

# OCR

Oxford Cambridge and RSA

**Friday 10 June 2016 – Afternoon**

**GCSE BUSINESS STUDIES**

**A293/01/CS** Production, Finance and the External Business Environment

**CASE STUDY**

**Duration:** 1 hour 30 minutes



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## Introduction

Aaron Furniture Ltd sells bedroom furniture through retailers in the UK. Its furniture is made to order either in its UK factory in Bowton or it is made by a supplier in Sweden and then imported. It sells different styles of bedroom furniture including the Egerton, Belmont and Ladybridge ranges. 5

Aaron Furniture was founded in September 1980 by Philip Aaron. As a result, the financial year for Aaron Furniture Ltd runs from September to August each year. Initially, Philip used his skills as a cabinet maker to make bespoke pieces of furniture in his garage. He sold the furniture at craft fairs. The business grew quickly and Philip moved production from his garage into a small factory in 1984. Further growth led to Philip purchasing land in Bowton on which he had a factory constructed that has since been expanded. 10

Aaron Furniture Ltd is now owned by Philip Aaron and members of his family who help run the business. Specialisation is used in the business. All the workers in the Bowton factory have a specific job to do. Each family member has a specialised management role in the business and the roles of the family members are shown below. 15

Name	Role	Relationship to Philip Aaron	
Philip Aaron	Managing Director		
Anna Aaron	Marketing Director	Wife	
Catherine Patel	Production Director	Daughter	
Sunjit Patel	Finance Director	Son-in-law	20

Extracts from the annual reports from three of the directors of Aaron Furniture Ltd are shown below.

### Finance Director's Report, 2014–2015 Sunjit Patel

#### *Extract 1 – Revenues, costs and profits*

In the financial year 2014–2015 Aaron Furniture Ltd made a loss, the first in its history. We have also increased the amount that we have borrowed. The total we pay in interest to the bank has risen and we will need to repay some of our existing loans in the next financial year. I believe that Aaron Furniture Ltd can return to profitability but some changes are needed in order to take advantage of a growing market. I have spoken to other directors about how we can return to profitability. 25 30

In this first part of the report I wish to present data about the revenues, costs and profits for the furniture that we import compared to the furniture we make in the UK. Some furniture such as the Belmont and Ladybridge ranges we make only in our UK factory. As a result of capacity limitations in the Bowton factory we make some of the Egerton range in the UK and some we have made in Sweden which we then import. In Fig. 1, I give the profit and loss data for the wardrobes in the Egerton range for 2014–2015. In Fig. 2, I indicate what has happened to the price of these wardrobes between 2010 and this year. This information is useful to compare the profitability of production in the UK with that of imports. On this data alone there may be a case for closing down our factory in Bowton and relying solely on imports. I can provide data for other items of furniture in the Egerton ranges, as well as for the Belmont and Ladybridge ranges, if necessary. Falling prices of timber and a strengthening of the pound against some other currencies may affect our decisions. The data for the other ranges is consistent with the data for the UK Egerton range made in the UK. 35 40

	Imported Egerton range wardrobes	UK produced Egerton range wardrobes
Pieces sold – Egerton range wardrobes	1000	600
Revenue	£500000	£300000
Total cost	£450000	£312000
Profit	£50000	–£12000

**Fig. 1** Profit and loss for imported and UK produced furniture in the 2014–2015 financial year for the Egerton range wardrobes

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Average price per Egerton range wardrobe sold in 2010–2011	Average price per Egerton range wardrobe sold in 2014–2015
£600	£500

**Fig. 2** The average price of Egerton range wardrobes in the 2010–2011 and in the 2014–2015 financial years

### Production Director's Report, 2014–2015, Catherine Patel

#### *Extract 2 – Proposed changes to production*

I am proposing changes to production. I would like to reduce the number of pieces of bedroom furniture that we offer in each range. At present Aaron Furniture Ltd makes bedroom furniture to order. Customers can have any size of bedroom furniture that they wish. This year the Egerton range of bedroom furniture included wardrobes, beds, dressing tables, bedside tables and bookcases. In this range, Aaron Furniture Ltd made no fewer than 22 different sizes of wardrobe in 2014–2015. We produced 16 different sizes of bedside table. My proposal is that Aaron Furniture Ltd should produce only two different sizes of each piece of furniture instead of making bespoke furniture. It will be necessary to change the production methods used in the Bowton factory. If we make these changes it may no longer be necessary to import furniture from Sweden.

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#### *Extract 3 – Total fixed and variable costs and selling price of bedroom furniture in the Egerton range*

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I have forecast the average revenue and costs for the Egerton bedside table in the 2015–2016 financial year. I think this will be useful when thinking about some of the issues that face us in the next financial year.

Total fixed cost apportioned to the Egerton bedside table	£12000
Average variable cost	£120
Average selling price	£180

**Fig. 3** Forecast cost and price information for the Egerton bedside table

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*Extract 4 – Buying a biomass burner*

The factory in Bowton creates a lot of waste chippings and wood. I have investigated the possibility of buying a biomass burner in which we could burn this waste. The cost of buying and installing a biomass burner will be £50000. The government is likely to provide a low interest loan to finance the purchase and installation of equipment such as a biomass burner. The biomass burner will provide all the energy needed to light, heat and power the machinery in the factory and offices. This will eliminate the cost of energy which was £10000 in the 2014–2015 financial year. The manufacturers claim that biomass burners are carbon neutral and that they produce very little smoke.

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*Extract 5 – Quality control review*

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Currently we use a traditional method of quality control in the Bowton factory whereby finished items are inspected before they leave the factory. I intend to review the use of this method of quality control in the next 12 months.

*Extract 6 – Warehousing*

The system that we currently use is to order wood every three months and store it in the warehouse next to the Bowton factory until needed. I will also investigate this during the next 12 months to see if any changes can be made.

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**Marketing Director's Report, 2014–2015, 'The Future for our Market', Anna Aaron***Extract 7 – The UK bedroom furniture market*

The period from 2008 to 2013 was very poor for furniture manufacturers in general in the UK. Sales did begin to rise in 2013 and then a little more quickly in 2014. Sales are only expected to return to the high levels of 2007 by the end of 2015. Employment has grown and real incomes have begun to rise in the UK. Both employment and real incomes are expected to continue to grow throughout 2016. The Bank of England is concerned about the rate of growth in the UK and there is talk of UK interest rates rising. I must note that competition in our segment of the market has increased both from foreign-based manufacturers, particularly in the Far East, and from the Swedish and Norwegian firms that have set up factories in the UK. One strength of our brand is that we can claim that most of our bedroom furniture is made in Britain.

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*Extract 8 – Looking at export prospects*

I am of the opinion that Aaron Furniture Ltd should begin to export to countries in the Eurozone and/or to Canada. I commissioned a market research report in early 2015 to identify countries in which we might sell the type of furniture we produce and the economic conditions in those countries. The main findings of this report are shown in Figs 4, 5 and 6 below.

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Area/Country	Forecast change in demand for bedroom furniture in the next 12 months
Eurozone countries	+4%
Canada	+8%

**Fig. 4** Forecast increase in the demand for bedroom furniture in the next 12 months – Eurozone and Canada

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Area/Country	Forecast change in prices of bedroom furniture in the next 12 months
Eurozone countries	+5%
Canada	+5%

**Fig. 5** Forecast price rises of bedroom furniture in the Eurozone and Canada in the next 12 months

Area/Country	Currency	Forecast change in the value of the pound against the currency in the next 12 months
Eurozone countries	Euro (€)	+5%
Canada	Canadian Dollar (C\$)	-4%

**Fig. 6** Forecast change in the value of the pound sterling (£) against the currency in the next 12 months

Production is an issue if we do begin to export. The current factory in Bowton which we own is working at capacity given current working methods. A new factory would be necessary. A factory has become vacant on an industrial site close to the one on which we are currently located. It is a bigger factory. This factory would meet the potential new demand for exports, as well as producing enough to meet the existing UK market. The new factory can be leased or we can buy it.

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*Extract 9 – Environmental considerations*

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Environmental considerations appear still to be important in the UK and in the potential export markets. We already label our produce as environmentally friendly. Currently we buy our timber from local producers which are certified under the Forest Stewardship Council (FSC) scheme. This confirms that the forests have been managed in keeping with the environmental and social standards set by the FSC for sustainable production. I list below two examples of principles that must be met to gain FSC certification. These are:

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- to respect workers' rights in compliance with labour conventions
- to maintain the ecology of forests and reduce the environmental impact of logging activities.

We could also consider importing timber to produce the furniture we make in the UK. There are similar advantages to us when buying timber imported from producers who have met the FSC criteria.

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