



# **AS BUSINESS**

**Paper 2 Business 2**

**7131/2**

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**SOURCE 1: G-Free**

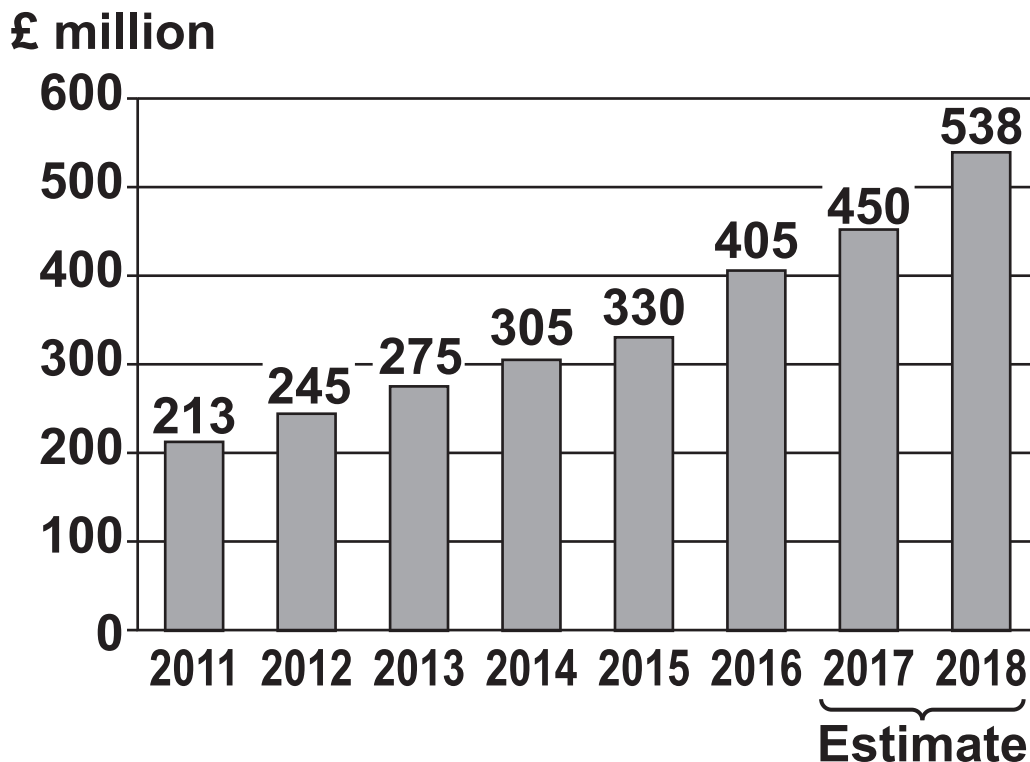
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**SOURCE 1****G-FREE LTD****BACKGROUND**

The UK market for gluten-free food is growing rapidly (see FIGURE 1). This rising demand is caused by three factors: 1

- greater awareness of food allergies
- some consumers believing that these foods are healthier 5
- the endorsement of this type of food as a 'lifestyle choice' by celebrities.

**FIGURE 1: UK sales of gluten-free food (£ million)**



The price of gluten-free food is up to 300% higher than similar products that contain gluten. This is due to the high costs of specialist ingredients, limited competition in the market, and price inelastic demand. 10

In 2004 chef, Stephanie Morris, started to develop gluten-free bread recipes for her son who had a severe food allergy. This bread was much better than that available in shops and she began to investigate the possibility of starting a small scale business. Initially, as a sole trader, she sold small batches of loaves in local food markets where it was well received. 15 20

In 2005 Stephanie invested a large part of her savings and left her secure job as a chef to start a bakery in a small factory. This decision involved a large opportunity cost for Stephanie, but she was optimistic that it could be worth the large risk. She found four investors to join her as co-directors of a private limited company: G-Free Ltd, as she was advised that limited liability would be useful. The other directors shared Stephanie's passion for the product, and had experience in manufacturing and retail distribution within the food sector. 25 30

The G-Free Ltd brand of gluten-free bread was launched in UK supermarkets in 2007 and received favourable coverage in health magazines. By 2009 it was established in the niche market of gluten-free bread and quickly became the market leader. 35

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**At first G-Free Ltd sourced ingredients from four suppliers who had specialist knowledge of the market. G-Free Ltd was a major customer for each of the suppliers and a close business relationship developed with them. The suppliers offered high-quality ingredients and flexible deliveries, but were not the largest or cheapest available.** 40

**The original small factory was described as being run using a team management approach on the Blake Mouton grid. The factory grew steadily to employ over 100 staff and in 2012 it received a regional award as being the best medium-sized business to work for. At the ‘award ceremony’ the judges commented favourably on:** 45

- the high level of employee engagement
- low labour turnover
- the willingness of employees to work flexibly.

## **CONTINUED GROWTH**

**Success with gluten-free bread led G-Free Ltd to develop a wider range of products from cakes and biscuits to croissants and crumpets – all gluten-free and many were developed from employee suggestions. In 2014 the company invested heavily in two new large bakeries. The existing suppliers could not offer the range or volumes now needed by G-Free Ltd. Its new products and increased scale meant that G-Free Ltd required more ingredients from a rising number of suppliers.** 55

**Costs associated with this expansion were seen as the reason for the business not turning sales growth into profit.** 60

**In 2015 G-Free Ltd experienced a serious problem in its operations. Some products were found to contain traces of gluten. Flour from one of its new suppliers was contaminated.** 70

**G-Free Ltd acted swiftly to withdraw the products – mindful of the importance of maintaining the trust of its customers and reviewed its quality control systems.** 75

**The continued growth of this market has recently attracted larger firms. Heinz, Nestlé and Warburtons have each launched their own gluten-free ranges. These firms have lower unit costs due to larger scale and the use of more technologically advanced systems. They also benefit from strong brand images from their other products that sell in mass markets; this has helped them enter the gluten-free niche.** 80

**The Operations Manager of G-Free Ltd believes that the company must react to this threat by reviewing its optimum resource mix, particularly as labour costs at G-Free Ltd are rising. The company plan a move towards a lean production system that will be more capital intensive. It will also aim to improve operational performance by reducing the number of suppliers it works with from 28 to 14.** 85  
90

**The plan will see a reduction in staffing at the factories. This is opposed by the Human Resources Manager who highlights that many of the staff have stayed loyal to the company for many years.** 95

**[Turn over]**

The plan will be completed by late 2018 at a cost of £28 m. The Finance Manager suggests the company fund this, and further growth, by becoming a public limited company. However, the founder, Stephanie Morris, sees herself and the original directors as key people to help ensure that the business stays true to its original aims and feels this may be threatened if the ownership is changed in this way.

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**FIGURE 2: Selected from G-Free Ltd Income Statements**

|                                    | 2015        | 2016        | 2017        | 2019<br>(est.) |
|------------------------------------|-------------|-------------|-------------|----------------|
| <b>Turnover £m</b>                 | <b>42.0</b> | <b>51.0</b> | <b>54.5</b> | <b>65.6</b>    |
| <b>Gross profit £m</b>             | <b>14.5</b> | <b>21.5</b> | <b>24.1</b> | <b>29.0</b>    |
| <b>Gross profit margin (%)</b>     | <b>34.5</b> |             | <b>44.2</b> | <b>44.2</b>    |
| <b>Expenses £m</b>                 | <b>16.1</b> | <b>18.2</b> | <b>21.3</b> | <b>18.7</b>    |
| <b>Operating profit/loss £m</b>    | <b>-1.6</b> | <b>3.3</b>  | <b>2.8</b>  | <b>10.3</b>    |
| <b>Operating profit margin (%)</b> | <b>-3.8</b> | <b>6.4</b>  | <b>5.1</b>  | <b>16.4</b>    |

**FIGURE 3: Selected data for G-Free Ltd**

|                                      | <b>2015</b>   | <b>2016</b>   | <b>2017</b>   | <b>2019<br/>(est.)</b> |
|--------------------------------------|---------------|---------------|---------------|------------------------|
| <b>Number of Employees</b>           | <b>452</b>    | <b>510</b>    | <b>525</b>    | <b>440</b>             |
| <b>Total Employee Costs (£m)</b>     | <b>9.8</b>    | <b>11.2</b>   | <b>12.0</b>   | <b>11.5</b>            |
| <b>Average Cost per Employee (£)</b> | <b>21 681</b> | <b>21 960</b> | <b>22 857</b> | <b>26 136</b>          |

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