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BUSINESS AND MANAGEMENT
CASE STUDY: ORGANIX

For use in May and November 2008

INSTRUCTIONS TO CANDIDATES

- Case study booklet required for Higher Level Paper 1 and Standard Level Paper 1 Business and Management examinations.

2208-5001 ; 8808-5001

ORGANIX

Origins

In 1992, Max and Terry Dalman inherited a farm in Canada, located on the outskirts of a town called Guelph. At the time the farm made an income insufficient for both of them. Max worked as a human resource manager in Ontario and his younger brother Terry had just returned from an extended period of travelling. For many months Max and Terry agonized about what to do with the farm. Because Max could see little potential in running the farm, he wanted to sell it. The farm was put on the market, but with falling land prices, they received only very low offers and decided not to sell. As a result the brothers had to review their objectives and the aims of the business.

During his travels, Terry observed the growing interest in fresh, organic produce. He persuaded Max of the benefits of converting the farm to an organic operation, specialising in fruit, but with a range of other cereal, vegetable and meat products. The brothers formalized their agreement with a Deed of Partnership setting out their roles and responsibilities in running the farm.

The first five years of running the farm were very difficult. It took time to meet organic quality standards, and it was not until 1997 that they were able to add officially the term "organic" to all their products. The next few years saw consistent growth in the business and by 2000 the farm employed six staff. Max took overall responsibility and along with an office administrator managed the staff, ordered supplies and marketed the business. Terry managed the production side of the business with four full-time farm workers. Produce was sold through a small number of organic food distributors. As this was a niche market, Max and Terry were able to charge premium prices for their organic products.

One of the main issues the business has faced is the significant variation in the prices it receives for its extensive range of fruits and vegetables. Prices fluctuate with supply and demand, making forecasting revenue very difficult. As a result, Max has kept wages low and this may be one of the reasons for the low morale of the workforce.

Expansion plan: phase 1, conception and implementation

In 2002, to offset the fluctuations in price and grow the business, Max proposed a new expansion plan. He argued that by expanding into other related markets they could diversify with the long-term aim of boosting turnover and profitability significantly. The expansion plan recommended a number of opportunities:

- in a converted barn, open an organic restaurant using mainly produce from their own and other nearby farms
- at the farm itself, and in local towns, open farm shops selling their produce and other related products such as fruit juices and jams
- at the farm, build holiday accommodation offering "farm experience" holidays where visitors have a chance to experience farm life and learn how to tend the animals and crops. The farm restaurant will provide all meals
- to gain further economies of scale in production purchase additional land from the neighbouring farm whose owner is approaching retirement.

Terry was unhappy with these proposals as he was essentially risk-averse in nature and wanted to focus on the core farming business. He was reluctant to undertake the investment required to fund the diversification. He preferred the farm as it was and saw no benefits from expansion. For nearly six months the brothers were in conflict. This was only resolved when Max threatened to dissolve the partnership and leave the business unless the expansion went ahead. Eventually Max and Terry managed to agree on a compromise where growth would be staggered over a period of time. They wrote a business plan that viewed the expansion as a 10-year project and drew up a legal document which set out the various elements such as projected costs and revenues and an agreed timeframe.

By the end of 2007, the barn had been converted and the restaurant had been running fully for two years. Part of the barn was running as a farm shop, which had been trading for three years. A property for a further farm shop has been leased in the neighbouring town and is scheduled to open in December 2008. Max negotiated a CA$500 000* mortgage on the farm with the local bank to finance the restaurant and farm shop. This resulted in an increased level of gearing for the business.

Planning permission has been requested from the local authority to build two holiday cottages. However, the bank's reluctance to lend additional funds at this time means that the cottages are unlikely to be completed for at least two years.

Diversification, marketing and branding

The diversification led to the employment in late 2004 of John Mugano as the marketing manager. John's first task was to develop a marketing strategy for the enlarged business. He proposed marketing all the different arms of the business under the single family brand. To create a vision for the business, he suggested the brand name *"Organix"* and argued for a unified brand identity under a single logo and business name. He wrote a mission statement for the whole business in an attempt to promote their organic and environmental credentials:

Organix: The Natural Way of Thinking

Max was uncertain about this approach. He felt that the target markets for each business were very different, but he wanted to allow John the independence to pursue his own approach. He reluctantly accepted John's proposals.

* CA$: Canadian dollars

One of John's key responsibilities is to oversee the implementation of the marketing strategy to incorporate the additional farm shops and the proposed new holiday accommodation. Given the premium prices of organic produce compared to conventionally produced fruit, vegetables and meat, he wants to open the new farm shops in locations with a high level of passing trade and a relatively high income level. He has spent a considerable amount of time sourcing data on income levels, population density and traffic patterns. Max has also asked him to commission market research on peoples' attitudes to organic produce and related health issues. He believes that income levels are important but social responsibility is the key determinant of peoples' decision to purchase organic products. John has already produced a marketing audit and believes that the business already has sufficient primary research to support his secondary research, and therefore does not need to carry out further market research before proceeding with the opening of further farm shops.

Expansion plan: phase 2, further development

The farm has 9 hectares dedicated to fruit and vegetable production and 80 hectares dedicated to rearing of animals. It is currently producing chicken, pork and beef. The majority of produce is sold through distributors. 25% of the fruit and vegetable production is used in the restaurant and for sale through the farm shop, in both of which the business earns significantly higher margins. Max is hoping to raise this percentage to around 50% by 2010.

In 2004, the first farm shop was opened on the farm itself with the target market being people within the immediate surrounding area. Adverts were placed in the local press with cut out discount coupons and leaflets distributed to local households. Sales improved gradually over the first four years. An increased range of products contributed to the improvement. About 60% of the products stocked came directly from the farm. The ambitious shop manager, Jenny Copertino, has the aim of raising the profile of *Organix* as a socially responsible business. As part of this, she is planning to keep the product range as local as possible and display the number of "food miles" that all products have travelled to demonstrate their commitment to the environment. She has many other ideas for the further development of the farm shop.

The restaurant opened in 2005 with the organic menu being the unique selling point. Max focused on providing exceptional quality food and service and recruited chef Oliver Jayo to prepare the menus and oversee the opening of the restaurant. Oliver was a young well-known chef who was involved in campaigns to raise the profile of organic standards. His forthright views on a range of issues led to a number of media appearances. Following the opening, he developed the menus and worked part-time as the head chef to train two other chefs. Terry disagreed strongly with Oliver's appointment and felt that it was an unnecessary expense, but Max and John argued successfully that his presence was a vital aspect of the overall marketing strategy of the business.

The launch generated a considerable amount of local publicity in various media. For the first three months the restaurant, open for lunch and evening meals, worked at nearly full capacity. However, this soon fell, the average capacity for the next nine months being 55% for lunch and 83% for evening meals.

By 2007, some problems emerged. Early in the year complaints increased and enough meals were returned to generate poor publicity, which led to a significant fall in customers. The restaurant's reputation declined. Bookings fell and by the end of 2007 stood at just 42% of capacity for lunchtime and 61% for evening meals. Terry believes that these levels of attendance are below break-even for the restaurant, but without preparing separate accounts, he cannot prove this. Oliver has become distracted with further media campaigns and is spending fewer hours in the restaurant. Terry is concerned that this may have led to the fall in food and service quality. When confronted, Oliver angrily denies this and blames Terry and poor ingredients from the farm for the quality issues. Max has intervened to try to resolve the dispute.

Human resource management initiatives

With the expansion of the business the workforce has grown. Terry manages the farm and production of all farm-related products for the farm shop. He has six farm workers. He believes they have little loyalty to the business because they are relatively low paid. He has high standards and expects them to be met. All farm staff meet every morning to receive their instructions for the day. Terry monitors their work closely and they are not allowed to leave until Terry is satisfied with the quality of the work done that day. This style of management has led to a high staff turnover with two farm workers leaving on average per year. In an attempt to retain some of the more reliable workers, Max has, against Terry's wishes, re-assigned them into other areas of the business. He is also considering the introduction of flexible working practices.

Max has found the management of the staff an increasingly onerous task and so decided to appoint a new part-time human resource manager. Alison Modano was appointed in April 2007 working two days a week. With further expansion of the business, Max expects this position to become full-time within a couple of years.

Max has typically employed students and temporary staff to serve customers in the restaurant, paying them the minimum wage. Most staff only stay for a few months. Alison is arguing that the restaurant should increase wages for serving staff by 35% to attract and retain a more skilled, experienced workforce. She claims that the resulting lower recruitment and training costs as well as higher productivity will compensate for the higher wage levels. Max likes the idea but is concerned about the financial implications of the higher wage levels and thinks any pay increase should be lower. Alison has a strong belief in allowing staff flexibility and ensuring that they are empowered requiring the minimum level of supervision. Max is sympathetic with Alison's approach but argues that while this may have been appropriate with higher paid staff, it will not work for the lower-paid farm and restaurant staff.

Financial review

Max is responsible for managing the financial position of the firm and employs an accountant to prepare the end of year accounts. An office administrator and part-time bookkeeper help him. The accounts are prepared for the whole business. In 2006, the business made a loss for the first time and Max and Terry were obliged to reduce significantly the income they drew out of the business. Confused why this loss occurred, they have commissioned *Seagers*, a firm of accountants, to prepare a detailed business report to determine where the problems have arisen. Terry has forced Max to agree to postpone any further expansion until the review process has been completed.

The changing external environment

A key aim of the diversification into organic produce is to minimize the impact on the business of global price fluctuations in non-organic produce. The past few years have seen historically high and stable prices for organic products. Demand for organic produce has been growing in most developed nations with a higher level of consumer awareness of food sources and processes. Many large supermarkets and other shops have struggled to meet this level of demand, which has kept prices high.

Recently, supermarket chains have been lobbying governments to reduce organic standards to make it easier for farms to convert to organic status. This change would reduce the current delay between a farm applying for organic status and meeting the strict standards required. The organic industry has been battling against this proposal believing that it would dilute organic standards and reduce the credibility of the "organic certification".

The future

With the expansion plan currently on hold and a loss being made in 2006, Terry and Max have been discussing the possibility of converting from a partnership to a limited company. They feel this may give them more security and protection and help them plan for further expansion more effectively. They have been discussing with the accountants and the bank their options for funding the rest of the expansion plan.