A2 Business Studies
Mid-Year Exam Paper 3

January 2014

Time allowed: 2 hours

INSTRUCTIONS TO CANDIDATES

- Section A: answer questions 1, 4 and 5 only
- Section B: answer one question
- Use blue or black ink only

FitsU

The beginning

Azureen opened her first shoe shop, called FitsU, 30 years ago. She correctly identified a market gap for womens' fashionable shoes at reasonable prices. Imports of cheap but well designed shoes from several low cost factories gave Azureen's shop a wide choice for customers. At first, her shop had little competition as few other retailers were selling imported shoes. Her business grew organically and rapidly. By 2005 FitsU owned 300 shops. It was the second largest shoe retailer, by value, in the country. Azureen sold the business in that year to venture capitalists who floated it shortly afterwards on the Stock Exchange as a public limited company.

2005 – Change of ownership and culture

The new directors of FitsU kept the brand name – but much else about the business changed. The profit sharing scheme for all employees was withdrawn without negotiation and all shop staff and shop managers were paid a low basic wage. This could be supplemented with bonuses if sales rose above a target fixed by Head Office. Without these bonus payments a Trade Union representative claimed that: 'My members' wages are now below the national minimum wage as the bonus payments are not guaranteed. My members do not feel involved in the huge changes that directors are forcing on them'.

The weekly staff consultation meetings were dismissed by the new Chief Executive Officer as 'a waste of time – workers could spend their time more effectively cleaning the shops'. As national unemployment was rising these changes had not led to an increase in staff turnover, but the number of suggestions made by staff for new shoe styles, ways to improve customer service and shop layouts had fallen to a record low level. Directors and senior managers at Head Office were paid generous salaries and were offered a share purchase scheme.

Rapid expansion continues

The company has added another 200 shops since 2005. Fifty of these are new branches and the rest were obtained by a takeover of a large but unprofitable shoe retailer, ShoeHut. The rate of organic and external growth has not been without its problems. Working capital is very limited, loans have increased and internal communication problems have arisen. There have been serious disagreements between directors of FitsU and ShoeHut. Rationalisation after the takeover led to many sudden job losses.

FitsU – planning to make shoes too

By 2010 the directors of FitsU were considering a proposal to open its own shoe-making factory to supply all FitsU shops. This would be operated for a trial period of four years and would be extended beyond that if successful. An existing FitsU manager from Head Office would be given the responsibility of operating the factory, as he has some experience of manufacturing.

'Vertical integration is the way to go in this industry – the cost savings and close cooperation with our shops will make sure the right styles are ready at all times' said the Chief Executive Officer. 'When we build up to full capacity we will be able to supply 80% of the shoes sold in our shops. I have prepared a forecasted net cash flow for this project.' (See Appendix A.)

The Marketing Director had always opposed this change in strategic direction for the business. She had said at a recent Board meeting: 'With rising disposable incomes our customers are increasingly looking for the well known global brands and just offering our own branded products will turn some of them away'. The directors agreed to use appropriate techniques to assist them make this strategic choice.

Financing decision
The Finance Director has been worried about the financial implications of rapid growth. She has gathered some recent accounting data to analyse the company's gearing and liquidity (Appendix B). She might have to consider sources of finance, other than further loans and debentures, to pay the $15m required for the purchase of the four year lease of the new factory and machinery, if this option is decided upon.

Technology – a new opportunity?
The current directors have a plan to revolutionise the approach of the business to IT. The Operations Director is keen to adopt Enterprise Resource Planning (ERP). He has said that: 'ERP software will allow us to track all orders to suppliers, the delivery of stock and the sale of each item. It will keep check on the progress of all orders and the sales performance of all styles. This will be particularly important if we open the factory – we will be able to keep a check on work-in-progress easily'.

The Marketing Director is looking into selling shoes through a newly designed website: 'Access to customers all over the world could double our sales rapidly and it would provide us with an instant way of communicating with potential customers', she told the FitsU marketing staff.

Product portfolio – is the balance right?
The business sells in four main market segments:
- Women's fashion shoes
- Sports shoes
- Children's school shoes
- Men's formal shoes.

The Marketing Director has obtained the data shown in Appendix C about these market segments.

The Marketing Director planned to analyse these data by using Boston Matrix analysis but workload had prevented her from doing this. The rapid expansion of FitsU was putting all directors under much pressure.

Appendix A: Forecasted Net Cash Flows, $m

End of year	New factory
0	(15.0)
1	4.5
2	4.5
3	6.5
4	6.5

10% discount factors:
Year 1 0.91
Year 2 0.83
Year 3 0.75
Year 4 0.68

Appendix B: Accounting data for FitsU

	As at: 31 May 2010	As at: 31 May 2011
Accounts receivable (Debtors) $m	24	32
Inventories (Stocks) $m	35	38
Cash $m	4	1
Current liabilities $m	65	88
Capital employed $m	200	215
Non-current (Long-term) liabilities $m	85	100
Gearing ratio %	42.5	
Acid test ratio	0.43	

Appendix C: Shoe sales and market growth data

	Growth of national sales in this sector between 2008-2010	Total national sales in each segment in 2010 $m	FitsU sales in each segment in 2010 $m
Women's fashion shoes	30%	250	150
Sports shoes	2%	50	5
Children's school shoes	13%	100	20
Men's formal shoes	1%	80	40

Section A

Answer **all** questions in this section.

1 Analyse the advantages to FitsU of increasing the use of technology in marketing and operations management. [10]

2 **(a)** Using data in Appendix A, calculate for the factory project:

(i) The Average Rate of Return (ARR) [4]

(ii) The Discounted Payback Period. [4]

(b) Comment briefly on the likely accuracy of the net cash flow data in Appendix A. [4]

(c) Discuss, using your results to **(a)** and other information, whether FitsU should open the shoe-making factory. [12]

3 **(a)** Using data in Appendix B, calculate for year ending 31st May 2011:

(i) The acid test ratio [3]

(ii) The gearing ratio. [3]

(b) Assume the decision to build a new factory is taken. Discuss whether the business should raise the finance required for the new factory from additional long-term loans. [8]

4 Discuss how the company should respond to the data in Appendix C, using Boston Matrix analysis to support your judgements. [16]

5 Evaluate the most appropriate Human Resource strategies that FitsU could adopt to increase staff motivation without increasing the unit costs of sales. [16]

Section B

Answer **one** question in this section.

6 Evaluate the usefulness of strategic choice techniques that FitsU directors might use in making the decision to manufacture shoes. [20]

7 Discuss the importance of effective management of change to the future success of FitsU. [20]