OCR
RECOGNISING ACHIEVEMENT

ADVANCED GCE UNIT **2880**

BUSINESS STUDIES

Business Strategy

THURSDAY 14 JUNE 2007 Morning

Time: 2 hours

Additional materials: Answer Booklet (16 pages)

Candidates may use calculators in this examination

CUP/T37893

INSTRUCTIONS TO CANDIDATES

- Write your name, Centre Number and Candidate number in the spaces provided on the answer booklet.
- Answer **all** the questions.
- Write your answers on the separate answer booklet provided.
- If you use extra sheets of paper, fasten these sheets to the answer booklet.
- Read each question carefully and make sure you know what you have to do before starting your answer.

INFORMATION FOR CANDIDATES

- The number of marks is given in brackets [ ] at the end of each question or part question.
- The total number of marks for this paper is 80.
- You will be awarded marks for the quality of written communication where an answer requires a piece of extended writing.
- This is a synoptic paper. When answering each question you must use the knowledge and skills gained throughout the whole A-level course.

This document consists of **8** printed pages.

SP MML 12906 3/06 T37893/2 **[Turn over**

Answer **all** the questions.

1 To what extent might an increase in interest rates affect the achievement of BBY's 2008 objectives? [18]

2 From the perspective of different stakeholders, was BBY's withdrawal from Tabakistan a sound business decision? [19]

3 Enquiries by Isabel suggest Karma Cruising would be available for sale at £20 m.

Should BBY purchase Karma Cruising? Justify your view. [19]

4 Recommend whether BBY should outsource its call centre to South Africa. [20]

Big Blue Yonder (Travel) Ltd

Selling holidays used to be easy, thought Isabel Bromage, Managing Director of Big Blue Yonder (Travel) Ltd (BBY). In the post-Christmas period families used to sit down with brochures from the package tour operators and choose their two weeks in the sun. Whilst there was competition between tour operators, the reality was that customers tended to wander passively into travel agents shops and purchase from a relatively narrow range of holiday types on offer. At the turn of the millennium, 47% of all UK holidays were to either Spain or France. In the same year UK residents made about 53m overseas visits, spending in the region of £22bn. These figures rose to 61m and £28.5bn respectively in 2003. Similarly, in 2000 package holidays accounted for 55% of the market, but this fell to 47% by 2003.

Isabel used to work for Thomas Cook, a vertically integrated tour operator. At that time Thomas Cook, like other major UK tour operators, owned everything from hotels and airlines to shops. Initially, her time at Thomas Cook had been happy, and her progress from university toward senior management swift. However, in late 2000 the then owners of Thomas Cook, Preussag, sold its stake to C&N Touristic, itself jointly owned by the German airline Lufthansa and retailer Karstadtquelle. The change in ownership, doubts about the direction the new owners would take Thomas Cook and a generous severance package, meant the end of Isabel's career there. With two of the big three UK tour operators under foreign ownership, and increasing signs of consolidation in the market, Isabel thought the time was opportune to move on in the travel business. In 2001 she was invited to buy into BBY, taking an equity stake of just under 15%. Her aim was to transform BBY from a specialist niche operator into the premier travel business in its market, grow the business and then sell in order to retire before her fortieth birthday. Now, six years later, she has another two years to realise the last element of that dream. Consequently BBY has multiple 2008 objectives in preparation for floatation; including sales of £150m and ROE of 12.5%. Achieving these objectives would boost the value of Isabel's equity stake and allow her to retire in financial comfort.

With the increasing use of direct selling and the Internet, the UK travel market has fragmented. A further pressure has been the rise of the low cost airlines, making both short breaks and holiday home purchase more realistic propositions for many UK residents. However, by careful market segmentation, BBY has been able to enjoy largely uninterrupted year on year growth since its incorporation in 1987. A typical BBY customer is a white collar worker aged 45 to 70. With mortgage paid, and children largely independent, they are enjoying a period which combines relative wealth and good health. Having seen exotic destinations on the television and in their newspapers and colour magazines, their BBY holiday is the dream trip which has been the promise for several years. However, they tend not to have the confidence for independent travel, preferring to travel in small groups of like-minded people. One of BBY's selling points is the availability of expert local tour managers to "hold hands" in locations not easily accessible to individuals.

The individual elements of the holidays sold by BBY can be created through Internet research and bookings, but BBY's customers value the security that an organised tour affords. Most customers deliberately want to travel out of peak times, enjoying less crowded destinations. Many also express the desire to help in looking after grandchildren during the long school holidays. Alice Agnew, Marketing Director, knows from BBY's own research that increasing numbers of customers are identifying themselves as either Daily Mail or Daily Telegraph readers. Advertisements in the travel section of these two newspapers are a rich source of new business, brochure enquiries and website "hits". About 90% of holidays are sold direct via the telephone, the company website being primarily used by customers when seeking information about destinations and prices. By operating most holidays either side of the peak seasons, the so called "shoulder period", BBY is able to negotiate competitive prices with its suppliers. Consequently BBY's prices are highly competitive given the nature of the service being sold, see Table 1. Pricing is a key aspect of the marketing strategy and is used to support brand integrity. Hence, for example, BBY will not discount under-booked tours to the general public, as is common practice in the wider travel industry.

Table 1

Brochure sample, holiday destinations and tours				
Destination	High	Low	% of total revenue 2006	Annual growth in revenue 2005–06
China; The silk route	£2,295	£2,015	12%	+15%
The natural wonders of Costa Rica	£2,220	£1,895	5%	+12%
Ecuador & Galapagos Islands	£2,580	£2,245	5%	+5%
Canadian Rockies and west coast	£1,795	£1,115	5%	–13%
Cuba; Castro's Tour	£1,800	£1,560	4%	–20%
Central Asia; Tabakistan	£1,850	£1,550	4%	+9%
Nepal; walk the Himalayan foothills	£1,570	£1,345	4%	+8%
New Zealand; the hobbits' holiday	£2,575	£2,040	3%	+6%
Alaska; frozen grandeur	£2,275	£2,135	2%	+4%

Customer enquiries and bookings are handled by operators on what is known as "The flag floor". In essence a call centre, the flag floor is a sea of colour because each operator displays on the top of their monitor the flag of any country which they have personally visited. In this way when a customer calls and wants information about a specific destination, as is often the case when researching, operators are readily able to transfer them to a colleague who has direct experience. Similarly, repeat callers will often ask to speak to a specific operator. Although this is problematic for Stephen Shackleton, Operations Manager, the investment in customer relationships means BBY has a far higher conversion rate of enquiry to booking than other direct travel sales businesses.

Employees on the flag floor enjoy a number of incentives including the ability to purchase any BBY holiday at cost. Travel to BBY destinations is similarly ensured by winning The Employee of the Month Award. At peak times there might be up to 50 operators on the telephones. The Personnel Manager, Claire Wallis, works hard to achieve the 2008 target for staff turnover of 6% or less. In the year just ended BBY had 169 full time staff engaged in non-sales roles. These include brochure production, Finance and Administration, as well as Employee Support Services.

The local press has recently reported speculation that a distribution hub for a major retail chain will open in late 2008. Claire believes this could cause a labour skills shortage because competition in the local labour market is already fierce. So far BBY has managed to avoid being understaffed by investing heavily in its employees, offering a combination of pay and working conditions which is particularly attractive to working parents and college students looking for flexible hours. Call centre staff are paid an hourly rate which equates to a budgeted full time salary of approximately £16,000. However, Claire is aware that further increases in labour costs will put an unacceptable pressure on margins. Consequently, she has been investigating outsourcing the call centre aspect of BBY. Her favoured solution is to contract with Tafel Bay Telekoms pty (TBT), a Cape Town based call centre. In seeking to win BBY's business, TBT has pointed out the minimal time difference, the fact that English is an official language in South Africa and the potential for 50% saving in staff costs.

The travel industry is not without its critics. Many in the environmental lobby cite increasing air travel as being a significant contributor to global warming and the international transmission of disease, such as SARS. Others argue that tourists destroy the very cultures they seek to experience, and as such create the prospect of an increasingly homogenous world culture. In some countries, and particularly those in the developing world, there is a real tension between the apparent economic benefits of tourism and the desire to preserve unique ways of life. BBY seeks to be sensitive to local cultures in planning destinations and itineraries, but occasionally does face criticism. This is one reason why Isabel is reviewing the company's operations in the central Asian republic of Tabakistan. In the last two years there has been increasing inter-ethnic conflict. One ethnic group has started to target what they see as western interests, threatening bombing and kidnappings. Thus far no BBY tour has been affected, but Isabel feels the risk is simply not worth taking and so has decided BBY will pull out, taking a loss of £5m. In contrast, Alice says the probability of any incident is manageable and, until such time as the Foreign & Commonwealth Office (FCO), declares travel to Tabakistan dangerous, BBY's insurers will still offer cover. To support her case Alice has shown Isabel Fig. 1, whilst being aware that the FCO might change its advice given the fluidity of the situation.

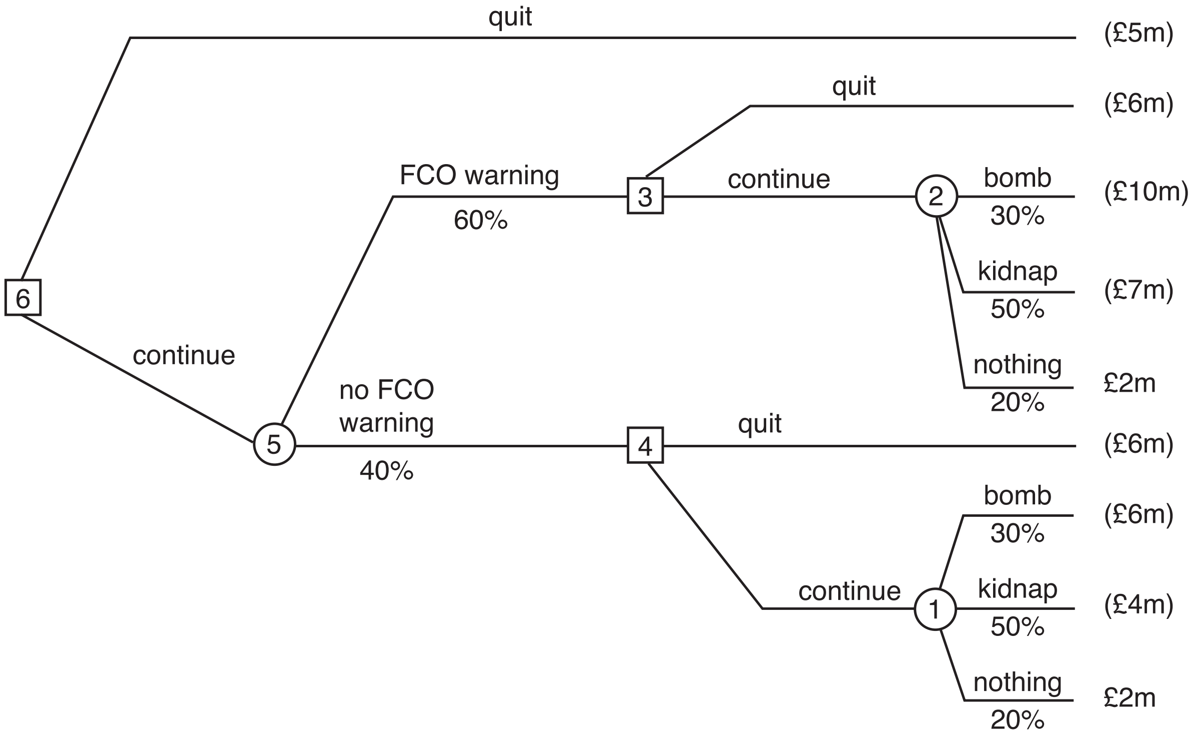

Fig. 1

What destinations BBY should offer is a source of constant debate amongst senior managers. With the UK cruise market attracting over 1 m passengers in 2004, growing at a rate of over 8% pa, and with cruise customers' average ages falling from 56.5 to 54.5 it seems an attractive market for BBY to explore. Like the travel industry in general, there has been considerable consolidation in the cruising market, leaving a few small independent operators vulnerable. One such firm is Karma Cruising, a Bradford based firm that specialises in European destinations, such as the Norwegian Fjords, the Baltic and the Mediterranean. Karma operate four ships, the largest at over 10,000 tonnes can accommodate 550 passengers. The possibility of operational and market overlap with BBY has not escaped Isabel. Karma has yet to file its 2006 accounts, so Isabel has had to rely on 2005 (2004) figures. Her ratio analysis shows ROCE of 9.1% (9.2%) and net profit margin of 1.1% (1.3%) on sales of £83m. Acquiring Karma would offer BBY about 8% savings in administration and employment. Further, the acquisition would expand BBY's database of customers from 2 m to 4 m. One downside is that the enlarged business would become split site, whilst another is the possibility of tarnishing BBY's brand image. But the acquisition would, at a stroke, achieve the 2008 growth target in a manner consistent with BBY's vision, see Fig. 2.

The BBY vision

To be the UK market leader in overseas escorted holidays for the 45+ age group

We will achieve this vision by:

- expanding our product portfolio, both organically and through acquisition, as suitable opportunities present themselves;
- building on our proven expertise in direct sales, whilst seeking other distribution channels;
- building on our core brand values: quality, care, expertise, honesty and integrity;
- sustaining industry leading margins.

Our market		
Description	Age	% of UK population
Aspirers	45–49	13.4%
Thrivers	50–59	12.6%
Seniors	60–69	9.9%
Elders	70+	11.6%

The 45+ age range is projected to grow by 27% over the next five years. This section of the UK population is thought to account for 80% of private wealth, 60% of saving and 40% of household consumption. In 2003 they spent £145 bn. Sometimes called the SKI generation (Spending the Kids' Inheritance) our target market sees no reason to stop being active because of age.

Fig. 2

Appendix 1

Big Blue Yonder (Travel) Ltd

Balance Sheets as at 1 December		**2006** **£000s**	**2005** **£000s**
Fixed assets	Tangibles (net)	4,472	4,409
	Investments	0	3
		4,472	4,412
Current Assets			
	Stock	5	5
	Debtors	5,904	5,536
	Cash	24,409	23,451
		30,318	28,992
Current liabilities			
	Creditors	23,921	23,475
Net Current assets		6,397	5,517
Net Assets		10,869	9,929
Share Capital (1)		100	100
Profit and loss account		10,769	9,829
Equity shareholders' funds		10,869	9,929

(1) Issued share capital 100,000 £1 ordinary shares

Profit and Loss Accounts for the year ended 1 December		**2006** **£000s**	**2005** **£000s**
	Turnover	131,834	117,077
	Cost of sales	118,477	104,704
	Gross Profit	13,357	12,373
	Employment costs	6,741	6,016
	Other administration	4,563	4,505
	Profit before taxation	2,053	1,852
	Taxation	339	595
	Net Profit	1,714	1,257
	Retained profit	940	940
	Dividends	774	317

Tabakistan is a fictional country used for the purpose of this Case Study only.