



**BUSINESS AND ORGANISATION
HIGHER LEVEL
PAPER 2**

Wednesday 23 May 2001 (morning)

2 hours 15 minutes

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- Answer four questions.

1. Sageplus Systems has expanded rapidly and is considering the purchase of an upgraded computer operating system for its offices world-wide. Two competitors have tendered for the business, Lynus and Solar. Most firms presently use Lynus systems, but Solar has recently released some innovative new products particularly suited to Internet use. The Solar system is slightly more expensive at an initial cost of \$22 million, compared to the \$18 million investment required for the Lynus system. The systems are expected to run for six years before being replaced. Cost savings will result from improved efficiency, which will help improve Sageplus's tight cash flow position caused by its large investment programmes. Sageplus currently run an older version of the Lynus system, so savings from the upgraded system occur earlier as less training is required and existing programmes can be modified. The Solar system is imported, so its cost may be affected by exchange rate fluctuations. The Data Systems manager has estimated the expected returns of the two systems to be as below:

Annual return (\$ million):

Year	1	2	3	4	5	6
Lynus	6	10	12	6	4	2
Solar	4	8	8	8	14	5

It is anticipated that interest rates will average 6% over the period. However, some economists have suggested that rates may rise faster in the medium term, if inflation is not controlled.

Present value of \$1 receivable at an annual discount rate of 6% at the end of:						
1 year	2 years	3 years	4 years	5 years	6 years	
\$0.943	\$0.890	\$0.840	\$0.792	\$0.747	\$0.705	

- (a) For each operating system, calculate:
- (i) the payback period; *[2 marks]*
 - (ii) the net present value (assume the interest remains at 6%). *[4 marks]*
- (b) Compare payback and discounted cash flow as methods of investment appraisal, and explain why Sageplus Systems may use one in preference to the other. *[6 marks]*
- (c) Evaluate the financial and non financial factors influencing the choice of operating system and advise Sageplus as to their choice. *[8 marks]*

2. Organic Foods is planning to expand its product range into the luxury end of the ice cream market. They intend to test the market with a single range of chocolate covered ice creams produced in a small industrial unit. They wish to charge a premium price for this product to reflect its natural quality and image and to cover higher production costs. However, research shows the market is sensitive to price, even at the upper end of the market. The production manager produces the following data for examination by the Board of Directors:

Costs

Fixed costs:	\$
Rent	54 000
Marketing	22 000
Transport	4 000
Salaries	50 000
General overheads	6 000
	\$
Variable costs per unit:	
Ingredient and packaging	0.45
Labour	1.35
Price per ice cream	\$3.50

The capital cost of the new production unit will be \$250 000, with a maximum output of 100 000 ice creams per year. The Board of Directors want an annual return on their investment of 8% to match similar product lines in the business. The marketing manager believes that, at the current marketing budget, the demand in the first year is likely to be 90 000 units. The Board asks the production manager to identify methods of lowering the break-even point.

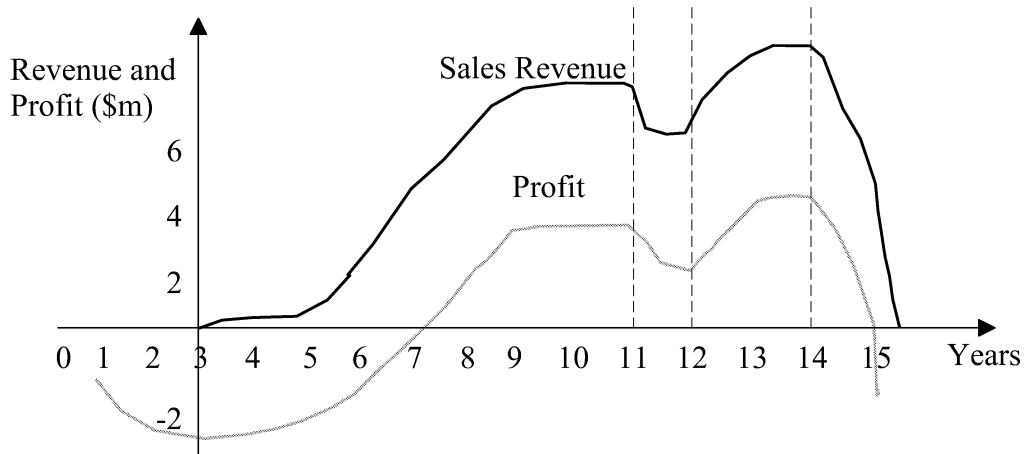
- (a) Construct a break-even graph for the Organic Foods ice cream range and identify the break-even point and margin of safety for the projected sales of 90 000 ice creams. Show your working for the graph. *[9 marks]*
- (b) Assess whether or not the target of 8% return on investment will be met at the 90 000 or 100 000 sales levels. *[4 marks]*
- (c) On behalf of the Production Manager, evaluate methods of reducing cost and maximising sales revenue and explain, with the use of diagrams, how these changes will impact on the break-even point (the use of specific figures in these diagrams is not required). *[7 marks]*

3. Tom Metzger started his business in 1988, which grew steadily from a team of twenty to over one hundred employees. Tom is proud of his close relationships with his staff, whom he treats like family. His door is always open. However, over the last few years he has spent an increasing amount of time out of the office in search of future business. Running a larger business has led to a more formal organisation. Tom appointed his son Philip Metzger, a recent graduate, to oversee the business in his absence. Philip set up clear department structures with department heads appointed from outside, who are now in charge of the day to day running of their individual teams. Philip rarely speaks directly to shop floor staff, but communicates through memos, the notice-board and information included with the monthly salary details.

The original staff resent the new department heads whom they believe know little about the business and its history. They are angry at being overlooked for promotion, feel excluded from management and are rarely consulted. They believe they have lost direct contact with customers, resulting in a less personal service. They continue to use informal communication rather than official department channels, as they dislike the new bureaucratic systems which slow decision-making. Only their loyalty to Tom Metzger and the relatively high wage keeps them in the business. John Carabello, who has become the unofficial leader of this group approaches Tom Metzger directly with their grievances. Tom Metzger is shocked at the level of their dissatisfaction and calls a meeting with John Carabello and Philip Metzger.

- (a) (i) Compare Tom Metzger and Philip Metzger's leadership styles and assess to what extent these have contributed to the change in organisation structure. *[6 marks]*
- (ii) Explain **three** factors which influence the style of leadership adopted by a manager. *[3 marks]*
- (b) (i) Using relevant motivational theory, discuss why Philip Metzger's approach has led to dissatisfaction among the original staff. *[6 marks]*
- (ii) Identify practical measures to reduce staff dissatisfaction and analyse whether these measures are likely to be successful if implemented. *[5 marks]*

4. You are a consultant hired to lead a course on marketing strategy for trainee managers from a large retail organisation. You are writing your notes to accompany the first seminar based on the product life cycle of a new perfumed facial tissue, 'Attyshoo'. The tissues contain special ingredients designed to improve breathing when the customer has a cold. The diagram below is used to illustrate the sales revenue and profit from the new product over its life cycle.



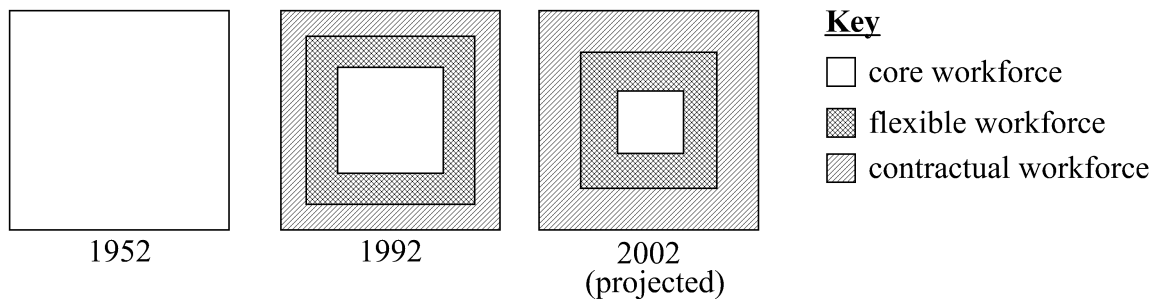
- (a) Explain the major activities that would happen before the launch of the product, and comment on their importance. *[5 marks]*
- (b) Analyse, using examples, how the marketing mix of this product might change from year 3 to year 11. *[8 marks]*
- (c) In year 12, sales and profits began to rise again after an annual fall. Describe strategies the company might have implemented to reverse the decline in sales. *[4 marks]*
- (d) Suggest **three** reasons why sales and profits fell so rapidly from year 14. *[3 marks]*

5. Kadett Products formed in 1952, operates successfully as a designer and manufacturer of kitchen units. In 1982, in the face of increasing competition it re-examined its core business and began to move more to the designing side; out-sourcing (contracting out) much of the assembly to specialist carpenters. At that time it developed the following Mission Statement, as a focus for future action:

*“Our people are our strength, our customers are our future,
our products are our reputation.”*

The business continued to expand on the designing side and Kadett moved into the business sector designing commercial kitchens. Numbers of full-time staff declined as more work was contracted out and casual and part-time staff were recruited to cope with seasonal demands. Kadett removed layers of management and ‘down-sized’ making over 500 staff redundant. Old organisation structures were replaced with project teams and employees were required to be increasingly flexible. By 1998, virtually no manufacturing took place ‘in-house’, although profits from selling units rose substantially. New management took over in 2000 and the focus changed to maximising shareholder value and profit. Plans were put forward to reduce the core further to just those professional staff, who had essential core skills. All other activities would be ‘out-sourced’ or completed by temporary staff.

Figure 1: Kadett’s personnel structure 1952 to 2002.



- (a) (i) What is a Mission Statement? [2 marks]
- (ii) Using Kadett’s Mission Statement analyse ways in which this can be put into practice in all of the firm’s activities. [6 marks]
- (b) Many firms are down-sizing and de-layering to create a smaller core staff. Identify reasons for this trend and assess the implications for staff. [6 marks]
- (c) As the objectives of the firm become more focused on shareholder value and profit, explain why Kadett Products may find it increasingly difficult to satisfy its Mission Statement. [6 marks]

6. Malmo Holdings, a multinational conglomerate, controls over sixty subsidiary companies world-wide. Its activities include mining, banking, leisure and publishing. Subsidiaries had worked under strict behaviour guidelines and controls imposed by Head Office, but over the years this bureaucratic structure restricted profitability. A new Chief Executive Officer, Linda Anderson, appointed to reorganise the firm and improve performance, empowered the subsidiaries by delegating executive decision-making to each regional managing director. With this delegation came the demand to raise profit levels, year on year, for a five year period. Bonuses and incentives were offered for exceptional growth.

After two years profits had improved 28% and shareholders were delighted. However, media stories began to appear about corruption and bribery in several regions. A Malmo Holdings subsidiary was accused of health and safety lapses, leading to an accident costing over 200 lives. One newspaper also linked another subsidiary with the forced ejection of an African tribe from an area where gold deposits had been found. Linda Anderson was horrified by these reports and, in a press statement, claimed that Malmo Holdings had the highest ethical standards, and pointed to their major contributions to charities and local communities. She accused rival media groups of a vendetta against the company.

- (a) Explain how empowering the subsidiaries and the setting of profit targets may have contributed to the problems highlighted in the media. *[4 marks]*
- (b) (i) Identify **three** examples of business activities that are legal, but may be considered unethical. *[3 marks]*
- (ii) What steps might be taken to ensure the effective implementation of an ethical policy? *[3 marks]*
- (iii) Explain how an ethical policy may provide a firm like Malmo Holdings with competitive advantages. *[5 marks]*
- (c) You are a public relations advisor for Malmo Holdings. Advise Linda Anderson on possible strategies to address the issues raised by the media and to minimise the damage to the firms' image. *[5 marks]*

7. In its 1997 five year strategic plan, Zoom, a transport company, set itself three major targets:

- to become a leading European transport operator
- to expand internationally
- to seek strategic alliances with other transport groups to facilitate its ambitious growth plans.

During 2001, the board of directors of Zoom met to review the firm's performance and to plan the following five years. The firm's development had indeed been spectacular in several European markets. It was already Europe's fourth largest transport operator and had developed a joint venture with three other European operators, helping its rapid expansion. In two countries its entry had been hindered by lack of knowledge of the market, laws and culture. The board of directors wanted to move into Asian and African markets, but were concerned that they would be faced with even greater problems than they had experienced in Europe.

- (a) Explain why Zoom is so keen to develop overseas. *[5 marks]*
- (b) Assess the advantages Zoom gains through the development of joint ventures as compared to other forms of growth. *[5 marks]*
- (c) (i) Analyse the problems that Zoom may encounter when entering foreign markets. *[5 marks]*
- (ii) Discuss exporting methods which may help overcome or minimise these problems. *[5 marks]*

8. Paolo Di Vito set up a coffee bar, 'E-Spresso' which offered customers computer access to the Internet. He funded the \$66 000 set up costs for new business from personal savings and money left to him by a relative. The launch was successful and after three months he expanded his business by selling coffee and sandwiches from two converted vans. He bought the vans using a \$48 000 bank loan. Paolo Di Vito now feels that he would like to open another 'Internet cafe' in a town close by. He does not have the capital for this venture so has drawn up a business plan to support an application for a further bank loan of \$70 000. \$12 000 will be used to purchase more coffee making equipment, \$10 000 to buy fixtures and fittings, \$7 000 to buy three computers and \$24 000 for another van. The remainder would be used to purchase stock and as working capital to pay wages and general expenses. In the future Paolo Di Vito is thinking of franchising his idea.

E-Spresso Balance Sheet as at 31st December 2001:

<i>Fixed assets</i>	\$	\$
Fixtures and fittings	14 000	
Coffee equipment	15 000	
Vans	48 000	
Computer equipment	<u>12 000</u>	
		89 000
<i>Current assets</i>		
Stock		18 000
Cash		<u>11 000</u>
		29 000
<i>Current liabilities</i>		
Trade creditors	4 000	
Working capital		<u>25 000</u>
<i>Net assets employed</i>		114 000
Represented by:		
Initial capital	66 000	
Bank loans	<u>48 000</u>	
<i>Total capital employed</i>		<u>114 000</u>

- (a) Identify the major elements of a business plan and explain why this document is useful to the bank to support its lending decisions. [5 marks]
- (b) Assume Paolo Di Vito is successful in obtaining a loan and uses this as planned. If his stock increases 40%, with trade creditors and initial capital remaining unchanged, draw up a balance sheet for the year ending 31 December 2002. [5 marks]
- (c) (i) Calculate the gearing ratio, before and after the loan. [2 marks]
- (ii) Explain **two** potential consequences of the change in gearing. [2 marks]
- (d) Advise Paolo Di Vito on whether he should franchise his idea. [6 marks]