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A2 GCE BUSINESS STUDIES

F297/01/CS Strategic Management

PRE-RELEASE CASE STUDY

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- A clean copy of the Case Study will be given to you with the Question Paper.
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- This document consists of **8** pages. Any blank pages are indicated.

DC (AC) 60428/3

French and Harris Ltd (FHL)

French and Harris Ltd (FHL) manufactures and packages chocolates and toffee for the retail and leisure industries. Founded four generations ago, its current Chairman and Managing Director is Calum French. FHL's recent history has been characterised by falling sales and rising costs. With losses mounting there was division amongst the shareholders as to what should be done. Some shareholders, having experienced negative returns on their investment for the last four years, wanted to 'cut their losses' and, therefore, place the business into voluntary liquidation. However, another group of shareholders felt that, because the balance sheet was so weak, winding-up would mean many innocent stakeholders would lose out. To close the business would, in their view, be unethical. Further, because as shareholders they only enjoy residual returns, they would receive little or nothing on liquidation. Consequently, this group was of the opinion that the business should receive yet another injection of equity capital which might enable it to trade through to eventual profit. Eventually, in late 2011, a rights issue was agreed, which went on to raise the target of £1.5m of additional equity.

Not long after the recapitalisation, FHL's board received an ultimatum from the bank; further credit would only be made available if the board agreed to new management. After much argument amongst the shareholders, pragmatism won. So, with considerable reluctance on their part, the shareholders appointed, with the bank's agreement, Parvin Bennett as Chief Executive Officer as of 1 April 2012. Parvin is a business consultant with an accountancy background, who specialises in corporate recovery and rescue. She has been employed on a contract for an initial three years, with a sizeable bonus payable by FHL if she can return it to profit by the end of 2014.

Prior to her appointment, Parvin had engaged in some research about FHL and the confectionery industry. This included a set of accounts **(see Appendix 1)**. Her research led to a short synopsis of FHL's capability and competitive position **(see Appendix 2)**. On the basis of this evidence Parvin concluded that, despite its losses, FHL could be rescued with decisive and clear management. It was, with some delicious irony, that she reflected her task would be made easier simply because of the scale of FHL's plight. Achieving FHL's objective of a return to profit by the end of 2014 would be a challenge, but an achievable one.

Despite Parvin's preparation, her first day at FHL was something of an unpleasant surprise. The fairly anonymous looking industrial unit in Newark offered no external indication of FHL's inner turmoil. There were cars in the staff car park and a road tanker was at the goods inward bay delivering 30 tonnes of liquid chocolate. However, being a Sunday, gaining access to the plant was not easy. Indeed, it was only after the Security Guard had been persuaded to phone Calum on his mobile that Parvin was allowed into the building. What she then found worried her. First, when she eventually found a Team Leader, Jamie Power, it soon became apparent that she was not expected. Second, although Jamie was very enthusiastic about the plant and its ability to produce quality chocolate products, not a lot seemed to be happening. When quizzed on this, Jamie denied that nothing was happening, saying that the staff were, in fact, very busy, and happily pointed out some staff cleaning machinery, whilst others were moving pallets of materials and generally tidying up. Third, the most recent item on a staff notice board was dated 25 January. Looking more carefully she saw that this was about a Valentine's social.

Parvin's first few months proved to be intensely challenging, yet personally hugely rewarding. Fear can be a great lever for change, and Parvin was quick to exploit this possibility. So, she unashamedly 'bullied' several stakeholders into accepting the fact that unfavourable terms were better than no terms. Consequently, one of the first things she did was to tell FHL's landlord that it could not afford to pay the next six months' rent when due. Although met with hostility, the landlord eventually accepted the argument that to insist on the full payment, on time, would cause FHL to fail, and thus considerably reduce the chance of ever recovering any of the rent due. Similar meetings with other stakeholders bought FHL much needed time, not least from

Her Majesty's Revenue and Customs (HMRC) to whom it owed a considerable sum in VAT, National Insurance and employees' PAYE contributions. Indeed, it was during a meeting with one creditor that Parvin reflected on the benefits of not being one of the registered directors of FHL, a degree of legal responsibility and liability which Calum had not realised until she had told him.

A key objective in those first few months was to address FHL's cash position. Hence, Parvin suggested that value from a batch of incorrectly inlaid boxes could be salvaged by removing the retailer's packaging and then selling them on to local market traders as loose chocolates. Whilst this sale, in itself, did not yield a significant cash injection, Parvin's intended message was not lost on many: when things are desperate, desperate actions may be needed. Similarly, recognising that the second quarter (January to March) of FHL's year is its least active, Parvin instructed Henry Penny, FHL's Personnel Manager, to summon Andy Loch to a meeting. Andy is the Shop Steward of the recognised trade union, 'Together'. Claiming that FHL had barely enough cash for nine days of operations, and quoting a forecast of less than 38% capacity utilisation, she told Andy that Henry was cancelling all agency staff contracts and putting all FHL staff on immediate short time working. However, employees would be called back in as and when more orders were secured. Andy's reaction was one of anger and bluster, yet eventual acceptance, having been talked through an abridged set of financial data. The meeting closed with Parvin agreeing to Andy's demand for a 'root and branch' review of the pay and conditions of FHL staff in early 2013. After the meeting Henry had tried to persuade Parvin that, with so much slack in the system, now presented an ideal opportunity to engage in off-the-job staff development. Undertaking this training would make short time working unnecessary.

Parvin believes that high volume manufacture is another key to FHL's long term prosperity. She has calculated that even a relatively modest increase in annual output would be enough for FHL to break-even. Parvin believes that if FHL were to be able to operate at 95% capacity utilisation it would generate a very healthy net profit margin, although she acknowledges that this may be a long way off. Consequently, she told Charlie Walker, FHL's Marketing Manager, to go 'out there' and sell capacity. Armed with a newly designed packaging concept, Charlie managed to persuade FHL's largest customer to place an order worth £65 000.

Several months on and having secured FHL's immediate future, Parvin is now better able to engage in long term planning. Even her 'red bucket meetings' have gained acceptance amongst the senior managers (incensed that Henry's wife once called him on his mobile phone about childcare during a strategy meeting, Parvin now insists that all hand-held devices are deposited in the red plastic bucket by the door, everyone stands and meetings last no more than 30 minutes). One item currently under consideration is a £100 000 order from a budget hotel chain, Sleep Shack, to be delivered in June 2013. The order is for individually wrapped chocolates, using Sleep Shack's logo, which it would use as a simple 'surprise and delight'. Margaret Miles, FHL's Finance Director, feels that the suggested price is too low and was heard to comment that "our last accounts show a loss, so I don't see how increasing output will help, rather it'll make things worse. We should be aiming to raise prices and so margins. The contribution on this order is barely above zero, given the price they want. It's 15% below the price at which we sell a similar product to our major customer. If they found out, there would be hell to pay."

Thoughts of capacity linked neatly with the forthcoming meeting with Andy Loch. In advance of the meeting Andy had sent all board members a briefing document outlining a proposal for a 5% increase in hourly rates, a guarantee of full-time working for FHL staff, and the introduction of a £100 monthly attendance bonus. Henry feels a better solution to FHL's labour cost structure is to do away with night shift working. All remaining workers would then be placed on an annualised hours contract. He has worked out that FHL could guarantee 64 'team' staff 2500 hours per year. Henry believes this could reduce FHL's wage bill by about 60%. Further, with appropriate communication between himself and Charlie, FHL could give team employees ten days' notice about their required hours for each week. The advantages of this employment strategy were clear to Parvin, but arguably too modest. With forecast demand to be as low as £4m in some quarters of 2013, Parvin can see further advantages in having a much smaller core workforce, with agency staff being used to ‘ride the peaks and troughs’ in demand. Analysing output by team, along with other measures of employee effectiveness, gave Parvin further reason to believe FHL’s employment strategy was not quite right **(see Table 1 and Table 2)**. However, the 2011 Agency Workers’ Regulations made her wonder whether her idea had sufficient merit to make it worthwhile, not least because of the resistance it would inevitably meet, especially from Andy.

Table 1
Quarterly value of production, by production team

		Team 1 £millions	Team 2 £millions	Team 3 £millions	Team 4 £millions	Team 5 £millions	Team 6 £millions	Team 7 £millions	Total £millions
2009	April – June	1.56	1.30	1.46	1.56	1.35	1.51	1.66	10.40
	July – Sept	0.93	0.77	0.87	0.98	0.80	0.90	0.95	6.20
	Oct – Dec	0.72	0.60	0.67	0.72	0.63	0.70	0.76	4.80
2010	Jan – Mar	0.48	0.40	0.45	0.48	0.41	0.47	0.51	3.20
	April – June	1.59	1.41	1.33	1.59	1.43	1.55	1.70	10.60
	July – Sept	0.90	0.75	0.84	0.90	0.78	0.87	0.96	6.00
	Oct – Dec	0.78	0.66	0.73	0.78	0.67	0.75	0.83	5.20
2011	Jan – Mar	0.48	0.41	0.45	0.48	0.41	0.46	0.51	3.20
	April – June	1.62	1.35	1.51	1.62	1.41	1.56	1.73	10.80
	July – Sept	0.90	0.75	0.84	0.90	0.78	0.87	0.96	6.00
	Oct – Dec	0.72	0.60	0.67	0.72	0.63	0.69	0.77	4.80
2012	Jan – Mar	0.42	0.35	0.40	0.42	0.36	0.40	0.45	2.80
	April – June	1.61	1.33	1.44	1.59	1.39	1.54	1.70	10.60
	July – Sept	0.93	0.78	0.87	0.93	0.80	0.89	1.00	6.20

• All figures are rounded to nearest £10 000

Table 2
Annual (October 2011 to September 2012) team effectiveness data

	Team 1	Team 2	Team 3	Team 4	Team 5	Team 6	Team 7
Internal quality	100%	100%	95%	98%	90%	98%	97%
External quality	100%	100%	98%	100%	99%	100%	100%
Attendance	98%	100%	95%	97%	89%	94%	96%
Labour turnover	10%	0%	0%	0%	5%	5%	0%
Notifiable accidents	1	2	0	0	0	0	1

With the turnaround of FHL now seemingly underway, Parvin is finding driving further change more difficult. Hence, the impetus and agreement that something needs to be done is steadily evaporating, making her task more difficult. Reflecting on her own tactical objectives, set as an interim toward the overall strategic objective of profit by the end of the 2014 financial year, she knows that there is still work to be done. Zero defects in manufacture and packaging should be attainable. Further, setting an objective of anything other than 'nil' accidents would be ludicrous.

Looking to the future, there are continuing uncertainties about the macroeconomic environment, with a further tightening of fiscal policy a distinct possibility. However, the major economic commentators in the serious press seem unable to agree whether tax rises will actually be necessary, whilst those who do are vague about where any increase might fall and what might be the scale of any increase. Parvin is also aware that Calum has been approached by a major competitor, Hambleton Chocolates and Confectionery (HCC), about a possible takeover of FHL. Although this uncertainty might be somewhat frustrating, it is this very uncertainty which makes business so exciting for Parvin as she contemplates the remainder of her contract.

Appendix 1 Annual accounts

FHL's Profit and Loss Accounts (Income Statements) for the financial years ending 30 September

	2012 **£000s**	**2011** **£000s**
Revenue	26 252	25 002
Cost of sales		
Materials	15 044	14 327
Direct labour, including agency	5112	4868
Gross Profit	6096	5807
Salaries, administration and overheads	4304	4483
Rent	120	120
Utilities	1632	1540
Marketing and product development	96	238
Net profit before interest, tax and dividends	(56)	(574)
Depreciation	72	65
Interest	246	238
Net Profit	(374)	(877)

FHL's Balance Sheets as at 30 September

		2012		2011
	£000s	**£000s**	**£000s**	**£000s**
Fixed assets				
Equipment		2576		2471
Current assets				
Stock	3152		3322	
Debtors	4631		3869	
Cash	2		1	
Total current assets		7785		7192
Current liabilities				
Trade creditors	5642		6187	
Overdraft	1846		1542	
HMRC	1558		1745	
Total current liabilities		9046		9474
Net current assets		(1261)		(2282)
Creditors falling due after one year		1000		1000
Net assets		315		(811)
Share capital		3800		2300
Profit and Loss Account		(3485)		(3111)
Equity shareholders' funds		315		(811)

Share register, 000s shares, at £1 par value, at balance sheet date

	2012	**2011**
Calum French	950	450
Rosemary French	200	200
French Family Trust	1300	800
James Harris	450	450
Richard Harris	80	100
Lai Louis	520	0
Minority shareholders (maximum holding 50 each)	300	300
Total	3800	2300

Appendix 2 FHL's capability and competitive position

FHL

- 190 staff employed at the 120 000 sq. ft. manufacturing facility.
    1. 36 management and administration staff
    2. 7 'teams' of factory floor workers
    3. 20 factory floor workers per 'team' working a rolling shift pattern, with each team supported by a further 2 warehouse staff.
- Each 'team' works a 12 hour shift in a fortnightly cycle; working four days, two days off, working two nights, two days off, working two nights, and then two days off.
- The factory operates 24 hours, 365 days per year, with each shift manned by two 'teams'.
- Union density, 'Together', 65% amongst factory floor workers.
- Consumption, or taking, of product is a dismissible offence.
- FHL is the fourth largest private label confectionery supplier in the UK.
- FHL can supply four major product types:

	Filled Bars	**Bagged Toffee**	**Inlaid Boxes**	**Twist Wrap Assortments**
Capacity, tonnes, pa	2500	6000	3000	5000
Revenue potential, £m, pa	10	18	20	18
Estimated income elasticity of demand	1.5	–0.8	1.8	1.1

- 2011 sales gained from in excess of 20 customers.
- Largest customer represents 45% of sales revenue.
- In 2011 20% of revenue was from exports.
- Being able to label its toffee as 'English' is a significant marketing differentiator for FHL's export customers, particularly in Australia, Japan and Canada.
- Export products have a lower salt content than those aimed at the domestic market.

Industry

- UK confectionery market is thought to be worth in excess of £6bn per year.
- Major brands, including Cadbury, have an 80% market share.
- The 'own label' industry is worth £500m per year.
- Hambleton Chocolates and Confectionery (HCC) with sales of £75m and profits of £3.6m per year, is the largest supplier to the 'own label' market.
- There is estimated to be 20% excess capacity in the 'own label' market.
- Raw material inflation (annual, between 2010 and 2011); Sugar 56%, Glucose 25%, Vegetable fat 20%, Milk 15%, Packaging 18%.
- Packaged, finished product is storeable for about 90 days.
- Confectionery is not classified as a 'food' by HMRC and so is subject to VAT at the standard rate.