Cambridge International AS & A Level

**Cambridge International Examinations**
Cambridge International Advanced Subsidiary and Advanced Level

**BUSINESS** **9609/31**

Paper 3 Case Study **October/November 2016**

**3 hours**

No Additional Materials are required.

*8333427221*

**READ THESE INSTRUCTIONS FIRST**

An answer booklet is provided inside this question paper. You should follow the instructions on the front cover of the answer booklet. If you need additional answer paper ask the invigilator for a continuation booklet.

**Section A**
Answer **all** questions.
**Section B**
Answer **one** question.
You are advised to spend no more than 40 minutes on Section B.
The businesses described in this paper are entirely fictitious.

The number of marks is given in brackets [ ] at the end of each question or part question.

This document consists of **6** printed pages, **2** blank pages and **1** Insert.


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CAMBRIDGE International Examinations

## Kaldi & Akbars (KA)

KA was established in 2010 by Anne Styles as a private limited company. Anne identified a gap in the coffee shop market in country Y. KA now has many coffee shops in country Y.

### Changing perceptions

The coffee shop market in country Y is highly competitive. There are many independent shops and several large chains. These large chains have a reputation for offering consistent quality products with excellent customer service. They also have a standardised layout with a clearly identifiable style of decoration and branding. Anne's vision was to try to change the way people think about coffee. KA sources coffee from an ethical supplier which is committed to promoting the interests of coffee bean farmers.

KA provides intensive training for coffee baristas (employees that make the coffee) before they are allowed to make a cup of coffee for a customer. Each KA shop has a unique design. Employees are encouraged to get to know their individual customer's preferences for coffee. With a high class interior design, its relaxed atmosphere, quality coffee experience and locally sourced food, KA has targeted the premium end of the market. This is reflected in the prices charged for the product range.

### Digital marketing

KA's approach to marketing has been to utilise digital technologies. KA has used social media to build customer interest and loyalty. In 2015 KA launched a mobile app (software program) that allows customers to use their mobile (cell) phone to pre-order and pay for coffee. This app has provided KA with valuable information about customer preferences and enables KA to target promotional offers at individual customers. Customers select their preferred purchase which can then be seen by the barista in the chosen shop together with the customer's name and photo. KA has achieved growth without any significant use of traditional forms of advertising.

### Business growth

For the first three years KA pursued an aggressive growth strategy and did not make a profit. Growth was financed largely by borrowing from banks. By the end of 2013 KA had opened 20 shops and consequently gearing reached 80%.

In 2014 Gayles, a major supermarket chain in country Y, took a minority shareholding in KA. This provided much needed finance for continued expansion and enabled KA to open coffee shops in Gayles' supermarkets as well. Anne remains in full operational control of the business and believes it now has a secure financial future. Extract data from KA's financial accounts is shown in Appendix A.

### Employment contracts

As the business has grown workforce planning has become more important. Staffing levels are essential to maintain a high level of customer service. KA uses a mixture of employment contracts. Most baristas are on permanent full-time contracts. Many of the other employees are given flexible, zero hours contracts. Temporary part-time contracts are also used for busy times of the year. Trade union representation has been discouraged by the Director of Human Resources. Labour turnover is high.

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**Expanding with Gayles**

With the financial backing of Gayles, KA opened 25 new shops in 2014. However, KA's Finance Director is concerned about five shops that have failed to meet projected revenue and profit targets. At the next Board meeting in December the future of these shops is to be decided. There are currently 40 employees working in these shops. Employees have yet to be informed that KA is considering closing these shops. KA does not own the premises but invested $2.5m preparing the shops for opening in 2014. This investment included the purchase of non-current assets such as seating and coffee machines. The Finance Director estimates that if these shops were closed then non-current assets to a value of $1m could be redeployed elsewhere in the business. Table 1 gives further financial data.

**Table 1: Financial data for the five shops being considered for closure**

| | Actual costs and revenue. Year ending 30 September 2016 ($m) | Forecast costs and revenue. Year ending 30 September 2016 ($m) | Notes |
|---|---|---|---|
| Revenue | 1.9 | 2.3 | |
| Annual leasing costs & other fixed costs | 0.8 | 0.8 | Leases signed until end of 2018 Includes allocated fixed costs such as national marketing |
| Variable material costs | 0.4 | 0.45 | |
| Other variable costs | 0.8 | 0.85 | |

**Difficult economic conditions**

Towards the end of 2015 economic growth slowed dramatically in country Y. In 2016 there have been rising unemployment and falling household incomes. Trading conditions have been difficult and profits have been squeezed by rising coffee bean prices. The Marketing Director has been reviewing the impact of these changes on the business. She estimates that KA has been losing sales to competitors selling cheaper coffee and that the reduction in household incomes of 3% over the past 12 months has reduced demand at KA by 5%. Further economic information is contained in Table 2.

**Table 2: Forecast economic and market Information for country Y**

| | |
|---|---|
| Annual real Gross Domestic Product (GDP) growth rate 2017–2020 | 1% |
| Inflation 2017 | 2% |
| Exchange rate index 2017 (2016 =100) | 96 |
| Index of coffee bean prices 2017 (2016 = 100) | 104 |
| Annual coffee shop sales growth 2017–2020 | 3.5% |

**Social audit**

Anne favours publishing a social audit of KA activities as she believes that this will demonstrate KA's commitment to Corporate Social Responsibility (CSR). Among the positive activities that she wishes to highlight are:

- The KA Foundation sponsors educational initiatives in developing countries
- Coffee sacks recycled to make carpets
- 40% of food supplies sourced locally
- Carbon emissions have been reduced in 2016.

**Strategic plans**

Anne remains committed to increasing the market share of the business. She has been working on two possible strategic options for expansion.

*Option 1 – KA Express*

The concept of KA Express is to give coffee lovers the opportunity to get a coffee from easy to use self-service coffee machines in a variety of locations such as railway stations, hospitals and libraries. The machines will be unique due to their stylish design, large choice of KA drinks and the coffee aroma released into the environment.

To develop the brand and purchase the machines will require an investment of $13m. This would enable KA Express to be placed in 60 locations in country Y.

*Option 2 – Take over a chain of coffee shops*

A potential target for takeover has been identified. This is a chain of 20 coffee shops owned by the premium Arabica Coffee House (ACH) brand. These shops are located in a region of country Y where there are no KA coffee shops.

The takeover would require an initial investment of $15m and a further $5m for redesigning and rebranding the coffee shops.

Further details of these options are given in Appendix B.

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## Appendix A: Accounting data

| | Year ended 30 September 2015 | Year ended 30 September 2016 |
|---|---|---|
| Total equity ($m) | 32.0 | 34.0 |
| Non-current liabilities ($m) | 30.0 | 29.0 |
| Operating profit ($m) | 9.2 | 6.0 |
| Revenue ($m) | 115.0 | 112.5 |
| Total dividends paid ($m) | 1.0 | 1.1 |
| Acid test ratio | 0.90 | 0.86 |
| Current ratio | 1.00 | 0.97 |

## Appendix B: Strategic choice between Option 1 and Option 2

| | Option 1: KA Express | Option 2: Takeover |
|---|---|---|
| Decision tree analysis | Chance of failure: 20%<br>Expected Monetary Value: $1m per year | Chance of failure: 25%<br>Expected Monetary Value: $2.5m per year |
| Force field analysis | Forces for change: 12<br>Forces against change: 10<br>Main force for change:<br>No competitors have similar concept<br>Main force against change:<br>Dilution of KA brand image | Forces for change: 14<br>Forces against change: 10<br>Main force for change:<br>Rapid expansion in desirable locations<br>Main force against change:<br>Difficult current trading conditions due to weakness in economy |
| Investment appraisal | Accounting rate of return (ARR) = 15% | Accounting rate of return (ARR) = 10% |

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[Turn over

## Section A

Answer **all** questions in this section.

**1** Analyse the benefits to KA of publishing a social audit. [10]

**2** **(a)** Refer to Table 1. Calculate the **actual** contribution of the five shops to KA. [4]

**(b)** Recommend whether KA should close the five shops. Justify your answer using your results from **2(a)** and any other information. [14]

**3** **(a)** Refer to Appendix A. Calculate **two** profitability ratios for KA in 2016. [6]

**(b)** Refer to Appendix A and your answer to **3(a)**. Assess the usefulness of financial data to any **two** of KA's stakeholder groups. [14]

**4** Refer to Table 2 and other information. Discuss the changes KA could make to its current marketing strategy in response to difficult economic conditions. [16]

**5** Evaluate the benefits to KA of having a mixture of employment contracts. [16]

## Section B

Answer **one** question from this section.

**6** Refer to Appendix B and other information in the case. Recommend to Anne which one of the two strategic options for future growth should be chosen. Justify your recommendation. [20]

**7** Assume Anne has decided to close the five coffee shops. Evaluate how Anne could successfully implement this strategic decision. [20]

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