General Certificate of Education
June 2007
Advanced Level Examination

BUSINESS STUDIES **BUS4**
Unit 4

Thursday 14 June 2007 9.00 am to 10.30 am

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 to be marked.

Information

- The maximum mark for this paper is 84.
  Four of these marks are for using good English, organising information clearly and using specialist vocabulary where appropriate.
- The marks for questions are shown in brackets.

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

Lowfare Airways plc

Lowfare Airways plc (Lowfare) is a UK-based budget airline which two years ago bought another budget airline, Vlodair, based in Poland. This expansion gave *Lowfare* airport operating bases in several Eastern European countries at a time of rapid economic expansion in the region. *Lowfare* opened new routes from the UK to these countries and *Lowfare*'s passenger numbers and revenue have risen sharply. However, the profitability of the business has not yet improved as profit margins on these cut price, short-haul (short distance) flights are low.

The sudden increase in the size of the business has led to many problems, not least of which is the frequent failure in communication between the UK head office and some operating bases abroad. Before the takeover, *Lowfare* executives would aim to meet managers at each airport frequently, to discuss passenger numbers, operating efficiency and staffing issues. *Lowfare*'s expansion has made the business much more dependent on electronic means of communication for sending reports back to head office and for issuing details of new company policies. The increase in staff numbers has made an additional level of supervisory management necessary.

Despite the disappointing profit performance following this expansion, the Board of Directors is determined to make *Lowfare* a major force in the airline industry. Six months ago, the directors studied sales forecasts for the next four years for both short-haul flights and intercontinental long-haul flights. The main growth potential clearly seemed to lie in long-haul flights, a part of the airline market that *Lowfare* had not yet entered for two main reasons. Firstly, its aircraft did not have the range to allow them to cross major oceans. Secondly, the drive for low costs had meant that *Lowfare* operated from small airports located a considerable distance from big cities. Long-haul airlines were always based in major airports which carried higher operating costs for the airlines but offered many more connecting routes for passengers to reach their final destinations.

Lowfare's Board of Directors is now meeting to consider a report which it had commissioned to investigate whether the company should expand into the long-haul market. One advantage of the purchase of Vlodair was that it owned licences to operate new long-haul routes. However, no capital had been available to start these services. The report found that the new project would not be cheap, but that profit margins were likely to be much higher on these flights especially if higher levels of passenger service were offered. New long-haul aircraft would need to be leased and additional staff recruited. Operating bases in major airports would have to be established. Marketing of the new long-haul routes would also be expensive as *Lowfare* was not regarded as a long-haul operator with a high quality of service.

The report suggested that a 'long-haul project', of four trial routes, should be established. Initially, it would be run for four years and require a capital investment of £25 million. Since *Lowfare*'s gearing is already quite high, the report recommended that finance from retained profits could be increased over the next two years by cutting dividends. The results from this 'test market' would indicate whether the marketing objectives would be achievable.

The Operations Director was asked to plan for the possible introduction of the 'long-haul project'. He prepared a critical path network diagram for the project using the data in **Appendix B**. Based on this, he suggested that he could plan for the four long-haul routes to be operational in approximately 21 weeks' time.

The Marketing Director is excited by the new proposal but warns her colleagues, "It will not be enough just to sell ourselves as a low-fare operator on the long-haul flights. The short-haul and the long-haul markets are very different and passengers have different expectations. Will transatlantic passengers be prepared to pay for their own sandwiches on board and £10 for each bag we store in the aircraft hold? Our market research indicates they will not. We need to repackage our marketing strategy to attract long-haul passengers. Currently, we spend under 1% of turnover on promotion, less than most of our rivals, but a small marketing budget for this project will spell disaster."

"If we adopt the 'long-haul project'," argued the Human Resources Director, "we will need to review the pay system used for cabin staff. The aim of the current Human Resource strategy is to help the business to achieve low costs with high sales turnover. Cabin staff are on a low hourly rate with the incentive to earn commission on in-flight sales. This has been successful, but would it be the correct system to use with long-haul flights where in-flight catering is included in the ticket price? I think that a new pay system is essential if we are to focus on a Human Resource objective of establishing a core of dedicated and loyal cabin staff who will offer top class cabin service."

The Board is keen to take a quick decision. Only that morning, the business papers carried details of a cut in short-haul fares announced by a major competitor.

Appendix A: Data analysed by the Board when considering the proposal for the 'long-haul project'

Initial capital cost	£25m
Forecasted annual net cash flow in: Year 1 Year 2 Year 3 Year 4	£5m £10m £15m £15m
Gearing ratio at 31 May 2007	46%
Projected annual average rate of return for 'long-haul project'	20%
Projected payback	2 years 8 months
Forecasted increase in global long-haul flights	8% per year for next 4 years
Forecasted increase in short-haul EU flights	4% per year for next 4 years
Current interest rate on borrowed capital	10%
10% Discount factors: 1 year 2 years 3 years 4 years	0.91 0.83 0.75 0.68

Turn over ▶

Appendix B: Data used for the critical path network diagram for the 'long-haul project'

Activity	Description	Preceded by:	Duration (weeks)
A	Recruit pilots	-	4
B	Arrange aircraft leasing	-	8
C	Negotiate leases for new operating bases	-	9
D	Prepare marketing plan and promotion campaign	-	12
E	Fit out new operating bases	C	6
F	Recruit and train passenger support staff at new bases	C	7
G	Test flights into new operating bases	A, B, E	2
H	Test all operating systems	F, G	4

1 (a) Analyse the likely causes of the poor communication within *Lowfare* after the expansion resulting from the purchase of the Polish airline. *(8 marks)*

(b) Recommend to the Board of Directors a pay system for cabin staff that would most likely help to achieve the new Human Resource objective (lines 54–61). Justify your recommendation. *(12 marks)*

2 (a) Construct a critical path network diagram for the 'long-haul project', using the information in **Appendix B**. Insert all earliest start times and latest finish times. *(10 marks)*

(b) Discuss the likely advantages and disadvantages to *Lowfare* of operating from small airports which are located a considerable distance away from big cities. *(10 marks)*

3 (a) To what extent do you think *Lowfare* was right to use a scientific approach to marketing decisions before starting long-haul routes? *(10 marks)*

(b) Do you agree with the Marketing Director that the size of the marketing budget for the long-haul routes is the key to the success of this new venture? Justify your answer. *(10 marks)*

4 (a) Calculate the net present value of the 'long-haul project', using the data in **Appendix A**. *(6 marks)*

(b) Should *Lowfare* go ahead with the international 'long-haul project'? Use your result from 4(a), data from **Appendix A** and any other information to support your answer. *(14 marks)*

END OF QUESTIONS