

Think Ahead

ACCA

STRATEGIC BUSINESS LEADER

SPECIMEN EXAM 1 PRE-SEEN INFORMATION

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SPECIMEN

1. Introduction

Peels Sleep Solutions ('PSS') is a bed mattress manufacturer based in Zeelande. PSS was created over a hundred years ago and is 100% family-owned.

PSS manufactures four different types of bed mattresses which it sells to five Zeelande-based retail partners who then sell the bed mattresses to consumers through department stores and showrooms across Zeelande.

Three years ago, PSS started selling its mattresses directly to consumers through the PSS website. PSS is currently the only bed mattress manufacturer in Zeelande which sells its mattresses directly through its own website.

PSS has a financial year end of 30 June.

It is currently August 20X3.

2. Mattress industry information – Zeelande

Overview

The bed mattress industry in Zeelande began around 120 years ago and by 20X2 generated approximately \$600 million in annual revenue.

The industry started with a small number of family-owned businesses which manufactured mattresses using natural fibres. Over the years, bed mattress manufacturing has evolved to include the use of springs, latex foam, memory foam and mass production techniques. Most bed mattress manufacturers in Zeelande remain family-owned and none are listed.

In the past, mattresses were sold by manufacturers to physical retailers who then sold the mattresses to consumers exclusively through their retail outlets (department stores and showrooms) only. This distribution channel has changed in the last decade as online retailers, with no physical outlets, have entered the market offering a 'bed-in-a-box'. This is a mattress which can be ordered through the online retailer's website and delivered directly to consumers rolled up in a box. These online retailers do not manufacture the mattresses themselves but have agreements with mattress manufacturers to provide standard manufactured mattresses which are branded with the online retailer's brand name.

In recent years, a number of physical showrooms and department stores have closed as a result of increased competition from online retailers and many physical retailers have also introduced their own websites to facilitate online ordering.

Today, most Zeelande bed mattress manufacturers generally have agreements with physical retailers and online only retailers.

The Zeelande mattress market consists of:

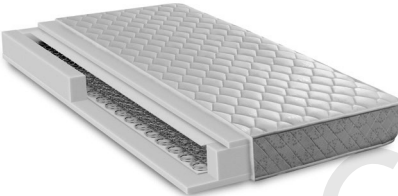
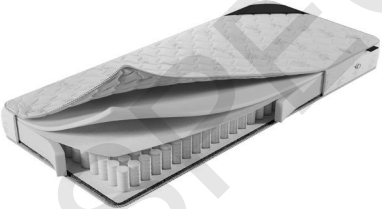


	Notes	30 June 20X3	30 June 20X2
Number of mattress manufacturers		106	110
Number of physical retailers	1	36	48
Number of online only retailers	2	59	34

Notes:

1. Some of these retailers own a number of physical showrooms and department stores across Zeelande. Many of these retailers now also advertise and sell mattresses through their own websites.
2. None of the online only retailers have physical showrooms or department stores.

Mattress types

There are four different types of bed mattresses produced and sold in Zeelande. These different types are available from both physical and online retailers and range in price and expected lifespan.

Type of mattress	Image	Description	Average life span (years)
Open coil		Made with single springs fixed together by wire.	6
Pocket sprung		Like an open coil mattress but with multiple springs sewn into fabric pockets.	8
Memory foam		Made of temperature sensitive material which moulds to body shape. No springs are used.	10
Latex		Like a memory foam mattress but the material which moulds to body shape has more natural elasticity and is made of natural products. No springs are used.	12

Different bed mattress manufacturers in Zeelande offer variations of these four different types of mattresses based on design, thickness, production methods and materials used. Not all mattress manufacturers in Zeelande produce all four different types of mattress.

All four bed mattress types are produced in the following sizes:

- Single – designed for one person
- Double – designed for two people
- King – designed for two people but are 12% wider and 6% longer than a double sized mattress.

Industry challenges and developments

Although gross profit margins in bed mattress production are very high, often around 40% or 50%, the industry faces a number of challenges.

Bed mattresses only need to be replaced every 6 to 12 years, meaning that demand growth in the market is limited. The bed mattress market grows as a result of population increase, which is estimated to increase by 4% over the next decade in Zeelande.

Customers have low levels of brand loyalty and will change mattress manufacturers based on factors including price, availability, and customer service.

As a result of increases in online sales, long 'trial' periods have become more common. A standard offer made by online retailers is a '200 free nights trial' where customers only pay for the bed mattress at the end of the trial period if they are satisfied with the product. This was introduced to encourage customers to buy online even though they could not physically try the mattress out for comfort in a showroom or department store before buying.

The increase in online sales has also led to the creation of a number of mattress review websites. These websites allow consumers to read bed mattress reviews and make direct comparisons between different bed mattresses based on comfort, the levels of body support offered, durability and price.

Lengthy product guarantee periods are now offered, with ten-year bed mattress guarantees offered by manufacturers being common.

The level of competition in the industry means that there is now a high degree of marketing spend by both mattress manufacturers and retailers. As the demand for digital advertising on social media platforms has grown, the cost of advertising has risen making it a significant cost for all companies in the industry.

Innovation and sustainability

Innovation within Zeelande's bed mattress industry is high. Many mattress manufacturers have promoted themselves as 'wellbeing' companies which invest heavily in sleep research to improve their products. Others have introduced mattresses with 'smart home integration', where data is collected while you sleep. A 'smart' bed mattress contains technology which monitors heart and breathing rates to determine the length and quality of sleep a person has. Some even include climate control features which can heat up a bed mattress on colder nights and generate cooling air flows on warmer nights.

The industry is focused on sustainability with many retailers offering a 'take back service' where old beds are returned to the retailer, dismantled and the component parts recycled.

Key performance indicator (KPI)

The most commonly used indicator for success in the bed mattress manufacturing sector in Zeelande is return on capital employed (ROCE). The industry average ROCE at 30 June 20X3 was 12%.

Industry body

Most manufacturers within the bed mattress industry in Zeelande are members of the Zeelande Mattress Foundation ('ZMF'). This is a well-respected organisation which was founded 70 years ago and, at 30 June 20X3, its members account for approximately 70% of the Zeelande bed mattress manufacturing market, based on revenue. ZMF aims to drive high standards across the Zeelande bed mattress industry through its focus on manufacturing practices, sustainability and ethics.

3. PSS overview

Background

PSS can trace its origins back over 100 years, to when Jacob Peels started making bed mattresses with wool and horsehair in Zeelande's farmland region. Over the next decade, Jacob established a team which designed a mattress with springs and improved durability and comfort. That innovative spirit continued, resulting in the creation of over 30 different patents in mattress design and manufacture. PSS is a member of the ZMF.

PSS currently operates from four separate manufacturing plants which are spread across Zeelande. It employs over 1,000 people and produces all four different types of bed mattress at each of its manufacturing plants.

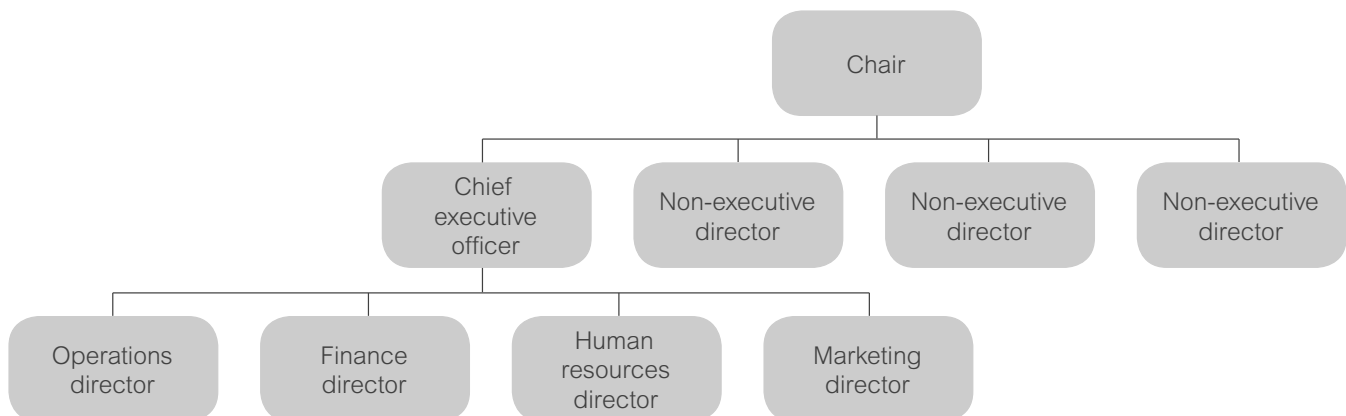
Although PSS continues to maintain strong working relationships with its five retail partners, in 20X0, PSS introduced a direct to consumer ('DTC') offering. A DTC offering is where consumers are able to buy a PSS mattress directly through the PSS website, which is then delivered direct to the consumer rolled up in a box. PSS is currently the only bed mattress manufacturer within Zeelande which sells its bed mattresses direct to consumers through its own website. As only the PSS memory foam and latex mattresses can be rolled, it is only these two types of mattress which are available as part of the PSS DTC offering.

Ownership

PSS is owned by members of the Peels family. The family members are all Zeelande residents and are passionate about preserving the PSS brand name and the quality of its products. The owners have always been satisfied with the level of dividends paid out.

Board structure

None of the Peels family owners are directors of PSS. Although PSS is a family-owned company, corporate governance plays an important part in its operations. The structure of the PSS board is shown below:



The marketing director role was created in 20X0 in response to the development of the DTC offering.

Information systems

PSS's data is held on servers operated by cloud based service providers.

PSS has a website which it uses to present information about the business and make DTC sales.

Products

PSS manufactures four different types of mattresses, details of which are below:

Product name	Type of mattress	Annual production (units)	Gross profit margin
Abha	Open coil	61,000	30%
Badin	Pocket sprung	49,000	33%
Charu	Memory foam	32,000	47%
Duras	Latex	15,000	55%

Production is spread evenly throughout the year, with no seasonality.

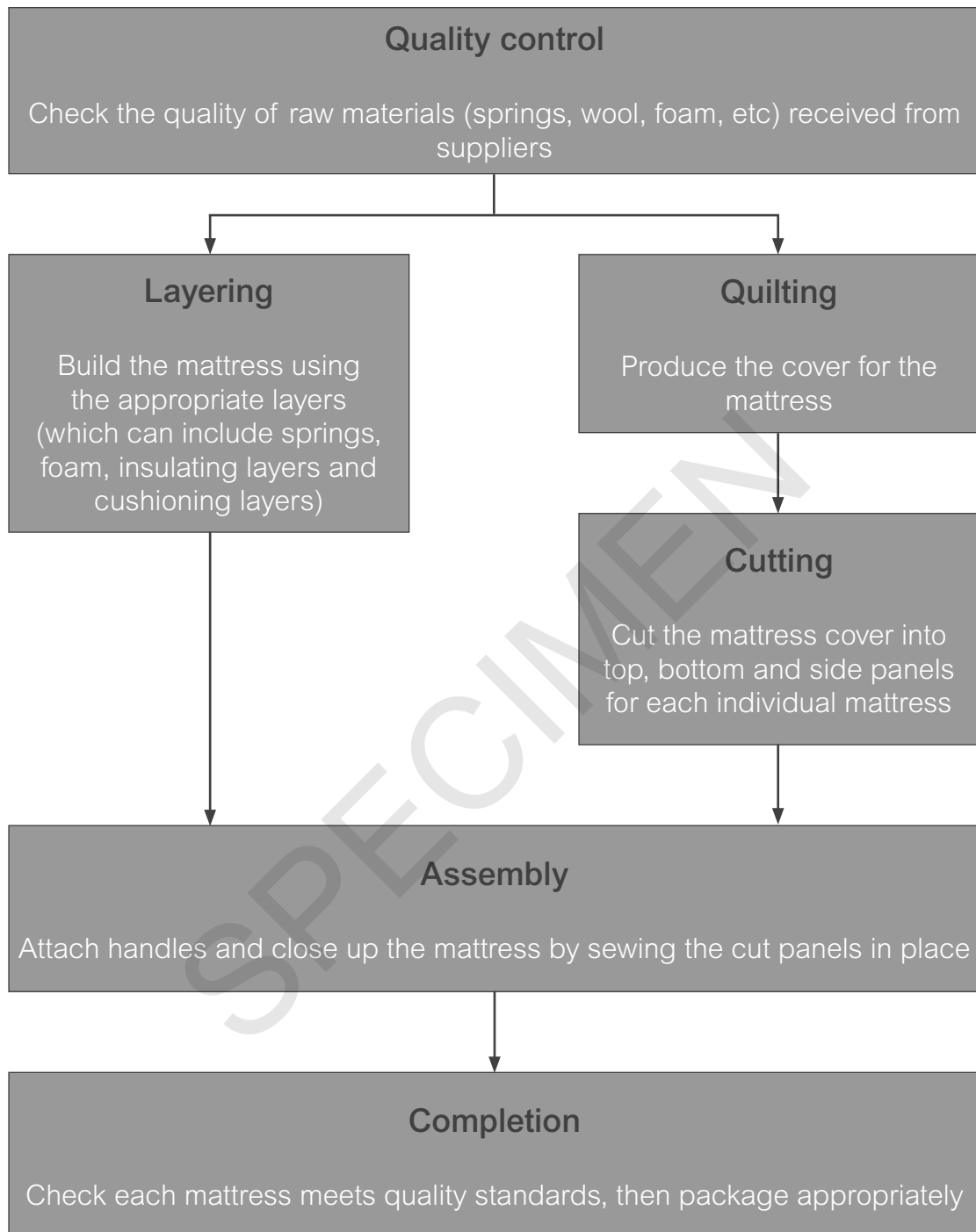
Suppliers

PSS has a number of valued suppliers for the various components which are included in the four types of bed mattresses. Suppliers are vetted and their products are closely quality controlled by PSS. Key suppliers are:

- Asher Springs Plc – for all the steel springs used in the Abha and Badin mattresses.
- Quellings Foam Plc – for all memory foam and latex used in the production of the Charu and Duras mattresses.
- Zeelande Farms Plc – for all wool, hemp, cotton and linen needed in the production of the Abha and Badin mattresses and the production of the covers for all the mattress types.

Manufacturing

Each separate manufacturing plant produces all four types of mattress. Employees involved in the manufacturing process at all four manufacturing plants are split into different teams:



Distribution

Retail partners

PSS has contracts with five retail partners. Each of the five retail partners has physical showrooms or department stores spread across Zeelande in which the full range of PSS mattresses are sold. Retail partners also sell mattresses which are produced by other Zeelande mattress manufacturers. None of the retail partners sell PSS mattresses online through their own websites.

Mattresses are sold to the retail partners at wholesale prices, which are, on average, 15% lower than the recommended retail price. Retail partners order mattresses in bulk from PSS and store them in their own warehouses. PSS charges retail partners a standard delivery charge when delivering to the retail partners' warehouses.

PSS offers 30-day credit terms to all retail partners which runs from the order date. Contracts with retail partners do not include any trial periods. PSS provides a ten-year manufacturing guarantee with each bed mattress.

Direct to consumer (DTC)

PSS sells its memory foam and latex bed mattress types (the Charu and Duras mattresses) online through its own website as part of its DTC initiative. The mattresses sell at the recommended retail price. A mattress is carefully rolled, vacuum packed into a box and delivered directly to consumers. PSS does not charge customers a delivery fee. A free 200-night trial is offered on all DTC mattresses with payment only taken at the end of the 200-night trial. Each mattress sold via the DTC channel also has a ten-year guarantee.

The DTC initiative has required extensive investment in bed rolling equipment, packaging equipment, information technology and increased employee recruitment.

During the financial year ended 30 June 20X3, revenue from DTC sales accounted for around 20% of all PSS revenue.

Risks

PSS has a risk register and a risk management programme in place. An extract from the risk register is below:

Political environment	<ul style="list-style-type: none">– Changes in environmental legislation could impact the way in which we operate and our reputation.
Economic environment	<ul style="list-style-type: none">– Competition and continued innovation within the industry may impact our performance and reputation.– As we design and manufacture mattresses, we face exposure to liability claims and claims against health and safety procedures.
Financial environment	<ul style="list-style-type: none">– Key raw materials (foam and springs) used in the production of our mattresses are susceptible to cost increases.– Marketing expenditure may not result in an increase in sales or brand awareness levels.

4. PSS website extracts



OUR MISSION

To manufacture well-designed, high quality bed mattresses in a sustainable and ethical manner.

It is our vision to give the people of Zeelande a good night's sleep.

Our values underpin all of our strategic decisions:

Quality Quality has always been at the heart of the PSS business. All our products are thoroughly tested to ensure that strict manufacturing quality and safety requirements are met.	Innovation We aim to create innovative products which set new benchmarks in meeting customer demand.
Customer service Our customers are the key to the continued success of the PSS business and their needs are always at the forefront of any business decisions which we make.	Sustainability PSS is a carbon neutral business and all waste which we generate across our manufacturing plants is recycled. Solar energy is used to power our plants. PSS offers a mattress disposal service on its DTC sales, where old mattresses are collected and dismantled for recycling: metal is sold to scrap dealers to be recycled, foam is sold to be broken into smaller pieces and re-used in the production of children's play mats and other mattress fillings are used in the production of protective clothing.
Employee welfare Our employees are an integral part of our success and we ensure that working conditions meet all legally required standards and health and safety regulations. We ensure that we comply with and promote workers' rights.	Ethics All aspects of the PSS business are run on an ethical basis. This covers our dealings with our suppliers, employees, customers, and other members of the Zeelande Mattress Foundation.

5. PSS financial information – selected summary

