

General Certificate of Education
January 2006
Advanced Level Examination



BUSINESS STUDIES
Unit 4

BUS4

Friday 20 January 2006 Afternoon Session

For this paper you must have:

- a 12-page answer book
- You may use a calculator.

Time allowed: 1 hour 30 minutes

Instructions

- Use blue or black ink or ball-point pen.
- Write the information required on the front of your answer book. The *Examining Body* for this paper is AQA. The *Paper Reference* is BUS4.
- Answer **all** questions.
- Do all rough work in the answer book. Cross through any work you do not want marked.

Information

- The maximum mark for this paper is 84.
4 of these marks will be awarded for the Quality of Written Communication.
- The marks for questions are shown in brackets.
- You are reminded of the need for good English and clear presentation in your answers. All questions should be answered in continuous prose. Quality of Written Communication will be assessed in all answers.

Read the Case Study and answer **all** the questions that follow.

Wilford Construction plc

Wilford Construction plc specialises in building luxury flats. The company buys plots of land in many areas of the UK and undertakes the complete planning and construction process. The demand for new housing increased steadily for several years up to 2004. Rising incomes and low interest rates benefited building firms, such as *Wilford Construction plc*, that focused on expensive flats. In 2004, the directors of the company had been so confident of the prospect of future growth that they decided to double the size of the Head Office building. This was completed in 2005 and was financed by the issuing of shares.

The slowdown in the housing market that started in 2005 hit *Wilford Construction plc* hard. By the end of the year, the company had been forced to lower the prices for several of its developments. Lower profit margins, combined with the higher overhead costs of the expanded Head Office, accounted for the substantially lower net profit in the latest financial year (**Appendix A**). Retained profits would have been even lower had it not been for an unexpected but welcome sale of a redundant workshop, formerly used by the business, raising £2 million more than its balance sheet value. The share issue and the pessimism in the housing market caused the company's share price to fall.

The Managing Director, Bill Wilford, believed that the loyalty of shareholders should be rewarded during difficult trading periods. He wanted to maintain the dividend payout but was concerned about the impact on retained profit. He suggested recently: "If we increased the expected life of the fixed assets purchased in 2005 by two years, we could double the retained profits." This met with a frosty response from the Finance Director. "Even if it does not break tax rules, it will, at the very least, mislead our shareholders," he pointed out.

At a recent Board meeting, many of the directors were keen to adapt the business to the new economic circumstances. The Marketing Director's latest sales forecast did not look promising. "Sales of highly priced flats are likely to continue to fall over the next two years, with a particular problem during the seasonal low periods of autumn and winter," she announced. The directors considered two alternative strategies.

The first strategy was to use existing building plots to build lower priced flats. A new 'modular' building method could be used. This would allow rapid construction using pre-formed panels made from newly developed materials that offered high heat insulation. These materials resulted from a research and development project funded jointly by *Wilford Construction plc* and a large university. The company lacked experience of this method of construction, but the Operations Manager was convinced that, with careful planning, it would take six weeks less to complete the new flats than would be the case with the luxury designs using traditional methods. "Pre-ordering of modular panels so that they arrive on site, on time, will cut our working capital needs," he suggested.

The alternative strategy was to continue to build the existing style of flats but to rent them to tenants rather than to sell them outright. The rental market would be a new segment for the company. The Marketing Director had asked some local estate agents about the state of the market for rented accommodation and this looked promising. She was keen

45 for the decision on whether to ‘construct for rent’ on a newly available site in the north of England to be made as quickly as possible. An option on whether to purchase this site, costing £1 million, had to be taken up within six days. Other directors wanted more evidence before making this strategic shift.

50 The company also had to make decisions concerning future building sites. Should it plan to build in cheaper locations, expecting housing prices to fall further? Regions outside London and the South East benefit from lower wage rates for building workers. The Operations Manager realised the need to select each location carefully, as it could influence not only the construction cost but also potential revenue from the completed property.

55 The Human Resources approach used by *Wilford Construction plc* is a ‘hard’ one. It emphasises control over both construction workers and labour costs. The company employs many construction employees on temporary contracts and also uses sub-contractors. The common view in the building industry is that this helps to reduce labour costs substantially. Fringe benefits, permanent contracts, appraisal interviews and staff shareholding schemes are only offered to salaried, administrative staff. Communication with construction workers is mainly in the form of verbal instructions from the Site Manager. The company is typical of many building firms in trying to avoid the cost of training and apprenticeship schemes by relying heavily on ‘poaching’ skilled staff from other firms when needed. The Human Resources Director is starting to question the overall impact of the company’s strategy towards its building workers. Individual labour productivity can only be calculated for certain trades such as bricklaying, but other measures of personnel effectiveness made depressing reading (see **Appendix C**).

65 From being a successful firm in a thriving industry, company fortunes had shown a marked decline in a few short months.

Appendix A: Profit and Loss Account for *Wilford Construction plc* for years ending:

	31/12/04 £m	31/12/05 £m
Sales Turnover	44	37
Gross Profit	18	13
Head Office costs	3	4
Other expenses, including depreciation of fixed assets	3	6
Total expenses	6	10
Net profit	12	3
Extraordinary one-off items	0	2
Profit before tax	12	5
Corporation tax @ 25%	3	1.25
Profit after tax	9	3.75
Dividends (2005 figure is proposed – not yet paid out)	3	3
Retained profit	6	0.75

Appendix B: Other financial data for *Wilford Construction plc* for years ending:

	31/12/04	31/12/05
Share price at year end	£2.00	£1.35
Total number of issued shares (millions)	28	30
Cost of equipment and vehicles purchased during the year	–	£15m
Assumed residual value of equipment and vehicles purchased during the year	–	£3m

Fixed assets depreciated using straight line method over 4 years.

Appendix C: Construction workers' performance data at *Wilford Construction plc* for years to:

	31/12/04	31/12/05
Number leaving the company before end of contract	30	35
Total days of absence	1500	2200
Total material waste	£1.2 million	£1.3 million
Serious accidents	14	16

Wilford Construction plc employed 200 construction workers in 2004 and 190 in 2005, each contracted to work for an average of 210 days per year.

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- 1 (a) Outline **two** difficulties that the managers of *Wilford Construction plc* may experience when attempting to communicate effectively with construction workers. (6 marks)
- (b) Discuss, using the data in **Appendix C** and other information, whether *Wilford Construction plc* is right to adopt a ‘hard’ approach to managing its construction workers. (14 marks)
- 2 (a) Using the data in **Appendix B**, confirm the Managing Director’s claim that: “If we increased the expected life of the fixed assets purchased in 2005 by two years, we could double the retained profits.” (Lines 19 – 21) (8 marks)
- (b) Would you advise the company to make the same total dividend payout to shareholders in 2005 as in 2004? Justify your answer, using appropriate shareholder ratios. (12 marks)
- 3 To what extent might the use of operational management tools improve the efficiency of *Wilford Construction plc*? (20 marks)
- 4 (a) Analyse the potential benefits to the company of using the marketing model before it decides whether or not to enter the rental market. (8 marks)
- (b) Discuss, using the Case Study and your knowledge of forecasting techniques, the difficulties that the Marketing Director of *Wilford Construction plc* might experience in forecasting the sales of flats for the next two years. (12 marks)

END OF QUESTIONS

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