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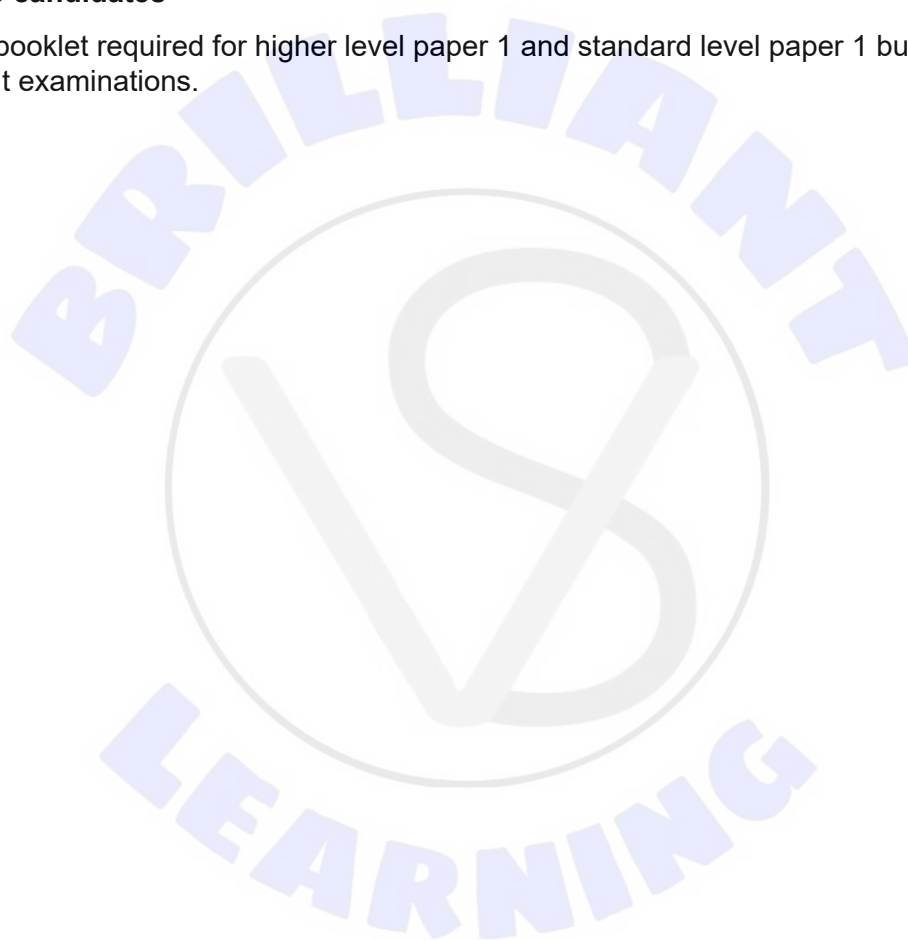
Business management

Case study: Accord

For use in November 2019

Instructions to candidates

- Case study booklet required for higher level paper 1 and standard level paper 1 business management examinations.



Accord

Aran and Kayla are successful international athletes. They live in a country that is a mainly tertiary economy with few primary producers. Aran, a marathon runner, has won several national titles. Kayla, a heptathlete, competes in tournaments nationally and overseas.

- 5 The government of this country has limited funds to support athletes. Aran and Kayla must frequently apply for scholarships and corporate sponsorship funding for travel, equipment and entrance fees to competitions. They also apply to charities and non-governmental organizations (NGOs) for financial support.

- 10 As athletes in a humid climate, Aran and Kayla drink a lot of water. Aran also began supplementing his water intake with expensive, carefully selected imported energy drinks, which were becoming increasingly popular. In 2018, the brand leader sold over six billion drinks, with its sales growing at 25 % each year. Aran researched energy drinks and discovered that the health benefits and costs are controversial. Some manufacturers argue that energy drinks can improve thinking skills and attention spans. This is similar to the way other caffeinated products, such as tea and coffee, are used by older consumers. Most medical pressure groups, however, argue that energy drinks have negative side effects, especially if consumed by younger consumers. They warn that the amount of caffeine and sugar contained in these drinks can be harmful.

- 20 Aran decided that he would only consume a limited range of carefully selected energy drinks to support his demanding training programme. These carefully selected energy drinks are supplied by multinational companies (MNCs) that sell through business-to-consumer (B2C) channels only. The market for these specialized energy drinks for athletes is niche and medical approval from sports governing bodies is required before the drinks can be used by athletes.

- 25 Concerned about the cost of the energy drinks and their composition, Aran decided to make his own drinks from imported ingredients such as oranges, kale and spinach. Aran called this energy drink Enrich. Enrich is made only from natural ingredients. Aran believes that Enrich will be the first all-natural energy drink on the market and considers “all natural” to be its unique selling point/proposition (USP). Kayla has questioned this USP, arguing that all-natural energy drinks already exist. Aran countered by saying that, in addition to providing excellent nutrition for marathon running, Enrich would save athletes money: they would not need to purchase vitamins or go to the doctor as often. Aran felt that Enrich should be viewed not only as an energy drink but as a brand of related products and services, which would allow Enrich to become a healthy lifestyle brand. He was already thinking about long-term goals.

- 35 Aran offered free samples of Enrich to athletes in different sports who lived and trained in his country. When Aran struggled to pay for his training and competitions, he also sold small quantities of Enrich to offset some of the expenses. Aran assures his customers that Enrich is nutritious, produced with 100 % natural ingredients and would meet the standards set by the sports governing bodies. Once refrigerated, it would also stay fresh for up to a week. Aran also thinks that Enrich could be frozen and transported to customers over longer distances, but further research and development is required.

- 40 With their international sporting careers nearing an end, Aran and Kayla decide to create a partnership called *Accord*. Their vision is to sell Enrich as an ethical energy drink free from added sugar, caffeine, artificial sweeteners and preservatives. The business would also have very high ethical objectives, which would determine their future marketing, operations and financial direction.

- 45 Kayla completed some secondary market research about the potential size of the market for all-natural energy drinks. She had just attended a food and beverage conference, where she

learned that some MNCs were considering producing fruit and vegetable energy drinks. Posing as a potential customer rather than a potential business owner, Kayla discovered that one MNC, ABC, had carried out some primary market research using a snowballing technique to see how large the all-natural energy drink market could become in four years.

Starting up *Accord* was easy and quick. Kayla registered the business and offered to manage the financial aspects. She also focused on building the brand value of Enrich by using social media, their athlete contacts and friends and family, which numbered over 100 people. She used these contacts to conduct primary market research on attitudes to natural and health-related energy drinks. The feedback was overwhelmingly positive. However, Kayla was concerned about the fact that this first attempt to conduct primary market research focused on people they already knew. If *Accord* had conducted random sampling on attitudes to natural and health-related energy drinks, would they have received the same favourable feedback? Given Aran's enthusiasm, she decided not to tell him about her concerns.

Kayla and Aran decided that Kayla should manage marketing and finance, and Aran manage the operations and supply chain. They chose not to create a human resource department because *Accord* had a small workforce. Aran already had the overseas supplier contacts but would need additional suppliers of fruit and vegetables. He would also need to find space to prepare and store the energy drinks. Aran thought that if Enrich was successful, they might need to find a small factory. This factory would use job/customized production.

Aran knew the price of the Enrich range was significantly more expensive than those charged by the large MNCs, which supplied an ever-increasing range of energy drinks, fruit drinks and other beverages. Enrich's drinks averaged \$3.00 per bottle, compared with a typical price of \$2.20 for similar drinks from MNCs. These MNCs, such as ABC, were large and experienced in the beverage market and had significant branding advantages, economies of scale and wider promotional reach. Enrich was restricted to below-the-line promotional methods, which Kayla thought the most cost effective. Kayla also thought that below-the-line promotional methods would allow *Accord* to have tighter control over their positioning as the foremost ethical provider of energy drinks.

However, Kayla's secondary market research indicated that many of the competing energy drinks produced by MNCs were being sold to teenagers, contrary to government policies and agreements with retailers such as supermarkets. The drinks had labels such as "not to be sold to children", but retailers were ignoring these laws. Kayla became convinced that Enrich could create a USP as the only locally produced, caffeine-free, all-natural energy drink. Enrich would be sold only through affiliated sports and leisure clubs. The additional health benefits and cost savings experienced by their customers would strengthen their USP and brand value.

The restriction of selling only through affiliated sports clubs would enhance their ethical credentials (as teenagers who are not members of a sports club would not be able to purchase the drinks) but would initially limit their sales. Kayla argued to Aran that establishing *Accord* and their brand was more important than generating large profits in the short term – profits would hopefully follow in future years. Kayla argued that Enrich had a first-mover advantage in this particular market given that the multinational competitors were only just beginning to consider the idea of all-natural energy drinks. As such, Kayla still regarded Enrich as a niche product.

Aran saw things differently. He thought that treating Enrich as a niche product would narrow the possible market segments. He favoured a mass-market approach. Aran considered Enrich a significant product innovation. If *Accord* waited to launch the brand as a mass-market product, they would be missing out on potentially high profits. Becoming impatient, he argued that they should borrow immediately for revenue and capital expenditures to finance increased production. They would soon need more skilled employees to manage the equipment. Through his contacts, Aran had heard that ABC would soon be launching a new all-natural energy drink.

Turn over

After three months of operation without a decision, sales of Enrich were satisfactory but below forecasts. Aran and Kayla were both working very long hours. Feedback from their friends and fellow athletes was positive, yet new customers contacting *Accord* through social media said they were confused about whether Enrich was a fruit juice or an energy drink. They also claimed that the health benefits of Enrich were exaggerated and the drink was too expensive.

This feedback took Aran and Kayla by surprise. Advising caution, Kayla felt that they should do more research on customer perception and the competition. However, Aran argued that they should expand production to lower per unit costs. They could then reduce prices and keep gross profit margins the same. He believed that sales would pick up in three months. However, they had invested so much time and effort into Enrich that they both wanted to continue with it. They decided to increase production using existing capacity.

Kayla was unsuccessful, however, in finding external sources of finance to increase production capacity. After considering several alternatives, a business angel looking to invest in new, socially responsible businesses contacted *Accord*. The angel investor wanted some involvement in the day-to-day management, which Kayla was reluctant to allow.

Aran also looked for potential investors. A famous athlete, Jesse, looking to rebuild his own brand identity after accusations of cheating, contacted Aran. Jesse had won a major competition in a specially designed innovative running outfit. The outfit reduced wind resistance, and other competitors complained that it gave him an unfair advantage. Jesse and the competitors carried out their disagreements on social media and sympathy for Jesse diminished after it was revealed that he was paid \$2 million to wear the running outfit against the wishes of his other sponsors.

Aran was nervous about Jesse but also sympathetic. He respected Jesse as an athlete and knew that his association with the brand could help boost the media reach of Enrich at a time of increasing sales. However, he feared a social media backlash could undermine and tarnish the brand.

After some further investigations into suitable premises and production equipment to support the future growth of Enrich, Kayla and Aran found an affordable abandoned confectionery production plant that would increase the production capacity. Some of the older confectionery-making equipment would need to be replaced.

Kayla carried out some further market research to see if the additional capacity could be used for another drink that would complement Enrich. These drinks could form part of the lifestyle brand that Aran had envisaged. Her investigations led her to discuss with Aran the idea of a drink based on green tea, called Detox, which could allow athletes to relax after a hard training day. As with energy drinks, the health effects of green tea to help athletes relax were not conclusive. However, Kayla argued that unless they introduced this new product, Enrich would struggle to be economically sustainable.

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