



BUSINESS AND MANAGEMENT (PRINCIPAL)

9771/02

Paper 2 Strategic Decisions

May/June 2017

3 hours

Additional Materials: Answer Paper/Booklet



READ THESE INSTRUCTIONS FIRST

If you have been given an Answer Booklet, follow the instructions on the front cover of the Booklet.

Write your Centre number, candidate number and name on all the work you hand in.

Write in dark blue or black pen.

You may use an HB pencil for any diagrams or graphs.

Do not use staples, paper clips, glue or correction fluid.

DO NOT WRITE IN ANY BARCODES.

Answer **all** questions.

At the end of the examination, fasten all your work securely together.

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

The syllabus is approved for use in England, Wales and Northern Ireland as a Cambridge International Level 3 Pre-U Certificate.

This document consists of **6** printed pages and **2** blank pages.

Topps Tiles plc

Introduction

Topps Tiles (TPT) is the UK's leading specialist retailer of tiles. The company opened its first store in 1963. TPT mainly sells wall and floor tiles with associated accessories but also a limited range of laminate and solid wood flooring. TPT has a product range of over 5000 items. The number of stores operated by the company has increased from 328 in 2013 to 335 in 2014. Many of TPT's tiles are sourced directly from factories around the world. The company sells to a mix of DIY enthusiasts and trade customers. Trade sales now account for 46% of revenue but margins are smaller in this sector.

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Market Share

The 2014 TPT annual report states that 'the primary goal for the business is to take profitable market share'. The medium term goal is to achieve 33% market share or, in simple terms, £1 in £3 that is spent in this market. Market share has risen from 28.5% in 2013 to 30.3% in 2014. The company annual report states that TPT intends to achieve this goal by focussing on three key areas:

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A: Providing an inspirational shopping experience

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B: Product development

C: Multi-channel distribution.

Some specialist retail analysts feel that this goal is achievable but may be difficult through organic growth alone. They also point out that the fortunes of the company are clearly linked to the strength of the housing market and certain external economic influences such as interest rates.

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Unemployment in the UK

The strength of the economy and the labour market have a considerable influence on the fortunes of TPT. The UK unemployment rate is currently 5.6% (July 2015) and has been in a relatively steady downward trend in recent years (see Fig. 1). Some economists doubt the significance of the decline because many of the jobs created are part-time or in low-wage sectors. Other data also suggests that real wage growth has only turned positive recently. Generally, lower unemployment is seen as a positive development for TPT but other economic factors are also important such as consumer confidence and inflation. The income elasticity of demand for TPT's main products is estimated to be +0.78 (see Table 1). Retail sector analysts consider the strength of the housing market to be the most important factor for the success of TPT. One drawback of the lower unemployment rate has been the difficulty in recruiting talented staff.

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Type of elasticity	Value (estimates)
Price elasticity of demand:	
Retail customers	-1.7
Trade customers	-2.4
Income elasticity of demand	+0.78
Advertising elasticity of demand	+1.4

Table 1: TPT elasticity values compiled by a retail analyst (2015)

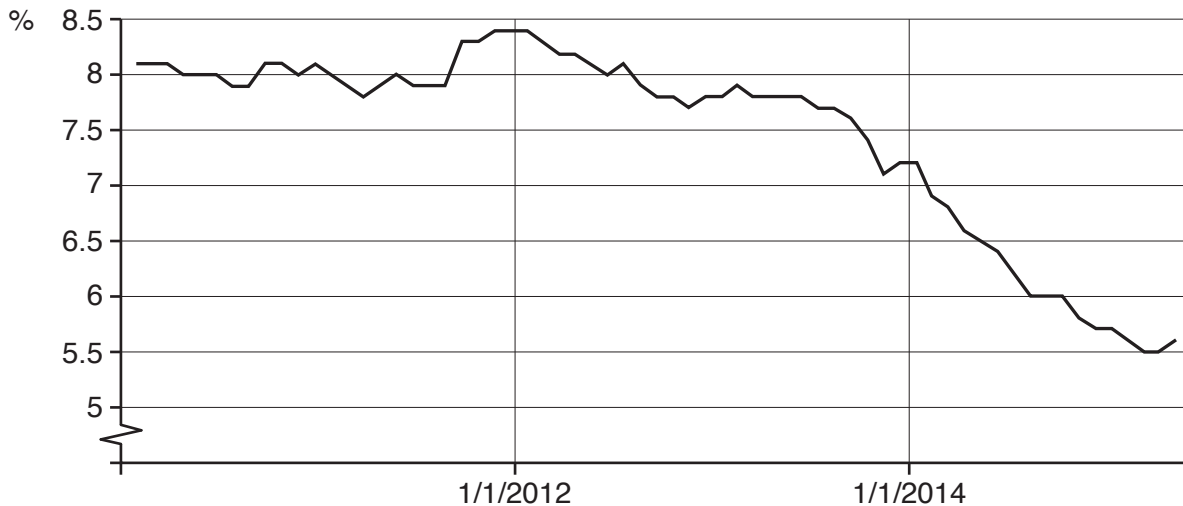


Fig. 1: UK unemployment rate (%)

Dividend growth pleases shareholders

The growing confidence of the TPT directors has led to an increase in the dividend being paid. In 2014 a total dividend of 2.25p per share was paid. This was a significant increase on the 2013 dividend of 1.50p. The dividend cover ratio suggests that the current dividend is affordable and further growth may be possible. However TPT's directors want to continue to fund further expansion from internal sources. The current dividend yield is above the Bank of England base rate but below the FTSE 100 company average of 3.4%.

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Employee profit sharing

TPT currently has 1817 employees. Of this number, 6 are directors and 14 are senior managers. The company offers an attractive employment package including enhanced maternity, paternity and sick pay. An employee share scheme is also in operation in which employees can buy shares in TPT at a 20% discount to the market price. These schemes last for three or five years at a time.

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According to employee feedback the most popular incentive scheme is profit sharing. This resulted in just under £10m being paid out to employees in 2014. The share of profits paid to the employee is linked to Key Performance Indicators (KPI) such as customer feedback, shop sales and manager performance appraisals. Evidence suggests that employee productivity has increased as a result of the profit sharing scheme. Some employees question the fairness of the scheme. Others doubt that it could continue during a recession and would prefer an increase in basic pay.

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Challenges ahead

Not everyone is optimistic for the future of TPT. The Times newspaper recently ran an investment article suggesting shareholders should sell their shares. The argument put forward was the increasing reliance by TPT on trade customers and increased competition. In addition some of the valuation measures, such as the price/earnings ratio, are rising above industry averages. The uncertain economic environment was also highlighted. The possibility of a slow-down in the housing market and Government deficit reduction plans are also causes for concern. On the other hand, in May 2015 the Chief Executive (Matt Williams) spent £1.2m on TPT shares, which took his overall stake to 0.9% of the business. The Return on Capital Employed has been increasing in recent years. Interest rates are predicted to stay low for the foreseeable future.

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Competitor	ROCE	Current Ratio
The Tile Giant (TTG)	24%	1.0
Cambridge Tiles (CT)	20%	2.0

Table 2: Selected ratio values for major competitors (2014)

	27 September 2014 £000	28 September 2013 £000
Revenue	195237	177849
Cost of sales	(76367)	(70826)
Gross profit	118870	107023
Employee profit sharing	(9827)	(6251)
Sales and marketing costs	(4672)	(3763)
Other operating expenses	(86185)	(83164)
Operating profit	18186	13845
Investment revenue	652	279
Finance costs	(2147)	(3733)
Interest rate derivatives		210
Profit before tax	16691	10601
Taxation	(4179)	(1457)
Profit for the year	12512	9144

Table 3: Extract from TPT Income Statement

	27 September 2014	28 September 2013
Earnings per share	6.5p	4.8p
Share price	107p	88p
Annual dividend cost	£3.1 million	£1.9 million
Dividend paid (per share)	2.25p	1.50p

Table 4: Further extract from TPT Income Statement

	27 September 2014 £000	28 September 2013 £000
Non-current assets		
Goodwill	245	245
Property, plant and equipment	41 294	35 348
Total non-current assets	41 539	35 593
Current assets		
Inventories	27 846	26 196
Trade and other receivables	5 800	7 711
Cash and cash equivalents	19 547	18 443
Total current assets	53 193	52 350
Total assets	94 732	87 943
Current liabilities		
Trade and other payables	(36 240)	(35 929)
Current tax liabilities	(4 888)	(3 734)
Provisions	(876)	(1 014)
Total current liabilities	(42 004)	(40 677)
Net current assets	11 189	11 673
Non-current liabilities		
Bank loans	(49 581)	(54 820)
Deferred tax liabilities	(261)	(426)
Provisions	(2 043)	(2 204)
Total non-current liabilities	(51 885)	(57 450)
Total liabilities	(93 889)	(98 127)
Net assets/(liabilities)	843	(10 184)
Total equity	843	(10 184)

Table 5: Extract from TPT Balance Sheet

Read all the case study material and then answer all the following questions.

Section 1

- 1 (a) Calculate the Return on Capital Employed (ROCE) as at 27 September 2014. [3]
- (b) Calculate the current ratio as at 27 September 2014. [3]
- (c) Comment on the significance to TPT directors of the result obtained in **either 1(a) or 1(b)**. [6]
- (d) Analyse whether TPT will be likely to increase its dividend payment in the future. Use the accounts and any other relevant information to support your answer. [13]

Section 2

- 2 Discuss whether a sustained decrease in UK unemployment should impact upon the strategic decisions of TPT. [25]
- 3 Evaluate the use of employee profit sharing at TPT. [25]
- 4 'The primary goal for the business is to take profitable market share.' (Lines 10–11)
Recommend and justify a potential strategy for TPT to achieve profitably its target market share. [25]

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