

**ADVANCED SUBSIDIARY GCE UNIT
BUSINESS STUDIES**

Business Behaviour

CASE STUDY

JUNE 2007

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- This copy may **not** be taken into the examination room.
- The business described in this case study is entirely fictitious.

This document consists of **4** printed pages.

FREE FROM NUTS Ltd. (FFN)

In Britain, thousands of people suffer from allergies to nuts and nut related products. Currently, about 4% of the population are affected and the number of young children with such allergies has tripled in the last ten years. A tiny trace of a nut can trigger a reaction known as anaphylactic shock – a potentially fatal allergic reaction with symptoms including swelling of the throat and mouth, difficulty in breathing and unconsciousness. In shops and supermarkets ingredients are listed on products, but sometimes they are written so small that they are easily missed. 5

Kirsty Lyall knows all about the dangers of nut allergies as her daughter, Bertie, has been highly allergic to nuts since she was a toddler. Rather than take the risk of buying ‘nut-free’ products from the shops, to ensure that Bertie could eat safely, Kirsty began to do her own cooking. She soon found that there was a demand for the cakes and biscuits she was baking in her home kitchen and realised that there was a gap in the market for nut-free products. In January 2003, Kirsty and her husband, Stephen, spent £6,000 of their savings on transforming their kitchen at home so that it complied with regulations. By June 2003, FFN had become a limited company and it began supplying local schools, independent retailers, health shops and cafés. A mail order operation was also set up. Three months later, FFN spent a further £100,000 to establish its first factory by converting a 1,500 square foot industrial building in Histon, Cambridgeshire. This investment included £25,000 of the Lyalls’ own money, with the rest coming from a DTI loan and a Government Enterprise grant. 10 15

FFN goes to extremes to make sure that its products are guaranteed to be free from nuts. All the machinery and equipment used has been manufactured in a nut-free environment, suppliers of raw materials are rigorously checked, cleaning products must not contain nut oils and staff must shower before entering the nut-free area. Workers even have to avoid eating nuts for 24 hours before they begin work. 20

FFN now sells over 40% of its output via mail order and the Internet (see Table 1). The customer base has grown to include larger firms and negotiations are currently at an advanced stage with two of the largest supermarket chains. Kirsty and Stephen are currently assessing the implications for both production and distribution of signing long-term contracts with the two supermarkets. They predict that within five years, supermarkets will be FFN’s main channel of distribution. 25 30

FFN produces cakes – including Christmas and Birthday Cakes – biscuits and desserts. It has adapted favourite recipes, such as brownies, flapjacks and celebration fruit cakes into nut-free versions, which provide all the taste one would expect from home-made cakes. Kirsty is currently keen to expand FFN’s products to include a savoury range suitable for café and restaurant menus. 35

Kirsty is aware that FFN must face changes in the methods of production that accompany growth. FFN’s Production Manager, Ivan Nechifor, was discussing plans with Kirsty at a recent meeting. “We need to employ more convenient, more efficient practices. What about using ready-made mixes for some of our products, or using preservatives to extend the product shelf life? The huge number of raw materials we use and different suppliers makes it difficult to keep stock levels under control. Just knowing where everything is, is becoming more and more difficult.” 40

“I’m very aware that I have got to stop looking at this business as ‘Kirsty’s little bakery’ but I am not keen on adopting such mass-produced techniques,” replied Kirsty. “They are bound to change the taste of what we make. Also, I don’t want to use additives in our products. I don’t understand them and our customers don’t want them either. I feel it would be a move that could undermine the quality and image of our brand. Are there not other ways of improving our stock control systems?” 45

“We have to find ways of increasing productivity if we are to maintain our current sales growth. Yes, there are modern methods of stock control that we could use, but greater automation of the process is also vital,” argued Ivan. 50

“Remember that this business was set up with my Bertie in mind. I must ensure that we are not going to endanger the life of people like her,” said Kirsty. “That’s why I do not like what you are suggesting and why I check every batch before it leaves the factory and every delivery from suppliers to ensure that they are meeting our quality standards.” 55

“That is something I was going to speak to you about,” replied Ivan. “I appreciate that we have to be rigorous when buying raw materials, but each of our more than 50 suppliers has to provide written confirmation that their products are nut-free at source. There are at least 100 different ingredients that we use in a typical week. That’s a lot of stuff to check.”

The continued and rapid growth of FFN has also caused Stephen to look at the human resources side of the business. Currently FFN employs 12 people producing 1300 boxes of biscuits, cakes and other products each week. A majority of the employees have food allergies themselves, or have friends and family who do. Two of the employees are qualified bakers. They are responsible for monitoring quality and the mixing of the different ingredients, as well as supervising the other production staff. These workers are unskilled or semi-skilled and primarily carry out the more mundane jobs such as transferring the mixture into baking tins and packaging the finished products. There is some use of machinery to carry out simple repetitive jobs, although it would be wrong to suggest the production process is automated. Four of the employees have been with FFN since it became a limited company. 60

All production workers are paid £7.50 per hour (gross) and work a standard 38 hour week. At times there is the possibility of overtime working in the evenings, for which time and a half is paid. Very occasionally, it is necessary to ask staff to work on a Saturday morning from 9.00 a.m. until 12 noon, for which a flat rate of £36 (gross) is paid. The qualified bakers receive a gross salary of £19,513 p.a. but are expected to be present when any overtime working is required. FFN tries to pay them an annual bonus as compensation for the extra hours worked, but this is dependent on profit levels each year. 70

The longest serving of the qualified bakers, Andy Brunt, has asked to speak to Stephen about the payment system for qualified bakers. Andy feels that he can no longer afford to work at FFN as the hours he works as a supervisor are not adequately rewarded. He was also disappointed at the very small bonus awarded last year, due to much of the profit being invested in new machinery. 80

The business issues that now face FFN centre on the management challenges that accompany expansion, and the age-old problem of cash flow. The questions of how to raise further capital in order to fund the next stage of the expansion, and how to ease cash flow pressure, are uppermost in the mind of Deepika Krishnayya, FFN’s Finance Director. The company raised cash recently by issuing new shares, although the Lyalls still own 90% of the business. Profits from the present operation are earmarked to help pay for investment in a second factory, although substantial further funds will be required. To this end, Deepika is planning to meet with representatives from a venture capital firm in the coming few days. They have requested a full set of FFN’s financial accounts for the previous two years (see Table 2 for extract). However, Deepika is concerned that these accounts do not tell the full story of FFN’s remarkable success. Unlike most accountants, Deepika is always keen to stress that the usefulness of final accounts to a company’s stakeholders is very limited. She is often heard to say, “The accounts are just numbers on a piece of paper. They do not show you what is going to happen, only what has happened...and even then only the accountant’s opinion of what has happened.” 85 90 95

Table 1 – FFN's Revenue by Market Segment (%)

	2003	2004	2005	2006	2007*
Mail Order	2	16	19	22	20
Website	0	2	16	19	20
Local Shops	72	42	31	29	26
Health Stores	7	12	10	6	3
Cafés	8	18	15	13	11
Schools & Hospitals	11	10	8	7	5
Supermarkets	0	0	1	4	15

* Forecast

Table 2 – Extract of Financial Information from FFN's Final Accounts (£)

<u>Year ending</u>	<u>31/3/06</u>	<u>31/3/07</u>
Sales Turnover	174,880	248,420
Net Profit	19,290	37,620
Fixed Assets	90,000	95,000
Current Assets		
Stock	5,840	18,550
Debtors	9,590	22,710
Cash	6,811	4,205
Current Liabilities		
Creditors	3,105	10,050
Overdraft	12,400	30,800
Dividends	500	2,500
Long-term Liabilities	44,000	42,000

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