



IB DIPLOMA PROGRAMME  
PROGRAMME DU DIPLÔME DU BI  
PROGRAMA DEL DIPLOMA DEL BI

# **Business and management Higher level and standard level**

**Specimen paper 1s and paper 2s**

**For first examinations in 2009**

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**BUSINESS AND MANAGEMENT  
CASE STUDY: SUNGEN LTD**

For use with specimen examination papers

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**INSTRUCTIONS TO CANDIDATES**

- Case study booklet required for Higher Level Paper 1 and Standard Level Paper 1 Business and Management examinations.

## SUNGEN LTD

The case study is based on two companies, *Electrical Solutions plc* and its subsidiary, *SunGen Ltd*.

### Company profile

In 1985, Derek Gorman opened *Electrical Solutions*, a small retail outlet selling electrical equipment. As an ambitious entrepreneur Derek set himself the target to be a millionaire before he reached the age of 35. He was constantly looking for new business and market opportunities.

5 There was an increasing international trend for electrical equipment, such as washing machines and televisions, to be sold in large out-of-town retail outlets to take advantage of economies of scale. Derek's market research highlighted that there were no such retail outlets in the suburbs of several large Australian cities. To take advantage of this business opportunity he developed a business plan and obtained a \$1.5 million bank loan (some of which was secured against his house) to open  
10 out-of-town electrical retailing outlets in the suburbs of Melbourne. Sales revenue far exceeded expectations and in 1992 he achieved his ambition and earned his first million dollars in salary and bonuses.

To develop the business further Derek converted *Electrical Solutions* into a private limited company and by 1995 it had opened 10 further stores in Melbourne, Canberra and Adelaide and had a  
15 turnover of over \$22 million. However, by 2000 turnover at *Electrical Solutions plc* slumped as large global conglomerates moved into Australia to take advantage of good trading conditions. These conglomerates were able to use their market and buying power to drive down prices making the market increasingly price competitive. *Electrical Solutions plc* was finding it increasingly difficult to match these price cuts.

20 Derek felt that being a private limited company was restricting further growth of the business. In 2001 the board of directors decided to float 65% of the shares of *Electrical Solutions plc* on the Australian Stock Exchange. Derek and his family kept 30% of the shares and the remaining 5% was reserved for employees under an employee share ownership scheme. Derek became the chief executive officer of *Electrical Solutions plc*, a role he had fulfilled for the limited company  
25 since its start-up. In 2000, Derek's daughter Catherine joined the firm as director with responsibility for purchasing. Catherine had been to university in Sydney and then spent four years working for a large Japanese car company where she pioneered environmentally sensitive manufacturing techniques.

30 At a board meeting in 2003, the directors agreed that for the company to grow further, it needed to diversify into other areas. With the existing intense competition in the electrical equipment retail market, *Electrical Solutions plc* looked for alternative expansion opportunities. It commissioned the consultancy firm, *Martrend*, to conduct market research on its behalf and to investigate potential new markets. *Martrend* identified that consumers were increasingly concerned about both global warming and rising energy prices and were looking for new solutions to meet their  
35 energy requirements. This offered a significant market opportunity for companies manufacturing solar power equipment and so *Electrical Solutions plc* considered entering this market. Some of the board of directors had reservations about this change of direction, but Catherine's passionate belief in sustainable energy persuaded the majority of the board to support the idea.

40 With solar power technology still developing, this represented a very new and risky market, but the report from *Martrend* provided convincing evidence that the market was set to grow rapidly and that there was an opportunity to gain first mover advantage.

45 In February 2003, *Electrical Solutions plc* set up *SunGen Ltd* as a wholly owned subsidiary of *Electrical Solutions plc*. Start-up capital was partly provided through a \$1 million bank loan. Further capital was contributed by the parent company, using funds released from the sale of the worst performing out of town retail outlets.

50 Derek's daughter Catherine was appointed the managing director of *SunGen Ltd*, which is based in Melbourne along with *Electrical Solutions plc*. It manufactures and sells solar power equipment to generate electricity for households and small firms. Customers can use this equipment to generate power for their own needs and they can sell any surplus electricity to the national electricity provider for use by other customers.

### **Production**

The production director of *SunGen Ltd* is Tony McGregor, an old friend of Derek's. Tony worked for many years as a manager for one of the large electricity companies. Derek persuaded him to move with an offer of a generous financial package including shares and bonuses. Some staff resented this appointment.

55 *SunGen Ltd* manufactures the solar power equipment to customer specification. The equipment is assembled from components that *SunGen Ltd* buy from a range of suppliers, as soon as an order is received from a customer. Consequently, *SunGen Ltd* holds minimal levels of stock. However, some suppliers have proved unreliable and long delivery times have resulted in some delays in delivery of the equipment to customers, causing dissatisfaction.

60 Significant recent growth means that the assembly area is currently running at an average 98% capacity. Significant overtime is often required to meet demand and some of the production staff are expressing their concerns about the unpredictable nature of the hours they are expected to work.

65 *SunGen Ltd* is also having problems with the quality of the components from one or two suppliers and in the worst case this resulted in an entire system being replaced for a customer. Tony has suggested to the board that *SunGen Ltd* changes suppliers, but many of the components are highly specialized and the only alternative suppliers are located in Asia. The board has asked Tony to look at the possibility of building closer relationships with local suppliers.

70 These supplier problems have led Tony to look at quality issues across all their operations. Catherine is a strong advocate of Total Quality Management and is promoting the use of quality circles and continuous improvement. By contrast Tony, who has quite a traditional management style, feels that quality control issues are the responsibility of management. He wants the employment of additional managers, with specific responsibility for quality.

75 Tony and Catherine are considering the possibility of buying a computer-controlled production management system. Currently, all production information is duplicated in several systems, which makes coordination difficult, leading to delays in production. Catherine argues that a computer-controlled system would enable them to manage production more efficiently. She believes this will reduce unit cost(s). Tony is not convinced and argues that the costs of the system will outweigh its benefits.

### Marketing

80 The market for solar power equipment is a niche market. The market is small, but is growing at approximately 20% per year and *SunGen Ltd* estimate they have around 65% of the market. There is currently only one other major firm, though their products differ from those of *SunGen Ltd* in several important respects. *SunGen Ltd's* marketing director is Ying Chau and she was appointed in 2004. Their current product portfolio is given in **Appendix 1** with details of  
85 the products.

The initial marketing strategy targeted mainly business customers. The key market segment is firms who construct houses. *SunGen Ltd* target these customers by exhibiting at trade shows and through personal selling.

90 *SunGen Ltd* want to persuade the government to accelerate the growth of the solar power equipment market. The company has commissioned a public relations firm to influence the government to implement two main changes:

- modifications to planning regulations to require house builders to fit systems that use renewable and sustainable energy systems in new houses
- subsidies to households who decide to fit renewable energy systems in existing houses.

95 In June 2005, the board of directors agreed to an expansion plan proposed jointly by Ying and Catherine to target their products at individual households. This move was partly based on the results of the market research conducted by *Martrend* in 2003. The results found that 45% of those questioned would consider fitting some sort of renewable energy generation system. Ying was a little unsure about the value of these results and argued that they should be  
100 interpreted carefully and further market research commissioned. Catherine felt there was sufficient evidence from the research of a viable market and has asked Ying to design an appropriate marketing strategy. As part of the strategy, *SunGen Ltd's* product mix was analysed using a product portfolio matrix (see **Appendix 2**). As the market is geographically dispersed, *SunGen Ltd* will require suitable distribution channels for their products, which need to be  
105 professionally installed.

### Human resource management

In 2004, Greg Robinson was transferred to *SunGen Ltd* from *Electrical Solutions plc* to manage the human resource department. His first priority was to recruit production staff. To speed up the process, he recruited a significant proportion of the staff internally from *Electrical Solutions plc*.

110 In 2005, Greg and Catherine decided to review the organizational structure. Greg agrees with Catherine that the company needs a flatter structure with fewer levels of hierarchy. Their aim is to ensure that the company is as flexible and responsive as possible, and able to cope with the

rapid levels of growth they anticipate. Tony is concerned that as a result of the flatter structure there will be problems with lines of communication and management control. He points out that important decisions may not reach all staff resulting in delays in production. Tony is supported by a number of the internally recruited staff, who argue that there is no clear leadership or vision. They feel that too often they are left to make decisions. Although they enjoy the extra responsibility they are unclear how their decisions fit with the company's strategic direction.

Along with the review, Greg and Catherine are considering changes to workers' contracts to make them more flexible. Production workers will be offered a certain number of hours each week according to the level of demand. A proportion of the workers will be placed on temporary contracts. The workforce is represented by a single trade union. It is threatening strike action if the proposed changes are adopted. Trade union representatives have met with Greg to try to resolve these issues.

Greg and Catherine believe that staff should be given incentives. They are proposing an additional training programme and appraisal system. Production staff will be required to attend a one-week residential training course, which is being organized for *SunGen Ltd* by an external training organization. At the end of the training programme the staff will negotiate performance targets with their line managers for the coming year. Then, at the end of the year, an appraisal system will be introduced to review these targets. High-performing staff will receive significant bonuses and other incentives.

### **Finance**

The finance department of *SunGen Ltd* consists of two staff plus the finance director, Alex Roderey. It is responsible for the preparation of monthly management accounts for the board of directors and the year-end accounts. Payroll, customer invoicing and other day-to-day operations are centralized in the finance department of *Electrical Solutions plc*. They make an annual charge to *SunGen Ltd* for providing these financial services.

Alex is concerned about the financial situation of *SunGen Ltd*. Although the growth in sales is promising, the company is still making significant losses and remains very short of working capital. *Electrical Solutions plc* is currently funding *SunGen Ltd* from their cash reserves, but these reserves are running down. *SunGen Ltd's* forecasts suggest they will become profitable in 2007, but they will need a further cash injection in the near future if they are to avoid problems with meeting their obligations to staff and suppliers. The financial situation is the main item on the agenda of the next meeting of the board of directors and Derek and two other representatives from the board of *Electrical Solutions plc* have been invited to attend this meeting. Alex will also raise the issue of longer-term funding at this meeting as he agrees with Catherine and Tony that they need to expand capacity by building a new production facility within the next 18 months to avoid a significant production backlog.

Key financial figures are given in **Appendix 3**.

### **Future prospects**

*SunGen Ltd* has made a positive start with strong sales growth and a good response to the product range from customers. Catherine is keen to make further use of their environmental profile and is currently developing a mission statement for the firm and a Corporate Social Responsibility report. This will consider issues relating to their products, staff, the environment, stakeholders and their accountability. The finance director, Alex, has raised concerns about the Australian housing market. Solar power equipment for new houses is a significant proportion of their business and therefore he is worried about reports from some commentators that house prices are set to fall. There is also uncertainty about the state of the economy in general. However, Catherine has dismissed these concerns as she feels that demand for their systems is based more on people's attitudes and environmental issues than on income levels. Forecasts for major Australian macro-economic indicators (as at November 2006) are given in **Appendix 4**. *SunGen Ltd* is also considering expansion options. *JBR*, an Indonesian construction company operating in partnership with the Indonesian Government, approached *SunGen Ltd* in June 2007 to participate in an environmental project building low cost housing in the capital, Jakarta. The building designs include solar panels to reduce energy costs and to meet Indonesian government environmental targets. Derek and Catherine are currently discussing the merits of this proposal.



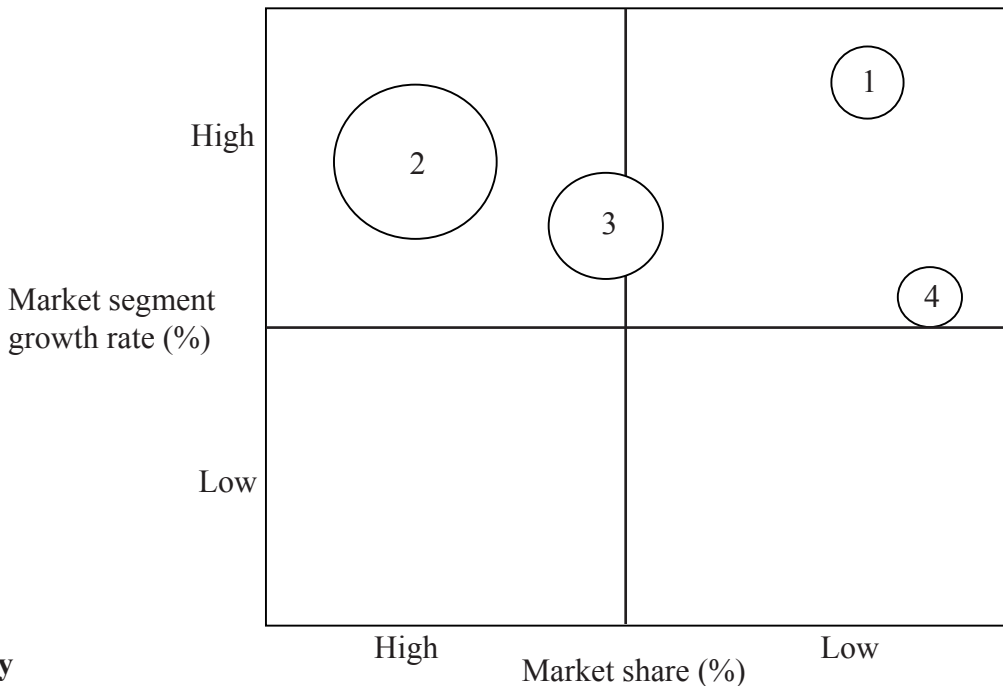
**Appendix 1**

**Current SunGen Ltd product portfolio**

<b>Product</b>	<b>Description</b>	<b>Target market</b>
Solar roof tiles	These roof tiles are designed to replace existing roof tiles and generate a significant proportion of the power required to run a house. Replacing a whole roof can be expensive, though a proportion of the roof could be replaced.	Builders of new and existing houses
Free standing solar panels	These free standing panels are available in a range of sizes, cheap to buy and fit and can be fitted anywhere, for example, on a roof or in a garden. They offer a good introductory product for customers wanting to generate a small amount of their own power.	Individual households
Solar glass	This is a premium product fitted instead of conventional glass that generates power for the building.	Business users and builders of new buildings
Metal solar roofs	These metal roofs are expensive and can only be fitted to new houses. Once fitted they will generate the majority of the power required for the house.	House builders

**Appendix 2**

**SunGen Ltd's product portfolio matrix**



**Key**

- 1 Solar roof tiles
- 2 Free standing solar panels
- 3 Solar glass
- 4 Metal solar roofs

*The size of the circle indicates the relative turnover of each product.*

### Appendix 3

#### Key financial information – *Electrical Solutions plc* and *SunGen Ltd*

<b>Key ratios</b>					
	<b>Year ended 31 March 2004</b>	<b>Year ended 31 March 2005</b>		<b>Year ended 31 March 2006</b>	
	<i>Electrical Solutions plc</i>	<i>Electrical Solutions plc</i>	<i>SunGen Ltd</i>	<i>Electrical Solutions plc</i>	<i>SunGen Ltd</i>
<b>Profitability</b>					
Gross profit margin (%)	28	24	– 6	22	– 8
Net profit margin (%)	9	8	– 12	8	– 14
ROCE (%)	23	22	– 6.3	20	– 16
<b>Liquidity</b>					
Current ratio	2.3	1.8	1.2	1.6	1.1
Acid test ratio	1.2	0.9	0.8	0.7	0.6
<b>Efficiency</b>					
Stock turnover (number of days)	91	102	33	105	28
Debtor days	15	14	46	14	49
Creditor days	34	35	41	38	39

<b>Key balance sheet and profit and loss figures Australian \$ 000</b>					
	<b>Year ended 31 March 2004</b>	<b>Year ended 31 March 2005</b>		<b>Year ended 31 March 2006</b>	
	<i>Electrical Solutions plc</i>	<i>Electrical Solutions plc</i>	<i>SunGen Ltd</i>	<i>Electrical Solutions plc</i>	<i>SunGen Ltd</i>
Turnover	17 500	18 200	700	19 400	1 800
Capital employed	6 850	6 590	1 320	7 750	1 570
Fixed assets	3 790	4 220	950	5 050	1 275
Loan capital	2 400	3 200	1 000	3 450	1 250
Working capital	3 060	2 370	370	2 700	295
Net profit before interest and tax	1 575	1 450	– 84	1 550	– 252

**Appendix 4****Australian economy – macro-economic forecasts (as at November 2006)**

<b>Indicator</b>	<b>2007</b>	<b>2008</b>	<b>2009</b>
Inflation (%)	2.2	2.9	3.4
Economic growth (% change in GDP)	3.7	2.4	0.9

*Companies, products, or individuals named in this examination question/case study are fictitious and any similarities with actual entities are purely coincidental.*

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**BUSINESS AND MANAGEMENT  
HIGHER LEVEL  
PAPER 1**

SPECIMEN PAPER

2 hours 15 minutes

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**INSTRUCTIONS TO CANDIDATES**

- Do not open this examination paper until instructed to do so.
- Read the case study carefully.
- Section A: answer two questions.
- Section B: answer the compulsory question.
- Section C: answer the compulsory question.

**SECTION A**

Answer **two** questions from this section.

1. (a) Describe **one** advantage and **one** disadvantage of *SunGen Ltd* recruiting a significant proportion of their staff internally from *Electrical Solutions plc* (line 108). [4 marks]
- (b) Explain the effect on motivation of offering high performing staff significant financial bonuses (lines 129-130). [4 marks]
- (c) Analyse the costs **and** benefits of changing the organizational structure of *SunGen Ltd* to a flatter structure (line 110). [7 marks]
2. (a) (i) Define the term *unique selling point*. [2 marks]
- (ii) Describe the unique selling point for *SunGen Ltd*. [2 marks]
- (b) Explain **one** external opportunity and **one** external threat that *SunGen Ltd* is facing as a result of their expansion plan. [4 marks]
- (c) House builders are the current target market of *SunGen Ltd*. *SunGen Ltd* is considering targeting individual households.
- Examine the marketing mix that would be appropriate for each of these target markets. [7 marks]
3. (a) (i) Define the term *working capital*. [2 marks]
- (ii) Identify **two** possible sources of finance for an increase in working capital. [2 marks]
- (b) As a result of problems with suppliers, *SunGen Ltd* has decided to keep larger levels of stock. Comment on the effects that this decision will have on *SunGen Ltd's* liquidity ratios. [4 marks]
- (c) Examine whether *SunGen Ltd* should implement a Total Quality Management approach as proposed by Catherine. [7 marks]

**SECTION B**

Answer *the compulsory question from this section.*

4. Alex Roderey has prepared the provisional accounts for the financial year ending 31 March 2007 and has submitted a ratio analysis to the board of directors. The key ratios from this analysis are shown in Item 1 in the Additional information (*page 5 of this examination paper*).

The board of directors has decided to expand capacity by building a new production plant.

- (a) (i) Define the term *liquidity*. *[2 marks]*
- (ii) Identify **two** appropriate sources of finance for the new production plant. *[2 marks]*
- (b) (i) Explain the difference between the net profit margin and the gross profit margin. *[2 marks]*
- (ii) Explain how the levels of profit **and** cash flow on the free standing solar panels are likely to change through the different stages of the product life cycle. *[6 marks]*
- (c) Discuss the changes in the profit **and** liquidity ratios between 2006 and 2007. *[8 marks]*

## SECTION C

Answer **the compulsory** question from this section.

5. *JBR*, an Indonesian construction company (*line 159 of case study*) proposed a joint venture with *SunGen Ltd*. Solar panels would be mass produced in Indonesia under licence from *SunGen Ltd*, using their managerial staff and expertise. Surplus panels would be exported to Australia to supply increasing market demand and to reduce capacity problems in the Australian factory. This would cut *SunGen Ltd's* unit costs, but lead to redundancies in their Australian factories. Parts would be imported from Australia, with the aim to find suitable local Indonesian suppliers within one year.

Catherine decided to commission further market and economic research from *Martrend* (*key results are shown in Items 3 to 7*). On the basis of this research, she believes the project offers an opportunity to develop *SunGen Ltd's* environmental profile, to support growth in the Asia Pacific region and to strengthen *SunGen Ltd's* position in the face of new market competition.

Derek, however, has raised the following concerns about the proposed joint venture:

- the terms and conditions of employment in the Jakarta factories
- the stability of the Indonesian currency and future economic trends
- the different corporate cultures and leadership styles of the two businesses
- opposition to the joint venture by Australian trade unions
- communication and distribution compatibility
- raising finance for the expansion.

Derek and Catherine convene a board meeting to consider the joint venture proposal.

- (a) Identify **two** driving and **two** restraining forces for the proposed joint venture with *JBR*. *[4 marks]*
- (b) Explain the purpose of *SunGen Ltd* having a mission statement and corporate objectives (*Item 8*). *[8 marks]*
- (c) Using Items 2 to 8, analyse **two** issues that will influence *SunGen Ltd's* decision to expand in Indonesia. *[8 marks]*
- (d) Using data from the case study and the additional information provided in Items 1 to 8, discuss *SunGen Ltd's* strategic options for the coming three years. *[10 marks]*

**Additional information**

**Item 1: Financial information – SunGen Ltd**

**Year ended 31 March 2007 – SunGen Ltd**

<b>Profitability</b>	
Gross profit margin (%)	-5
Net profit margin (%)	-25
ROCE (%)	-7
<b>Liquidity</b>	
Current ratio	1.0
Acid test ratio	0.4

**Item 2: SunGen Ltd’s product portfolio June 2007 (please refer to the case study Appendix 1)**

<b>Item 3: Economic data as at June 2007*</b>						
Indicator	Australia			Indonesia		
	2007	2008	2009	2007	2008	2009
Inflation (%)	2.2	2.9	3.4	16.4	17.5	15.8
Economic growth (% change in GDP)	3.7	2.4	0.9	5.9	6.3	6.6
Interest rates (%)	4.75	5	5.25	12.25	12	12

<b>Item 4: Population</b>	
Indonesia	250 million
Australia	20 million

<b>Item 5: Exchange rate Australian Dollar: Indonesian Rupiah*</b>			
2007	1	:	6900
2008	1	:	7300
2009	1	:	7500



<b>Item 6: Housing Data*</b>						
Indicator	Australia			Indonesia		
	2007	2008	2009	2007	2008	2009
House price index (1995 = 100)	250	220	200	450	480	540
New house starts/builds (change over previous year)	- 4 %	- 8 %	+ 2.5 %	+ 8 %	+ 12 %	+ 22 %

<b>Item 7: Environmental survey 2007 – Australia</b>	
	<b>Changes from 2004 to 2007</b>
Those who would consider fitting solar panels	+ 2.8%
Those concerned about the environment	- 12.3%
Those concerned about oil prices	+ 28%
	<b>Change 2006 to 2007</b>
Awareness of <i>SunGen Ltd</i> brand name	+ 42%
Those who believe <i>SunGen Ltd</i> is a socially responsible company	- 22%

<b>Item 8: SunGen Ltd’s mission statement and key corporate objectives</b>
<p><b>Mission:</b></p> <p style="text-align: center;"><i>“To reduce the world’s dependence on fossil fuels by developing sustainable energy sources.”</i></p> <p><b>Corporate Objectives:</b></p> <ul style="list-style-type: none"> <li>➤ To expand our business in the Asia Pacific region</li> <li>➤ To raise the awareness of our stakeholders of the issue of sustainability</li> <li>➤ To maximise shareholder value and customer satisfaction</li> <li>➤ To operate our business in a manner which helps develop sustainable communities wherever we operate</li> </ul>

\* Figures for 2007 are actual. All figures for 2008 and 2009 are forecasts

# **MARKSCHEME**

## **SPECIMEN PAPER**

### **BUSINESS & MANAGEMENT**

#### **Higher Level**

#### **Paper 1**

**SECTION A**

1. (a) Describe *one* advantage and *one* disadvantage of *SunGen Ltd* recruiting a significant proportion of their staff internally from *Electrical Solutions plc* (Line 108).

[4 marks]

Initially a significant proportion of the staff for *SunGen Ltd* were recruited internally from *Electrical Solutions plc*. This may result in various advantages and disadvantages:

**Advantages**

- appropriate staff can be selected and their skills, abilities and experience will be well known. This is a good way to ensure an appropriate balance of skills and experience for the *SunGen Ltd* start-up
- the process of recruitment is likely to be faster and more efficient by recruiting staff internally
- *any other appropriate advantage.*

**Disadvantages**

- the internally recruited staff may form an informal group with differing aims and objectives from other groups. This may result in the potential for conflict within *SunGen Ltd* staff
- recruiting a large proportion of staff internally may result in missing out on external expertise that could potentially have been more specialist and appropriate for a startup in a different area of business
- the recruitment of a large proportion of staff internally may be a demotivating factor for other *SunGen Ltd* staff
- *any other appropriate disadvantage.*

Award [2 marks] for an appropriate description of an advantage and [2 marks] for an appropriate description of a disadvantage. Maximum of [4 marks].

- (b) Explain the effect on motivation of offering high performing staff significant financial bonuses (*lines 129-130*).**

***[4 marks]***

The impact of the financial bonuses on motivation will depend on the importance of financial reward to employees and this may vary from one member of staff to another. Some will regard recognition and responsibility (non-financial factors) as more important and in these cases, the impact on motivation of the bonuses is likely to be lower. However, we can reasonably expect that the bonuses will have the following effects on motivation:

- financial bonuses are likely to boost motivation. Financial bonuses for good performance are likely to be considered as a form of recognition for a “job well-done” and this may help boost esteem needs (as identified in Maslow’s hierarchy of needs)
- the bonuses may also, on the basis that they act as a form of recognition, act as a “motivator” as identified by Herzberg
- in terms of equity theories of motivation, the high-performing staff will feel that their contribution has been recognised and perhaps therefore feel that their remuneration package is fair.

Overall, motivation can be expected to increase – it is the extent of the increase that cannot be certain. Arguably, high-performing staff will be the most motivated already and therefore the impact on motivation might be less than expected.

*N.B.* Candidates need not refer to the work of specific theorists in their answers, but can be credited appropriately if they choose to.

***[4 marks]***

The impact of the bonuses on motivation is fully and clearly explained.

***[2 to 3 marks]***

The impact of the bonuses on motivation is explained, but the explanation may be lacking in detail.

***[1 mark]***

A limited answer that may simply identify the impact of the bonuses on motivation.

- (c) Analyse the costs *and* benefits of changing the organizational structure of *SunGen Ltd* to a flatter structure (line 110).

[7 marks]

Flatter organizations will have various advantages:

- faster vertical communication flows – this may help *SunGen Ltd* to improve efficiency and enable faster decision-making with clearer implementation of strategy. Workers have been concerned at a lack of leadership and vision and this may help communication of the strategic direction better.
- employees may feel more empowered if they are more involved with decision-making in a flatter structure. This may result in a boost in motivation and again help create a clearer sense of vision for the company.
- flatter structures may help reduce costs with fewer staff in middle management positions. Given the recent growth in costs this may help make *SunGen Ltd* profitable quicker.
- flatter structures may, if employees are given more responsibility and feel empowered, lead to a more innovative and creative workforce, which is vital in a fast-moving industry like the one *SunGen Ltd* is operating in.
- flatter structures may be more efficient particularly when firms are small (as *SunGen Ltd* is) and when the staff are highly involved with the product, which is likely to be true for *SunGen Ltd*. This may help increase productivity and therefore enable a faster route to productivity and more efficient use of the existing resources.

However, there are likely to be disadvantages:

- staff may lack direction – this appears to be a problem already at *SunGen Ltd* and given that a flatter structure might increase the span of control, this might worsen the situation.
- communication might fail or be distorted. Where there is a larger span of control and a flatter structure, there may be faster vertical flows of information, but there may be horizontal communication problems with information not adequately reaching all members of staff at a given level.
- decisions that are made may not reach all staff on time and this may result in delays in production. Given that these are already occurring at *SunGen Ltd* and that problems have led to delays in production, this may worsen the situation. Appropriate communication strategies will be required to ensure that this is not an issue.
- decisions might take longer if consensus is sought and more staff are involved in decision-making. As *SunGen Ltd* work in a fast-moving, rapid development industry, this may hold back their growth.
- staff may be demotivated by a lack of promotion opportunities because of the flatter structure. The extent of this demotivation will depend on the extent to which the flatter structure helps boost involvement and empowerment and compensates for this.
- the greater span of control may make it more difficult for managers to “control” staff at their level and put them under increased time pressure and stress.

Candidates should analyse these costs and benefits and comment on the extent to which they are likely to occur in the context of *SunGen Ltd*.

***[6 to 7 marks]***

Balanced and detailed analysis of the costs and benefits of a flatter structure. The analysis is related to the case and business terminology is used appropriately where relevant.

***[3 to 5 marks]***

Identification and explanation of the costs and benefits of a flatter structure. At the top end of the band this is generally related to the case and considers both costs and benefits. At the lower end of the band the explanation may lack balance and may not be related to the case.

***[1 to 2 marks]***

A limited and generalised answer that may simply identify costs and benefits with no development or analysis.

2. (a) (i) **Define the term *unique selling point*.** **[2 marks]**

The unique selling point (or unique selling proposition) is the principal characteristic of a good or service that separates it from its competitors. According to this concept, successful advertising campaigns are based on emphasising a product's unique selling proposition. It is the thing that will make customer's choose the product over other similar ones in the market.

**[2 marks]**

A clear and appropriate definition of unique selling point.

**[1 mark]**

Some appropriate elements of a definition of unique selling point, but the definition may be lacking in detail or clarity.

- (ii) **Describe the unique selling point for *SunGen Ltd*.** **[2 marks]**

The unique selling point (USP) for *SunGen Ltd* is the environmentally friendly nature of their product. The ability to generate free electricity from the product and thereby avoid the environmental impact of other forms of energy.

*Credit candidates if they describe another different, but nevertheless appropriate USP.*

**[2 marks]**

Identification and clear description, of an appropriate USP for *SunGen Ltd*.

**[1 mark]**

Identification of an appropriate USP, perhaps with some description but lacking clarity.

- (b) Explain *one* external opportunity and *one* external threat that *SunGen Ltd* is facing as a result of their expansion plan.

[4 marks]

The *SunGen Ltd* expansion plan is to target their products “at individual households”. Their current target market is mainly house builders who use the product on new properties or houses being restored professionally. The intention of the expansion plan is to start to broaden the target market to individual households. This may result in a number of external opportunities and threats:

### Opportunities

- Governments are under pressure to meet tighter environmental targets from international treaty obligations (*e.g.* Kyoto treaty) and this may result in incentives being offered to households to purchase products of this nature. If *SunGen Ltd* has in place appropriate distribution strategies for their products to individual households, then they will be able to take advantage of this. *SunGen Ltd* are also, through a PR firm, trying to put pressure on the government to introduce these kind of regulations and also tighten environmental regulations. Their expansion plan will put them in a better position to take advantage of this potential new market.
- The market for solar power products is growing at around 20% per year and their expansion plan will put them in a better position to take advantage of this market growth.
- There are currently few competitors and there are important differences in their products. *SunGen Ltd's* expansion plan will put them in a better position to gain first-mover advantage in this new market segment.
- Environmental awareness is increasing among individual consumers and the expansion plan will help *SunGen Ltd* take advantage of this as it will enable them to build appropriate distribution channels to meet this potential demand.
- *Any other appropriate external opportunity.*



**Threats**

- A reduction in economic growth is forecast, and though this is not a recession, *SunGen Ltd's* products are arguably income elastic in nature and so the lower level of economic growth may lead to a fall in expenditure on solar power products.
- The market is still risky. Although *SunGen Ltd* would have first-mover advantage, it is still a niche market in nature and the results of the market research could be argued to be a little ambiguous. This may represent a threat to their abilities to expand into this new market.
- The market is geographically dispersed in nature and this may represent a challenge to the setting up of appropriate distribution channels.
- The rapid growth forecast in the market may attract new firms into the market and this will be a potential threat to *SunGen Ltd's* position in this market.
- Some increase in inflation is forecast and this may lead to uncertainty among consumers. This combined with the drop in economic growth could potentially reduce the growth forecast in the market.
- *Any other appropriate external threat.*

Award **[1 mark]** for identifying an appropriate external opportunity plus an additional **[1 mark]** for an adequate explanation. Maximum of **[2 marks]** for an external opportunity. Award **[1 mark]** for identifying an appropriate external threat plus an additional **[1 mark]** for an adequate explanation. Maximum of **[2 marks]** for an external threat.

- (c) **House builders are the current target market of *SunGen Ltd*. *SunGen Ltd* is considering targeting individual households.**

**Examine the marketing mix that would be appropriate for each of these target markets.**

*[7 marks]*

The market for individual households is being targeted by *SunGen Ltd* as part of their expansion plan. The marketing mix that is appropriate to this market is likely to be different in nature to that currently required for the target market of house builders.

#### **House builders – marketing mix**

**Price** – price will be important to house builders as it will represent an important element of their costs and they will want to minimise these. *SunGen Ltd* may use cost-based pricing or a similar pricing strategy to ensure they are competitive and encourage the maximum possible level of demand.

**Product** – house builders will be a very “technically-aware” market and so *SunGen Ltd* will emphasise the nature of the product in their marketing mix. They will want to stress the various different versions of the product available and ensure that they fit in with the various different requirements of the house builder market.

**Promotion** – the promotional strategy used for house builders will be quite specific and is likely to focus mainly on the use of below the line promotional strategies. The use of targeted e-mail, newsletters, personal selling and trade shows is likely to be most appropriate as their market is quite closely defined and easier to target using these approaches.

**Place** – distribution of the product to house builders is likely to be quite straightforward. House builders are likely to order several/multiple products at any given time and the distribution channel is direct from manufacturer to final consumer (house builders).

#### **Individual households – marketing mix**

**Price** – because they are cheap to fit, the solar panels should also have a low initial price. A penetration pricing strategy could be used to convince people to buy them and given the “luxury” nature of the product, it can be argued that the product will be price elastic in nature. A penetration pricing strategy will help in this situation. Given that *SunGen Ltd* are effectively competing with electricity companies, they will need to take electricity pricing into account. As energy prices increase, it may be that they can move more towards a skimming pricing strategy.

**Product** – the nature of the product will need to be stressed to ensure consumers are aware of the nature of the product. The ability of the product to generate electricity that can be fed back into the electricity grid may need to be stressed along with the characteristics of the product.

**Promotion** – the promotional strategy used for individual households is likely to be more focused on above the line promotion. The market for individual households is a geographically dispersed one and to reach them may require above the line promotion strategies. These may include newspaper and magazine advertising, internet advertising on appropriate lifestyle and other web sites and perhaps radio and other media advertising. TV advertising is very unlikely for a firm the size of *SunGen Ltd.* Point of sales promotion may also be used in places where the panels are being made available.

**Place** – the market for solar panels is very geographically dispersed and this will require appropriate national distribution channels. This may mean franchising a dealer network or perhaps negotiating a deal with national DIY chains or hardware stores. It may also be possible to use a B2C distribution method through the Internet.

*Candidates may refer to other “P’s” in their answer and should be credited appropriately for this.*

***[6 to 7 marks]***

A detailed and balanced examination of the marketing mix for both target markets considering at least four P’s. Business terminology is used appropriately where relevant.

***[3 to 5 marks]***

Some examination of the marketing mix for both target markets, considering at least two of the four P’s in some detail or at least three P’s in less depth. Candidates should be awarded a maximum of ***[3 marks]*** for an examination of the marketing mix of just one of the two target markets.

***[1 to 2 marks]***

A limited and essentially descriptive answer that may simply list points related to the marketing mix of each target market.

3. (a) (i) **Define the term *working capital*.** **[2 marks]**

Working capital is the amount of money that a business has to fund its day-to-day operations. It is a measure of liquidity and can be calculated by deducting current liabilities from current assets. It is the portion of capitalization invested in current assets.

**[2 marks]**

A clear and appropriate definition of working capital.

**[1 mark]**

Some appropriate elements of a definition of working capital, but the definition may be lacking in detail or clarity.

(ii) **Identify *two* possible sources of finance for an increase in working capital.** **[2 marks]**

The sources of finance could include short-term sources of finance such as:

- bank overdraft
- debt factoring
- trade credit
- selling stock.

Award **[1 mark]** for each source identified up to a maximum of **[2 marks]**.

- (b) **As a result of problems with suppliers, *SunGen Ltd* has decided to keep larger levels of stock. Comment on the effects that this decision will have on *SunGen Ltd*'s liquidity ratios.**

***[4 marks]***

The two main liquidity ratios are the current ratio and the acid test ratio. The acid test ratio deducts stock from current assets to allow for the fact that stock is the least liquid of the current assets. The latest figures given in Appendix 3 indicate that *SunGen Ltd* has a current ratio of 1.1 and an acid test ratio of 0.6. The value of the acid test ratio indicates possible liquidity problems already. If *SunGen Ltd* choose to keep higher levels of stock because of their problems with suppliers then this is likely (*ceteris paribus*) to lead to an increase in the current ratio as their current assets grow. However, the higher levels of stock will have no impact on the acid test ratio as this excludes stock to give a better measure of liquidity.

***[3 to 4 marks]***

The impact of the higher stock levels on both the current and acid test ratios is appropriately considered and fully explained. For ***[4 marks]*** there is appropriate reference to the case study.

***[1 to 2 marks]***

There is some consideration of the impact of higher levels of stock on liquidity, but this may not include reference to the case or to both the current and acid test ratios.

**(c) Examine whether *SunGen Ltd* should implement a Total Quality Management approach as proposed by Catherine.**

**[7 marks]**

Catherine is a strong advocate of Total Quality Management (TQM) and wants to use quality circles. This approach will involve the whole workforce in ensuring quality at all stages of production. The TQM approach will need to be embedded in the culture of the company and may be expensive with the implementation of new systems. It should, however, identify quality issues before production has taken place in contrast to a traditional quality control approach that checks the quality of finished goods.

The examination of the TQM approach needs to consider the merits of the approach in the context of *SunGen Ltd*. A wide range of points could be raised:

- TQM would require a company-wide approach and commitment from all staff – is this likely to be available? Tony, the production manager has a more traditional approach to quality control and is keen to appoint new managers to take charge of quality. Will he be committed to this approach? Given that he is a key player in these changes, it will be important to know his view. Without a total commitment from Tony and all other staff, a more traditional approach may work better.
- TQM could require substantial investment in staff training and is likely to take a considerable time to yield benefits, but the benefits are likely to be greater in the medium to long term than with traditional approaches.
- TQM may put more emphasis on the process and not enough on the product. However, it may enable the company to focus more clearly on the needs of customers.
- TQM may help develop a team approach to quality and involve all staff. This may help motivate staff. In contrast a more traditional approach may mean more autocratic leadership and may demotivate staff.
- TQM focuses on finding quality problems before production, this ensures that the product shipped to customers is defect-free. This may help build better customer relations and may be more appropriate in the light of their expansion plans to individual households. Given some problems that they have had with quality, this may be a help in restoring better customer relationships.
- a TQM approach may help improve communication flows – both formal and informal. This may help improve productivity and ensure better use of resources. A more traditional approach relies on top-down communication. Which of these approaches is more appropriate will depend on the perceived staff reaction to each approach.

***[6 to 7 marks]***

A detailed and balanced examination of the implementation of a TQM approach to quality management. The examination is related to the case study and clearly identifies how a TQM approach will affect *SunGen Ltd.* Business theory and terminology is used appropriately where relevant.

***[3 to 5 marks]***

An appropriate description of the implications of a TQM approach to quality management. At top end of the band there is some consideration of both the costs and benefits of TQM and the answer is generally related to the case study, but it may be lacking in balance and unrelated to the case study at the lower end of the band.

***[1 to 2 marks]***

A limited and essentially descriptive answer with identification of some costs and/or benefits of a TQM approach to quality management.

**SECTION B**

4. (a) (i) **Define the term *liquidity*.** **[2 marks]**

Liquidity refers to how quickly and cheaply an asset can be converted into cash. Money (in the form of cash) is the most liquid asset.

**[2 marks]**

A clear and appropriate definition of liquidity.

**[1 mark]**

Some appropriate elements of a definition of liquidity, but the definition may be lacking in detail or clarity.

- (ii) **Identify *two* appropriate sources of finance for the new production plant.** **[2 marks]**

The new production plant will need to be financed from long-term sources of finance. These may be either internal or external sources of finance, though their room to manoeuvre may be a little restricted by their current situation in terms of ownership and liquidity. They already have a substantial loan and their gearing ratio is nearly 70%. They are not able to issue shares as they are a wholly owned subsidiary of *Electrical Solutions plc*, though *Electrical Solutions plc* may be able to issue shares and use this as a means to raise capital. Possible appropriate sources of finance could therefore include:

- internal investment from *Electrical Solutions plc* – perhaps from profit or cash reserves
- sale and leaseback – *SunGen Ltd* may be able to sell some assets and lease them back, though this may be difficult given their rate of expansion
- mortgage – it is possible that they could mortgage some of their fixed assets (given fixed assets of \$1.3 m). The viability of this depends on the current ownership of the fixed assets
- joint venture – they could perhaps undertake a joint venture, for example, with a production company in a related area of activity
- Government grant – they may be eligible for some local or national grants because of their environmental profile
- *any other relevant source of finance (though this must be in the context of the case study).*

Award **[1 mark]** for each appropriate source of finance identified up to a maximum of **[2 marks]**.



- (b) (i) Explain the difference between the net profit margin and the gross profit margin.**

*[2 marks]*

The gross profit margin measures the profitability of the firm once the cost of goods sold has been taken into account. It is calculated by dividing the gross profit by the turnover and multiplying by 100 to get the figure as a percentage. The net profit margin measures the profitability of the firm once the expenses have also been deducted. It is calculated by dividing the net profit by the turnover and multiplying by 100 to get the figure as a percentage. The difference is therefore that the net profit margin is measured after expenses as well as the cost of goods sold have been deducted.

*[2 marks]*

A clear and appropriate explanation of the difference between the gross and net profit margins.

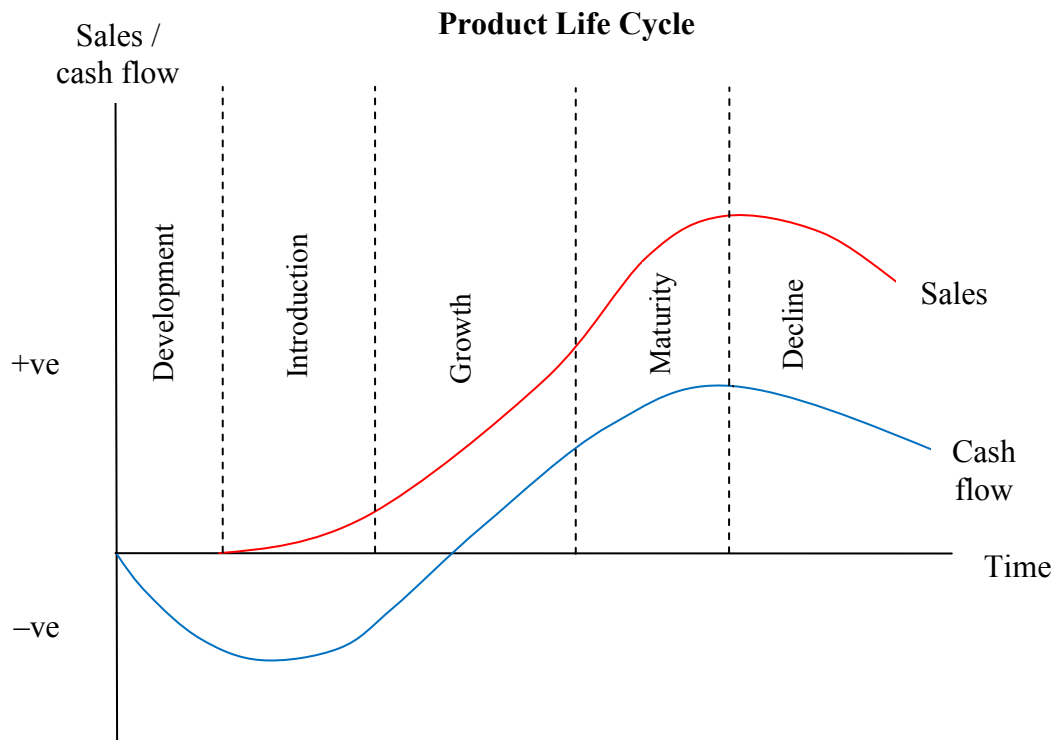
*[1 mark]*

Some appropriate elements of an explanation of the difference between the gross and net profit margin, but the explanation may be lacking in detail or clarity.

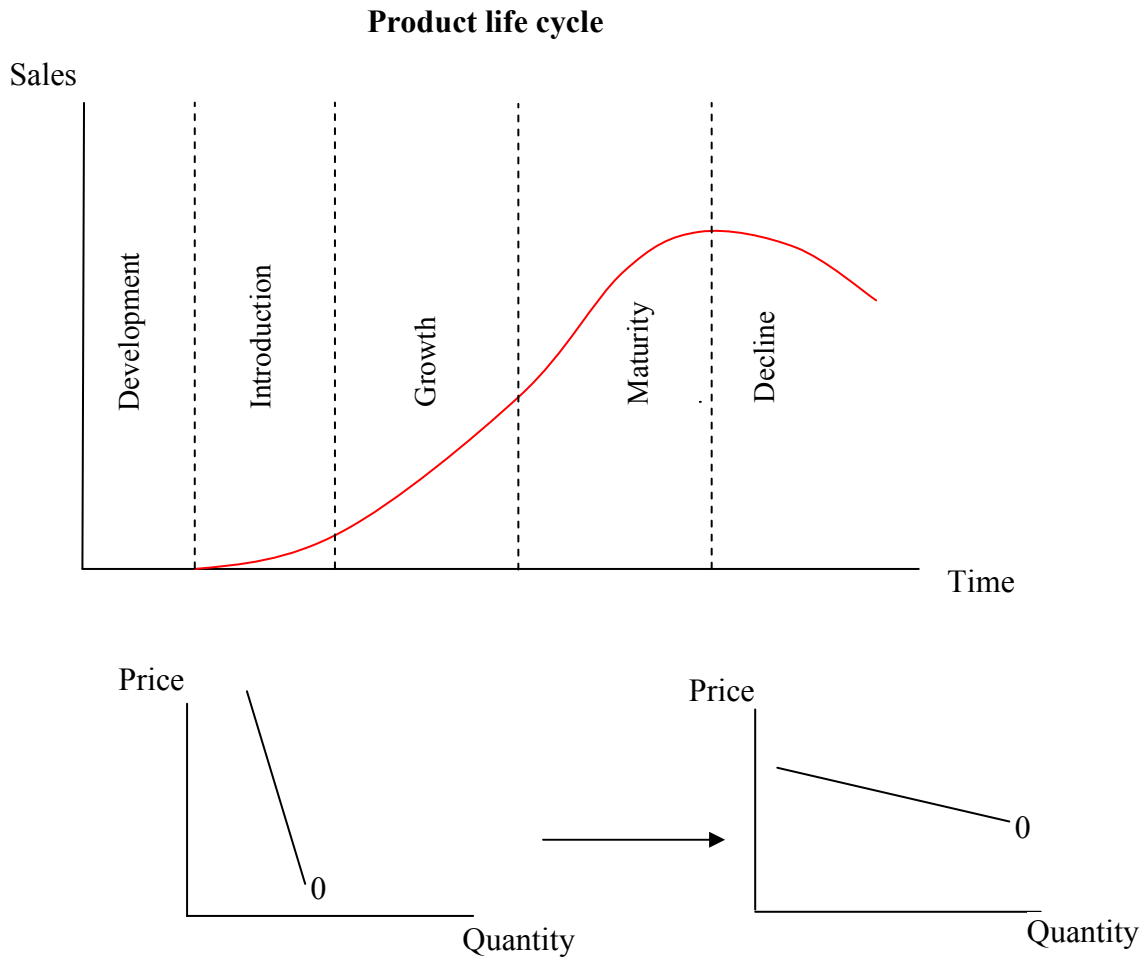
- (ii) Explain how the levels of profit *and* cash flow on the free standing solar panels are likely to change through the different stages of the product life cycle.

[6 marks]

The cash flow from a product like the free standing solar panels as it moves through its life cycle will change. Initially high development costs (likely for solar panels) and high promotional costs will mean a negative cash flow, but as the products moves through the growth phase and into maturity, the cash flow should start to become positive. This could be shown diagrammatically.



As a result profitability of the free standing solar panels will also change through the life cycle of the product. This will be partly due to the fact that price elasticity will tend to vary at each stage of the product life cycle.



Demand becomes more elastic through product life cycle

In the growth phase of the product life cycle, the solar panels may tend to be fairly price inelastic in nature. People buying at this stage will tend to be “innovators” and they may be prepared to take risks with new products. Price will not be such an important consideration for them – they have a greater “need” for the product. This may lead to a high profit margin at this stage of the product life cycle, though overall profitability is likely to be low (or even negative) due to the high development and production setup costs for the solar panels.

However, as the product moves towards maturity, the price elasticity will increase. The amount of competition will increase and the increasing number of substitutes will make consumers more price sensitive. The nature of the consumers will also change and they are likely to be more motivated to buy by factors like price, functionality and reliability. This is particularly likely to be true for solar panels as they gain more widespread acceptance. This may lead to a lower profit margin at this stage of the product life cycle, though overall profitability is likely to be higher due to higher sales and the fact that introductory costs should have been paid off. Profitability will, however, depend on the nature of the competition for the product.

*N.B.* Candidates may explain profitability without reference to elasticity and this should be fully credited.

***[5 to 6 marks]***

A clear and detailed explanation of how both cash flow and the level of profit will change through the life cycle of the solar panels. The explanation is related, where appropriate, to the case study.

***[3 to 4 marks]***

Some explanation of how cash flow and the level of profit will change through the life cycle of the panels though this may be lacking in balance and consider one area in more depth than the other. Award a maximum of ***[3 marks]*** if the change in just the cash flow or level of profit is explained in detail.

***[1 to 2 marks]***

A limited answer that may identify some changes in cash flow and/or the level of profit during the life cycle of the solar panels though this may not be directly related to the case study.

- (c) **Discuss the changes in the profit *and* liquidity ratios between 2006 and 2007.**

*[8 marks]*

From a comparison of the ratios in Appendix 3 and the ratios given, it would appear that there has, in general terms, been a deterioration in the financial position of *SunGen Ltd.* However, this is susceptible to a more detailed analysis. Relevant points to raise might include:

### **Profitability**

**Gross profit margin** – this has improved, though is still showing a gross loss. Because the figure is negative, a reduction is an improvement. This may indicate either an increase in productivity/efficiency in production or perhaps simply better control over direct costs.

**Net profit margin** – this has worsened. Given the improvement in the GPM, this may indicate poor control over indirect costs (overheads). However, there may be a number of other factors at play as well. There may be costs associated with expansionary activities/growth *e.g.* marketing activity related to the expansion to targeting individual households, market research costs, research and development activity relating to proposed new products or perhaps costs associated with the planned expansion of their production facilities (*e.g.* architect fees *etc.*).

**ROCE** – this has improved in the sense that it is not as bad as before. This indicates improved efficiency in terms of the use of their assets to deliver profit. This may be related to increases in production efficiency or other related factors.

### **Liquidity**

**Current ratio** – this has deteriorated slightly, but is still 1.0 indicating perhaps just sufficient liquidity. However, when looked at along with the acid test ratio, it may well be that there is a problem. It would appear that stock is a significant proportion of current assets and this would make it difficult for them to realise assets sufficiently. It would appear that their working capital position has deteriorated further since 2006. Other factors behind this change could include a worsening in credit control, with debtor days increasing and creditor days falling or increasing by less than debtor days.

**Acid test ratio** – the ATR has shown a significant worsening from 0.6 to 0.4. It was, arguably, already too low and has gone down significantly. This appears to indicate that stock is now a much higher proportion of their current assets and has significantly lowered their overall liquidity. It may be that they have increased stock due to the supplier problems they have had or perhaps due to a projected increase in demand. However, the ATR value does indicate a worrying shortage of working capital that may need addressing quite quickly.

***[7 to 8 marks]***

A detailed and balanced discussion of the changes in both profitability and liquidity covering all ratios given. The discussion is related to the case study and considers reasons for the changes in the ratio values. Business theory and terminology is used appropriately, where relevant.

***[4 to 6 marks]***

An examination including detailed description of the changes in both profitability and liquidity ratios, though at the bottom end of the range, the examination may not be balanced in terms of coverage and/or may not cover all the ratios given. At the top end of the range, some attempt at discussion is made.

***[1 to 3 marks]***

A limited and essentially descriptive answer, perhaps with some description of changes in some of the ratio values, but limited identification of reasons for changes in the ratio values.

**SECTION C**

5. (a) Identify *two* driving and *two* restraining forces for the proposed joint venture with *JBR*.

*[4 marks]*

**Driving forces:**

- reduced unit cost and economies of scale
- additional production to meet growing demand in Australia
- an opportunity to develop an environmental profile
- to support growth in the Asia Pacific region
- to strengthen *SunGen Ltd's* market position in the face of increasing competition
- *any other relevant driving force.*

**Restraining forces:**

- the terms and conditions of employment in the Jakarta factories
- the stability of the Indonesian currency and future economic trends
- the different corporate cultures and leadership styles of the two businesses
- opposition to the joint venture by Australian trade unions
- communication and distribution compatibility
- raising finance for the expansion
- *any other relevant restraining force.*

Award *[1 mark]* for each relevant driving force identified up to a maximum of *[2 marks]* and *[1 mark]* for each relevant restraining force identified up to a maximum of *[2 marks]*.

- (b) Explain the purpose of *SunGen Ltd* having a mission statement and corporate objectives (*Item 8*).

**[8 marks]**

A mission statement is a statement of the philosophy and overall corporate aims of a business, which provides the guiding hand for all its operations. Corporate objectives are the intermediate goals of the organisation based upon its mission statement. These objectives detail targets for each division or department of the business, which must be realised if the firm is to achieve its longer-term aims.

The purposes of having a mission statement and corporate objectives are to:

- provide a focus for the organization and a sense of shared purpose, which directs and stimulates the organization and its stakeholders
- determines the nature and direction of the organization
- identifies purpose, strategy, values and standards of behaviour
- gives employees a clear view of the importance of objectives such as quality and customer service
- identifies the role of departments and individuals in the achievement of the company's aims
- allows authority to be delegated without loss of coordination.

For *SunGen Ltd* the mission and corporate aims are likely to focus on its environmental aims and objectives, Total Quality Management and market/product development.

**[7 to 8 marks]**

A clear, relevant and developed explanation of the purpose of *SunGen Ltd* having a mission statement and corporate objectives. The concepts are well understood and applied.

**[4 to 6 marks]**

The explanation is relevant with some understanding of the concepts and an attempt to illustrate why *SunGen Ltd* requires a mission statement and/or objectives. At the top of the band there is more detail and development of concepts.

**[1 to 3 marks]**

A limited response, but with some, albeit limited, understanding of aims and objectives.



- (c) Using Items 2 to 8, analyse *two* issues that will influence *SunGen Ltd's* decision to expand in Indonesia.

**[8 marks]**

Possible issues influencing *SunGen Ltd's* decision to expand into Indonesia include:

- the opportunity to develop solar roof tiles into a cash cow
- the relatively higher rates of economic growth predicted in Indonesia compared to Australia where economic growth is set to slow considerably
- the higher rates of inflation in Indonesia compared to Australia – although the trend in inflation is encouraging
- the higher level of interest rates in Indonesia
- the strengthening of the Australian Dollar compared to the Indonesian Rupiah
- the higher population in Indonesia indicating a much larger potential market
- the relatively higher increases in house prices over the next three years in Indonesia compared to Australia where prices are forecast to fall. This is shown by increases in the house price index in Indonesia as compared to Australia
- the buoyant house market in Indonesia represented by new house starts/builds
- the company mission to develop sustainable energy sources
- satisfying the company objectives to expand in the Asia Pacific region
- the corporate objective to maximise shareholder value
- *any other relevant issue from Items 2 to 8.*

The significance of the selected issue needs to be analysed and some reference made to whether these issues are negative or positive influences on *SunGen Ltd's* decision. For instance, if the economic growth issue was raised, the effect on the housing market might be considered in terms of demand. If the rate of inflation or interest rates are identified, the effect on economic stability and the cost of housing would be relevant.

**[7 to 8 marks]**

Two issues are identified from Items 2 to 8, which will influence *SunGen Ltd's* decision to expand in Indonesia. Each issue is analysed (in detail) as a positive or negative influence on *SunGen Ltd* by reference to the figures or data presented.

**[4 to 6 marks]**

At the top of the band two issues are analysed, although data may not be presented to support the examination and/or there may be no or little attempt to categorise the issues as positive or negative for *SunGen Ltd*. At the lower end of the band, the two issues may be merely outlined.

**[1 to 3 marks]**

A limited answer with maybe only one issue considered and no development of ideas.

- (d) Using data from the case study and the additional information provided in Items 1 to 8, discuss *SunGen Ltd's* strategic options for the coming three years.

[10 marks]

The answer should be considered within a strategic framework of:

- where *SunGen Ltd* is at present (strategic analysis)
- the options available to *SunGen Ltd* over the coming three years (strategic choice)

and

- how *SunGen Ltd* may achieve its objectives (strategic implementation)

It is to be expected that the answer will include relevant information from the case and Items 1 to 8 and employ a range of business concepts, tools and terminology.

*Possible strategic options may include:*

- expansion into new markets, such as Indonesia and/or contraction of markets such as Australia
- targeting new customers *e.g.* individual households rather than focusing on industrial markets
- development and/or rationalisation of the product range
- diversification into new markets with new products
- expansion of production facilities and the greater implementation and application of automated manufacture and design, using a range of new technologies *e.g.* CAD/CAM
- identifying new sources of finance
- development of a greater environmental image, taking advantage of marketing and promotion opportunities
- changes in corporate and organizational structure, *e.g.* changes in HR, flattening of structures, manpower planning, joint ventures and mergers
- subcontracting of production and consideration of changes to distribution channels.

In the discussion of options, there needs to be some appreciation of economic, market and social trends as well as the financial position of *SunGen Ltd* itself. A number of issues may be identified from Items 1 to 8, for example:

- problems with solar roof tiles and metal solar roofs, which have a relatively small revenue and risk becoming dog products
- the decline in profitability in *SunGen Ltd* and liquidity problems hampering any future expansion
- potential economic problems within Australia, *e.g.* higher levels of inflation leading to increases in interest rates and the effects of this on *SunGen Ltd*. A significant slowdown in economic growth in relation to other countries in the region such as Indonesia, which may offer greater future prospects
- the impact of changes in exchange rates on exports and imports of parts and finished products, especially in relation to import into Australia from Indonesia and export of products from Australia to other countries in the region

- relative merits and demerits of expansion into Indonesia in terms of the size and development of markets and the forecasts for the coming three years
- changes within Australia in terms of environmental awareness and concern and the likely impact on *SunGen Ltd's* operations and marketing
- specific actions to develop and implement *SunGen Ltd's* mission and corporate objectives, such as sustainable energy sources and the implementation of social and environmental audits in light of changing attitudes and priorities.

Answers may include reference to theorists such as Porter and Handy and the use of tools such as BCG (The Boston Consulting Group Matrix), product life cycles and Ansoff's matrix. Discussion may be supported by financial data and the use of relevant financial ratios. Some supported conclusions should be reached, such as a recommendation to accept *JBR's* proposal for a joint venture.

It should be recognised that, given time constraints, answers are likely to cover only a few options and to include a much narrower range of issues and concepts than identified above. There is no "correct" answer, but judgments should be supported.

***[9 to 10 marks]***

There is a good appreciation of a range of options available to *SunGen Ltd* given its internal and external environment. There is good understanding of the significance and relevance of the data presented in the case study and Items 1 to 8, to the options identified. There is evidence of critical thinking and synthesis of ideas. Supported judgments are made applying relevant business theories and concepts.

***[6 to 8 marks]***

There is consideration of some options available to *SunGen Ltd* and the use of data from the case study and Items 1 to 8 to support the examination and analysis. At the bottom of the band there may be an attempt to evaluate, but this is very poor and/or limited in scope. At the upper end of the band the discussion includes some supported conclusions and the inclusion of business theory and concepts, although these may be limited in scope and depth.

***[3 to 5 marks]***

At the bottom end of the band, the answer is predominantly descriptive and narrow in scope and depth. At the upper end of the band, there is some analysis of the information provided in the case study and Items 1 to 8. Any evaluation is likely to be very simplistic.

***[1 to 2 marks]***

A limited and generalised answer, which may be little more than a list of disconnected and unsupported statements and proposals. Little use is made of the data available.

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**BUSINESS AND MANAGEMENT  
HIGHER LEVEL  
PAPER 2**

SPECIMEN PAPER

2 hours 15 minutes

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**INSTRUCTIONS TO CANDIDATES**

- Do not open this examination paper until instructed to do so.
- Section A: answer one question.
- Section B: answer two questions.

**SECTION A**

Answer **one** question from this section.

**1. Chinese Medicine**

Mrs Chen owns a small traditional Chinese medicine chain store in a large city in China. The chain is known for the excellent quality of its fresh medicine as well as a reliable and quick service. Mrs Chen’s success is mainly due to a well established very close relationship based on mutual trust and open communication with her local suppliers who are able to quickly supply any type of medicine required by the clients.

As the company is becoming more profitable, Mrs Chen is thinking of expanding the store’s activities.

The expansion may be within China or, indeed, outside China so as to meet the needs of the growing Chinese communities abroad. The success of the proposed expansion is likely to be dependent on regional levels of economic growth.

Mrs Chen is currently considering several options. The estimated costs of each individual option and the expected profit (loss) for each option are:

Option	Costs	Expected return (\$) under different economic conditions with probability of conditions expressed in percentage (%)		
		Improved economic conditions 20 %	Unchanged economic conditions 50 %	Worsened economic conditions 30 %
1. Expansion into the European Union	\$2 m	\$4.6 m	\$2.4 m	\$1 m
2. Expansion into the USA	\$1.75 m	\$5 m	\$3 m	-\$1.5 m
3. Expansion into different regions in China				
(a) With no change in product portfolio	\$0.5 m	\$1 m	\$0.5 m	-\$0.5 m
(b) With larger product range	Extra \$0.5 m	\$2 m	\$1 m	\$0.75 m

*(This question continues on the following page)*

*(Question 1 continued)*

- (a) Describe the type of growth that Mrs Chen is considering for expansion. *[4 marks]*
- (b) (i) Construct a decision tree and calculate the predicted outcome for each expansion option. *(Show all your working)* *[7 marks]*
- (ii) Briefly comment on the most financially desirable option for expansion of Mrs Chen’s business. *[2 marks]*
- (iii) Explain **two** possible effects on Mrs Chen’s Chinese medicine business resulting from worsening economic conditions in China. *[6 marks]*
- (c) Analyse the usefulness of the decision tree model for Mrs Chen. *[6 marks]*

## 2. Willow Carpets

*Willow Carpets*, a regional manufacturer of carpeting for high-end commercial and institutional office space, is changing from the use of synthetic to natural fibres in its carpets. By making the change, *Willow Carpets* intends, in the long run, to be the market leader in its segment by appealing to the increasingly environmentally conscious among its end-users. This change is part of a multi-year shift in *Willow Carpets*' operations to become “green”, or environmentally friendly.

The change will affect the firm's cost structure:

- because of the higher cost of natural fibres, in the short run *Willow Carpets* will experience a 12.5% increase in its variable cost per square metre, to €4.5
- to be consistent with its use of natural fibres, *Willow Carpets* will also shift to using a natural cleaning solvent for its machinery, increasing fixed costs of the manufacturing facility from €2 400 000 to €2 520 000 for the coming year
- other expenses (administrative and other), and other fixed costs, will be €1 200 000.

On average, *Willow Carpets* sells its carpets for €18 per square metre, and the firm will not be able to raise prices for at least several years.

However, in the coming years, *Willow Carpets* anticipates seeing its market share grow, as consumers are increasingly demanding environmentally friendly products. *Willow Carpets* also believes that it can eventually position itself as a local price leader, enabling it to raise the price of carpets significantly and eventually to earn better margins than before the shift to natural fibres.

- (a) Define the terms *variable cost* **and** *fixed cost*. [4 marks]
- (b) (i) Calculate *Willow Carpets*' break-even point, expressed in number of square metres of carpet, if it continued to use synthetic fibres **and** after it has switched to the use of natural fibres. (*Show all your working*) [4 marks]
- (ii) Construct a break-even chart for *Willow Carpets* under its new “green” approach. [6 marks]
- (iii) Explain the impact on the break-even level of output and margin of safety of an increase in global prices of natural fibres. [5 marks]
- (c) Examine *Willow Carpets*' possible motives in shifting to natural fibres. [6 marks]

## SECTION B

Answer *two* questions from this section.

### 3. Wedding Bliss

Zara Bliss is a successful sole trader who designs and hand-makes tailor-made wedding clothes for both brides and grooms from the local area. Factors contributing to her success include:

- an excellent reputation for unique and creative designs branded as *Wedding Bliss*
- close relationships with her customers who look for original designs and are willing to pay a high price for the unique product and the service.

Zara enjoys flexible working time as she operates from a studio at home. She values her complete creative freedom but dislikes the administrative side of the business.

Demand for Zara’s clothes is seasonal. At certain times, she is unable to satisfy all customer orders. As a consequence, some of her customers have gone to her competitors. Zara wants to expand her business and to create a new line of clothes in order to reduce the waiting time as well as to ensure more consistent cash flows. She is considering some external growth options.

A national clothes manufacturer, *Belle Ltd*, has approached her in order to buy her brand name and employ her as designer and creative director. The competitive advantage of the clothes manufacturer lies in mass-market affordable wedding clothes. Zara has been offered a good salary and 10% ownership.

Zara is under pressure to decide quickly but she feels that she needs to apply a more formal decision-making process.

- (a) Identify **four** stages in a formal decision-making framework. *[4 marks]*
- (b) With reference to the stimulus material explain the differences between internal and external growth. *[6 marks]*
- (c) Use Porter’s Generic Strategies Model to examine the change in the competitive advantage of *Wedding Bliss* if the brand is taken over by *Belle Ltd*. *[6 marks]*
- (d) Discuss whether Zara Bliss should remain as a small sole-trader or accept the offer from *Belle Ltd*. *[9 marks]*



#### 4. Yum!

*Yum!* is one of the biggest companies in the fast-food industry in America. In 2004 it earned pre-tax profit of \$1 billion on sales of \$9 billion. *Yum!* is the parent of the *Kentucky Fried Chicken (KFC)*, *Pizza Hut* and *Taco Bell* brands.

Mr Novak, the Chairperson of the company, has declared that he is going to improve the relationship with the franchisees, who own 75% of 43 000 *Yum!* restaurants around the world (consequently restaurant managers get stock options).

*Yum!* gains economies of scale across its restaurant brands through:

- centralized purchasing and organization of advertising
- collective acquisition of restaurant sites
- bringing international operations within a single organization
- putting several brands into a single restaurant unit with one operating kitchen.

Mr Novak believes that there is potential for further growth in the American market. Analysts, however, think that there is little scope for fast-food companies to grow in America by opening new outlets. Three quarters of Americans already live within three miles of a fast-food outlet. To expand, fast-food chains would have to win business from one another.

Analysts are more optimistic about growth in the European and Asian markets. By entering China, *Yum!* has gained first mover advantage and now has twice the number of restaurants of its nearest rival – *McDonald's*.

*Yum!* like other fast food companies has felt obliged to respond to health concerns. It has put more salads and lighter dishes on its menus in order to attract the health conscious eaters.

[Source: adapted from Fast Food Yummy Secret – Special Report “Yum!” Brands, *The Economist*, 27 August 2005]

- (a) Define the terms *economies of scale* **and** *franchisee*. [4 marks]
- (b) Explain how *Yum!* benefits from **two** types of internal economies of scale. [6 marks]
- (c) Analyse the advantages **and** disadvantages to *Yum!* of operating their restaurants as franchises. [6 marks]
- (d) Using the Ansoff Matrix, evaluate the strategic growth options available to *Yum!*. [9 marks]

## 5. Body Beautiful

*Body Beautiful Ltd* is a company that owns a health club in a central city location. In the last three years the local city government, in an attempt to encourage a healthier lifestyle, have given two new competitors a licence to build nearby health clubs. One of the new health clubs, *Well-Being* has attracted many customers of *Body Beautiful Ltd* by creating a range of additional service benefits. These include:

- online booking for all exercise classes
- self-health monitoring systems using the latest technology
- the provision of a health clinic run by a doctor on site.

The market research carried out by *Well-Being* revealed that their customers, largely wealthy 35-55 year old professionals, perceived the service benefits as distinct unique selling propositions. *Well Being* customers are, therefore, very loyal to the new brand.

The management of *Body Beautiful* in order to become more customer-focused and competitive decided to:

- research the needs and profiles of current and potential customers to reduce the movement of members to the new clubs and to attract new customers
- target a new untapped segment – teenagers who are not very health conscious and who are looking for technologically advanced gym equipment
- replace some of the dated equipment with newer models supplied by an internationally branded single supplier. The price of the equipment is very high and the waiting time for the new equipment is at least six months.

- (a) Identify **two** primary sources and **two** secondary sources that *Body Beautiful* can use in its market research. [4 marks]
- (b) Using both above and below the line promotional techniques, prepare a promotional mix for *Body Beautiful* to attract “teenagers who are not very health conscious”. [6 marks]
- (c) Analyse the usefulness of market segmentation for a health club like *Body Beautiful*. [6 marks]
- (d) With reference to Porter’s Five Forces model, evaluate **three** of the competitive forces affecting *Body Beautiful* in the health club market. [9 marks]
-



# **MARKSCHEME**

## **SPECIMEN PAPER**

### **BUSINESS & MANAGEMENT**

#### **Higher Level**

#### **Paper 2**

**SECTION A**

1. (a) Describe the type of growth that Mrs Chen is considering for expansion. **[4 marks]**

Mrs Chen is considering internal growth as a method of expansion. Internal growth arises from within the company through increasing sales of existing products and/or launching new products. Mrs Chen is considering both expansion into the US or Europe with the current product range as well as expansion within China, possibly with the introduction of new products. This growth method is slower than external growth – merger or acquisition – and is usually financed by debt or reinvesting profit. Mrs Chen is likely to use her growing profit to finance the growth.

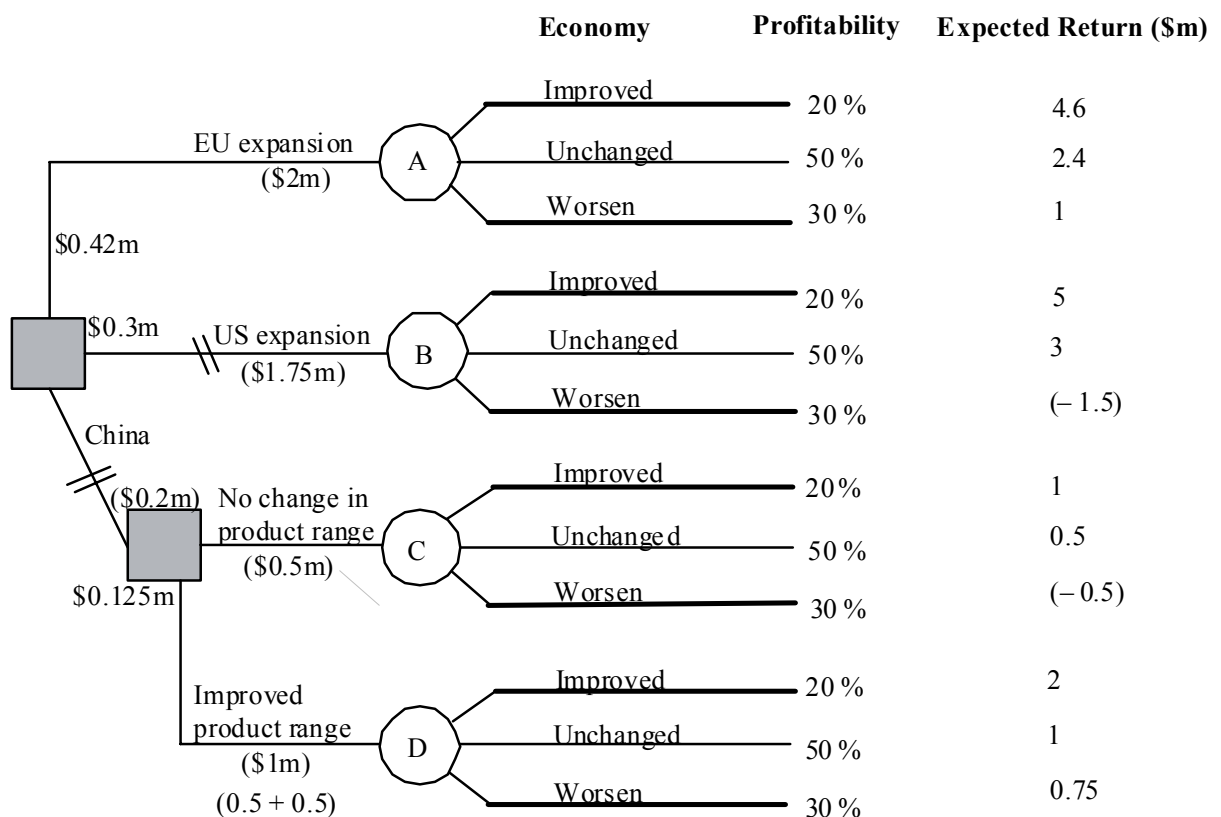
**[3 to 4 marks]**

The internal growth method is accurately described with relevant and specific reference to Mrs Chen’s options.

**[1 to 2 marks]**

The internal growth method is briefly described or merely listed. Limited, if any, reference is made to the stimulus material.

- (b) (i) Construct a decision tree and calculate the predicted outcome for each expansion option. (Show all your working) **[7 marks]**



Key

Decision point

Possible outcomes

Rejected options

**Solutions**

**Option 1:**  $\$4.6\text{m} \times 0.2 = \$0.92\text{m}$   
 $\$2.4\text{m} \times 0.5 = \$1.2\text{m}$   
 $\$1\text{m} \times 0.3 = \underline{\$0.3\text{m}}$   
 $= \$2.42\text{m} - \$2\text{m}$   
 $= \$0.42\text{m of net return}$

The most profitable option

**Option 2:**  $\$5\text{m} \times 0.2 = \$1\text{m}$   
 $\$3\text{m} \times 0.5 = \$1.5\text{m}$   
 $\$(1.5\text{m}) \times 0.3 = \underline{\$(0.45\text{m})}$   
 $= \$2.05 - \$1.75\text{m}$   
 $= \$0.3\text{m of net return}$

**Option 3:** without change to product range:  
 $\$1\text{m} \times 0.2 = \$0.2\text{m}$   
 $\$0.5\text{m} \times 0.5 = \$0.25\text{m}$   
 $\$(0.5\text{m}) \times 0.3 = \underline{\$(0.15\text{m})}$   
 $= \$0.3\text{m} - \$0.5\text{m}$   
 $= \$(0.2\text{m}) of net return$

with a change to product range:  
 $\$2\text{m} \times 0.2 = \$0.4\text{m}$   
 $\$1\text{m} \times 0.5 = \$0.5\text{m}$   
 $\$0.75 \times 0.3 = \underline{\$0.225\text{m}}$   
 $= \$1.125\text{m} - \$1\text{m}$   
 $= \$0.125\text{m of net return}$

***[6 to 7 marks]***

The decision tree is accurately constructed. The calculations of each option are correct and well presented. For ***[7 marks]*** a key is provided. Workings are shown.

***[3 to 5 marks]***

The principal elements of the decision tree are constructed but may not be entirely accurate. The calculations of each option are largely correct and clearly presented at the top end of the band. Deduct ***[1 mark]*** per error. Working may not be shown.

***[1 to 2 marks]***

The decision tree is not accurately constructed, the calculations of each option are not all presented or accurate but there is some evidence of a general knowledge of the model.

- (ii) **Briefly comment on the most financially desirable option for expansion of Mrs Chen’s business.** **[2 marks]**

The most financially suitable option is EU expansion as this option will generate the highest net return of \$0.42 m for Mrs Chen.

*N.B. Apply “Own Figure Rule” where candidates select the appropriate option for their calculations.*

**[2 marks]**

The most financially suitable option is selected and the other two options are rejected on the model.

**[1 mark]**

The most financially suitable option is selected but the other two options are not visually rejected on the model.

- (iii) **Explain two possible positive effects on Mrs Chen’s Chinese medicine business resulting from worsening economic conditions in China.** **[6 marks]**

Two possible positive effects may include:

- as income falls some people might not be able to afford private health care, and resort to buying Chinese medicine. The demand will increase
- during worsening economic conditions the price level is unlikely to decrease. Mrs Chen’s products may become more internationally competitive. Her demand and profit is likely to increase
- due to a decrease in economic activities in China Mrs Chen might be able to negotiate lower prices from her supplier and stock for better days
- Mrs Chen might be able to negotiate a lower interest rate from the bank to finance her proposed expansion
- *any other relevant issue explained.*

**[5 to 6 marks]**

A clear and detailed explanation of two possible positive effects resulting from worsening economic conditions in China. Reference is made to Mrs Chen’s Chinese medicine business.

**[3 to 4 marks]**

Some explanation of two possible positive effects resulting from worsening economic conditions in China, though the explanation may be lacking in clarity or detail. Award a maximum of **[3 marks]** for a detailed explanation of just one effect.

**[1 to 2 marks]**

A brief and general answer or possibly just a list of two effects, with no development.

**(c) Analyse the usefulness of the decision tree model for Mrs Chen.**

***[6 marks]***

The use and construction of the decision tree model will enable Mrs Chen to:

- visually see some courses of action not previously considered
- place numerical values on decisions
- incorporate the risk involved in each decision by considering the probability of each event occurring.

All of the above should enable Mrs Chen to improve the decision-making process and, therefore, the results.

On the other hand the limitations of this technique may include:

- the financial information is not exact and figures are merely estimated
- the probabilities also are only estimated
- non-financial, qualitative factors are not incorporated into the decision-making process. Some qualitative issues might be more significant than the quantitative ones
- time lag occurs in decision-making and, therefore, some of the numerical information may be out of date.

***[5 to 6 marks]***

Balanced and detailed analysis of both the strengths and limitations of the model used by Mrs Chen.

***[3 to 4 marks]***

Some analysis of the strengths and/or limitations of the model, though this may be lacking in balance and tend to be descriptive at the lower end of the band.

***[1 to 2 marks]***

A limited and essentially descriptive answer.

2. (a) Define the terms *variable cost* and *fixed cost*.

**[4 marks]**

Fixed costs are production costs that do not depend on the level of output. Fixed costs could include loan repayments, security costs and marketing and administration costs. Fixed costs are often also termed as overheads.

Variable costs are costs that vary with the level of output. Variable costs include costs like raw materials and labour costs that are directly attributable to production.

**[1 mark]** for some appropriate elements of a definition of variable cost, but the definition may be lacking in detail or clarity. **[2 marks]** for a clear and appropriate definition of variable cost.

**[1 mark]** for some appropriate elements of a definition of fixed cost, but the definition may be lacking in detail or clarity. **[2 marks]** for a clear and appropriate definition of fixed cost.



- (b) (i) Calculate *Willow Carpets'* break-even point, expressed in number of square metres of carpet, if it continued to use synthetic fibres *and* after it has switched to the use of natural fibres. (*Show all your working*)

[4 marks]

Break-even point = fixed costs / contribution

**Break-even point – synthetic fibres**

Price = €18

Variable cost per unit = €4.5 less 12.5% = €3.94

Therefore contribution = €14.06

Break-even = 3 600 000 / 14.06 = 256 045 sq metres

**Break-even point – natural fibres**

Price = €18

Variable cost per unit = €4.5

Therefore contribution = €13.5

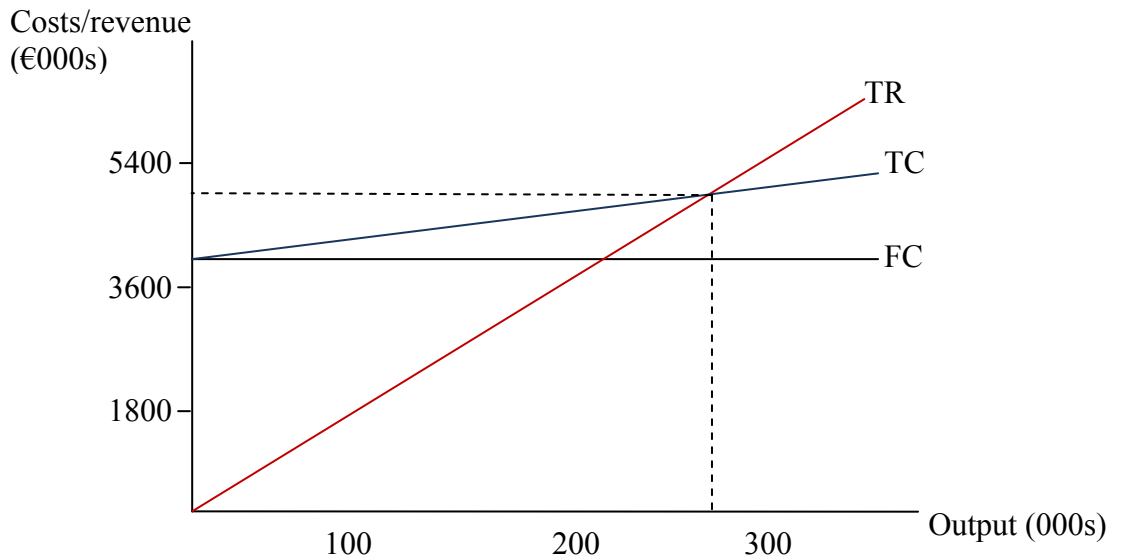
Break-even = 3 720 000 / 13.5 = 275 556 sq metres

Award [1 mark] for workings that show a clear understanding of the process of calculating the break-even level of output for the use of synthetic fibres and [1 mark] for the correct answer (to within 100 sq metres).

Award [1 mark] for workings that show a clear understanding of the process of calculating the break-even level of output for the use of natural fibres and [1 mark] for the correct answer (to within 100 sq metres).

(ii) Construct a break-even chart for *Willow Carpets* under its new “green” approach.

[6 marks]



Award marks as follows:

[1 mark] for each appropriately labelled axis – maximum of [2 marks].

[1 mark] for an appropriately drawn total revenue curve.

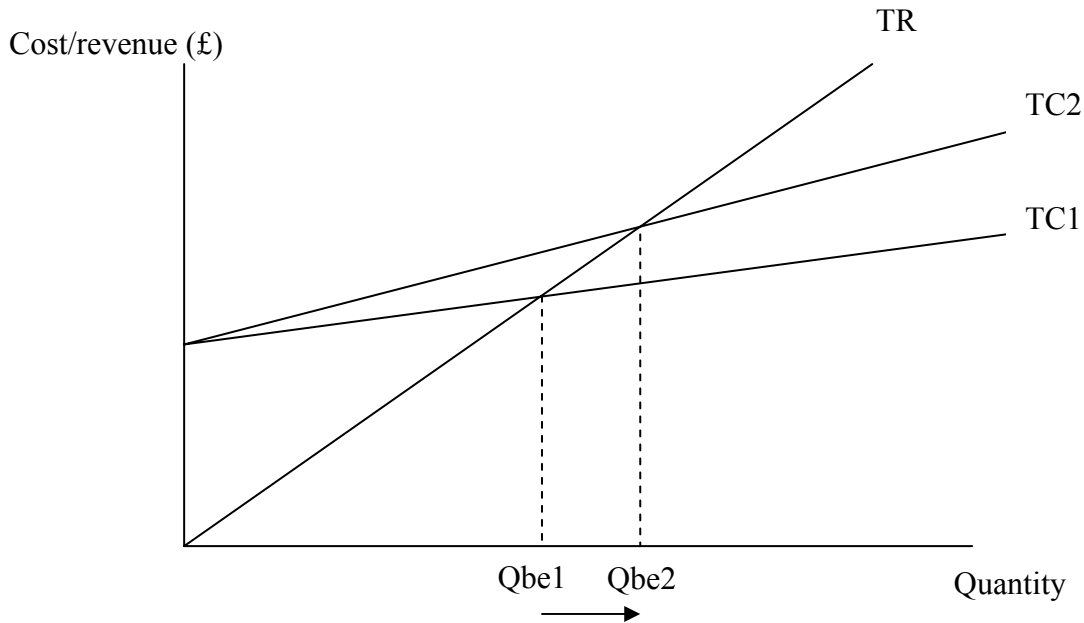
[1 mark] for an appropriately drawn total cost curve.

[1 mark] for the identification of the break-even level of output (whatever the value) and [1 mark] for showing the correct value of the break-even level of output.

**(iii) Explain the impact on the break-even level of output and margin of safety of an increase in global prices of natural fibres.**

**[5 marks]**

The use of natural fibres represent a variable cost for *Willow Carpets* and so any increase in the price of these will cause an increase in variable cost per unit. This will have the effect of shifting the total cost curve upwards and so will increase the break-even level of output and reduce the margin of safety at the current level of output. The diagram below illustrates this.



**[4 to 5 marks]**

A clear and detailed explanation of the impact of the increase in the price of natural fibres on both the break-even level of output and the margin of safety.

**[2 to 3 marks]**

Some explanation of the impact of the increase in the price of natural fibres on either the break-even level of output or the margin of safety.

**[1 mark]**

A brief and general answer or possibly just a list of the effects with little or no development.

- (c) **Examine *Willow Carpets*' possible motives in shifting to natural fibres.** **[6 marks]**

*Willow Carpets* appear to be trying to anticipate a changing pattern of demand among consumers and turning this to their advantage in a marketing context. Increased environmental awareness among consumers has led to a changing pattern of demand with greater demand for environmentally friendly products. By adopting this “greener” approach now, it will enable *Willow Carpets* to develop a unique selling proposition and act as a market leader. This may also enable them to operate as a price leader in the market in the future and earn better margins.

The higher costs of using natural fibres may be compensated by a higher level of demand and ultimately higher margins in the future. It may even be that in the short term the demand for carpets made from natural fibres is more price inelastic and this may enable them to charge relatively prices and restore their margins, but this will depend on the extent of competition in the market.

**[5 to 6 marks]**

A detailed and well balanced examination of the possible motives for shifting to natural fibres. There is reference where appropriate to the stimulus material.

**[3 to 4 marks]**

Some examination of the possible motives for shifting to natural fibres, though this may be lacking in detail and balance and may tend to description at the lower end of the band. There is some reference to the stimulus material, but this may be limited at the lower end of the band.

**[1 to 2 marks]**

A limited and essentially descriptive answer that may simply offer a list of possible motives with little or no development.

**SECTION B**

3. (a) **Identify *four* stages in a formal decision-making framework.** **[4 marks]**

The stages of a scientific decision-making process:

- identify objectives
- collect information and ideas
- analyse information and ideas
- choose a course of action
- communicate and carry out
- measure outcome
- evaluate the result and report
- revise objectives/information.

Award **[1 mark]** for each stage correctly identified up to a maximum of **[4 marks]**. The stages identified do not necessarily have to be in the correct order.

- (b) **With reference to the stimulus material explain the differences between internal and external growth.** **[6 marks]**

Internal growth arises from within the company. The company grows by using its own resources. The expansion is based on reinvested profit or debt finance. For example, Zara uses the profit to move to bigger premises or Zara buys another machine.

External growth arises when a firm increases its size by taking over or merging with another firm (integration). The external growth options are faster. Zara merges with another sole trader or with a private limited company as mentioned in the case. Zara changes her company to a private limited company by issuing shares privately.

**[5 to 6 marks]**

A detailed and relevant explanation of both internal as well as external growth is provided. A relevant example is used in both cases with reference to the stimulus material.

**[3 to 4 marks]**

Some explanation is provided of the growth method(s), but the explanation may be lacking in balance. For a detailed explanation of just internal growth award a maximum of **[3 marks]**.

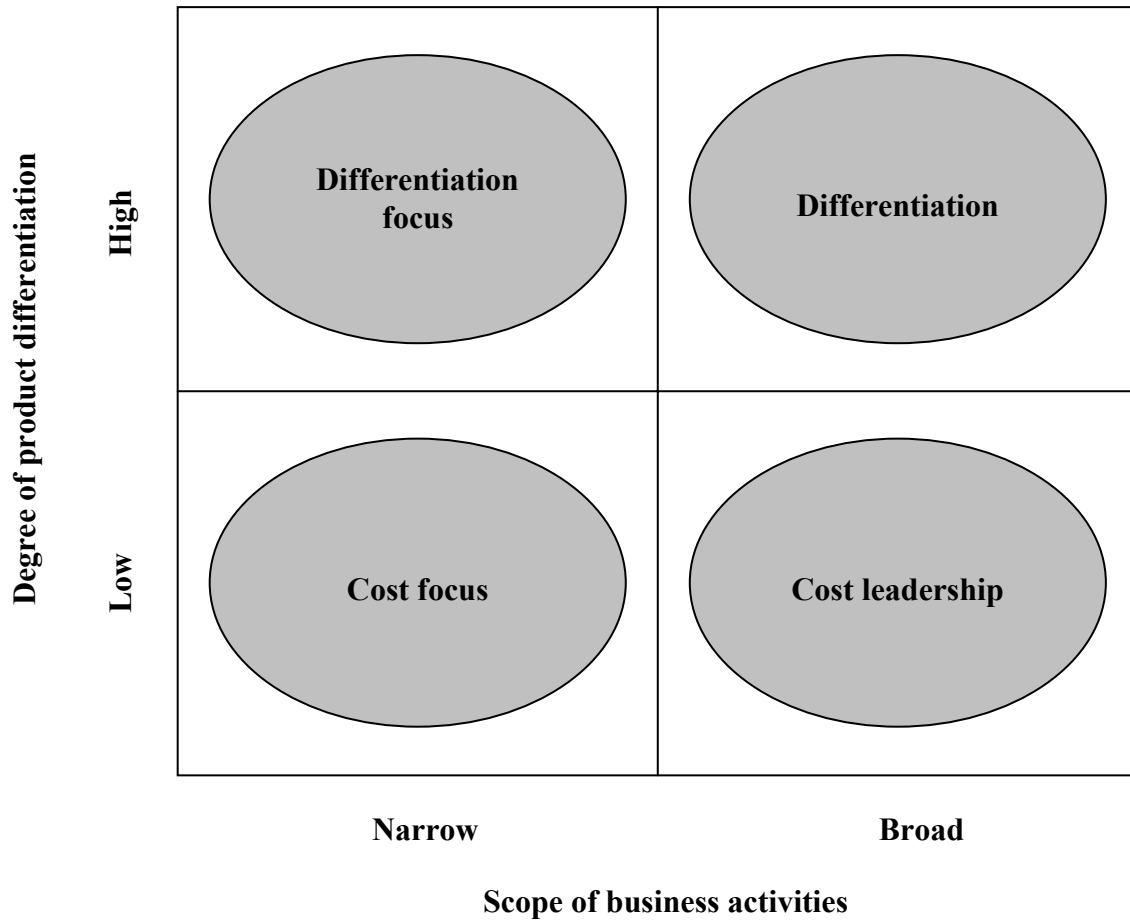
**[1 to 2 marks]**

A general and limited answer, lacking balance.

- (c) Use Porter’s Generic Strategies Model to examine the change in the competitive advantage of *Wedding Bliss* if the brand is taken over by *Belle Ltd.*

[6 marks]

Porter’s four strategies are summarized in the figure below:



The differentiation and cost leadership strategies seek competitive advantage in a broad range of market or industry segments. By contrast, the differentiation focus and cost focus strategies are adopted in a narrow market or industry.

**Strategy – Differentiation**

This strategy involves selecting one or more criteria that is used by buyers in a market – and then positioning the business uniquely to meet those criteria. This strategy is usually associated with charging a premium price for the product – often to reflect the higher production costs and extra value-added features provided for the consumer. Differentiation is about charging a premium price that more than covers the additional production costs, and about giving customers clear reasons to prefer the product over other, less differentiated products.

**Strategy – Cost leadership**

A business aim is to become the lowest-cost producer in the industry. This strategy is usually associated with large-scale businesses offering “standard” products with relatively little differentiation that are perfectly acceptable to the majority of customers.

**Strategy – Differentiation focus**

A business aims to differentiate within just one or a small number of target market segments. The special customer needs of the segment mean that there are opportunities to provide products that are clearly different from competitors who may be targeting a broader group of customers. The important issue for any business adopting this strategy is to ensure that customers really do have different needs and wants – in other words that there is a **valid basis for differentiation** – and that existing competitor products are not meeting those needs and wants.

**Strategy – Cost focus**

A business seeks a lower-cost advantage in one or a small number of market segments. The product will be basic – perhaps a similar product to the higher-priced and featured market leaders, but acceptable to sufficient consumers. Such products are often called “me-too’s”.

Currently Zara is using a differentiation focus strategy. She has created a unique competitive advantage by providing hand made/tailor-made wedding clothes for brides and grooms. She charges a premium price for her highly differentiated product that customers are willing to pay for. If she merges with a national mass producer clothes manufacturer – *Belle Ltd*, the chance is that she will follow the current strategy used by the organisation, which is cost leadership. The competitive strategy is based on mass production, undifferentiated, standard products for which the customers pay low prices. Both strategies can be very profitable.

***[5 to 6 marks]***

A detailed and well-balanced examination of the changes in the competitive advantage of *Wedding Bliss* if taken over by *Belle Ltd* with reference to all of the Porter’s Generic Strategic options.

***[3 to 4 marks]***

Some examination of the changes in competitive advantage of *Wedding Bliss* if taken over by *Belle Ltd*, though this may be lacking in detail and balance, and may tend to description at the lower end of the band. There is some use of the Porter’s Generic Strategic options, but this may be limited at the lower end of the band.

***[1 to 2 marks]***

A limited and essentially descriptive answer that may lack any reference to Porter’s Generic Strategies.

(d) **Discuss whether Zara Bliss should remain as a small sole-trader or accept the offer from *Belle Ltd.***

**[9 marks]**

The merits of *Wedding Bliss* being a sole-trader are:

- Zara has sole ownership
- Zara can make all the decisions and, therefore, is able to keep her flexible working pattern
- Zara keeps all profit
- limited formal documentation is needed and this is Zara's preference. She dislikes administrative tasks
- *Wedding Bliss* can be a very customer focused organization and so it can continue the close relationship with its customers. Being customer focused is the main contributor to her current success
- Zara can also have complete creative freedom and flexibility – issues of significant importance for her
- *any other relevant point.*

However:

- Zara is losing customers during the busy period. Irreversible damage can be done to the brand image
- Zara as an owner has an unlimited liability and might lose her personal assets in case of financial difficulties
- Zara wants her business to grow and she may also find it difficult as a sole-trader to raise more finance in order to grow
- given the fact that she actually wants to grow, Zara will have to be legally responsible for the increased administration
- limited opportunities for Zara to specialize if the firm grows.

The merit of *Wedding Bliss* becoming part of a large private limited company:

- Zara as well as the other shareholders will have limited liability
- Zara can share responsibilities of running the business with other owners
- Zara can still specialise in the design side rather than the administrative side
- ownership will not be lost to outsiders
- the mass-market production/flow production technique is likely to result in lower cost of production due to economies of scale. Therefore, profit may increase and Zara will have 10% ownership
- *any other relevant point.*

However:

- *Wedding Bliss* will lose its unique selling point of being a customer-focused company. By not using a job production method to tailor-make wedding clothes the brand may be eroded
- 10% ownership will not give Zara a significant input into decision-making
- Zara may lose her highly valued current flexibility.



It looks as if the merits for *Wedding Bliss* of remaining a highly customer focused/sole-trader organization outweigh the disadvantages. Moreover, Zara can still grow and employ an administrative manager while maintaining her interest and talent. Perhaps a partnership would be a better option.

*Accept a different but well substantiated discussion.*

***[7 to 9 marks]***

Balanced and detailed discussion as to whether Zara Bliss should remain a small sole trader. Appropriate reference is made to the stimulus material. For ***[9 marks]*** a substantiated conclusion is offered.

***[4 to 6 marks]***

Some analysis of whether Zara Bliss should remain a small sole-trader, though this may be lacking in detail and balance, and may tend to description at the lower end of the band. Some reference is made to the stimulus material but supported judgment and substantiated conclusions may not be offered.

***[1 to 3 marks]***

A limited and essentially descriptive answer that may simply offer a list of some possible advantages and/or disadvantages.

4. (a) Define the terms *economies of scale* and *franchisee*. [4 marks]

Economies of scale – the reduction in the long run unit costs as the scale of production increases.

A franchisee is a person or a company who has bought the local rights to use the name, logos and training methods of another company.

[1 mark] for some appropriate elements of a definition of economies of scale, but the definition may be lacking in detail or clarity. [2 marks] for a clear and appropriate definition of economies of scale.

[1 mark] for some appropriate elements of a definition of franchisee, but the definition may be lacking in detail or clarity. [2 marks] for a clear and appropriate definition of franchisee.

(b) Explain how *Yum!* benefits from *two* types of internal economies of scale. [6 marks]

Based on the information provided in the stimulus *Yum!* benefits from:

- **Marketing economies of scale** as it is able to purchase advertising slots and run an advertising campaign collectively. Given the enormous power of *Yum!*, the costs per unit of the above will reduce considerably.
- **Purchasing economies of scale** – *Yum!* is able to acquire restaurant sites for all of its brands collectively. This gives *Yum!* a considerable bargaining power that is likely to result in lower costs per site.
- **Technical economies of scale** – as large plants are often more efficient *Yum!* puts several brands into a single kitchen. The increase in kitchen size does not increase the cost proportionately as the equipment can be used for longer or for larger output. Therefore, cost per unit will fall.

[5 to 6 marks]

A clear and detailed explanation of two relevant types of internal economies of scale. Direct reference is made to *Yum!* and to the stimulus material.

[3 to 4 marks]

Some explanation of two relevant types of internal economies of scale, though the explanation may be lacking in clarity or detail. Award a maximum of [3 marks] for a detailed explanation of just one type of economy of scale.

[1 to 2 marks]

A brief and general answer or possibly just a list of two types of economy of scale with no development.

- (c) Analyse the advantages *and* disadvantages to *Yum!* of operating their restaurants as franchises.

**[6 marks]**

The possible advantages for *Yum!* of operating their restaurants as franchises are:

- it facilitates quick growth/expansion without incurring high capital costs. Given *Yum!*'s desire for growth it can be a good option
- further global presence can be established rapidly with minimal risk. *Yum!* will be able to compete more easily with other famous branded franchisors
- *Yum!* will save on running costs of the branches as the franchisee will finance most of the investment
- the franchisee is likely to be highly motivated and interested in running the business and will have local knowledge
- royalties as well as a sign-on payment will be paid to *Yum!*
- *any other relevant point.*

The possible disadvantages for *Yum!* of operating their restaurants as franchises are:

- operational methods to ensure uniformity of service and quality standards may not be adhered to
- the franchisee may have different objectives from those of *Yum!* so conflicts may occur
- failure of an individual franchisee can seriously affect the brand image of *Yum!*
- *Yum!* might have to pay for some initial training costs as well as marketing and supervision costs. Given *Yum!*'s global reach, these costs can be significant
- *any other relevant point.*

**[5 to 6 marks]**

Balanced and detailed analysis of the advantages and disadvantages of operating the restaurants as franchises with direct reference to *Yum!*

**[3 to 4 marks]**

Some analysis of the advantages and/or disadvantages of operating the restaurants as franchises, though this may be lacking in balance and tend to be descriptive at the lower end of the band. For a detailed analysis of just advantages or just disadvantages award a maximum of **[3 marks]**.

**[1 to 2 marks]**

A limited and essentially descriptive answer that may simply offer a list of some possible advantages and/or disadvantages.

(d) Using the Ansoff Matrix, evaluate the strategic growth options available to *Yum!*.

[9 marks]

Ansoff's Product/Market Matrix

Product \ Market	Present	New
Present	Market penetration	Product development
New	Market development	Diversification

Mr Novak believes that there is further scope for a market penetration strategy, whereby *Yum!* will further penetrate the American (home) market. However, analysts believe that this market is saturated as three quarters of all Americans live within three miles of a fast food outlet. Continuing with this strategic growth option may result in a price war with its major competitors. *Yum!* may see its profits falling if prices are significantly reduced to attract customers.

Given the market analysts' more optimistic prediction about Europe and Asia, *Yum!* can continue to use a market development strategy into new places in Europe and into some Asian markets. *Yum!* has used this strategy before as it is said that in China it has the first mover advantage. *Yum!*, therefore, has the knowledge and the experience of using this strategic growth option successfully.

Another strategic growth option available for *Yum!* is of product development. *Yum!* has started to respond to the social changes in the external environment and cater for the health conscious people by providing salads and lighter dishes. Given this trend, *Yum!* should further continue to develop other products for health conscious customers. From the analysis above it appears that *Yum!* can opt for the two options of growth – market development and product development.

*Accept any other evaluation (the choice of one option, for example) provided it is well substantiated.*

***[7 to 9 marks]***

Balanced and detailed evaluation of the Ansoff strategic growth options available to *Yum!*. Appropriate reference is made to the stimulus material. For ***[9 marks]*** an appropriate supported judgment is given.

***[4 to 6 marks]***

Some appropriate analysis of the Ansoff strategic growth options available to *Yum!* Some reference is made to the stimulus material at the top end of the band, though this may be lacking at the lower end of the band.

***[1 to 3 marks]***

A limited and essentially descriptive answer that may simply offer a list of the Ansoff strategic growth options available to *Yum!* There may be limited, if any, reference made to the stimulus material.

5. (a) **Identify *two* primary sources and *two* secondary sources that *Body Beautiful* can use in its market research.** **[4 marks]**

Primary research involves the collection of first hand information that does not already exist within the company. Possible primary sources may include:

- the use of a focus groups like teenagers/current customers
- questionnaires to current members and to non-members
- interviews with customers
- telephone/on line surveys on the needs of teenagers and current customers
- first hand and personal experience of competitor facilities.

Secondary research involves the use of information that already exists. Possible secondary sources may include:

- Government, other relevant general and specific publications as well as Internet sites on demography, social trends, and life style/leisure activities of various segments
- economic forecasts such as changing income, employment, interest rates
- statistics/information published by the competitors or about the competitors.

*Any other relevant suggestion for both primary and secondary sources.*

**[1 mark]** for each correct identification of a primary source that is relevant to the case up to a maximum of **[2 marks]**. **[1 mark]** for each correct identification of a secondary source that is relevant to the case up to a maximum of **[2 marks]**.

- (b) Using both above and below the line promotional techniques, prepare a promotional mix for *Body Beautiful* to attract “teenagers who are not very health conscious”.

*[6 marks]*

The response to this question is a rather open ended one. It is expected that the candidates use examples of both below and above the line promotion techniques and a promotional mix that are relevant and applicable to the teenage segment. The use of the various promotional mix components should be consistent.

For example:

- promotions below the line may include sales promotion like product endorsement by a famous popular sport personality who explains the benefits of health clubs; product placing on TV programmes watched by the youth segment; free trial offers or gifts which are appealing to teenagers
- direct mailing after identifying the e-mail address of teenagers
- articles about the benefits of sport activities placed in magazines targeting teenagers (PR)
- above the line promotion may include advertising placed in local magazines and newspapers that the teenager segment is likely to read or cinemas as well as schools and other places they are likely to visit. Posters can also be placed near schools and so on
- *credit any other relevant suggestion.*

*[5 to 6 marks]*

A promotional mix incorporating the use of both below and above the line promotion techniques. The promotional mix is appropriate to the youth segment. Relevant reference is made to the service/products that *Body Beautiful* is offering.

*[3 to 4 marks]*

A promotional mix incorporating the use of below and/or above the line promotion. Some reference is made to the teenage segment at the upper end of the band.

*[1 to 2 marks]*

A limited promotional mix that may simply be a list of promotional techniques.

- (c) **Analyse the usefulness of market segmentation for a health club like *Body Beautiful*.**

**[6 marks]**

Market segmentation – dividing the market into distinct groups of buyers with different characteristics, behaviour and needs that require a separate product/service or marketing mix.

Through market segmentation *Body Beautiful* will collect specific information and knowledge on the relevant segments and consequently will be able to:

- target the most relevant segment(s)
- adapt, vary and differentiate its service so as to satisfy individual segment(s) specific needs and, therefore, become a more customer-focused organization
- differentiate and so become more competitive in a highly competitive market
- develop a more concentrated marketing effort – *Body Beautiful* will adapt its marketing mix and so increase revenue while reducing costs.

However:

- *Body Beautiful* must ensure that its chosen characteristic for segmentation (age) is a relevant one so that profits are increased rather than decreased
- a lot of money might be spent on market research
- the youth market can be very volatile and young people can change their mind quite often and look for a different experience somewhere else
- other competitors may copy the *Body Beautiful* strategy.

Given its current volatile competitive position and provided that *Body Beautiful* researches the market thoroughly, segmentation of an untapped market can be useful.

**[5 to 6 marks]**

Balanced and detailed analysis of the usefulness of market segmentation with relevant application to the stimulus.

**[3 to 4 marks]**

Some analysis of the usefulness of market segmentation, though this may be lacking in balance and tend to be descriptive at the lower end of the band.

**[1 to 2 marks]**

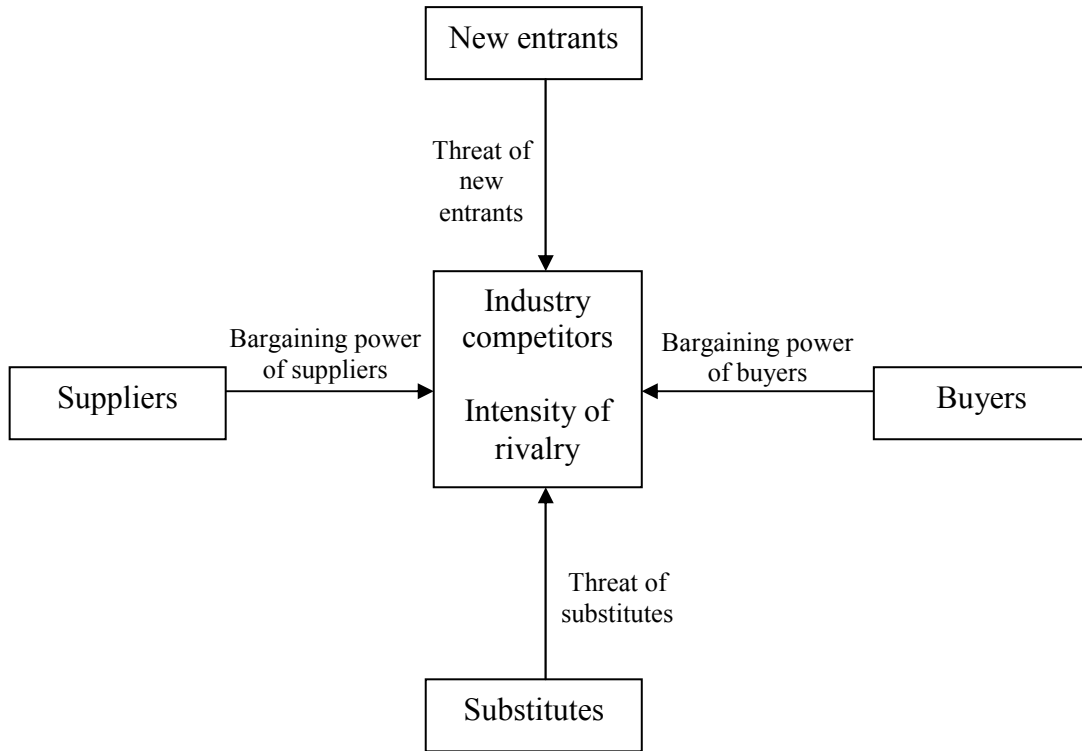
A limited and essentially descriptive answer.



(d) With reference to Porter’s Five Forces model, evaluate *three* of the competitive forces affecting *Body Beautiful* in the health club market.

[9 marks]

Porter Five Forces Model:



The threat of new entrants is very high. Two other competitors have just entered into the market and the likelihood is that given the current government policy, more will apply for a license to operate.

The bargaining power of the buyers is also extremely high. More choices and better facilities provided by more competition has already created less loyalty and some customers have moved to the new health clubs. This trend is likely to continue if *Body Beautiful* does not become more competitive. Therefore, the threat of a substitute is also very high especially as some of the customers perceive *Well-Being* to be better.

The bargaining power of the suppliers of the state of the art gym equipment is very high. Unless *Body Beautiful* finds new suppliers without compromising on quality, the opportunity to negotiate better prices is very limited. It looks as if the rivalry between the competitors is intense as the government tries to increase the level of competition. It is unlikely that *Body Beautiful* will be able to influence either the government policy or the supplier policy.

*Body Beautiful* is currently in a very vulnerable position and should indeed take the suggested actions to reduce the threat of substitutes and the bargaining power of its customers by becoming a more customer-focused organization and by differentiation of services.

***[7 to 9 marks]***

Balanced and detailed evaluation of three of the competitive forces affecting *Body Beautiful* in the health club market. Appropriate reference is made to the stimulus material. For ***[9 marks]*** an appropriate supported judgment is given. *(Do not penalize a candidate that does not draw the model).*

***[4 to 6 marks]***

Some appropriate analysis of at least two competitive forces affecting *Body Beautiful* in the health club market. Some reference is made to the stimulus material at the top end of the band, though this may be lacking at the lower end of the band. For detailed evaluation of just one competitive force award a maximum of ***[4 marks]***.

***[1 to 3 marks]***

A limited and essentially descriptive answer that may simply offer a list of points with limited or no direct reference to Porter's five forces model. There may be limited, if any, direct reference to the stimulus material.

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**BUSINESS AND MANAGEMENT  
STANDARD LEVEL  
PAPER 1**

SPECIMEN PAPER

1 hour 15 minutes

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**INSTRUCTIONS TO CANDIDATES**

- Do not open this examination paper until instructed to do so.
- Read the case study carefully.
- Section A: answer two questions.
- Section B: answer the compulsory question.

## SECTION A

Answer **two** questions from this section.

1. (a) Describe **one** advantage and **one** disadvantage of *SunGen Ltd* recruiting a significant proportion of their staff internally from *Electrical Solutions plc* (line 108). [4 marks]
- (b) Explain the effect on motivation of offering high performing staff significant financial bonuses (lines 129-130). [4 marks]
- (c) Analyse the costs **and** benefits of changing the organizational structure of *SunGen Ltd* to a flatter structure (line 110). [7 marks]
2. (a) (i) Define the term *unique selling point*. [2 marks]
- (ii) Describe the unique selling point for *SunGen Ltd*. [2 marks]
- (b) Explain **one** external opportunity and **one** external threat that *SunGen Ltd* is facing as a result of their expansion plan. [4 marks]
- (c) House builders are the current target market of *SunGen Ltd*. *SunGen Ltd* is considering targeting individual households.
- Examine the marketing mix that would be appropriate for each of these target markets. [7 marks]
3. (a) (i) Define the term *working capital*. [2 marks]
- (ii) Identify **two** possible sources of finance for an increase in working capital. [2 marks]
- (b) As a result of problems with suppliers, *SunGen Ltd* has decided to keep larger levels of stock. Comment on the effects that this decision will have on *SunGen Ltd's* liquidity ratios. [4 marks]
- (c) Examine whether *SunGen Ltd* should implement a Total Quality Management approach as proposed by Catherine. [7 marks]

**SECTION B**

Answer **the compulsory** question from this section.

4. Alex Roderey has prepared the provisional accounts for the financial year ending 31 March 2007 and has submitted a ratio analysis to the board of directors. The key ratios from this analysis are shown in Item 1 in the Additional information below.

The board of directors has decided to expand capacity by building a new production plant.

- (a) (i) Define the term *liquidity*. [2 marks]
- (ii) Identify **two** appropriate sources of finance for the new production plant. [2 marks]
- (b) (i) Explain the difference between the net profit margin and the gross profit margin. [2 marks]
- (ii) Explain how the levels of profit **and** cash flow on the free standing solar panels are likely to change through the different stages of the product life cycle. [6 marks]
- (c) Discuss the changes in the profit **and** liquidity ratios between 2006 and 2007. [8 marks]

**Additional information**

**Item 1: Financial information – SunGen Ltd**

**Year ended 31 March 2007 – SunGen Ltd**

<b>Profitability</b>	
Gross profit margin (%)	–5
Net profit margin (%)	–25
ROCE (%)	–7
<b>Liquidity</b>	
Current ratio	1.0
Acid test ratio	0.4



# **MARKSCHEME**

## **SPECIMEN PAPER**

### **BUSINESS & MANAGEMENT**

#### **Standard Level**

#### **Paper 1**

**SECTION A**

1. (a) Describe *one* advantage and *one* disadvantage of *SunGen Ltd* recruiting a significant proportion of their staff internally from *Electrical Solutions plc* (Line 108).

[4 marks]

Initially a significant proportion of the staff for *SunGen Ltd* were recruited internally from *Electrical Solutions plc*. This may result in various advantages and disadvantages:

**Advantages**

- appropriate staff can be selected and their skills, abilities and experience will be well known. This is a good way to ensure an appropriate balance of skills and experience for the *SunGen Ltd* start-up
- the process of recruitment is likely to be faster and more efficient by recruiting staff internally
- *any other appropriate advantage.*

**Disadvantages**

- the internally recruited staff may form an informal group with differing aims and objectives from other groups. This may result in the potential for conflict within *SunGen Ltd* staff
- recruiting a large proportion of staff internally may result in missing out on external expertise that could potentially have been more specialist and appropriate for a startup in a different area of business
- the recruitment of a large proportion of staff internally may be a demotivating factor for other *SunGen Ltd* staff
- *any other appropriate disadvantage.*

Award [2 marks] for an appropriate description of an advantage and [2 marks] for an appropriate description of a disadvantage. Maximum of [4 marks].

- (b) **Explain the effect on motivation of offering high performing staff significant financial bonuses (*lines 129-130*).**

***[4 marks]***

The impact of the financial bonuses on motivation will depend on the importance of financial reward to employees and this may vary from one member of staff to another. Some will regard recognition and responsibility (non-financial factors) as more important and in these cases, the impact on motivation of the bonuses is likely to be lower. However, we can reasonably expect that the bonuses will have the following effects on motivation:

- financial bonuses are likely to boost motivation. Financial bonuses for good performance are likely to be considered as a form of recognition for a “job well-done” and this may help boost esteem needs (as identified in Maslow’s hierarchy of needs)
- the bonuses may also, on the basis that they act as a form of recognition, act as a “motivator” as identified by Herzberg
- in terms of equity theories of motivation, the high-performing staff will feel that their contribution has been recognised and perhaps therefore feel that their remuneration package is fair.

Overall, motivation can be expected to increase – it is the extent of the increase that cannot be certain. Arguably, high-performing staff will be the most motivated already and therefore the impact on motivation might be less than expected.

*N.B. Candidates need not refer to the work of specific theorists in their answers, but can be credited appropriately if they choose to.*

***[4 marks]***

The impact of the bonuses on motivation is fully and clearly explained.

***[2 to 3 marks]***

The impact of the bonuses on motivation is explained, but the explanation may be lacking in detail.

***[1 mark]***

A limited answer that may simply identify the impact of the bonuses on motivation.



- (c) Analyse the costs *and* benefits of changing the organizational structure of *SunGen Ltd* to a flatter structure (line 110).

[7 marks]

Flatter organizations will have various advantages:

- faster vertical communication flows – this may help *SunGen Ltd* to improve efficiency and enable faster decision-making with clearer implementation of strategy. Workers have been concerned at a lack of leadership and vision and this may help communication of the strategic direction better.
- employees may feel more empowered if they are more involved with decision-making in a flatter structure. This may result in a boost in motivation and again help create a clearer sense of vision for the company.
- flatter structures may help reduce costs with fewer staff in middle management positions. Given the recent growth in costs this may help make *SunGen Ltd* profitable quicker.
- flatter structures may, if employees are given more responsibility and feel empowered, lead to a more innovative and creative workforce, which is vital in a fast-moving industry like the one *SunGen Ltd* is operating in.
- flatter structures may be more efficient particularly when firms are small (as *SunGen Ltd* is) and when the staff are highly involved with the product, which is likely to be true for *SunGen Ltd*. This may help increase productivity and therefore enable a faster route to productivity and more efficient use of the existing resources.

However, there are likely to be disadvantages:

- staff may lack direction – this appears to be a problem already at *SunGen Ltd* and given that a flatter structure might increase the span of control, this might worsen the situation.
- communication might fail or be distorted. Where there is a larger span of control and a flatter structure, there may be faster vertical flows of information, but there may be horizontal communication problems with information not adequately reaching all members of staff at a given level.
- decisions that are made may not reach all staff on time and this may result in delays in production. Given that these are already occurring at *SunGen Ltd* and that problems have led to delays in production, this may worsen the situation. Appropriate communication strategies will be required to ensure that this is not an issue.
- decisions might take longer if consensus is sought and more staff are involved in decision-making. As *SunGen Ltd* work in a fast-moving, rapid development industry, this may hold back their growth.
- staff may be demotivated by a lack of promotion opportunities because of the flatter structure. The extent of this demotivation will depend on the extent to which the flatter structure helps boost involvement and empowerment and compensates for this.
- the greater span of control may make it more difficult for managers to “control” staff at their level and put them under increased time pressure and stress.

Candidates should analyse these costs and benefits and comment on the extent to which they are likely to occur in the context of *SunGen Ltd*.

***[6 to 7 marks]***

Balanced and detailed analysis of the costs and benefits of a flatter structure. The analysis is related to the case and business terminology is used appropriately where relevant.

***[3 to 5 marks]***

Identification and explanation of the costs and benefits of a flatter structure. At the top end of the band this is generally related to the case and considers both costs and benefits. At the lower end of the band the explanation may lack balance and may not be related to the case.

***[1 to 2 marks]***

A limited and generalised answer that may simply identify costs and benefits with no development or analysis.

2. (a) (i) **Define the term *unique selling point*.** **[2 marks]**

The unique selling point (or unique selling proposition) is the principal characteristic of a good or service that separates it from its competitors. According to this concept, successful advertising campaigns are based on emphasising a product's unique selling proposition. It is the thing that will make customer's choose the product over other similar ones in the market.

**[2 marks]**

A clear and appropriate definition of unique selling point.

**[1 mark]**

Some appropriate elements of a definition of unique selling point, but the definition may be lacking in detail or clarity.

- (ii) **Describe the unique selling point for *SunGen Ltd*.** **[2 marks]**

The unique selling point (USP) for *SunGen Ltd* is the environmentally friendly nature of their product. The ability to generate free electricity from the product and thereby avoid the environmental impact of other forms of energy.

*Credit candidates if they describe another different, but nevertheless appropriate USP.*

**[2 marks]**

Identification and clear description, of an appropriate USP for *SunGen Ltd*.

**[1 mark]**

Identification of an appropriate USP, perhaps with some description but lacking clarity.

- (b) Explain *one* external opportunity and *one* external threat that *SunGen Ltd* is facing as a result of their expansion plan.

[4 marks]

The *SunGen Ltd* expansion plan is to target their products “at individual households”. Their current target market is mainly housebuilders who use the product on new properties or houses being restored professionally. The intention of the expansion plan is to start to broaden the target market to individual households. This may result in a number of external opportunities and threats:

### **Opportunities**

- Governments are under pressure to meet tighter environmental targets from international treaty obligations (*e.g.* Kyoto treaty) and this may result in incentives being offered to households to purchase products of this nature. If *SunGen Ltd* has in place appropriate distribution strategies for their products to individual households, then they will be able to take advantage of this. *SunGen Ltd* are also, through a PR firm, trying to put pressure on the government to introduce these kind of regulations and also tighten environmental regulations. Their expansion plan will put them in a better position to take advantage of this potential new market.
- The market for solar power products is growing at around 20% per year and their expansion plan will put them in a better position to take advantage of this market growth.
- There are currently few competitors and there are important differences in their products. *SunGen Ltd's* expansion plan will put them in a better position to gain first-mover advantage in this new market segment.
- Environmental awareness is increasing among individual consumers and the expansion plan will help *SunGen Ltd* take advantage of this as it will enable them to build appropriate distribution channels to meet this potential demand.
- *Any other appropriate external opportunity.*

### Threats

- A reduction in economic growth is forecast, and though this is not a recession, *SunGen Ltd's* products are arguably income elastic in nature and so the lower level of economic growth may lead to a fall in expenditure on solar power products.
- The market is still risky. Although *SunGen Ltd* would have first-mover advantage, it is still a niche market in nature and the results of the market research could be argued to be a little ambiguous. This may represent a threat to their abilities to expand into this new market.
- The market is geographically dispersed in nature and this may represent a challenge to the setting up of appropriate distribution channels.
- The rapid growth forecast in the market may attract new firms into the market and this will be a potential threat to *SunGen Ltd's* position in this market.
- Some increase in inflation is forecast and this may lead to uncertainty among consumers. This combined with the drop in economic growth could potentially reduce the growth forecast in the market.
- *Any other appropriate external threat.*

Award **[1 mark]** for identifying an appropriate external opportunity plus an additional **[1 mark]** for an adequate explanation. Maximum of **[2 marks]** for an external opportunity. Award **[1 mark]** for identifying an appropriate external threat plus an additional **[1 mark]** for an adequate explanation. Maximum of **[2 marks]** for an external threat.

- (c) **House builders are the current target market of *SunGen Ltd*. *SunGen Ltd* is considering targeting individual households.**

**Examine the marketing mix that would be appropriate for each of these target markets.**

*[7 marks]*

The market for individual households is being targeted by *SunGen Ltd* as part of their expansion plan. The marketing mix that is appropriate to this market is likely to be different in nature to that currently required for the target market of housebuilders.

**House builders – marketing mix**

**Price** – price will be important to housebuilders as it will represent an important element of their costs and they will want to minimise these. *SunGen Ltd* may use cost-based pricing or a similar pricing strategy to ensure they are competitive and encourage the maximum possible level of demand.

**Product** – housebuilders will be a very “technically-aware” market and so *SunGen Ltd* will emphasise the nature of the product in their marketing mix. They will want to stress the various different versions of the product available and ensure that they fit in with the various different requirements of the housebuilder market.

**Promotion** – the promotional strategy used for housebuilders will be quite specific and is likely to focus mainly on the use of below the line promotional strategies. The use of targeted e-mail, newsletters, personal selling and trade shows is likely to be most appropriate as their market is quite closely defined and easier to target using these approaches.

**Place** – distribution of the product to housebuilders is likely to be quite straightforward. Housebuilders are likely to order several/multiple products at any given time and the distribution channel is direct from manufacturer to final consumer (housebuilders).

**Individual households – marketing mix**

**Price** – because they are cheap to fit, the solar panels should also have a low initial price. A penetration pricing strategy could be used to convince people to buy them and given the “luxury” nature of the product, it can be argued that the product will be price elastic in nature. A penetration pricing strategy will help in this situation. Given that *SunGen Ltd* are effectively competing with electricity companies, they will need to take electricity pricing into account. As energy prices increase, it may be that they can move more towards a skimming pricing strategy.

**Product** – the nature of the product will need to be stressed to ensure consumers are aware of the nature of the product. The ability of the product to generate electricity that can be fed back into the electricity grid may need to be stressed along with the characteristics of the product.

**Promotion** – the promotional strategy used for individual households is likely to be more focused on above the line promotion. The market for individual households is a geographically dispersed one and to reach them may require above the line promotion strategies. These may include newspaper and magazine advertising, internet advertising on appropriate lifestyle and other web sites and perhaps radio and other media advertising. TV advertising is very unlikely for a firm the size of *SunGen Ltd.* Point of sales promotion may also be used in places where the panels are being made available.

**Place** – the market for solar panels is very geographically dispersed and this will require appropriate national distribution channels. This may mean franchising a dealer network or perhaps negotiating a deal with national DIY chains or hardware stores. It may also be possible to use a B2C distribution method through the Internet.

*Candidates may refer to other “P’s” in their answer and should be credited appropriately for this.*

***[6 to 7 marks]***

A detailed and balanced examination of the marketing mix for both target markets considering at least four P’s. Business terminology is used appropriately where relevant.

***[3 to 5 marks]***

Some examination of the marketing mix for both target markets, considering at least two of the four P’s in some detail or at least three P’s in less depth. Candidates should be awarded a maximum of ***[3 marks]*** for an examination of the marketing mix of just one of the two target markets.

***[1 to 2 marks]***

A limited and essentially descriptive answer that may simply list points related to the marketing mix of each target market.

3. (a) (i) **Define the term *working capital*.** **[2 marks]**

Working capital is the amount of money that a business has to fund its day-to-day operations. It is a measure of liquidity and can be calculated by deducting current liabilities from current assets. It is the portion of capitalization invested in current assets.

**[2 marks]**

A clear and appropriate definition of working capital.

**[1 mark]**

Some appropriate elements of a definition of working capital, but the definition may be lacking in detail or clarity.

(ii) **Identify *two* possible sources of finance for an increase in working capital.** **[2 marks]**

The sources of finance could include short-term sources of finance such as:

- bank overdraft
- debt factoring
- trade credit
- selling stock.

Award **[1 mark]** for each source identified up to a maximum of **[2 marks]**.



- (b) **As a result of problems with suppliers, *SunGen Ltd* has decided to keep larger levels of stock. Comment on the effects that this decision will have on *SunGen Ltd*'s liquidity ratios.**

***[4 marks]***

The two main liquidity ratios are the current ratio and the acid test ratio. The acid test ratio deducts stock from current assets to allow for the fact that stock is the least liquid of the current assets. The latest figures given in Appendix 3 indicate that *SunGen Ltd* has a current ratio of 1.1 and an acid test ratio of 0.6. The value of the acid test ratio indicates possible liquidity problems already. If *SunGen Ltd* choose to keep higher levels of stock because of their problems with suppliers then this is likely (*ceteris paribus*) to lead to an increase in the current ratio as their current assets grow. However, the higher levels of stock will have no impact on the acid test ratio as this excludes stock to give a better measure of liquidity.

***[3 to 4 marks]***

The impact of the higher stock levels on both the current and acid test ratios is appropriately considered and fully explained. For ***[4 marks]*** there is appropriate reference to the case study.

***[1 to 2 marks]***

There is some consideration of the impact of higher levels of stock on liquidity, but this may not include reference to the case or to both the current and acid test ratios.

**(c) Examine whether *SunGen Ltd* should implement a Total Quality Management approach as proposed by Catherine.**

**[7 marks]**

Catherine is a strong advocate of Total Quality Management (TQM) and wants to use quality circles. This approach will involve the whole workforce in ensuring quality at all stages of production. The TQM approach will need to be embedded in the culture of the company and may be expensive with the implementation of new systems. It should, however, identify quality issues before production has taken place in contrast to a traditional quality control approach that checks the quality of finished goods.

The evaluation of the TQM approach needs to consider the merits of the approach in the context of *SunGen Ltd*. A wide range of points could be raised:

- TQM would require a company-wide approach and commitment from all staff – is this likely to be available? Tony, the production manager has a more traditional approach to quality control and is keen to appoint new managers to take charge of quality. Will he be committed to this approach? Given that he is a key player in these changes, it will be important to know his view. Without a total commitment from Tony and all other staff, a more traditional approach may work better.
- TQM could require substantial investment in staff training and is likely to take a considerable time to yield benefits, but the benefits are likely to be greater in the medium to long term than with traditional approaches.
- TQM may put more emphasis on the process and not enough on the product. However, it may enable the company to focus more clearly on the needs of customers.
- TQM may help develop a team approach to quality and involve all staff. This may help motivate staff. In contrast a more traditional approach may mean more autocratic leadership and may demotivate staff.
- TQM focuses on finding quality problems before production, this ensures that the product shipped to customers is defect-free. This may help build better customer relations and may be more appropriate in the light of their expansion plans to individual households. Given some problems that they have had with quality, this may be a help in restoring better customer relationships.
- a TQM approach may help improve communication flows – both formal and informal. This may help improve productivity and ensure better use of resources. A more traditional approach relies on top-down communication. Which of these approaches is more appropriate will depend on the perceived staff reaction to each approach.

***[6 to 7 marks]***

A detailed and balanced evaluation of the implementation of a TQM approach to quality management. The evaluation is related to the case study and clearly identifies how a TQM approach will affect *SunGen Ltd.* Business theory and terminology is used appropriately where relevant.

***[3 to 5 marks]***

An appropriate description of the implications of a TQM approach to quality management. At top end of the band there is some consideration of both the costs and benefits of TQM and the answer is generally related to the case study, but it may be lacking in balance and unrelated to the case study at the lower end of the band.

***[1 to 2 marks]***

A limited and essentially descriptive answer with identification of some costs and/or benefits of a TQM approach to quality management.

**SECTION B**

4. (a) (i) **Define the term *liquidity*.** **[2 marks]**

Liquidity refers to how quickly and cheaply an asset can be converted into cash. Money (in the form of cash) is the most liquid asset.

**[2 marks]**

A clear and appropriate definition of liquidity.

**[1 mark]**

Some appropriate elements of a definition of liquidity, but the definition may be lacking in detail or clarity.

- (ii) **Identify *two* appropriate sources of finance for the new production plant.** **[2 marks]**

The new production plant will need to be financed from long-term sources of finance. These may be either internal or external sources of finance, though their room to manoeuvre may be a little restricted by their current situation in terms of ownership and liquidity. They already have a substantial loan and their gearing ratio is nearly 70%. They are not able to issue shares as they are a wholly owned subsidiary of *Electrical Solutions plc*, though *Electrical Solutions plc* may be able to issue shares and use this as a means to raise capital. Possible appropriate sources of finance could therefore include:

- internal investment from *Electrical Solutions plc* – perhaps from profit or cash reserves
- sale and leaseback – *SunGen Ltd* may be able to sell some assets and lease them back, though this may be difficult given their rate of expansion
- mortgage – it is possible that they could mortgage some of their fixed assets (given fixed assets of \$1.3 m). The viability of this depends on the current ownership of the fixed assets
- joint venture – they could perhaps undertake a joint venture, for example, with a production company in a related area of activity
- Government grant – they may be eligible for some local or national grants because of their environmental profile
- *any other relevant source of finance (though this must be in the context of the case study).*

Award **[1 mark]** for each appropriate source of finance identified up to a maximum of **[2 marks]**.

- (b) (i) Explain the difference between the net profit margin and the gross profit margin.**

*[2 marks]*

The gross profit margin measures the profitability of the firm once the cost of goods sold has been taken into account. It is calculated by dividing the gross profit by the turnover and multiplying by 100 to get the figure as a percentage. The net profit margin measures the profitability of the firm once the expenses have also been deducted. It is calculated by dividing the net profit by the turnover and multiplying by 100 to get the figure as a percentage. The difference is therefore that the net profit margin is measured after expenses as well as the cost of goods sold have been deducted.

*[2 marks]*

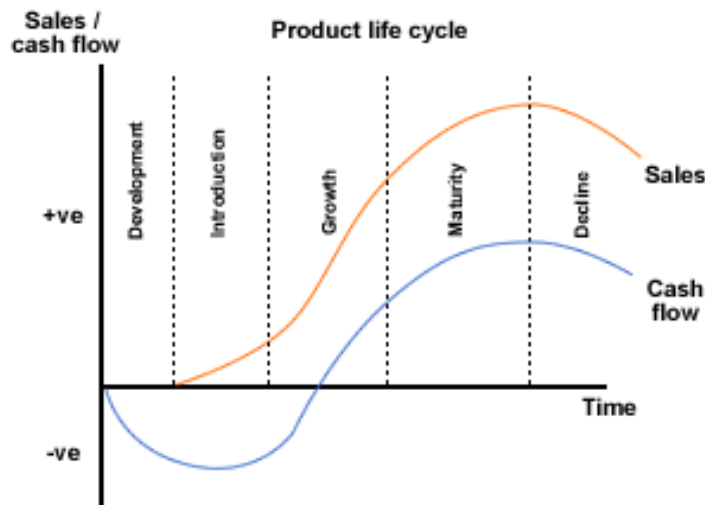
A clear and appropriate explanation of the difference between the gross and net profit margins.

*[1 mark]*

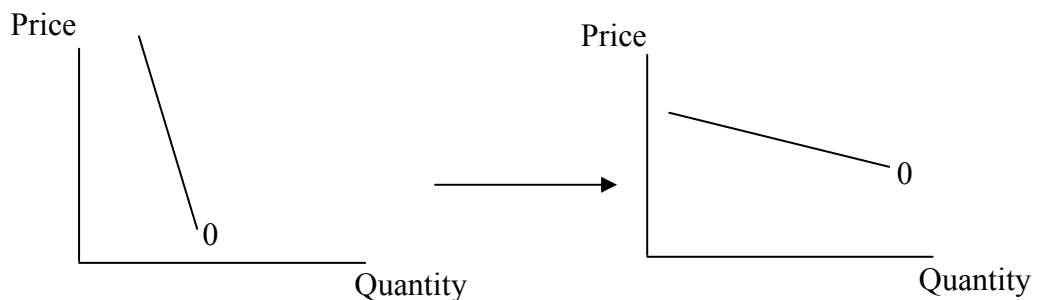
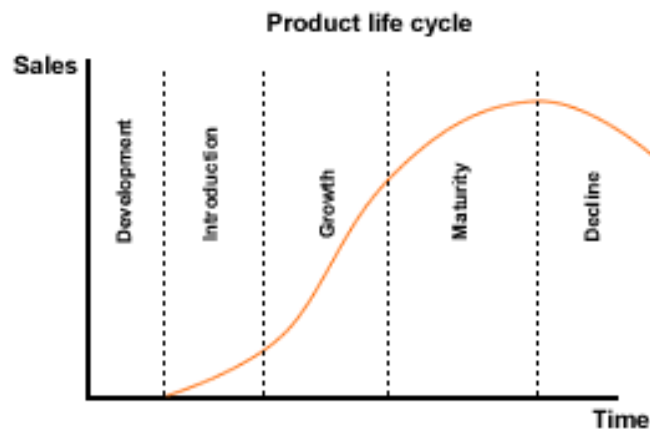
Some appropriate elements of an explanation of the difference between the gross and net profit margin, but the explanation may be lacking in detail or clarity.

- (ii) Explain how the levels of profit *and* cash flow on the free standing solar panels are likely to change through the different stages of the product life cycle. [6 marks]

The cash flow from a product like the free standing solar panels as it moves through its life cycle will change. Initially high development costs (likely for solar panels) and high promotional costs will mean a negative cash flow, but as the products moves through the growth phase and into maturity, the cash flow should start to become positive. This could be shown diagrammatically.



As a result profitability of the free standing solar panels will also change through the life cycle of the product. This will be partly due to the fact that price elasticity will tend to vary at each stage of the product life cycle.



Demand becomes more elastic through product life cycle

In the growth phase of the product life cycle, the solar panels may tend to be fairly price inelastic in nature. People buying at this stage will tend to be “innovators” and they may be prepared to take risks with new products. Price will not be such an important consideration for them – they have a greater “need” for the product. This may lead to a high profit margin at this stage of the product life cycle, though overall profitability is likely to be low (or even negative) due to the high development and production setup costs for the solar panels.

However, as the product moves towards maturity, the price elasticity will increase. The amount of competition will increase and the increasing number of substitutes will make consumers more price sensitive. The nature of the consumers will also change and they are likely to be more motivated to buy by factors like price, functionality and reliability. This is particularly likely to be true for solar panels as they gain more widespread acceptance. This may lead to a lower profit margin at this stage of the product life cycle, though overall profitability is likely to be higher due to higher sales and the fact that introductory costs should have been paid off. Profitability will, however, depend on the nature of the competition for the product.

*N.B. Candidates may explain profitability without reference to elasticity and this should be fully credited.*

***[5 to 6 marks]***

A clear and detailed explanation of how both cash flow and the level of profit will change through the life cycle of the solar panels. The explanation is related, where appropriate, to the case study.

***[3 to 4 marks]***

Some explanation of how cash flow and the level of profit will change through the life cycle of the panels though this may be lacking in balance and consider one area in more depth than the other. Award a maximum of ***[3 marks]*** if the change in just the cash flow or level of profit is explained in detail.

***[1 to 2 marks]***

A limited answer that may identify some changes in cash flow and/or the level of profit during the life cycle of the solar panels though this may not be directly related to the case study.

- (c) **Discuss the changes in the profit *and* liquidity ratios between 2006 and 2007.**

**[8 marks]**

From a comparison of the ratios in Appendix 3 and the ratios given, it would appear that there has, in general terms, been a deterioration in the financial position of *SunGen Ltd.* However, this is susceptible to a more detailed analysis. Relevant points to raise might include:

### **Profitability**

**Gross profit margin** – this has improved, though is still showing a gross loss. Because the figure is negative, a reduction is an improvement. This may indicate either an increase in productivity/efficiency in production or perhaps simply better control over direct costs.

**Net profit margin** – this has worsened. Given the improvement in the GPM, this may indicate poor control over indirect costs (overheads). However, there may be a number of other factors at play as well. There may be costs associated with expansionary activities/growth *e.g.* marketing activity related to the expansion to targeting individual households, market research costs, research and development activity relating to proposed new products or perhaps costs associated with the planned expansion of their production facilities (*e.g.* architect fees *etc.*).

**ROCE** – this has improved in the sense that it is not as bad as before. This indicates improved efficiency in terms of the use of their assets to deliver profit. This may be related to increases in production efficiency or other related factors.

### **Liquidity**

**Current ratio** – this has deteriorated slightly, but is still 1 indicating perhaps just sufficient liquidity. However, when looked at along with the acid test ratio, it may well be that there is a problem. It would appear that stock is a significant proportion of current assets and this would make it difficult for them to realise assets sufficiently. It would appear that their working capital position has deteriorated further since 2006. Other factors behind this change could include a worsening in credit control, with debtor days increasing and creditor days falling or increasing by less than debtor days.

**Acid test ratio** – the ATR has shown a significant worsening from 0.6 to 0.4. It was, arguably, already too low and has gone down significantly. This appears to indicate that stock is now a much higher proportion of their current assets and has significantly lowered their overall liquidity. It may be that they have increased stock due to the supplier problems they have had or perhaps due to a projected increase in demand. However, the ATR value does indicate a worrying shortage of working capital that may need addressing quite quickly.



***[7 to 8 marks]***

A detailed and balanced discussion of the changes in both profitability and liquidity covering all ratios given. The discussion is related to the case study and considers reasons for the changes in the ratio values. Business theory and terminology is used appropriately, where relevant.

***[4 to 6 marks]***

An examination including detailed description of the changes in both profitability and liquidity ratios, though at the bottom end of the range, the examination may not be balanced in terms of coverage and/or may not cover all the ratios given. At the top end of the range, some attempt at discussion is made.

***[1 to 3 marks]***

A limited and essentially descriptive answer, perhaps with some description of changes in some of the ratio values, but limited identification of reasons for changes in the ratio values.

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**BUSINESS AND MANAGEMENT  
STANDARD LEVEL  
PAPER 2**

SPECIMEN PAPER

1 hour 45 minutes

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**INSTRUCTIONS TO CANDIDATES**

- Do not open this examination paper until instructed to do so.
- Section A: answer one question.
- Section B: answer two questions.

## SECTION A

Answer **one** question in this section.

### 1. Corner Store

Juan Pinilla, a sole trader who has been running a corner store for 40 years, has managed to survive the competition of the large supermarket chains. His son Pedro helps him run the store.

Juan expects that for **every month** in 2007, he will:

- sell an average of \$60 000
- mark up all his purchases an average of 20%
- use an average of 50% of the gross profit to pay for the expenses.

Pedro wants to add a delivery service and believes that buying a van at \$100 000 will allow the firm to create additional sales of \$4000 per month. The running costs of the van are estimated at \$1000 per month. A commercial bank is willing to lend the firm the money for the van but is asking to see its estimated payback period first. The bank will charge 11% interest on the loan.

- (a) Identify **four** reasons why people may prefer to buy from large supermarkets. *[4 marks]*
- (b) (i) Prepare a trading and profit and loss account for the year ending 31 December 2007. *(Show all your working)* *[6 marks]*
- (ii) Calculate the payback period for the van. *(Show all your working)* *[4 marks]*
- (c) Examine the costs **and** benefits of Pedro's proposal to buy a van. *[6 marks]*

## 2. Vintage Clothing

Patricia and her friend Carol have developed a taste for vintage clothing. They believe they can develop a successful business enterprise selling second hand and vintage style clothing to young buyers. They anticipate they will need the following:

- a shop to rent: \$3000 per month
- a salary for a full time shop attendant: \$1000 per month
- running costs: \$1000 per month
- capital to furnish the shop: \$10 000
- capital to buy the first batch of second hand clothes: \$3000.

They can purchase vintage garments for an average cost price of \$10 a piece. Each garment will sell at an average price of \$30. Their aim is to sell 300 garments per month.

Carol’s father lent them \$10 000 but insisted they formed a private limited company.

After two years of great success, Carol is considering growing by franchise although Patricia believes it is better to grow by setting up branches.

- (a) Describe **one** advantage and **one** disadvantage of a private limited company. *[4 marks]*
- (b) Calculate, showing all your working:
- (i) the break-even point per month. *[2 marks]*
- (ii) the margin of safety at the set target. *[1 mark]*
- (iii) the profit or loss at 300 garments sold per month. *[2 marks]*
- (iv) the profit or loss at 200 garments sold per month. *[1 mark]*
- (c) Construct a break-even graph to illustrate the points from (b). *[4 marks]*
- (d) Analyse the **two** growth alternatives. *[6 marks]*

**SECTION B**

Answer **two** questions in this section.

**3. L’Oreal takes over The Body Shop**

The world’s top cosmetics group *L’Oreal* has taken over the famed fair trade advocate *The Body Shop* for £652 million (US\$1090 million). Anita and Gordon Roddick, founders and owners of 18 per cent of *The Body Shop*, will earn approximately £130 million from the deal.

In its mission statement, *The Body Shop* states that it exists to “passionately campaign for the protection of the environment, human and civil rights, and against animal testing within the cosmetics and toiletries industry”. Their ethical approach is organized into five pillars: Defend Human Rights, Protect Our Planet, Support Community Trade, Activate Self-Esteem, and Against Animal Testing.

On the other hand, *L’Oreal* has been criticized for continuing to test certain ingredients on animals. Animal rights groups have protested relentlessly about this issue, saying that the company should be doing more to stop the practice, ahead of a total ban on the testing of animal products on ingredients, proposed for 2008.

Together with industry experts, animal rights campaigners are asking how *The Body Shop* can continue to wave the ethical banner when it is owned by a company with seemingly opposing values.

[Source: adapted from *The Body Shop*’s website]

- (a) Define the term *takeover*. [2 marks]
- (b) (i) Explain the purpose of a mission statement. [3 marks]
- (ii) Comment on the purpose of Non Government Organizations (NGOs) such as animal rights groups. [3 marks]
- (c) Examine the reasons why organizations consider setting ethical objectives. [5 marks]
- (d) Evaluate the decision to accept the takeover of *The Body Shop* by *L’Oreal*. [7 marks]

#### 4. Harley-Davidson roars into China

Motorcycle maker *Harley-Davidson* has opened a dealership in Beijing, its first outlet in China in more than 50 years. Entry to the Chinese market has long been a goal of the Milwaukee-based company, given the country's booming economy and its citizens' growing spending power. In 2001, after China joined the World Trade Organization, import restrictions, quotas and tariffs also dropped substantially for foreign motorcycle manufacturers.

*Harley-Davidson*, teamed up with dealer *Feng Hou Lun*, one of the most well-established retailers of imported motorcycles in China. The retail outlet, which is to be located in Beijing's Fourth Ring Road, will employ 14 people and be run by *Feng Hou Lun*'s founder, Wan Jidong.

The dealership is to sell several models of *Harley-Davidson* motorcycles, parts, accessories and collectible goods. The outlet will also provide services, rider training and events such as organized rides.

*Harley-Davidson*'s market penetration is expected to be gradual, mainly because of riding restrictions in most large cities. In Beijing and Shanghai, for example, motorcycles are banned from most major streets and highways. Shanghai also stopped accepting motorcycle registrations in 2002.

Another challenge is the price of the motorcycles, which range from \$12 000 to \$37 450. Urban incomes average about \$2 200 a year in Beijing.

[Source: adapted from the BBC Internet News, March 2006]

- (a) Define the term *market penetration*. [2 marks]
- (b) Prepare a SWOT analysis for Beijing *Harley-Davidson*. [6 marks]
- (c) Analyse the difficulties that *Harley-Davidson* might encounter when entering China. [5 marks]
- (d) Evaluate *Harley-Davidson*'s decision to team up with local motorcycle dealer, *Feng Hou Lun*. [7 marks]

## 5. Recruitment at Let's Design Ltd

When the marketing manager of *Let's Design Ltd* resigned, Alex Bate, the general manager, decided to fill the position with an internal promotion. He based his decision on his knowledge that it costs nine times more to hire someone new and that no one had been internally promoted in the company in the last two years. He gave the job to Rupert Tait, a young and creative designer who had been with the company for five years. Rupert was highly regarded by his colleagues and when the appointment was made public, the marketing department held a party to celebrate.

Yet two months after his appointment, problems have started to become apparent. Marketing tasks fell behind and the department was unable to keep up with its orders. At senior management meetings Rupert complained about the lack of cooperation from his team: he said no one was willing to put in the extra time to get the work finished. At the same time other senior managers have heard through informal channels of communication that Rupert's team complained about his leadership style, saying he was too lenient and passive. Alex Bate is planning to take formal action because of Rupert's poor performance. One possible outcome is that he could dismiss Rupert and recruit for his position externally.

- (a) Define the term *informal communication*. [2 marks]
  - (b) Explain the steps that are included in an external recruitment process. [6 marks]
  - (c) Analyse the possible causes of Rupert's unsuccessful management performance. [5 marks]
  - (d) Evaluate Alex Bate's idea of dismissing Rupert and recruiting externally. [7 marks]
-

# **MARKSCHEME**

## **SPECIMEN PAPER**

### **BUSINESS & MANAGEMENT**

#### **Standard Level**

#### **Paper 2**



**SECTION A**

1. (a) Identify *four* reasons why people may prefer to buy from large supermarkets. **[4 marks]**

Possible reasons are:

- larger stores enjoy economies of scale and can sell at lower prices
- large supermarkets can offer a greater variety of products
- easy car access
- more attractive point of sale
- more variety of payment possibilities (debit, credit cards, cheques, *etc.*)
- *any other valid reason.*

Award **[1 mark]** per reason identified, up to a maximum of **[4 marks]**.

- (b) (i) Prepare a trading and profit and loss account for the year ending 31 December 2007. (*Show all your working*) **[6 marks]**

**Profit and loss account:**

Sales	$\$60\,000 \times 12$	$= \$720\,000$	
CGS	$\$50\,000 \times 12$	$= \$600\,000$	
Gross profit	$\$10\,000 \times 12$	$= \$120\,000$	
Expenses	$\$5\,000 \times 12$	$= \$60\,000$	
Net profit	$\$5\,000 \times 12$	$= \$60\,000$	

**Profit and loss account for Juan Pinilla’s store for year ended 31 December 2007:**

	\$000
Sales revenue	720
<i>Less</i> cost of goods sold	<u>600</u>
Gross profit	120
<i>Less</i> expenses	<u>60</u>
Net profit before interest and tax	60

**[5 to 6 marks]**

An accurate profit and loss account is prepared, and laid out in suitable format. All working is shown.

**[3 to 4 marks]**

A profit and loss account is prepared. Allow a total of three errors either in calculation(s) or format. Award a maximum of **[3 marks]** if monthly figures are used and/or no working is shown.

**[1 to 2 marks]**

A basic understanding of the trading and profit and loss account is shown.

**(ii) Calculate the payback period for the van. (Show all your working) [4 marks]**

Additional sales  $\$4000 \times 12 = \$48\,000$  per year  
Additional costs =  $\$1000 \times 12 = \$12\,000$  running costs per year  
Interest payment to the bank =  $\$11\,000$   
Total extra costs =  $\$23\,000$   
Additional net profit =  $\$25\,000$

Payback period =  $\$100\,000 / \$25\,000 = 4$  years

Award **[1 mark]** for calculating the correct sales revenue, **[1 mark]** for calculating the correct additional costs (including interest), **[1 mark]** for the correct payback formula and **[1 mark]** for the correct answer. Maximum **[4 marks]**.

**(c) Examine the costs and benefits of Pedro's proposal to buy a van. [6 marks]**

**Costs:** There are increased risks in buying a van, since the business will become more complex. A driver needs to be hired and that means caring for an extra worker. Vans need to be maintained, and accidents can happen. Insurance costs have to be taken into account. Estimated sales might not be realistic and the firm might face difficulties paying back the bank loan. The banker becomes a creditor that can sue the firm, and Juan Pinilla is fully liable as a sole trader. It is possible that the business will grow so much that it will exceed the capacity of the firm to supply customers in a timely form.

**Benefits:** The van will bring additional profit. It will help lower purchasing costs, by allowing the owners to go to cash and carry warehouses and buy their own supplies. They can also add delivery services, increasing their area of influence and selling to a market of customers who are impaired from going to the store, but still like personalized service. At a cost of 11% per year on the loan, and an investment in profit of 25%, financially the van seems like a good investment. It is also convenient to think of strategies to compete with the chains, and this is a good way to compete.

*Credit other valid costs and benefits.*

**[5 to 6 marks]**

Costs and benefits are examined in detail and the answer is well balanced.

**[3 to 4 marks]**

Costs and benefits are examined, but the answer lacks detail and/or balance.

**[1 to 2 marks]**

A limited and general response.

2. (a) Describe *one* advantage and *one* disadvantage of a private limited company. *[4 marks]*

Possible advantages:

- a private limited company enjoys limited liability for all its shareholders
- more shareholders could be invited to join and supply more capital
- a private limited company is a legal entity; therefore its life survives the owners
- *any other appropriate advantage.*

Possible disadvantages:

- it is more expensive to set up and there is more bureaucracy involved in the process
- if the business venture remains small, the costs might be too high to bear
- a private limited company has rights and obligations, so it will pay taxes as a legal entity
- possible limits to the amount of capital available for expansion
- *any other appropriate disadvantage.*

Award up to *[2 marks]* for each advantage described and up to *[2 marks]* for each disadvantage described.

- (b) Calculate, showing all your working: *[2 marks]*
- (i) the break-even point per month.

$$\begin{aligned} \text{Fixed costs} &= \text{rent} + \text{salary} + \text{expenses} \\ \text{Fixed costs} &= \$3000 + \$1000 + \$1000 = \$5000 \\ \text{Contribution} &= \text{selling price} - \text{variable cost} \\ \text{Contribution} &= \$30 - \$10 = \$20 \\ \text{Break-even} &= \text{FC/Contribution} = \$5000/\$20 = 250 \text{ garments per month} \end{aligned}$$

Award *[1 mark]* for correct break-even point and *[1 mark]* for appropriate working. Maximum *[2 marks]*. Award *[1 mark]* where the working shows a clear understanding of break-even, but the answer is not correct.

- (ii) the margin of safety at the set target. *[1 mark]*

$$\begin{aligned} \text{Margin of safety} &= \text{set target} - \text{break-even point of output} \\ \text{Margin of safety} &= 300 - 250 \\ \text{Margin of safety} &= 50 \text{ garments} \end{aligned}$$

Award *[1 mark]* for correct margin of safety.

**(iii) the profit or loss at 300 garments sold per month.**

**[2 marks]**

$$\begin{aligned} \text{Output} - \text{break-even output} &= 300 - 250 = 50 \\ \text{Margin of safety} \times \text{contribution} &= 50 \times \$20 = \$1000 \end{aligned}$$

**Or**

$$\begin{aligned} \text{Total revenue (300)} - \text{Total costs (300)} &= \text{Profit/Loss} \\ \$300 \times \$30 - [\text{FC} + (300 \times \$10)] &= \text{Profit/Loss} \\ \$9000 - (\$5000 + \$3000) &= \text{Profit/Loss} \\ \$9000 - \$8000 &= -\$1000 \end{aligned}$$

Award **[1 mark]** for the correct profit and **[1 mark]** for the appropriate working or method. Maximum **[2 marks]**. Award **[1 mark]** where the working shows a clear understanding of the method of calculation, but the answer is not correct.

**(iv) the profit or loss at 200 garments sold per month.**

**[1 mark]**

$$\begin{aligned} \text{Output} - \text{break-even output} &= 200 - 250 = -50 \\ (\text{Output} - \text{break-even output}) \times \text{contribution} &= -50 \times \$20 = -\$1000 \end{aligned}$$

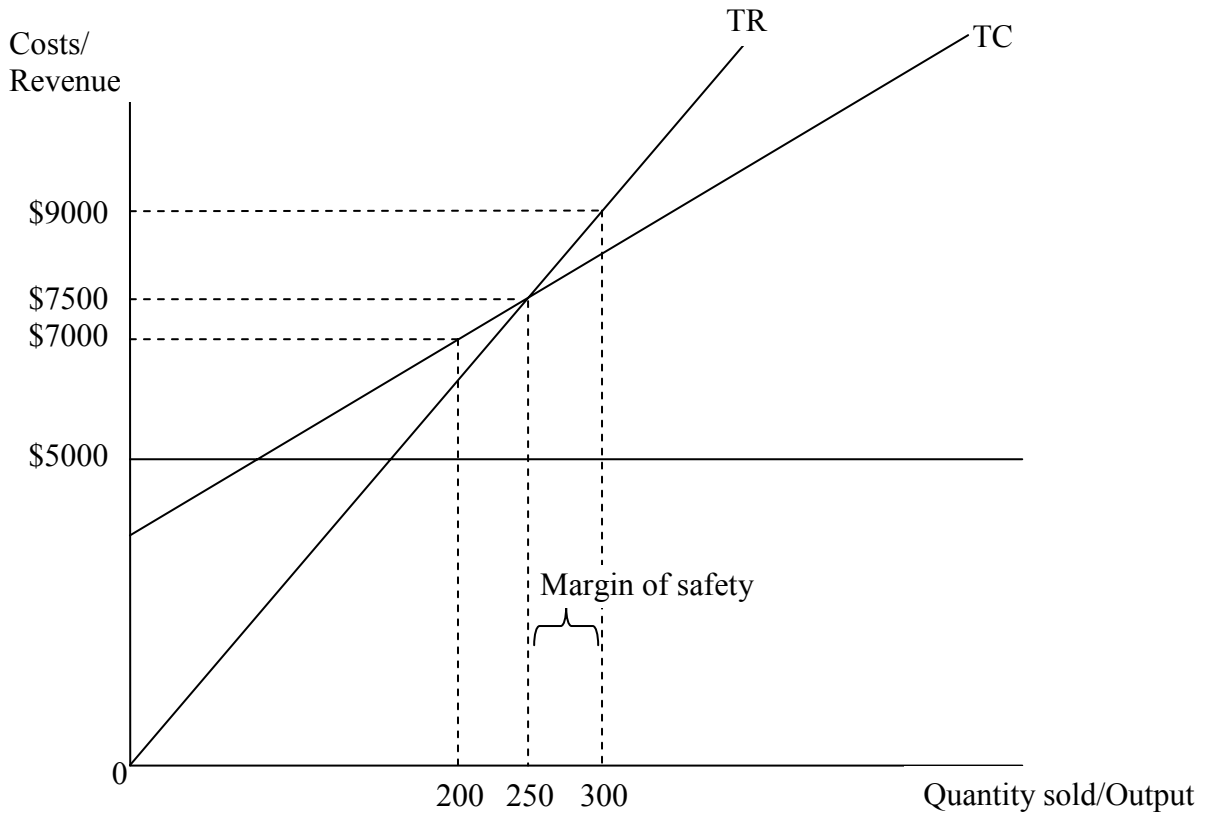
**Or**

$$\begin{aligned} \text{Total revenue (200)} - \text{Total costs (200)} &= \text{Profit/Loss} \\ (200 \times \$30) - [\text{FC} + (200 \times \$10)] &= \text{Profit/Loss} \\ \$6000 - (\$5000 + \$2000) &= \text{Profit/Loss} \\ \$6000 - \$7000 &= -\$1000 \end{aligned}$$

Award **[1 mark]** for the correct calculation of loss.

(c) Construct a break-even graph to illustrate the points from (b).

[4 marks]



Award [1 mark] for correct axes labelled, [1 mark] for correct total cost (TC) line, [1 mark] for correct total revenue (TR) line and [1 mark] for correctly showing break-even point and margin of safety. Maximum [4 marks].

**(d) Analyse the *two* growth alternatives.**

***[6 marks]***

Carol wants to grow by franchising because the method has a number of advantages. There is less risk involved since the capital needed for the new shop(s) is invested by the franchisee. The franchisee will need to find the funds to pay a franchise fee and to get started. The franchisor will earn royalties and/or sell the supplies to the franchisee. Therefore Patricia and Carol will earn revenue that is independent of whether the franchisor is profitable or not. Growth can be more rapid – there might be a number of franchises opened at the same time. Yet, at the same time, a franchise set up is complex. The quality of the service has to be equivalent to the original shop to guarantee the same quality to the customers. The image that all the stores provide must be the same. This supervision is not always easy to carry out. It is costly and time consuming.

If branches are opened, Carol and Patricia will not need to deal with the owners of the franchise, who are entrepreneurs with their own ideas. Yet they will need to find their own sources of finance. This is costly and risky. Since the growth depends on the capacity to raise finance, the speed at which the growth happens is limited and might be slower than growth by franchise. Yet there are also benefits: the exclusive characteristics of the shop are kept. They will be fully responsible for the image that they transmit to the public. Maybe less quantity is sold than with a franchise, but the margin made per unit might be higher, perhaps giving a greater level of total profit.

*Accept other points made about either growth method that are sensible and relevant to the case.*

***[5 to 6 marks]***

Balanced and detailed analysis of the two growth alternatives. Both positive and negative aspects of both growth alternatives are analysed. The analysis is related to the case and business terminology is used appropriately where relevant.

***[3 to 4 marks]***

Some analysis of the two growth alternatives though this may be lacking in balance and tend to be descriptive at the lower end of the band. Shows knowledge of theory but fails to relate to the case.

***[1 to 2 marks]***

A limited and essentially descriptive answer.

**SECTION B**

3. (a) **Define the term *takeover*.** **[2 marks]**

A takeover is a method to achieve the growth objectives of a firm. Takeovers occur when one company purchases the majority of the shares of another company. Takeovers can be hostile or friendly. Since shares in the private sector allow one vote per share to the shareholder, controlling 51% of shares allows for the control of the taken over company. Takeovers usually cause the price of shares to go up before the deal is actually closed.

**[2 marks]**

A clear and appropriate definition of takeover.

**[1 mark]**

Some appropriate elements of a definition of takeover, but the definition may be lacking in detail or clarity.

- (b) (i) **Explain the purpose of a mission statement.** **[3 marks]**

The purpose of a mission statement is to give direction to the firm and to allow its strategic planning to have a clear direction. Starting from the mission statement, strategies, objectives and tactics are defined. It serves as a light, and at all times – there is no time frame for it – it allows all stakeholders to have a view and understanding of the essence of the firm. It is also a way of transmitting the ethos, the values and culture to all the stakeholders (including customers, suppliers, employees and owners).

**[3 marks]**

The purpose of a mission statement is fully and clearly explained.

**[2 marks]**

The purpose of a mission statement is explained, but the explanation may be lacking in detail.

**[1 mark]**

A limited answer that may simply identify some elements of a mission statement.

- (ii) **Comment on the purpose of Non Government Organizations (NGOs) such as animal rights groups.**

***[3 marks]***

Non Government Organizations are firms that operate in the private sector, but are non profit seeking. Their purpose is to achieve the benefit of a particular group, which is usually not well represented by the profit seeking organizations, or by the public sector. These organizations are non profit and are usually run by volunteers who feel very strongly about the cause. They are important external stakeholders of the profit seeking firms, since their actions can have a serious impact on the profit seeking sector.

Animal rights groups are organizations that seek to defend the rights of non-human animals and proclaim that animals should not be used in laboratories for testing. The organizations try and impede what they consider to be the incorrect use of animals. They aim to influence society in such a manner that the firms which use animals in their experiments will feel the monetary consequence of selling less, or not selling to those people who have been made conscious of the animal use (or abuse) by the profit seeking firm. They also lobby for humane legislation.

***[2 to 3 marks]***

The purpose of Non Government Organizations is commented on in some depth and for ***[3 marks]*** reference is made to animal rights groups to illustrate the answer.

***[1 mark]***

A limited answer that may simply identify one or two characteristics of non government organizations but with no development or comment on their purpose.



**(c) Examine the reasons why organizations consider setting ethical objectives. [5 marks]**

Having ethical objectives, or developing a Corporate and Social Responsibility (CSR) policy, can benefit a business in different ways.

- The most important one is that as consumers become more socially responsible they will exercise their purchasing power in a discriminating way, and this can result in higher profits for firms that are seen as socially responsible and ethical.
- It can help recruitment and retention (potential employees might be happier joining a firm with a CSR policy) and actual employees might feel better working in a firm that cares for society and the environment at large.
- It can help create a brand image adding a distinguishing feature to the product and differentiating it from its competitors. Some firms might do this to divert the attention from their core business – which might be essentially contaminating, such as a tobacco company.

In the case of *The Body Shop* the brand is solely and completely built on ethical objectives. The firm was born under the premise of never using animals for experimental testing. And this has influenced every activity of the firm. All its marketing including its colour codes and designs are all based on this “birth mark”.

**[4 to 5 marks]**

A detailed examination of at least two reasons for setting ethical objectives.

**[2 to 3 marks]**

Some examination of at least two reasons for setting ethical objectives, though the examination may lack detail or clarity, or a detailed examination of one reason.

**[1 mark]**

A limited and general response.

**(d) Evaluate the decision to accept the takeover of *The Body Shop* by *L’Oreal*. [7 marks]**

All the shareholders of *The Body Shop* will make a capital gain on the sale of their shares to *L’Oreal*, not just the Roddick’s. If in fact the firm was founded by shareholders who wanted to make a capital gain, and a profit, then there is no reason for which they should be upset by the takeover (and since the firm is a public limited company it is correct to assume profit seeking motives). Since the firm essentially sells cosmetics for a profit (it is not a charity), then it makes sense to accept the sale willingly.

If the prime reason to be a shareholder of *The Body Shop* is of a different kind, and capital gains and profits play no role in the business venture, then it might be considered quite negative to be purchased by a firm like *L’Oreal*.

The success of the takeover will depend on the extent to which *The Body Shop* will be able to maintain its uniqueness and identity by being a part of the French multinational, which has explicit differing values.

For *L’Oreal*, the purchase satisfies the need to keep growing by diversification. It might choose to keep the identity of *The Body Shop* intact. The reaction of consumers to the takeover is hard to predict. Some might not be aware of the change of ownership and will therefore keep buying *The Body Shop* products and some might be aware and choose to “punish” the takeover by not purchasing their products any more. What *L’Oreal* does in terms of respecting or not the *Body Shop* brand will be decisive in determining the reaction of consumers. The reaction of the activists, such as the animal protection groups, will influence the behaviour of the consumers. The knowledge and commitment of the consumers will also play a role.

Internally, the takeover will lead to a certain amount of restructuring. This could lead to cultural clashes between both organizations. So a number of *Body Shop* employees might be against the takeover. On the other hand, it might open doors for growth and exchange of ideas and different ways of thinking. Opportunities for employees to become workers of a much bigger organization might be appealing. Some workers might be in favour of the takeover.

So the sale is understandable from a profit seeking, private sector view point, but the risk that is run is that the reaction of consumers might be completely negative and that *The Body Shop* will lose its “raison d’etre”. It might very well be that *L’Oreal* decides to embrace the same ethical objectives as *The Body Shop*, in which case the activists and consumers might all end up having gained from the situation.

Since *The Body Shop* is a plc, unless a majority of shareholders decide against the takeover to resist the sale, there is little chance of resistance. Accepting the takeover is probably the only reasonable action to take.

*Credit other valid ideas that candidates might include, if well supported.*

***[6 to 7 marks]***

The decision of accepting the takeover is evaluated in detail. Both positive and negative aspects are analysed and the effect of the decision is considered in the light of different stakeholders. Judgments are made.

***[4 to 5 marks]***

The decision to accept the takeover is analysed, but may not be fully evaluated. The answer may lack balance.

***[2 to 3 marks]***

The decision to accept the takeover is described and any evaluation is likely to be superficial and unsupported in nature.

***[1 mark]***

A limited and essentially descriptive answer.

4. (a) Define the term *market penetration*. [2 marks]

Market penetration is one of the four growth strategies as defined by Ansoff as part of the Ansoff Matrix. Market penetration occurs when a company enters/penetrates an existing market with existing products.

[2 marks]

A clear and appropriate definition of market penetration.

[1 mark]

Some appropriate elements of a definition of market penetration, but the definition may be lacking in detail or clarity.

(b) Prepare a SWOT analysis for Beijing *Harley-Davidson*. [6 marks]

Strengths:

- an old well established and reputable brand
- a brand that brings images of freedom to the consumer mind
- a quality product
- capacity to produce and export motor bikes.

Weaknesses:

- a high price relative to current average income
- a very American firm, that knows little about the Asian market
- a long distance to cover between the States and China, making the costs of transport and insurance high.

Opportunities:

- rapid economic growth in China
- growth in disposable income of Chinese population
- greater economic freedom in China after joining WTO.

Threats:

- probable competition from well established Asian brands (such as *Yamaha*)
- government rules and regulations (e.g. ban on the use of motorbikes in the city)
- fluctuations in exchange rates
- the continuing undervaluation of the Yuan making prices less competitive.

*Credit other relevant and valid entries.*

***[5 to 6 marks]***

A SWOT analysis is well prepared, with a minimum of one relevant and valid entry per category. Opportunities and threats are all external. Entries are fully explained.

***[3 to 4 marks]***

A SWOT analysis is prepared, though it may be that not all the categories are covered. Some entries may not be valid (opportunities or threats may be internal) and/or not relevant.

***[1 to 2 marks]***

There is an attempt at preparing a SWOT, but it is incomplete and/or inaccurate.

- (c) Analyse the difficulties that *Harley-Davidson* might encounter when entering China.

**[5 marks]**

The difficulties the firm will have to face have to do with issues of documentation, shipping, financial, legal, communications, governmental regulations, licensing and property rights. The issue of language is an important one, since only some people in China will be able to communicate in English, but a large number will not and all the support material must be translated.

There is also an issue of different time zones, forcing communications to take place during the night in either country. Documentation will be important and it may be difficult to get in to a country that has been so impenetrable in the past.

The great distance between the countries increases the travelling time making it difficult to increase supply rapidly.

Financially, it is necessary to have credit to fund the operation, since motorbikes will be sold long after they are made (because of geographical distance).

Exchange rates will play a large role in the transactions and any decision from the Chinese government to change the exchange rate will affect the business.

Macroeconomic variables in the USA and China will affect the rate. Global issues will do as well. Political stability/instability will also be a potential challenge, as the decision to ban motorcycles proves. Success in international trade will require that the start-up entrepreneur dedicates time, study and investment in order to gain appropriate knowledge and experience on these issues.

**[4 to 5 marks]**

Balanced and detailed analysis of the difficulties faced by *Harley-Davidson* in China. For **[5 marks]** there is clear reference to the case.

**[2 to 3 marks]**

Some difficulties faced by *Harley-Davidson* in China are described and any analysis is lacking in detail and/or depth. The answer shows some knowledge of international marketing issues. Where one difficulty is analysed in detail award a maximum of **[3 marks]**.

**[1 mark]**

A limited and essentially descriptive answer.

- (d) Evaluate *Harley-Davidson's* decision to team up with local motorcycle dealer, *Feng Hou Lun*.

[7 marks]

Doing business in China is not easy. The difficulties are many and varied and having a local partner can smooth the process. (In fact its government did not grant permission for firms to set up without a domestic partner). The partner can be very helpful with local contracts and with local legislation in general. It is important to establish a bridge with the culture and the language. Locals will have easier access to importing agents, and will deal with the placing element more smoothly. Selling motorcycles is not just about bikes, it also involves offering an after sales service for the customers to be happy with the investment. *Feng Hou Lun* is a well established dealer, and has all the necessary experience in the market. *Harley Davidson* has cut out a step from the introductory process by teaming up with an experienced dealer. Market penetration will be easier. The domestic market might be more willing to interact with people who are not culturally different.

On the other hand the partner can also be a risk factor, since it might try to out smart the foreign firm. Some partners have walked away with clients, to start competing rather than supporting the partnership. The Chinese partner will have information that might be valuable and confidential and not treat it as such. It is also costly and if the firm could make a go without the partner it is possible that profits might be higher. Yet it seems that the risks of going alone in an Asian country are too high. The decision to merge with *Feng Hou Lun* is wise and probably necessary.

[6 to 7 marks]

A balanced and detailed evaluation of the decision to team up with a local dealer.

[4 to 5 marks]

The decision to merge with a local dealer is analysed, but may not be fully evaluated. The answer may lack balance.

[2 to 3 marks]

The decision to merge with a local dealer is described and any evaluation is likely to be superficial and unsupported in nature.

[1 mark]

A limited and essentially descriptive answer.

5. (a) Define the term *informal communication*.

*[2 marks]*

Informal communication is the communication that takes place beyond formal communications, outside the official channels. It could take place in a staff room, or during lunch breaks, or when workers socialize together. It is usually believed that when formal communication is poor, informal communication flourishes. Yet a certain amount of informal communication is healthy and inevitable.

*[2 marks]*

A clear and appropriate definition of informal communication.

*[1 mark]*

Some appropriate elements of a definition of informal communication, but the definition may be lacking in detail or clarity.



**(b) Explain the steps that are included in an external recruitment process. [6 marks]**

External recruitment follows some or all of the following steps:

- Job analysis: the first thing the employer must know is what exactly the job entails. To carefully analyse what the job is about and what the future employee will have to do after appointment is called job analysis. This is a really important process since the recruitment process will be better the clearer the position to be filled is.
- Job design/description: once analysed, the information is laid down so that there is a clear knowledge of what the firm is looking for and for potential appointees to be aware of what he or she will be expected to do, and will be responsible for.
- Job profile/worker's profile: a list of the characters that the potential employee should have, including knowledge, skills and experience.
- Advertising: the job must be advertised, and there are different ways to do this, depending on the importance of the appointment and the size and nature of the firm. The position can be advertised in the local, regional, national or international press. The selection process can also be outsourced and delegated to a specialist firm.
- Reception and selection of curriculum vitae (CVs): application letters and CVs (or resumes) have to be read and a relatively short list chosen. A number of people can be involved in the process, so that the decision does not fall on one single individual.
- Interview process: the short listed candidates are interviewed by one or more people. The interview process can be long, and involves a number of people, who may work for the new appointee(s). These people have the responsibility to interview the candidates and express their opinions in the decision making process.
- Decision, offer of pay package and appointment: once the decision is made, a pay package is discussed and an offer is made to the selected candidate. If the offer is accepted, the appointment is made and an induction and training programme are put into practice.
- Induction and training programme: workers who join firms must be shown around, made to feel comfortable, and trained in the new job.

***[5 to 6 marks]***

The majority of steps included in an external recruitment process are fully and clearly explained.

***[3 to 4 marks]***

Some of the steps included in an external recruitment process are explained, or the majority of the steps are explained, but the explanation lacks detail.

***[1 to 2 marks]***

A limited answer that may simply identify a few steps in an external recruitment process.

- (c) **Analyse the possible causes of Rupert's unsuccessful management performance.**

***[5 marks]***

Rupert is a “laissez faire” leader, very probably because he has moved from being a colleague to being a boss, without any relevant or suitable preparation. He finds it difficult to show any signs of authority, basically because it is difficult and uncomfortable to tell former colleagues what to do. When one is used to being a colleague, it is not easy to move to a leadership position.

Rupert has not established formal ways of communication, being used to communicating informally with his former colleagues. In the new situation it seems that his former colleagues are using informal ways to complain about him, rather than going directly to him with the issues they might have. Rupert is doing something similar, complaining at the meetings about his team, rather than talking to them.

It is also true that no one in the firm has prepared Rupert for the big change of status that he was asked to go through. Grooming talented personnel with individual coaching increases job satisfaction and retention and many large firms are preparing potential internal promotions carefully. Alex Bate assumed that because Rupert could do the job as a designer, he would do a good job as a manager.

It might also be probable that the workers themselves are theory X style workers, who like to be told what to do at all times. Rupert might have judged them differently as a colleague.

***[4 to 5 marks]***

A balanced and detailed analysis of a number of possible causes of the unsuccessful management performance. For ***[5 marks]*** there is clear reference to the case.

***[2 to 3 marks]***

Some possible causes of the unsuccessful management performance are described and any analysis is lacking in detail and/or depth. Where one reason is analysed in detail award a maximum of ***[3 marks]***.

***[1 mark]***

A limited and essentially descriptive answer.

**(d) Evaluate Alex Bate's idea of dismissing Rupert and recruiting externally. [7 marks]**

To dismiss Rupert involves:

Severance pay. This is expensive, since he has been working with the firm for five years. Although workers are not happy with his performance, it is still important to know that someone can be promoted internally. It means that others can be promoted in the future too. It also implies that management has to recognize that the decision was a mistake.

To keep him involves:

Spending on a training programme, and maybe having sessions with the employees to try and come up with a new way of working together. This is time consuming and the risk is run of not being able to improve the situation.

External recruitment is, as mentioned in the case, expensive and also time consuming. The benefits are that new blood and hence new ideas are brought into the firm. It is a chance to grow and to start doing things differently. But there is no guarantee that the new corner will be more efficient or qualified than Rupert. The process will take time and changes might not be implemented for a long time.

Theory says that a lot of leadership traits can be learned. It is not all nature, but also nurture. Rupert could become a better manager with the right training. Workers in his department are not cooperative. The issue might need to be discussed more openly, and not on the grape vine. It is important that all the information is laid out in the open for all those involved to discuss it.

It is probably better for the workers and the firm to retrain Rupert, but it might also be acceptable to consider outside recruitment if properly supported.

**[6 to 7 marks]**

A balanced and detailed evaluation of the idea to dismiss Rupert and recruit externally.

**[4 to 5 marks]**

The idea to dismiss Rupert and recruit externally is analysed but may not be fully evaluated. The answer may lack balance.

**[2 to 3 marks]**

The idea to dismiss Rupert and recruit externally is described and any evaluation is likely to be superficial and unsupported in nature.

**[1 mark]**

A limited and essentially descriptive answer.

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