

OXFORD CAMBRIDGE AND RSA EXAMINATIONS
Advanced Subsidiary GCE

APPLIED BUSINESS

F242/CS

UNIT 3: Understanding the Business Environment

CASE STUDY

PRE-RELEASE MATERIAL FOR JANUARY 2006 EXAMINATION

To be opened on receipt.

INSTRUCTIONS TO TEACHERS

- This case study **must** be opened and given to candidates on receipt.

INFORMATION FOR CANDIDATES

- You **must** make yourself familiar with the case study before you take the question paper.
- You **must not** take notes into the examination.
- A clean copy of the case study will be given to you with the question paper.

This case study consists of 6 printed pages and 2 blank pages.

KEITH'S KOOKERY

Keith had worked in the catering industry since leaving college twelve years ago. He had enjoyed his job as a chef with Goodgrub Ltd but unfortunately the company had been taken over and Keith, along with most of the other employees, had been made redundant.

Although Keith received a £4 000 redundancy payment, there seemed to be few openings available within the catering industry in his locality. He wondered long and hard about his future. Should he look for a job in another occupation? In the end he decided that, with his redundancy money, and an inheritance from his grandmother, he would start up his own bakery business.

In July 2002 he bought a small bakery shop, which had existing planning permission for an extension to the kitchen area. As a fully qualified chef, Keith already held the required personal food hygiene and handling certificates. The last stage before his grand opening was to have his new premises inspected by the environmental health officer from the local council. Keith's Kookery began trading in August 2002.

As a sole trader, Keith worked very long hours, six days a week, in order to build up his new business. He also employed a college student on a Saturday to provide extra support. As the bakery flourished, Keith became increasingly over-worked.

Keith's major customers included the staff who worked in a local insurance company's call centre. Since the opening of the bakery, Liz, who worked in the insurance company's offices, had become a regular customer. Liz used to come in daily for sandwiches for herself and for other staff in the offices. If Keith was not too busy, Liz would stop for a social chat. During one of their lunchtime chats, Keith found out that Liz was interested in cooking and was not very happy in her present job. They decided to join forces. Liz obtained the appropriate food handling qualifications and left her job in insurance to join Keith in the bakery in January 2004.

They formed an informal business partnership as they did not feel the need to complete a deed of partnership. Liz invested £10 000 into the bakery to purchase equipment and to improve the décor of the shop. The timing of this injection of new capital into Keith's Kookery was fortunate. A recent visit by the environmental health officer had identified some areas of concern about the state of the older equipment which Keith had been using.

Keith sometimes wondered how he had managed before Liz came along. Keith and Liz worked hard and Keith's Kookery continued to flourish. Keith had used his chef's training to produce a gourmet range of sandwiches which were particularly good and undoubtedly the most popular line. As the reputation of the business for both the quality of the product and excellent customer service grew, customers came from all over the district to purchase from Keith's Kookery.

The profits of the business began to slowly grow and in order to maintain a strong cash flow Keith and Liz continued to draw a relatively small amount out of the business as a wage each month. Keith and Liz were aware of the need to monitor the financial performance of Keith's Kookery. In addition to the preparation of financial accounts, they introduced budgetary control and variance analysis. **Fig. 1** shows an extract from the budget of Keith's Kookery for the 10 month period from January to October 2005.

Budget Extract – Keith’s Kookery January to October 2005

| Item | Budget (£) | Actual (£) | Variance (£) Adverse/Favourable |
|------------------|------------|------------|------------------------------------|
| Drawings | 30 000 | 32 000 | 2000 Adverse |
| Purchases | 36 000 | 35 600 | 400 Favourable |
| General expenses | 15 000 | 16 500 | 1500 Adverse |
| Business rates | 20 000 | 20 000 | 0 |

Fig. 1

At the moment, all the accounting records of Keith’s Kookery are compiled manually. However, in order to save time and effort, Keith and Liz are researching the costs of installing a new computer system incorporating appropriate accounting software packages.

During the later part of 2005, Keith and Liz have become increasingly aware of changes in the ordering habits of the customers of Keith’s Kookery. There has been an increasing move towards more healthy options amongst the sandwiches they have sold. There have also been requests from some customers for organic bread and sandwich fillings. Keith and Liz have already introduced the use of organic milk and ‘fair trade’ tea and coffee to see if customers are prepared to pay a ‘little more’ for healthy and ethically produced food. So far, there has been no decrease in their sales of tea and coffee even though, originally, there had been a price increase.

Although Keith and Liz are aware that they could charge a premium price for organic products such as sandwiches and pies, they are concerned that there might be contamination within their kitchen between the organic and non-organic foods. If this were to happen, then the customers of Keith’s Kookery might be able to take legal action against Keith and Liz because the organic foods sold would not be ‘as described’. There would also be a need for Keith and Liz themselves to be sure that all the materials which they purchased as ‘organic’ were from reputable sources which had been approved by the Soil Association.

A movement towards the provision of organic products which support a healthier lifestyle would be the ideal base from which to further expand the business. Keith was particularly keen to introduce a range of organic pies as sales of their existing healthy options pies had increased significantly during the second half of 2005.

It was, therefore, decided that they would turn their whole business organic. Keith and Liz had already been contemplating expansion of the premises – especially as the existing planning permission on the site was due to expire within the year. They obtained a quotation from a local builder who felt that the new extension could be built for £50 000. At the moment, the builder is available to start construction in February 2006. Any delay, however, would mean that starting building would have to be postponed until at least May as the builder has other commitments.

The one stumbling block, it seemed, was the cost. Keith had ploughed all of his money into the business when it was launched and Liz had invested all of her life savings. They were already taking only a low wage from the business and both Keith and Liz felt that this could not be reduced. They would not, therefore, be able to fund this proposed expansion from internally generated funds. They both felt, however, that it was an opportunity not to be missed and, therefore, agreed to discuss with their bank manager the possibility of taking out a loan secured on the premises. 75

Keith has worked out that currently they serve approximately 100 customers a day with an average spend of £4.50. He feels that if the business were to turn completely organic the average spend would increase to £5.00. Expansion of their current range and larger premises would also allow them, over the next few months, to increase their customer base to approximately 130 customers per day. This obviously would take time to achieve and would require the employment of extra staff. 80

Having made an appointment with the bank manager, Keith and Liz have been asked to prepare a business plan for Keith's Kookery. The bank manager has asked them to include the following: 85

- A SWOT analysis;
- A PEST analysis;
- A cash flow forecast; 90
- A break even analysis;
- A statement of the business objectives of Keith's Kookery;
- A consideration of possible ideas about the future ownership of Keith's Kookery.

Whilst preparing these documents, Keith and Liz are also giving some thought to the recruitment of new members of staff and the legal implications of advertising for and selecting appropriate employees. 95

Prior to the meeting with the bank manager, Keith has undertaken some research into the likely economic prospects for the UK economy over the next few years. His findings are outlined in **Fig. 2** below.

Forecast Data UK Economic Performance 2006-2009

| Indicator | 2006 | 2007 | 2008 | 2009 |
|---------------------------|--------|-------|-------|-------|
| Inflation rate | 2.0% | 2.3% | 1.9% | 1.8% |
| Interest rate | 5.25% | 5.5% | 5.5% | 5.75% |
| Unemployment | 0.92 m | 1.1 m | 1.3 m | 1.3 m |
| Annual growth in real GDP | 2.2% | 1.5% | 0.9% | 1.6% |

Fig. 2

As Keith and Liz were leaving for their meeting with the bank manager, they picked up the local free newspaper which contained a full page advertisement for a new buffet style pizza restaurant which is to open a couple of hundred yards away from Keith's Kookery. There was also an article on the possible relocation of the insurance company's call centre to India. 100

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