

326/01

**BUSINESS STUDIES**

**BS6**

P.M. THURSDAY, 21 June 2007

(1<sup>3</sup>/<sub>4</sub> hours)

**ADDITIONAL MATERIALS**

In addition to this examination paper, you will need:

- a calculator;
- a 12 page answer book.

**INSTRUCTIONS TO CANDIDATES**

Answer **all** the questions.

**INFORMATION FOR CANDIDATES**

This paper is a synoptic paper. It is designed to test candidates on the connections between different aspects of the subject and requires the integration of knowledge, understanding and skills acquired from different parts of the subject content.

Mark allocations are shown in brackets.

Candidates will be assessed on their quality of written communication i.e. the structure and presentation of ideas; the clarity of expression; grammar, punctuation and spelling. Up to three marks will be awarded for written communication.

No certificate will be awarded to a candidate detected in any unfair practice during the examination.

Study the information provided about *Caffè Nero* and answer the questions that follow.

## CAFFÈ NERO

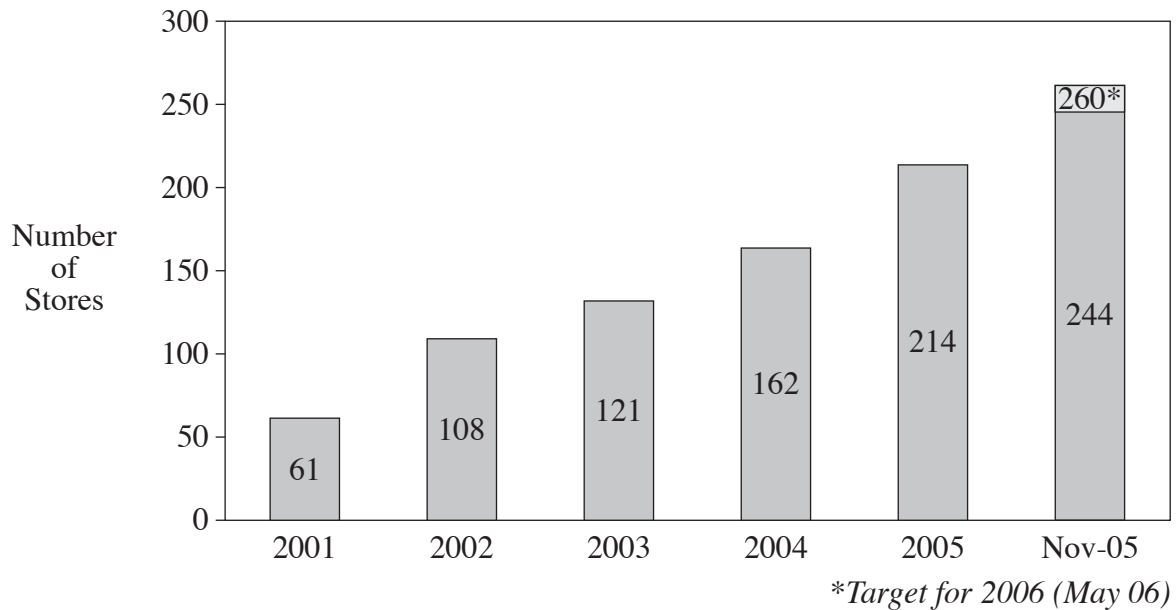
Caffè Nero Group Plc was founded in 1997 and is currently the largest independent coffee retailer in the UK. By May 2006 it aimed to have opened 260 Caffè Nero stores from Brighton to Glasgow. It has been ranked the best UK Coffee House brand for the 6th year running by UK consumers.



- 5 According to Caffè Nero, its aim is to provide a European style coffee house experience offering premium espresso-based gourmet coffee, authentic Italian food products and a relaxing atmosphere in every store. “At Caffè Nero we strive to be the place where you want to go outside of your home and work, a place you feel comfortable in as part of your daily, or weekly or even occasional routine. Our mission is to provide you with fantastic espresso coffee and fresh quality food, in a warm, inviting atmosphere served by friendly, caring people. If we can do this, we will have created a quality neighbourhood gathering spot.”
- 10

The business has grown rapidly, partly as a result of acquisition and partly through organic growth, i.e. opening new outlets of its own. Caffè Nero does not at present franchise any of its cafés. They are all situated in the UK, although the business is now actively considering a policy of overseas’ expansion.

15 The graph below shows the growth in the number of stores opened by Caffè Nero.



The following article from Money Week discusses the remarkable success of Gerry Ford the founder of Caffè Nero.

20 “It may seem surprising now that just 11 years ago Seattle Coffee Company was opening one of the first branded coffee houses in the UK”, says the Financial Times. “The subsequent explosion of “coffee culture” is usually exemplified by the expansion of Starbucks.”

“But while Starbucks’ rampage across Britain has been backed by a hefty \$5bn US parent, Gerry Ford has built Caffè Nero from scratch into one of the country’s three biggest coffee-house chains. It’s a classic David and Goliath story and investors can’t get enough of it: Caffè Nero shares have more than quadrupled since 2003.”

25 Caffè Nero has certainly demonstrated that “with the right recipe, the English can be lured away from tepid beer and milky tea”, says Business Week. So what is that recipe? Better-than-average coffee, a “slick Italian theme” and a “jovial” Californian founder.

30 It’s easy to see where Ford, 48, gained his entrepreneurial streak. He grew up in San José, capital of what is now Silicon Valley, and used to ride his bike in an orchard that subsequently became Ebay’s headquarters. “At university [Stanford], we would set up our own companies”, Ford told The Daily Telegraph. “It was ‘if you didn’t have a desire to start up your own business and be creative, then what was wrong with you?’.”

35 The young Ford combined this exposure to American can-do with several formative spells in Europe – thanks to the lengthy sabbaticals his university professor father took in France and Germany. After studying politics and international relations at Stanford (where he knew US Secretary of State Condoleezza Rice) and cutting his business teeth at Hewlett-Packard, it seemed a natural move to head back to Europe, where he took a PhD at Oxford and an MBA at INSEAD.

40 A stint at London-based private equity firm Apax Partners convinced him that his future lay in business. In 1992, he left to set up his own venture capital group, Paladin Associates. Five years later – a year before Starbucks invaded Britain – he launched Caffè Nero.

The genesis of Ford's "dream of continental-style espresso bars" grew from the many hours he'd spent hanging out in European coffee houses while writing his PhD, says *The Independent*. "He liked the atmosphere and wanted to create it, en masse, in the UK."

45 By 2001, the fledgling chain had created enough momentum to float. But getting the City upside proved an upward battle. "The whole market was very difficult", says Ford. There was "a dismissal, a non-belief . . . no matter what we said".

50 The turning point was the growing conviction that, far from being a frothy bubble, the coffee house was here to stay, says the *FT*. In the meantime, Caffè Nero built itself a niche as a cooler, more laid-back venue than its main rivals, Starbucks and Costa Coffee. A unique selling point (USP) for many regulars is the chain's toleration of smoking. Ford does his best to personify the brand's edgier qualities: his favourite film is *The Godfather* and his preferred means of transport is a Piaggio scooter. Growth, meanwhile, continues unabated: Ford expects the current tally of 260 stores to reach 450 within the next few years, mostly opening in provincial towns. There has been talk of international expansion – the Middle East and eastern Europe are target markets – but for now, Ford prefers to focus on Britain.  
55 "We're riding on a lifestyle change here."

Back in 1997, "investors chuckled at Ford's conviction that people would pay upwards of £2 a day for a cup of coffee", says *BusinessWeek*. The continued success of Caffè Nero, in the teeth of Britain's recent retail slowdown, demonstrates that, for many, this "little daily luxury" has become a daily necessity.

60 Sheer size has pushed Starbucks to the top of the coffee-bean heap: it has 26% market share versus Caffè Nero's 12%, according to retail analysts Allegra Strategies. But for the past six years, customers have rated Caffè Nero top for coffee quality, atmosphere and service. Sales growth has reflected this: up 7.5% in the past six months – a "stunning performance", says the *Investors Chronicle*.

65 With coffee sales predicted to continue their exponential growth, the situation looks rosy, says the *Evening Standard*. But with a new coffee outlet opening every week – and outfits such as McDonald's, Tesco and Wetherspoon muscling in on the action – "the war between the coffee lords is growing ever fiercer". How will Caffè Nero hold its own? Firstly, says Ford, there's the quality argument: customers have a "radius" in which they will choose their preferred outlet. "If you've got a Starbucks or a Costa on the corner, but a Caffè Nero a block away, and you like our coffee more, you'll go to the Caffè  
70 Nero." More than 30 of the chain's stores are located next to Starbucks.

Secondly, the chain has demonstrated it is second to none at controlling costs. "Rent discipline is a key success factor for us", says Ford. So is speedy profitability. Ford boasts that he can drive each new opening from nought to profitability "in just three months".

**Caffè Nero Profit and Loss Account for the year ended 31 May 2005**

	2005	2004
	£'000	£'000
Turnover	70 117	50 547
Cost of Sales	53 059	39 905
Gross Profit	17 058	10 642
Administrative expenses	11 049	8 286
Net Profit	6 009	2 356

**Caffè Nero Balance Sheet at 31 May 2005**

	2005	2004
	£'000	£'000
<b>Fixed Assets</b>	39 150	27 052
<b>Current Assets</b>		
Stocks	542	408
Debtors	2 087	2 270
Cash at Bank and in Hand	3 982	3 171
<b>Total Current Assets</b>	6 611	5 849
<b>Less Current Liabilities</b>		
Creditors	14 006	10 919
Net current liabilities	(7 395)	(5 070)
Total Assets less current liabilities	31 755	21 982
Creditors due after more than one year	15 965	11 661
<b>Net Assets</b>	15 790	10 321
<b>Shareholder Funds</b>		
Share Capital	7 930	7 449
Reserves	6 264	6 264
Profit and Loss Account	1 596	(3 392)
<b>Total Shareholder Funds</b>	15 790	10 321

Sources: [www.caffenero.com](http://www.caffenero.com), an article by Jane Lewis in Money Week  
([www.moneyweek.com](http://www.moneyweek.com)) 10 February 2006

1. Explain how Caffè Nero's marketing mix contributes to its success. [10]
2. Discuss the view that franchising would have been a more appropriate method of expansion for Caffè Nero. [10]
3. Analyse the possible human resource problems resulting from Caffè Nero's rapid expansion. [10]
4. Analyse and evaluate Caffè Nero's financial situation. [10]
5. Consider the issues that Caffè Nero should take into account when deciding whether or not to expand its operations overseas. [10]