Cambridge International AS & A Level

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BUSINESS **9609/33**

Paper 3 Case Study **May/June 2019**

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This Insert contains the case study for use with the Question Paper.
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Africo Chocolate (AC)

AC is a family business, based in an African country. AC is a private limited company, owned and managed by the Lukwesa family, which started the business over 50 years ago. AC produces chocolate powder, using cocoa beans sourced from local farms in its home country, which is world famous for the quality of its cocoa beans. AC has expanded steadily over the years, financed by retained profit and bank borrowing. AC's profits have remained steady, giving the family shareholders a good return.

Processing of the cocoa beans into chocolate powder takes place at 2 factories which are 300km apart. Factory S is located in the south of the country, near the capital city and the coast and Factory N is in the north, not far from the border with another country. Both factories have full teams of production managers and employees, but administration, finance and marketing are based in offices at factory S.

AC's chocolate powder is sold in bulk to business customers, which are well-known chocolate companies around the world. These companies carry out final manufacturing, transforming chocolate powder into their own branded mass market and luxury chocolate products for consumers. AC has excellent relationships with its customers who value the company's punctuality of supply and consistent product quality.

Marketing

AC adopts 'fair trade' principles. This means that they pay farmers a guaranteed agreed price for their crops, which is often higher than the current market price for cocoa beans. AC also pays its own employees more than the legal minimum wage. The Lukwesa family believes that 'fair trade' is an important ethical marketing advantage for their company. AC's business customers are then able to use the 'fair trade' label on their final chocolate products and charge a higher price to consumers. Although the global demand for 'fair trade' chocolate is increasing, the chocolate market is becoming much more competitive.

Economic and legal changes

The economy in AC's home country is developing and growing at a fast rate. The level of employment is increasing and the government has introduced new laws to protect employees. All workers now have a right to sick pay and a contract of employment. The daily minimum wage has also been increased by 10%. The government is keen to support business development and reduced the tax on company profits by 2% this year. Current and forecast economic data is shown in Appendix 1.

New management and new ideas

Ali Lukwesa has recently taken over as Managing Director of the business. Ali is ambitious and determined to reorganise and modernise the company. He would like to raise the business profile of AC and take advantage of opportunities presented by the fast growing world demand for chocolate products.

Ali is considering closing factory N in 2020 and centralising all functions at factory S, which has land available for expansion. The factory N site could be sold for $1.5m. This will cover the redundancy costs for employees and contribute to the factory S expansion. AC will need to borrow $7m to finance the project, including updating machinery and modernising facilities. AC's Operations and Human Resources Directors are opposed to this plan. Ali has forecast that the overall impact on capital employed will be to increase it by $8m. Table 1 shows an extract from AC's latest accounts.

Table 1: Extract from AC's latest accounts

	$m
Current assets	5
Current liabilities	4
Non-current assets	20
Non-current liabilities	21
Capital employed	54

Ali and the other directors will use the data about the two factories shown in Appendix 1 before making a final decision.

Cocoa bean supply problems

Ali would like to expand AC's chocolate powder production. However, AC competes with other chocolate processors for their supply of cocoa beans. Cocoa bean prices are driven by global supply and demand factors. AC has been forced to increase the prices it pays to farmers by 15% in 2019. AC's Production Director has also been investigating new supplies of cocoa beans from a neighbouring country, but there are doubts about the quality and reliability of the supply. However, many farmers in AC's home country are now planting cocoa bean bushes, hoping to gain from the current high prices.

Human resource planning

At present, production and administrative employees at both factories have full-time permanent contracts. Labour turnover is low and the relationship between directors and employees is good. Ali would like to introduce new employment contracts. Senior managers would remain on their existing full-time contracts, but all other employees would have a more flexible pattern of work imposed, including more use of temporary and short-term employment contracts. This will enable longer hours of production and operations will respond more quickly to changes in demand.

Long-term strategic planning

Ali is looking to the future. He wants to consider two options for growth. At a recent meeting with his team of directors, Ali said: 'If we want our company to grow, I believe we need to move with the times. Each of these two options will be expensive. We will need to make a strategic choice between them. Perhaps we should convert AC into a public limited company as well. We will need to make changes to our business plan, whichever option we choose.'

The two options for growth are:

Option A
Start production of an AC branded range of luxury chocolate products. These would be aimed at the increasing numbers of middle and high-income consumers in AC's home country. The products could be sold through supermarkets. AC would also consider exporting the chocolates.

Option B
Secure future supplies of cocoa beans for the company by the purchase of a large farm in AC's home country. This would be cultivated to grow cocoa beans, with the first crop expected after three years. Surplus cocoa beans could also be sold to other companies.

Ali asked his directors to carry out research into markets and costs, to help make the strategic choice. Data from Ali's own research is shown in Appendix 3.

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Appendix 1: Data for Factory S and Factory N for year ending 31 December 2018

	Factory S	**Factory N**
Full capacity (millions of kg)	4.00	2.50
Current production (millions of kg)	3.10	2.20
Revenue ($m)	9.3	6.60
Raw materials cost ($m)	2.79	1.98
Variable labour cost ($m)	1.55	0.66
Variable transport cost of processed chocolate powder ($m)	0.62	0.77
Factory fixed costs ($m)	2.00	1.50
Allocated fixed costs of marketing and administration departments ($m)	0.50	0.30

Appendix 2: Economic data for AC's home country

Economic indicator	**Actual data for 2018**	**Average yearly forecast for the next three years**
Economic growth (%)	7	4.5
Inflation (%)	5	8
Unemployment (%)	8	6
Interest rate (%)	6	9
Change in currency exchange rate against major currencies	2% depreciation	No change

Appendix 3: Extract from Ali's research data for Options A and B

	Option A – Production of luxury chocolates	**Option B – Purchase land and farm cocoa beans**
Capital cost ($m)	2	1.5
Lead time to set up project (years)	1	3
Probability of success (%)	70	80
Estimated annual economic return if successful ($m)	0.8	0.6
Driving forces	• Use of own processed chocolate powder • Control over marketing of final product	• Secure cocoa bean supply • Good transport links with Factory S
Constraining forces	• Lack of expertise in chocolate final processing and retailing	• Lack of expertise in farming cocoa beans
Opportunities	• Growing market for chocolate products in the home country and worldwide	• Growing demand for cocoa beans from AC and other companies
Threats	• Competition from well-known brands	• Weather and crop disease. • Over-supply in market for cocoa beans.

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