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paradigm shift.

To allow for the impact of stapling in the recommended place (vertical staple in the top left corner of the page), we have slightly offset the text at the top left of some pages – this is not a formatting error

Errata and improvements – please continue to monitor our learning platform through to exam day in case we discover errata or can offer further ideas and improvements (see page 2 of this Exam Room Pack for further details)

Dog Gourmet Supplies Ltd (November 2021 Case Study)

Exam Room Pack

Tip – print single-sided

For maximum efficiency under time pressure, we recommend that you print this Exam Room Pack single-sided: this will allow you to “peel” the pages over when searching for information as only the facing page will be printed, saving significant amounts of time as compared to flipping around in a double-sided print.

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We are pleased to announce that all profits from this publication will be transferred to our sister company Paradigm Shift Housing Limited to provide subsidised housing to NHS staff and other Key Workers. Thank you for your support of this project!

Disclaimers

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All page references marked as “p” plus a number are references to pages in the **Advance Information**. Any cross-references between pages within this Exam Room Pack itself will be very clearly marked as such.

Our notes applicable to the R2 & R3 financial models are based on our best efforts to determine the possible subject matter but obviously we cannot guarantee what will be tested on examination day.

Remember that the **R2 & R3 calculations** are generally only worth **10-20% of the marks in each of R2 & R3** and in several recent examinations these calculations have been marked at least partly on an “own figure” (i.e. any result is acceptable) basis.

So please do not fall into the trap of spending a disproportionate amount of time on the calculations during your examination attempt!

We have placed our thematic summaries in **alphabetical** order (except for our **Example report cover page**) – please familiarise yourself with our ordering of the content before examination day as it is not necessarily the order that you will use the pages in the examination itself.

Repetition of content

Please note that we have **intentionally copied and pasted** some text into different pages of the Exam Room Pack to ensure that certain key points are not missed depending on which page you turn to – this repetition is **intentional and carefully considered** and does not represent an error or fault with the publication.

Formatting of this ERP

We have prepared this ERP using a format which we believe is clear, efficient and effective, based on previous experience of preparing a number of similar ERPs and discussing the format with our tuition course students at previous sittings.

Whilst we recognise that some students may have their own ways of working and would prefer different formatting, for reasons relating to copyright and time constraints, we will **not** provide you with a personalised reformatted version nor with the original source files under any circumstances – therefore, please do not contact us to request this.

If you require the text to be placed on different pages or in a different order then please work on your own version as it is unreasonable to expect us to produce customised versions for individual students.

Errata and Further Ideas Notification

If we discover or are made aware of any errata in this ERP (and/or find that further ideas should be added) we will post a message regarding the necessary issues(s) on our **online learning platform**.

Please note that we will NOT email you in relation to these matters, due to time constraints and the possibility that you may not receive our email in time or at all – we believe that it is safer for us to place the information on a **website** but please kindly continue to **monitor** our online learning platform **right through to examination day** as we obviously do not know when any errata might be identified or notified to us by students.

We provide our errata notifications as part of our good faith efforts to assist you as much as possible but the provision of the relevant notifications does not in any way constitute our acceptance of any liability as a result of any errors and omissions and it **remains your sole responsibility as a candidate to confirm all facts and figures stated in this Exam Room Pack to the official ICAEW Advance Information**.

Many thanks again for your purchase and best of luck for your examination!

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Your report cover “page” should be included just before your Executive Summary response at the top of the word processing area in the assessment software.

There is no separate answering section for the cover “page” so placing the content at the start of the Executive Summary is acceptable.

Example report cover page

Draft report to the board of Dog Gourmet Supplies Limited (“DGS”)

Oakley Dunstable

3 November 2021

This report has been prepared for the exclusive use of the board of DGS and no liability is accepted in the event of further distribution.

Company background

Origins, philosophy and location

DGS is a **family-run** business founded by **Stephanie Bailey** in 1970 (p9)

Stephanie Bailey found that the foodstuffs being provided by the **major** manufacturers at the time of founding DGS were geared more towards creating successful **brands** to support **high-volume sales** than towards delivering a **high-quality** diet for dogs with **specific dietary needs** (p9) – she decided to start manufacturing her own **specialised** dog foods to meet the specific **high-energy** requirements of **working** dogs (p9)

Over the years, DGS has grown into a **well-established** and **highly-regarded** dog food producer, manufacturing **wet** and **dry** food as well as treats (p9)

The philosophy of DGS is centred on providing nutrition for dogs “**as if pets were people**” (p9, p34) – this means ensuring that the **quality** of ingredients, of **formulations** and of **processing** is at the same standard as it would be for **human-grade** food (p9)

Given the emphasis on pet health, Stephanie Bailey has always made it clear that DGS pet food should avoid common dietary **allergens** and should use only **natural** preservatives and colourings (p10)

DGS is a dog food **manufacturing** and **wholesaling** company located on the outskirts of **Droitwich Spa**, a town around **200 kilometres** north-west of **London** in the county of **Worcestershire** (p5)

DGS operates from a **single** site which contains its **head office**, the **food manufacturing** and **packaging** facility and **warehouse** (p5) – DGS’ clients are **all** based in the **UK** and are mainly **veterinary practices**, **specialist pet stores** and a **high street grocery retail chain** (p5)

The Droitwich Spa facility

DGS operates from **land and buildings** that were part of the **farm** that Stephanie Bailey’s parents owned (p10)

The original farm buildings were combined with an industrial unit that was built in **1995** and which has been further developed and extended over the years as requirements dictated (p10) – the **plant and equipment** similarly have been added to as the business has grown (p10)

The facility operates a number of production lines for **manufacturing** and packaging of various dog food products sold (p10)

There are **some storage** facilities on site, used to hold packaging and consumables, raw materials and finished goods (p10)

The opportunity to **expand storage capacity** on site is **limited** (p10)

A critical issue for DGS is to ensure that **production capacity** is utilised as **efficiently** as possible (p10) – significant **capacity** constraints are being experienced, **particularly** since DGS started selling to **Taylors** (p27)

Selective approach to ingredients

DGS is extremely **selective** over the **ingredients** used in its dog food (p10) – it excludes **dairy items**, other common **allergens** and artificial **additives** from its ingredient range (p10) – DGS also requires its **suppliers** to be able to provide **evidence** that confirms the **source** of the ingredients supplied to DGS (p10)

Bank loan

DGS has a **5%** bank loan **secured** on **land** included in **PPE** (p18) – the interest on the loan is at a **fixed rate** of **5%** and payable **annually in arrears** (p18) – the loan is repayable in **2030** and carries an **early redemption penalty** (p18)

Global and UK market: statistics and drivers

The **global** market for pet food is growing at an average rate of **5%** per annum (p7) whilst the **dog food market** makes up approximately **half** of the **UK** market for manufactured pet food (p7)

Drivers of this growth include an increase in pet **ownership**, with pet food being an **essential** item for pet owners (p7) – a tendency for owners to **reflect** their own **lifestyle** onto their pets (health and dietary preferences) and to **treat their pets** like humans (p7) – there has also been **increased pampering** of pets (p7)

Scientific advances in pet nutrition and food technology, combined with increasing demand for **specialised** pet food, have enabled the industry to **develop** and **diversify**, with pet foods becoming increasingly **sophisticated** in terms of **production** and **product offering** (p7)

Recent changes in pet ownership and mergers and acquisitions

Pet ownership rose by around **10%** during **late 2020** and **early 2021**, the result of an increased demand for the **companionship** and **diversion** that a pet provides (p7)

According to the PFMA, **young people** are the **main drivers** of recent growth in pet ownership, with **more than half** of new owners being aged **16 to 34** (p7)

The pet food manufacturing industry is dominated by a **few large** companies (p7) – typically, these are **vertically integrated** manufacturing businesses which benefit from substantial **economies of scale** with respect to manufacturing, distribution and marketing (p7)

The sector continues to experience **merger and acquisition activity**, as companies seek to achieve greater economies of scale (p8) – the large manufacturers also pursue **economies of scope**, with the very largest each having a number of dog food brands (p8)

The market size and growth together provide opportunities for **smaller manufacturers** to cater for **specialist** niches (for example, **higher income bracket** customers who can afford to pay more for **high-quality** or **innovative** products) (p8)

Contextual factors

UK sales methods

Most pet food sales (including **dog food**) in the UK reach consumers via the **large supermarket** chains (p8) – there are additional channels to market that pet food manufacturers can use, such as **veterinary practices**, **specialist pet stores**, **local breeders** and **garden centres** (p8)

Many vet practices are merging and forming **collectives**, as well as being acquired by other organisations (p8)

There are **thousands** of vet practices in the UK, of which around **30%** are owned by **large** corporations (including the large pet food manufacturers), **20%** are **smaller** chains of vet practices, and the remaining **50%** operate independently (p8)

A similar trend has taken place in the **specialist** pet store market over the last few years, with the formation of some **very large chains** (p8) – the UK pet store sector is still **fragmented**, however, with hundreds of independent retailers (p8)

A more recent development is the increase in sales from pet food manufacturers via **digital channels**, either through the **websites** of **supermarket chains** and **specialist pet food retailers** or through those of **purely online** pet food retailers (p8)

The advent of e-commerce has also allowed **business-to-business** (B2B) organisations such as **pet food manufacturers** to retail their own brands **Direct-To-Customer** (DTC) (p8)

General background

DGS is a UK **manufacturer** and **wholesaler** (p10) – it does **not**, to date, sell **directly** to pet owners but rather its channels to market are through a network of **retail clients**: vets, specialist pet stores, dog breeders and garden centres (p10)

DGS has **recently** begun selling through an **upmarket UK-wide grocery retail chain**, Taylors (p10)

Relationships

Strong **relationships** between DGS and its clients in **key channels** (**specialist** pet stores and **vet** practices) have for many years helped support its underlying, **highly-differentiated** brand strength, which focuses on the health of dogs (p21)

Takeover activity in vet practices and pet store sectors has created significant challenges (p21) – **over the last couple of years**, therefore, DGS has been exploring a **shift away** from its selective pet-oriented outlets to more **mainstream** food retailers (p21)

Selective

Stephanie Bailey has always been **adamant** that the business is highly selective about which retailers it works with, so that the **differentiated** nature of its products is maintained and ideally enhanced (p10) – to support this, DGS has wherever possible entered **exclusive supply** arrangements such that DGS' retail clients **do not stock other brands** of dog food (p10) – however, with the merger and acquisition activity occurring in DGS' main channels to market, **exclusive** arrangements are becoming **increasingly difficult** to set up and maintain (p10)

Website

DGS' ability to sell is reliant on developing and maintaining **relationships** with its clients (p10) – therefore, whilst DGS has a website, **historically** there has been **no perceived need** for it to have any shopping facility for the general public (p10) – rather, the website is used mainly as an **information source**, allowing DGS to explain the health advantages of DGS pet food, promote its relationships with vets and breeders to further **differentiate** its products and direct interested dog owners to their **nearest retailer** of DGS products (p10)

The directors are aware that the DGS website is **not currently as high-profile** as they would like it to be (p10)

Customers – general

Discounts

As retailers, none of DGS' clients pay the **full recommended retail price** (RRP) price: individual **discounts** (and **credit terms**) are linked to the predicted size of orders over a year, and the level of **exclusivity** that they offer DGS (p22) – **Taylors**, **VST** and **PiP** enjoy better **discounts** than the average that DGS normally offers, with **VST** and **PiP** both receiving discounts of **32%** (p22) – this obviously puts DGS' margins under **greater pressure** so manufacturing **efficiency** and **productivity** are more important than ever in ensuring that DGS continues to grow profitably (p22)

Average discounts by channel

	2020	2019	2018
Vet practices	30%	28%	25%
Specialist pet stores	30%	27%	25%
Other	23%	23.6%	22.7%
Taylors	40%	40%	n/a
Overall weighted average discount	31.2%	27.4%	24.4%

Average discount is calculated as: $(\text{RRP value of sales} - \text{Actual sales revenue}) \div \text{RRP value of sales}$.

Example discount calculation 2018: RRP value of sales = £19.3 million
Actual sales revenue = £14.6 million

Overall **weighted** average discount = $(19.3 - 14.6) / 19.3$ = **24.4%**

The DGS website offers retailers the opportunity to apply to become a DGS business **partner** (p10) – Stephanie Bailey has always insisted that DGS carries out a review of any **potential new retailers** that apply to become a partner, and DGS requires any potential retailer to sign a **non-disclosure agreement** (NDA) before discussing any discounts (p10)

Customers – named (1)

Taylors (YE 30 Sep 2020 discount: **40%** (p12, p22, p37), **90 days** credit terms (p37))

An **up-market UK-wide grocery retail chain** (p10)

In November 2018, DGS signed a supply contract with the national grocery retailer Taylors (p21) – Taylors has **nearly 250 large** stores and **over 650 smaller** stores and “convenience” shops in city centres and transport hubs (p21)

Taylors has an “**up-market**” reputation and currently has a **significant** share of the UK groceries market (p21) – Taylors sells its **own-brand** dog food, as well as dog food products from the **competitors** of **DGS**, offering a **variety** of **quality** and **price points** (p21) – given its target market, Taylors does **not** sell **very cheap** dog food (p21)

Advertising for Taylors tends to focus on its **unique selling points**: the **quality** of its products, the **expertise** of its **staff** and its **ethical standpoint** (p21) – Taylors uses **celebrities** in its **marketing** (p21)

Ongoing investment has resulted in Taylors’ **e-commerce** platform increasing the proportion of sales through online channels, now accounting for **20%** of its total business, up from **5%** in 2019 (p21)

Taylors is considered a **good fit** with DGS, given Taylors’ **high-end brand** and **higher-income** customers (p21) – whilst DGS’ products do face significant competition in Taylors’ stores from other dog food brands, DGS’ **premium products** are appealing to segments within Taylors’ **own customer base** and DGS is seeing **very encouraging growth** in orders from Taylors as a result of its pet-owning customers (p21)

Taylors has invested in **sophisticated inventory control systems** so it can feed back to DGS very promptly on which products are generating interest from its own customers and is able to provide **more information** about its online customers’ profiles (p21) – this has proved very interesting as it is clear that Taylors has given DGS access to a **very different kind of pet-owning customer** (p21) – Taylors has also been able to provide **more generalised advice** to DGS on the **type of products that customers of Taylors prefer** or would like to see (p21)

Taylors (continued)

Orders from Taylors admittedly come in at the **last minute** on occasion, but the **increase in revenue has been worth it** for DGS (p21)

DGS feels that the combination of an **up-market brand**, an **affluent** and **discerning** customer base, a **wide distribution** network, an impressive **e-commerce business** and insight into pet owners’ changing demands **outweighs** the more demanding **discounts** and the **short notice** on orders from Taylors (p21)

Veterinary Support Trust (VST) (YE 30 Sep 2020 discount: **32%** (p22))

VST is one of the **largest family-owned veterinary groups in the UK**, with branches **across** the **UK** and a **head office in London** (p21) – branches are based in town centres and the group focuses on care of **small** animals (p21) – the **4** largest branches incorporate their own **animal hospitals** (p21)

After leaving **PAW**, **Hugh Logan** brought **VST** as a client to **DGS** and **DGS** was **delighted** with this, given the **ongoing client losses** in DGS’ **traditional channels** to market (p21)

All branches of VST sell a **range** of pet food, including vet-prescribed products, age-related products and pet food for other special dietary requirements (p21) – historically, the group has stocked a **large range of brands**, but in **recent years** it has restricted the number of brands following some **negative press** regarding pet food manufacturers making **unsubstantiated health claims** (p22)

The **reputation** of VST, combined with its ability to reach **dedicated pet owners**, will help support both **revenue** growth and DGS’ **reputation** as a **health food choice** for dogs (p22)

Customers – named (2)

Pets in Paradise (PiP) (YE 30 Sep 2020 discount: **32%** (p22))

PiP became a DGS customer in 2018 when **Hugh Logan** left **PAW** (p22) – PiP has grown into one of the **largest chains of pet stores** in the UK, with a **substantial online** presence (p22)

PiP caters for **dogs, cats** and a variety of other small pets and offers a wide product range, including **pet food**, accessories and toys (p22)

Larger stores offer a range of services including **dog grooming, vaccinations, health-checks** and so on (**3** stores have an **on-site** vet practice) (p22) – staff are **widely regarded** as being **specialists** in animal health and nutrition (p22)

PiP branches sell a range of sizes of all the major dog food brands, both **wet** and **dry** foods, as well as **frozen food** and **dog treats** (p22) – bestsellers include **natural foods**, weight control foods and grain-free foods, with variety packs of these types being particularly popular (p22) – **online** there are **45 brands** available but these are selectively chosen for their health benefits (p22)

Whilst DGS faces **competition**, DGS enjoys the **positive publicity** of having their products stocked and promoted by **PiP**, both in-store and online (p22)

Taylors, VST and PiP: Overview

Taylors, VST and **PiP** are **significant** clients which are important additions to DGS' client list (p22) – given the **restructuring** in their channels to market, the ability to win and service **highly visible, successful** and **well-regarded** large clients of their client is critical to DGS' success (p22)

Taylors generated **almost 20%** of DGS' business in 2020 and whilst **VST** and **PiP** do not have the **scale** of Taylors, they are still **significant** clients for DGS (p22) – DGS must be mindful of any reported issues or production orders that come in from these clients and must **prioritise accordingly** (p22) – feedback from the production team is that there are an increasing number of **short-notice orders**, a marked change from the typical regular monthly order (p22) – this seems to be due to a **shift** in the type of food that pet owners are buying (p22)

Digital marketing pro-forma and inputs points

Digital marketing pro-forma data (p39)

Performance metrics

Awareness: organic traffic to website
 Awareness: paid ads driving traffic to website
 Awareness: traffic to website driven by affiliates
 Interaction: bounce rate
 Conversion: item in shopping cart
 Conversion: average CTR
 Conversion: average order value
 Advocacy: brand mentions per month

Monthly impact of POM

10,500 visitors due to POM's SEO
 1,200 visitors arrive after clicking a paid ad
 3,600 visitors arrive via an affiliate link
 40% of visitors leave immediately
 17% of visitors place item in shopping cart
 6.5% of all visitors make a purchase
 £58
 500 mentions on SM

Costs of POM agency

- Monthly retainer: £2,500
- Paid ads: costs are driven by number of times that ads are clicked on, averaging £5 per click
- Affiliate costs: 3% of attributable revenue
- Initial investment: £140,000 for development of e-commerce platform and marketing strategy

Profit impact of POM per month

	Visitors	CTR@6.5%	Value@£58 £	Costs £
Organic search traffic via Google due to improved SEO/SM	10,500	682.5	39,585	(2,500)
Traffic attributed to paid ads	1,200	78.0	4,524	(6,000)
Traffic attributed to affiliate referrals	3,600	234.0	13,572	(407)
Total increased visitors	15,300	994.5	£57,681	£(8,907)
				£
Increase in gross profit *	25% x £57,681			14,420
Increase in delivery costs *	6% x £57,681			(3,461)
Agency costs				(8,907)
Monthly impact on profit				<u>£2,052</u>
Full-year impact on profit (12 x £2,052)				<u>£24,624</u>

* X Ltd has a gross margin of 25% and delivery costs are estimated at 6% of revenue.

Inputs points

25% GP% is **higher** than DGS achieved in YE 30 Sep 2020 (20.2% (p14))

Delivery costs estimate of **6%** may not be appropriate to DGS (compare to distribution costs for YE 30 Sep 2021 per your Appendix 1)

Visitor figures are **estimates** and may be higher or lower in practice – may **vary** from **month** to **month**

Same CTR for **all methods** (organic search, paid ads, affiliate referrals) seems unlikely – similarly, **same average order value** for all methods seems unlikely

May be worth comparing **value (revenue)** versus **costs** for each method to see which methods provide best **return** (or whether there is a method that is not worthwhile)

Website visits: drivers

Website search (e.g. Google): **around 50%** of traffic (p41)

Direct (e.g. pre-saved link): **around 25%** of traffic (p41)

Referral links from other sites (e.g. blog): **around 10%** of traffic (p41)

Social media (e.g. Facebook, Instagram, TikTok): **around 10%** of traffic (p41)

Reasons why X Limited undertook improvements to e-commerce

To increase the number of website **visitors** (p39)

To improve the **buying experience** so that visitors stay longer (p39)

To increase the number of visitors who **click all the way through** to completing a purchase (click-through-rate or CTR) (p39)

To increase the **amount** that visitors **purchase** on each visit (**average order value**) (p39)

More generally, to improve X Limited **brand advocacy** (p39)

Ethics (1)

Important warning regarding our Ethics notes – we have done our best to work through all the possible Ethics issues that we can see in the Advance Information but the examiners will sometimes introduce completely new Ethics issues unrelated to the Advance Information on exam day so you must not assume that all Ethics issues which arise in your examination necessarily have to come from the notes provided here

Allergens

Stephanie Bailey has always made it clear that DGS pet food should avoid common dietary **allergens** (p10)

Artificial additives

Stephanie Bailey has always made it clear that DGS pet food should use only **natural** preservatives and colourings (p10)

DGS does **not** use **artificial** additives (p31)

Battery-farmed animals

DGS **only** uses **meat** from animals that are **grass-** or **barn-raised** (p31) – it does **not** use **battery-farmed** animals (p31)

Bonus system and potential manipulation of parameters

Hugh Logan, Suzanne Coder and Sayali Patel have some **flexibility** on the level of **discount**, **credit terms** and **dispatch** arrangements that they can offer to their own clients, **within parameters** set by **Louis Bailey** (p20)

Bonus system and potential nepotism

Charlie Bailey (who manages the relationship with Taylors) is not included in the **same bonus** calculation as the rest of the team (p19)

Bonus system fairness

Hugh Logan has complained that the bonus system is **unfair** (p20, p23) – clients are different **sizes** and the **chance of a big client win** depends on which specific region is allocated to the sales team member (p20) – **Hugh Logan** has also objected that he has to spend **time** working on clients which are **allocated** to **Suzanne Coder's territory** (p20) – **Hugh Logan** has complained that **smaller** clients find that they never know what to order so **last-minute** work is created whilst **Suzanne Coder** states that **larger** clients require **more time and attention** (p20)

Bots and fake website hits

It is possible to **pay** organisations to **drive** traffic to a website, although these can sometimes be **artificial visitors** (also known as “**bots**”) (p41) – whilst this can potentially help search engine rankings, **artificial** visitors have a number of **downsides**: in particular, they do not actually **buy** anything (p41)

Breach of rules on monthly orders

Individual clients can, and often do, **amend** monthly orders – **strictly**, such changes require **a month's notice**, but **increasingly** this is **not** being **adhered to** (p26)

Cats are carnivores

Cats are **carnivores** so unlike dogs, they **need** to eat **meat** (p44) – cats cannot simply be provided with dog food in a different **wrapper** (p44)

Competing with existing retail clients through DTC

DGS has **no contractual restrictions** with any of its clients to prevent it from using DTC but DGS would need to be cautious that it does not **jeopardise** its **relationship** with its **clients** through being seen to be **competing on price** (p37) – DGS may therefore have to use **other methods** such as the provision of support (blogs, e-newsletters, other promotional material, creation of an online society of pet owners) (p37)

Customer complaints and additional work for sales team members

2 significant clients (**PiP**, **VST**) were allocated to Suzanne Coder because their **head offices** are based in the **Southern** region but **Hugh Logan** states that these clients **phone him** all the time, including to make **complaints** about the quality of service (sometimes deliveries are late or incomplete) (p20) – according to **Hugh Logan**, clients also say that **DGS does not understand** their needs whereas **PAW** did and so they want **Hugh Logan** to look after them (p20)

Delivery commitments

Potential **new** clients will need to be assured that DGS can be **relied** upon to **deliver** as required when orders are placed (p19)

Ethics (2)

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Direct-To-Customer (DTC) risks

DGS has **no contractual restrictions** with any of its clients to prevent it from using DTC but DGS would need to be cautious that it does not **jeopardise** its **relationship** with its **clients** through being seen to be **competing on price** (p37) – DGS may therefore have to use **other methods** such as the provision of support (blogs, e-newsletters, other promotional material, creation of an online society of pet owners) (p37)

Duty of care

As a **sales** person, **Hugh Logan** obviously understands that **sales growth** is **important** but not at **any cost** (p23) – his view is that DGS has a **duty of care** to employees, clients, their customers and their pets (p23)

Fake website hits

Some **unscrupulous marketing agencies** inflate their ad revenue by making a site's **audience** appear greater than it is in reality by creating **artificial visitors** (p43)

Fish derivatives, specialist fish processor and “Sensitive” range

DGS only uses **fish derivatives** from **reputable** and **traced** sources (p31)

All DGS' fish ingredients are sourced from a **specialist fish processor** (p31) – **very high-quality fish** is required for DGS' “**Sensitive**” range as it is **easily digestible** for dogs with sensitive digestive issues (p31)

Flushing out process: critical checks

A **critical check** is overseeing the **flushing-out process** and then carrying out **testing** to ensure that all parts of the production plant are **sterile** (p25)

Once a **production run** is **complete**, the **entire plant** must be **flushed out** and **decontaminated** (p25) – all **traces** of ingredients and mix must be **removed** (p25) – this stage is critical to ensure **no cross-contamination** to a different product variant, as well as to remove any risk of **infection** from pathogens (e.g. Salmonella) because of the risks associated with **meat-based** ingredients (p25)

Flushing out process: resource use and sustainability

The Cleaning In Place (CIP) process requires the use of **copious amounts of water and chemicals** because of the need to flush out any remaining pet food mix and then to **sterilise** the plant (p26, p29) – the **flushing out process** and **changeovers** are **time-consuming** and **labour-intensive** (p26, p29) – in addition, it results in the **loss** of significant amounts of **valuable** product mix, and thus contributes to materials wastage (p26)

Hazardous nature of manufacturing dog food

Given the potentially **hazardous** nature of **manufacturing** dog food, **safety** during the production process is an **important** aspect of the **quality assurance protocols** (p25)

Health claims by pet food manufacturers

Historically, the **VST** group has stocked a large range of brands, but **in recent years** it has **restricted** the number of brands following **some negative press** regarding pet food manufacturers making **unsubstantiated** health claims (p22)

Hugh Logan: prior experience at PAW

Hugh Logan joined DGS after leaving a **rival** manufacturer **Pet Alliance Wholesalers** (PAW), bringing **2** clients with him (**Veterinary Support Trust** (VST) and **Pets in Paradise** (PiP)) (p19)

Influencers

Influencers are paid to drive **traffic** to a website (p41) – **Paradigm Shift Financial Training comment**: the influencer may be tempted to make **dishonest** statements to drive traffic (for example, making strong claims about DGS' products, which may be untrue)

Companies which use influencers are also **reliant** on them not saying or doing anything online that might **harm** the company's **brand** (p41)

Important warning regarding our Ethics notes – we have done our best to work through all the possible Ethics issues that we can see in the Advance Information but the examiners will sometimes introduce completely new Ethics issues unrelated to the Advance Information on exam day so you must not assume that all Ethics issues which arise in your examination necessarily have to come from the notes provided here

Ethics (3)

Ingredients

DGS is extremely **selective** over the ingredients used in its dog food (p10) – it excludes **dairy items**, other **common allergens** and **artificial additives** from its ingredient range (p10) – DGS also requires its suppliers to be able to provide **evidence** that confirms the source of the ingredients supplied to DGS (p10)

Kibble and small dogs

Small dogs cannot eat **large** kibble (p26)

Long hours for staff

The effects of **unexpected changes** in production **scheduling** and production **capacity** constraints have been overcome by **extended working**, additional **overtime** (as well as short-term temporary staff resourcing) (p27)

Materials wastage rate on the increase

In the last 2 years, **materials wastage** has **increased** for DGS (p26), reaching **9.7%** in 2020 from **8.8%** in 2019 and **6.3%** in 2018 (p26)

Meat sourcing

DGS sources **meat** from **UK** farms and DGS has **regular discussions** with farmers regarding meat requirements to ensure that all necessary protocols are being adhered to (p31) – DGS uses a **range** of different farmers to ensure that it does not encounter **supply issues** (p31)

Negative press and health claims

In recent years, DGS' client **VST** has **restricted** the number of **brands** it retails following some **negative press** regarding pet food manufacturers making **unsubstantiated health claims** (p22)

Nepotism

Nepotism is the **preferential** treatment of **relatives** or **friends** (p45) – this may be a controversial topic in business ethics, but it is **not necessarily unethical** (p45) – family businesses can benefit from multiple generations of family involvement but recruiting underqualified family members can **undermine the company culture** and passes an increased burden on to other staff (p45)

New client assessments: brand positioning, due diligence and credit rating agency

All new clients are assessed by the team to ensure that **brand positioning** of any new client is consistent with DGS' own **differentiated** brand (p20) – the finance team also carry out **due diligence** on any prospective new client, including the use of a **credit rating agency** (p20)

Non-Disclosure Agreements (NDAs)

Stephanie Bailey has always insisted that DGS carries out a **review** of any potential new **retailers** that apply to become a **partner**, and DGS requires any potential retailer to sign a **non-disclosure agreement** (NDA) **before** discussing any **discounts** (p10)

One month notice period

Strictly, changes to **monthly** orders require a **month's notice**, but **increasingly** this is not being **adhered to** (p26)

Pay rises

DGS tends to offer a **2%** annual pay rise (p13, p14, p27)

PAW behaviour

PAW has been **disputing** its rivals' **claims** regarding their **natural ingredients** and the promotion of **health benefits** of their products (p43) – PAW maintains that these are **unsubstantiated** and **misleading** (p43)

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Ethics (4)

Philosophy and commitments

Stephanie Bailey decided to start manufacturing dog food after finding that the major manufacturers were geared more towards creating successful **brands** to support **high-volume sales** rather than delivering a **high-quality diet** for dogs with **specific dietary needs** (p9) – she has always been emphatic that DGS should stay **loyal** to the initial values that gave rise to the company (p9)

The **philosophy** of DGS is centred on providing nutrition for dogs “as if pets were people” (p9, p34) – in context, this means ensuring that the **quality** of ingredients, of **formulations** and of **processing** is at the same standard as it would be for **human-grade food** (p9)

“Pigging” solutions and sustainability benefits

Company M found that some of the benefits of a “**pigging**” solution included **improved working conditions**, **lower utility** usage (**water** and **power**) and **fewer expensive cleaning chemicals** (p30) – this made it **easier** for Company M to meet its **environmental responsibilities** (p30)

Plastic trays

More and more **cat food brands** are starting to offer **wet** cat food in convenient **plastic** trays, often in single-serving sizes (p44) – previously, **metal** was used (p44)

Pressure on DGS from a very long list of poorly managed clients

Hugh Logan states a really **serious mistake** could happen and the implications for DGS, its clients, their customers and their pets could be **catastrophic** raising ethical concerns in his mind (p23)

Ade John has also raised a number of **concerns** from unexpected **production scheduling**: **overworked** and **highly-stressed staff**, bottlenecks in supply and longer running times, placing plant and equipment under increased pressure (p27)

Product recall

DGS has **never** had a **product recall** (p27) – **Paradigm Shift Financial Training comment**: this means that the board and staff have **no experience** of how to handle the process

Regulation of dog food manufacture

The manufacture of dog food is **heavily regulated** and DGS is particularly **diligent** with regard to its responsibilities (p31) – **Stephanie Bailey** has always been insistent on **personally** being able to guarantee the **integrity** of the ingredients for DGS **health-based** products, as well as the **quality** of the manufacturing processes (p31)

Review of new retailers

Stephanie Bailey has always insisted that DGS carries out a **review** of any potential new **retailers** that apply to become a **partner**, and DGS requires any potential retailer to sign a **non-disclosure agreement** (NDA) **before** discussing any **discounts** (p10)

Salmonella “near miss” incident

On one occasion recently, **staff shortages** meant that a shift went through the **close-down** and **flushing-out process** without an **experienced** shift supervisor present (p27) – the team’s work was not overseen in the way that DGS’ **control procedures** stipulate and the resulting failure to flush out production plant correctly following a **poultry-based** production run resulted in **contamination** of subsequent batches, which have tested positive for **Salmonella** (p27)

Scheduling of maintenance of plant and machinery

Maintenance, repair and **upgrade work** is typically scheduled in advance to pre-empt breakdowns and avoid downtime (p26) – where possible, it takes place overnight or at weekends outside normal shifts, to prevent **interruption** of production runs (p26)

Shelf-life

DGS’ **dry** pet food and treats have a shelf-life of up to **a year** and its **wet** pet food has a shelf-life of **2 to 5** years (p25)

Social media influencers and affiliates

An **influencer** is someone who, by virtue of his/her **celebrity status** or **reputation** in a particular field, is **well regarded** and so can help **drive** more **traffic** to a website (p41) – an **affiliate** arrangement involves agreeing with another organisation to promote one another’s products (p41) – a company is **reliant** on the **influencer/affiliate** not doing anything **online** that might **harm** the company’s **brand** (p41)

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Stress for staff

Unexpected production scheduling has resulted in **overworked** and **highly-stressed staff** (p27)

Sustainability of production

Social media posts indicate that consumers are concerned about various aspects of production of pet foods: **greenhouse gases** produced by **livestock** raised for pet and human food, use of **land, water** and **energy** (which pumps **greenhouse gases** into the environment) (p45) – others raise concerns about the problems caused by **intensive-farming**, the waste of **water** and **power** in manufacturing pet food as well as **emissions** from **factories** and **wasteful packaging** (p45)

Taylor's customer data

Taylor's is able to feed back to **DGS very promptly** on which products are generating **interest** from its own customers and to provide even more information about its **online customers' profiles** (p21)

Traceability

DGS **only** uses **fish, vegetables** and **rice** from **reputable, traced** sources (p31)

Hugh Logan quarterly performance review

Comments from Hugh Logan

Hugh states that **growth** in the business has been **encouraging** (p23) but he recaps his **concerns** raised in previous staff meetings and performance reviews (p23)

According to Hugh, the **commission structure** and the way in which clients are allocated is **unfair** and Hugh has **already** informed the board about this (p23)

Hugh reiterates his concerns about letting the **least experienced member** of the team manage DGS' **biggest** and most **critical client** (p23) – Hugh states that he understands the desire in a family firm to manage **progression** but the **downside risks** of this are **significant** (p23)

The lack of **alignment** between the way in which behaviour is rewarded for **growth** and the impact on the rest of the business is increasingly **dysfunctional**, according to Hugh (p23)

Hugh states that the team is being **pressed** to meet what he feels are **increasingly irrelevant KPIs** and the impact in terms of **profitability** is being ignored (p23)

Hugh states that DGS is being forced into chasing **ever-smaller clients** who are increasingly **demanding** (p23)

According to Hugh, pressure is being created by having a **very long list** of poorly managed clients whom apparently they are **not allowed to say no** to or ever to disappoint (p23)

This pressure is being passed onto **all** of the **operational** teams: procurement, production, cleaning, quality assurance, packaging, warehousing and dispatch (p23)

Hugh states a **really serious mistake** could happen and the implications for DGS, its clients, their customers and their pets could be **catastrophic** raising **ethical** concerns in his mind (p23)

As a **sales person**, Hugh obviously understands that sales **growth** is important but not at any cost (p23) – his view is that DGS has a **duty of care** to employees, clients, their customers and their pets (p23)

Commentary on Hugh Logan's performance in the period (by Louis Bailey)

After a **promising start** with DGS, sales KPI performance is a bit **mixed** (p23)

Hugh has a **great skill at winning clients**, but **average revenue** continues to be **lower** than is preferred with a **consequent impact** on meeting the **total revenue target** for the **Northern** territory (p23)

Difficult trading conditions in DGS' wholesale markets are noted and Hugh's comments will be taken **onboard** and **addressed** as soon as DGS gets through the current **very busy period** (p23)

Key DGS calculations

Digital marketing (p39)

Profit impact of POM per month

	Visitors	CTR@6.5%	Value@£58 £	Costs £
Organic search traffic via Google due to improved SEO/SM	10,500	682.5	39,585	(2,500)
Traffic attributed to paid ads	1,200	78.0	4,524	(6,000)
Traffic attributed to affiliate referrals	3,600	234.0	13,572	(407)
Total increased visitors	15,300	994.5	£57,681	£(8,907)

		£
Increase in gross profit *	25% x £57,681	14,420
Increase in delivery costs *	6% x £57,681	(3,461)
Agency costs		(8,907)
Monthly impact on profit		£2,052

Full-year impact on profit (12 x £2,052)	£24,624
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* X Ltd has a gross margin of 25% and delivery costs are estimated at 6% of revenue.

Discount calculation (p22)

Average discounts by channel

	2020	2019	2018
Vet practices	30%	28%	25%
Specialist pet stores	30%	27%	25%
Other	23%	23.6%	22.7%
Tailors	40%	40%	n/a
Overall weighted average discount	31.2%	27.4%	24.4%

Average discount is calculated as: (RRP value of sales - Actual sales revenue) ÷ RRP value of sales.

Example discount calculation 2018: RRP value of sales = £19.3 million
Actual sales revenue = £14.6 million

Overall **weighted** average discount = $(19.3 - 14.6) / 19.3$ = **24.4%**

Pigging example (Company M) (p30)

"The production line holds around 350 litres of product. Depending on the product, this can be worth around £0.50 a litre and is flushed out once a day. Over a year, that adds up to 350 litres x 250 working days x £0.50 = £43,750 a year of recovered product that can be re-used. The reduction in material wastage was very material for us.

Nu-Dog-Fit (p34, p35)

Nu-Dog-Fit development and marketing costs: commentary on variances

	Budget £000	Actual £000	Variance £000
Formulation of recipe	10	4	6
Prototyping/focus groups	28	9	19
Marketing campaign and creative	27	26	1
Promotional events	86	*104	(18)
	151	143	8

* Actual promotional event costs are net of the unexpected £37k revenue generated during the soft launch in 2019, giving a total outlay on promotional events of £141k.

Gateway 3: Evaluation of Nu-Dog-Fit

	Predicted 2020	* Flexed 2020	Actual 2020		Predicted 2021
Years ending 30 Sept					
Volume: tonnes	50	60	60	Variance**	137
	£000	£000	£000	£000 %	£000
Revenue	203	244	250	6 2.5%	570
Materials	(127)	(152)	(155)	(3) (2.0%)	(265)
Labour	(20)	(24)	(23)	1 4.2%	(48)
Production	(53)	(64)	(62)	2 3.1%	(131)
Cost of goods sold	(200)	(240)	(240)	- 0.0%	(444)
Gross profit	3	4	10	6	126
Gross profit %	1.5%	** 1.6%	4.0%		22.1%

* 'Flexed' represents the predicted figures, restated to reflect actual volumes sold

** Ignoring rounding

Nu-Dog-Fit Gateway 3 evaluation: re-assessed ROI after one year's trading

Expected average gross profit = $(126 + 10) / 2$ = £68k
Actual costs incurred up to official launch = £143k
Expected ROI at Gateway 3 = 47.6%

The 4 DGS Gateways (p33)

Gateway 1 – **soft** approval launch after research phase

Gateway 2 – **official** launch

Gateway 3 – **post-year 1** assessment

Gateway 4 – **post-year 2** assessment

Note: we have not included any references to any of the real-world entities mentioned in the Advance Information in this list of **Named things** as real-world entities are never referred to in the Exam Paper. This is deliberate and does not represent an error in this Exam Room Pack.

Named things (1)

Ade John – **Director** responsible for **manufacturing and operations** (p9) – **not** a member of the **Bailey** family (p9) – Ade John provided a **detailed** and **lengthy criticism** of problems with **operations and quality assurance** in December 2020 (p27)

Annie Bailey – **child** of **Louis Bailey** (p9) who has a **degree in food science** (p9) – joined the DGS **product research and development team** (p9)

Bailey Family – the **only shareholders** in DGS (p9)

Charlie Bailey – **child** of **Louis Bailey** (p9) who has **completed a degree in management and marketing** (p9), recently joining DGS (p19) – joined the DGS **sales and business development** team after a year working for a **digital marketing agency** (POM) (p9), discussing his experience with the board (p37, p39)

Company M – medium-sized **pet food manufacturing company** based in the **South of England** which invested in a PRC “**pigging**” solution (p30)

Dog Gourmet Supplies Limited (DGS) – best of luck with your exam if you need to check who DGS are ...

Droitwich Spa – a town around **200 kilometres** north-west of **London** in the county of **Worcestershire** (p5)

Harold Bailey – a **vet** and **husband** of **Stephanie Bailey** (Stephanie Bailey is the founder of DGS) (p9) – retired from the business as **Chair** in 2010 owing to **ill-health** and **Stephanie Bailey** has held the **role** since then (p9)

Hugh Logan – joined DGS in **2018** after leaving a rival manufacturer **Pet Alliance Wholesalers** (PAW), bringing **2 significant** clients with him, the **Veterinary Support Trust** (VST) and **Pets in Paradise** (PiP) (p12, p19)

Independent Vet Practice (IVP) – a **consortium** which has existing commercial arrangements with one of the **large** pet food **manufacturers** (p12) – in YE 30 Sep 2018, **2** of DGS’ **medium-sized clients** decided to join forces with **IVP** and served notice to **terminate** their contracts with **DGS** (p12)

Jace Moon – your Case Study “**character**” and a **final year trainee ICAEW Chartered Accountant**, working in the business advisory unit of **Oakley Dunstable** (p5)

John Steptoe – **CEO** of **PAW**, who has stated that PAW will not back down and will do “**whatever it takes!**” (p43)

Louis Bailey – **child** of **Stephanie Bailey** and **Harold Bailey** (p9) and **Director** responsible for **sales, business development** and **product research** (p9)

Oakley Dunstable – **firm** of **ICAEW Chartered Accountants** located in the county of **Worcestershire** in England (p5)

Pet Alliance Wholesalers (PAW) – one of DGS’ “**close rivals**” with a strong level of **audience engagement** and **volume of activity** on its website (p37) – **Hugh Logan** left **PAW** to join DGS in **2018** (p12, p19) – per media reports, PAW is **currently disputing** its rivals’ **claims** regarding their **natural ingredients** and **promoted health benefits** of their products – **PAW** maintains that these are **unsubstantiated** and **misleading** (p43)

Pet Food Manufacturers Association (PFMA) – an **association** of pet food **manufacturers** (p7) – **most** of the **100** companies that **manufacture** pet food in the **UK** are members of the PFMA (p7)

Pets in Paradise (PiP) (see also page 10 of this Exam Room Pack) – a **specialist pet chain** won from **PAW** when **Hugh Logan** moved to **DGS** from **PAW** (p12, p19) – one of the **largest chains of pet stores** in the UK, with a **substantial online presence** (p22) – PiP caters for **dogs, cats** and a variety of **other small pets** and offers a wide product **range**, including **pet food**, accessories and toys (p22) – bestsellers include **natural** foods, **weight control** foods and **grain-free** foods (p22) – received a **32%** discount from DGS in YE 30 Sep 2020 (p22)

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Named things (2)

Pets Vets Limited (PVL) – a well-known **vet practice** with a large **chain** of **surgeries** which **used** to **stock** the DGS range as the **only health-based** dog food that PVL stocked (p12) – PVL's success made it an **acquisition target** and it was **bought** by one of the **market-leading vet practice chains** which, in turn, was **owned** by one of the **large pet food manufacturers**, which instructed PVL to **cease stocking DGS products** (p12)

Product Recovery & Cleaning Limited (PRC) – a **market-leading CIP** enhancement organisation which has installed a **“pigging”** system in **many food manufacturing** organisations, including those producing **pet food** (p29) – PRC is **well regarded** in the field and comes **highly recommended** (p29)

Pro-Online Marketing Limited (POM) – **digital marketing agency** that **Charlie Bailey** worked for (p37) – POM has a **high profile** and a **very public team** of **young managers and directors** with the **average age** of new employee recruits to the **social media team** being **18** (p37) – POM's philosophy is that the experts in social media are the people that use it (p37)

Preet Sharma – **Director** responsible for **finance** and **IT** (p9) – **not** a member of the **Bailey** family (p9)

Sayali Patel – member of the **sales and business development team** who joined **DGS directly** from **university** 12 years ago (p19)

Scott Destrier – head of production research who has produced a research paper on **“pigging”** whose **findings are not fully accepted** by **Ade John** (p27)

Steff Jaune – **CEO** and **owner** of **Company M** (p30), a **medium-sized** pet food **manufacturing** company based in the **South of England** that installed a PRC **“pigging”** solution (p30)

Stephanie Bailey – **founder, Chair** and **CEO** of **DGS** (p9) – as **Stephanie Bailey** approaches her **80th** birthday, she has recognised that she needs to step back from the business and let her **children** and **grandchildren** take it over more fully (p9)

Suzanne Coder – member of the **sales and business development** team who was recruited by **Stephanie Bailey** almost 30 years ago (p19)

Taylor's (see also page 9 of this Exam Room Pack) – an **up-market UK-wide grocery retail chain** (p10) and **key DGS client** which generated around **20%** of DGS' revenue in YE 30 Sep 2020 (p22) – receives a **40%** discount from DGS (p12, p22, p37)

Val Williams – a **partner** in the **business advisory department** of **Oakley Dunstable** to whom **Jace Moon** reports (p5)

Veterinary Support Trust (VST) (see also page 9 of this Exam Room Pack) – client won from **PAW** when **Hugh Logan** moved to **DGS** from **PAW** (p12, p19) – one of the **largest family-owned veterinary groups in the UK**, with branches **across** the **UK** and a **head office** in **London** (p21) – the **4 largest branches incorporate their own animal hospitals** (p21) – **all** branches sell a **range** of pet foods (p21) – in recent years, VST has restricted the number of brands following **some negative press** regarding pet food manufacturers making unsubstantiated health claims (p22) – received a **32%** discount from DGS in YE 30 Sep 2020 (p22)

William Bailey – **child** of **Stephanie** and **Harold Bailey** (p9) and **Director** responsible for **procurement** and **inventory** (p9)

Worcestershire – **county** in which **DGS** is based at its **Droitwich Spa** base (p5) and in which **Oakley Dunstable** is based (p5)

Nu-Dog-Fit pro-forma and inputs points

Initial investment costs/Actual costs through to launch (p34)

Nu-Dog-Fit development and marketing costs: commentary on variances

	Budget £000	Actual £000	Variance £000
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Gateway 3 variance analysis example (p35)

Gateway 3: Evaluation of Nu-Dog-Fit

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Gross profit %	1.5%	** 1.6%	4.0%		22.1%

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** Ignoring rounding

Gateway 3 ROI example (p35)

Nu-Dog-Fit Gateway 3 evaluation: re-assessed ROI after one year's trading

Expected average gross profit	= (126 + 10)/2	=	£68k
Actual costs incurred up to official launch		=	£143k
Expected ROI at Gateway 3		=	47.6%

Inputs points

DGS policy is to **net off** any unexpected **revenues** from the **sale** of **prototypes** in the **soft launch** phase against "**promotional events**" costs (p34) – **Paradigm Shift Financial Training comment**: this has the effect of **reducing** the initial investment costs, **increasing** the ROI for any given level of GP

DGS initially believed that the **formulation** would need to be **quite different** from existing products but, in practice, the formulation was **very similar** to some of DGS' **existing** recipes, and consequently a **saving** in some budgeted areas was achieved (p34)

The area of promotional events represented a considerable level of overspend as the **dog-owning customer type** that reacted well to **Nu-Dog-Fit** was **markedly different** from the **typical DGS** customer, resulting in **unbudgeted** activities such as attendance at **sporting events** (p34) – with hindsight, this cost area might have been better anticipated (p34)

Previous dog food new product launches showed a **small variance** only when **the new products were similar to existing products** and thus attractive to DGS' traditional customers (p34)

Background to Nu-Dog-Fit

Initial research indicated that a **narrow niche** existed for **active show dogs**, working dogs and racing dogs that would support a high price point (p33)

Marketing insights suggested a **trend** from a potentially significant segment of **younger pet owners** wishing to project their **healthy** lifestyle onto their pets, suggesting the **recipe** could be marketed as a **sports-related performance** dog food (p33)

The **target** customer was more likely to **shop online** than DGS's **more typical customer** (p33)

Nu-Dog-Fit is currently available as a **wet food** but a **kibble** range will be considered in due course as informed by **client demand** (p33)

“Pigging” research paper

Cleaning In Place (CIP) solutions

DGS has a **CIP** system but, because much of its equipment is either **small-scale** or **larger second-hand re-purposed equipment**, DGS **lacks** many of the **innovations** that **modern technology** has incorporated in automated CIP systems (p29)

As a consequence, **changeovers typically involve a lot of water and chemicals**, are **time-consuming, labour-intensive** and **wasteful**, as much usable product mix is often **lost** through the **flushing-out** process (p29)

In **December 2020**, Scott Destrier, head of production research, wrote a research paper exploring the introduction of a product recovery “**pigging**” system (p29) – the “**pig**” in question is a **highly specialised** piece of technology that moves through the **pipework** of the machinery, maintaining contact with the **inside** of the pipes whilst being able to travel round corners and in either direction (p29) – “**pigging**” systems **increase yields, reduce changeover time** and **cross-contamination** and improve batch control and traceability by creating clear barriers between batches (p29)

The “**pigging**” process is used in many industries which involve **pipe-based** production methods so “**pigging**” solutions (and other advanced complements to **CIP** systems) are supplied by a **well-developed and highly competitive market** (p29) – there are therefore a **number of highly reputable, specialist** contractors who would be able to install such a system for DGS (p29)

“**Pigging**” solutions are **typically** part of **new** installations but they **can** also be fitted to **existing** equipment (p29)

Product Recovery & Cleaning Limited (PRC) is a **market-leading** CIP enhancement organisation which has installed “**pigging**” systems in **many food manufacturing** organisations, **including those producing pet food** (p29) – PRC is **well regarded** in the field and comes **highly recommended** (p29)

PRC provided DGS with a case study regarding **Company M** to illustrate the **benefits** of its system (p29)

If PRC were to install such a system for DGS, it would be able to do so during **downtime** so that operations would not be impacted during the **implementation** period (p29)

Company M Case Study

Company M is a **medium-sized** pet food manufacturing company based in the **South of England** (p30) – at its **production** facilities, it produces a **range** of pet foods, primarily for **dogs** and **cats** (p30)

After discussing Company M’s objectives and requirements with company management, PRC designed and supplied a product recovery system which included a “**launch and receive**” area which allowed an operator to start the “**pigging**” sequence, launch the pig through a series of valves, **flush out valuable product** and clean the pipe for the production run (p30)

Special technology ensures **accurate** and **reliable pig location** and subsequent control by the system (p30)

PRC engineers ensured that Company M employees were **fully trained** on how to **operate** and **maintain** the equipment **properly** and **safely** (p30)

Installation was completed during **production downtime** (p30)

Results of installation of pigging system at Company M

The primary aim of **reducing** product waste and thus **increasing yield** was achieved (p30) – the pigging system recovered **up to 99.5%** of product that is normally flushed away and lost (p30) – **Steff Jaune (CEO and owner of Company M)** provided the following **summary** of the benefits obtained: the production line holds around **350 litres** of product which, depending on the product, can be worth around **£0.50 a litre** and is flushed out **once a day so over a year**, that adds up to 350 litres x 250 working days x £0.50 = **£43,750** a year of recovered product that can be re-used (p30) – the **reduction in material wastage** was **very material** for Company M (p30)

According to Steff Jaune, the **other benefits** were **harder to quantify**: increased **capacity**, improved **working conditions**, **lower utility usage (water and power)** and fewer **expensive cleaning chemicals** (p30) – **Company M** did not even **bother** evaluating the **financial costs** of those as it was just **happy** that the company’s **environmental responsibilities** were easier to fulfil afterwards (p30)

Press articles (1)

Fake Traffic generation

Fake traffic is traffic generated by **software** because **marketing agencies** are **paid** based on the **amount of traffic** that a website receives, or the **number of times** that an ad for a website is viewed (p43) – this can encourage **unscrupulous** agencies to **inflate** their ad revenue by making a site's audience appear greater than it is in reality by creating **artificial** visitors (p43)

Some programs are **very sophisticated** but there are a few metrics that indicate where things are not as they should be (p43) – if something **looks too good to be true**, it is probably because it **is** (p43)

Bounce rate – this is defined as the **percentage** of **single-page** sessions (someone lands on your website and then leaves) with **no interaction** with the page (p43) – if this number is extremely high or, conversely, extremely low, it is potentially due to fake traffic (p43)

New sessions – a sudden **increase** in **new users** is **unusual**, as is a big increase in **repeat visits** with no new users (p43) – this could indicate the same programmed visitors (bots) coming back again and again (p43)

Geographical location of visitors – a big increase in visitors from a **different country**, especially one with a **language different** from that of the website's content would be unusual (p43)

Badly-behaved pet food manufacturers

A primitive **dog-fight** is emerging as **players** in the pet food industry appear to have started **snapping and snarling** at each other (p43)

Disputes within the industry are **increasingly apparent**, as larger, established marketers **contest** claims made by the **upstarts** (p43) – a newcomer who is fighting back, **Pet Alliance Wholesalers** (PAW) has been aggressively taking on the bigger dogs in the neighbourhood by **disputing its rivals' claims regarding their natural ingredients and the promoted health benefits of their products** (p43) – PAW maintains that these are **unsubstantiated** and **misleading** (p43) – when asked for a comment, **John Steptoe**, CEO of PAW, stated that the company would not back down and would do "**whatever it takes!**" (p43)

Why do we care about cats

Cat lovers may be **cleverer** and **more caring** according to research (p44) – to reduce anxiety levels, giving your cat a **cuddle** is **scientifically beneficial** and can make you feel **less stressed** (p44) – further **research** shows a **link** between **cat ownership** and a **reduced risk of heart attack or stroke** (p44)

In an **ever-disconnected** world, cats provide a **connection** with another **living creature** and this brings companionship and reduced feelings of loneliness (p44) – according to a **scientific study**, **infants** exposed to cats were **less likely** to **develop allergies** in later life (p44) – as **cats** are **smaller**, they **do not eat as much as dogs** so you get the same **companionship** benefits at a **fraction of the price** (p44)

All of these reasons perhaps explain why **cat ownership** is on the **rise**, with **very different types** of people becoming **cat lovers these days** (p44) – we have even seen some **high-profile celebrities** posting pictures of their new cat companions on **social media** (p44)

Press articles (2)

Dietary preferences of cats

According to recent **research**, approximately **half of cat owners** feel that pet food manufacturers **treat cats as second-class citizens** (p44) – **cat food market growth** follows **cat population growth**, and that is **rising** (p44) – the **number of cat food brands** has consequently **increased** by **almost 20%** in the last **2 years** (p44) – while **wet pet food** overall has been gaining in popularity and sales, the segment seems to provide a **particularly strong opportunity** for innovation in respect of **cats** (p44) – cats often **prefer wet food** and, because it is high in water, the format offers a way to ensure that cats are **well hydrated** – wet food makes cats feel full, helping control **obesity** issues, which are **increasingly common** (p44)

A downside of **wet food** (for any species) has been that many owners find **metal** cans inconvenient and messy to open and store in the fridge (p44) – more brands are starting to offer wet cat food in convenient **plastic** trays, often in single-serving sizes, or in **resealable tubs** that can be warmed to room temperature, which many cats prefer (p44)

Cats are **carnivores** so unlike **dogs**, they need to **eat meat** and hence they cannot just get dog food in a different wrapper (p44)

Ecological impact of pets

Domestic **pets' eating habits** combined with those of humans are responsible for **huge volumes of greenhouse gases** being released into the atmosphere every year (p45) – this is due to all the **livestock** raised that goes into pet and human food (p45) – raising **livestock** takes up **land, water** and **energy**, which pumps lots of **heat-trapping gasses** into the environment (p45) – it is **not clear** whether this is the **fault** of farmers, pet manufacturers or pet owners (p45)

Social media commentators have stated that it is about time that **pet food manufacturers start taking the environment seriously** (p45) – the problems caused by intensive farming, the **waste** of **water** and **power** in manufacturing pet food, the emissions from factories and the wasteful packaging all add up to a **huge environmental problem** (p45) – a **social media commentator** states that pet food manufacturers need to be clearer on their **ethical responsibilities** and take action (p45)

Nepotism

Nepotism is defined as the **preferential treatment** of **relatives** or **friends**, **especially** by giving them **jobs**, by those with power or influence (p45) – preferring one's relatives for jobs over non-relatives may be a controversial topic in business ethics, but it is **not necessarily unethical** to do so (p45)

While it is the custom to recruit and promote the **most qualified candidate** for a role, a number of factors play into the issue: the circumstances of the business, what are considered acceptable policies, and the **consistency** by which such policies are implemented (p45) – it is not uncommon for smaller organisations to hire internally rather than externally, and to encourage referrals from family and friends (p45) – there can be **highly beneficial** effects of this type of policy, as long as it is applied consistently and fairly (p45)

Family businesses can benefit from multiple generations of family involvement (p45) – however, the **recruiting of underqualified family members** can create a business issue if it **undermines** the company **culture** and **passes an increased burden** onto other staff (p45)

Production processes (1)

DGS' product range includes a **range** of **wet** and **dry** dog food products, as well as dog **treats** (which can be in **either** format) (p25) – each product variant, whether **wet** or **dry**, has a **separate production run**, requiring a **separate set-up** and **close-down process** (p25) – **wet** and **dry** dog food products are made using different processes, and each has its own **specialised** processing and cooking equipment (p25)

Dry pet foods are made by mixing dry and wet ingredients to create a **dough** which is cooked into **biscuits** known as "**kibble**" (p25) – **wet** pet foods are made by **mixing** recipe ingredients together with water and **selected thickening agents** to form a **gravy** or **jelly** as required (p25) – the mix is **injected** into a suitable container which is **sealed** prior to cooking (p25)

Production run stages

Ingredient selection – it is critical that the **correct ingredients** are selected for each production run (p25)

Mixing and pre-conditioning – some formulations require a **pre-mixing, grinding** or **pre-conditioning** stage, which facilitates the main manufacturing process (p25)

Cooking – **dry** food cooking involves preparation of a **dough** mixture of ingredients, which is then passed through a combined heating and extrusion process before being shaped and sliced into **kibble** (p25) – **wet** food ingredients are combined and the mixture is then pumped into the required container type (can, tray or pouch) – the container is **hermetically sealed** and the food is then cooked inside the container, which **sterilises** the wet food product (p25)

Cooling, packing and storage – dry food is **temporarily stored** and transported to the packaging area, where it can be packaged into a variety of different pack weights (e.g. 2kg, 6kg, 12kg), depending on client orders (p25) – DGS' **dry** pet food and treats have a shelf-life of **up to a year** and its **wet** pet food has a shelf-life of **2 to 5** years.

Return to store – any **surplus** ingredients that are not contaminated and which are suitable for storage are **returned to inventory** (p25)

Cleaning in place (CIP) – once a production run is complete, the entire plant must be **flushed out** and **decontaminated** – this stage is critical to ensure no cross-contamination to a different product variant, as well as to remove any **risk of infection** from **pathogens** such as **Salmonella** because of the risks associated with meat-based ingredients (p25)

Quality assurance check and sign-off – all stages of a production run require **quality-checking** and **sign-off** (p25) – a critical check is overseeing the **flushing-out** process and then carrying out testing to ensure that all parts of the production plant are sterile (p25)

Given the **potentially hazardous** nature of **manufacturing** dog food, **safety** during the production process is an important aspect of quality assurance protocols (p25)

Product variants offered by DGS

DGS recipes are available with **4** different **proteins**: **3** types of **meat** (**chicken, lamb** and **beef**) and **fish** (p26) – each of these **proteins** is combined with selected ingredients for **different dietary requirements** including age-groups, health issues, sensitivity, performance, dog size and complete food versus treat/snack (p26)

These in turn can be packaged in a variety of formats and sizes (p26) – in total, DGS has **over 30** different product variants, **each** of which requires a **separate production run** (p26)

Production processes (2)

Production planning

Production **scheduling** and **planning** are driven by **client orders**, which traditionally have not changed significantly **month-by-month** in terms of products required (p26) – this has made production scheduling easier to manage (p26) – **most** products have **1** production run a **month** (p26)

Anticipated customer orders and inventory levels are used to **plan monthly** production schedules (p26)

DGS maintains inventory of raw materials, packaging and consumables (p26) – as **storage space on-site is limited**, DGS generally holds only a **limited** inventory of **finished goods** (p26)

For **larger** clients such as pet food retailers and garden centres that can hold inventory at their **own stores**, a **replenishment delivery is dispatched once a month** (p26) – for such clients, the sales and business development team agree an **annual order quantity** and this forms the basis of the **monthly** replenishment (p26) – individual clients can, and often do, amend **monthly** orders (p26) – **strictly**, such changes require a **month's notice**, but **increasingly** this is not being **adhered to** (p26)

Some orders are fulfilled directly from **inventory** for **smaller** clients, **particularly smaller vet practices with limited on-site storage** (p26) – as **orders arrive** at DGS, the products are picked, packed and **dispatched** from stores **within 24 hours of receipt** (p26) – the impact of limited on-site storage is that unexpected changes to orders can give rise to **unscheduled production runs** (p26)

Cleaning in place (CIP)

The **CIP** process requires the use of **copious** amounts of **water** and **chemicals** because of the need to **flush out** any remaining pet food mix and then to **sterilise** the plant (p26) – the **flushing-out** process is **time-consuming** and **labour-intensive** (p26) – in addition, it results in the **loss** of significant amounts of valuable product mix, and thus contributes to **materials wastage** (p26)

Materials wastage

As well as the impact of CIP, **wastage** may also be caused by **poor production scheduling**, **poor inventory control** and **spoilage** (p26) – the **materials wastage KPI** represents the **volume of materials lost** compared to the **total volume** of materials used in a period (p26)

In the past, DGS was very **efficient** in its production scheduling, typically beating its materials wastage **production KPI target**, which is set at **7%** (p26) – in the pet food **industry** this is considered **excellent** whilst a figure of **5%** would be viewed as **exceptional** (p26) – the **last 2** years, however, have seen materials wastage increase: the wastage rate was **6.3%** for 2018, **8.8%** for 2019 and **9.7%** for 2020 (p26)

Plant maintenance

The production equipment requires **ongoing** maintenance, repair and upgrade (p26) – this work is typically **scheduled in advance** to pre-empt breakdown and avoid downtime (p26) – where possible, the work takes place **overnight** or at **weekends** outside normal shifts, to prevent **interruption** of production runs (p26)

Quality assurance

Pressure on production

In **December 2020**, **Ade John** highlighted again some of the production **capacity** constraints that continue to affect DGS (p27) – Ade John stated that these issues have been raised for a while and they have been **ongoing issues**, particularly since **DGS started** to sell to **Taylors** (p27) – the growth in the business is coming at the same time as **changing client types**, a **new product launch** and **changing demand** from pet owners (p27) – the result is unexpected **changes** in production scheduling and that means an **increased number of set-ups** which in turn means **more downtime** between each shift and thus **longer shifts** (p27) – this has been overcome by **extended working**, additional **overtime** and **short-term temporary staff resourcing** (p27)

DGS has only budgeted for the usual **2%** annual pay rises over the last couple of years but in **2020**, the business had an almost **5% increase in production hours** (p27)

A bigger issue is **production overheads** which are **driven** by a complex combination of **volume**, **length** and **number of shifts**, **labour usage**, **production set-ups** and the **type of products** (p27) – **increases** in **production overhead costs** (£222k in 2019 and a further £284k in 2020 so a total of £506k over 2018 levels) can be **controlled** if DGS can **control production** but at present, DGS gets the information on **client orders** very late, so efficient scheduling planning is difficult (p27) – materials are also impacted (p27)

The unexpected **production scheduling** has resulted in **overworked** and **highly-stressed staff**, **bottlenecks** in **supply** and **longer running times**, placing the plant and equipment under increased pressure (p27)

DGS **normally operates** on a **pre-emptive maintenance** basis but with **no time** between production runs to carry out the normal routine maintenance, they are experiencing a **higher incidence** of **breakdowns** as a result (p27) – DGS would **prefer** to be **proactive**, not **reactive**, to problems (p27)

Control failures and Salmonella “near miss”

Another, more worrying, implication of the heightened pressure to achieve production output has been some **control failures**, which have resulted in **contaminated** products (p27) – on one occasion recently, staff shortages meant that a shift went through the **close-down** and **flushing-out** process without an **experienced shift supervisor** being present (p27) – the team’s work was not **overseen** in the way that DGS’ control procedures stipulate and the resulting failure to flush out production plant correctly following a **poultry-based production run** resulted in **contamination** of **subsequent batches**, which have tested positive for **Salmonella** (p27)

The Salmonella incident was classified as a “**near miss**” as **standard quality control** procedures (which involve **sampling** from batches before a product is moved to the dispatch area) **identified** the problem **before** any products left the factory (p27) – DGS therefore still has an **unblemished** record of **never having had a product recall** (p27) – the **implications** of a **recall** on the DGS **brand** would be **significant** (p27)

In a busy market place, DGS’ reputation for **quality** is one thing that DGS can point to as a **differentiator** (p27) – Ade John states that DGS needs to **rethink** its approach to **client management** and how to manage its capacity more effectively so that DGS can return to production that is scheduled and carried out in a **safe** and **efficient** manner (p27) – one proposal has been to create some **capacity** as well as generate some **savings** via a product recovery system known as “**pigging**” (p27) – in the view of Ade John, **Scott Destrier’s** proposal **does not address** the **underlying problems** which, in Ade John’s view, are the **result of a sales and business development team issue** (p27) – according to Ade John, DGS needs to **manage its clients better** (p27)

Hugh Logan, **Suzanne Coder** and **Sayali Patel** all agree that **last minute orders** (which appear to be **frequent**) cause **pressures** and **stress** for the **production team** (p20)

Our **R1 Metrics Skeleton Outline** page summarises the metrics which are **generally noted** by the examiner in each of the yearly performance reviews in the Advance Information (suggesting that the examiner is leaving hints as to what you should definitely include in your own response) – you should then add **additional data** as this page only indicates the **bare minimum required**, based on the hints left by the examiner

R1 metrics skeleton outline

Revenue

Total revenue (p12, p13, p14)

Average revenue per client (sales KPI) (p12, p13)

Number of clients (sales KPI) (p12, p13)

Revenue bridge (p12, p13)

Taylor's: figures and comments (p12, p13)

Cost of sales

Materials costs (p12, p13, p14)

Materials wastage % (manufacturing KPI) (p12, p13, p14)

Production labour (p12, p13, p14)

Production overheads (p12, p13, p14)

Total cost of sales (p12, p13, p14)

Profitability

Comparison of change in CoS with change in revenue to comment on net impact on GP

GP (p12, p13)

GP% (p12, p13)

Further points: industry norms

The **global** pet food market is growing at **5%** per annum (p7)

The market is **highly competitive** (p12, p13, p19, p37) and DGS is subject to **considerable pressure** on **pricing** and **discounting** (p13, p22, p37), resulting in **pressure** on **GP%** (p22) which has a clear **pattern** of **declining significantly** each year recently (p12, p13, p14)

Mergers and acquisitions are definitely a **trend** in the market (p8, p10, p19), making it difficult to **secure** or **maintain exclusivity arrangements** (p10) and potentially leading to a **loss of clients** for DGS (p12)

Pet ownership rose by around **10%** during **late 2020** and **early 2021** (p7) – young people are the **main drivers** of this **change**, with more than **half** of new owners aged **16 to 34** (p7)

DGS' target of a **7%** materials wastage rate would be considered "**excellent**" in the industry whilst a figure of **5%** would be viewed as "**exceptional**" (p26)

The **sector average annual price increase** of **ingredients** in 2020 was **1.5%** (p31)

Annual pay rises

DGS budgets for a **2% annual pay rise** (p13, p14, p27)

Average discount for YE 30 Sep 2020

The DGS overall **weighted average discount** for YE 30 Sep 2020 was **31.2%** (p22)

Cat market statistics

Approximately half of cat owners feel that pet food manufacturers treat **cats** as **second-class citizens** (p44)

The **cat population is rising** and the **number** of cat food **brands** has consequently increased by **almost 20%** in the **last 2 years** (p44)

Competitive advantage period

According to the board, new DGS products tend to enjoy a **5-year** period before **rivals** start creating a **closely competing offering** (p34)

Differentiation problems

DGS' **core differentiator** (**natural ingredients** and **no artificial additives**) has been **copied** by rivals with **two-thirds** of all dog food launches making similar claims (p35) – the **large** number of **launches** based on **health** has meant that this is now a **common expectation** and that **brands** need to **go further** to stand out (p35)

Digital marketing benchmarks

POM charged **Company X** a **monthly retainer** of **£2,500** (p39) – **paid ad** costs averaged **£5 per click** (p39) – affiliate costs were **3%** of **attributable revenue** and the initial investment was **£140,000** (p39)

Global market growth

The **global** pet food market is growing at **5%** per annum (p7)

R2/R3 assumptions and inputs (1)

Heart health opportunities

Research shows that **almost 70%** of **dog owners** look for **heart health** benefits whereas **fewer than 10%** of **new pet food launches** promote such benefits as **heart** and **cardiovascular** system claims (p35)

Increase in pet ownership

Pet ownership rose by **around 10%** during **late 2020** and **early 2021** (p7) – **young people** are the **main drivers** of this change, with **more than half** of **new owners** being aged **16 to 34** (p7)

Inflation allowance

DGS advertised a **planned 3% increase** in the **RRP** of Nu-Dog-Fit for the **second** year of sales, taking the **RRP** to **£6.18 per kg** (**£6.00 per kg** in the **first year of sales**) (p34)

KPIs – where applicable, mention impact of R2/R3 projects on these

Average revenue per client (p12)

Increase in clients (p12)

Materials wastage percentage (p12) (**7%** target is “**excellent**” in the market (p26) while **5%** would be viewed as “**exceptional**” (p26))

Nu-Dog-Fit average revenue and RRP (YE 30 Sep 2020)

Average revenue was **£4.17 per kg**, which was **higher** than the **average revenue** for **existing DGS products**, showing the **premium price point** for Nu-Dog-Fit (p13) – the **RRP** was **£6.00 per kg** (p34) – **Paradigm Shift Financial Training comment:** these figures imply an **average discount of 30.5%**

Nu-Dog-Fit variants

There are only **4** variants of Nu-Dog-Fit which helps with the **prediction** of the **number of production set-ups** and related **flushings** and **wastage rates** (p35)

“Pigging” solutions benchmarks (Company M)

Reclaimed product was worth **£0.50 per litre** and was **flushed once per day** over a **250 working day year** (p30) – a total of **£43,750** of product **reclaimed over a year** (p30)

PiP discount, branches and product range

PiP receives a **32%** discount (p22) – **3** of PiP’s stores have an **on-site vet practice** (p22) – **PiP** has **45** brands available **online**, but these are **selectively** chosen for their **health benefits** (p22)

Product launch differentiators (including heart health)

DGS’ **core product differentiator** (**natural** ingredients and **no artificial additives**) is used in **two-thirds** of all **dog** food product **launches** (p35) – launches based on **health** have led to this being a “**common expectation**” (p35)

Almost 70% of dog owners look for **heart health** benefits for their pets whereas **fewer than 10%** of **new** pet food **launches** promote such benefits as **heart** and **cardiovascular** system claims (p35)

Product range and production runs

In total, DGS has **over 30** different product variants, **each** of which requires a **separate production run** (p26) – most products have **1** production run **per month** (p26)

Target ROI

The board of DGS assesses new products using a **target ROI** of **25%** based on **gross profit averaged over a 2-year period** (p33)

Taylor’s discount and credit terms

40% discount (p12) and **90 day credit terms** (p37)

R2/R3 assumptions and inputs (2)

Taylor’s online sales

Online sales now account for **20% of Taylor’s business** (p21) – in YE 30 Sep 2020, this implies that **£590k** of DGS dog food sold through **Taylor’s** was purchased **online** by pet owners (p13)

Taylor’s stores and reputation

Taylor’s has **nearly 250** large stores and **over 650** smaller stores and “**convenience**” shops in **city centres** and **transport hubs** (p21)

Taylor’s has an “**up-market**” reputation (p21) – Taylor’s sells its **own-brand** dog food as well as products from DGS’s **competitors** (p21) – **Taylor’s** does not sell **very cheap** dog food (p21)

Website visits: drivers

Website search (e.g. Google): **around 50%** of traffic (p41)

Direct (e.g. pre-saved link): **around 25%** of traffic (p41)

Referral links from other sites (e.g. blog): **around 10%** of traffic (p41)

Social media (e.g. Facebook, Instagram, TikTok): **around 10%** of traffic (p41)

Variances

Materials wastage and **production costs** were **forecast accurately** for Nu-Dog-Fit (p35) – DGS can generally **predict production costs** with a **2.5% tolerance** (p35) – **key uncertainty** over new product launches surrounds **demand** at the **planned price point**: results for Nu-Dog-Fit in 2020 in terms of both **volume** and **price point** were at **best-case** levels, **strongly ahead** of predictions (p35)

VST discount and branches

VST receives a **32%** discount (p22) – VST’s **4** largest branches incorporate their own **animal hospitals** (p21)

Bank loan

DGS has a **5%** bank loan secured on **land** included in **PPE** (p18) – the interest rate on the loan is at a **fixed** rate of **5%** and payable **annually in arrears** (p18) – the loan is **repayable** in **2030** and carries an **early redemption penalty** (p18)

Discounting and credit terms: basis of decision

None of DGS' **clients** pay the **full RRP**: individual **discounts** (and **credit terms**) are linked to the predicted **size** of orders over a year, and the level of **exclusivity** that they offer DGS (p22)

Economies of scale, economies of scope and storage capacity

The sector continues to experience **merger and acquisition activity** as companies seek to achieve **greater economies of scale** (p8) – the **large manufacturers** also pursue **economies of scope** based on having a large **number** of brands (p8) – the opportunity to **expand storage capacity** on site is **limited** (p10)

Mainstream move

Takeover activity in the **vet practices** and **pet store** sectors has created **significant challenges** for DGS (p21) – over the last couple of years, DGS has been exploring a **shift away** from its **selective pet-oriented outlets** to **more mainstream food retailers** (p21)

Product research and development team

Product **launches** are a **regular** feature for DGS, as for many companies in the sector (p10)

DGS employs a **team of nutritionists** who are responsible for researching and developing dog food **recipes** that meet **specific health and dietary needs** (p10) – they work with the **market insights** from the **sales and business development** team in identifying pet owners' demands (p10)

Product launches follow a **process** that has been **developed** and **refined** over many years (p10) – this process includes **decisions at key stages** in a new product's **lifecycle**, based on a **financial evaluation** (p10)

R2/R3 narrative points

Promotional events and type of product

The area of **promotional events** represented a **considerable level of overspend** on the **Nu-Dog-Fit** product as the dog-owning customer type that reacted well to **Nu-Dog-Fit** was markedly different from the typical DGS customer, resulting in **unbudgeted** activities such as attendance at sporting events (p34) – with **hindsight**, this cost area might have been **better anticipated** (p34)

Previous dog food new product launches showed a **small variance** only when the new products were **similar** to **existing products** and thus attractive to **DGS' traditional customers** (p34)

Quality

DGS has a very strong focus on **quality** (p9), **healthy** (p9) and **premium products** – DGS applies the **philosophy** of working "**as if pets were people**" (p9, p34)

Shelf-life

DGS' **dry pet food** and treats have a **shelf-life** of up to a year and its **wet pet food** has a shelf-life of **2 to 5** years (p25)

Value obtained from digital marketing

Companies must be able to **attribute revenue** to **specific marketing costs** to understand which marketing spend is proving **most effective** in **generating actual sales** (p41)

Variances and likelihood of errors in estimates

Please refer to our **Nu-Dog-Fit pro-forma and inputs** page on **page 21** of this **Exam Room Pack** for important narrative points here

The key driver of **wastage** is **flushing-out**, which is a **function** of the **number** of **production set-ups**. (p35)

Review of YE 30 Sep 2020

Revenue

Revenue of £15,381k was **£392k (2.6%)** higher than YE 30 Sep 2019 (p13) – **main driver** of growth was again Taylors (p13) – **YE 30 Sep 2020** benefitted from a **full year** of Taylors revenue whereas **YE 30 Sep 2019** involved **9 months** of trading with Taylors (p13)

Assuming **20%** of Taylors' **own revenue** is generated through its **website**, this implied that **£590k** of DGS dog food sold through Taylors was purchased **online** by pet owners (p13)

There was an increase of **£1,130k** in revenue from **specialist** pet stores, **mainly** those with a **well-developed online platform** to complement their physical store network (p13) – these benefitted from pet owners increasingly **switching** their purchasing behaviour to **online** (p13)

Sales through **other channels** (**vets** and **other clients**) showed a **combined decrease** in revenue of **£2,823k** as these channels **rely more** on customers visiting their **physical locations** for sales (p13)

Revenue bridge

Net increase of **10** new clients at 2019 average revenue should have contributed **£210k** to revenue (10 x £21.05k, allowing for rounding) (p13)

Increased **competitive rivalry** in wholesale markets caused further pressure on **discounts** (p13), resulting in **average revenue per client** (excluding Taylors) declining from £21.05k to **£18.25k** (p13), resulting in a **drop in revenue** of **£1,903k** ((£18.25k - £21.05k) x 681 clients) (p13)

The overall impact was therefore £210k - £1,903k = £(1,693k) (p13)

The revenue increase of **£2,085k** from Taylors more than made up for the **£1,693k** drop (p13)

Paradigm Shift Financial Training note: as the **first 2 steps** in the revenue bridge require the **prior year average revenue figure**, we can be sure that you will need the YE 30 Sep 2020 figure of **£18.25k** for these purposes

Nu-Dog-Fit

October 2019 saw the **official launch** of **Nu-Dog-Fit** (p13) – first year results were encouraging, with revenue of **£250k** on volume of **60 tonnes** with average revenue of **£4.17 per kg**, which was **higher than the average revenue for existing DGS products**, showing the **premium price point** for Nu-Dog-Fit (p13) – the uptake is evidence that DGS is accessing different types of buyers, given that the product is designed to appeal to a **broader** pet-owning segment than DGS' **typical** pet food customer profile (p14)

Cost of sales

Total CoS rose by **£854k (7.5%)** (p14) – **combined** with only a **£392k** increase in **revenue**, this resulted in a drop of **£462k (12.9%)** in **GP** and a **reduced GP%** of **20.2%** (p14) (YE 30 Sep 2019: 23.8%) (p13)

The **increase in costs** was **once again** primarily driven by **materials**, which rose by **£466k (8.1%)** (p14)

The **materials wastage KPI** worsened to an **average** of **9.7%** of total materials costs (YE 30 Sep 2019: 8.8%) (p14) – this was due **again** to an **increased number of production runs**, partly due to **Nu-Dog-Fit** but mostly due to **further increases in unscheduled production runs** arising from **unexpected order patterns**, both from new clients and from changing demand among pet owners (p14) – the rest of the increase was caused by an **increase in input volume** needed to support the **increase in sales** and **increases in the price of ingredients passed on by suppliers** (p14)

Production costs increased by **£104k (6.8%)** principally as a result of a **5% increase** in the **number of production hours together** with the **2%** annual salary increase for **production staff** which took place in **October 2019** (p14)

Production overheads were **28.9%** of revenue (YE 30 Sep 2019: 27.8%) and increased by **£284k (6.8%)** again due to the further **increased complexities** in the business impacting production scheduling (**higher volumes, changing client base, new product variants** and **changing demand from pet owners**) (p14)

Sales team: general

Sales and business development team

Louis Bailey leads a sales and business development team comprising:

- **Hugh Logan**: joined DGS in 2018 after leaving a rival manufacturer **Pet Alliance Wholesalers (PAW)**, bringing 2 significant clients with him, the **Veterinary Support Trust (VST)** and **Pets in Paradise (PiP)**
- **Suzanne Coder**: recruited by Stephanie Bailey almost 30 years ago
- **Sayali Patel**: joined DGS directly from university 12 years ago
- **Charlie Bailey**: recently joined DGS (p19)

The **wholesale** nature of DGS' business means that winning new clients requires the creation of **business relationships** (p19) – **potential clients** will typically need to be **assured** that any new pet food products will be well received by dog owners, and that DGS can be **relied upon to deliver** as required when orders are placed (p19) – such relationships can take **time** to establish and build, and **business development** is **often slow** (p19) – the challenge is to **win** new clients **without sacrificing margin** in the form of **discounts** (p19)

Clients have **tended to stay** with DGS, as they have found that pet owners would pay a **premium price** for the **superior quality** of DGS' dog food, enhancing the clients' **own margins** (p19) – the recent acquisition activity in DGS' channels to market has changed this, creating increased **price-based competition** (p19)

Marketing activities are used to support **business development activities** and, whilst responsibility for **marketing** is shared amongst the team, **Louis Bailey has led on it in the past** – **Louis Bailey** has recently begun to **delegate** this responsibility to **Charlie Bailey** (p19)

Extracts of comments from team meeting held 12 April 2021

Hugh Logan believes the **KPIs** do not make any **sense** because DGS clients are **all different sizes** and there are **different territories** with different-sized cities (p20) – **2 large clients** were allocated to **Suzanne Coder** because their head offices are based in the **Southern** territory but **Hugh Logan** states that these clients **phone him** all the time, including to make **complaints** about the quality of service (sometimes **deliveries** are **late** or **incomplete**) (p20) – these clients also say that DGS does not **understand** their needs whereas **PAW** did, and so they want **Hugh Logan** to look after them (p20)

Hugh Logan states that the **commission system is not fair** and he has asked to get this changed since he joined DGS (p20) – Hugh Logan states he has been told **repeatedly that it will be improved** but **nothing** has happened (p20) – Hugh Logan believes it would make much more sense to **split the work** by **channel to market** or even **product range** rather than by **geography** (p20) – **Hugh Logan** is **unhappy** that **Charlie Bailey**, the **newest** member of the team, was allocated **Taylors**, DGS' **biggest** client (p20)

Hugh Logan has won **lots of smaller clients** but states that such clients find they never know what to order and everything comes through at the **last minute**, putting the production team under a lot of **pressure**, creating risks and meaning that bigger clients get preferential treatment (p20)

Suzanne Coder states that larger clients take a **lot more looking after** and smaller clients are **easier** (p20) – she states that **larger clients take more experience** so as she has been at the business the **longest**, it makes sense for her to deal with the **largest clients** (p20) – her clients increasingly **change** their **minds too** but **so far the production team is keeping up** (p20) – however, there is always the worry a **demanding client** could create **pressures** in the **production team** potentially leading to a **serious incident** (p20)

Sayali Patel does not **mind** whether clients are **large** or **small** as they all need to be looked after (p20) – she notes that the **total revenue target** that each employee has is the **same overall** (p20) – she does agree with Hugh Logan that clients **keep changing their minds** on orders with **very little notice** (p20)

Team performance assessment

Hugh Logan, Suzanne Coder and Sayali Patel each have **responsibility** for a **territory** of approximately **one-third** of the UK by geographical area (**Northern, Southern and Midland**) (p19) – the assessment of individual team member performance is based on the **sales KPIs** (**average revenue per client** and **net increase in number of clients**), as well as achieving a **total revenue target for their territory** (p19)

Merger and acquisition activity is **increasing competitive rivalry**, making it **more difficult** for DGS to **attract clients** as well as **triggering client losses** (p19)

Channels	Number of clients as at 30 September		
	2020	2019	2018
Veterinary practices	448	445	441
Specialist pet stores	125	121	118
Other	108	105	106
Total	681	671	665
Average revenue per client (£000)	18.25	21.05	21.95

Average revenue per client is calculated by reference to the **number of clients** at the **end of each financial period** (p19) – there is a **single large client** (**Taylors**), which is **excluded** from those looked after by Hugh Logan, Suzanne Coder and Sayali Patel (p19) – it is **managed directly by Charlie Bailey** with guidance from **Louis Bailey** (p19) – **average revenue per client** excludes any **revenue** from **Taylors**, and Charlie Bailey is **not included** in the **same bonus** calculation as the rest of the team (p19)

Sales team: targets and commission

Individual targets and commission (2020)

Hugh Logan, Suzanne Coder and Sayali Patel have the **same total revenue target** but some **flexibility** on the **level of discount, credit terms and dispatch arrangements** that they can offer to their **own clients**, within **parameters** set by **Louis Bailey** (p20) – **any exceptions** need to be **agreed in advance** with him (p20)

All new clients are assessed by the team to ensure that the **brand positioning** of **any new client** is **consistent** with DGS' own **differentiated brand** (p20) – the finance team also carry out **due diligence** on any prospective new client, including the use of a **credit rating agency** (p20)

The changes in DGS' markets have created **significant challenges** in achieving the **sales KPIs** and these changes, combined with the impact of the Taylors account, have created some **discontent** within the team (p20)

Team member	Revenue target	Actual revenue	Clients	Average revenue per client	Area
	£000	£000	Number	£000	
Hugh Logan	4,200	3,618	321	11.27	Northern Southern Midland
Suzanne Coder	4,200	4,575	139	32.91	
Sayali Patel	4,200	4,236	221	19.17	
	12,600	12,429	681	18.25	
Charlie Bailey	2,952	n/a	1		n/a

Quality and traceability

The **quality** of DGS' pet food is of the **highest importance** and that starts with the **quality of ingredients** (p31)

Every recipe is formulated by **highly-skilled pet nutritionists**, who include **experienced vets**, ensuring that it is **precisely balanced** for specific dietary requirements (whether **health, performance** or **other specific needs**), as well as appealing to dogs in terms of **taste, texture** and – for dry food – **size** and **shape** (p31)

The skills of DGS **nutritionists** are complemented by those of its **production engineers** and **technicians** who help **manufacture** pet food that looks **appealing** for pet-owning customers (p31) – DGS **only** uses **meat** from **animals** that are **grass-** or **barn-raised** (p31) – it does not use **battery-farmed** animals (p31) – DGS also uses **fish derivatives, supplements, carbohydrates, other ingredients, liquids** and **other additives** but **no artificial additives** are used (p31)

DGS sources all its **meat** from **UK farms** and also regularly discusses with its farmers the **meat requirements** of the company to ensure that all **necessary quality protocols** are being adhered to (p31) – DGS uses a **range** of different **farmers** to ensure it does not encounter **supply issues** (p31)

DGS' **fish** ingredients are **all sourced** from a **specialist fish processor** (p31) – the fish ingredients need to be **very high-quality** as fish is used in DGS' "**Sensitive**" range (p31) – fish is **easily digestible** for dogs with **sensitive digestive issues** (p31)

DGS sources **vegetables, rice**, etc. from **reputable, traced** sources (p31)

Ingredients such as **oils** and **additives** are **typically sourced** from one of the **large, specialised** pet food ingredient manufacturers (p31) – these are **wholesale organisations** that enjoy **economies of scale** in **procurement** and **distribution** allowing them to **process** and **supply** pet food ingredients, many of which are **homogenous** products, at **affordable** prices (p31)

Suppliers and procurement summary

Quality assurance philosophy and procedures

The **manufacture** of dog food is **heavily regulated** and DGS is particularly **diligent** with regard to its **responsibilities** (p31) – **Stephanie Bailey** has always been **insistent** on **personally** being able to guarantee the **integrity** of the ingredients for DGS **health-based** products, as well as the **quality** of **manufacturing** processes (p31)

Quality assurance is required throughout the **entire supply chain**, starting with the **creation** of a **recipe** to ensure that it is a **complete** and **balanced diet**, then progressively over the **audit** and **inspection** of **ingredient suppliers**, facilities **sanitation** and **security, storage** of both **ingredients** and any **manufactured** products, including **during** and **after** processing (p31)

Supplier contracts are reviewed every **3** years and an **evaluation** is made as to whether an individual supplier contract needs to be put out to **tender** (p31) – prices charged by suppliers are less of a **concern** than **quality issues** for **supplier choice** and DGS has always been **prepared** to pay more if the **quality** is at the **required level** (p31)

The **procurement** team is nevertheless **conscious of average sector price** increases of ingredients and uses these as a **benchmark** for assessing the **price-to-quality** trade-off (p31) – in **YE 30 Sep 2018**, the sector average annual price increase of ingredients was **1.0%** and the same figure applied to **YE 30 Sep 2019** (p31) – for **YE 30 Sep 2020**, the figure was **1.5%** (p31)

Website issues (1)

Reasons to improve the website: DTC and younger pet owners

DGS' **ability** to sell is **reliant** on **developing** and **maintaining relationships** with its clients (p10)

Whilst DGS has a **website**, historically there has been **no perceived need for it** to have any **shopping facility** for the **general public** (p10) – rather, the website is used mainly as an **information source**, allowing DGS to **explain the health advantages** of DGS pet food, promote its **relationships** with **vets** and **breeders** to further **differentiate** its products and **direct interested dog owners** to their **nearest retailer** of DGS products (p10)

The **directors** are aware that the **DGS website** is not currently as **high-profile** as they would like it to be (p10)

The website also offers retailers the **opportunity** to apply to become a **DGS business partner** (p10) – **Stephanie Bailey** has always insisted that DGS carries out a **review** of any **potential new retailers** that apply to become a **partner**, and DGS requires any **potential retailer** to sign a **non-disclosure agreement (NDA)** before **discussing any discounts** (p10)

DGS is **planning to make some enhancements** to the **DGS website** and it is hoped that these will **go live** after its **September 2021 year end** (p37) – the enhancements include building a **shopping cart** facility to allow DGS to sell **Direct-To-Customer (DTC)** i.e. to **pet owners** rather than through its **normal channels** of **vets, pet stores** and **Taylors** (p37)

Nu-Dog-Fit was **launched successfully** because it appeals to **younger pet owners**, many of whom are likely to **shop online** as well as **exercise** regularly (p37) – the **pet owners** are **quite different** from the **typically older purchaser** of **DGS dog food** and it is apparent that the **well-developed e-commerce infrastructure** of clients such as **Taylors** has given DGS access to a new audience (p37)

Further reasons to pursue DTC

Owing to the **competitive pressures** in DGS' **normal channels**, DGS is increasingly having to offer **extended credit terms** and **larger discounts** on **RRP** to its clients – for example, **Taylors** receives a **40% discount** on **RRP** and **90 days' credit** (p37)

The purpose of **upgrading** the website is to **generate revenue** at a **higher margin** via **DTC sales** by enabling **DGS** to **sell directly to pet owners** at **significantly reduced discounts** (p37)

Avoiding price competition

DGS has **no contractual restrictions** with any of its **clients preventing** DGS from using a **DTC** approach but DGS would need to be **cautious** that it does not **jeopardise** its relationship with its clients (for example, by being **seen** to be **competing directly** with them on **price**) (p37)

DGS' offering would therefore be linked to the **support** that it can **offer newer pet owners** in the form of access to **blogs, e-newsletters** and **other promotional material** (p37)

The intention is that by **engaging with pet owners** (for example, by creating an **online society of pet owners**), DGS can **persuade customers** to form an **ongoing relationship** with DGS, potentially getting customers to sign up to a **subscription service**, and thus a **direct comparison** on **price point** with its **key clients** would be **less apparent** (p37)

The **new website** will need to generate sufficient **traffic** and be **suitably engaging** so that visitors stay on the **site** and **buy DGS' products** (p37)

Currently, DGS has **little online activity** (e.g. DGS **rarely posts** on **social media**) and so its **website** receives **few visitors** – the **volume of online activity** is **relatively low** compared to a **selection of close rivals**, including **Pet Alliance Wholesalers (PAW)** (p37)

DGS' **online activity** gets **very little engagement** with its **target audience** (for example, the audience does not **interact** with it, **does not share it** or **comment on it**) (p37)

Website issues (2)

Illustration of impact of a digital marketing agency

Charlie Bailey spent a **year** with a **digital marketing agency**, **Pro-Online Marketing Limited (POM)** (p37) – it was clear that in its field, POM was **disruptive** and **winning clients as a result** (p37) – **POM** has a **high profile** and a **very public team** of **young managers and directors** with the **average age** of new employee recruits to the **social media team** being **18** (p37) – **POM's philosophy** is that the **experts** in **social media** are the people that use it (p37) – **POM's client X Ltd** is in a **related sector** to DGS and the **underlying issues** are **identical** (p37) – X Ltd invested **£140,000** in its strategy (p39)

POM was **commissioned** by **X Ltd** to improve its **e-commerce operations** (p39) – overall objectives were to **increase** the **number** of **website visitors**, improve the **buying experience** so that visitors **stay longer**, increase the number who **clicked** all the way through to **completing a purchase** (known as **click-through-rate (CTR)**), increase the **amount** that visitors **purchased on each visit (average order value)** and, more generally, improve **X Ltd brand advocacy** (p39) – the work involved the building and ongoing development of the **X Ltd website** and **e-commerce platform**, together with subsequent management of its **digital marketing operations**, primarily involving **Search Engine Optimisation (SEO)** (p39) – **POM** combined the **SEO** with an **enhanced online presence**, primarily through **setting up** and **managing a social media campaign** (p39)

POM also **generated traffic** by arranging **paid advertisements (paid ads)** and by setting up and **managing affiliates (other organisations that promoted X Ltd's products)** (p39) – **POM** made any **required payments** relating to **paid ads** and **affiliates** and then **recharged X Ltd** for these **costs**, in addition to its **monthly retainer** (p39)

Profit impact of POM per month

	Visitors	CTR@6.5%	Value@£58 £	Costs £
Organic search traffic via Google due to improved SEO/SM	10,500	682.5	39,585	(2,500)
Traffic attributed to paid ads	1,200	78.0	4,524	(6,000)
Traffic attributed to affiliate referrals	3,600	234.0	13,572	(407)
Total increased visitors	15,300	994.5	£57,681	£(8,907)

		£
Increase in gross profit *	25% x £57,681	14,420
Increase in delivery costs *	6% x £57,681	(3,461)
Agency costs		(8,907)
Monthly impact on profit		£2,052
Full-year impact on profit (12 x £2,052)		£24,624

* X Ltd has a gross margin of 25% and delivery costs are estimated at 6% of revenue.

How to improve a website

Around half of all traffic to a website is from **website searches**, **direct** pre-saved links create around a **quarter** of the traffic to a website, **referral** links from other sites such as **blogs** create **around 10%** of traffic and **social media** is responsible for **around 10%** of traffic (p41)

Paid ads can be an effective way of getting a link to a website to **appear high up** on a **search result** but they involve costs and internet users may not click the link (p41) – **Search Engine Optimisation (SEO)** means **enhancing aspects** of the **website** so that it appears on the **top of a results page after a search** (p41)

This is typically an **ongoing exercise** and can require **technical skills** that a business **may not possess in-house** such as **information architecture**, **technical design** and **build of the website** (p41) – creating a **better service or product** will **improve a website's ranking** following a **search**, as will obtaining **positive endorsements** from **influencers/affiliates** who are viewed as **"high-quality"** (p41)

Traffic can be obtained from **social media** by being **active** and posting content online including through the use of **"influencers"**: paying an **individual** who, by virtue of **his/her celebrity status** or **reputation** in a **particular field**, is **well regarded** and will help drive more **traffic** to a site (p41) – it can also include **paid ads** such as **Facebook** ads that target the **customer segment stipulated** (p41)

An **affiliate relationship** involves agreeing with **another organisation** to promote one another's products (p41)

It is also possible to pay an organisation to **drive traffic** to a site, although these can sometimes be **artificial visitors** known as **"bots"** (p41) – whilst this can potentially help **search engine rankings**, **artificial visitors** have a number of **downsides**, not least because they do not actually buy anything (p41)

Use of **influencers** and **affiliates** is **not without its problems** – the business is **reliant** on them **not saying or doing anything online** that might **harm a brand** so they need to be **chosen with care** (p41)

To determine whether **promotional activity** is worth the **cost**, the business will need to be able to **attribute revenue** to **specific marketing costs** to understand which **marketing spend is proving most effective** as there are **lots of channels** and each of these has **different touch points with potential customers** (p41) – the **effectiveness** of **each channel** and each touch point within them **varies**, so **tracking revenue** and **linking it to costs** incurred will help **make the most of a limited budget** (p41)

Winter is coming – advice for a “problem-focused” R2/R3

Occasionally, the examiners set a “problem-focused” rather than a “project-focused” scenario: this was last done in the November 2017 past paper Requirement 3. As the DGS Advance Information indicates a number of existing problems at the business, we think there is a chance this scenario may arise: hence these notes.

Advice on dealing with a “problem-focused” R2/R3

Don't panic! Maybe it is an **unfamiliar** Requirement but it is the **same for everyone** and the **pass rate** at the **November 2017** sitting was **in line** with the **normal** pass rate

The Case Study **skills areas** and **fundamental marking approach** cannot be **varied** just because of the **nature** of the Requirement so **stick** to your **usual technique** and **points**, and just **tweak** your ideas as required

Think carefully about the **client(s)** involved in the scenario, the **dates** and **timescales**, the **type** of problem created, the **operational** and strategic **implications** ... all of these aspects will have been **very carefully chosen** by the **examiner** so try your best to **read his mind!**

It is always worth considering whether the problem is **wider** or **worse** than expected ... has it **only just happened** (meaning that the **full impact** is not yet evident)? ... is it something that **appears** to relate to a **single client/issue** but which is in fact a **wider problem**?

It is probably worth having a **recommendation** to **investigate** whether the **problem** is **wider** and to look at how to **resolve the matter** in the long term

Look for the **flaws** in any **short-term emergency fix** proposed by the **board** ... for example, offering an **additional discount** or **compensation** sets a potentially **expensive precedent** for the future

Remember to look for the opportunity to score your **Ethics** marks – **regardless of what is thrown at you in R2 or R3**, the **Ethics** markscheme Boxes will be **exactly as normal** and probably **20%** of the marks for the Requirement

Remember – the November 2017 past paper had a very unpleasant R3 which required students to deal with an existing problem at a client (rather than the more usual project-based R3) but the global pass rate was the same old **75%** so do not despair if something odd pops up as everyone will find the scenario difficult!