Answer **all** *the questions.*

1. NEW PRODUCT DEVELOPMENT AT 'FIVE FARMS' LTD.

Jenny Harris has managed a farm shop, called Five Farms Ltd, on the Welsh Borders for the last three years. The shop is owned by five local farmers, all of whom supply produce to the shop. Business is slow and she has to contemplate laying off one of the part time employees. The shop stocks a wide variety of top quality meat and game, vegetables and dairy products, as well as cider, jams and honey.

A local businessman had recently asked Jenny to make up ten gift hampers as a reward for his sales force and the feedback she got was very complimentary: 'As a sales manager I am always looking for incentives and these really went down well with my team'. She was also surprised at how much he was prepared to pay. Having carried out some further market research she discovered that the market for hampers was worth £75 million in the UK in 2011. She firmly believed that this could be a market that the business could get into and she put together some figures to present to the owners at their next monthly meeting.

Her proposal was to put together a top quality hamper. Its **USP** would be that it is made up entirely of products sourced from UK farms and targeted at the high end of the domestic market, where hampers were currently selling at £120 to £140. Some of the products she had in mind, such as the seafood, the baskets and the wine, would have to be purchased from other suppliers, but the majority of the contents would be the very best quality products sourced from their own farms.

She would need three key items:

- A well designed website.
- Extensive advertising for the first six months.
- Extra equipment at the rear of the shop for putting together the hampers.

She estimated that this would amount to £10 000 in fixed costs in the first year. The variable costs, including the basket, packaging, food and drink and delivery costs would come to £90. She felt that they would sell at a premium price of £140 in order to reflect the high quality and prestigious nature of their product. At this price, she predicted that she could sell 600 in the first year.

Jenny put her proposal to the owners and four of the five were quite enthusiastic. Tom Hibbard, the youngest of the five, who had recently graduated from agricultural college, was not so convinced. 'Who on earth will pay £140 for a hamper in these hard times? Your pricing policy is wrong and I suspect you would not even sell enough to break even. As I recall from my time in college, you should adopt what is known as a **penetration pricing policy** and not the policy you have in mind'. Jenny strongly disagreed and put forward the findings of the market research she had undertaken.

(a) (i) Construct and label a break-even chart on the graph paper provided on page 5 and write the number of hampers that would need to be sold to break-even in the box provided. [4]

(ii) Draw the margin of safety on the chart if all the hampers were sold in the first year. [1]

(iii) The margin of safety consists of how many hampers? Write your answer in the box provided. [1]

(Tear out page 5 and place it in your answer book)

(b) Explain the advantages of break-even analysis to a business such as Five Farms Ltd. [6]

(c) (i) What is the meaning of the term *'penetration pricing policy'*? [3]

(ii) To what extent do you agree with Tom Hibbard's view that Jenny's pricing policy is wrong? [6]

(d) What is a *USP* and how might it benefit Five Farms Ltd. with the selling of its hampers? [3]

(e) Discuss the issues, other than pricing, that the five owners should consider when deciding upon Jenny's new proposals. [8]