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## CONTEXT

### The UK Retail Book Trade in 2005

Books are big business in the UK. More new books are published in the UK than in any other country, apart from the USA and China. Only China exports more books than the UK. In recent decades, despite the growth of television, videos, DVDs, computers and the internet, the reading of books is still increasing. The purchase of books in the UK grew by 6.56% per annum (pa) between 1999 and 2004, this rate only being superseded by that of videos (12.65% pa) and computer games (11% pa). In 2004, the UK public bought 205 million books at a total expenditure of £3.1 billion, which represented 4% of total leisure spending. Of this total, 65% were classed as 'consumer' titles, 10% as educational and the remaining 25% as scientific, medical and academic. 5

The structure of the book industry has been changing rapidly. Smaller publishing firms are being forced out of business. Ten large publishing groups produce 65% of adult consumer titles and ten (but not the same ten) produce 80% of academic texts. 10

Changes have been equally dramatic in the retail side of the business, especially since 1995, when the Net Book Agreement ended. This agreement was one of the last examples of Retail Price Maintenance in the UK, whereby producers could establish fixed or minimum prices at which products could be sold in the retail market. In the book trade, except for second-hand goods, books could not be sold below their published price. Since the abolition of the Net Book Agreement, sales of new books at cut prices and through promotions (e.g. buy one, get another at half price) have been common and price wars have broken out. New players have entered the market, notably supermarkets, which sell a limited range of popular books at huge discounts. Even these cut-price books can earn supermarkets a mark-up of 20%, which compares favourably with the mark-up earned by the groceries and other retail products they sell. It is estimated that by 2009, 10% of books purchased will be bought from supermarkets. 15

Book clubs and mail order companies, also offering discounted prices, are continuing to expand. The most recent growth sector has been in online ordering, in which the leading player is Amazon. This internet business sells new and secondhand books at discounted prices, has a worldwide distribution network and even sells copies of new books from the USA before they are published or released in the UK. The legality of this practice has been questioned, but Amazon acts as an intermediary, rather like eBay, putting consumers in contact with publishers, rather than directly selling or handling the product themselves. **Appendix 1** shows the structure of the UK book market in the summer of 2004. 20

Amongst the larger retailers in the UK market, WH Smith has diversified into a wide range of products, including CDs, DVDs and stationery goods, greatly reducing its reliance on the selling of books. Waterstone's is part of the HMV group. Ottakar's was floated in 1998, eleven years after its foundation. 25

After several successful years, Ottakar's issued a profits warning in 2005. It had been hit particularly hard by the publication of the latest 'Harry Potter' blockbuster children's novel in July of that year. Despite a promotional campaign, portraying itself as 'Pottakar's', the business sold only 70 000 copies of the book on the first day, whereas it had budgeted to sell 100 000. The recommended retail price was £16.99. Ottakar's was selling the same book at £11.99. Supermarkets, Asda and Tesco, sold the book at less than £8 per copy and Kwik-Save charged only £4.99. The book sold a total of 2 million copies on its first day of publication. 30

The founders of Ottakar's, James Heneage and Philip Dunne, attempted to get other major shareholders to join them in a bid to take the business off the stock market and re-establish it as a private company. They feared a takeover bid and indeed one came from Waterstone's. Ottakar's had 135 stores, mainly in small towns. Waterstone's branches were mainly in cities and larger towns. In only 29 locations did both firms have outlets. Although the merger would give Waterstone's over 25% of the market and might attract the attention of the competition authorities, Waterstone's was confident that the case could be argued that there were other major competitors in the market. Waterstone's was offering a bid price so far above the market value of Ottakar's shares it would give a price/earnings ratio in excess of 20. This resulted in one of Ottakar's leading shareholders deserting the buyout proposal and accepting Waterstone's offer. Thus the management buyout plan was doomed and Ottakar's had to accept the Waterstone's bid, creating an even stronger player in the retail market. However, after a campaign by authors and publishers, the takeover bid was referred to the Competition Commission. The Commission approved the bid in principle but Waterstone's then submitted a bid well below their previous offer.

Smaller independent bookshops are in an ever-worsening position, despite their combined market share. Whereas the larger retailers can pressurise publishers for discounts and marketing subsidies, the small independent retailers deal directly with wholesalers and, lacking economies of scale, cannot compete in the cut-price market. Many scarcely bothered to try to sell the Harry Potter blockbuster for example. Although small booksellers can access 'backlists', they cannot compete with Amazon in sales of these books which are no longer in publication. Often placed in small towns, independent traders can sometimes exist where larger businesses do not operate, and they can give personal service to a loyal group of consumers but times are hard and, as profits fall, many small bookshops are closing.

### **Midchester Bookshop**

Adrian and Mary Warren entered the retail book market in 2004 when, against the advice of their accountant, they purchased a seven-year lease on Midchester Bookshop, based in the main street of Midchester, the county town of Wessex. The Warrens, aged in their late fifties, were quite wealthy. Adrian, a former civil servant, had taken early retirement from a very senior post in the Treasury. Mary was a successful author of children's books, featuring a character called Eric the Elf. The Warrens sold their £2.5 million property in the 'stockbroker belt' of Surrey and purchased for £750 000 a smaller house between Midchester and Sandy Bay. Adrian planned to spend much of his retirement sailing his yacht out of the small coastal resort of Sandy Bay.

Mary Warren had loved Midchester ever since she had studied at the university there. Midchester has a castle, cathedral and medieval streets and is popular on the cultural tourist route, attracting many visitors from the UK and abroad, especially in summer. History was Mary's passionate hobby. She and her publisher had decided to 'kill off' Eric the Elf, as her children's stories were becoming rather dated, and she intended to start writing historical novels for the adult market, based on figures from the colourful history of Midchester. She had written two such novels, but so far had not found a publisher to accept them. One publisher had asked her to consider writing under a nom de plume, as her name was too much associated with children's books.

Mary also had a lifelong ambition to own and run a bookshop, even if she made little profit. Despite the misgivings of the couple's accountant, Adrian agreed to support his wife, especially as she would be providing most of the finance!

Mary soon found that running the bookshop, although enjoyable, was time-consuming and demanding. She employed one full-time assistant and two part-timers at weekends, with Adrian occasionally lending a hand. The shop sold guidebooks and books of local interest as well as the normal range of consumer, textbook and academic titles, but like all small retailers, was not able to carry a large stock. Sales were somewhat seasonal, as the tourist trade in the summer was quite profitable, but winter was a quieter time. Students from Wessex University, despite having a large bookshop on campus, often visited, trying to sell used textbooks or asking if some out-of-print book could be obtained. Mary started a small second-hand section, mainly for textbooks, and endeavoured to search for obscure titles on backlists. Apart from the students, the age structure of Midchester is rather skewed towards the elderly, so Mary's attempts to sell children's books were not successful, despite the publicity that her name attracted. Mary had achieved success with Heritage Tours Ltd, a firm which specialised in cultural tours of the UK especially for tourists from overseas. Heritage Tours Ltd agreed, in return for a small fee, to direct its customers towards Midchester Books during visits to Midchester and to mention the shop in its brochures.

As **Appendix 2** shows, Midchester Bookshop made losses in the first three years of trading. The accountant warned that the tax authorities would not sanction permanent losses and might classify the shop as a hobby (which, in truth, it largely was) rather than as a business. He recommended that ownership of the shop be placed under the name of Elf Enterprises Ltd, which was the company to which Mary's royalties were paid. Although she was no longer writing for children, Mary was continuing to earn royalties from her published books. Mary was determined to continue with the shop even though she was worried about the demands on her time and the fact that she had little opportunity to research for and write her historical novels.

Adrian thought that some changes would have to be made as Midchester Bookshop faced an uncertain future. He and Mary discussed extending the second-hand books area, or specialising in searching for obscure and out-of-print titles, which would allow a more Just-in-Time approach to stockholding. A marketing drive, focused on local tourist guidebooks and on the internet, was agreed. Approaching other tour firms similar to Heritage Tours Ltd seemed to be a path worth pursuing. Stocking more guidebooks in foreign languages, putting advertisements in the castle and cathedral bookshops or even offering to take over and run these outlets were other ideas considered.

Mary suggested operating a library service, as Midchester Public Library had closed, but thefts from bookshops are high and there was no guarantee that loaned books would be returned. Mary considered becoming a specialist antiquarian bookshop, but this might require experience and expertise which would have to be acquired.

The accountant pointed out that the future for the UK tourist industry was uncertain in the light of terrorist activities, such as those in London in 2005. However, Adrian suggested that economic factors would also need to be considered because they can affect tourism in a positive or a negative way.

Adrian considered selling the remaining four years of the lease, but there were restrictions on the use of the premises and the price for which the business would be sold was likely to be low. Mary was determined to continue in business, as she considered that profits were not as important as job satisfaction, but both Adrian and the family's accountant considered that some changes would have to be made.

## APPENDIX 1

### Market shares in the retail book industry (%)

	2004	2009 forecast
Waterstone's	14.7	18.0
Ottakar's	5.5	7.0
Online sellers	8.0	11.8
Supermarkets	7.0	10.0
Independent booksellers	24.0	13.5
WH Smith	13.8	13.1
Book clubs/mail order	16.0	14.0

(Source: Verdict Research Group, quoted in *Daily Mail*, 29 March 2005)

## APPENDIX 2

### Extracts from Midchester Bookshop Profit and Loss Account (£000)

	2004-05	2005-06	2006-07
Sales Revenue	160	165	160
Cost of Sales	100	105	105
Gross Profit	60	60	55
Other costs	40	45	45
Lease	25	25	25
Profit before interest and tax	(5)	(10)	(15)

#### Sources: adapted from

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