

MARKSCHEME

May 2001

BUSINESS AND ORGANISATION

Higher Level

Paper 1

1. (a) Calculate the salaries of Monesh and Najat (the directors) for 1999 and express this as a percentage of sales revenue for 2000. **[3 marks]**

$$\begin{aligned}
 \text{1999 total revenue} &= \$600\,000 \\
 \text{Fixed Salaries of 35\%} &= \$600\,000 \times \frac{35}{100} = \$210\,000 \\
 \\
 \text{2000 total revenue} &= \$420\,000 \\
 \text{Salary \%} &= \frac{\$210\,000}{\$420\,000} \times 100 = 50\%
 \end{aligned}$$

(Award [1 mark] for each accurate calculation and an additional mark for clear working up to a maximum of [3 marks].)

- (b) (i) Prepare profit and loss accounts for both 1999 and 2000, and **[6 marks]**

Profit and Loss Account for the Year ending 31 December:

	1999	2000
	<i>\$000</i>	<i>\$000</i>
Sales Revenue	600	420
less Cost of Sales	<u>200</u>	<u>140</u>
Gross Profit	400	280
<i>less</i>		
Overheads	40	40
Director Salaries	<u>210</u>	<u>210</u>
Net profit	150	30
<i>less</i>		
Taxation and Interest	50	10
Dividends	<u>80</u>	<u>15</u>
Retained profit	<u>20</u>	<u>5</u>

[5 to 6 marks]

Accurately records the relevant entries in the correct order and calculates both gross and net profit. For full marks the presentation and figures must be completely accurate.

[3 to 4 marks]

Shows a clear understanding of the presentation of a P/L account, but there may be several calculation errors or omissions.

[1 to 2 marks]

Calculations include many errors and/or omissions, but the account is still recognisable as a P/L account and several entries are correct.

There must be some accuracy to be awarded ***[1 mark]***.

- (ii) **State the amount of net profit reinvested in the business after taxation, interest and dividends had been paid in both 1999 and 2000.**

[1 mark]

For ***[1 mark]*** the candidate recognises that the retained profit of \$25 000 is the residual figure after the deduction of taxation, interest and dividends. The candidate should be awarded ***[1 mark]*** even if the answer is wrong as the result of previous errors, provided the process of calculation is correct

- 2. Explain *three* reasons for Monesh and Najat’s decision to turn their partnership into a private limited company.**

[3 marks]

Advantages of a limited company over a partnership.

- Limited Liability – means that Monesh and Najat cannot lose their personal possessions if their business fails with significant debts.
- More capital may be raised as there is no limit to the number of shareholders
- The business has continuity and will not end if one of the owners die or if they wish to leave the business.

(Award [1 mark] per explained point up to a maximum of [3 marks].)

3. (a) **Analyse why Craftshops are able to offer ribbons, buttons and decorations at lower prices than Memento.**

[4 marks]

Craftshops is a multinational. As a result it has the several advantages:

- economies of scale
 - it can purchase in bulk obtaining discount
 - costs are likely to be lower through specialisation, technical and marketing economies and lower financial charges
- sourcing of products from around the world gaining from cheaper raw material and labour costs
- loss leading may occur on high volume goods to attract customers into the shop
- destroyer pricing
 - Craftshops are able to offer low prices to force competitors out of the market
- lower quality product and reduced storage costs
- strong US dollar
- Memento used premium pricing

(Award [1 mark] per analysed point up to a maximum of [4 marks].)

- (b) **Assess the competitive advantage that small firms like Memento have over larger organisations.**

[3 marks]

Small firms are able to:

- offer a more personal service and adapt their service or product to the particular needs of the customer as they do not mass produce
- be more innovative and flexible
- make decisions more quickly
- identify niche markets which larger firms ignore as they have insufficient profit potential and do not allow mass production
- satisfy local or regional needs by locating in the community
- offer lower wages if employees are not unionised
- motivate staff more easily

(Award [1 mark] per point up to a maximum of [3 marks].)

4. Refer to the key ratios in Table II. Analyse the performance and liquidity of Memento and comment on its present financial position.

[4 marks]

- The current ratio has risen from 1.4 to 2.7. The rule of thumb is between 1.5 and 2. At 2.7, Memento would be able to cover its liabilities provided it was able to turnover its stock. It could be argued that too much cash is tied up in stock
- The acid test ratio has fallen from 0.96 to 0.6. The rule of thumb is 1:1. The large fall is the result of the increase in stock levels.
- Stock turnover measures the number of times that a business sells the value of its average stock in a trading year. Sales have fallen as stock levels rose.
- The return on capital employed is a key performance measure as it relates profit to the size of the business. The higher the ratio the better. This measure is falling. It would need to be compared with other competing firms and investments, but it has fallen from 1999 to 2000, showing a fall in efficiency.
- Debtors' days and creditors' days reflect the business' ability to manage its working capital. Debtors' days have increased faster than creditors' days showing that the firm is allowing its debtors longer to pay than it is allowed by its creditors.

The key ratios simply affirm the worrying position of Memento. Its liquidity position is such that it may quickly move into receivership. If some of its debtors are now bad debts then its position is even worse. Clearly it will need to divest itself of stock rapidly and manage its cash flow far better.

[4 marks]

Shows a good understanding of ratio analysis and is able to analyse the changes over the year identifying the liquidity problems and declining performance.

[2 to 3 marks]

Attempts to explain the relevance of the ratios but for ***[2 marks]*** may not be clear about some of them or the consequences of the changes.

[1 mark]

Shows little understanding of ratios, but at least recognises the worrying signs.

5. Prepare a report from Sanjay, the financial consultant, to Monesh and Najat identifying major strengths and weaknesses of Memento. The report must be in a suitable format for a business document. Present justified and prioritised recommendations for action in the following areas:

- administration
- stock control and product range
- finance and pricing
- marketing.

[12 marks]

Weaknesses

- poor liquidity and falling efficiency
- falling sales
- poor administration
- poorly trained staffing, lacking IT skills
- high stock levels, some of it obsolete
- possible bad debts
- poor customer service
- uncompetitive prices
- personal differences between Monesh and Najat
- unprofitable products
- too high salaries
- failure to respond to competitors
- reliance on a narrow customer base
- some customers believe Memento offers poor value for money
- mailing list out of date

Strengths

- wide product range with high quality, value for money products
- specialist niche market – particularly in silks which are still profitable
- low overheads
- unique silks and high craftsmanship

Administration

Memento's records are poor and their systems inadequate and out-of-date. These problems could be addressed by:

- training Jill to use computer systems
- appointing an IT trained office manager
- updating mailing lists to identify active customers and delete those who are not
- ensuring all telephone calls are returned
- purchasing a computer with database, word-processing, spreadsheet and Internet capabilities

Stock control and product range

- liquidate obsolete and excess stock where possible through very low prices or find alternative outlets *e.g.* markets or specialist buyers of obsolete stock
- prepare a inventory control system preferably using a computer programme
- stock items which can be clearly differentiated from those offered by Craftshops. If this is impossible stop ordering these lines
- buy only to order - some form of J-I-T arrangement. This may be difficult for such a small firm
- consider specialising only in silks

Finance and pricing

- meet rapidly with bank to arrange temporary loan or overdraft facility while the business is turned around. Find alternative sources of finance *e.g.* family and friends
- seek a business partner or consider a sell-off
- reduce staff salaries and seek to lower unnecessary overheads
- relate pricing on products to customer type. Offer larger discounts for bulk orders
- increase price for ‘marginal’ clients and ensure costs are fully recompensed in price
- be prepared to reject loss making orders

Marketing

- emphasise the quality of the product and differentiate from competitors *e.g.* silks
- consider alternative forms of promotion such as direct mailings and Internet sales
- carefully relate costs to revenue and ensure that marketing is focused and productive
- use existing client base as a starting point and offer incentives for introduction of new clients by existing customers
- consider external specialist advice when the financial situation permits

(Award up to [2 marks] for an appropriate report format. e.g. title, to, from, date, introduction, main body, recommendations and conclusions. The report need not be structured with these headings in full, but must be a document suitable for presentation.)

[9 to 10 marks]

Identifies key strengths and weaknesses and produces a comprehensive and intelligent action plan covering all four aspects identified using appropriate illustration from the case study and the tables. Recommendations are justified and prioritised.

[6 to 8 marks]

Identifies some strengths and weaknesses and produces a plan covering all four aspects and referring to the case study, although the approach may be brief in two of these. There is some attempt to justify recommendations.

[3 to 5 marks]

Identifies some strengths and weaknesses and produces a brief plan which may not draw upon case study information.

[1 to 2 marks]

Produces a limited analysis both in scope and accuracy.

6. Identify *four* sources of secondary data that Sanjay could use to support his action plan and analysis of Memento's market. Explain how Sanjay could use this information.

[4 marks]

Secondary data

Secondary data is second-hand information gathered by others and not specifically for the present use. Possible secondary sources include:

- government statistics and reports particularly on the economy *e.g.* economic trends
- market intelligence reports (for example Keynotes and Mintel)
- newspaper, journal (trade press) and magazine articles and special reports
- trade association data
- international publications
- retail audits
- past sales figures
- stock movements
- competitor information

Uses

- to adjust product range introducing new products or dropping others
- to identify appropriate target segments
- to establish what competitors are doing
- to develop a trend analysis or information to support alternative analysis such as decision trees
- to examine alternative distribution opportunities such as the internet
- to analyse previous sales and activities to judge their success and inform future actions

[4 marks]

Clearly understands the concept of secondary data. Four relevant sources are identified and the information to be gained from each explained with illustrations.

[2 to 3 marks]

Identifies several sources. The information gained may not be well examined and may lack some relevance for Memento.

[1 mark]

Shows little understanding of the concept of secondary data but the data may have peripheral use.
