Diploma Programme
Programme du diplôme
Programa del Diploma

Business management
Higher level
Paper 2

Monday 30 April 2018 (morning)

2 hours 15 minutes

Instructions to candidates

- Do not open this examination paper until instructed to do so.
- A clean copy of the **business management formulae sheet** is required for this examination paper.
- Section A: answer one question.
- Section B: answer two questions.
- Section C: answer one question.
- A calculator is required for this examination paper.
- The maximum mark for this examination paper is **[70 marks]**.

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Section A

Answer **one** question from this section.

1. Visionary Toys (VT)

Visionary Toys (*VT*) produces highly innovative toys for children. *VT* began operation in January 2017 and its unique selling point/proposition (USP) is producing toy parts with a 3D printer. *VT* uses the reducing balance method of depreciation. 3D technology changes rapidly and the financial directors are also considering ways of reducing *VT*'s tax liabilities in 2018. The financial director presented financial information for *VT* at the end of 2017.

Table 1: Revenue and expense information for the year 2017 and balance sheet items at 31 December 2017

Cash	$1000	CA
Net fixed assets	$27 000	FA
Interest paid	$250	-
Creditors	$4000	CL
Debtors	$3500	CA
Accumulated retained profit – end of 2017	$10 000	OE
Costs of goods sold	$7500	–
Sales revenue	$27 250	–
Short-term loans	$1500	CL
Overdraft balance	$2000	CL
Expenses	$7000	-
Share capital	$13 500	OE
Dividends paid	$2500	-
Long-term liabilities	$5000	LL
Stock of toy parts	$4500	CA

(a) Define the term *unique selling point/proposition (USP)*. [2]

(b) (i) Construct a fully labelled balance sheet for *VT* for the end of 2017. [5]

(ii) Calculate the acid test (quick) ratio for *VT* for 2018. [1]

(c) Explain **one** reason for *VT* to use the reducing balance method of depreciation. [2]

2. Jill Anderson

Jill Anderson operates a restaurant. Although Jill's meals are viewed as being excellent quality, sales are slowing. Jill is considering replacing existing meals with gluten-free meals. The following financial and forecast information is for the month of May 2018. Jill's restaurant can only produce either existing or gluten-free meals.

Table 1: Existing meals

Average price of existing meals = \$8
Rent = \$2000 per month
Variable cost per unit of existing meals = \$5
Sales of existing meals served = 800 per month
Jill's salary = \$400 per month, which is paid irrespective of the level of sales

Table 2: Estimated costs and price if Jill produces the gluten-free meals

Average estimated price of gluten-free meal = \$14
Variable cost per unit of gluten-free meals = \$10
Sales forecast of gluten-free meals = 1200 per month
Fixed cost increase for new machinery per month = \$400

A local gluten-free manufacturer, which is not part of Jill's existing supply chain, has offered to supply already prepared gluten-free meals at \$8 per meal. Jill is unsure whether to make or buy the gluten-free meals.

(a) Define the term *supply chain*. [2]

(b) Calculate:

(i) the total contribution of existing meals sold per month (*show all your working*); [2]

(ii) the total profit or loss on existing meals for May 2018 (*show all your working*); [1]

(iii) the forecast profit or loss if Jill decides to **make** and sell gluten-free meals (*show all your working*); [2]

(iv) the contribution per unit of a gluten-free meal if Jill decides to **buy-in** the gluten-free meals (*show all your working*). [1]

(c) Using your answer from (b) (iii) and (iv), explain whether Jill should buy-in or make the gluten-free meals herself. [2]

(Ques

Section B

Answer **two** questions from this section.

3. Speedy Delivery (SD)

Speedy Delivery (*SD*) is a private limited company that delivers freshly cooked meals by bicycle. *SD* only delivers. Restaurants subcontract *SD* to deliver meals to customers who place orders online and expect quick and efficient delivery. *SD* has been operating profitably for two years. Currently, it has the highest market share in the city.

SD is now facing two issues:

- It operates at 98 % capacity utilization. Recently, some restaurant owners complained to *SD* that meals arrived late and cold to customers.
- The market for home delivered, freshly cooked meals is growing quickly and some new delivery companies have just entered the market.

The CEO wants to address the delivery quality issues and the threat of competitors, two of whom recently merged. He is considering an internal growth strategy involving investing in new electric scooters and employing more staff to deliver a greater number of meals more efficiently. *SD* must raise a large sum of finance. Major shareholders are in disagreement regarding the internal growth strategy.

The financial manager has provided some financial information.

Table 1: Current information

can take as debt

Gearing ratio	65 %
Current ratio	0.9
Gross profit margin (GPM)	20 %
Net profit margin (NPM)	9 %
Return on capital employed (ROCE)	4 %
Debtor days	90
Creditor days	60

Table 2: Predicted return on the investment

Average rate of return (ARR)	6 %
Payback period	3.2 years

(This question continues on the following page)

(Question 3 continued)

(a) Define the term *market share.* [2]

(b) Explain **one** advantage **and one** disadvantage for *SD* of working at almost full capacity utilization. [4]

(c) Explain **one** advantage **and one** disadvantage for *SD* of using an internal growth strategy. [4]

(d) Discuss **two** appropriate sources of finance for *SD* to purchase the scooters. [10]

Private ~~PLC~~: • share capital (flotation & IPO)

• debenture / loan capital

two best one's

• ~~short term~~

• retained profits

obligation

relatively cheap / highest market share – low risk

maintain control

opportunity costs

4. Healthy Start (HS)

Tom Donat started *Healthy Start* (*HS*), a national chain of stores preparing and selling healthy snacks, which are produced in batches. *HS*'s target market is teenagers and young adults. Tom was concerned about high levels of fast food consumption and youth unemployment. His vision statement for *HS* is: "To encourage life-long healthy eating habits and to train school leavers (drop outs) in acquiring work skills".

HS hires many school leavers without qualifications. Because of the valuable social service that *HS* provides, an independent online media provider will feature *HS* in a new online reality TV show.

All employees, including managers, start at the lowest level of the organizational hierarchy and train on the job. Job enlargement, job enrichment and intrapreneurship opportunities are available. 20 % of all profits earned are put back into *HS* to finance these opportunities. Staff turnover is lower than the industry average.

Competition from global fast food restaurants has intensified. Their economies of scale mean that *HS* struggles to increase its market share. Online reviews indicate that some customers perceive *HS*'s snacks as healthy but overpriced and with small-sized portions.

Tom is considering two options:
- **Option 1**: Implement flow production. *HS* will buy new technology and assign each employee to a specific job on the production line. *HS* will increase portion sizes and keep prices the same.
- **Option 2**: Implement a new social media marketing campaign linked to the new online TV show. The campaign will focus on the health benefits of *HS*'s snacks.

(a) Describe **one** role of a vision statement for *HS*. [2]

(b) Explain how the following can benefit *HS*:

(i) job enlargement; [2]

(ii) intrapreneurship. [2]

(c) Explain **two** possible economies of scale available to global fast food restaurants but not *HS*. [4]

(d) Discuss the two options that Tom is considering for *HS* in response to the intense competition. [10]

OPTION 1

Adv. → EoS

Disadv. → capital costs

OPTION 2

Adv. → Brand recognition

Disadv. → Unlikely to succeed

5. Taxi-M (TM)

Taxi-M (*TM*) operates 2500 taxis in a developing country. All drivers are full-time employees and have a professional taxi license. Although not compulsory, *TM* regularly conducts safety inspections of the taxis. Though safe, most of *TM*'s taxis are old and *TM* charges high prices. Many customers complain.

However, a multinational company, *RE*, with offices around the world, has started to offer a mobile application (app) called *Best-Taxi* (*BT*). Using their mobile phones, passengers can use *BT* to book and pay for a car journey. Any car owner can offer journeys through *BT*. For security reasons, the *BT* app registers passengers' and drivers' personal details.

TM's sales are falling and profits are down. A number of *TM*'s drivers are becoming demotivated. Facing lower incomes, poor management and rumours of redundancies, many loyal drivers have left to offer taxi services using their own cars and the *BT* app. Some of these drivers are earning considerably higher wages than before.

The situation for *TM* appeared critical. However, local media have reported a higher rate of road accidents by *BT* drivers than licensed taxi drivers. Several of its drivers have assaulted and robbed customers. In response, *TM*'s management decided to downsize and differentiate itself from *BT* by positioning its service as a high-price, high-quality traditional taxi service. *TM* will:

- sell older cars and lease new luxury cars
- develop a unique selling point/proposition (USP) emphasizing comfort and safety.

Customers can book taxis by telephone and by stopping them in the street. *TM*'s target market will be business people, higher income families and passengers concerned about safety.

(a) Define the term *redundancy*. [2]

(b) Explain **one** positive **and one** negative impact of the multinational company, *RE*, on the developing country. [4]

(c) With reference to Maslow's motivation theory, explain **two** reasons that some *TM* drivers left to drive for *BT*. [4]

(d) Discuss the new strategy to differentiate *TM* from *BT*. [10]

Section C

Answer **one** question from this section. The organizations featured in sections A and B and in the paper 1 case study may not be used as a basis to your answer.

6. With reference to an organization of your choice, examine the impact of **globalization** on human resources **strategy**. [20]

7. With reference to an organization of your choice, examine the impact of **ethics** on organizational **change**. [20]

8. With reference to an organization of your choice, examine the impact of **innovation** and **culture** on an organization. [20]

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no section D: $\frac{26}{30} = 87\%$.

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Example / Ejemplo 27 [27]   Example / Ejemplo 3 [3]

1

(a) A unique selling point is an aspect of a particular product or brand that differentiates its self from other competition. Usually this would make customers more willing to purchase the particular good or service. ②

(b)(i) Balance sheet for VT as at 31 Dec 2017

	$	
Net fixed assets	27 000	
Current assets:		
Stock	4500	
Cash	1000	
~~Debtors~~	~~3500~~	
Total current assets	~~5500~~	9000
Current liabilities		
Creditors	4000	
Short-term loans	1500	
Overdraft	2000	
Total current liabilities	7500	
Working capital	1500	
~~CA~~ TA - CL	28500	
Less: long term liabilities	5000	
Net Assets	23500	
Financed by: Share capital	13500	
Acc. ret. profit	10000	
	23500	

⑤

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(b)(ii)

$$\text{Acid test ratio} = \frac{CA - \text{Stock}}{CL}$$

$$= \frac{9000 - 4500}{7500}$$

$$= 0.6$$ (2018)

1

(c) The reducing balance method of depreciation will depreciate an asset more during its earlier years. For VT's 3D technology, this is better as innovative technology, with its short product life cycle tends to follow the trend of the reducing balance method.

2

3/

3

(a) market share = $\frac{\text{sales revenue}}{\text{market sales revenue}} \times 100$

BOD

=> It shows what proportion of the market is controlled by a particular organisation.

2

(b) Advantage: A high ~~rate~~ capacity utilisation rate like that of 98% (by SD) is advantageous as it lets the organisation to operate at a large scale, making efficient use of all the resources available to them - little would be spent on ~~the~~ fixed assets which do not contribute to sales revenue as nearly all resources are always being used. This is likely a leading contributor to SDs high market share and reasonably good NPM of 9%.

Disadvantages: diseconomies of scale may occur, where the employees can no longer cope with the high levels of demand and very low leniency and acceptance of error in organisations with high capacity utilisation. This is likely a leading reason as to why SD is facing quality control issues, because they do not have the resources and labour to operate at this scale.

4

6

(c) ~~Internal~~ o

Advantage: Internal growth strategies ensure that the organisation's owners have more control over how the business grows, as it is more predictable and does not involve ~~corroborating with other~~ strategies like M&As, JVs, SAs OR franchises in which the organisation has significantly less control over the organisation's future. In the case of SD, using internal growth, ~~Disadvant~~ the CEO should be able to have full control over the business' future strategy.

Disadvantage: internal growth is usually slower than external growth. This is because finance must be raised, and the resources to participate in such growth do not yet exist. This is in contrast with the merger of two rival organisations who can quickly attain more market share ~~the~~ through synergy and shared resources. SD will need to invest large amounts of time and money in raising capital and hiring more staff.

4

4

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Example / Ejemplo 27 [27] Example / Ejemplo 3 [3]

[3] (d) Speedy delivery (SD), a private limited company is looking to raise finance for an internal growth venture in response to becoming outsized and the introduction of competition within the market.

Driving	Debenture: Loan capital	Restraining
~~(3)~~ relatively cheap · (4) and easy	~~3~~ 4 | 2	· long term debt obligation (2)

Driving	Retained Profits	Restraining
(3) maintain control -	3 | 4	- opportunity cost ~~(3)~~ (4)

~~Loan capital,~~ ~~debt and~~

Debentures (a type of loan capital) is frequently used on medium-to-long term investments, as it provides organisations with ~~acce~~ relatively easy and cheap access to a large sum of finance, which is very beneficial for SD. This is because, with an already low gearing ratio of 65%.

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and a relatively low payback period, SD would be able to get access to relatively low risk debt. This would let them invest in the new scooters, without severely negatively impacting business operations due to the capital expenditure.

However loan capital is still accompanied by long term debt obligations, which could harm long term liquidity. With an already extraordinarily high debtor days ~~ratio~~ ratio of 90 days (vs. 60 for creditor days), as well as a current ratio of 0.9 (reasonably low), SD must ensure that their long term cash flow is sustainable, allowing for fluctuating interest rate repayments. While this is unlikely to present an issue for SD, it remains a plausible restraining force for the decision.

Retained profits are a go-to source of finance for an organisation with the means. This is because there are no short or long ~~te~~ term obligations for organisations who ~~use~~ use it as a source of finance. Instead, it enables organisations to receive 100% of the return of an investment. As SD has been operating profitably for 2 years, ~~and~~ ~~tee~~ they are likely to have some amount of ~~accu~~ accumulated retained profits, ~~as~~ ~~making~~ giving this source of finance a relatively strong driving force.

Retained ~~po~~ profits, however, have a certain element ~~of~~ ~~of~~ of opportunity cost, detracting from day-to-day operations or from other long term investment opportunities. For SD, they must ensure they maintain enough retained profit to afford cash on their balance sheet, ensuring they have sustainable working capital to manage the 30 day deficit between creditor and debtor days. Currently, this seems to not be the case, with a low current ratio. Hence, using retained profits does not seem sustainable for SD, and they are advised against it.

To conclude, SD is advised to utilise loan capital as an external source of finance to grow. The current financial position of SD dictated opportunity for loan capital, as well as unjustifiable risk for retained profits. This is further emphasised by the forcefield analysis, where loan capital was 4 vs 2, and retained profit was outweighed by the restraining forces.

4

(a) A vision statement outlines the long term, unquantifiable aspirations of an organization, thereby acting as a USP which enhances the brand value of an organisation. This is particularly the case when the ~~vis..~~ vision statement ~~foc~~ focuses more on CSR-related aspects of the organisation.

=> stakeholders

=> No application

0

(b)(i) Job enlargement, or horizontal loading, includes giving employees a wider range of responsibilities over ~~#~~ tasks which are similarly challenging. This ~~all~~ gives employees to become more motivated through being given more job variation. ~~however is limited in that employees do not actually learn new skills.~~ For ~~HS~~ HS, this is in line with their vision statement, ~~(ii) Intrapreneurship~~ meaning that employees will feel motivated and the public will see additional brand value.

~~&~~ (ii) Intrapreneurship lets employees innovate within the business setting, enabling new ideas to be created and developed. While this plays into Daniel Pinks mastery and autonomy theories, there is little benefit to a food company like HS, as high school leavers are unlikely to ~~be~~ be motivated enough, and there is little room for innovation in food store chains.

2

=> do not talk about limitation

=> mention application to industry needing innovation

3/

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3

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Example / Ejemplo 27 [27]   Example / Ejemplo 3 [3]

[4]

(c) → Purchasing economies: large chains will be able to purchase food from suppliers for a relatively low average price per unit, as they would be able to purchase in bulk due to their larger operating scale. This would bring down costs, hence lowering overall average costs. For HS, their smaller batches for the smaller target market, as well as their lack of international presence means that their food is perceived as overpriced.

definition
application
BOD

⇒ Global food chains will also benefit from marketing economies of scale. They will not only be recognised around the world which adds immense brand value, but will also be able to use similar marketing campaigns in many locations hence lowering costs. As HS operates nationally, they do not benefit from the economies of scale achieved from global brand recognition or consistent global marketing campaigns.

3

3/

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In response to ~~AHH~~ multinational competition from in the fast food chain industry, Tom at HS is considering the following two options, which are detailed on the ~~fo~~ two force field analyses below.

Driving	OPTION 1	Restraining
(4) economies of scale -		~~- capital expenditure (2)~~
		~~- demotivating (3)~~
		~~= costs (2)~~
4	~~2~~ 4	- goes against vision (4)

Driving	OPTION 2	Restraining
(2) Brand recognition -		- unlikely to succeed. ~~(3)~~ (5)
2	5	

The first option, implementing flow production, is commonly used to achieve high levels of economies of scale, ~~ranging from £~~ as employees and machinery would become specifically trained in a set, or set few task. This strategy, likely already employed by larger fast food chains, would be more beneficial than batch production in this sense, as ~~emplo~~ operations can be very efficient. This way, they will be able to increase portion sizes, one of the primary complaints with the current production method, which is likely to make them more competitive with other ~~other~~ fast food organizations. This is very important for HS as they need to improve their efficiency if they are to offer any sort of competitive product in an industry where customers are likely to prioritise price over other social objectives, particularly within HS's ~~their~~ target market of teens and young adults. These customers are unlikely to have the appetite to spend "unnecessarily" extra on food.

The first option, however, directly contradicts HSs vision statement, as it would likely remove the non financial rewards like horizontal and vertical loading which is offered to the employees. This would not only demotivate the workers, but detract significantly from ~~HS~~ HSs social-related brand image. There would be a good chance that HS would lose the new reality TV show, as well as a plethora of loyal customers who would no longer be satisfied paying the same price for the product, despite the larger portion sizes.

The second option, to implement a new marketing campaign would likely give HS an added layer of brand recognition and brand loyalty which is desperately needed in situations where competitors have better economies of scale. This strategy is in-line with HSs vision statement.

However, it has already been established that the CSR-centric approach to business in the industry is unlikely to work amongst the target market of teenagers and young adults. The second option is option, therefore, is attempting to address a problem that cannot be fixed - rather, they should be attempting to solve issues which are ~~does~~ more realistic for the identified target market. Hence, this strategy is seen ~~as a~~ with a restraining force of 5 on the FFA.

In conclusion, neither of the two options are very well supported by the FFA or the reasoning above. However, it was identified that the second option is not well suited towards HSs target market and current business situation. Hence, with balanced forces on the FFA, it is recommended that HS go with option 1 to attain the better economies of scale aforementioned.