



GCE A level

1083/01

BUSINESS STUDIES – BS3

A.M. FRIDAY, 13 June 2014

2 hours

ADDITIONAL MATERIALS

In addition to this examination paper, you will need:

- a calculator;
- a 12 page answer book.

INSTRUCTIONS TO CANDIDATES

Use black ink or black ball-point pen.

Answer **all** the questions.

Write your answers in the separate answer book provided.

INFORMATION FOR CANDIDATES

The number of marks is given in brackets at the end of each question or part-question.

You are reminded that assessment will take into account the quality of written communication used in answers that involve extended writing in questions 4 and 5.

You are reminded that questions 4 and 5 are synoptic and so will test understanding of the connections between different elements of the subject.

Study the information provided about *Dairy Crest Group plc* and answer the questions that follow.

Dairy Crest Group plc is the UK's leading dairy foods company. It is an integrated dairy business selling fresh milk and branded dairy products. The company's portfolio of brands includes Country Life milk, Davidstow Cheese, Friij milkshakes and Utterly Butterly margarine. The company also has a doorstep milk delivery operation 'Milk & More' which offers an on-line service.



5 History

Dairy Crest began as a division of the Milk Marketing Board which was set up by the government in 1933 in response to the economic depression that existed at the time. It was a producer-run product marketing board whose role was to buy and market milk from hard-pressed dairy farmers. At the time the majority of the farms were small and farmers were struggling to make a living.

10 In 1980 the Milk Marketing Board's milk processing operation was made into a separate division called Dairy Crest. The division became the buyer of the last resort for all surplus raw milk, ensuring that all milk producers in this country had a buyer for their milk. In 1989 Dairy Crest became a limited company in its own right.

15 In 1993 the company launched Friij, the popular flavoured milk drink and in 1995 Dairy Crest acquired Mendip Foods Ltd, the makers of Britain's favourite cheese brand – Cathedral City.

20 In 1996 Dairy Crest became a public company listed on the London Stock Exchange and from then on continued to grow through acquisition. Its purchases included Unigate in the year 2000, St Ivel's spread business, including Utterly Butterly, in 2002 and Express Dairies milk business in 2006. The company bought St Hubert, the leading spreads business in France and Italy in 2007, and then sold it in 2012.

Dairy Crest sells milk to supermarkets and, in addition, sells its own milk brand, Country Life.



Dairy Crest's Vision and Values

The company's vision and values are the principles on which it aims to build a stronger and more successful company.

25 Dairy Crest's vision is stated as follows:

- We are proud of our links to the countryside and our dairy heritage
- We want to earn the right to consumers' loyalty by providing healthy, enjoyable and convenient products
- We aim to meet consumers' needs and go where this takes us
- 30 • As we grow, we will look after our people and the communities where we work.

The company lists its five values as follows:

- WE LISTEN – Consumers are the heart of our business - we aim to increase our share of our consumers' spending and be number one or two in all of our markets
- WE RESPECT – We value our people and are stronger together
- 35 • WE CARE – We act responsibly with a passion to do the right thing
- WE CREATE – We constantly look for new and better ways of doing things
- WE LEAD – We value success and strive to be the best.

Changes in the Dairy Industry

40 The liquid milk industry has changed significantly over the last twenty years. On the one hand there has been a big change in the methods of milk production. Farmers are producing more milk with fewer cows. In its natural state a cow will live for about twenty years. It will produce about three litres of milk a day and carry on producing milk for up to nine or ten years, but under modern intensive farming methods in the United Kingdom the average production is 22 litres a day and many cows are killed after four or five years as they become less productive. These intensive production methods
45 have often resulted in supply exceeding demand.

Instead of drinking milk, many consumers are now drinking carbonated drinks such as Coke and Pepsi or even just bottled water. As a result, milk prices have fallen in real terms and many of the 13500 dairy farmers in the United Kingdom only survive because they receive subsidies from the government. The average subsidy is £32 000 per farm.

50 Over the last ten years many farmers have left the industry, but the size of herds has increased.
 There are 30% fewer cows, but as yields per cow have increased 22%, overall milk production has
 fallen by 8%. Total milk production in 2012 was almost 13 billion litres, 2 billion of which was bought
 directly from farmers by Dairy Crest. Farmers' leaders have warned that if these trends continue and
 the price of milk is not increased demand will outstrip supply and the difference will be made up with
 55 imports. At present, the United Kingdom imports 33% of its butter, 50% of its cheese and 40% of its
 yogurt.

The rise of the supermarket has put pressure on the price that farmers receive for their milk. Most milk
 is processed by one of the big three milk processors: Dairy Crest, Arla and Müller Wiseman Dairies
 who are in fierce competition with each other to supply the supermarkets. In March 2012, Dairy Crest
 60 announced that it had lost its contract to supply milk to Tesco. The contract represented 3% of the
 company's total sales of liquid milk. At the same time the company decided to close two of its dairies
 and increase capacity at the Group's other three "as part of its long-term plan to reduce costs and
 sustain profitability in an extremely challenging market environment for its liquid milk business". One
 of the dairies that was closed was predominantly a glass-bottling operation, since there has been a
 65 fall in the sales of milk in glass bottles as residential sales continued to decline overall and customers
 increasingly opt for plastic bottles and milk bags.

The Cheese Market

In the year to 30 September 2012, the total volume sales of mature cheese, which makes up 51% of
 cheddar volumes, were up by 10%. There were average price rises across all varieties of cheddar,
 70 driving expenditure on the total cheddar market to increase by 5.8% over the latest 52 weeks.

Branded cheddar has grown ahead of own-label cheddar, driven by very strong performances from
 a number of individual brands, including Dairy Crest's brands Cathedral City and Davidstow. The
 increase in total sales can be attributed to both volume sales increases and average price increases.
 Average price is up 43p per kg, to £6.75, an increase of 6.8%.

52-week data ending 30 September 2012						
Branded/ Labelled Cheddar	Branded Cheddar	Annual Growth %	Standard Supermarket Label Cheddar	Annual Growth %	Value Supermarket Label Cheddar	Annual Growth %
Spend	£703m	10.1%	£525m	0.9%	£227m	4.8%
Volume	104 000 tonnes	3.1%	82 000 tonnes	-1.0%	38 000 tonnes	-8.5%
Average Price	£6.75 per kilo	6.8%	£6.40 per kilo	1.9%	£5.98 per kilo	14.5%

The Total Market for Cheddar Cheese

75 **Milk & More**

Another major change in the industry has been the decline of the traditional milkman. Twenty years ago more than 2.5 billion litres of milk were being delivered to the doorstep each year, ten years ago this had fallen to 637 million litres a year and by February 2013 the quantity of milk delivered by milkmen to people's houses had fallen to 208 million litres. The reason for this decline in doorstep deliveries has been the rise in sales of supermarket milk, which is cheaper and is available, in some areas, up to 24 hours a day.



Dairy Crest's response to the fall in sales direct to homes was to set up Milk & More in 2009. This is an online service which allows customers to order a range of groceries online in the evening to be delivered by the milkman the next morning. Dairy Crest believes that Milk & More will reverse the decline in doorstep deliveries within two years. It currently has 180 000 customers, spending on average above £10 a week. Milk & More is making more than £1 million a week and is the second-biggest grocery delivery business in Britain behind Tesco.

Dairy Crest's Strategy

Dairy Crest states that its strategy is:

- 90 • to build market-leading positions in branded and added-value markets
- to focus on cost reduction and efficiency improvement
- to reduce the risk from fluctuations in commodity prices, to increase total revenue and to generate organic growth
- 95 • to make acquisitions (mergers and takeovers) and disposals where they will generate value.

In April 2013, the company announced plans to invest a further £5m in its dairy in London. The investment is part of a £75m three-year investment programme aimed at driving down operating costs in order to make the business more competitive. The company's 2012 Annual Report included the following statement about cost saving:

- 100 A key part of Dairy Crest's strategy has been to reduce costs and drive efficiencies year in and year out. In the year ended 31 March 2012, the company saved £22 million from a range of initiatives, up from £20 million the previous year. This allowed Dairy Crest to offset some of the inflationary pressures facing consumers from higher commodity costs, boost the amount it spent on marketing its key brands and maintain profit levels in challenging trading conditions.
- 105 Dairy Crest now uses e-auctions, where suppliers offer their products online; this has helped to drive down costs. The company has used new technology to improve its purchasing, and its e-sourcing strategy has led to savings in the costs of gas, plastic packaging and transport.

The company has developed innovative new milk bottles that use 15% less plastic and are easier for consumers. The dual objectives of a lighter bottle and improved performance have been achieved with a new design that does not force the material as far into each of the bottle corners. A further important element of the innovative design is the positioning of the handle at a corner edge of the bottle. Stored in the fridge, the handle can therefore be positioned facing outwards, making it easier for consumers.

115 Dairy Crest has also developed the JugIt system for its Country Life milk, selling milk in bags to customers who are supplied with a reusable jug. This cuts the cost of packaging and makes the milk cheaper for the purchaser, as well as encouraging customer loyalty. However, some customers who have tried the system do not like using it.



Country Life's milk bag and JugIt system reduces packaging by 70%

The Risks Facing Dairy Crest

The company has identified a number of risks, including the following:

- 120 • It faces strong competition on both its branded and retailer branded products.
- Consumers could move away from dairy products for economic, health, ethical or other reasons, leading to lower sales and profits.
- Volatile milk and non-milk costs (vegetable oils, diesel, electricity, gas and packaging) could reduce margins.
- 125 • Restricted milk supply due to economic factors, weather, fuel availability or an epidemic which affects dairy cows.
- An accident, product contamination, the failure of equipment or systems, or deliberate act could disrupt production, affect food safety, cause injury, and/or cause reputational damage with adverse consequences. The company is also reliant on information
- 130 technology and exposed to losses in the event that systems fail.
- The company needs to retain high quality employees to provide customers and consumers with safe, high quality products and services.

Future Prospects

135 On 30 June 2012 Dairy Crest announced that it had sold St Hubert, its French operations, for £344 million, giving it plenty of money to pursue acquisitions in Britain. It had originally bought St Hubert in January 2007 for £248 million. Dairy Crest had originally hoped to make further acquisitions in Europe in order to expand there but, as it had been unable to find any business suitable for a takeover, it decided to sell St Hubert and concentrate its efforts in the United Kingdom.

140 Dairy Crest said that the proceeds from the deal would initially be used to reduce debt. However, the company said that it would consider a range of options for the funds, which represent almost 80 per cent of the company's market value, including acquisitions and returning money to shareholders.



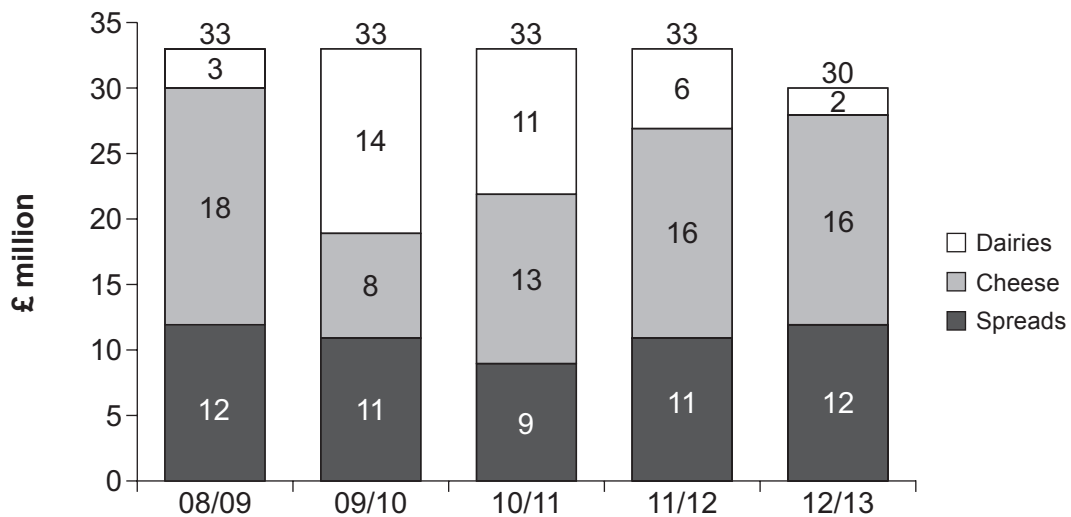
145 Industry analysts believe that a likely take-over target for the company could be Yeo Valley, the family owned organic yoghurt brand, which could fetch as much as £180 million. Dairy Crest has previously said that it wants to re-enter the yoghurt market, although it is not clear whether Yeo's owners would be willing to sell, with the brand enjoying strong growth in recent years. Other potential targets could be Premier Foods' Ambrosia brand or Kraft's Dairylea business, although Dairy Crest has in the past sought to buy less well-known brands and build them up over time.

Company Performance

The business is split into three divisions: dairies, cheese and spreads. The table below shows the percentage revenue derived from each division in 2012.

	Revenue
Dairies	66%
Cheese	14%
Spreads	20%
Total	100%

Operating Profit by Segment – excluding St. Hubert



The performance of the company's top brands in 2012 is given in the table below:

Brand	Market Rank	2011/12 Brand Growth	2011/12 Market Growth
Cathedral City	Number One	+12%	+3.1%
Clover	Number One	+16%	+12%
Country Life	Number Three	-1%	+12%
Frijj	Number One	+7%	+27%

DAIRY CREST plc's FINANCIAL STATEMENTS

Profit and Loss Accounts for the year ending 31 March

	2012 £m	2011 £m
Revenue	1632	1605
Less Operating Costs = Cost of Sales + Expenses	1537	1507
Net Profit	95	98

Balance Sheets at 31 March

	2012 £m	2011 £m
Fixed (non-current) Assets	732	820
Current Assets		
Stock	188	165
Debtors	132	147
Bank & Cash	80	51
Total Current Assets	400	363
Current Liabilities		
Trade Creditors	266	271
Other	7	83
Total Current Liabilities	273	354
Long-term (non-current) Liabilities	585	462
Net Assets	274	367
Shareholders' Capital		
Share Capital	104	104
Reserves	170	263
Total Shareholders' Capital	274	367

Sources: www.dairycrest.co.uk

1. Identify and explain the various changes that have taken place in the dairy industry in recent years which have had an impact on Dairy Crest plc. [10]

2. Explain possible ways in which the management of Dairy Crest plc might respond to the risks which face the business. [12]

3. Analyse and evaluate the performance of Dairy Crest plc, using both financial **and** non-financial methods. [14]

4. Evaluate Dairy Crest plc's vision and values from the point of view of its various stakeholders. [12]

5. Assess the view that the best strategy for growth for Dairy Crest plc is through acquisitions (mergers and takeovers) rather than through organic growth. [12]

END OF PAPER

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