Cambridge Assessment International Education

Cambridge International AS & A Level

BUSINESS **9609/32**

Paper 3 Case Study **October/November 2021**

INSERT **3 hours**

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INFORMATION

- This insert contains the case study.
- You may annotate this insert and use the blank spaces for planning. **Do not write your answers** on the insert.

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AerCore (AC)

Omar is the founder and Chief Executive Officer (CEO) of AC, a private limited company. AC was founded in 2000 and manufactures fitness equipment in country K. Membership of fitness centres is increasing in country K as a result of rising incomes and greater awareness of the benefits of exercise. AC sells and leases fitness equipment such as treadmills and rowing machines to fitness centres, hotels and large corporations. AC does not currently sell directly to consumers. AC exports to a neighbouring country though sales have declined there in the past two years.

Foreign manufacturers have begun to sell their fitness equipment in country K due to the growth of the market.

Control from the centre

Omar and six other family members own all the shares of AC and they are the only directors. Omar keeps control of all aspects of the business. Organisation is hierarchical and centralised. Managers have only limited authority.

AC has expanded gradually over the years, financed by retained profits and bank loans. AC has made sufficient profit to give shareholders a good return. Table 1 shows selected data from AC's latest annual accounts.

Table 1: Selected data from AC's annual accounts as at 30 September 2021

	($m)
Revenue	84
Cost of sales	44
Expenses	36
Total dividends	2
Current assets	3
Current liabilities	2
Non-current liabilities	40
Shareholder equity	25

Omar has plans to significantly expand AC in the next three years. Omar believes this requires the board to consider two key questions:

- Should AC convert to a public limited company (plc)?
- Would decentralisation benefit AC?

Consumer fitness equipment market

AC currently focuses on the industrial sector of the fitness market. Marketing relies on promotion at trade fairs, advertising in industry magazines and direct selling to hotels, gyms and corporate offices. Omar's brother Khalil is the Marketing Director. He has identified that there is rapid growth in the consumer equipment fitness market. In this market people purchase fitness equipment to use in their own homes. Khalil believes that price is important to these consumers. The equipment does not need to be as durable as for the industrial sector.

His research suggests the increasing number of people who are overweight is a driving factor for growth in the use of fitness products at home. The Board of Directors has agreed to his proposal to develop products more suitable for entering the consumer market in 2022. Khalil has researched the consumer fitness equipment market in country K. Table 2 gives a summary of his research.

Table 2: The consumer fitness equipment market in country K in 2020

Market share of the three biggest suppliers of fitness equipment	60%
Number of suppliers of fitness equipment	50
Change in advertising expenditure by the market leading brand	+30%
Average spend on fitness equipment	$550
Growth of consumer market	3%
Proportion of households with fitness equipment	5%
Proportion of consumers buying fitness equipment online	75%

Khalil will outline his proposed marketing strategy to the Board of Directors next week. He will recommend an objective of achieving a market share of 5% within 2 years.

Manufacturing problems

AC's employees are skilled and there is a production line for each product. Quality control inspectors are employed to ensure that fitness equipment conforms to the quality standards set by AC. However, Omar is concerned about the increase in the proportion of substandard output. The operations manager estimates that the average cost to AC of correcting substandard output is $70 per unit. The operations manager has also reported that production of treadmills was recently stopped for two days due to late delivery of an important component. Table 3 contains factory data.

Table 3: Factory data for 2020

Number of employees	80
Number of days lost through absenteeism	600
Average monthly output (units of equipment)	5100
Percentage of substandard output	3%

Omar asked the operations manager to investigate the problems and make a recommendation for change. The operations manager reported the following:

- Production line workers are paid approximately 90% of the industry average.
- Labour turnover in 2020 was 15%.
- Workers feel that they are not valued by AC.
- Workers do not feel that they are trusted.

The operations manager has recommended that AC should introduce Total Quality Management (TQM). He has also told Omar that he has insufficient authority to make the necessary decisions to manage operations effectively.

Growth strategies

Competitive rivalry in the fitness industry is high. Existing businesses aim to maintain market share. Growth is mainly driven by entering new markets. Research and development focuses on product development. As well as entering the consumer market in country K, Omar will present two other strategies for growth at the next Board meeting. These are outlined below:

Option 1: market development.
Enter the fitness market in country P. Initially this would target the industrial sector.

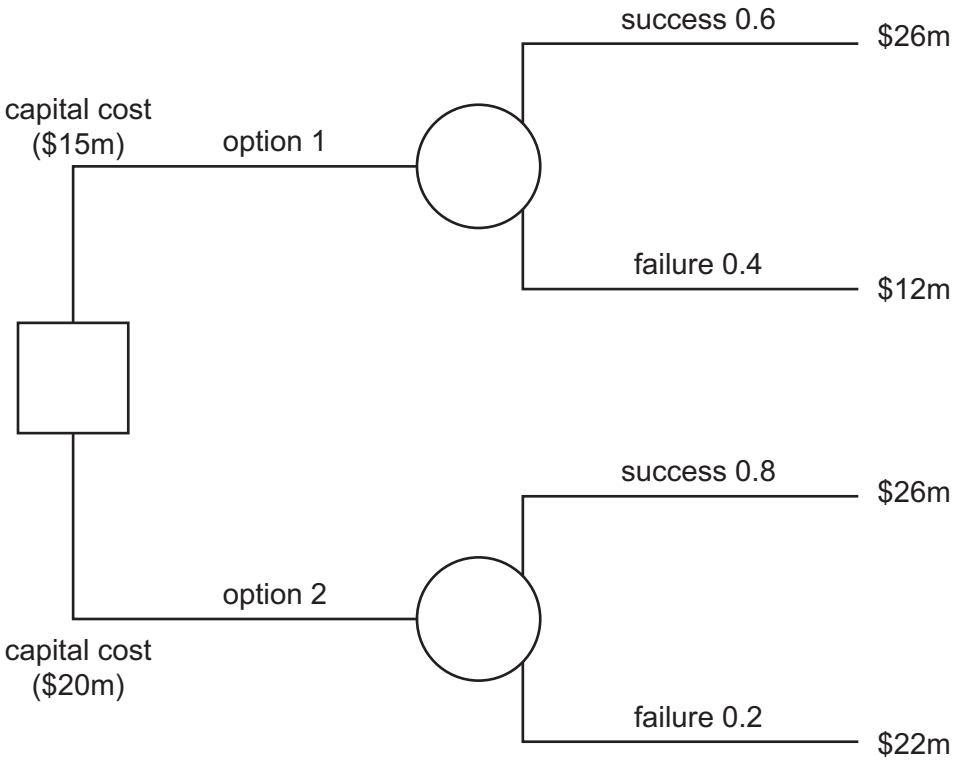
Option 2: diversification.
Diversify into the tertiary sector by opening a chain of fitness centres in country K. These would target the premium segment of the market.

Omar has researched both options and estimated sales and costs to help make the decision. Extracts from his research are shown in Appendix 2.

Appendix 1: Forecast economic data for country K

	2022	2023	2024
Annual growth in real GDP (%)	3	5	3.5
Inflation rate (%)	6	9	10
Indirect tax rate (sales tax) (%)	10	12	12
Direct tax rate (income tax) (%)	24	26	26
Unemployment rate (%)	9	7.8	7.4
Interest rate (%)	6	8	8

Appendix 2: Strategic choice techniques for the potential growth strategies



	Option 1: market development	Option 2: diversification
Payback	4 years	5 years
Accounting rate of return (ARR) first ten years	10%	13%
Key driving forces	• Strong economic growth in country P • Growth in fitness centre membership	• Stable growing market in country K • Opportunity for increased sales of AC's equipment • Develop branding
Key restraining forces	• Existing competition • Foreign exchange rate risks • Capacity constraints	• Lack of managerial expertise in tertiary sector • Cost

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