

MARKSCHEME

May 2001

BUSINESS AND ORGANISATION

Higher Level

Paper 2

1. Sageplus Systems

(a) For each operating system, calculate:

(i) the payback period;

[2 marks]

Payback

	Lynus	Solar
	\$m	\$m
Initial cost	18	22

Accumulated returns:

End of year:

1	6	4
2	16	12
3	28	20
4	34	28

Payback *2 yrs 2 mths* *3 yrs 3 mths*

Lynus pays back more quickly.

(Award [1 mark] per correct calculation up to a maximum of [2 marks].)

- (ii) the net present value (assume the interest remains at 6%). *[4 marks]*

Discounted Cash Flow

	Lynus \$m		Solar \$m	
	DF	PV	DF	PV
Initial cost	-18×1	-18	-22×1	-22
Year				
1	6×0.943	5.658	4×0.943	3.772
2	10×0.890	8.9	8×0.890	7.12
3	12×0.840	10.08	8×0.840	6.72
4	6×0.792	4.752	8×0.792	6.336
5	4×0.747	2.988	14×0.747	10.458
6	2×0.705	1.41	5×0.705	3.525
		<u>33.788</u>		<u>37.931</u>
Net present value		<i>15.788</i>		<i>15.931</i>

Solar has the highest NPV

[4 marks]

Accurately calculates the net present values. Full working must be shown.

[2 to 3 marks]

Shows a clear understanding of the principles of net present value and the method of calculation, but makes minor errors in calculation.

[1 mark]

The calculations are not completely clear and there are many errors.

- (b) **Compare payback and discounted cash flow as methods of investment appraisal, and explain why Sageplus Systems may use one in preference to the other.**

[6 marks]

Payback:

- simpler to calculate and understand than DCF
- quick screening method
- useful in industries where technology changes frequently and so the cost of investment needs to be recovered quickly
- adopted when firms have cash flow problems and payback needs to be quick. Discriminates against projects with long payback periods

Discounted cash flow:

- includes all cash flows, even those after the investment has paid back
- takes the timing of cash flows into account, unlike payback
- more complex than payback and more difficult to understand

In Sageplus's case they may well go for the payback system. This is because of their tight cashflow position and nature of their quickly changing industry.

[5 to 6 marks]

Accurately compares the two methods of appraisal. Explains why one system may be preferred, supported by relevant and valid discussion.

[3 to 4 marks]

Compares the two methods of appraisal. Ideas may not be fully developed and illustration may be poor.

[1 to 2 marks]

Presents a simplistic and very general response. The answer may have no development of ideas or relevant illustration and fails to address the issue of choice.

- (c) Evaluate the financial and non financial factors influencing the choice of operating system and advise Sageplus as to their choice.

[8 marks]

Factors:

- payback and DCF results
- new competing operating systems from other firms
- demand patterns for Sageplus systems
- economic factors such as inflation and recession
- increase in interest rates above 6% making early returns more valuable
- staff training issues
- familiarity with Lynus systems
- future upgradeability and compatibility with other technologies
- Sageplus's cash flow position
- possible exchange rate fluctuations
- uncertainty about the future

The DCF and payback results are very close. The firm is likely to be influenced by other factors. Familiarity with Lynus is important and it pays back more quickly, which may be crucial given their cashflow situation.

[7 to 8 marks]

The evaluation is extensive and clearly identifies the potential conflicts between the firm's objectives. The answer identifies external influences which may affect returns. A judgement is made.

[3 to 6 marks]

Factors are identified but their relative importance may not be emphasised. The answer has some illustration and reference to Sageplus's position.

[1 to 2 marks]

Presents a simplistic and general response with little or no evaluation.

2. Organic Foods

- (a) Construct a break-even graph for the Organic Foods ice cream range and identify the break-even point and margin of safety for the projected sales of 90 000 ice creams. Show your working for the graph.

[9 marks]

The completed break-even chart and working is shown overleaf.

$$\begin{aligned} \text{Selling price} &= \$3.50 \\ \text{Variable costs} &= \underline{\$1.80} \\ \text{Contribution to FC} &= \underline{\$1.70} \end{aligned}$$

$$\text{Break even} = \frac{\text{Fixed Costs}}{\text{Contribution}} = \frac{\$136\,000}{\$1.70} = 80\,000 \text{ ice creams}$$

The margin of safety is 10 000 units [90 000 actual output – 80 000 break-even]

[9 marks]

Prepares an accurate break-even chart which identifies the break-even point and the margin of safety. The graph is correctly labelled and titled and there should be evidence of appropriate working to produce the figures.

[6 to 8 marks]

Prepares a break-even graph with one or two minor errors. There may be some omissions in labelling or working, but the main elements are evident. The graph is well produced. At the lower end the margin of safety may be omitted.

[3 to 5 marks]

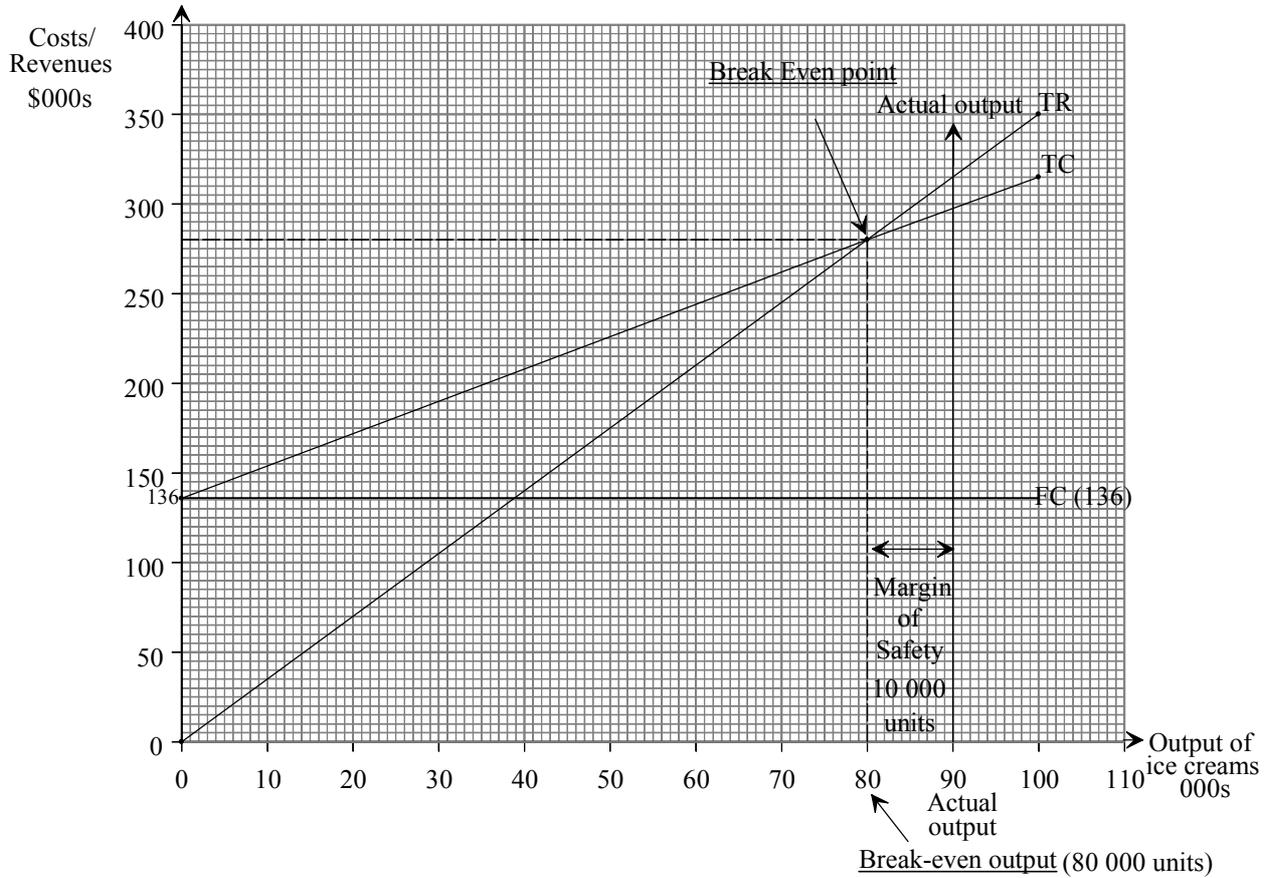
Prepares a graph which has several errors and omissions. The graph may be poorly produced, especially at the bottom of the band and working is not clear or missing.

[1 to 2 marks]

Attempts a break-even graph, but it is very poor and almost wholly inaccurate.

N.B. If the candidate does not construct a break-even chart, but calculates the break-even point through the use of a formula, the maximum mark that may be awarded is [4 marks] provided the margin of safety is identified and [3 marks] if it is not.

Break-Even Chart for Organic Foods



Units (000s)	Costs/Revenues \$000				
	FC	VC	TC	TR	+/-
0	136	0	136	0	(136)
10	136	18	154	35	(119)
20	136	36	172	70	(102)
30	136	54	190	105	(85)
40	136	72	208	140	(68)
50	136	90	226	175	(51)
60	136	108	244	210	(34)
70	136	126	262	245	(17)
80	136	144	280	280	0
90	136	162	298	315	+17
100	136	180	316	350	+34

- (b) **Assess whether or not the target of 8% return on investment will be met at the 90 000 or 100 000 sales levels.**

[4 marks]

90 000 units represents a 10 000 margin of safety and 100 000 units represents a 20 000 margin of safety.

Each unit above the break-even point provides \$1.7 profit

Total profit at 10 000 × \$1.70 = \$1700 profit
at 20 000 × \$1.70 = \$34 000 profit

Therefore, return on investment = $\frac{\$17000}{\$250000} \times 100 = 6.8\%$

= $\frac{\$34000}{\$250000} \times 100 = 13.6\%$

Organic foods will not meet their ROI target at 90 000 units, but will do so at 100 000 units.

[4 marks]

Offers a correct solution supported by a suitable working.

[2 to 3 marks]

Makes one or two errors.

[1 mark]

Presents an inaccurate calculation but shows some understanding of the process of calculating ROI.

(c) On behalf of the Production Manager, evaluate methods of reducing cost and maximising sales revenue and explain, with the use of diagrams, how these changes will impact on the break-even point (the use of specific figures in these diagrams is not required).

[7 marks]

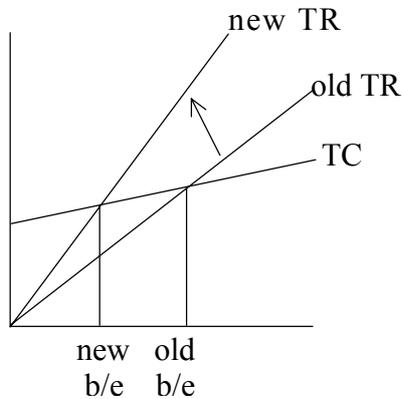
Reducing costs:

- rent – cheaper premises – need to ensure the capacity and suitability is not reduced and that an alternative location will not affect distribution
- marketing – reduction. Naturally any cut is likely to affect sales, so it would have to be shown that alternative, cheaper methods would be as effective
- transport – difficult to reduce
- salaries – look at alternative rewards e.g. performance related pay
- overheads – items like energy could be examined

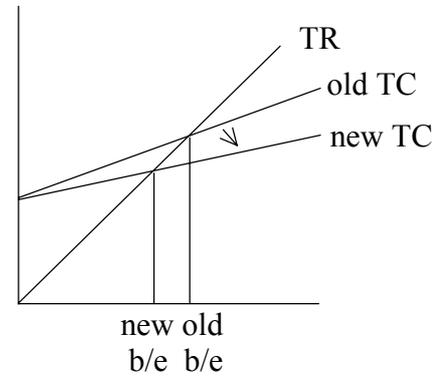
Increasing revenue/sales:

- prices could be reduced to increase demand or increased to produce more revenue per item. The effect depends on elasticity
- improved promotion techniques would increase sales as would increasing marketing budgets. The increased expenditure would need to be balanced against the increased revenue

(a) Increasing sales revenue



(b) Decreasing costs



[6 to 7 marks]

Identifies costs that may be reduced and methods of increasing revenue with an evaluation of the impact. Accurate graphs are drawn to represent the effect on break-even point.

[3 to 5 marks]

The evaluation may be limited and there is an attempt to construct relevant graphs.

[1 to 2 marks]

Identifies costs that may be reduced and methods of increasing revenue although these may be brief or incomplete. The evaluation and/or graphs may be limited or even missing.

3. Tom Metzger

- (a) Compare Tom Metzger and Philip Metzger's leadership styles and assess to what extent these have contributed to the change in organisation structure.**

[6 marks]

Tom is a democratic and participative leader. His approach may also be referred to as paternalistic. He has a theory Y approach to leadership (McGregor) valuing his staff's input and believing that they wish to contribute to the business.

Philip is a 'hands off' manager who does not like to deal directly with his staff. He is not a good communicator. He could be considered to be a Theory X manager, but he is prepared to delegate responsibility and certainly appears to trust departmental managers, so this may not be appropriate. Certainly, he may be considered too bureaucratic.

The effect on the organisation has been to turn the structure from an essentially informal flat hierarchy to a much more formal, centralised and hierarchical structure. The systems put in place appear to be bureaucratic.

It may well be, given the growth of the firm, that these new structures are necessary to produce adequate control systems and that the changes would have happened irrespective of the leadership approach.

[5 to 6 marks]

Accurately describes the contrasting styles and tries to bring some theory into the answer for ***[6 marks]***. The better candidates may recognise that Philip is not necessarily autocratic, but rather, more formal. The effect on the structure is well described, and it is recognised that other factors may have contributed to the change. The answer contains illustrations from the text.

[3 to 4 marks]

Describes the contrasting styles in general terms. The effect on the structure is recognised but not necessarily well explained.

[1 to 2 marks]

Presents a simplistic and very general response. The answer may have little development of ideas or relevant illustration.

- (ii) Explain *three* factors which influence the style of leadership adopted by a manager.

[3 marks]

This question attempts to get the candidate to consider situational or contingent leadership approaches (Fiedler) or the work of Adair although the candidate may not refer to these by name. The influences are likely to relate to: the nature of the individual (*e.g.* experience, age, training, education, personality, willingness to follow), the nature of the group and the nature of the task. Some answers may talk about the personality or background of the leader himself/herself. Other factors could be the history and tradition of the organisation and/or the existing organisation structure.

[3 marks]

Explains three relevant issues.

[2 marks]

Explains only two relevant issues or merely lists three issues.

[1 mark]

Presents a limited answer, or only lists one or two items.

- (b) (i) **Using relevant motivational theory, explain why Philip Metzger's approach has led to dissatisfaction among the original staff.**

[6 marks]

Relevant motivation theory:

- F W Taylor and scientific management
- Maslow's hierarchy of needs
- Herzberg's two factor theory
- Mayo Hawthorne results

The problem with Philip's approach is that it has reduced the level of needs that the workforce is able to obtain. Under Tom Metzger they were able to satisfy some of their social and esteem needs. He provided motivating factors such as recognition, responsibility and job satisfaction. They felt empowered and valued. Now they feel unconsulted and their hygiene needs are not being met *e.g.* company policy, relationship with supervisors and status. The opportunity for advancement appears to have been blocked. The firm is providing good pay and this could be equated with a Taylorist or theory X approach.

[5 to 6 marks]

Identifies relevant motivational theory and identifies the lack of motivators for the original staff. The best candidate will comment on how the available motivators have actually reduced, providing examples of these.

[3 to 4 marks]

Addresses motivation aspects although may not employ relevant theory by name. For **[4 marks]** there is an attempt to illustrate the discussion from the text.

[1 to 2 marks]

Presents a generalised and simplistic response.

- (ii) **Identify practical measures to reduce staff dissatisfaction and analyse whether these measures are likely to be successful if implemented.**

[5 marks]

Possible practical measures to address dissatisfaction:

- The firm needs to offer the opportunity to satisfy higher level needs. This might be done through combinations of job enrichment, enlargement and empowerment allowing the original employees to use their full abilities.
- The culture of the business may be altered to be less formal and bureaucratic and to allow the workforce to feel valued.
- It could be argued that financial incentives could be more closely linked to performance and that opportunities for promotion are clearer.
- The introduction of team-working

The problems of implementation relate to the relationship between Tom and Philip and the addition of the new layer of department heads. Both Philip and the department heads may oppose the reduction of their powers. It is difficult to change an established organisation culture.

[5 marks]

Identifies relevant practical approaches to address dissatisfaction and provide opportunities for the satisfaction of higher needs. Appropriate terminology and examples are included.

[3 to 4 marks]

Identifies some practical approaches to address dissatisfaction although these may lack some detail and development. For ***[4 marks]*** there is an attempt to link these to the satisfaction of higher needs.

[1 to 2 marks]

Presents a generalised and simplistic response.

4. Product Life Cycle

- (a) Explain the activities that would happen before the launch of the product, and comment on their importance.

[5 marks]

Pre-launch activities:

- generating ideas and market research and audits
- business analysis
- research and development
- design and prototype testing and any possible modifications as a result
- test marketing
- developing the market mix and setting up distribution channels

For this product the ingredients and perfume are clearly crucial to its success and must prove to improve breathing as well as providing an agreeable fragrance. Issues of strength may need to be addressed as well as financial viability. Can a competitive price be set?

Products that are actually commercialised also need to cover the costs of those rejected ideas which were never commercialised.

[5 marks]

Identifies most of the pre-launch, although they may not be grouped into discrete activities as above and comments at their importance and relevance. Suitable examples are included.

[3 to 4 marks]

Identifies some of the main pre-launch activities and explains their importance and relevance.

[1 to 2 marks]

Presents a limited assessment of pre-launch activities with little explanation of the activity. Comments are general and unrelated to the stated situation.

- (b) **Analyse, using examples, how the marketing mix of this product might change from year 3 to year 11.**

[8 marks]

The marketing mix is dynamic over the life of the product:

- *price*: initially this may be set at lower levels to attract customers and gain market share – penetration pricing. As the sales grow the price is likely to be increased and remain stable throughout maturity. As product sales decline there may be adjustments downwards.
- *product*: in the initial stages customer feedback may lead to modifications in design and function. Upgrading may continue throughout the life of a product although this is likely to be limited in maturity.
- *place*: the product may be test launched in a limited number of outlets. As sales grow the firm will have to increase the number of outlets where the product is available.
- *promotion*: initial promotion will be essentially informative and awareness raising. As sales increase there will be a move to more competitive and persuasive approaches. During maturity promotion will be mostly reminding and maintaining

[6 to 8 marks]

Examines all elements of the marketing mix and shows a clear awareness of its dynamic nature throughout the life of a product. Although the answer may not be as comprehensive as above, changes to each element are detailed with some development of ideas, and the use of appropriate terminology for maximum marks.

[3 to 5 marks]

May not cover all four elements and the ideas are not fully developed. Nonetheless the dynamic nature of the mix is shown and there must be illustrations of these changes over time.

[1 to 2 marks]

Presents ideas which lack focus and are often rather generalised. The dynamic nature of the mix is not very evident and a scattergun approach is used.

- (c) **In year 12, sales and profits began to rise again after an annual fall. Describe strategies the company might have implemented to reverse the decline in sales.**

[4 marks]

This question expects a recognition, and identification of extension strategies.

Possible extension strategies:

- finding new markets *e.g.* exporting or selling in new regions or shops
- developing the range *e.g.* different box sizes
- changing the appearance or design *e.g.* different colours, new fragrances, new box design
- encouraging more frequent use
- new pricing
- more promotion

[3 to 4 marks]

Identifies several relevant extension strategies and provides examples of these which relate to tissues.

[1 to 2 marks]

Produces a limited answer. There are few strategies suggested and/or these are not related to the situation outlined.

- (d) **Suggest *three* reasons why sales and profits fell so rapidly from year 14.**

[3 marks]

Possible reasons for decline:

- newer, better alternatives
- concerns about the efficacy or safety of the product
- the firm no longer supports the product through promotion
- chains stop stocking the product

(Award [1 mark] for each identified reason.)

5. Kadett Products

(a) (i) What is a Mission Statement?

[2 marks]

A mission statement provides an underlying philosophy, a statement of values, vision or fundamental purpose for all the activities of a business. The mission is not specific and does not contain performance measures. Objectives and aims are more specific and quantifiable.

(Award [2 marks] if the candidate identifies the mission as above. Award [1 mark] if the answer refers to aims or objectives.)

(ii) Using Kadett's Mission Statement, analyse ways in which this can be put into practice in all of the firm's activities.

[6 marks]

The mission needs to be redefined into specific and measurable operations *e.g.*

People: excellent recruitment and staff development / training programmes. Providing excellent working environments and paying strict attention to health and safety. Offering opportunities for advancement and recognition of excellent performance.

Customers: providing customers with high quality service standards and excellent customer care. Listening to their requirements and meeting their needs. Responding to grievances. Providing guarantees and back up services.

Products: providing high quality, value for money products. Ensuring the highest safety standards.

[5 to 6 marks]

Recognises the three strands of the mission statement and provides relevant examples of how the philosophy could be put into practice within each area.

[3 to 4 marks]

Recognises the three strands of the mission statement and provides some relevant examples of practice in each. If no reasons are given, award a maximum of **[3 marks]**.

[1 to 2 marks]

Presents a limited response.

- (b) **Many firms are down-sizing and delayering to create a smaller core staff. Identify reasons for this trend, and assess the implications for staff.**

[6 marks]

A core staff receives full benefits and advantages of full time contractual employment e.g. contributory pensions, sickness benefit, contractual security through the requirement of notice and redundancy payments. The reduction of this core allows more flexibility in recruitment so that firms can match their workforce to demand patterns. Peripheral and contractual staff do not receive as lucrative packages as full time staff. Downsizing means the general reduction in numbers where as delayering refers to the flattening of the organisational hierarchy. Both reduce the wage bill. Flattening the organisation may improve the responsiveness of the business to change. Staff will need to regularly upgrade their skills and/or offer more flexibility in working practices. Staff may feel less secure in their employment and potentially less motivated.

[5 to 6 marks]

Shows a clear understanding of the concepts and the reasons behind the move to smaller cores and flatter hierarchies, and assesses the implications for staff.

[3 to 4 marks]

Shows some understanding of the concepts and the reasons behind the move to smaller cores and flatter hierarchies. Attempts to identify implications for staff.

[1 to 2 marks]

Presents a limited response and descriptive response.

- (c) **As the objectives of the firm become more focused on shareholder value and profit, why may Kadett find it increasingly difficult to satisfy its Mission Statement?**

[6 marks]

The practical commitments suggested by the mission statement and detailed above e.g. quality products, excellent value for money, staff development, secure working environments cost money and may detract from shareholder value and profit. It could be argued in the longer term that ethical approaches, high quality service and well trained staff will lead to the increase in profits required by shareholders. However, many shareholders and investors require a quicker return, so firms may transfer money away from reinvestment into dividends.

[5 to 6 marks]

Recognises the potential conflict between the three strands of the mission statement and shareholder return. The discussion is supported with a detailed explanation of this potential conflict.

[3 to 4 marks]

Shows some understanding of the conflicts and provides some development of issues.

[1 to 2 marks]

Presents a limited response.

6. Malmo Holdings

- (a) Explain how empowering the subsidiaries and the setting of profit targets may have contributed to the problems highlighted in the media.**

[4 marks]

Empowerment: the modern term for delegation, except that not only is authority delegated, but also the right to make more judgements about what is done. Delegated tasks may be surrounded with strict limits on the scope for action. Empowerment means giving more power and control in the workplace, which may increase the risks of things going wrong. In the question, the issues of corruption, health and safety breaches and the ejection of the tribe may be the result of reducing control systems.

[3 to 4 marks]

Shows a clear understanding of the concept of empowerment and is able to relate the risks of this to the examples provided in the text

[1 to 2 marks]

Produces a limited answer, which shows some understanding of the term empowerment, and/or the risk of allowing greater autonomy.

- (b) (i) Identify examples of activities that are legal, but may be considered unethical.**

[3 marks]

Possible illustrations:

- the exploitation of natural resources of other countries without sufficient recompense for that country
- exploitation of cheap labour
- employment practices that are not illegal in the host country, but are in the country of the company
- price discrimination *e.g.* charging higher prices even if the customers are less able to afford these
- forms of animal experimentation
- sales of drugs which have not been fully investigated

Candidates could come up with a myriad of alternatives. It is essential that the activities are not illegal *e.g.* misrepresentation or fraud.

(Award [1 mark] for each relevant example up to [3 marks].)

- (ii) What steps might be taken to ensure the effective implementation of an ethical policy?**

[3 marks]

A code of practice needs to be publicised and widely distributed. It needs to have the explicit support of top management. It is likely that any code is integrated into induction and training packages and clear sanctions exist for its breach. An audit against the code may be required for new investments or developments.

[3 marks]

Identifies methods of dissemination, training and sanctions with development of these ideas.

[2 marks]

Identifies two of the above or three without development.

[1 mark]

Identifies only one method.

- (iii) Explain how an ethical policy may provide a firm like Malmo Holdings with competitive advantages.**

[5 marks]

Competitive advantage is created by developing resources and capabilities that other firms do not have. Competitive advantage rests in the experience and knowledge of a workforce. USP or distinctiveness may also provide a competitive edge.

The advantages of an ethical policy:

- marketing advantages – ethical behaviour is developed into a USP *e.g.* Body Shop. This forms the basis of public relations and advertising. Consumers who share these values are more likely to purchase from the organisation.
- positive effects on motivation and recruitment – staff with better qualifications are recruited. They will likely share the same attitudes and values, which may motivate them in their selling activities and create greater loyalty.

[5 marks]

Shows a clear understanding of the concept of competitive advantage and is able to explain how an ethical policy may translate into competitive advantage.

[3 to 4 marks]

Shows some understanding of competitive advantage and attempts to explain how an ethical policy may create competitive advantage.

[1 to 2 marks]

Presents a limited response.

- (c) **You are a public relations advisor for Malmo Holdings. Advise Linda Anderson on possible strategies to address the issues raised by the media and to minimise the damage to the firm's image.**

[5 marks]

Possible courses of action:

- show a clear willingness to address the issues and promise that unethical behaviour will be stopped and guilty parties punished
- immediately dismiss those involved
- produce evidence to refute the claims
- take legal action for libel against the newspapers involved
- produce counter good news stories about the firm and its ethical approach
- downgrade the seriousness of the breaches
- refuse to discuss the incidents and hope they go away
- set up an internal investigation and hope that by the time it reaches any conclusion there is no media interest.
- attack those making the allegations and find similar examples of unethical behaviour

[4 to 5 marks]

Identifies several suitable courses of action. Award full marks for four/five points or the development of three points.

[2 to 3 marks]

Identifies courses of action, but these may be limited in number, scope or relevance.

[1 mark]

Presents a limited and highly generalised answer.

7. Zoom

(a) Explain why Zoom is so keen to develop overseas?

[5 marks]

Reasons for developing overseas:

- larger markets, increased sales and profits – economies of scale
- spreading risk – economic cycles may differ across economies. One country may be booming when another is in recession
- unfavourable trading situation in the domestic market – overseas markets may provide an extension strategy
- legal differences – goods may be sold in one country which are illegal or restricted in others *e.g.* guns
- cheaper raw materials and labour

[5 marks]

Recognises the marketing and economic advantages of international expansion and is able to provide relevant illustrations and details to support the points made.

[3 to 4 marks]

Recognises several reasons for international expansion, although there may be a limited development of ideas for **[3 marks]**.

[1 to 2 marks]

Presents a limited and/or descriptive response.

(b) Assess the advantages Zoom gains through the development of joint ventures compared to other forms of growth.

[5 marks]

A joint venture is where two or more companies share the cost, responsibility and profits (losses) of a business venture. They gain some of the advantages of a merger or acquisition such as greater sales and profits and cost savings (economies of scale). Each firm can specialise in the part of the venture where they possess knowledge and expertise. Competition may be removed without losing separate identity.

What the firms do not suffer are the administrative costs of merging or expense of a take-over. Many take-overs are unfriendly and image may be negatively affected.

[5 marks]

Shows a clear understanding of the concept of joint ventures, mergers and acquisitions and is able to clearly distinguish between these different approaches, using relevant examples.

[3 to 4 marks]

Shows some understanding of the terms, but answers may be more limited and/or they fail to clearly distinguish between the three approaches.

[1 to 2 marks]

Presents a limited response with little understanding of the terms, possibly discussing only mergers.

- (c) (i) **Analyse the problems that Zoom may encounter when entering foreign markets.**

[5 marks]

Problems:

- political differences and instability: some political systems are immoral and bribery is required. There may be administrative restrictions on foreign firms
- legal differences may affect the marketing and distribution of goods and services e.g. labelling, safety standards, environmental controls
- economic and social differences – income and tax levels, social and moral attitudes, sexism and racism
- cultural differences – social meanings may be different.
- different lifestyles
- language barriers
- additional costs e.g. licences
- differences in business practice e.g. accounting approaches, payment, currency restrictions

[5 marks]

Effectively analyses the factors which might affect Zoom and the likely relevance to their operations.

[3 to 4 marks]

Identifies some of the factors may not develop an analysis of the likely effects of each.

[1 to 2 marks]

Presents a simplistic and very general response. The answer may have little development of ideas or relevant illustration.

- (ii) **Discuss exporting methods which may help overcome or minimise these problems.**

[5 marks]

Methods of overcoming or minimising problems:

- research of the markets and the use of expert advisors or government agencies
- joint ventures with local firms who understand the markets
- licensing products into markets or creating local franchises
- appointing local distribution agents

[5 marks]

Suggestions for minimising exporting problems are relevant and well expressed.

[3 to 4 marks]

Suggestions for minimising problems are presented, but they may be limited in scope and/or number.

[1 to 2 marks]

Presents a simplistic and very general response.

8. E-Spresso

- (a) Identify the major elements of a business plan and explain why this document is useful to the bank to support its lending decisions.**

[5 marks]

Elements of a business plan:

- personal information (CV) of owners and key employees
- a clear statement of objectives split into short, medium and long-term. These should be in the form of quantifiable targets
- any unique selling point which will differentiate the product or service from its competitors
- market research
- a marketing plan based around the 4Ps of the marketing mix and a sales forecast
- possible statistical and/or financial analysis *e.g.* break-even, trend analysis
- a production plan if the firm is manufacturing
- financial information – projected cash flow budgets, profit and loss account and balance sheet
- financial guarantees, security or collateral

The bank will wish to see the business plan because it:

- shows the entrepreneur has thoroughly researched and clarified the idea
- the bank is able to make a judgement on risk and the future ability of the business to repay its loan

[5 marks]

Identifies the major elements of a business plan, with suitable examples and the outlines two main reasons for a bank requiring the document.

[3 to 4 marks]

Identifies some of the elements of a business plan and gives at least one reason for the bank requiring the document.

[1 to 2 marks]

Presents limited content of a business plan and/or may not identify any reason for the bank requiring the document.

- (b) Assuming Paolo Di Vito is successful in obtaining a loan and uses this as planned. If his stock increases 40%, with trade creditors and initial capital remaining unchanged, draw up a balance sheet for the year ending 31 December 2002.

[5 marks]

E-Spresso balance sheet for the year ending December 2002:

<i>Fixed assets</i>	\$	\$
Fixtures and fittings	24 000	
Coffee equipment	27 000	
Vans	72 000	
Computer equipment	<u>19 000</u>	
		142 000
<i>Current assets</i>		
Stock	25 200	
Cash	<u>20 800</u>	
	46 000	
Current liabilities		
Trade creditors	4 000	
Working capital		<u>42 000</u>
<i>Net assets employed</i>		184 000
Represented by:		
Initial capital	66 000	
Bank loans	<u>118 000</u>	
<i>Total capital employed</i>		<u>184 000</u>

[5 marks]

Accurately calculates the new financial position and presents the balance sheet with no errors.

[3 to 4 marks]

Makes one or two errors and/or the presentation is poor in places.

[1 to 2 marks]

The calculations are generally inaccurate and the presentation is poor.

- (c) (i) Calculate the gearing ratio, before and after the loan. [2 marks]

$$\text{Gearing Ratio} = \frac{\text{Long term loans}}{\text{Capital employed}} \times 100\%$$

$$2001 \quad \frac{48000}{114000} \times 100 = 42.11\%$$

$$2002 \quad \frac{118000}{184000} \times 100 = 64.13\%$$

(Award [1 mark] for each calculation up to a maximum of [2 marks].)

- (ii) Explain two potential consequences of the change in gearing. [2 marks]

Gearing focuses on the long-term financial stability of an organisation as it shows how reliant a firm is on long-term borrowing. If the gearing ratio is above 50% the firm is said to be highly geared. Highly geared companies are more vulnerable to economic downturns and high interest rates and inflation. It has to pay interest on borrowings before it can pay dividends or reinvest money in the business. Banks may be reluctant to lend more to highly geared companies. Paolo's business is now very highly geared and its growth and profitability may be restricted by this position.

(Award [1 mark] for each explained consequence up to a maximum of [2 marks].)

(d) Advise Paolo Di Vito on whether he should franchise his idea.

[6 marks]

Benefits:

- rapid expansion without incurring the high capital costs of expanding through direct investment
- a national or international presence can be obtained without heavy investment
- saving on running costs *e.g.* wages, rent, raw materials and administration
- the franchisee finances most of the expansion costs
- motivated franchisees are likely to be more committed than salaried managers
- franchisees may have extensive knowledge of the local market
- the franchisor will receive both an upfront franchise fee and royalties

Drawbacks:

- controlling franchisees and getting them to operate within guidelines may be difficult
- a poor franchisee may harm the reputation and image of the whole chain
- the franchisee may seek to take the knowledge and skills and later set up his own business (although the franchise contract may attempt to prevent this)

[5 to 6 marks]

Accurately identifies potential benefits and possible drawbacks of franchising with relevant examples to support this. Advises Paolo Di Vito on the franchising of his business.

[3 to 4 marks]

Addresses only one or two benefits or drawbacks and does not develop these ideas.

[1 to 2 marks]

Presents a limited response.
