CONTOH SOAL

CASE STUDY: BEAUTY LUX LTD

The date is March 20X8.

BEAUTY LUX LTD (BL) designs and manufactures luxury luggage (leather bags and suitcases) at its UK factory, located in South West England.

COMPANY INFORMATION

BL sells luggage through its website to customers around the world, who order and pay online using a debit or credit card.

BL luggage is instantly recognisable because all items are made from leather which is printed with the distinctive BL logo. Each item fastens with a buckle, strap and lock. Product designs are frequently updated but remain very distinctive.

BL sources the very best leather from a single supplier in Belgium, which dyes it by hand and then prints it. All additional components (buckles, straps, locks) are supplied by a Turkish company.

BL's luggage production process at its factory is very labour intensive. Highly skilled craftspeople cut, stitch and finish each item by hand. At full capacity the factory can produce 600 items per week. Inventory of finished luggage is kept to a minimum because most items are only made after the customer has placed an order. BL luggage sells for between £1,200 and £1,500 per item and BL makes an average 48% gross profit margin. Because BL luggage is in demand, customers are normally willing to wait up to three months for delivery. All BL luggage is guaranteed for life and BL offers an after-care service whereby customers can send their luggage back to the factory for any repairs.

BL places great emphasis on the fact that its luggage is "hand-made in England" and customers are willing to pay premium prices for this distinctive feature. BL offers a range of styles and colours but in limited quantities to maintain the image of exclusivity.

Marketing is a significant expense. In addition to TV, radio and print advertising, BL uses a range of product placement strategies and upmarket promotions. Demand for BL's luggage has increased following a recent rise in its popularity amongst celebrity internet bloggers, and also due to a direct competitor receiving adverse publicity after a hacking incident in which customer details were stolen.

BL outsources distribution to an international logistics company, Pello Ltd (Pello). Finished luggage is sent directly from BL's factory to Pello's UK warehouse, and from there to appropriate global distribution centres. In the UK, Pello employs a dedicated team responsible for the BL contract who provide value-added services, such as pre-wrapping and care-label tagging, before despatching the items. Pello's information systems are fully integrated with BL's, so Pello can view customers' orders and provide real-time reporting on deliveries. Pello's distribution operations are regularly inspected by BL to ensure that they comply with BL's strict quality and security standards.

COMPETITION

Competition in the luxury luggage market consists of:

- Two global companies that produce luggage for a range of market segments
- Several well-known manufacturers of luxury goods that make luxury luggage as one of their many product ranges
- Many smaller independent businesses, such as BL, that focus on the luxury luggage segment only.

NEW CONTRACT

BL has recently been asked to tender for a contract to design and supply two flight bags for each member of the cabin crew of TARAF AIR Ltd (TARAF). TARAF is a global airline specialising in luxury travel. The contract would run for two years from 1 May 20X8 and would require BL to supply 4,500 bags during the contract period. The bags would use lower quality leather and fastenings from new suppliers but would still be printed with the BL logo. To help BL's sales director decide what price to quote for the new contract, the production director has prepared the following cost estimate:

- Each flight bag requires one meter of leather in total, of two different types: 60% of the leather would be purchased at a price of £95 per meter, and the remainder would be purchased at a price of £105 per meter.
- Labour and other variable costs would be £185 per bag and the additional components would cost £26 per bag.
- BL normally recovers fixed production overheads at a rate of 50% of the total variable cost for each item of luggage. The production director estimates that fixed production costs would increase by £405,000 per annum as a result of the new contract.

<u>REQUIREMENTS:</u>

1. Explain how the key elements of BL's value chain support its competitive strategy. You are not required to draw a value chain diagram.
2. Identify and explain the key cyber-security risks that BL faces and suggest how these risks can be managed.
3. Explain the financial and non-financial factors that BL should consider in deciding whether to tender for the new contract with TARAF. Show relevant supporting calculations.

_____________________________________*END OF TEST*_________________________________

ANSWER

1. **Key elements of Value Chain**

The value chain is the organisation of resources through a sequence of activities that enables BL to add value, in this case to the luggage product that it produces. BL is pursuing a differentiation strategy in accordance with Porter's generic activities – its luggage is perceived to be of high quality and sells at a premium price, allowing it to earn an average gross margin of 48%. So BL needs to focus on resources and processes which support its differentiation strategy.

Primary activities (inbound logistics, operations, outbound logistics, sales and marketing, and service) are those that create value and are directly concerned with providing the output: luggage. Support activities (Firm infrastructure, Procurement, HR, Technology) do not create value directly themselves but enable the primary activities to take place and result in a high quality product and high quality customer service.

The crucial activities that allow BL to sustain its competitive advantage as a ifferentiator are known as value drivers. Value drivers are evident at each stage in BL's value chain:

Inbound logistics/Procurement:

Inbound logistics is supported by procurement, sourcing the very best quality leather from Belgium, which is hand dyed and contributes to the premium product. There is likely to be a relationship of trust with the single supplier. Other materials come from Turkey – these need to be of appropriate quality to maintain BL's brand image.

Operations/HR:

BL has a very labour-intensive production process. Highly skilled craftspeople undertake most of the production by hand, differentiating the luggage from mass-produced items and adding to the image of luxury. As this is a key value driver, the HR function needs to support operations to ensure that employees with appropriate skills are hired and receive suitable training.

Outbound logistics/Technology

Distribution is outsourced to an international logistics company, Pello, which undertakes some value-added services associated with the initial delivery of the product: prewrapping of the luggage and care-label tagging. This relationship and the services Pello provides help BL differentiate its product from competitors and technology is used to integrate the two systems and coordinate operations and distribution. The fact that BL regularly inspects Pello's operations ensures that the service it provides is consistent with BL's brand image.

Marketing and Sales

This is a key value adding activity. BL spends a considerable amount on advertising. In particular its use of product placement strategies and celebrity promotion help to create an image of the luggage as a "must-have" product that customers are prepared to wait for. The adoption of BL's products by celebrity internet bloggers help add to its perceived value.

Service

After purchase, BL offers a lifetime guarantee as evidence of its quality product and its after-care service allows customers to send their bags back to the factory for any repairs.

The offer of this sort of service guarantee is likely to give the customer confidence in BL's products although as customers may want to stay on-trend with the latest colour and design they may in fact replace items regularly rather than keep using them for life.

Firm infrastructure – The firm culture/ethos of "hand-made in England" helps to sustain BL's brand image particularly with overseas customers.

Linkages

BL's competitive advantage is sustained by the linkages in its value chain and its wider value system of suppliers and distributors.

For example the fact that BL secures the highest quality leather (procurement/inbound logistics) and its product is made by hand by highly skilled craftsmen (HR/operations) is

likely to ensure high quality production. This reduces the need for and hence the cost of the lifetime guarantee/repairs service.

Also the use of technology to integrate and coordinate activities (evidenced by BL's online ordering and payment system, interface with Pello and real-time reporting of deliveries) allows for smooth functioning of the distribution process and a higher quality service.

Some activities that add value to BL's product extend beyond BL itself. For example the Belgian supplier's success in producing high quality hand-dyed and printed leather is critical to the overall quality of the product. BL regularly inspects its distributor Pello to ensure that it complies with the most stringent quality and security standards.

2. Key cyber security risks and risk management

Cyber risk is any risk of financial loss, disruption or damage to the reputation of an organisation from some sort of failure of its IT systems.

In addition to the general risks faced by all businesses, BL faces some specific cyber risks because its business with customers is done online. Any technical failure would have a significant and immediate impact because problems with the e-commerce site are immediately visible to customers/prospective customers. It is likely to lead to loss of customer confidence and damage BL's brand and reputation.

BL must take steps to minimise the risk of systems failure, protect the integrity of its systems, safeguard information and ensure the continuity of its operations. BL should ensure it has a business continuity plan in place so that the business can continue to operate in the event of a crisis. Risks may be transferred, avoided, reduced or accepted.

Specific cyber risks and recommendations for risk management:

- Denial of service attack

  An attack by hackers could result in BL's website being inaccessible or too slow, or the payment system could go down. Alternatively BL may have to withdraw the website if there is a virus/malware attack on its systems or if hackers access the website and deface it, for example.

  This is likely to result in frustrated customers. Sales could be lost if customers decide to switch to a competitor although the fact that the luggage is sought after and customers are prepared to wait for items to be produced may simply mean the transaction is delayed rather than lost. Risk can be reduced by ensuring appropriate systems development and maintenance takes place and by having back-up servers. Systems need to be upgraded regularly to ensure they are capable of providing the necessary capacity, particularly given the growth expected. BL's website should be regularly updated and tested to ensure it is fully functioning.

BL could also reduce the risk by ensuring that customers are directed to alternatives such as phone ordering in the event of system delays or failures. BL could transfer the risk by outsourcing the provision of the website to a specialist provider.

- The company's online ordering and payment system could potentially be abused. Any identity theft/card fraud arising would severely damage BL's reputation.

  BL should ensure it reduces this risk by having access controls, data encryption, appropriate payment verification software, firewalls and secure communication.

- Hackers may be able to gain access to sensitive data, either for malicious reasons or to gain competitive knowledge. Loss of critical data relating to customers personal data held in databases eg, through viruses or deliberate sabotage would damage BL's reputation with existing and potential customers. Customers will expect BL to have appropriate security systems in place. If it does not, any cyber security issues or concerns about vulnerability will damage customer confidence and threaten the success of the business.

- Any failure to comply with data protection legislation could also result in BL facing penalties/litigation.

  The risk can be reduced by ensuring appropriate security features are in place to control access and content. BL must ensure its ordering and inventory system and any customer databases that it operates are kept up-to date, and backed up regularly with hard copies kept off-site. It must have systems in place to monitor compliance with data protection regulations and ensure all data held is secure (eg, via encryption).

- Risk is increased due to BL's shared system access with Pello. Whilst sharing information brings competitive advantage the inter-connectedness reduces the control that BL has over its digital security and increases the risk that it is vulnerable to attack – particularly through the weakest links in the systems chain. If Pello's system is hacked or fails this could result in delayed deliveries, customer complaints and lost customers which would severely damage BL's brand image.

BL needs to ensure that there is clear responsibility and accountability for cyber security, particularly in relation to the integrated system. In addition to inspecting the quality of Pello's operations BL should satisfy itself regarding Pello's cyber security.

General risk management procedures:

BL needs to ensure that it has individuals with the specialist skills and expertise to help the organisation protect itself against cyber-attacks. The board need to regularly consider the organisation's risk tolerance and risk appetite in relation to cyber security and reflect this in risk management strategies.

Where risks cannot be reduced or eliminated it may be possible to transfer them via:

- Insurance (however this may be costly and it may be problematic to quantify the extent of business loss from a security incident)
- Contracting out the management of e-commerce to a third party who can host the system. The loss may still occur and

3. Taraf contract

Non-financial factors

Taraf is a luxury airline and so its image of high quality is consistent with that of BL.

However wealthy customers may not be happy that the cabin crew have luggage with the BL label if they view themselves as superior in status.

There is a waiting list for the existing product as customers have bags made to order and are prepared to wait for up to three months. Making the product available "en masse" to Taraf's cabin crew may detract from the high-end brand image and reduce the attraction of the label as a limited edition item.

There is a risk associated with using lower quality leather but printing it with the same logo which means the bags are clearly identifiable as BL items, presenting an image to the marketplace that the bags are the same as BL's existing products. If there are any problems with the quality or life of the bags this may have a knock-on impact on the existing brand.

BL is planning to introduce two new suppliers which increases the risk as these relationships are not tested. BL will need to carry out due diligence on the suppliers and ensure quality control is in place to ensure the leather, etc whilst being cheaper, is still of appropriately high quality. Depending on the location of the suppliers it may also give rise to additional exchange risk

Financial factors

See appendix for costing and pricing calculations.

In fixing a price for the contract BL needs to bear in mind the following:

The variable costs for the new bags are cheaper than the current range (£310 per bag compared to £416/£520). Presumably this is largely due to savings in the leather costs because the bags are of lower quality. If incremental fixed costs are considered then the production cost per bag and hence the breakeven contract price would be £490 per item.

BL normally makes a 48% gross margin which would result in a selling price of £942 per bag. However this margin is on sales of one-off items to consumers and Taraf is likely to require a volume discount.

Currently the factory can produce 600 items per week and, given the waiting list, can be assumed to be at full capacity. The Taraf contract represents 7.5 weeks' worth of production in total (4,500/600). If the bags cannot be made alongside the existing luggage (eg, by running an extra shift), then there may be an opportunity cost associated with accepting the contract because it will replace existing production. However it is possible that sales may not be lost if customers are simply prepared to wait another month for their order. More information is required about when/how the bags are to be delivered.

BL need to consider the impact of any predicted exchange rate movements on the cost. Also no information has been provided on the distribution and delivery costs associated with the contract.

Recommendation

BL needs to consider the other parties that may be asked to tender and the likely price that Taraf is prepared to pay. It does not appear likely that the contract will offer any scope for renewal since at the end of two years the cabin crew will all have flight bags, so there is no benefit in reducing the price now in anticipation of further revenue later, particularly if accepting the contract merely replaces sales to existing customers who are not prepared to wait.

The contract is sizeable and would probably generate an attractive amount of additional contribution provided it does not result in lost sales to existing/potential customers. One option to minimise the impact on BL's brand would be to consider making the bags as a Taraf own-label product.

Appendix of calculations:

	£ per bag
Leather (0.6 × 95) + (0.4 × 105)	99
Buckles	26
Labour and VC	185
Total VC per bag	310
Bags required	4,500
Total VC for contract	£1,395,000
Incremental FC = 2 years × £405,000	£810,000
Total contracr costs	£2,205,000
Production cost per bag = selling price to breakeven	£490
Selling price to achieve 48% margin (£490/0.52)	£942.31

Existing luggage:

Selling price	Production cost (assuming 48% GPM)	Variable cost per item = 2/3 total production cost	FC per item = 1/3 total production cost
£1,200	£624	£416	£208
£1,800	£780	£520	£260