

ADVANCED GCE
BUSINESS STUDIES
Strategic Management

F297

Candidates answer on the Answer Booklet

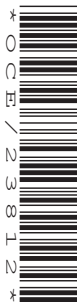
OCR Supplied Materials:

- 16 page Answer Booklet

Other Materials Required:

- Calculators may be used

Monday 1 February 2010
Afternoon

Duration: 2 hours**INSTRUCTIONS TO CANDIDATES**

- Write your name clearly in capital letters, your Centre Number and Candidate Number in the spaces provided on the Answer Booklet.
- Use black ink. Pencil may be used for graphs and diagrams only.
- Read each question carefully and make sure that you know what you have to do before starting your answer.
- Answer **all** the questions.
- Do **not** write in the bar codes.
- If you use extra sheets of paper, fasten these sheets to the Answer Booklet.

INFORMATION FOR CANDIDATES

- The number of marks is given in brackets [] at the end of each question or part question.
- The total number of marks for this paper is **90**.
- The quality of your written communication will be taken into account when marking your answers to questions labelled with an asterisk (*).
- When answering each question you must use the knowledge and skills gained throughout the whole A-level course.
- This document consists of **8** pages. Any blank pages are indicated.



**A calculator may
be used for this
paper**

Answer **all** the questions.

- 1 (a) With reference to Table 2, calculate the Accounting Rate of Return (ARR) and the Pay Back Period (PBP) of each of the three options being considered. [13]

(b) Recommend whether Candy Cabs should go ahead with any of the three options being considered. Justify your view. [18]
- 2 Evaluate the extent to which the legal identity of Candy Cabs impacts on its ability to achieve its objectives. [18]
- 3 Discuss how a period of sustained UK unemployment might affect the success of Candy Cabs. [18]
- 4* Recommend, to Catherine and Yvonne, how the proposed changes in drivers' employment status might be implemented. [23]

Candy Cabs

More of a daemon than a dragon, Andrew Boddie is a serial investor. Well known in Oakford as a successful solicitor, he is always on the lookout for investment opportunities. For Andrew an attractive investment is one which yields a return commensurate with risk. In Andrew's view businesses exist to make their owners wealthy and anything they do should always be judged against how the owners' returns are increased. Although he is not without sentiment, he sees business ethics as an indulgence affordable only by those who make decent profits. 5

Andrew's investment in Candy Cabs arose from a conversation he had had with David Devine. David works as a Small Business Advisor for a major retail bank. He had been approached by Catherine Davies and Yvonne Chang who were seeking a loan in order to establish a taxi business in Oakford. Regrettably, aspects of their business plan did not satisfy the bank's stringent lending criteria and so they were turned down. However, in his personal view, David thought that the venture had merit and might appeal to Andrew. Consequently, David put the three in touch with each other. The resultant discussions were somewhat asymmetric, with Andrew having the stronger bargaining position. After considerable deliberation Catherine and Yvonne yielded to Andrew's demands and so agreed to establish the legal identity of the business as a partnership, with Andrew being a sleeping partner. For Andrew, Candy Cabs slotted neatly into his portfolio of businesses, whilst for Catherine and Yvonne it offered a route to their dream of building a respected business serving the needs of the local community (see Appendix 1). 10 15

The taxi business is both competitive and regulated. Catherine and Yvonne soon discovered, however, that the barriers to entry in the taxi business are remarkably low. Indeed, the local authority is keen to ensure that the community is served by well run but inexpensive taxis. Obtaining a licence to operate as a hackney carriage business was relatively straightforward. With the local authority not requiring "the knowledge", the only requirement was for staff to pass Criminal Records Bureau (CRB) and other regulatory checks. Each of Candy Cabs' vehicles is subject to the normal statutory safety checks, and payment of a £120 licence fee (per annum) to secure the white operator's plate which must be displayed on each vehicle. The plate serves two functions. First, it reassures members of the public that the taxi is "legal". Second, it prevents the vehicle being used for private purposes. Having started with just one car, a second hand VW Passat diesel saloon, Candy Cabs now operates a fleet of six Passats. In addition, Candy Cabs has one, seven seat, VW Sharan and one VW Caravelle. All vehicles are painted in its distinctive pink and white livery and are reckoned to be available for hire 18 hours per day. Candy Cabs has a policy of disposing of vehicles via auction after either four years or 300,000 miles. There are several benefits of having a standardised fleet. One of these is the reduced servicing costs the business has negotiated with the town's VW franchise holder, Traylen Motors. 20 25 30

Although both Catherine and Yvonne believe that Candy Cabs is a successful business, its five year life has not been without stress. Most of this stress surrounds their relationship with Andrew. Although Andrew very much takes the back seat, he is inclined to sudden bursts of interest in Candy Cabs. On these occasions his demands for information tend to cause either, or both, Catherine and Yvonne to be deflected from the day-to-day running of the business. However, if they ever want something from Andrew he can prove to be frustratingly illusive. For example, when Catherine decided that they really needed to have a full set of accounts to judge Candy Cabs' performance, Andrew simply said that was a waste of time because there is no such legal requirement for the business. He also said that it was not worth worrying about accounts; they managed to pay wages every month, and the cash balance in the bank was rising so "... things must be fine". Not convinced about this reasoning, Catherine and Yvonne sat down one afternoon a few weeks ago and tried to create accounts on their own. However, as both are self-confessed "financial illiterates", they found this a real struggle (see Appendix 2). What they could agree on was where the business should be going in 2010 and beyond. Without Andrew's input they decided that by the end of 2010 they should have two more "people carriers", and have sales rising by 8% pa. In 2008 Candy Cabs had a turnover slightly in excess of £806,000. 35 40 45 50

To achieve this growth target, Catherine and Yvonne are considering three options. The first is to encourage more journeys, particularly amongst the elderly population of Oakford. Catherine knows from conversations with Candy Cab passengers that many pensioners have their own cars. However, for a variety of reasons, these cars are rarely used. This is despite the fact that owning a car means paying vehicle excise licence and insurance. As a result, for this type of customer, the average cost of each private car journey is disproportionately high, although its marginal cost may be quite low. Candy Cabs has agreed with Traylen Motors, that Traylen Motors will buy these underutilised vehicles from Candy Cabs' existing account customers aged 70 or more. Traylen would then sell the car on through the trade, and pay Candy Cabs 90% of the purchase price within 60 days. In effect, Candy Cabs would give customers pre-paid, non-transferable, taxi vouchers in exchange for their seldom used car. 55 60

The second option is to operate taxi services in Upham. Upham is eight miles from Oakford and already has a taxi business, Terry's Taxis. However, Terry's has two major and linked weaknesses. First, it has a relatively poor reputation, such that people who live in Upham would prefer to travel home from Oakford with Candy Cabs rather than book with Terry's. Second, Terry himself is nearing retirement and gives every indication of being more focused on this than running his business. Catherine feels that at the first sight of a competitive fight Terry would simply capitulate leaving the door open for Candy Cabs to expand. To expand in this way would require two additional vehicles and the recruitment of four full-time equivalent drivers. Currently Candy Cabs employ 31 drivers, working a mixture of part and full-time hours. Catherine reckons that a budget of about £20,000 would cover the set-up costs, and a burst of marketing activity. 65 70

The final option is entering the executive car hire market. Occasionally, local businesses have enquired about Candy Cabs taking senior managers to the airport, regional meetings and the like. Despite Candy Cabs' excellent reputation in the private market, no bookings have actually been made for executive travel. The implication seemed to be that a booking would have been made if Candy Cabs operated more luxurious cars. Catherine has already had an informal chat with Traylen Motors which thinks that, for about £15,000, it could source a high specification, less than three year old, VW Touareg. Catherine is convinced that with this car Candy Cabs could command a premium price. A few rough calculations indicate that Candy Cabs could charge about £200 per booking, with a maximum of three bookings per day. Catherine thinks there is enough demand to budget for 200 bookings per year. Allowing for operating costs and wages, a booking should yield a 25% margin. 75 80

Catherine has estimated the financial costs and benefits of the three options (see Table 1).

Table 1 – Estimated usage of each of the three options

	Taxi vouchers	Taxi services in Upham	Executive travel
Journeys per day	5	40	n/a
Cabs	2	2	1
Average revenue per journey	£8	£8	£200
Days	350	350	200
Margin (percentage)	10%	10%	25%
	£2,800	£22,400	£10,000

From her estimates Catherine then made another series of assumptions in order to assess the likely cash flows of each of the options (see Table 2).

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Table 2 – Estimated (net) cash flows of the three options

	Taxi vouchers	Taxi services in Upham	Executive travel
Set up	(£1,000)	(£20,000)	(£15,000)
Year 1	£2,800	£5,000	£10,000
Year 2	£2,800	£10,000	£10,000
Year 3	£2,800	£25,000	£10,000
Year 4	£2,800	£25,000	£10,000

The taxi business serves a diverse and segmented market. An increasingly important segment is local authority work; for example, taking children to school in the mornings and returning them home at the end of the day. The local authority is anxious that its chosen contractors offer “best value”. Consequently, every six months Candy Cabs’ contract is subject to review. In awarding this work the key considerations for the local authority are price, punctuality and passenger safety. Happily, Andrew plays golf with the responsible officer at the council. Last year this market accounted for 10% of Candy Cabs’ income. The local authority pays monthly, taking 60 days trade credit. Another 40% of income came from regular account customers who are invoiced monthly with a 30 day payment term. To hold an account, customers are expected to spend at least £40 per month. Often account holders will ask the switchboard for a specific driver.

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Being a hackney carriage business enables Candy Cabs to ply for trade. As such it can pick up passengers anywhere. This market pays cash, and accounts for the rest of Candy Cabs’ income. Although there is no such thing as an average journey, Yvonne reckons that £8 per fare would be about right. Candy Cabs work on a net margin of 10%. Oakford, being a largely rural area, has very limited provision of public transport during the day, and it is non-existent after 6.30pm and on Sundays.

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Although at times frustrating, Catherine and Yvonne both agree that working with Andrew could never be described as dull. Last week he came up with “a big idea” that would make the three of them “richer for doing less!”. In essence, other than continuing to operate the switchboard, he wants to turn Candy Cabs into a virtual business. Rather than employ staff and own vehicles, he wants to rent out Candy Cabs’ expertise and brand identity. The drivers’ employment status would change so that they become self-employed contractors. Further, each would be responsible for their own vehicle, either as an individual or as part of an owning consortium. By controlling the switchboard Catherine and Yvonne would know where all the cabs are and whether there are fare paying passengers on board. In this way they would know who to charge, so generating income for the partnership. At a stroke, Andrew claims, Candy Cabs would lose responsibility for national insurance and other employment costs, gain a significantly reduced administration burden with the bonus of less legal risk due to vicarious liability. Passengers would not know the difference, because to all intents and purposes a “pink Passat” would arrive to take them where they wanted to go. It would also avoid the current, acrimonious argument about tip sharing amongst the staff.

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Appendix 1

The Candy Cabs 5 Ps

Here at Candy Cabs we have five passions:

- 1 Pink – our cabs are pink; our uniform is pink. Pink is our colour, making Candy Cabs instantly recognisable and different.
- 2 Punctuality – our aim is to be the best cab business in the locality. To do this we need to understand what our customers want from us. High on that list is punctuality; we'll be there when we say we will, so that our passengers can plan their busy lives accordingly.
- 3 People – that's passengers and staff, because without either there'd be no Candy Cabs. We value our staff, giving them an excellent and rewarding place to work so that when they are in contact with our passengers they are polite, courteous and helpful.
- 4 Professionalism – ours is a relationship business meaning we need to recognise the importance of each and every customer interaction. Within our highly competitive market customers can and will exercise choice. We have to ensure that once a customer has experienced Candy Cabs they are so delighted that they won't feel the need to look elsewhere. So, we will offer each and every customer a service second to none.
- 5 Price – we'll charge a fair fare. A fare that is fair to our customers but is also fair to us. The price we charge has to be low enough to offer customers value for money but high enough to reward everyone involved in Candy Cabs, whether staff or owners.

Appendix 2

Candy Cabs

Estimated Balance Sheet, as at 1 September, 2009 – prepared by Catherine and Yvonne
£

Fixed Assets	Cars and office equipment	<u>50,000</u>
Current Assets		
	Stock	150
	Debtors (1)	40,297
	Prepayments; insurance, road tax, etc	1,558
	Bank balance	15,897
	Petty cash	<u>564</u>
		58,466
Current Liabilities		
	Creditors	9,674
	Office rent due	<u>1,250</u>
		10,924
Net Current Assets		47,542
Total Assets less Current Liabilities		<u>97,542</u>
Loan from Andrew		22,500
Net Assets		<u>75,042</u>
Owners' investment (2)		3,000
Profit from previous years (3)		72,042
Owners' funds		<u>75,042</u>
Note 1	Local authority	13,430
	Account holders	26,867
Note 2	Andrew Boddie	1,000
	Catherine Davies	1,000
	Yvonne Chang	1,000
Note 3	Balancing item	

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