic forecast for the coming years remains uncertain and this makes it difficult to decide. Alec is at a total loss as to what to do to secure the future of the company to which he has devoted over 30 years of his life. Sue has one proposal but it would mean major change for the company.

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Sue's proposal

Sue's proposal is to move to mass production, manufacturing snooker cues for export to China. A much bigger factory would be needed, fully equipped with computer controlled automated machinery. The cues would be made on a production line and lacquered using a conveyor sprayer. Production staff with the necessary skills to operate the rapid copy lathes would need to be employed. To keep costs down the cues would be made from Canadian maple, a less responsive timber which is currently used by most of *155 Ltd*'s competitors.

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A strong marketing campaign which emphasises the high quality reputation of the British-made *155 Ltd* brand would be needed to secure sales. In addition, Sue recommends sponsoring a top class Chinese snooker player to endorse the new range of snooker cues. Such a player is likely to be given a minimum of 1 million Yuan per annum for at least five years.

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The capital budget spend would need to be financed by a variable interest rate commercial mortgage with a ten year term. Capital investment appraisal suggests a payback period of approximately 12 years, with an ARR of 28%.

Appendix 1

Snooker Finds A New High-Class Home In China

In London snooker rooms are slowly vanishing. In the Essex town from where legendary player Ronnie "The Rocket" O'Sullivan hails, there is only one snooker room left. Most snooker fans in Britain are over 60, with young people in the UK today opting for football, cricket or tennis.

There are multiple reasons for the fading attraction for fans, including a reluctance by the television networks to follow live snooker matches, which can go on for seven or eight hours. And since 2005, when the World Snooker Association banned sponsorship by tobacco companies, the sport has been short of finance. Prize money is low in relation to other sports.

However, snooker seems to be suited to the Chinese. According to data, China has as many as 60 million snooker amateurs, among whom 25 million play regularly. Nearly a million Chinese say they play snooker every day.

The timely appearance of Ding Junhui, China's most successful player ever, who has already compiled more than 200 century breaks (scoring 100 points or more during a game without missing a shot), has further promoted the development of snooker in the country. Even before the appearance of Ding, the broadcasting of UK snooker tournaments, often late at night on the state-owned CCTV, had very high ratings. But it was not until Ding won the China Open Championship in 2005 that the sport truly opened up across the Chinese market, as both the number of competitions and advertisement revenue increased.

The sport profits from the fact that there is still relatively little development of professional sport in China, which means that CCTV can devote hours to airing games. When John Higgins and other players saw that China's state television would rather air a live snooker tournament at the expense of an ongoing football match, they could not believe their eyes. "This is unthinkable in Britain," the Scottish world champion noted. "The probability of a snooker player appearing in advertising is about as high as buying a winning lottery ticket."

Appendix 2

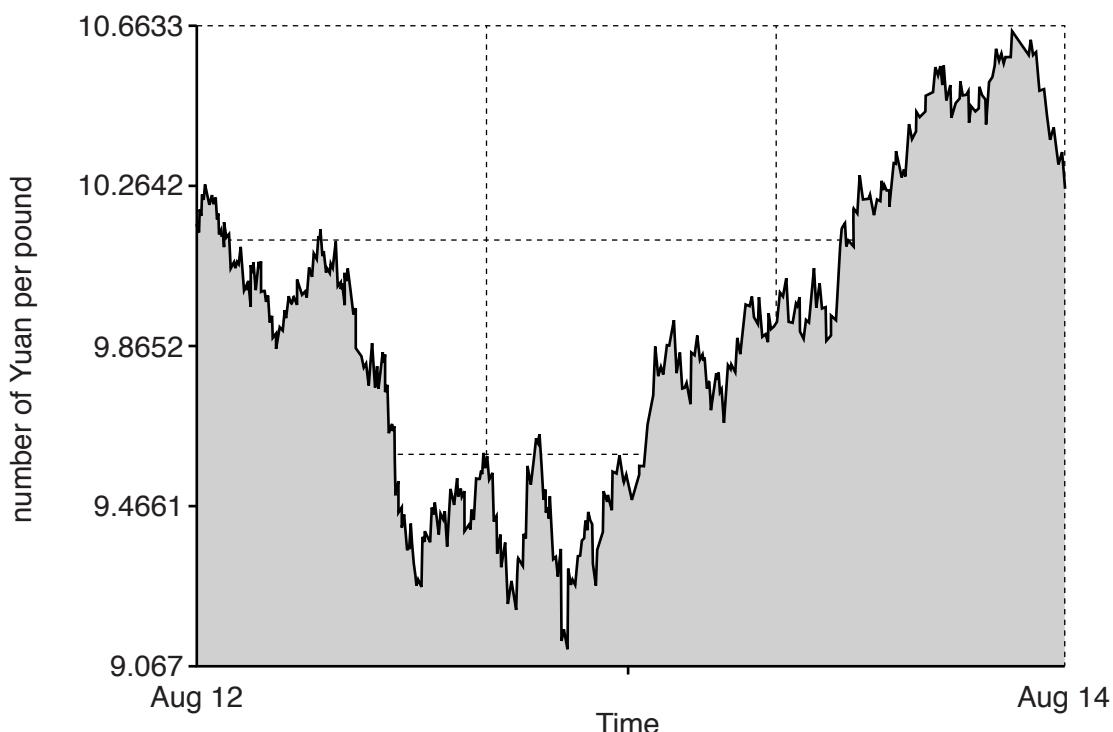
China's Economic Conditions

Since opening up to foreign trade and investment in 1979, China has been one of the world's fastest-growing economies and it has emerged as a major economic and trade power. China's rapid economic growth has sharply improved Chinese living standards and helped raise hundreds of millions of people out of extreme poverty. By 2010 China had become the world's second largest economy and was one of the leading exporters and importers of merchandise.

In 2012 and 2013 China achieved GDP growth rates of about 8% and 7.5% respectively. It is forecast that China's GDP will grow by about 7.5% in 2014 and that it will continue to grow by about 7–8% per annum over the next few years.

Appendix 3

UK Pound Sterling/Chinese Yuan Exchange Rate



Appendix 4

Snooker's Shifting Empire

World Snooker, the commercial arm of the governing body, has in recent years, particularly since the banning of tobacco advertising, looked to overseas markets in order to revive commercial growth. In 2003, a new deal was signed with Eurosport which, for the first time, brought live snooker to over 100 million homes in 58 territories across Europe, the Middle East and North Africa. There are now dramatic surges of popularity in Germany, Poland, Romania and Bahrain, with television figures outstripping those for golf and tennis. All those nations need is an idol, a Ding Junhui, and the snooker revolution taking place in China could be repeated elsewhere.

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