

**ADVANCED SUBSIDIARY GCE
APPLIED BUSINESS**

F242/CS

Unit 3: Understanding the Business Environment

CASE STUDY

MONDAY 2 JUNE 2008

Morning

Time: 1 hour 30 minutes



INFORMATION FOR CANDIDATES

- This is a clean copy of the Case Study which you should already have seen.
- You should refer to it when answering the examination questions which are printed in a separate booklet.
- You may **not** take your previous copy of the case study into the examination.
- You may **not** take notes into the examination.

This document consists of **4** printed pages.

Brookside Farm

Background

Brookside Farm is located near Alton Towers in Staffordshire. It is a small 200 acre farm focussing primarily on dairy production, although part of the land is given over to sheep grazing. The farm has been owned by four generations of the Drummond family for 100 years. The current owner is Robert Drummond who farms the land with his wife, Sandra, and their two children, Steven, aged 22, and Karen, 18. 5

The profitability of the business has declined because of changes in European Union farm payments and the low farmgate price for milk. It is a source of annoyance to Robert and many other farmers that the price they receive for each litre of milk is only a small fraction of the price charged to consumers by the large supermarkets. The decline in cash flow has led to frequent problems in Brookside Farm meeting debt payments, as well as arguments within the family. 10

After one heated discussion in 2006, Robert realised that he had to seek advice on the way forward. He arranged meetings with both the county representative of the National Farmers Union (NFU) and his accountant. Colin Giles, from the NFU, sympathised with Robert over the farm's deteriorating financial situation and advised him to consider diversifying his income source. "But, I don't want to run an open farm as some form of visitor attraction," said Robert. Colin could appreciate Robert's opposition to the idea of visitors to the farm, but advised him to consider developing a bed and breakfast business in the large farm house and in two currently unused farm buildings. Robert found this idea more acceptable, but wondered how his wife would react and how much it would cost. 15 20

A Change of Focus

At the meeting with Simon Lewis, his accountant, the seriousness of the financial situation was explored in greater depth. Simon pointed out that without any improvement in the farm's performance there was a danger that Robert could lose the farm at some point in the future. "When I die I want to hand on a functioning farm to my children", said Robert. "I don't want to hand on a theme park!" Simon replied that without change Robert might not have anything to hand on at all. 25

Simon advised that the farm should make greater use of information technology in all aspects of the work. "You will find that you would have greater control over farm operations and the accounts if it was all on computer", said Simon. Although Robert himself was not very good with computers and had resisted computerisation of the business for years, he was persuaded that the use of ICT was now necessary. Fortunately, Karen had good ICT skills and could take this on. "But we could do with some advice on buying, what do you call it, software?" said Robert. 30 35

Simon also advised Robert to consider diversifying and adding value to the existing product. Robert enquired what he meant by adding value to the existing product. "Well, Robert, it is business jargon for transforming a basic or generic product such as milk into something for which people are prepared to pay a premium price." "You mean converting milk into cheese or ice cream or maybe making sausages?" said Robert. "Exactly," replied Simon, "but I would advise against moving into cheese production." "Why is that?" asked Robert. "Cheese is an overstocked market and I am sure that I read somewhere that sales of cheese are falling," replied Simon. What Simon did not reveal was that he was a shareholder in a cheese making farm. 40

Robert was quite interested in the idea of adding value but felt he would need more information. He took Simon's advice about cheese making but was interested in the ice cream idea. He wondered how much it would cost to set up in ice cream production. "What are the risks? How do we go about selling it?" asked Robert. Simon did not have all the answers to these questions but he advised Robert to seek specialist advice on capital investment, the skills required, the legal implications and the techniques of marketing. 45
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"Obviously, we are talking about a sizeable investment and, because of the risks involved, you should also consider establishing the business as a private limited company", advised Simon. "But I don't want to sell shares in the business to outsiders", replied Robert. "Selling a small equity stake might be necessary to finance the investment but in any case converting to a company will give you the benefit of limited liability", said Simon. 55

Family Decisions

Back at the farm, Robert convened a family meeting to discuss the issues raised. Karen said "I've been arguing the case for computerisation for some years." She was enthusiastic about computer control of accounting and other operations on the farm but would need some training in the use of dedicated software. 60

Sandra was interested in the bed and breakfast idea even though much of the work would probably fall on her. "But before we develop a bed and breakfast business, we will have to spend a great deal of money on the two farm buildings and some changes will be necessary in the existing farm house", commented Sandra. "What we need to work out is how long it would take to get the money back from this investment", said Karen. It was agreed that the bed and breakfast venture would start in 2007 and that a loan would be required to finance the building improvements. 65

Steven was interested in the ice cream proposal. "We could market it as good quality, natural farm house ice cream," he suggested. He wondered, however, if the family had the skills and expertise required. Robert, Steven and Karen all wanted to work on the land and did not really want to spend time in a food processing plant. Sandra refused to take on this other venture. Steven compromised at this point. "I am willing to supervise the ice cream venture but we will need paid help and some initial advice from experts on ice cream making and on marketing. However, I don't think that we can launch into both the bed and breakfast and ice cream ventures at the same time." Therefore, they decided to go for a 2008 launch into the ice cream market. "If Ben and Jerry could do it in Vermont, then I am sure we can do it in Staffordshire", said Steven. "But we must play to our strengths by emphasising that it is a natural and locally produced product. One good marketing point is that Brookside Farm ice cream will be made and sold locally and this will reduce the 'food miles' that everyone seems to be talking about nowadays." "We also need advice on all the legal implications of the ventures", cautioned Sandra. 70
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The Decision

They all agreed that if they were to go ahead with the bed and breakfast venture in 2007 and the ice cream venture in 2008, the business would have to be established as a private limited company. This was essential, not so much in terms of raising extra finance, but in terms of the other advantages of company status. Robert instructed his solicitor to draw up documents for the incorporation of Brookside Farm as a limited company (Brookside Farm Limited). Robert was to be the largest shareholder with a 40% stake, with the remaining shares divided equally between Sandra, Steven and Karen. 85

The building and conversion required for the bed and breakfast venture was estimated at £65 000. The capital cost of the ice cream plant and building was estimated at £100 000. A substantial bank loan was required which would increase the farm's fixed costs. In addition, 90

it was decided to spend £20 000 on advice from experts in ice cream making and consumer marketing. As a result of the advice, Steven considered appropriate two year marketing objectives to be:

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- product placement in 20 local stores and at a nearby theme park;
- the development of five flavours.

Steven was placed in charge of ice cream production and Brookside Farm Limited (BFL) took on an employee, Mary Collins, to work at the ice cream plant. Mary had a food science and hygiene diploma and the expectation was that once established, she would be able to take day-to-day control of the ice cream plant. This would allow Steven, partially at least, to return to working on the land.

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The Future

The economic environment was looking good as BFL embarked on the ice cream venture. The economy had been growing steadily over the last three years and during this time inflation remained at the higher end of the government's target range. However, unemployment had been increasing and commentators on the news speculated that the Bank of England was likely to raise interest rates.

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