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BUSINESS AND MANAGEMENT
STANDARD LEVEL
PAPER 2

Friday 9 November 2012 (morning)

1 hour 45 minutes

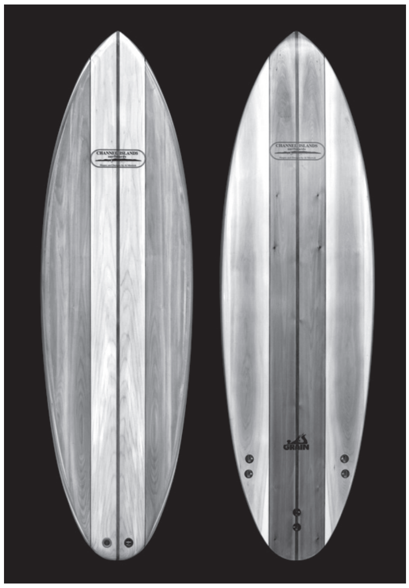
INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- Section A: answer one question.
- Section B: answer two questions.
- A calculator is required for this examination paper.
- A clean copy of the ***Business and Management*** *formulae sheet* is required for this examination paper.
- The maximum mark for this examination paper is *[60 marks]*.

SECTION A

*Answer **one** question from this section.*

1. Wavin' Surfboards (WS)



[Source: http://www.grainsurfboards.com/, 20 July 2012. Used with permission]

Wavin' Surfboards (*WS*) manufactures surfboards. The business was founded in 1978 by Brent Bass who operated it as a sole trader. In 1991, after years of sales growth and employing many employees, Brent changed *WS* into a private limited company. The growth in scale of operation was a challenge for Brent, who had a laissez-faire leadership style. He loved surfing and as a young person he started producing and selling surfboards at his home. He had not received any business training. As the business grew Brent struggled to develop the business and management skills necessary to operate the business.

Due to the high quality and popularity of the surfboards, sales continued to increase. Brent's accountant believes that the company will need a new larger building in two years. The span of control within the company is currently wide, and increasing the number of units (surfboards) produced would require employing more managers. For Brent, this would mean spending more time supervising managers and less time producing and promoting surfboards. Brent would also have to decide whether to recruit the new managers internally or externally.

Brent's accountant prepared a comparison of the current and proposed new scale of operation.

	Current building		Proposed new building	
	Actual units produced per year	Maximum capacity units produced per year	Initial forecasted units produced per year	Maximum capacity units produced per year
Sales in units	2400	3000	3300	6000
Variable costs per unit ($)	800	800	750	750
Fixed costs per year ($)	590 000	590 000	1 050 000	1 050 000
Managers' salaries per year ($)	450 000	450 000	600 000	900 000

The current sales price per surfboard will remain at $1400 no matter the scale of operation.

[Used with permission]

(This question continues on the following page)

(Question 1 continued)

(a) (i) Identify **one** advantage and **one** disadvantage of internal recruitment. *[2 marks]*

(ii) Describe **one** method of external recruitment. *[2 marks]*

(b) Prepare a fully labelled break-even chart for *WS* at its current actual sales of 2400 units in the **current** building. *[5 marks]*

(c) (i) Calculate the contribution of **one** surfboard in the proposed **new** building. *[1 mark]*

(ii) Calculate the initial forecast profit for *WS* for its first year of operation in the proposed **new** building *(show all your working)*. *[3 marks]*

(iii) Explain why Brent's accountant forecasted lower variable costs per unit in the proposed **new** building. *[2 marks]*

(d) Using appropriate calculations for the actual units produced (2400) in the **current** building **and** initial forecasted units produced (3300) in the proposed **new** building, analyse the impact of the proposed new expanded scale of operation on profits and profitability. *[5 marks]*

2. Woolman Windows (WW)

Woolman Windows (*WW*) manufactures windows for houses. The windows are sold to suppliers of building materials in Canada. *WW's* windows have two pieces of glass sealed in a wooden frame with a special glue that prevents any air from passing through. The windows are energy-efficient. In addition, moisture never appears between the two pieces of glass, a problem common to many other energy-efficient windows. The *WW* brand is widely recognized in the residential construction industry in Canada.

Because of the housing crisis in North America, *WW* has seen its sales fall and its financial position deteriorate.

Table 1: selected items from *WW's* balance sheet as at 31 May 2009 (all figures in $ thousands).

Cash	150
Creditors	515
Debtors	850
Loan capital	X
Short-term borrowing	285
Retained profit	1300
Share capital	300
Stock	400
Total (net fixed assets)	1800

Table 2: selected items from *WW's* profit and loss account for the year ended 31 May 2009 (all figures in $ thousands).

Cost of goods sold	4700
Expenses	2150
Gross profit	2195
Sales revenue	6895

WW manufactures only standard-sized windows using flow production. *WW* offers trade credit* with payment in 30 days. However, *WW* is considering taking "special orders", that is, to manufacture windows that are not standard-sized. Doing so might be profitable if the number of windows per special order were a minimum of 100 windows (break-even point). *WW* would manufacture special orders using batch production. For special orders, the buyer would pay 50% upon placing the order and the remainder upon delivery. The disadvantage is that an additional employee would have to be employed to plan the production process for each special order. *WW* is uncertain if special-order sales will be sufficient to cover the cost of the recruitment and training of the new employee.

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* trade credit: credit extended to a business from its suppliers. Trade credit is usually listed on the balance sheet of a business as "creditors" or, in some countries, "accounts payable".

(This question continues on the following page)

(Question 2 continued)

(a) Define the following terms:

(i) *share capital* [2 marks]

(ii) *batch production*. [2 marks]

(b) (i) Using the information in **Table 1**, construct a balance sheet for *WW* as at 31 May 2009 and calculate the loan capital (figure X). [5 marks]

(ii) Using relevant information from **Table 1**, calculate the acid test (quick) ratio *(show all your working)*. [2 marks]

(iii) Using relevant information from **Table 1**, calculate the gearing ratio. [1 mark]

(iv) Using the information in **Table 2**, calculate the net profit before interest and tax *(show all your working)*. [2 marks]

(v) Using relevant information from **Table 2**, calculate the gross profit margin. [1 mark]

(c) Using financial and non-financial information, examine *WW's* decision to start producing special-order windows. [5 marks]

SECTION B

*Answer **two** questions from this section.*

3. Sokol restaurant

Sokol is a well-established traditional restaurant in a village in Slovenia. *Sokol* has a new owner, Andrej Marinić. Andrej conducted some market research in order to analyse *Sokol's* business environment and reached the following conclusions:

- *Sokol* has a good market share: last year, it served 12 000 out of the 60 000 meals served in total by all the restaurants in the village
- *Sokol* has two target markets: (i) young locals who want to eat out with friends, (ii) tourists who want traditional Slovenian dishes.

Andrej has constructed a position map* using the two axes of price (cheap or expensive) and styles of food (traditional or modern). The research showed that *Sokol* is perceived as cheap and traditional. *Sokol's* three main competitors have the following characteristics:

- Restaurant A: very expensive and very modern
- Restaurant B: cheap and traditional
- Restaurant C: cheap and modern.

The position map helps Andrej identify a new business opportunity: keeping the same traditional style but changing to a more expensive, exclusive, up-market image. *Sokol* would target two new market segments: (i) locals for special occasions such as family celebrations, (ii) tourists who are prepared to pay higher-than-average prices.

Andrej has three options:

1. To set up a joint venture with a five-star hotel that is to open in the nearby village.
2. To set up a strategic alliance with Restaurant A. The manager of Restaurant A is keen to collaborate in events such as the annual village festival.
3. To merge with Restaurant B, as they are the only two restaurants serving traditional Slovenian dishes. This merger, however, would result in redundancy (lay-off) for some employees, which would create negative publicity in the village.

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* position map: sometimes called "perception map" or "perceptual map"

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(Question 3 continued)

(a) Define the term *redundancy* (*lay-off*). *[2 marks]*

(b) Calculate *Sokol's* market share for the last year. *[1 mark]*

(c) Construct the position map of *Sokol* before Andrej made any changes to his restaurant. *[5 marks]*

(d) Analyse the usefulness of market segmentation and targeting specific markets for *Sokol*. *[5 marks]*

(e) Advise Andrej about the most suitable option for *Sokol*. *[7 marks]*

4. Procter & Gamble (P&G) and the dry cleaning* industry

Procter & Gamble (*P&G*) is a multinational company that manufactures a wide range of products and has global sales of US$80 billion. In the United States (US), *P&G* has now entered the dry cleaning industry, which is dominated by small independent, locally-owned businesses. "*Tide Dry Cleaners*®" is named after its best-selling soap (detergent) for washing clothes, Tide. *P&G* hopes to attract customers into its franchise stores with its well-known soap brand and then retain them with superior service.

According to research conducted by market analysts, consumers think that independent dry cleaners:

- are inconsistent in the service they provide
- have inconvenient opening hours
- rarely display prices
- are dirty, hot and smell of chemicals.

Tide Dry Cleaners® aims to promote a different image. The franchises are larger than most independent dry cleaners and have longer opening hours. They are painted in the same bright orange colour as Tide's soap packaging. The dry cleaning is done onsite, so service is quicker. Tide soap with its well-known long-lasting fresh scent is always used to dry-clean the clothes. The premises are kept clean, well-ventilated, cool and smelling of Tide soap.

Because competition is fierce, all *Tide Dry Cleaners*® offer discounts and below the line promotion. Already, many independent dry cleaners are concerned about the competition from the new *Tide Dry Cleaners*® franchises. One independent dry cleaner recently experienced a 50 % decrease in sales after a new *Tide Dry Cleaners*® franchise opened nearby. In the past, dry cleaning chains have had difficulty competing with independent stores, due to diseconomies of scale.

[Source: Adapted from http://www.nytimes.com/2010/12/09/business/09tide.html?page wanted=all]

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* dry cleaning: a cleaning process for clothing and textiles that differs from traditional soap-and-water cleaning, which, with delicate fabrics, can be very time-consuming and can sometimes damage the cloth or fabric

(a) Define the term *below the line promotion*. *[2 marks]*

(b) Explain **one** possible type of diseconomy of scale that *P&G* may experience in the dry cleaning industry. *[2 marks]*

(c) Explain **two** types of primary research that the market analysts may have used. *[4 marks]*

(d) Using the Ansoff matrix, analyse *P&G's* entry into the dry cleaning industry. *[5 marks]*

(e) Discuss franchising as a way for *P&G* to enter the dry cleaning industry. *[7 marks]*

5. Starbucks® and Tata Coffee

Starbucks® is a multinational coffee shop chain based in the United States (US). *Starbucks®* is in discussions with *Tata Coffee*, an Indian company, about opening *Starbucks®* coffee shops in the fast-growing Indian market. The Indian government limits the entry of foreign-owned retail chains into India.

Tata Coffee grows and sells its own coffee. It is owned by *Tata Group*, the largest Indian business conglomerate*. *Starbucks®* and *Tata Coffee* are considering forming a strategic alliance or a joint venture. For the past seven years, the two companies have done business with each other. *Starbucks®* has purchased coffee from various suppliers in India (for its coffee shops in Europe and the US), including from *Tata Coffee*.

Forming a strategic alliance or a joint venture with *Tata Coffee* will allow *Starbucks®* to enter the Indian market. Additional advantages for *Starbucks®* include:

- *Starbucks®* could open coffee shops inside hotels of the *Tata Group's* nationwide hotel chain
- *Tata Group* would consider allowing *Starbucks®* to open coffee shops in the numerous retail chains that it owns.

Coffee has long been popular in southern India but not in the north. Over the past decade, however, consumption of coffee in the north has increased significantly, as new coffee shop chains with more choice, appeal to young Indians with disposable income. India (with its population of over 1 billion) is developing fast (with a growth rate of 8 % of its GDP this year). *Starbucks®* has carried out research and found that the global brand name "*Starbucks®*" is already well-known in India, although there are no *Starbucks®* coffee shops there yet.

The competition in India is intense. *Café Coffee Day®*, an Indian company, dominates the market. An Italian company owns the other big coffee shop chain, *Barista™*.

[Source: adapted from "Starbucks to broaden dealings in India". *International Herald Tribune*, 14 January 2011.]

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* conglomerate: a company that is made up of a number of different companies and business that is typically in diversified fields and, often, different sectors of the economy

(a) Define the term *multinational company*. *[2 marks]*

(b) Explain the importance of branding for the decision of *Starbucks®* to enter the Indian market. *[4 marks]*

(c) Explain **one** PEST factor that may influence the decision of *Starbucks®* to enter the Indian market. *[2 marks]*

(d) Analyse **one** advantage and **one** disadvantage for *Tata Group* (owner of *Tata Coffee*) of forming a strategic alliance with *Starbucks®*. *[5 marks]*

(e) Discuss the decision of *Starbucks®* to enter the Indian market. *[7 marks]*