Cambridge International A Level

Cambridge International Examinations
Cambridge International Advanced Level

BUSINESS **9609/32**

Paper 3 Case Study **May/June 2018**

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Denali Adventures (DA)

Lino is the founder and Chief Executive Officer (CEO) of DA, a public limited company. Founded in 1990, DA is a leading manufacturer of equipment for outdoor pursuits in country A, located in Europe. DA makes a range of products including rucksacks, tents, sleeping bags and other camping equipment. All of DA's output is sold to specialist retailers. DA has grown internally since its foundation. This has been assisted by:

- significant economic growth in country A
- improved public access to mountain areas in country A
- DA's focus on product testing, development and innovation.

Decentralised control

Lino still owns 25% of the shares in DA. He is very protective of the image of DA and still regards it as his company. Lino has always encouraged a soft approach to the management of human resources. The organisational structure of the business is decentralised. DA has made substantial investment in the training and development of employees. The business is split into four product areas and product leaders are encouraged to manage teams democratically.

Shareholder unrest

Shareholders are worried about the shareholder value created by DA. At the Annual General Meeting (AGM) in May, a representative from a major investor argued that, 'We have supported the Board through difficult trading conditions in recent years and now believe that shareholders should be rewarded for their commitment to the business. Without an increase in the dividend yield to match the industry average we may be forced to reassess our shareholding in DA.'

Lino reassured shareholders that long-term growth strategies currently under consideration would enable DA to maximise shareholder value. He added that 'these growth strategies depend critically on the ability of DA to retain profit for investment'. Data presented to shareholders at the AGM is contained in Appendix 1.

Increasing problems in manufacturing

In contrast to some leading competitors, DA has manufactured its own products since integrating with a manufacturing business in 2004. This has given DA a competitive advantage. Manufacturing is based in country A and currently employs 60 production workers. In 2015 operations became more capital intensive following investment in a new batch production system. At the same time, quality assurance was introduced and DA successfully gained an international quality standard certificate. However, Bian, the factory manager, is concerned about a number of recent problems:

- labour turnover of 10 workers in 2016 and 15 workers in 2017
- an increase in defective products from 0.3% in 2015 to 1.5% in 2017
- an increase in machine downtime due to necessary maintenance
- late delivery of supplies of materials halting production on two occasions in 2017.

Bian believes that the introduction of lean production techniques will solve these operational problems. She estimates that this would require an investment of $2m. She provided a detailed plan to the Board of Directors two months ago with the changes required. This has been approved. She is currently in negotiation with trade unions at the factory but, as yet, has not reached agreement regarding implementation of the plan.

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Extending the product portfolio

As part of DA's plans for growth, the Board of Directors has agreed to extend the product portfolio. This will be achieved by developing a range of walking boots aimed at serious mountain walkers. This is a competitive market segment and Joon, the Marketing Director, believes that a combination of product design, aggressive promotion and competitive pricing will be essential for a successful launch of this new range. Joon's marketing team have conducted primary and secondary market research to help make these critical marketing decisions. Using this data, Joon is now working on the final details of a marketing strategy with the objective of achieving a market share of 5% by value within one year. The range will be launched in early 2019. The most expensive boot in the range will be branded as the 'DA Explorer'.

Further information regarding the market for walking boots in country A is contained in Appendix 2.

Growth strategies

The Board of Directors has set corporate aims of increasing sales by a minimum of 30% within five years and to increase shareholder value. Competitive rivalry in country A is high. The market for outdoor pursuits equipment in country A is saturated and further growth is unlikely. Industry analysts believe that success requires a dynamic organisation that anticipates and is responsive to market changes. Having already agreed to enter the consumer market for walking boots, other strategies for growth were considered at the most recent Board meeting. These are outlined below:

Strategy 1 – Market development: Enter the outdoor pursuits equipment market in country B. This is a high income country in Europe. Initial discussions have been held with retail outlets. Although this is a competitive market, the latest industry report has predicted continued growth in sales of outdoor pursuits equipment.

Strategy 2 – Forward vertical integration: Enter the retail market by taking over Outdoor Life (OL), a chain of outdoor pursuits retail outlets in country A. OL has been unprofitable for the past three years. However, DA's Board of Directors believes that with investment in upgrading outlets, this could be the leading retailer of outdoor pursuits equipment within five years. The Marketing Director also believes that there is potential to develop online retailing.

Further data is provided in Appendices 3, 4 and 5. The Board of Directors will decide which strategy to proceed with in July.

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Appendix 1: Selected financial data reported at the AGM

	2016/17	2017/18
Revenue	$76m	$75m
Profit (after tax and interest) for the year	$7m	$6m
Total dividends	$1m paid	$1.1m proposed
Non-current liabilities as at 20 April	$30m	$35m
Capital Employed as at 20 April	$95m	$100m
Share price as at 20 April	$7	$5
Total number of issued shares	10m	10m
Average dividend yield for other companies in the outdoor pursuits equipment market	5%	5%
Central bank base lending rate	5%	7%

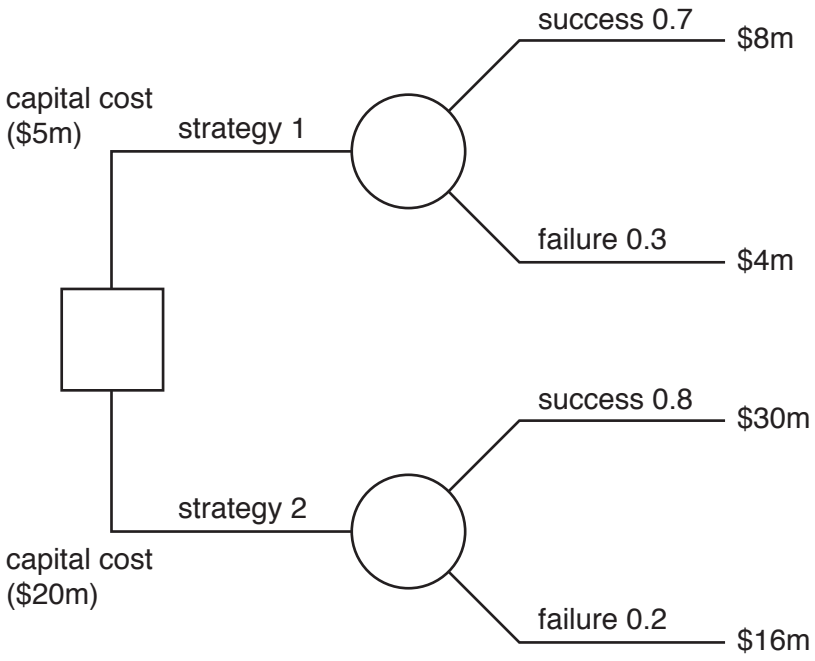
Appendix 2: Market data for walking boots in country A and DA's sales forecasts

Forecast demand for DA walking boot range in 2019 with promotional spending of $200 000	40 000 units
Forecast demand for DA walking boot range in 2019 with promotional spending of $300 000	50 000 units
Forecast demand for DA Explorer in 2019 at a price of $200	10 000 units
Forecast demand for DA Explorer in 2019 at a price of $180	11 300 units
Forecast annual growth of walking boots sales 2018–2021	1%
Walking boot sales in 2017 by volume	1.5m units
Walking boot sales in 2017 by value	$165m
Number of walking boots brands	30

Note: A unit is a pair of boots

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Appendix 3: Decision tree for the two potential growth strategies



Appendix 4: Data for DA's two potential growth strategies

	Strategy 1: Market development	Strategy 2: Forward vertical integration
Payback	3 years	4 years
ARR (first five years)	7%	9%
Key driving forces for	• Strong economic growth in country B • Market is not saturated	• Control over significant distribution channel • Outdoor Life (OL) has own brand products
Key restraining forces against	• Strong brand loyalty to current market leaders • Exchange rate risks	• Capital cost • Lack of experience of retailing

Appendix 5: Forecast data for Country B

	2018	2019	2020
Annual growth in real GDP (%)	4	5.4	5
Inflation (%)	4	8	7
Exchange rate index: country A: country B	100	95	92
Indirect tax rates (%)	10	12	12
Direct tax rates (%)	22	20	20
Unemployment rate (%)	10	6.5	5.8

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