Business : Specimen Paper 4

Business (9609) - Paper 4 - Specimen paper analysis - May/June 2023

Ryan's Farm (RF)

RF was set up in **Australia** in **2001** when John Ryan bought a **farm**, **equipment** and **inventory** for **$1.5m**. He financed the purchase with a **bank loan** which was **fully repaid by 2008**. Initially, RF produced **sugarcane**, **pineapples** and **mangoes**.

Timeline of RF's strategy for growth

2008-2014	**Several purchases of land** to **increase capacity**, gain **economies of scale** and **maximize profit margins**. **All profit reinvested** in RF
2015	**All land converted to sugarcane production** (see Appendix 1).
2016	**Takeover of BKL**, a neighboring farm, **for $10m** (see Appendix 2). Financed by **bank loan** and **sale of shares** in RF Limited, a newly created **private limited company**. **John holds 51%** of shares and is **Managing Director**
2018	RF **purchases a new building financed by a mortgage** (see Appendix 3).
2019	RF's **shareholders approve the company's financial results** at the annual general meeting (AGM) (see Appendix 4).

Developing a new business strategy

In **2020 a fire destroyed all RF's buildings** and its **inventory of recently harvested sugarcane**. RF was **unable to continue operations**. John Ryan has chosen to **retire** and has **left his controlling share of the company to his daughter**, Sue.

Sue is determined to create a successful **new farming business** called **RF2**. She has adopted the following mission and aims as the basis of a business strategy.

Mission

Profitability through sustainability

Aims

- **develop business options** for farming the land
- identify **market opportunities**
- develop **core competencies**
- **operate efficiently** within a dynamic environment
- **choose appropriate finance**

Sue would now like advice on which approaches she should use to develop a new business strategy.

Appendix 1: Sugarcane production in Australia (2015)

- Large profit margins.
- **80% of Australian sugarcane is exported**. The main export markets include **Russia**, **China**, **Indonesia** and the **United States.**
- Australia **does not subsidise** sugarcane production. However, **European** and **American producers are subsidised.**
- **Brazilian sugarcane farmers** are **more efficient** than Australian sugarcane farmers.
- **Global demand** for sugarcane and sugarcane products is **forecast to continue growing.**
- There is **pressure** on the industry to make **production more sustainable**, e.g. using **less water.**

Appendix 2: HR Director's report summary following RF's takeover of BKL (2016)

The **two farms had very different corporate cultures**. RF uses **hard HRM** whereas **BKL used soft HRM**. Most of the BKL employees were on **flexi-time contracts**. RF employees have **annualized contracts**.

RF moved BKL employees onto **annualised contracts**, but **half of them chose to leave. Recruitment is difficult**. **Productivity is forecast to fall.**

Appendix 3: Data on the new building (2018)

- **Increases RF's inventory capacity by 300%**. Allows RF to **hold high levels of inventory** for **several months** to take advantage of price changes.
- **Computerized inventory control system.**
- Links with the enterprise resource planning (**ERP**) system used by all the major sugar factories.

Appendix 4: Analysis of RF's financial accounts between 2015 and 2018

	2015	2016	2017	2018
Current ratio	1:1	1:1	1:1	1:1
Acid test ratio	0.6:1	0.5:1	0.5:1	0.3:1
Return on capital employed (%)	9	7	6	5
Rate of inventory turnover (times)	0.8	0.8	0.8	0.6
Gearing (%)	5	30	20	60
Profit for the year ($m)	2	2.3	1.8	0.6

(1) Evaluate RF's strategy for growth between 2008 and 2019. [20] (Cambridge specimen answer)

A strategy for growth is a plan of how a business increases in size or scale. RF grew in a number of different ways between 2008 and 2019. I will evaluate each of these ways in turn.

Part of RF's strategy was internal growth by reinvesting the profit made by the business to purchase the factors of production. For example, between 2008-2014 RF purchased land to expand the growth of sugarcane, pineapples and mangoes. Any profit made was reinvested. Likewise, RF purchased a new building in 2018. The benefits of internal growth are that it is less risky, doesn't require added costs of interest, and RF can produce more products at a lower average unit cost (economies of scale). This is likely to have increased the profitability of RF and, in the long run, the profits of the business. Up until 2016, this also increased the wealth of John as he was the sole owner, beyond 2016 it would have increased the value of shares and dividends of the business, as that was when RF became a private limited company. However, because the profits were being reinvested, John and the shareholders may not have benefitted. This might have been particularly bad for shareholders as many of them would have only purchased shares in return for dividends and share price.

This can be particularly seen in the reduction in profit between 2015 when RF made $2m and 2018 where RF only made $0.6m, a reduction of 70%. However, as it is a primate limited company, they could not sell their shares on the stock market, so it is unlikely to have affected the share price.

RF also successfully used external growth by taking over the neighboring farm BKL in 2016, financed through a $10m bank loan. The benefits of external growth are that it is a quick way to grow the business. RF gains all the production facilities of the neighboring farm, as well as its customer base. However, seeing as there were significant differences in how the two farm's human resources are managed, there was a clash of corporate culture. With RF using hard HRM and annualized contracts and BKL using soft HRM and flexi-time contracts, by trying to assimilate BKL's employees into RF's culture, half of BKL's employees chose to leave. This caused issues for RF, in that recruitment was difficult and no doubt costly as well. This also impacted RF's productivity, and in a labor intensive primary business such as a farm, this likely had a significant impact on RF. Without enough employees, not only would productivity have fallen, so will production, sales and the overall profit of RF. Thus, the shareholders are likely to have received little to no dividends, affecting their income.

RF financed the takeover using a bank loan and conversion to a private limited company. Whilst this provided quick finance for expansion, it also significantly increased the gearing (risk) of RF (from 5% in 2015 to 30% in 2016). Likewise, the internal growth of purchasing the new building in 2018 also used external finance (a mortgage), giving RF a gearing og 60% which is considered highly geared. This means that RF's growth strategy led to increased risk and was possibly a contributing factor in the business being unable to survive the fire in 2020.

Overall, RF's strategy led to significant growth. For example, the new building increased RF's inventory capacity by 300%. Likewise, the purchase of BKL, despite its HRM issues, will have added a significant amount of land, one of the most important factors of production for a primary sector business. All in all, the internal growth seemed to be less risky for the business, especially in the 2008-2014 timeframe than the external growth strategies which added significant risk to the business.

However, as an overall strategy including both internal and external growth, RF may have grown in size and scale, but ultimately ended 2018 with lower profit than its previous years. Likewise, the return on capital employed was lower in 2018 compared to 2015. This suggests that although RF increased its size and scale, the business was less successful due to this growth strategy. This is likely because RF was experiencing diseconomies of scale.

The overall success for the strategy of growth cannot be fully evaluated because of the fire which destroyed all of RF's buildings and inventory. The risky elements of the growth strategy had already occurred by this point but the return on this strategy will remain unknown because of this crisis. It would have thus been beneficial for RF to have invested in contingency planning, such as having its inventory spread across multiple locations, in order to have helped mitigate the damage caused by any fires or similar crises

It is likely that if RF had continued to trade, it would have been able to make use of the growth, reduced its gearing and increased profit in the future. However, this cannot be known and would have also depended on many external influences such as the state of Australia's economy and the levels of competition for sugar cane production in Europe, America and Brazil.

(Total marks awarded = 18 / 20)

<u>How should we evaluate the strategy for growth?</u> *(remember, may not ask about growth strategy, may ask you a horrible other question like they did in may/june paper)*

- You will be given case study with a timeline of a business, appendices further explaining each situation, and then a table of financial data for the business over the years
- Helpful to go through it chronologically, each paragraph can be dedicated to evaluating the business's growth strategy that year (or spanning multiple years like 2008-2011)
- Pick out what strategies the business used to grow, whether it's internal growth like reinvesting profits, external growth like a takeover / merger, marketing efforts, introduction of new machinery to increase flexibility, increasing capacity by purchasing a new building etc.
- Evaluate the potential benefits/limitations of that strategy to the business, did it help them grow? How? At what cost? What were the negative effects on the business? How could they have prevented these negative effects?
- Reference the financial data throughout - *they chose to go with this strategy, which decreased their productivity, leading to a decrease in quality and consumer satisfaction, this is reflected in table 1 where sales fell by 20% in the span of a year*

- Tell them what they did right, but also criticize areas where they went wrong, come up with other ways they could have achieved their goals for growth.
- Make sure you explain them and apply them to the business itself. Give your own alternative solutions - *instead of choosing to do XYZ, RF could have instead done ZYX, which could have led to increased profitability with less risk, this is due to the fact that unlike XYZ, ZYX does not…. This would have been highly beneficial to RF, as it would not have raised their already increasing levels of gearing.*
- Can evaluate hypotheticals not mentioned in the case study - *if they chose to go with this strategy, it would also depend on the external environment such as economic or political factors….*
- This is good evaluation, so long as it's applied directly to the business.
- Conclude with whether the business's overall strategy for growth was successful. Did they achieve their goals? Why or why not? Are they more profitable now than they were? Is it hard to tell? Can you think of anything they can improve on going forward?

Distribution of marks

- AO1 out of 3 marks. (*Knowledge*, so don't feel the need to over explain concepts)

- AO2 out of 2 marks. (*Application*, try to include lots of case study details anyways, will help you stay on track and focused on the case study business)

- AO3 out of 8 marks. (*Analysis* - analysis of the overall strategy that identifies connections between causes, impacts and/or consequences - *doing this led to reduced profits, which may have forced XYZ LTD. to rely on external sources of finance such as bank loans, further increasing their gearing from 10% to 20%*.)

- AO4 out of 7 marks. (*Evaluation* - A developed judgment/conclusion is made in the business context that draws together developed evaluative comments which weigh up some key arguments in the business context)

Word count?

- Cambridge's specimen answer was about 800 words long (I added to it a bit, making it 855)
- Go for a similar amount, if you write too much you're waffling, if you write too little you probably don't have enough content

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2 Advise Sue on which approaches she should use to develop a new business strategy for RF2. *(Cambridge specimen answer)*

Strategic management involves the analysis, choice, and implementation of a plan to reach an objective. Sue wishes to achieve 'profitability through sustainability' with a number of specific business aims. To do this, Sue will need a range of approaches to perform a strategic analysis.

Firstly, Sue could analyse RF as a business including what resources the business currently has. SWOT (strengths, weaknesses, opportunities and threats) and core competencies (what the business is good at) analysis could be used to do this. Sue, as John's daughter, would have a good knowledge of the elements of RF that still exist after the fire. This should allow her to understand what the business has and what the business is good at. For example, she has lived in a farming family, so her analysis will utilise her knowledge of farming and market opportunities. However, because it is a dynamic business environment, an internal analysis of RF is unlikely to be much help in designing a new strategy, especially since the buildings and inventory has been destroyed. It took John 20 years to build up the business in this primary sector and Sue may be better to look for a new market opportunity which will not be found by looking at what the business used to be good at.

Therefore, in this situation, SWOT and core competency analysis alone is unlikely to be beneficial to Sue because she is starting and should focus on a new market.

Sue needs approaches which will help her find a new target market utilising the land that she has. Ansoff's matrix could be used to balance out the risk that Sue wishes to take against the market opportunities. For example, if Sue wishes to take a balanced approach, then she could use market development and use the land to produce sugarcane (as John did) but focus on the international market which is growing. If she can focus on sustainability and use less water, this may make RF more attractive in the international market.

Once Sue has chosen the business direction, she could use market research to develop a five forces analysis. This would allow her to analyse the relative opportunities and dangers of the market so that she can develop a relationship with the suppliers and the buyers.
Lastly, Sue could try something totally new by implementing a blue ocean strategy. This would involve finding a gap in the market without any competition and gain a new target market. The benefits to this are that she may be able to charge high prices due to the lack of competition and have high profitability to re-invest in the business. However, it is not easy to find an undeveloped market especially in the primary sector where most things have been done before.

I advise Sue to use a combination of approaches to develop a new business strategy for RF2. She should start by conducting a SWOT and core competency analysis to understand RF2's situation. Then she should use Ansoff's matrix to decide on the level of risk and then look for a blue ocean strategy to maximise profitability. The combination of these approaches should allow Sue to understand the market and find a strategy that will best utilise RF2's resources and are most likely to achieve her mission of profitability and sustainability.

However, using these approaches will take time that Sue may not have. Farming is a seasonal industry and if Sue spends too much time analysing the situation without production, then RF2 may not be able to pay its indirect costs, such as the mortgage and bank loan, and this could lead to the company going into administration.

Whether these approaches will lead to success for Sue will depend on how urgent the new strategy actually is. If Sue has enough funds to do a full analysis of the business and market, then these approaches are most likely to bring success. However, if RF2 must start production quickly to pay its debts, then Sue might need to stick to what she knows and go back to the production of sugarcane at least in the short term.

(What to know for Business Strategy question - Question 2)

Strategy	What it does	How it works	Advantages	Disadvantages
Blue Ocean Strategy	Strategy that focuses on creating uncontested market spaces, rather than compete in existing ones	- Identifies new and untapped markets - should eliminate or reduce factors that the industry has long competed on but are no longer valued by customers. -raise and create factors that the industry has never offered before and that are highly valued by customers. - Can use market research to identify untapped market through trends and help identify customers unsatisfied needs/wants	- reduced competition - do not have to compete on price or quality - can charge higher prices, resulting in higher profits and market share - better resource allocation - opportunity for growth, do not have to compete	- requires significant research and development to identify new markets - require lots of investment and resources to establish in new market - high risk, no established market and demand uncertain - growth can be limited if market size / share is limited
Scenario Planning	Strategic planning technique that helps businesses prepare for different future scenarios. Used to plan for long-term future, with lots of uncertainty	(1) Identify key factors likely to impact business in future (2) Develop scenarios - using quantitative and qualitative analysis to assume how future may unfold (3) Assess potential impact of scenarios - opportunities/threats (4) Plan for each scenario - develop strategies and contingency plans to help navigate deal with threats/challenges and capitalize on potential opportunities	- Improved decision making - Identify possible opportunities/threats - Reduce risks with contingency plans and strategies - can be used to facilitate communication between different stakeholders	- can be time consuming and expensive - complex, requires expert help ($$$) - over reliance on scenarios - difficulty in predicting rare events (not 100%) - accuracy depends on quality of data and assumptions used
SWOT Analysis	Strategic planning technique used to identify internal **S**trengths and **W**eaknesses of a company, as well as external **O**pportunities and **T**hreats (*directly affects business*)	- Internal analysis like reviewing performance/financial data can help identify strengths/weaknesses in business - Market research like industry trends, consumer needs helps identify opportunities and threats in the market or competitive environment. (new competitors) - Be found using experts, or SWOT workshops with brainstorming - Typically used to identify current position and guide decision making	- Focus on core issues, develop strategies to resolve weaknesses / capitalize on strengths, prepare for threats and seize opportunities - Can be used for team building - Prepare for future - Flexible tool, can adapt whenever	- Subjective, depends on the agenda/bias of those doing analysis - Can identify a large number of things, but does not prioritize - Limited scope, tends to focus on most obvious factors - Therefore should do PEST analysis alongside to gain a more holistic view
PEST Analysis	Tool used to analyze the macro-external factors that affect a	- **Political** : government policies, regulations and stability, looks at political unrest, trade regulations, taxes, labor laws, subsidies - **Economic** : state of economy,	- helps business be prepared for external factors out of control - helps identify potential	- can be time consuming and expensive (pay experts to do research/analyze)

	business or industry. **P**olitical, **E**conomic, **S**ocial and **T**echnological factors. (*may or may not impact business, not directly anyways*)	inflation rates, interest rates,exchange rates and rates of GDP, unemployment rates - **Social** : demographic trends, cultural norms and lifestyle changes, considers population growth, education levels and social attitudes - **Technological** : rate of technological change and innovation, considers automation, digitalisation, and new tech - These factors can be analyzed by looking at data, reports, news articles to identify trends/changes	opportunities (subsidies) or threats (taxes) business may face - Make decisions and strategies that align with changes in the external environment (like adapting to new regulations or economic recession) - can be used to evaluate multiple markets/industries	- accuracy of analysis depends on quality of data used - subjective, different individuals interpret factors differently - analysis limited to macro-environmental factors, does not consider internal factors of business or industry specific factors like competition - Hence why should be done with SWOT
Porter's Five Forces	Framework used to analyze the competitive environment of a business. Often used to determine level of competition and profitability of an industry - whether to enter new market or how to develop strategy for current market. There are **5 forces** that determine profitability + attractiveness of an industry	(1) **Threat of new entrants** - examines how easy it is to enter market, evaluates barriers to entry and level of competition (the easier to enter, the more competitive) (2) **Bargaining power of suppliers** - number of suppliers, cost of switching suppliers, availability of substitutes (if few suppliers, hard to bargain.) (3) **Bargaining power of consumers -** number of buyers, availability of substitutes. Buyers exert power over price when they have many substitutes to choose (4) **Threat of substitutes -** high level of substitution can reduce demand and profitability (5) **Rivalry among existing competitors -** high levels of competition can lead to price wars, aggressive marketing and reduced profit	- helps organizations identify key sources of competition and develop strategies to enhance their competitiveness. - can be used to evaluate potential business opportunities, such as entering new markets or partnerships - can be used to determine whether to stay in market, - help find better alternative markets - help understand key drivers of profitability in an industry	- only considers factors that impact industry competitiveness, does not consider macroeconomic or technology changes - assumes industry is static, industry competitive landscape is dynamic and changes over time - may not be applicable to all industries, such as monopolized or heavily regulated industries
Core Competence Framework	Helps business identify unique strengths or core competencies to gain competitive advantage i.e Apple's minimal design	- identifies key strengths and resources of a business, which can be leveraged for competitive adv. - Core competencies are unique combination of knowledge, skills, technology that a business has that is hard for competitors to imitate - Framework requires businesses to focus on core competencies, and outsource non-core activities	- By focusing on core competencies, businesses can reduce costs and be more efficient - useful for businesses looking to gain competitive advantage, in competitive industry	- Narrowed focus, focusing too much on CC's can lead to missing opportunities - Can be difficult to identify CC's, diverse products, new businesses etc. - Can create a sense of complacency

Ansoff Matrix	Strategic planning tool that helps businesses identify potential growth opportunities and strategies. Provides **4 options** for business to consider	**(1) Market penetration -** selling more of an existing product to an existing market, usually by marketing and pricing strategies **(2) Market development -** selling an existing product to a new market, by finding a new demographic or expanding geographically **(3) Product development -** developing new products to sell to an existing market, involving R & D to create new products or improve existing ones **(4) Diversification -** developing new products for new markets, requires lots of R & D and is high risk	- simple and clear framework for identifying growth opportunities - helps organizations to think strategically about their future direction - structured way to assess the risks and benefits of different growth strategies - can be used by organizations of all sizes and in all industries	- does not take into account external factors factors that could impact growth opportunities (economic, technology, political, competition etc.) - Can oversimplify complex business decisions - May not be appropriate for organizations that operate in highly dynamic or rapidly changing markets.
Force Field Analysis	Technique used to identify the driving and restraining forces that affect a proposed change in an organization. The purpose is to identify the factors that will either help or hinder the change.	The steps are as follows : (1) change is identified and written down (2) Two columns, one for driving forces and one for restraining (3) Each force is given a score between 1-5 based on magnitude of its impact (4) Scores are tallied up (5) If driving forces outweigh straining forces, change likely to occur and vice versa	- Helps to identify the forces that are driving or restraining the change - Can be used to decide on actions to be taken to help resolve driving forces - Easily presented to stakeholders for discussion	- Very subjective, the magnitude of forces may differ depending on who is conducting the analysis - does not provide specific solutions - may not take into account external factors that could impact the proposed change
Decision Trees	A graphical representation of decision making scenarios, with different possible outcomes.	- Starts with a single node, which represents initial decision - Each brand represents possible decision or outcome - Tree grows and branches out until all possible decisions and outcomes have been considered - Each decision is assigned a probability, and then the expected value of each decision can be calculated - Used in strategic planning, financial forecasting, risk analysis and marketing research	- Can help make complex decisions based on multiple variables and possible outcomes - Can help identify most important factors and prioritize resources correctly - Adaptable, can be updated as new information is made available - Easy to understand and visualize	- Rely heavily on accurate data, any inaccurate data can lead to incomplete decisions - Can be subjective, different people may assign different probabilities to same decisions and outcomes - Can be time consuming and resource intensive, if complex decision