

OXFORD CAMBRIDGE AND RSA EXAMINATIONS

Advanced GCE

BUSINESS STUDIES

Business Strategy

CASE STUDY

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INSTRUCTIONS TO CANDIDATES

This copy may **not** be taken into the examination room.

The business described in this case study is entirely fictitious.

This case study consists of 8 printed pages.

The Container Group plc

The Container Group plc (TCG) manufactures plastic containers for a wide range of applications. The Group comprises a series of wholly owned subsidiary companies. It is organised into a series of customer-based divisions, as shown in Table 1. A five year financial summary is shown in Appendix 1. Balance Sheets for the Group and its Paints Division are shown in Appendix 2.

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Table 1

Divisional Summary, 2003

Division	Turnover £'000	Profit £'000	Net assets £'000	Employees Average	Market share %	Market growth % pa
Food & Drink	160,686	1,719	34,281	2,353	18.9%	+8.5%
Industrials	40,902	356	10,755	692	11.6%	+1.9%
Paints	14,608	74	2,353	369	14.8%	-2.1%
Toiletries	35,059	445	9,410	655	16.7%	+4.5%
Packaging	20,450	27	6,049	277	15.9%	+3.6%
Specialist	20,451	163	4,370	268	N/a	N/a
Group Total	292,156	2,964*	67,218	4,614		

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*After exceptional item

The Group's mission statement highlights the need to be adaptable and reflects its belief that it is highly customer focused. The statement continues '...as a Group we will prevent pollution wherever possible ... take active steps to minimise the negative effects of packaging through recovery and recycling.'

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Within each division there are a number of individual factories. Most divisions use a range of manufacturing technologies. These technologies are blow moulding, injection moulding, and thermoforming. The Paints Division, reflecting the nature of the product put into the container, only uses injection moulding.

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Injection moulding is the most straightforward of the three technologies used by TCG. In this process, plastic is heated until it becomes liquid. It is then injected under pressure into a mould. On cooling, and so solidifying, the plastic takes up the shape of the mould. The technology is well proven and can be acquired quite easily. The weight of plastic used in the containers ranges from 15 g through to about 1 kg for the jumbo sizes. The majority of the workforce within the Paints Division is unskilled; the exceptions being the fitters who set up the machines, the administrative staff and management. Union density is high amongst operative staff. David Woodrow, the Divisional Director, has on several occasions, tried to introduce a variety of training schemes to raise the capabilities and motivation of the factory floor operatives. Each initiative has been met with an immediate demand for higher wages before any training can take place. The uplift in wages is justified as necessary by the trade union representative to bring the wages paid in the Paints

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Division into line with the Group average. The Paints Division's industrial relations record is poor. Similarly, absenteeism amongst operative staff is above the Group average. 40

The market for moulded products is price competitive, with few opportunities for significant added value. Management places great emphasis on cost reduction in order to achieve the required return on capital, something that has not been achieved by the Paints Division in three of the last four years. This is a source of real concern to David. In the last two years, he has noticed increasing import penetration into the Paints Division's UK market, particularly from competitors based in European countries with low labour costs. The Division's labour costs account for about 1/3 of total cost, the other 2/3 being split roughly equally between material and overheads. David is surprised that one competitor, Horbacz S.A., based in Poland, is able to transport containers half way across Europe and still sell at competitive prices. With little price differential, TCG only enjoys a competitive advantage because of its short lead times. David realises that this favourable position does not arise from the Division's own actions, rather those of its customers. 45
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Blow moulding used extensively in the Food and Drink Division, is a complex manufacturing process. For example, although at first glance the humble plastic ketchup bottle may appear to be unspectacular, it is in fact the opposite. Each bottle is a plastic laminate, each layer having a different property and role. The layer in contact with the food has to be inert. Other layers have to be air tight so as to preserve the contents. The outer layer has to be able to withstand the high temperatures at which the contents are packaged and pasteurised. The design and manufacture of these containers requires specific skills at several key stages. These skills are in short supply and the Group has policies in place to train and retain such workers. The employees' skills and specialisation enable TCG to command larger margins for such products. The positive attributes of plastic for customers, retailers and consumers are gradually enabling TCG to win more business from customers who have traditionally used glass containers. This is despite the 2:1 cost disadvantage of plastic to glass. Berinda Banks, Divisional Director, is aggressively targeting such food manufacturers. 60
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The Group has no centralised research and development (R & D) facility. Rather, it prefers to enter into contracts with specialist research laboratories and universities to develop new packaging technologies. One such project is researching how to produce different shapes and styles of container, for example square cross section containers. Such a shape would have a number of advantages throughout the distribution chain and on into retail operations. Another project is developing a plastic container to replace aluminium 'tins' for products such as soft drinks. Berinda's division has an objective of 7% growth in business in the coming year. She believes that the only way to achieve this objective is through winning new customers. 75
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A frequently cited disadvantage of plastic is its environmental impact when compared to glass. Legislation surrounding disposal of redundant products within other markets has caused TCG to review its purchasing, manufacturing and sales policies. In common with other large businesses, TCG regularly conducts environmental audits. Indeed, one major US owned UK customer will only purchase from firms that have audits and environmentally aware policies in place. It is against this background that Berinda has to respond to an urgent telephone call from Head Office concerning a recent newspaper report (see Fig. 1). 85

The County Courier is a newspaper that serves an area in which there are two TCG 90

plants, both in Berinda's division. Divisional policy reflects Group policy regarding the disposal of all waste. Waste is sorted at each plant into three categories, recycleable, inert and hazardous. TCG pays a specialist firm, Greenhough Environmental, to dispose of inert and hazardous waste. Inert waste is mainly production off-cuts. These can be used again in non-food applications having been reprocessed, by first shredding and then blending with new raw materials. A shredding machine has a capacity of 0.5 tonnes per hour and an operating cost of £2.60 per hour. The employment cost of the unskilled operator is £8.50 per hour. If the plant is short staffed, reprocessing may not be possible and so material goes to a land fill site at £20 tonne (subject to annual review due to the Land Fill Tax escalator). Typically about 0.1% of output is substandard. 95 100

One factor that unites all of TCG's operations is plastic, a product of the petrochemical industry. As a commodity, plastic prices (\$/t) are prone to fluctuation. Last year, TCG used about 75,000t of raw material. All raw materials are purchased through the Group, which then sells to each Division using a system of transfer pricing. There are several benefits of this centralised approach, a key one being the ability to secure lower input costs by exploiting the Group's buying power (see Fig. 2). The amount used by each division reflects the products made. For example, the Food and Drinks Division and the Toiletries Division tend to manufacture relatively lightweight containers. In contrast, the Paints Division and the Industrial Division use a disproportionate amount of raw material when compared to the value of their output; 12% and 19% respectively. 105 110

The Group's status as a quoted company means that its actions are open to public scrutiny. Group Managing Director, Liz Speed, is constantly aware of the diverse range of needs of its different stakeholders. Influential amongst these are, of course, the shareholders. In common with many plcs, TCG has a broad constituency of shareholders. The largest single shareholder is the company's own pension scheme, with a holding of 9.0%. The second largest, an institutional investor holds 6.8%. Other similar funds also have sizeable holdings totalling 62.6% of the issued shares. As Liz and her fellow senior managers are appointed by the shareholders, she is more aware than most of the need to optimise shareholder wealth. Hence, monitoring of share price is a daily consideration at Head Office. Part of the reward package for the Directors is a share option scheme at an exercise price of £1.75 per share. Fig. 3 shows a summary of TCG's share price in recent months. In the last twelve months none of the Directors exercised their option. Plans to extend the share option scheme to the employees as part of the remuneration package have met with a lukewarm response from their representatives. 115 120 125

Extract from *The County Courier*

'We're being dumped upon by big business'

By our environmental correspondent, Mark Northen.

For months residents of the picturesque village of Langford have been battling with a growing mountain of chemical waste. The unsightly and dangerous waste is being dumped illegally at Yew Tree Farm. Local residents have told this paper that, despite their pleas to the local council, nothing has been done.

The waste first started to arrive early in the spring says Tim Corbett, 82. 'I've lived here for all of my life and have never seen anything like it. I go to bed at night worried about what I'll wake up to. Sometimes its one lorry, other times more. But it's not every night.' Another resident, who didn't want to be identified, told our reporter that when out walking his dog one night last week he had tried to stop a lorry. After an argument with the driver he was threatened with physical violence. When the shaken man called the police he was told that no officer could attend unless violence had actually been committed.

Melanie Gaylor, Environmental Enforcement Officer for the local council, says that the council is doing all that it can. Yew Tree Farm was sold in 2002 to a Liechtenstein registered development company. The company lodged a planning

application for the building of an equestrian centre soon after. 'Following extensive public consultation with local residents, none of whom raised any objection, outline permission was granted. The council understands that initial groundwork started in the summer of 2003. We have been assured that any vehicles entering the site are engaged in this work.'

Jean Armstrong, local Post Mistress, said that to begin with everything was going well. 'We were all really quite excited about it. Yew Tree Farm had been derelict for years. We were worried it might be sold for executive housing. So when we heard that it was going to be a business we were all delighted. But now we find it's been turned into a dump. We're worried about the kiddies in the village. Anyone can just wander up there. It's just not safe. It's only a matter of time until someone gets hurt. There's about fifty tons of it up there. It's like living next to a chemical time bomb.'

We can now exclusively reveal that the waste comes from The Container Group. Last year the business made £300m. No one from the company was available for comment last night.

Fig. 1

Raw material cost index

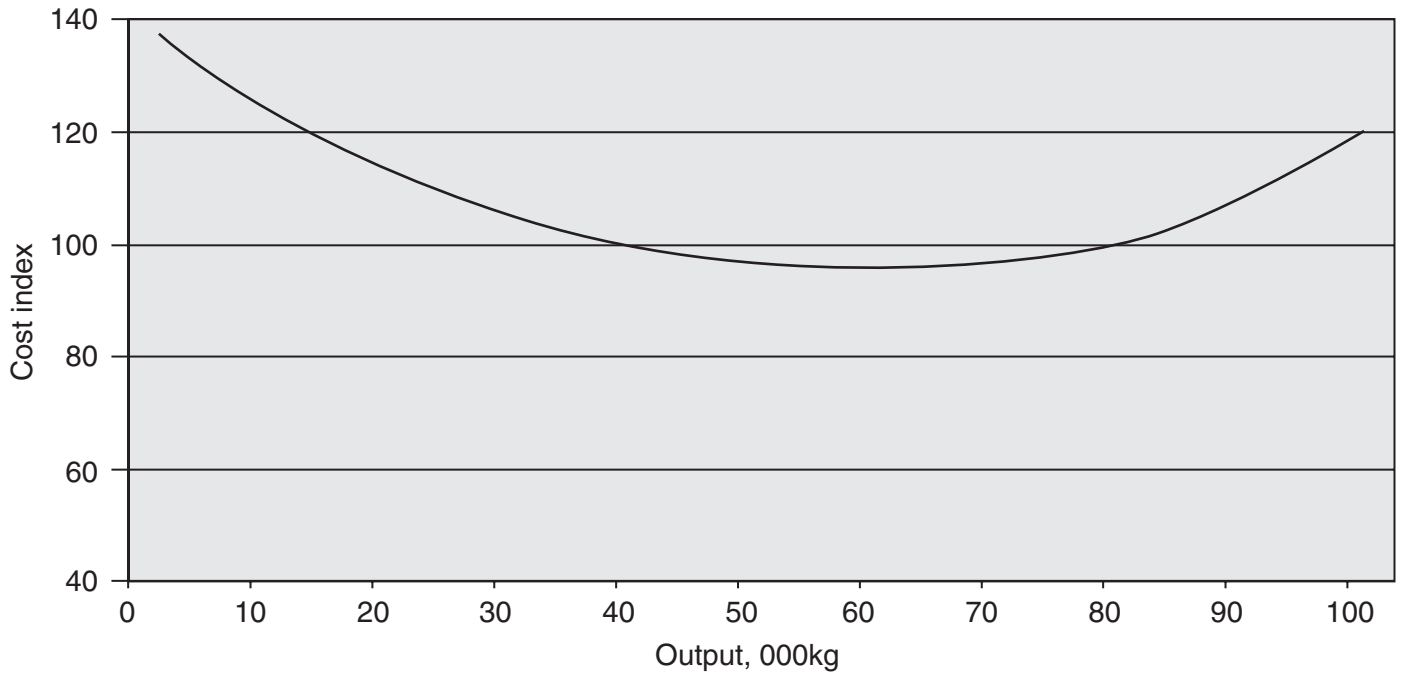


Fig. 2

TCG Share Price (pence per share)

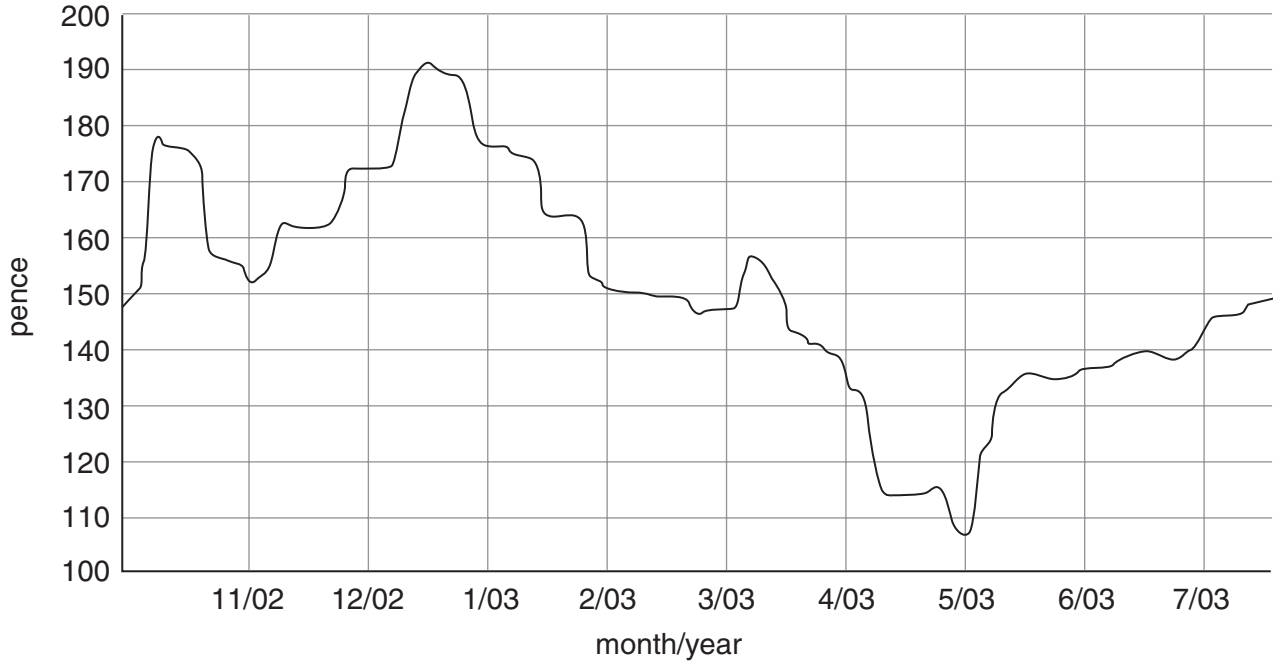


Fig. 3

Appendix 1

5 Year Financial summary

	2003	2002	2001	2000	1999
	£000s	£000s	£000s	£000s	£000s
Turnover	292,156	242,531	220,891	197,054	106,068
Operating Profit	18,887	18,862	17,050	14,026	9,450
Net Profit	2,964	12,530	11,237	9,405	6,121
Capital Expenditure	23,556	21,667	19,306	15,317	9,970
Earnings per share	£0.150	£0.175	£0.145	£0.135	£0.140
Average number of employees	4,614	3,861	3,560	3,278	1,790

Appendix 2

Balance Sheets as at end of financial year

	Group	Paints Division	
	2003	2003	
	£000s	£000s	
Tangible Assets	134,449	5,754	
Intangible Assets	<u>5,891</u>	<u>0</u>	
	140,340	5,754	
Current Assets			
Stock	39,670	2,984	
Debtors	51,375	3,569	
Cash	<u>981</u>	<u>0</u>	
	92,026	6,553	
Current Liabilities			
Creditors	82,008	6,100	
Net Current Assets	10,018	453	
Total Assets less Current Liabilities	<u>150,358</u>	<u>6,207</u>	
Creditors due after one year	83,140	3,854	
Net Assets	<u>67,218</u>	<u>2,353</u>	
Share Capital	3,500	200	
Profit and Loss Account		63,718	2,153
Equity Shareholders' Funds	<u>67,218</u>	<u>2,353</u>	