

OXFORD CAMBRIDGE AND RSA EXAMINATIONS
A2 GCE

F248/01/CS

APPLIED BUSINESS

Strategic Decision-Making

CASE STUDY

To be opened on receipt

THURSDAY 14 JUNE 2012: Afternoon

DURATION: 2 hours

plus your additional time allowance

MODIFIED ENLARGED

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FONTANE LTD

THE BUSINESS

FONTANE LTD is a specialist manufacturer of domestic-sized chocolate fountains. The company has been trading for six years and supplies chocolate fountains for retail all over the world.

Whilst many mass producers have traded quality for lower prices and increased sales, FONTANE LTD has resisted this urge. Instead, as a matter of policy, it manufactures high quality chocolate fountains made almost entirely of stainless steel. Superior to plastic, the seamless high gauge stainless steel gives a smoother flow to the chocolate and better durability than most of the models on the market. FONTANE LTD has managed to secure increasing orders year on year. The secret of its success lies partly in the engineering skills of its owners and partly in the extensive high-end branding which the company has undertaken.

THE BACKGROUND

The idea to set up the business began in February 2005 when four BSc engineering students took a short break in Las Vegas. On their first evening in the city, Alhad, Boe, Carl and Rachel heard about a new chocolate fountain at Belaggio's Patisserie. They visited the patisserie for lunch the following day, and were amazed at what they saw – the world's largest chocolate fountain standing over eight metres tall and circulating over 950 kg of luscious chocolate. It was an amazing structure, befitting of even the best engineering student!

Back in the UK the students continued to marvel at the feat of engineering they had seen. Carl even designed a smaller chocolate fountain, similar to the one which they had seen in Las Vegas, as part of his degree project. This smaller version gave the young engineers an idea. After their graduation they would go into business together manufacturing chocolate fountains.

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Within six months of completing their studies they had managed to test the prototype, carry out thorough market research, finalise the design, produce a business plan, secure finance and lease a factory unit on an inexpensive site in Cornwall. Rachel recruited the necessary staff and in January 2006, full-scale production began.

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FONTANE LTD recorded its first trading profit in 2009 and now has reserves totalling £140 000. The factory produces around 150 chocolate fountains a day. The company sells the chocolate fountains in bulk to wholesalers, importers and retailers across the globe for around £35 each. FONTANE LTD'S chocolate fountains command a retail price in excess of £80 per fountain (or currency equivalent) on general sale.

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Alhad, Boe, Carl and Rachel remain the only four shareholders, each holding 25% of founders' shares with voting rights. Rachel, FONTANE LTD'S Managing Director, is the only shareholder still working in the business. In addition to Rachel, the company has 34 full-time employees on its payroll. Rachel is preoccupied with the need to keep control. She worries about the production line breaking down, staff absence, productivity levels and profit margins. She sets the organisation goals and regularly monitors its performance.

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THE TROUBLE

Food grade stainless steel is sourced from China. FONTANE LTD benefited from low metal prices caused by the worldwide recession in 2008/2009, but since then prices of stainless steel have risen steadily. Like the state of the economy, commodity prices are beyond FONTANE LTD's control. **65**

Over 80% of FONTANE LTD's sales are to export markets. The majority of orders come from Western Europe, China and Japan. The dual voltage motor specifically designed by Carl to power all of FONTANE LTD's chocolate fountains makes the product especially popular in Japan where, due to the lower mains voltage, most competitor models will not operate. **70**

FONTANE LTD relies heavily on its export markets for growth, but fluctuating exchange rates always make growth unpredictable. Sterling exchange rates have been so volatile in the last few years that the four shareholders no longer believe that market penetration alone will secure the company's growth. **80**

The shareholders are, therefore, considering the following options.

THE OPTIONS

OPTION 1 – ADDITIONAL APPLIANCES

Extend the product range by producing other ‘fun food’ homeware appliances such as popcorn makers, candy floss machines, electric fondues, hot dog grills, doughnut makers and ice cream machines. The appliances would be branded to target the high end of the market and trade on FONTANE LTD’s reputation for excellent design and quality products.

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A second factory unit would need to be leased, fitted out and staffed. At an estimated cost of £440 000 FONTANE LTD would need to use all of its reserves and, in addition, take out a three year business expansion loan of £300 000. Capital investment appraisal for this option indicates a payback period of 3¼ years, with an ARR (accounting (average) rate of return) of 52% over six years.

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OPTION 2 – COMMERCIAL FOUNTAINS

Concentrate solely on chocolate fountains but, in addition to the domestic-sized fountains, make a range of larger, more powerful fountains for commercial use. These commercial chocolate fountains could be made in a variety of sizes up to 1½ metres tall to suit the event being catered for. Functions as diverse as wedding receptions, engagement parties, birthday celebrations, anniversaries, school proms, concerts, corporate hospitality, festivals, fayres and charity events could benefit from the addition of a commercial-sized chocolate fountain. The cost of adapting the existing factory unit to make the larger fountains is minimal and likely to come to no more than £30 000.

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FONTANE LTD could make the commercial fountains available for sale (option 2a) OR for hire (option 2b) and the shareholders need to consider each of these alternatives separately. **115**

OPTION 2A – SELLING COMMERCIAL FOUNTAINS

The ‘for sale’ route would require the employment of an additional sales representative and the production of promotional materials. With an estimated additional cost of £30 000, the total spend of £60 000 on this option route could be easily funded from reserves. Capital investment appraisal for this route suggests a payback period of just over two years, with an ARR of 100% over six years. **120**
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OPTION 2B – HIRING COMMERCIAL FOUNTAINS

The ‘for hire’ route would be a more significant departure from FONTANE LTD’s current operations. It would require not only the supply of the machines but also the provision of a personalised service. The correct size of chocolate fountain would need to be supplied on the correct day, at the correct time and to the correct venue. Colour co-ordinated tablecloths and napkins would need to be provided, along with the customer’s choice of chocolate and dipping foods. For a complete service, staff may even be required to operate the machines during the event. Complex administrative systems would need to be created and a website for bookings designed. With an additional cost of £90 000, the total spend of £120 000 on this option route would use up almost all of FONTANE LTD’s reserves. Capital investment appraisal for this route suggests a payback period of just over 1½ years, with an ARR of 67% over six years. **130**
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THE DECISION-MAKING PROCESS

The shareholders intend to decide which one of the options to take (option 1, 2a or 2b) at their next shareholders' meeting. Rachel, who strongly favours option 2a – selling commercial fountains – thinks that it would be a good idea to use a decision tree to help discuss the options at that meeting. None of the shareholders has ever used a decision tree before but they are willing to try.

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Whichever option (1, 2a or 2b) the shareholders choose, the production of domestic-sized chocolate fountains will continue uninterrupted and an integrated marketing strategy will be needed.

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APPENDIX 1

CHOCOLATE FOUNTAINS

There are two types of chocolate fountain: the home chocolate fountain for personal use and the commercial chocolate fountain.

Home chocolate fountains range in size up to 48 cm tall. They are generally made of plastic with stainless steel components. Higher quality models are made almost entirely of stainless steel and are more highly priced. These home fountains will hold up to 2.7 kg of chocolate.

Commercial chocolate fountains are stainless steel works of art! The smallest commercial fountain is around 0.5 m high, whilst the tallest chocolate fountain (UK model) is about 1.45 m high. The largest can hold up to 35 kg of chocolate, more than enough for the chocoholics among us! Commercial chocolate fountains are now commonly used at parties, corporate events, weddings and charity functions.

APPENDIX 2

UK MARRIAGE STATISTICS

Fewer people are getting married than at any time in more than 100 years. A total of 232 990 couples tied the knot in 2008 – down from 235 370 in 2007 and the lowest total since 1895.

APPENDIX 3

CONSUMERS STAY AT HOME MORE, AND THE HOUSEWARES INDUSTRY TAKES NOTE

As the recession takes a toll on most businesses, the housewares industry is actually expecting to see some benefit as more consumers eat, entertain and generally spend more time at home in order to save money.

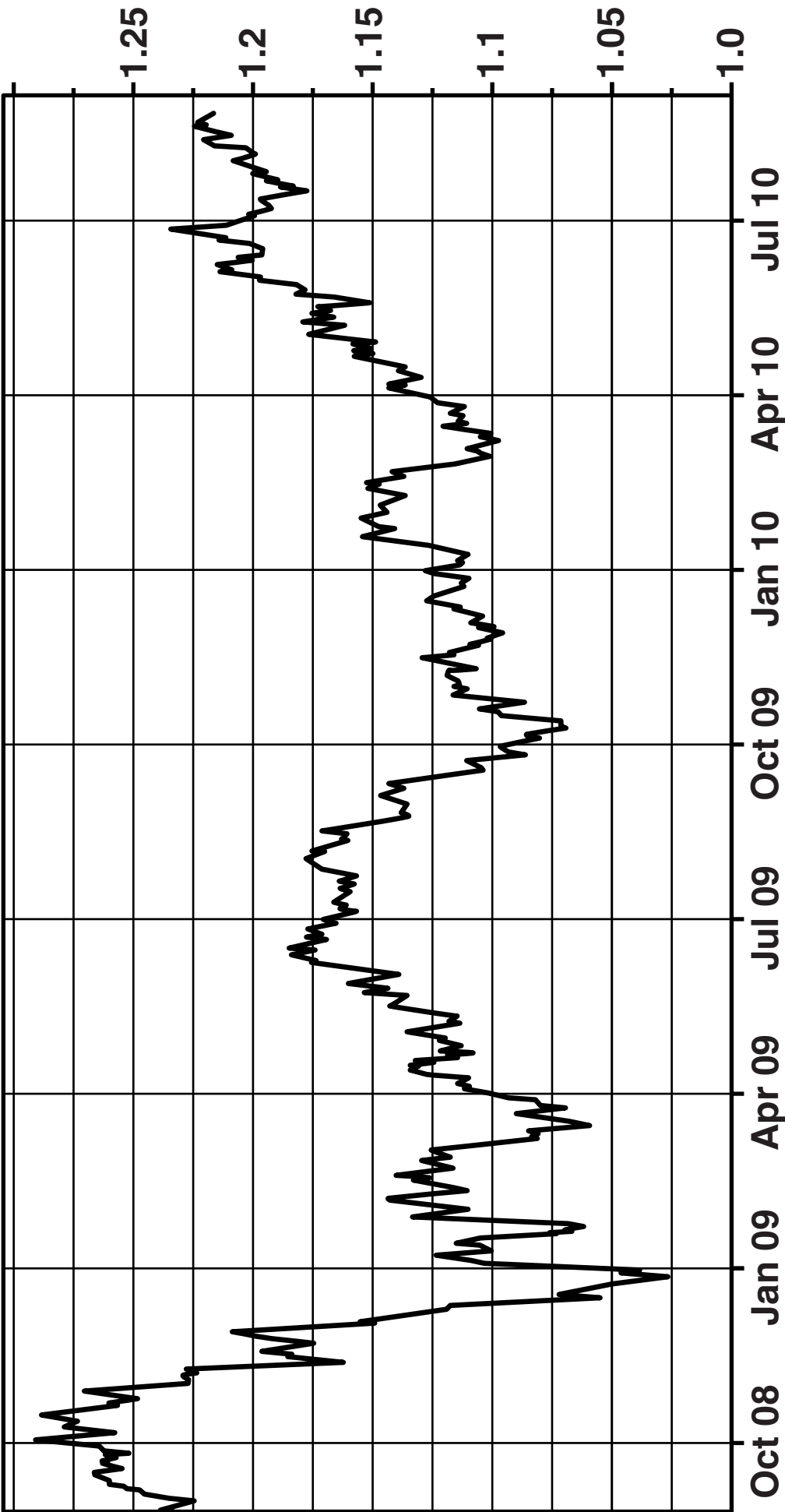
“If you’re staying at home more, you’re entertaining more at home. It’s a real opportunity for our industry to reconnect,” said Tom Mirabile, Vice President of Global Trend and Design for Lifetime Brands. “Consumers in the past have wanted it done for them. That’s changing – especially in the kitchen.”

CHANGING COOKING BEHAVIOURS AND ATTITUDES

- **The kitchen is a key social location**
- **Entertaining at home is widening in popularity**
- **Young adults are increasingly fuelling the entertaining at home trend**
- **Family mealtimes built around home cooking are resurgent**
- **Younger consumers value cooking ability by the level of creativity**
- **The dinner party market is strong**

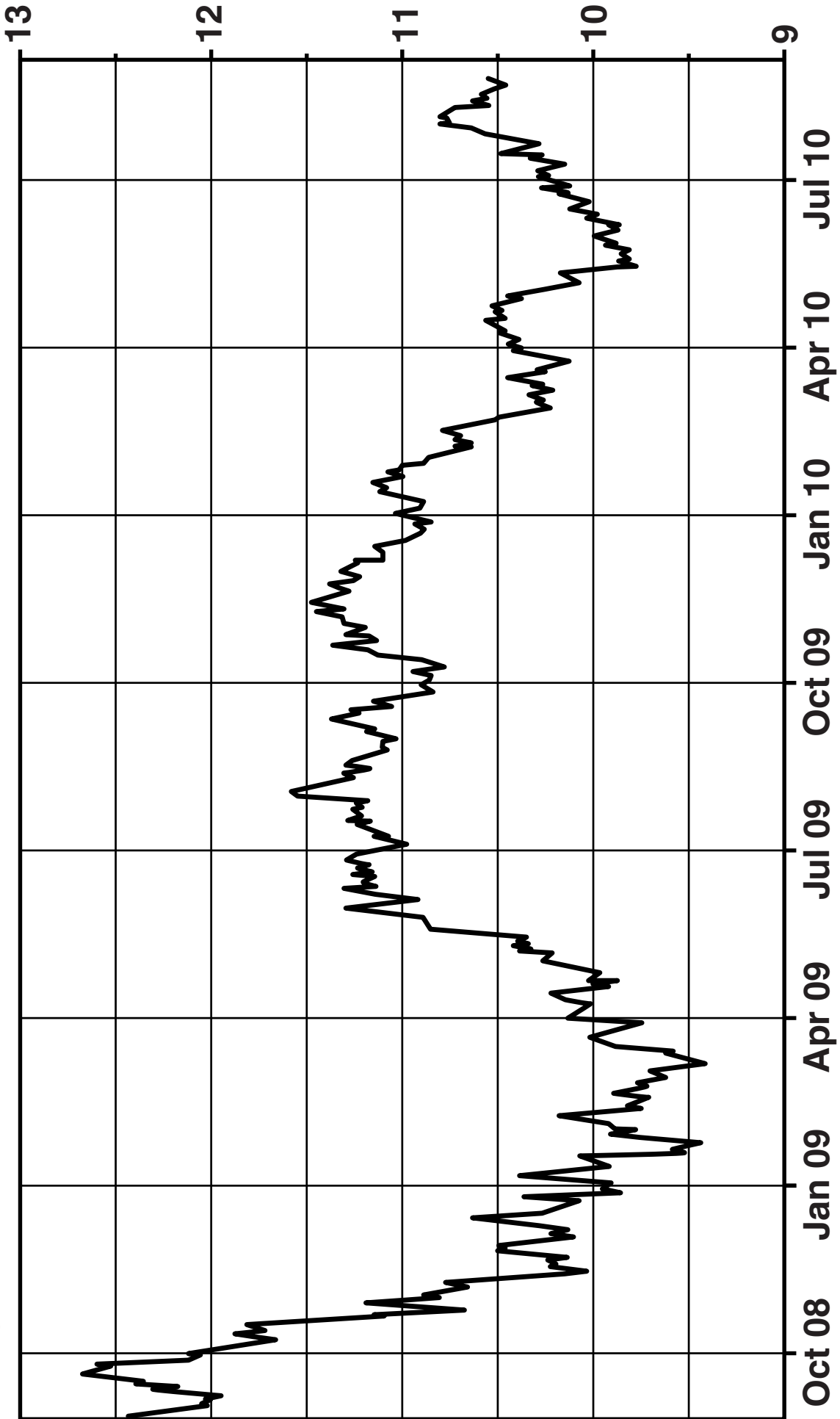
APPENDIX 4 – UK POUND STERLING (GBP) EXCHANGE RATES

GBP/Euro
exchange rate



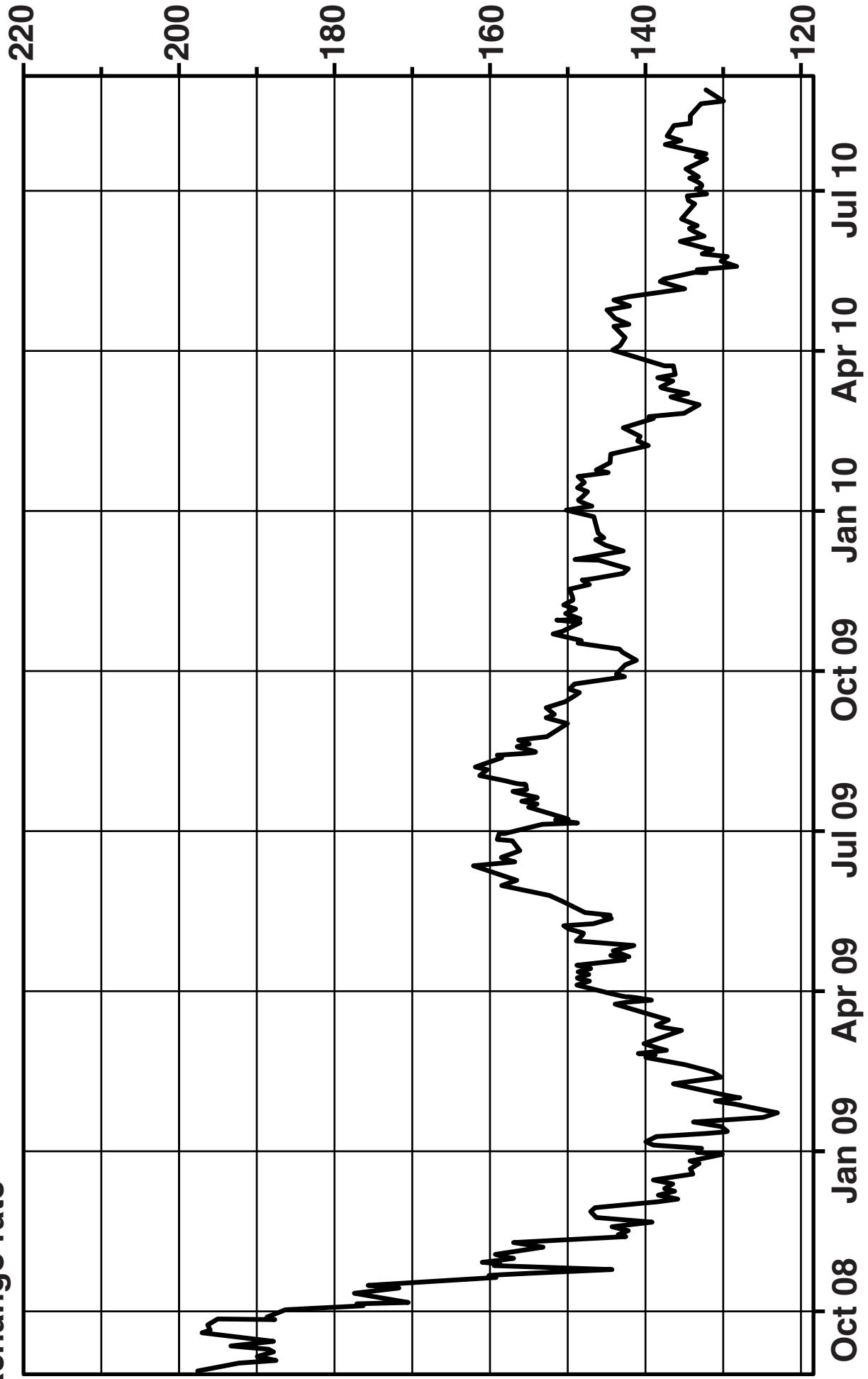
APPENDIX 4 – UK POUND STERLING (GBP) EXCHANGE RATES

GBP /
Chinese Yuan
exchange rate



APPENDIX 4 – UK POUND STERLING (GBP) EXCHANGE RATES

GBP /
Japanese Yen
exchange rate



END OF CASE STUDY

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