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OXFORD CAMBRIDGE AND RSA EXAMINATIONS

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Level 3 Cambridge Technical in Business

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Unit 3: Business decisions

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INSTRUCTIONS

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INFORMATION

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Heavenly Scented Soaps by James

EARLY BEGINNINGS

'Heavenly Scented Soaps by James' 'HSSJ' is a sole trader business based in a small village in the East of England. The business was started by James Scott, seven months ago, after he was made redundant from his job as a bus driver. James used his redundancy payment to purchase manufacturing equipment, buy raw materials and pay for the conversion of part of an outbuilding behind his house into suitable premises for making soaps. James uses rectangular-shaped soap moulds because he decided to make traditional looking bars of soap. The business sells the handmade soaps at local craft fairs and farmers' markets.

James sold his first batches of soap at a number of farmers' markets and craft fairs in the summer of 2020. James was pleasantly surprised that his soaps were selling well and, on some occasions in the height of summer, he had to close his stall early because he had sold out. During the autumn James gradually increased production and is pleased to see that demand seems to be keeping pace with his increased supply.

FURTHER THOUGHTS

Continuing to sell his handmade soaps at farmers' markets and craft fairs, James has noticed that many customers are asking him similar questions (some of these questions are shown in Appendix 1). This has prompted James to think more deeply about the soap industry, the soaps he produces and his own entrepreneurial skills. Through research and personal reflection, James has realised a few things he had not realised before:

1. The soap market is very competitive and it is by chance that there are no direct competitors in the immediate local area.
2. Many customers are concerned about the ethical impact of soaps, including the use of environmentally damaging chemicals during production and whether any of the ingredients have been tested on animals.
3. Many customers are concerned about the health impact of soaps, especially people who suffer from skin allergies.
4. More customers might buy his soaps if he made a wider range of soaps, including novelty shapes.
5. He lacks the imagination and creativity to create innovative soaps that might appeal to a wider market.
6. He enjoys making his soaps and gets on well with his customers, but he lacks knowledge of how to run a business.

AN OFFER

One day, while James was selling his soaps at a nearby farmers' market, he was approached by Sarah Beswick. Sarah, a retired businesswoman, explained that she had been aware of James' business for several months and knew that his soaps were of a high quality. She could see that James was an excellent salesperson who was very popular with customers. She explained, however, that the soap market was one where it was difficult for a new business to become established and grow; being a good salesperson would not be enough. In Sarah's opinion what the business needed was a clear competitive strategy. After establishing that James had

no idea what his strategy was, Sarah offered to help James grow his business in an innovative way in return for being a business partner. Sarah thought that her business skills and creativity complemented James' product knowledge and interpersonal skills.

THE OPTIONS

Sarah's offer intrigued James, but would he be better off keeping the business small or increasing output without extensive innovation? Finance was limited. James told Sarah his thoughts and provided Sarah with further information. Sarah presented James with financial forecasts for all three options based upon the information he had given her and her own research.

OPTION 1 – Continue as at present

James could continue to build the business gradually by ploughing back surplus cash each month. This would require minimal additional expenditure other than that generated from sales. James estimates that no more than £3500 of capital expenditure would be required for this option, mainly to finance additional storage capacity in the outbuilding. James could use cash currently held by 'HSSJ' to cover the capital cost. However, in sixth months' time, James estimates that he would need to employ a part-time salesperson to manage the craft stall on occasions that he was unable to attend in person. James estimates that this would result in additional revenue expenditure of £4000 per year.

Sarah has estimated that the payback period for this investment would be 3 years and 10 months with an Average Rate of Return (ARR) of 7.9% over the next four years.

This option would see James continuing as a sole trader without any further involvement with Sarah.

OPTION 2 – Increase production of existing products

James knows that his traditional looking bars of soap are very popular with customers. James thinks it would be possible to double his existing production levels without having to move from his existing premises by converting the rest of the outbuilding and investing in, and installing, additional equipment to make the extra soap. James estimates that this would require a capital expenditure of £10 000. The business' bank would be prepared to fund half the cost of the capital expenditure and James could use cash currently held by 'HSSJ' to cover the remaining half. However, James would need to employ a part-time worker to help with production and sell at additional craft fairs and markets in the surrounding area. James estimates that this would result in additional revenue expenditure of £12 000 per year.

Sarah has estimated that the payback period for this investment would be 3 years and 9 months with an Average Rate of Return (ARR) of 8.8% over the next four years.

This option, also, would see James continuing as a sole trader without any further involvement from Sarah.

OPTION 3 – Introduce a new range of novelty soaps

Sarah has presented James with a proposal to move into a new market - novelty soaps. Sarah expects this option to quadruple demand, and therefore production, over the next six months. Although this is beyond the capacity of the existing outbuilding, Sarah has identified suitable premises on an industrial estate in a nearby town, available on a rolling twelve-month lease. Sarah thinks that outlets for the soaps could be found in specialist gift shops throughout the area as well as an expanded presence at local markets and craft fairs. She has estimated that the conversion of the new premises would involve capital expenditure of £25 000. If 'HSSJ' contributes £5000 towards this then Sarah is prepared to invest the remaining £20 000 in return for a 50% share in a new business partnership. This would be created by transferring the assets of James' existing sole trader business into the new partnership. Sarah estimates that there would be additional revenue expenditure of £30 000 per year, mainly as a result of employing two part-time workers, as well as paying the lease on the premises.

Sarah has estimated that the payback period for this investment would be 2 years and 5 months with an Average Rate of Return (ARR) of 14% over the next four years.

OPTION 3 is Sarah's preferred option. This option would see the creation of a new business partnership between James and Sarah.

APPENDIX 1: Customer questions and comments

“Are your ingredients tested on animals?”

“Will your soaps give me a skin rash?”

“Do you have anything exciting coming out in time for Christmas?”

“I like the quality of your soap but I prefer novelty shapes which I buy from a retailer in the city.”

“Your soaps smell nice but my small children would find them a bit boring.”

“Your products are nice, but they are more expensive than the soaps I can get from the supermarket.”

APPENDIX 2: Report on UK soap-buying trends

In an effort to reduce plastic usage, UK consumers are turning to good, old-fashioned bars of soap. The nostalgic, aesthetic and – crucially – environmentally-friendly aspects of bar soap seem to resonate strongly with the British public.

In the year to 14 July 2019, sales of bars of soap are up 4% on the year before. Meanwhile, shower gel sales are rising at just 1.1%; and sales of liquid soap, which became popular in the 1990s, are actually declining by 4.5% year on year.

Asda has seen growth of bar soap sales of 8.5%, while 5.7% more bar soap is being sold at Tesco.

49% of bar soap users agree that they avoid products harmful to the environment and buy bar soap to reduce their plastic usage. 42% agree that they prefer natural products.

This report also uncovered that older people were more likely to be concerned about plastic usage. Data shows that bars of soap are much more likely to be used by 55 – 74 year olds than other age groups. Other data shows that 55 – 74 year olds are more likely than younger consumers to agree that they avoid products harmful to the environment.

Of course, part of the increase in bar soap sales could be linked to the luxury brands who are embracing this trend. Bar soaps are now slightly more indulgent than they have been in the past, as there is now a bigger opportunity for a more premium offering.



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