

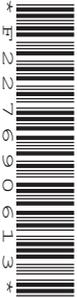
Wednesday 12 June 2013 – Afternoon

A2 GCE BUSINESS STUDIES

F297/01/CS Strategic Management

CASE STUDY

Duration: 2 hours



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Cavendish Cycles Ltd (CCL)

Cavendish Cycles Ltd (CCL) retails bicycles and related life-style complementary products. Its first shop, 'Maillot Jaune', was opened in the spring of 1981, in Oakford (East Midlands), selling road bicycles and a limited range of accessories. Since then the business has steadily grown with another 'Maillot Jaune' branded shop in nearby Market Harworth (opened in 1992). In addition it has three other outlets selling and hiring bicycles to the leisure and off-road market. These three trade under the name 'Peddlers'. The first Peddlers opened in 1994 adjacent to the sailing club at a local reservoir. In 2001 the second opened outside Market Harworth on the route of a disbanded railway line. The most recent Peddlers is next to a camp and caravan site on the edge of Rockingham Forest. The forestry owners saw all-terrain and adventure sports cycling as a further opportunity to encourage visitors to its site, and knowing of CCL's reputation and integrity, approached CCL with a proposal to open a small, ten year rent free, hire and sales outlet. Hence, in 2011 the third Peddlers opened.

An e-commerce operation, branded as CCL Direct, was opened in 2010.

The company is owned and run by the Cavendish family. Founder and Managing Director, Phil Cavendish, has a simple two pronged business philosophy which has enabled CCL to grow in an increasingly competitive market. First, recognising that differentiation through product offering is all but impossible, CCL's focus is on its customers' experience. Hence, whether a customer is thinking of buying an £8.99 drinking bottle or a £3500 bicycle, they should be treated with equal respect and made to feel valued. Consequently, all staff receive training in customer care, bicycle servicing and product knowledge. So, even if a customer walks into one of the outlets simply seeking advice, staff are encouraged to see this as the chance to start a new relationship and, all being well, one which may ultimately lead to a sale at some future date. Customer care is, in Phil's view, the only way in which CCL can compete with either national retailers or Internet based firms.

Second, scale matters. Hence, although CCL has grown, Phil strives hard to inculcate amongst all the staff a small business culture. So, all the staff at each store know each other and will 'muck in' and take 'turn and turnabout', whether selling or servicing bicycles. For CCL there is no such thing as 'somebody else's job', rather it is 'everyone's job'. One of Phil's favourite phrases is 'Team; together everyone achieves more'. To further encourage the right culture all staff benefit through an annual bonus triggered by the performance of the whole business, even though each of CCL's six outlets is treated as a profit centre (see **Appendices 1 and 2**).

The average age of the 59 non-administration staff is late twenties. Phil, and the ten strong Accounts, Personnel and Administration staff are on average, older. Aside from working for CCL, a common characteristic amongst the staff is their preference for an outdoor life-style, with many actively participating in cycling competitions. As a service sector business, with direct customer contact, Phil thinks that the staff represent a significant source of competitive advantage and, as such, he is invariably disappointed when someone leaves.

Phil dislikes large businesses, particularly those which seem to see their systems and procedures as more important than their customers' needs. High on his list of dislikes are utility companies and banks. Although he has not been in a classroom for decades, he can still recall his economics teacher extolling the virtues of the 'invisible hand of the market; successful businesses grow and prosper, whilst bad businesses fail'. It seems to Phil that this no longer applies. His views are imposed on CCL to such an extent that it has no bank borrowing and it has been, and will continue to be, zero geared (see **Appendix 3**). Hence, the business' growth has been internally funded.

Although this may have resulted in a relatively modest rate of growth for CCL, the shareholders (all of whom are members of Phil's family) felt the benefit during the banking crisis which began in 2008. With no debt, CCL did not have to worry about continued access to long term capital. Further, changes in UK monetary policy have no cost implication for CCL; although it does have an impact on its revenue stream because of customers' confidence and willingness to spend. Other macroeconomic policies and factors do have an impact on CCL and Phil keeps an eye on a variety of indicators; ironically provided in a quarterly economic report published by CCL's bank (see Table 1).

Table 1 – Key economic indicators

Year	East Midlands unemployment rate	Annual rate of inflation (UK)	Annual rate of GDP growth (UK)
2009	7.4%	-1.6%	-0.7%
2010	7.4%	5.0%	1.1%
2011	7.9%	5.3%	0.1%
2012*	8.0%	2.4%	0.1%

* forecast figures

Always mindful of the external environment when establishing CCL's strategy, Phil has agreed with the other shareholders three objectives for 2014 of:

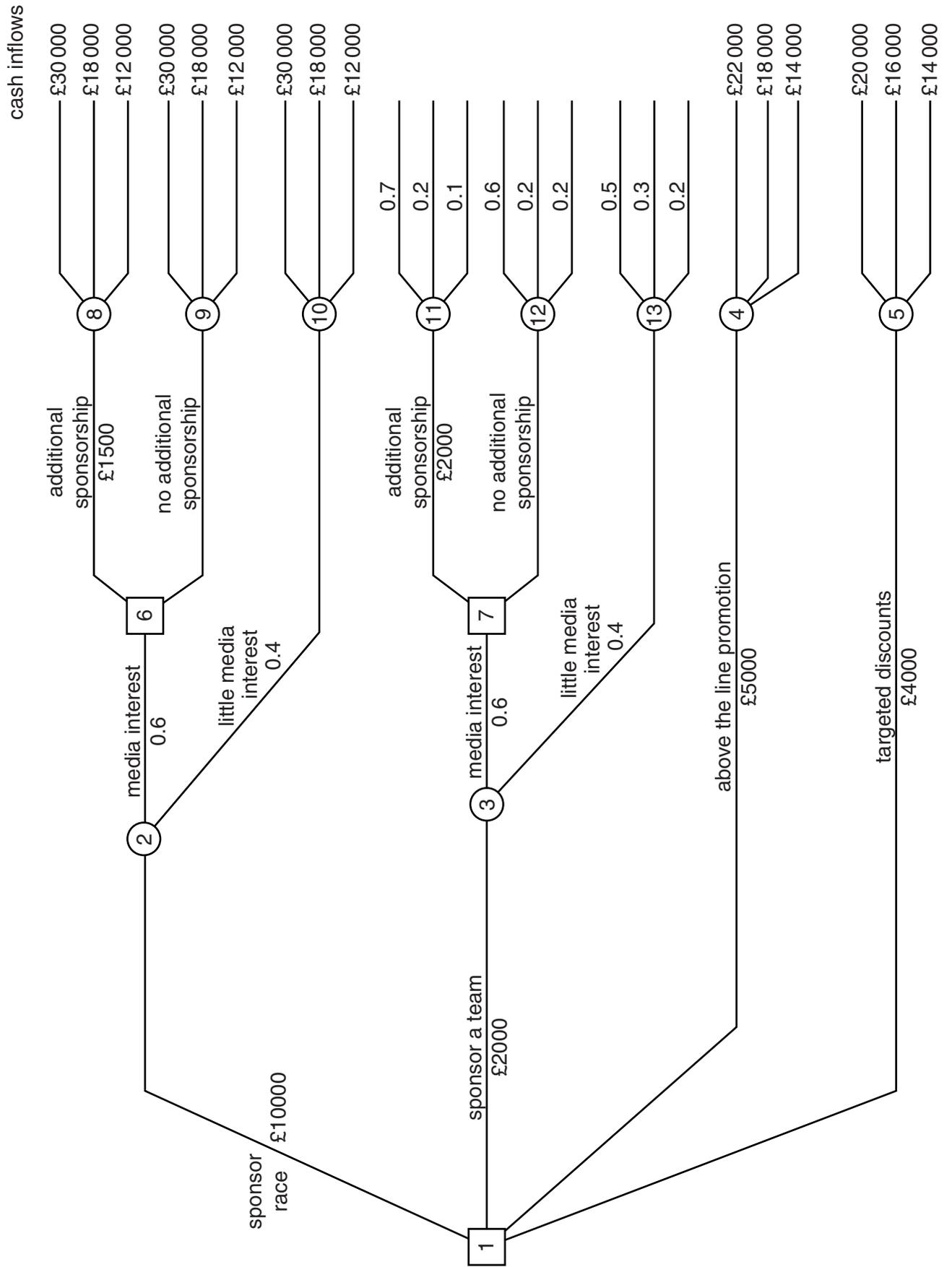
1. bringing the Rockingham Forest 'Peddlers' outlet to break-even by the end of the 2014 peak season
2. increasing the proportion of revenue from e-commerce to 55% by the end of the 2014 financial year
3. becoming the number one bicycle retailer in the East Midlands.

To achieve the third objective, Phil has asked Bradley Smith, CCL's Marketing Manager, to create a promotional strategy for 2014. After much deliberation Bradley has suggested four possibilities:

1. sponsoring a regional bicycle race and so securing naming rights
2. sponsoring a team in that race
3. using above-the-line promotion
4. using the marketing budget to subsidise retail prices and so offer targeted discounts on a number of key lines.

If either of the two bicycle race based options are chosen, and the cycling media promise to give the race extensive coverage, then Bradley suggests an additional sponsorship would be sensible. To help explain this to Phil, Bradley sketched out the options as a diagram (see Fig. 1). Bradley is aware that, at the moment with further research still needed, he cannot complete the diagram; however, he has been able to calculate some of the expected cash inflows and probabilities for good, average and poor returns for each option.

Fig. 1 – Bradley’s proposed sponsorship options



Phil believes that CCL acts ethically in its relationships with all of its stakeholders. However, sometimes there is a fine line between good commercial practice and ethics, with price discrimination being a case in point. Like many businesses which face changes in market demand, both across the year (peak and off-peak) and on a weekly (weekday and weekend) basis, CCL has a pricing structure for its hire business, 'Peddlers', which varies with time (see Table 2). 75

Table 2 – Peddler's 2013 bicycle hire tariff

Type of bicycle	Off-peak			Peak, Easter to August bank holiday		
	2 hours	4 hours	All day	2 hours	4 hours	All day
Mountain	£11.99	£14.99	£21.00	£13.99	£16.99	£21.00
Road	£13.99	£16.99	£24.00	£15.99	£18.99	£24.00
Hybrid	£9.99	£11.99	£18.00	£11.99	£14.99	£18.00
Electric	£17.99	£19.99	£30.00	£19.99	£22.99	£30.00
Tandem	£23.99	£24.99	£37.50	£24.99	£27.99	£37.50
Children's	£5.99	£8.99	£9.00	£5.99	£8.99	£9.00

In addition, Peddlers offers a family ticket (two adults and a minimum of two children) at a 10% discount. Further, pre-booked groups, spending more than £200, also get a 10% discount. Neither discount is available on peak season bank holidays. During the peak season the Peddlers outlets open from 8am to dusk. Despite these long opening hours, the bulk of the hires occur between 10am and 6pm, and, especially on warm summer weekends, significant queues for the hire of bicycles can develop. 80

Peddlers used to offer helmet hire for £1. However, last year it was decided to hire helmets for a £1.50 donation to one of two charities; the regional air ambulance or Headway. Despite the increase in fees, Peddlers saw helmet hire rise by 25%. Encouraged by this experience, CCL decided to donate £5 to charity for every helmet sold. An unintended consequence of this decision was some regional publicity for the business. 85

In September each year the entire bicycle hire-fleet is serviced and then a proportion is sold at a 50% discount to replacement cost over the following months. This not only keeps the hire-fleet modern, but it can also lead to sales of complementary products. In addition to bicycles, some clothing, such as replica team jerseys and other accessories, is included in the end of year sale. 90

By its very nature, CCL is a business with a low carbon footprint. Recent growth in both sales and hire are, in part, attributable to shifts in society's values. Whereas cycling used to be the preserve of the committed enthusiast or transport for the factory worker, cycling is now very much a mainstream leisure activity. Hence, the average price paid for a bicycle has risen well ahead of inflation to an average figure of £989 in 2012. An area of increasing interest has been for electrically assisted bicycles, primarily for urban uses such as short commutes or shopping. Such bicycles are comparatively expensive but, with increasing fuel bills, Phil can see this as being a significant source of growth in the coming years. Unlike the motorcar industry, the charge range seems not 95

to be an issue. To further reduce CCL's carbon footprint, Sam Tipper, Manager of the Rockingham Forest outlet, has been investigating the installation of solar photovoltaic panels on its south facing roof. His research has suggested that ten panels would cost approximately £15 000 and yield an energy saving of about £1200 per annum. Installations for the other two Peddlers outlets would be possible at an additional capital cost of £35 000 and would give similar energy savings. 100

However, Finance Director, Ned Boulting, believes that CCL should diversify. A five year lease to operate the golf pro shop at Market Harworth Golf Club is about to come on the market. His view is that there are many synergies between the two businesses, not least in retail management and merchandising. Further, CCL's experience in e-commerce could make it a very exciting venture. Discreet enquiries suggest that with some hard bargaining the shop could be acquired as a going concern. His projections are shown in **Table 3**. 105 110

Table 3 – Projected cash flows

Year	Cash flow, net receipts, £
0	(40 000)
1	8 000
2	10 000
3	12 000
4	12 000
5	12 000

This possible expansion is but one of the issues facing Phil. Bradley is very keen to merge both brands, 'Maillot Jaune' and 'Peddlers', into a single identity – 'Summit Cycles'. Phil, however, thinks that there would be little to be gained by such a move, yet an awful lot to lose. He is more focused on managing the growth in e-commerce sales, and CCL's other objectives for 2014. With economic growth likely to remain uncertain for some time to come, he is concerned that the outlook for CCL is far from secure, especially as many of CCL's customers rely on discretionary income to make their purchases. So, whilst life-style remains a key driver for demand, Phil knows it can only continue if customers actually have the cash to spend. Although under no financial threat, Phil feels the growth in CCL's sales across the last four financial years (2009 £6.8m; 2010 £9.7m; 2011 £11.6m; 2012 £13.3m) may not be repeatable across the next four years. 115 120

Appendix 1 – Profit centre performance, 1 September 2011 to 31 August 2012

	Maillot Jaune Oakford	Maillot Jaune Market Harworth	Peddlers Reservoir	Peddlers Market Harworth	Peddlers Rockingham Forest	e-commerce	CCL
Manager	Will Farmer	Ben Turnbull	Olivia Tsong	Andrew Jarvis	Sam Tipper	Jo Russell	
Staff	4	4	12	10	2	27	
	£000	£000	£000	£000	£000	£000	£000
Revenue	1640	1458	1495	1415	440	6845	13293
Cost of sales	738	656	598	566	220	3080	5858
Overheads	872	775	795	752	234	3640	7068
Profit	30	27	102	97	-14	125	367

Appendix 2 – Monthly profit centre revenue, 1 September 2011 to 31 August 2012

	Maillot Jaune Oakford	Maillot Jaune Market Harworth	Peddlers Reservoir	Peddlers Market Harworth	Peddlers Rockingham Forest	e-commerce	CCL
	£000s	£000s	£000s	£000s	£000s	£000s	£000s
September	183	172	51	44	28	411	889
October	99	86	28	26	26	384	649
November	140	92	22	14	23	845	1136
December	165	118	59	56	19	368	785
January	72	89	52	39	19	386	657
February	56	54	34	36	24	375	579
March	59	57	35	33	21	381	586
April	68	66	28	29	26	402	619
May	126	130	34	69	30	855	1244
June	206	184	373	354	74	901	2092
July	216	188	393	359	76	879	2111
August	250	222	386	356	74	658	1946

Appendix 3 – CCL's Balance Sheet as at 31 August 2012

	£000s	£000s
Fixed Assets		
Premises	500	
Equipment	<u>27</u>	
Total Fixed Assets		527
Current Assets		
Stock	2908	
Debtors	1108	
Cash	<u>175</u>	
Total Current Assets		4191
Current Liabilities		
Trade creditors		<u>1454</u>
Net Current Assets		<u>2737</u>
Net Assets		<u>3264</u>
Equity		
Share capital		100
Profit and loss account		<u>3164</u>
Equity Shareholders' Funds		<u>3264</u>

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