Cambridge International AS & A Level

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Cambridge International Advanced Subsidiary and Advanced Level

BUSINESS STUDIES **9707/31**

Paper 3 **May/June 2015**

CASE STUDY

3 hours

Additional Materials: Answer Booklet/Paper

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READ THESE INSTRUCTIONS FIRST

If you have been given an Answer Booklet, follow the instructions on the front cover of the Booklet.
Write your Centre number, candidate number and name on all the work you hand in.
Write in dark blue or black pen.
You may use an HB pencil for any diagrams or graphs.
Do not use staples, paper clips, glue or correction fluid.
DO **NOT** WRITE IN ANY BARCODES.

Section A
Answer **all** questions.
Section B
Answer **one** question.
You are advised to spend 40 minutes on Section B.
The businesses described in this question paper are entirely fictitious.

At the end of the examination, fasten all your work securely together.
The number of marks is given in brackets [ ] at the end of each question or part question.

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Chan Chicken Farms (CCF)

Ed is Chief Executive Officer (CEO) of Chan Chicken Farms (CCF). This company was set up 35 years ago as a family business selling chickens produced on the family farm. The family quickly expanded the business by buying other chicken farms and setting up a meat processing factory. The business was listed on the country's Stock Exchange five years ago and a new management team appointed. Ed and his fellow directors quickly established the public limited company's primary objective to be 'maximising shareholder value'. This was to be achieved by a low cost strategy and extending the company's product portfolio.

Cutting costs

Ed's first decision, after he was made CEO, was to insist that CCF stopped using traditional methods of raising organic chickens allowed to roam freely outdoors and focus instead on chickens kept indoors with very little space. This has resulted in lower costs of chicken meat which is the major input for CCF's meat processing factory. Within the factory, training was also reduced – even for skilled positions such as machine maintenance employees and food health inspectors. Wage rates were reduced and teamworking abandoned in favour of traditional flow production. Some full time workers were replaced by workers on temporary and part time contracts. As a result of these changes, labour productivity had fallen. At times, due to the cost cuts, not enough workers were recruited to deal with peak demand levels during festival periods. All of these changes had led to quality and supply problems which damaged CCF's excellent reputation with consumers and food retailers. There have been two outbreaks of food poisoning caused by CCF products that had not been cooked thoroughly. Today's Business Recorder newspaper headline did not make good reading for Ed: 'Health scares linked to CCF's products'. The Operations Director warned the Board two years ago that unit costs had not fallen as much as expected so the planned price reductions would not be possible. He had added: 'Our competitiveness in the market depends not just on prices but also our brand image and the type of publicity we receive. At present, we are losing competitiveness compared to our rivals'.

Extending the product portfolio

Under the ownership of the original family, CCF sold chicken through market stalls and to major food retailers. The meat processing factory produced chicken based products such as pies, curries and burgers. These were sold, fresh and frozen, under the CCF brand name. The current team of directors have increased the product range of CCF branded goods. The production of many other meat based products such as stews and pasta dishes is now outsourced and bought-in from suppliers before being packaged at the CCF factory and sold under the CCF brand. 'We can now appeal to many different market segments and we have new products being introduced regularly to replace ones with falling sales, such as burgers' the Marketing Director said in a recent interview with the Business Recorder. She admitted during the interview that, because of the product portfolio strategy, there might be increased storage costs and a need to spread the limited marketing budget across a wide range of different products.

Location decision

CCF's Board have decided to relocate production of their chicken based products to a new factory. The existing factory is old and equipment often fails. It is poorly located for transport of products to retailers. Two potential sites, P and Q, have been identified for the new meat processing factory. The Operations Director has a preference for Location Q as his family has a home nearby. He has produced the data in Table 1 for presentation at the next Board meeting. 'Producing our food products from a modern and technologically advanced factory should allow the company to pursue its low cost strategy successfully' he reported to the Board. The Finance Director plans to finance the new factory from the sale of the existing site and other internal sources such as reducing this year's proposed dividend payout. Ed believes that this would cause anger amongst shareholders who received a dividend yield of 4% last year. In addition, many of them are very unhappy about the bad publicity the company has received. 'I think we should borrow the additional capital required while interest rates are low' he told the Finance Director.

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Table 1: Comparative data for two potential locations

	Location P	Location Q
Site and construction costs	$25m	$30m
Government grants available?	No	Yes – 20% of site and construction costs
Forecast annual net return	$7m	$6m
Annual overhead costs	$2.2m	$2.4m
Forecast average contribution per item sold	$1.5	$1.7
Local unemployment rate	10%	15%
Average distance to food retailers' warehouses	15 kilometres	30 kilometres
Distance from current CCF factory	10 kilometres	100 kilometres

Managing human resources effectively

Bella was appointed last month as the new Human Resources Director. 'The company must learn from past mistakes' she told fellow directors at the first Board meeting she attended. 'My department accepts some of the responsibility for the quality and supply problems at the meat processing factory which, I think, mainly resulted from inadequate workforce planning by my predecessor. Once the location for a new factory has been decided, I will prepare a detailed workforce plan which will ensure that previous mistakes when dealing with employees are not repeated. The effective management of human resources within CCF will help the company achieve its primary objective.'

Strategies for a new direction for CCF

Ed is determined to look beyond the current problems faced by the business and focus on future strategies. At the next Annual General Meeting (AGM) he wants to take shareholders' attention away from CCF's bad publicity and outline two possible strategic directions CCF could take. He has commissioned a SWOT and PEST analysis and, although he will not make this public at the AGM, he believes that these analytical techniques will help the Board recognise the appropriateness of the two strategies he is proposing (see Appendix 2 and Appendix 3).

Ed's two possible strategies for a new direction for CCF are:

1. Take over a large food retailing company to provide guaranteed outlets for CCF's product range
2. Open a chicken farm in a neighbouring nation, country Y, to supply that market for the first time.

Appendix 1: CCF's latest financial data

Profit after tax ($m)	45
Proposed dividends ($m)	35
Non-current liabilities ($m)	78
Shareholders' funds ($m)	85
Share price 12 months ago ($)	4
Current share price ($)	3
Total number of issued shares	100m
Estimated value of current meat processing factory site ($m)	5

Appendix 2: CCF SWOT analysis

Strengths • Public company status – access to share capital e.g. rights issue • Long established trading record • High market share	**Weaknesses** • Some directors lack proven track record • Meat processing factory and equipment is old
Opportunities • Demand for most meat products increasing as income levels rise • Neighbouring countries such as country Y lack food production capacity	**Threats** • Rivals might take advantage of CCF's bad publicity e.g. by emphasising food safety • Some retailers planning to set up own meat processing operations

Appendix 3: CCF PEST analysis

Political • Frequent changes of government in most countries in the region lead to changes in legal constraints • Reducing barriers to international trade within the region	**Economic** • Low interest rates • Rising consumer incomes in most countries in the region including country Y
Social • Increasing membership of animal rights pressure groups • Higher income consumers preferring meat from organic sources	**Technology** • Fully computerised food processing equipment now available • Online shopping increasing in popularity

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Section A

Answer **all** the questions in this section.

1 Analyse the benefits and limitations to CCF of an extensive product portfolio. [10]

2 **(a)** Using data in Appendix 1, calculate:

(i) CCF's gearing ratio [3]

(ii) the current dividend yield ratio assuming the proposed dividend is paid. [5]

(b) Using your results from **(a)** and other information, recommend to CCF which source(s) of finance should be used to pay for the new meat processing factory. [14]

3 Recommend which of the two sites CCF should choose for its new meat processing factory. Justify your answer with an analysis of the data in Table 1 and other relevant information. [16]

4 Discuss the importance to CCF of corporate social responsibility when aiming to maximise shareholder value. [16]

5 Discuss the extent to which workforce planning for the new factory could ensure effective management of human resources. [16]

Section B

Answer **one** question in this section.

6 Evaluate the usefulness of SWOT and PEST techniques to CCF's directors when undertaking strategic analysis before deciding on the future direction for the business. [20]

7 Evaluate how the directors of CCF could ensure that future strategic changes are implemented successfully. [20]

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