

General Certificate of Education
January 2004
Advanced Subsidiary Examination

BUSINESS STUDIES
Unit 3

BUS3



Monday 12 January 2004 Afternoon Session

In addition to this paper you will require:

- a clean copy of the Case Study (enclosed);
- an 8-page answer book.

You may use a calculator.

Time allowed: 1 hour

Instructions

- Use blue or black ink or ball-point pen.
- Write the information required on the front of your answer book. The *Examining Body* for this paper is AQA. The *Paper Reference* is BUS3.
- Answer **all** questions.
- Do all rough work in the answer book. Cross through any work you do not want marked.

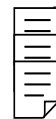
Information

- The maximum mark for this paper is 53.
- Mark allocations are shown in brackets.
- You will be assessed on your ability to use an appropriate form and style of writing, to organise relevant information clearly and coherently, and to use specialist vocabulary, where appropriate. The degree of legibility of your handwriting and the level of accuracy of your spelling, punctuation and grammar will also be taken into account.
- Up to 3 marks will be awarded for the quality of your written communication.

Answer **all** questions.

- 1 Outline how *King and Dillworth Ltd* might benefit if the directors start next month's Board meeting by discussing and reaching agreement on their company aims. (6 marks)
- 2 The section of the Case Study headed "**Item 3**" contains evidence of potentially unfair competition by the larger building companies. Explain why such behaviour is regarded as unethical. (8 marks)
- 3 To what extent might *King and Dillworth Ltd's* future be affected by a fall in interest rates **and** a 10% fall in the external value of the pound during this year and next? (15 marks)
- 4 Some commentators hold the view that government action to protect consumers is unnecessary. Explain the evidence from the Case Study that supports this view. (6 marks)
- 5 Discuss whether the directors of *King and Dillworth Ltd* should carry out a full SWOT analysis of the business before the next Board meeting. (There is no need to include a SWOT analysis in your answer.) (15 marks)

END OF QUESTIONS



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ASSESSMENT and
QUALIFICATIONS
ALLIANCE

BUSINESS STUDIES
Unit 2 and Unit 3

BUS2&3/PM

Case Study

To be distributed to candidates no sooner than Monday 17 November 2003

NOTICE TO CANDIDATES

You will be given **one** copy of this Case Study for use during your preparation for the examination, which you may annotate as you wish, but which you will **not** be allowed to take into the examination.

You will be provided with a clean copy of the Case Study, along with the question paper, for use in each examination.

You are advised to carry out your own research using this Case Study. It is the business concepts and ideas raised by the Case Study which should be researched. The company referred to in the case is fictitious.

Your teacher is encouraged to give assistance and advice as required.

King and Dillworth Ltd

A. The company

King and Dillworth Ltd is a small building company based in North West England which specialises in home improvements such as replacement windows, extensions and conservatories. The company was formed in 1984 when two businesses joined together. Paul King, a sole trader specialising in small-scale domestic building work, wanted to expand more quickly than organic growth appeared to allow. Nick Dillworth, the owner of a successful company making and selling replacement windows, was looking to protect his business by moving into a broader range of construction work. The new company looked perfect for both sides, but differences in objectives and approach quickly emerged. Disagreements between Paul King and Nick Dillworth, the two largest single shareholders in the new limited company, were frequent, fierce and prolonged. The rest of the directors tended to side with one or other of them.

The most significant source of income for the company is the manufacture and installation of replacement uPVC windows. This range of products accounts for 70% of the company's annual turnover, which was £2.25 million in the last financial year. On average, customers pay about £3 000 for a set of replacement windows and the gross margin is approximately 50%. The company currently makes its own windows, buying materials for the frames from a range of local suppliers. Glass is imported from a manufacturer in Luxembourg. Fixed costs are high, in particular advertising and marketing expenditure, head office salaries and overheads. Net margins have been around 10% for many years, but, for the last few years, rising fixed costs and the costs associated with quality problems have reduced profitability. Currently, net margins are between 5% and 7%. With high fixed costs, maintaining a high level of capacity utilisation is crucial. The directors are aware that even small reductions in turnover can cause significant reductions in profitability. There has been very little growth in sales of replacement windows in the last 18 months.

Although they represent only a relatively small proportion of turnover, conservatories are the company's most profitable product and are the fastest growing area of sales. This segment of the market has grown partly because of consumers' rising incomes and partly as a consequence of rising house prices, which has meant that many people are deciding to build an extension or conservatory rather than move house. Low interest rates have made borrowing more attractive so some people are choosing to finance their conservatories through debt. This borrowing is often secured against rising property values through second or increased mortgages. All customer orders are paid in full on completion which, together with the 30 or 60 days' credit the company gets from its suppliers, helps to maintain a healthy cash flow.

Over the last 20 years, *King and Dillworth Ltd* has developed an excellent reputation for quality, reliability and after sales service. They are not the cheapest in the area and rarely compete purely on price. Approximately 30% of customer orders are from direct recommendations and a particularly successful strategy has been to mailshot addresses in an area where work is currently being carried out. In the past, this has resulted in a number of additional orders from people in the surrounding streets who see the work being carried out and respond to the leaflet dropped through their letterbox. In recent years, however, this source of work has declined. The company's budget for advertising and marketing has risen sharply over the last few years and is spent mainly on mailshots and local press and radio advertising. Although historically the company has had a good reputation, a growing number of production and installation problems have started to emerge and are damaging the company's reputation.

In total, there are 35 employees (see **Appendix 1**, for a diagram showing part of the hierarchy). There are 12 installation staff, who work in six teams of two, installing windows or constructing conservatories and extensions. They are managed by the Production Manager. As Operations Director, Paul King's span of control includes the Production Manager and the six manufacturing workers who construct the window frames at the company's head office. All manufacturing and installation staff are paid a basic monthly wage, with bonuses for achieving manufacturing and installation deadlines. The sales department is made up of four canvassers who telephone or knock on doors and attempt to arrange appointments for one of the four sales consultants to visit the house and advise the customers about the company's products. It is company policy to avoid "hard sell" tactics that other companies may adopt, and the sales staff are told not to place undue pressure on potential customers. This policy has meant that *King and Dillworth Ltd* has lost sales to the competition, but in the long run the directors feel it has added to its reputation as a trustworthy company. The Sales Director manages this area of the business. Sales staff are paid on a commission-only basis, which is a percentage of the value of the sales they make.

The Head Office has eight administration staff who report to Nick Dillworth, the Managing Director, and who are responsible for finance, personnel and general clerical support. These workers are salaried.

In addition to Nick and Paul, there are a number of other people on the Board who were present at the formation of *King and Dillworth Ltd*. The Finance Director advised Paul and Nick on the original business plan and helped to solve some of the early problems of a business start-up, including advising Paul on the benefits and drawbacks of limited liability status. He is a close ally of Nick's and tends not to want to take risks. The Sales Director, on the other hand, supports Paul's attempts to modernise the company (see **Appendix 2**, for the equity structure of the company).

The agenda for today's Board meeting contains only three items, and all of them would be fiercely argued. Nick Dillworth began the meeting by saying: "These items are really about the corporate aims of the business. Today's decisions are about the long-term objectives of the company."

Turn over ►

B. The Board Meeting

Item 1: Human Resource Issues

For this item, the Board invited the Production Manager. He is a close ally and friend of Nick's, as well as being the longest serving employee. He has been with *King and Dillworth Ltd* since the beginning and had worked in Nick's previous company. As Operations Director, Paul King does not enjoy being the Production Manager's line manager and their management styles often clash. Paul complains that the Production Manager resists all Paul's attempts to delegate and that all attempts to consult result in a list of reasons why innovations will not work. The Production Manager, on the other hand, feels that Paul is too keen on change for its own sake. He complains that Paul is: "always giving me more jobs and taking me away from my main priority, keeping a close eye on the workers on the sites".

The Production Manager's presentation to the Board began on familiar territory. "The on-site teams are not working as hard as they could. As the company has grown, I've found it more difficult to control and lead them the way I used to in the old days. We've now got six teams at different locations at any one time and I can't be everywhere at once. I've got to keep a close eye on these lads or they'll take advantage."

For the last few years, the Production Manager has argued for the appointment of supervisors who could lead the installation teams on site. This would allow a closer eye to be kept on the workers and would give him the chance to concentrate on other aspects of his job such as stock control, quality control and the planning of jobs. All the Board agreed that something needed to be done to solve the series of manufacturing and installation problems that had emerged over the last few months.

The problem most worrying the Board was the rising number of faulty windows fitted recently. Also, the installation workers seemed reluctant to return to customers to put right the faults. Quality craftsmanship has been a key feature of *King and Dillworth Ltd's* reputation built up in the early years, but customer complaints have increased. A recent market survey by the Sales Director revealed that a reputation for poor quality and a failure to repair defects quickly were resulting in a loss of customers to the competition. This failure to deal effectively with "remedials", as they are known in the industry, was damaging the company's reputation. For the first time in years, the number of recommendations was falling.

The Finance Director saw the financial implications of appointing supervisors. "Look, we've always resisted making the organisational hierarchy taller. In fact, we've gone through a process of delayering in all areas apart from production. I can't see the financial justification for another level in the structure. We've already got very high fixed costs and management salaries are easily the largest component." The other directors were also very aware of the way that labour costs had risen, both in absolute terms and as a proportion of total costs, in each of the last three years.

"It might have a positive motivational effect," accepted Paul King. "Job enrichment would be giving more responsibility to the supervisors and we could give them financial rewards based on their team's performance."

"I think Paul's got a point about motivating the workers," said the Sales Director, "but I thought we'd moved away from performance-related pay because of all the problems we had last time." There was agreement around the table as everyone remembered the difficulties of introducing an acceptable performance-related pay scheme. "We need to introduce more flexibility into the teams and to encourage the workers to take on a range of jobs and be willing to work in more than one team."

At that point, Paul King made an alternative proposal. "I suggest we investigate the different ways we could reward the teams, including ways of enabling all employees to share in the decisions of the business and be able to contribute to its improvement. Without a new approach here, there's no way we'll be able to introduce the changes to production methods that we're about to discuss under Item 2."

Item 2: Operations Management Issues

A week before the Board meeting, Paul had distributed proposals to change some aspects of production to maximise efficiency and bring down costs. The company had been successful during the boom years, but had suffered particularly badly in the recession. Paul and some other directors did not feel the company was in a fit enough state to deal with a reduction in turnover if the local economy suffered a slowdown. They also felt that a reduction in capacity utilisation would severely affect its profitability.

Paul's plan has three key elements.

1. Reduce stock levels of building materials for conservatories and extensions to the absolute minimum and purchase the materials needed to install the windows only as and when needed. Purchase stocks from a small number of suppliers.
2. Delegate authority for quality control and quality assurance to the on-site teams, allowing them to set their own targets for: completion time, material usage and wastage levels and customer satisfaction. Discuss the introduction of Quality Circles.
3. End production of their own uPVC windows and sub-contract the manufacture to another company. This would allow *King and Dillworth Ltd* to sell or lease out a large part of the warehousing and production space.

Paul argued that reducing stock would release cash for other purposes. Others argued that the business would lose bulk buying discounts if they moved to more frequent, smaller orders. "Anyway, I don't trust our suppliers to get it right if we make it more complicated," argued Nick. "We've fought for years to drive prices down. I don't want to tie myself to one or two suppliers who'll let me down."

Paul pointed out the benefits of forging closer links with a smaller number of suppliers and of staying loyal to preferred supply partners, but Nick and a few other Board members were worried about exposing the company to risk, especially as they were about to consider a major expansion.

As far as the second part of the plan was concerned, Nick was convinced that the on-site teams did not possess the skills, time or inclination to check their own work. The Finance Director agreed that it was a bad idea, pointing out the initial costs involved in setting up such a system and the potential cost of poor quality work being allowed to go through. "Think of the legal consequences if just one poorly constructed job went unchecked," he argued.

Thirdly, sub-contracting the manufacture of windows would be a major change. "Think of the cost involved in making the manufacturing staff redundant and the legal implications," argued Nick. The warehouse was purchased by means of a commercial mortgage early in 1988 as a way of taking advantage of the boom in construction at that time. It had not always seemed such a good idea since, as the construction market had fluctuated in line with the business cycle. Questions were asked about the fact that at the same time as the warehouse purchase, the entire office IT system was upgraded with little prior thought to the training needs of the staff expected to use it. It is a complaint amongst some Board members that Nick continues to insist that office staff receive software and hardware upgrades whenever they become available. Paul feels this particularly keenly as the production staff complain of a lack of investment in their areas.

Despite the reservations of some of the Board, it was decided that the plan had sufficient merit for further study and consideration. The Board agreed that Paul should produce a more detailed feasibility study presenting final proposals at next month's meeting. It was not the total acceptance that Paul had hoped for, but he was relieved the plan was still alive. He was determined to collect hard evidence to prove his plan was the way forward.

Turn over ►

Item 3: The Proposed Contract with Irkvale Homes plc

Two months ago, discussions had begun between the directors and their opposite numbers on the Board of Irkvale Homes plc to explore a joint venture. *King and Dillworth Ltd* would be sub-contracted by Irkvale Homes plc to work on its large-scale house building projects throughout the North West. The plan was that *King and Dillworth Ltd* would be contracted to supply and install uPVC windows, doors and conservatories in houses built by Irkvale Homes plc.

Nick was enthusiastic about the idea, whilst Paul and the Finance Director had reservations. Irkvale Homes plc was the largest domestic house builder in the North West, with a multi-million pound turnover and a reputation for fierce competition and cost cutting. The Sales Director had initiated the joint venture through a personal contact with Irkvale Homes plc and was very committed to the proposal. She began by referring the Board to data she had collected on the market conditions facing *King and Dillworth Ltd* at present (see **Appendix 3**). She felt that *King and Dillworth Ltd* needed to enter new markets and expand or be swallowed up by the larger competitors in the area. "Let's face it; we're not big enough or strong enough to survive. Everyone in this area knows that even at the best of times there's excess capacity in this industry. We need to be in a position to protect ourselves against our larger rivals." She also pointed to a recent survey by Dunn and Bradstreet that showed that there had been a 7% increase in business failures in 2002. "Over 42 500 UK businesses went under last year and over half of those failures were small businesses like ours," she said.

It was true that Irkvale Homes plc had emerged as the dominant firm in an area where the three largest building companies accounted for over half the total market. The remaining 42% was accounted for by many relatively small companies like *King and Dillworth Ltd* who found it difficult to compete against the big three. This situation was made worse, allegedly, by a suspicion amongst the smaller firms that the big three were acting to stifle competition and acting in collusion, an allegation never proven and one denied strongly by the Boards of all three firms.

Many of the Board members of *King and Dillworth Ltd* also felt that the present economic conditions provided evidence of a potential growing market for new houses in the North West and that the company should take advantage of the economies of scale made possible by the joint venture (see **Appendices 4 and 5**). "We'll never get the kind of large-scale orders possible here by working alone," said the Sales Director.

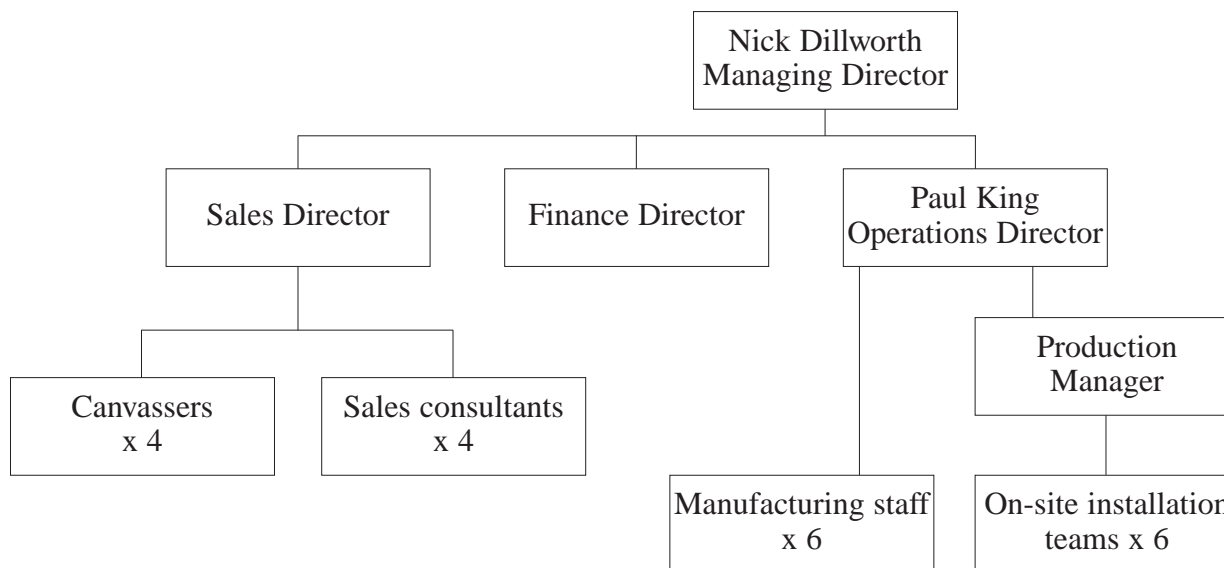
The Finance Director was particularly worried about the implications for the firm's labour needs in the medium term, pointing out that the firm would need more workers, and possibly a wider skills base. This had significant implications for workforce planning and for the training budget. "We've never had this sudden growth before and we've never planned ahead for our labour needs, relying instead on gradual growth and recruiting people as and when we need them. I think now is the time to match our labour needs with our long-term objectives."

"I can see the commercial potential of this deal, but I'm worried it will completely change the corporate culture of the business," argued Paul. "You know that Irkvale Homes plc's construction site workers are all sub-contracted from other firms such as ours. They don't have any of the legal responsibilities to those workers that we do to our site workers." Paul had long known of Irkvale Homes plc's reputation as a tough employer keen to drive down costs. "I think this might destroy our relations with the production staff even further."

It was clear that a decision was not going to be possible at today's meeting, although there was sufficient interest in the venture with Irkvale Homes plc for the Board to agree to Paul going away and carrying out a full strategic review of the company's current position and the likely costs and benefits of agreeing to the deal with Irkvale Homes plc.

Today's Board meeting had not quite been the defining moment in the company's development. Perhaps next month's meeting would prove to be far more significant.

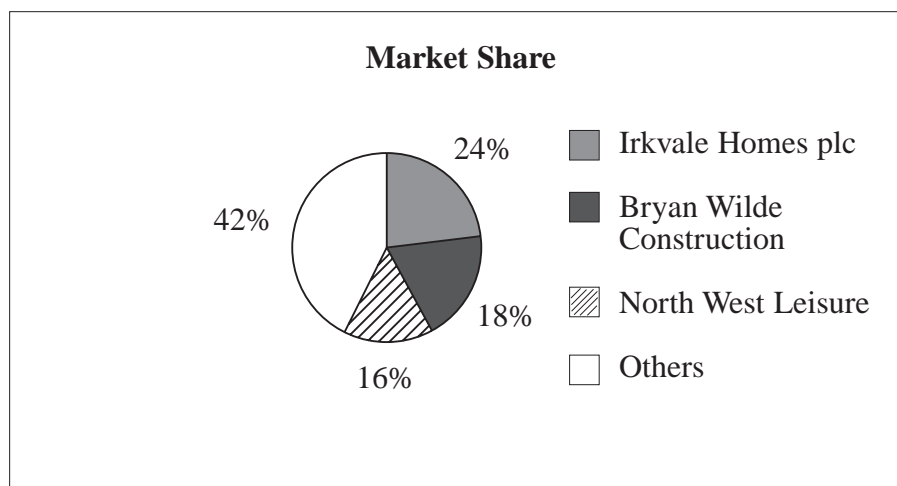
Appendix 1: Extract from Organisational Chart for King and Dillworth Ltd



Appendix 2: Equity Structure of King and Dillworth Ltd

Shareholder	% of total equity
Dillworth	22
King	15
Sales Director	10
Finance Director	10
Others	43

Appendix 3: Market Share in the House Building and General Construction Market (North West England)



Turn over ►

Appendix 4: Latest Selected Economic Data for North West England and the UK

Indicator	UK	North West
Real GDP per head	£12 972	£11 273
Unemployment (%)	5.2	5.6
Capacity utilisation rates of construction companies	72%	65%
New house builds (last quarter increase from last year)	7%	9.8%

Appendix 5: Forecasts for the UK Economy

Indicator	Average of forecasts for this year	Average of forecasts for next year	Average of forecasts for 2 years' time	Average of forecasts for 3 years' time
Real GDP growth (%)	1.6	2.6	2.9	2.6
Headline inflation (%)	1.7	2.6	2.8	2.4
Underlying inflation (%)	2.2	2.3	2.2	2.3
Interest rates (%)	3.0	3.5	3.25	3.0
Unemployment (million)	0.96	1.0	0.9	1.0