A-level

BUSINESS

Paper 3 Business 3

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Source 1: AM plc (Aerial Manufacturing plc)

The past

Aerial Manufacturing plc (AM plc) manufactures toys. For 20 years the business has made remote-controlled toy aircraft, drones and helicopters. These have been sold through retailers in the UK. Shortly after the company was founded, it moved all its manufacturing operations to a factory in China. This allowed AM plc to take advantage of cheap manufacturing costs – primarily due to the low wages paid to factory workers in China at the time. The company's headquarters – including its product design department – stayed in the UK.

A new boss

A new Chief Executive, Roger Hicks, was appointed a few months ago. Prompted by shareholder dissatisfaction over low profitability, he was given two main objectives:

- increase sales turnover quickly
- increase dividend payments to shareholders by 2025.

Roger immediately analysed the existing strategic position of the business. He knew that recent rises in wage rates in Chinese factories meant that wage rates there are now closer to those in the UK. He analysed performance data from the AM plc factory (Appendix A) and visited the factory. He found what Blake and Mouton would describe as a 'produce or perish' style of management. Unlike similar factories in China, which use a 'middle of the road' style, AM plc's factory relied on a high division of labour where each worker completed one small repetitive task. Supervisors were paid a bonus according to the output per worker for their section. As a result, rest breaks had been shortened and shifts extended by supervisors desperate to achieve bonuses for themselves. Following his review, Roger knew things had to change and introduced a new corporate strategy.

A new corporate strategy

AM plc will no longer make toys or sell through retailers. Roger's new strategy will build on the company's existing expertise in manufacturing remote-controlled aircraft and drones but targeting different customers. AM plc will design and manufacture sophisticated drones to be used by businesses which need an aerial capability as part of their operations. Drones are used in many industries including agriculture, construction and distribution. Roger intends to produce a range of drones specialising in inspection, high-quality video footage and parcel delivery.

AM plc will be selling directly to businesses. Roger is confident that this strategy offers opportunities for huge growth as it is founded on the company's core competence of designing and manufacturing drones. Instead of trying to be a cheap supplier in the mass market for toys, the business will switch to a strategy of focused differentiation. Differentiation will come from being a long-established business in the industry with exceptionally high-performing and durable products. Market research is encouraging, with sales forecasts shown in Appendix B.

A new site

Roger believes he must move AM plc's manufacturing back to the UK. His operations director has identified two possible sites for a new factory. Site A is 30 miles from London. The area offers an attractive place to live and work, easy access to many potential customers' headquarters and good transport links to the rest of the UK. Site B is in the North West of England. After the recent closure of a nearby car factory, local unemployment is high. Site B is £2m cheaper than Site A and close to a port, therefore offering easy shipping for exports. Further data about each site is in Appendix C.

A new factory

Roger's vision of the new factory focuses on highly skilled workers using advanced robotics. Output will be of exceptionally high levels of quality, but with the flexibility to adjust the products being made to suit individual customers' specific requirements. Roger will use a 'Just in Time' system at the new factory. This will have implications for the frequency and size of deliveries, cash flow and the inventory turnover ratio.

Building a factory will be a complex process involving thousands of different activities. Roger understands the challenges involved in planning and managing a project of this size. In a former job as project manager for a multinational manufacturer, he had supervised the construction of several factories. He intends to use network analysis to identify the critical path. The existing factory in China will be closed in ten months and Roger is confident the new factory will be operational by then.

Finances

Roger has allocated a total budget for the change in strategy of £10m. Much of that will be spent on the new site, factory and production equipment, with the rest available for marketing. He has a bank loan arranged to borrow up to the full £10m.

Roger is confident that his decisions will lead to success in meeting his two objectives.

Appendix A 2020 performance data on AM plc's Chinese factory and similar factories in China

	AM plc Chinese factory	Average for similar factories in China
Unit cost	£23	£25
Productivity (units of output per worker per month)	240	200
Labour turnover	40%	15%
Defect rate per 1000 products	80	10

Appendix B Sales forecasts for AM plc based on quantitative market research

Years after change of strategy	Sales volume (units sold)	Sales value (£m)
Year 1	2300	11.5
Year 2	2800	14
Year 3	4000	20
Year 4	6000	30

Appendix C Information on possible sites for AM plc's new factory

	Site A	Site B
Initial investment (purchase of land plus factory construction and production equipment)	£8m	£6m
Average selling price per unit	£5000	£5000
Fixed costs per year	£6m	£4.5m
Variable costs per unit	£2500	£3000
Maximum capacity (units per year)	10 000	8000

Appendix D Extracts from latest annual accounts for AM plc

	£m
Sales turnover	22
Cost of sales	20
Inventories	5
Other current assets	1
Current liabilities	6
Non-current liabilities	5
Total equity	15

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