

AQA
Business Studies
Units 2 and 3
Case Study for June 2005
Chinatown

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28 March 2005



Introduction

These resources are aimed at helping you to get to grips with the AQA Business Studies Case Study for the June 2005 exam for Units 2 and 3. It has been prepared in the form of a dialogue between Jack Wei and an interviewer. This approach allows us to take all of the issues that arise from the case and give Jack's point of view (as we see it anyway!). This dialogue is entirely fictional since Jack doesn't exist and neither does the interviewer.

There will be six interviews overall: one for each section of the case study. The titles of each interview will be

- ◇ The beginning
- ◇ Great Leap forward
- ◇ From Tertiary to Secondary
- ◇ **Making it Happen**
- ◇ Running the business
- ◇ Another step forward?

The interviews will be released at weekly intervals from now on with the first interview, the beginning, being released on 28 March 2005.

The case itself is the copyright of the AQA Board and can be downloaded free of charge from this address: <http://www.aqa.org.uk/qual/gceasa/qp-ms/AQA-BUS23-W-PM-Jun05.pdf>

We are using the case study as the basis of all of the interviews but are then adding our analysis of the case plus a wide variety of additional materials that we feel are appropriate for a full analysis of it.

Part Four: Making it Happen

Interviewer: Thank you for seeing me again Jack, it's very good of you. I think we are about to get to a very meaty part of your business history now as we start to talk about Wei Foods Ltd: your wife Ling's venture.

Jack: Yes, she did very well. What do you want to know?

Interviewer: Basically, how did she do it? I mean, she came from China just a few short years ago; but she's young and inexperienced and although you are both clearly hard working and good at what you do, here is the situation as I see it.

Ling walked into a supermarket and told them that their Chinese food products were rubbish. She spent hours in her kitchen at home producing her own microwavable dishes and within a very short space of time she was the holder of a signed contract worth around £25 million a year. Even so, all she had was small kitchen experience, some good ideas, lots of energy and absolutely nothing else.

- no factory
- no people
- no suppliers
- lots of competition
- no money

I hope I've summarised that properly without offending anyone Jack.

Jack: Well, you're a bit hard on Ling but generally, what you say is accurate.

Interviewer: Sorry!

Jack: Don't worry, I know the English can be tactless! This is what happened. We spent a lot of time putting together a business plan of Ling's ideas. Of course, that is a highly confidential document but it set out

- our objectives
- our ideas for production
- detailed ideas of Ling's recipes
- market research
- a financial and non financial forecast and plan
- potential finance requirements
- and so on

We needed £2 million to get this operation up and running and we had around three months to do it because the supermarket we are working with demanded (and Ling agreed!) that our products are available from 1 February onwards.

Chop chop!

Interviewer: I think it would give my readers a lot of hope if you could explain where the money came from: I know other small business people would get a lot of hope from being able to relate to someone in their situation making good progress.

Jack: First part of the recipe for success is the idea, the second part is hard work, lots of hard work. Ling is young and very energetic and she knew that she wanted to succeed. Even though this job was really impossible she wanted success.

So, we asked around. We walked the streets going from bank to bank, we talked to our families and friends. Remember we had my business too and that was turning into a cash cattle.

Interviewer: Cash cattle? Sorry, what's that?

Jack: You know, the Boston Matrix ... star, dog, question mark, cash cattle

Interviewer: Ah, you mean cash cow!

Jack: Ah, ha, ha, haaaa! My English! Well, in the end, this is the deal we did:

- £1 million of the finance came from a loan from the China Merchant Bank;
- the remainder came from share capital invested by the Bank
- myself and Ling
- old friend of mine, Sam Yip

The loan from the bank was on a fixed interest rate basis at 6.5%: this was late 2004 early 2005 when base rates were around half of that level. Of course, they needed security so they secured the loan on our assets and Ling's recipes.

(Note: in the appendix, we have repeated the graph of UK interest rates 1994 - 2003 Ed)

Interviewer: Ling's recipes? How on earth did they do that?

Jack: Well, we publish Ling's recipes in a very formal way and we copyright them. We also warn all other Chinese food factories that we will hit them hard if they steal those recipes: we knew from the supermarket's reaction that Ling had a real talent and had created something of enormous value.

Interviewer: You can do that?

Jack: We did it: Ling has translated some of the recipes into small kitchen versions, too and we will give them away from time to time: as a line goes out of fashion, we will do that!

The shareholdings are like this, here, look at my a spring roll chart ... better than a pie chart don't you think!

Figure 1



Source: data taken from the case study

Interviewer: So the bank essentially provided £1.38 million out of the £2 million you needed? You must have been laughing all the way to the ... er ... bank!

Jack: You should have seen our business plan. You should have seen how we negotiated with the senior loans officers at the Merchant Bank. Merchant bankers are serious business minded people who only deal with other business people and they seemed to know from the very beginning that Ling was a force to be reckoned with and that her products were world beaters. They talked to the supermarket people too, don't forget.

Interviewer: What was the supermarket thinking, though? Aren't you and they worried that you are going to be their sole supplier and that they will be your sole customer?

Jack: That's true in the short to medium term: it will be a one to one agreement. However, our business plan shows; and don't publish this please, that within three years we will be well on the way to working with other customers as well as with the supermarket. In every way Wei Foods Ltd is a start up and the supermarket is helping by guaranteeing their business for the duration of the initial contract at least.

We have promised, as part of our contract, that there will be no breaks in supply. Ling is ready to fight to make sure there will be no breaks.

Interviewer: Didn't you consider asking the supermarket to help you, by the way? That could have been a better way of starting out don't you think?

Jack: We thought of that but only briefly: then we realised that it could be embarrassing if ever there were problems or disputes. The supermarket did, however, strongly suggest from the beginning that they wouldn't consider financing our business as they were signing a contract to guarantee their business and we needed to sort out the rest as a matter of good faith and so on. We were happy with that and we saw the wisdom of their words.

Interviewer: Did they help with your market research in any way?

Jack: Er, yes: they liked what Ling did for them and they gave her a multi million Pound contract! What more did Ling need?

Interviewer: Ah, I see! Silly me! You set up a private limited company called Wei Foods Ltd. Why did you do that?

Jack: Firstly, to keep Ling's business separate from mine: for business and personal reasons.

This was Ling's idea and although she's my wife, she wants to retain her independence and so on. She asks for help and advice of course but she wants to be in control of her own destiny. Don't tell her I said this but if I think she's going to make a mess of something I do help her out and so far she's happy with that.

Interviewer: Was that personal or business?

Jack: Personal, really. For business reasons, we need to keep the two businesses separate: I run a large and successful restaurant and Ling runs a large and successful manufacturing operation. They are completely separate organisations with separate management and staff and separate objectives.

Secondly, we need to ring fence the finances: there is little point in my restaurant being successful and pretending that Wei Foods Ltd is successful when in fact it is being financed by my restaurant ... and vice versa. Cross subsidisation my accountant calls it. No, we have set up Wei Foods to give Ling's business its identity and to protect the rest of our operations.

Thirdly, it gives us limited liability: don't forget, though, that the bank has taken many of the assets as collateral so limited liability doesn't mean a huge amount really.

Interviewer: Ling is the Managing Director (MD) of Wei Foods Ltd isn't she? What does that mean in practical terms?

Jack: It means that Ling says what happens in the factory and the rest of the business.

Interviewer: What's the scale of the factory in terms of capacity and so on?

Jack: The factory's got a maximum capacity of 600,000 units per week: it works two shifts a day six days a week. As told, we should have around 80 factory workers and 60 others including maintenance, administration, supervisory and managerial jobs.

We also felt the need for a chilled ingredients stock room large enough to hold three days' stock: the raw materials for 300,000 units. There is also a chilled finished goods stock room that can hold two days' stock.

This contract and this set up means that Ling has to balance her production very accurately: there is very little room for mistake. There is some scope for overcoming major crises though as we are only operating a two shift system meaning that there is plenty of spare time should we ever need it.

Interviewer: And when did you come on stream>

Jack: The supermarket contract kicked in with demand for 300,000 units a week must from 1 February 2005. If ever Ling misses a deadline there are financial penalties: these penalties are an excellent motivator.

Interviewer: Did you never worry about any part of this deal, Jack?

Jack: I have to say that around the 2004 Christmas period, I was worried that the installation of the machinery and equipment at the factory was going too slowly but Ling never worried. She told me that Production Engineer was using *simultaneous engineering* to manage the installation, testing and set up of the factory. In the end, everything was up and running a day earlier than planned.

Interviewer: I don't think I've heard about simultaneous engineering before: can you tell me what it is?

Jack: Here's a secret: I'd never heard of it before either. So I did a bit of digging around and found an old paper from the Cranfield School of Management that told me this, here have a look:

Rolls Royce defines the objective rather than the process of simultaneous engineering as follows:

"Simultaneous engineering attempts to optimise the design of the product and manufacturing process to achieve reduced lead times and improved quality and cost by the integration of design and manufacturing activities and by maximising parallelism in working practices"

Jack: It took me a long time to understand that sentence; but then this helped even more, from the same article from Cranfield:

Hartley and Mortimer provide a clearer description of the process:

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Analysis by Duncan Williamson working in collaboration with Chris Sivewright

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Simultaneous Engineering is not just project management by Task Force under another name.

Vital elements include:

- *Multi disciplinary Task Force*
- *Product defined in customer's terms, then translated into engineering terms in considerable detail*
- *Parameter design to ensure that the product is optimised for use and quality*
- *Design for Manufacture and Assembly (DFMA)*
- *Simultaneous development of the product, the manufacturing equipment and processes, quality control and marketing*

Source: *How to Perform Simultaneous Process Engineering* Michael Sweeney

Interviewer: So it means doing everything really carefully, keeping quality aspects in mind at all times, making sure that you've designed the whole set up so that manufacturing will be optimised and that you should be prepared to install and assemble the various parts of the factory at the same time and not necessarily bit by bit in a straight line.

Jack: I think you understood that pretty well. It looks like common sense to me, though.

Interviewer: That's what I thought!

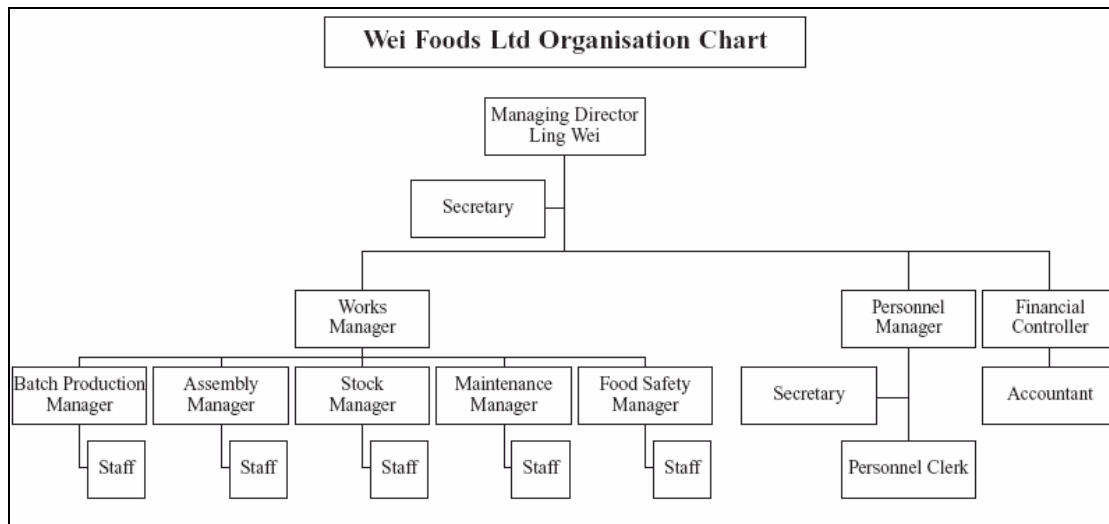
Jack: After Christmas, Ling hired an experienced Works Manager to run the factory on a day to day basis, plus a Personnel Manager and a Financial Controller. She would take care of customer service herself.

Interviewer: Wasn't that a bit late? After all, if the works manager is going to manage the factory that had just been installed by simultaneous engineering, don't you think he should have been in post during the installation and set up phase?

Jack: That was one reason why I was worried in the run up to Christmas. I am also worried that Ling has hired a production engineer and a works manager from the beginning. I'm not sure she needs both.

I also think that the personnel management appointment was a bit late although to be fair, Ling was dealing with a couple of agencies to help her out with recruitment. Ling is working with this organisation chart now:

Figure 2



Source: the case study

Interviewer: Do you think she needed all of these people from the beginning? Where's the Production Engineer, too? Surely, she should have had some multi talented and flexible people around her to start with and then bring in the expensive experts later?

Jack: It's also a very traditional chart too and I agree with you ... don't print that ... I wanted her to use more of a matrix approach so that she built in the maximum amount of flexibility. As it is, some of the people started their lives at Wei Foods by saying things like, that's not in my department ...

I told Ling to re educate or get rid of those people: she needs flexible people at all times and the matrix organisation gives you that. This is a diagram I got from a course I went on a while ago that taught me a lot about the matrix organisation.

Figure 3

Matrix Structure			Production	Marketing	ICT	Finance	R&D
Production	Factory A	Product 1					
		Product 2					
		Product 3					
Marketing		Product 1					
		Product 2					
		Product 3					
ICT		Networking					
		Web Site					
		Systems					
Financial Accounting		Cash					
		Debtors					
		Creditors					
Management Accounting		Production					
		Budgeting					
		Ad hoc Exercises					
R&D		Research					
		Development					

See how it works?

Interviewer: Yes, I can see, for example, that the production people just work for themselves whilst the marketing people are working for production and themselves, ICT works for everyone ...

Jack: It's so much more flexible and realistic too since this is actually what happens. And no one can say, it's not in my department.

Interviewer: You said last time that profit margins were very tight with this contract, what impact did that have on Wei Foods' operations?

Jack: It means that Ling is working very near to her break even point all of the time, until she can get some economies of scale into her system.

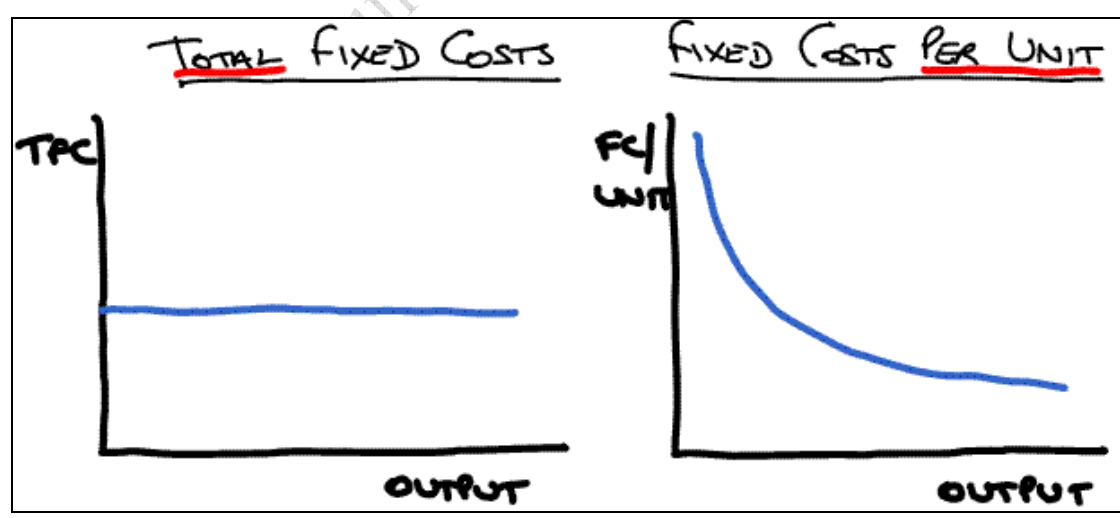
Ling's budgets showed that the profit per pack/serving could be as low as 10 pence at the expected sales level of 400,000 units per week. Careless handling of stock or sloppy production standards could easily wipe out the profit level.

Interviewer: Economies of scale? Where would they come from, after all it's a brand new very efficient factory isn't it?

Jack: Yes but Ling's selling around 400,000 units a week but her capacity is 600,000 a week, so she could leverage her fixed costs by expanding her output: remember, she needs to look for alternative customers before too long too.

Interviewer: Sorry, I missed that lecture: how could she leverage her fixed costs by expanding her output? I don't get it.

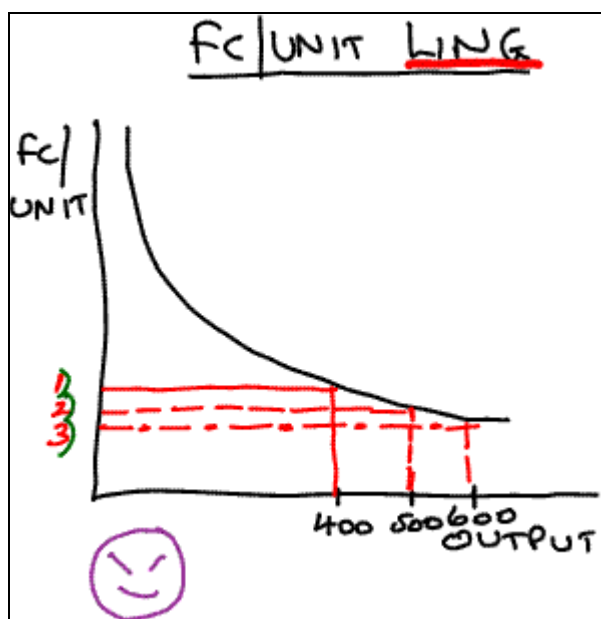
Jack: Cost and management accounting page 2, sir! Let me draw you two simple diagrams. Firstly, fixed costs and secondly fixed costs per unit.



Now can you see what leveraging the fixed costs might mean?

Interviewer: Yes, thanks Jack. I knew that, it just slipped my mind, that's all.

Jack: Of course. So, Ling is at 400,000 units and if she moves to, say 500,000 then 600,000 units a week, you can see the impact that scale has on her average fixed costs per unit:



Fixed costs per unit at 1) is the average now, at 2) is the average if output moves to 500,000 units a week and 3) is the average fixed cost per unit if Ling works at maximum capacity. The average falls and falls ... that's economies of scale and that's leveraging the fixed costs!

Interviewer: Very interesting for my reader, Jack. Can I use your diagrams?

Jack: I even signed my last one for you!

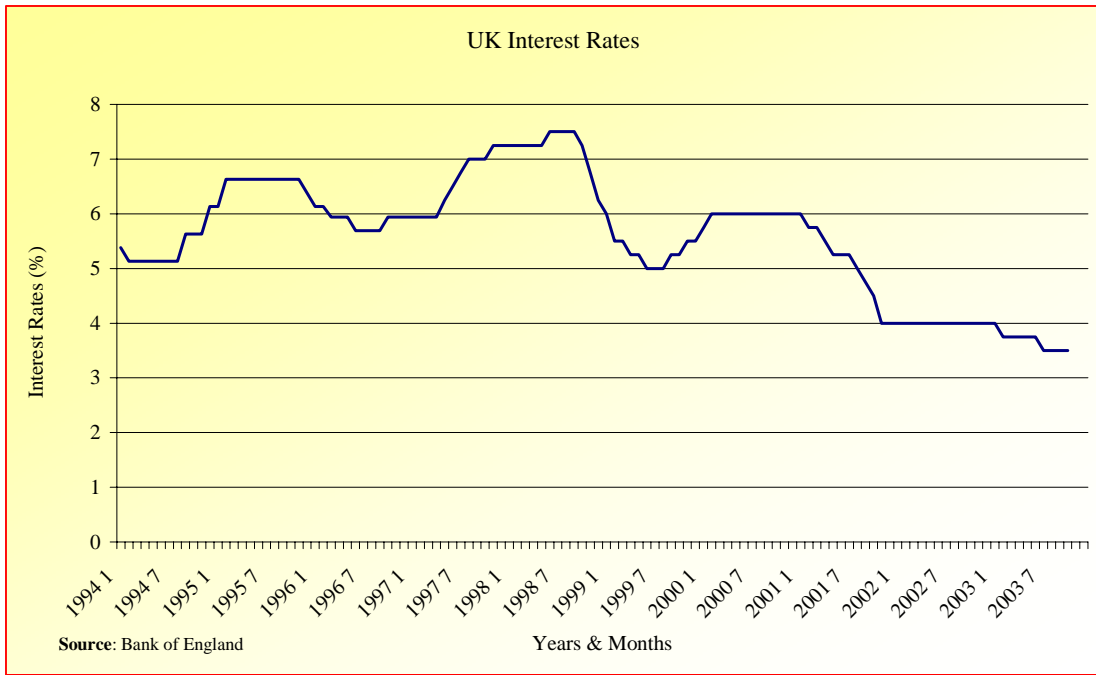
Interviewer: This has been a fascinating session **Jack:** I still don't know how you and Ling persuaded the bank and the supermarket to do what you did but congratulations anyway. I hope that Sam Yip is satisfied too!

Can I come back next week, Jack, to talk about the factory's teething problems?

Jack: Not a problem and this time I think you should talk to Ling herself. I'll make sure she is here to talk to you; but don't forget to keep all my secrets. Would you like some Chinese tea?

Interviewer: Yes please!

Appendix: UK interest rates from 1994 - 2003



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