

# Answers

## Unit 1 Business and its environment

### 1 Enterprise

#### Key skills exercises

**1-8** See textbook for all answers.

**9** One reason is that Sami wants to be independent by owning his own business. **[K]** This is shown by the fact that 'he feels he is being watched over all the time by his manager' which does not give him any independence at all. **[Ap]** He was bored in his job. Working in a petrol station lacks variety and working for himself will involve many different tasks.

**10** Capital equipment – pottery wheel.  
Land – a suitable building for his pottery.

**11** Gaining the necessary finance for the capital equipment and the lease of the building.  
Building a customer base.

**12** By buying raw materials at a low cost (e.g. clay) and making products with them (e.g. pots and vases) that he can sell for higher prices.

**13** Sami will employ at least one other worker. **[K]** He will need someone to help him sell pots and carry out the administrative tasks such as looking after the paperwork. **[Ap]** This will help reduce unemployment in Sami's country. **[A]**

By producing and selling pots he will increase the total output (GDP) of the country.

**14** He might lack the necessary management skills (e.g. ordering inventories of clay on time, keeping accurate accounting records).  
The business might run out of finance due to lack of cash planning.

**15 Outline:** Answers should analyse the factors that can lead to the success of a new business: innovative idea, large number of potential customers, adequate finance, good leadership. and apply at least one of these benefits to Sami's business. Answer should then analyse at least one problem/difficulty that Sami might face which would reduce the chances of the business being a success (e.g. lack of business experience). An overall and justified conclusion needed.

**16 Outline:** Analyse the entrepreneurial characteristics that can lead to the success of a new business: hardworking; creative; leadership skills; commitment. Do you think that Sami has some of these skills? Which of these skills is/are likely to be most important in the case of Sami's business?

#### Exam-style questions

##### Paper 1

**1** See textbook.

**2** See textbook.

**3 a Outline:** The key differences are the objectives set for social objectives. All businesses will need to make a surplus/profit to allow for expansion and return on capital – but how do the objectives of the 'environment' and 'meeting a social need' affect how social enterprises operate compared to other businesses?

- b Outline:** Analyse why hard work is an important condition for a successful entrepreneur. Analyse why it alone might not be sufficient to ensure business success. Analyse the importance of creativity; initiative; multi-skilled; self-confidence; innovation and self-motivation are important characteristics too. Overall conclusion needed.

## Paper 2

- 1 a** See textbook.
- 1 b** See textbook – and give an example for this business.
- 2** See ‘Improve this answer’ below.
- 3 Outline:** Identify and analyse the importance of Sadiq’s personal qualities/characteristics – how have they helped make the business a success?
- 4 Outline:** Analyse the benefits of expansion: it will give Sadiq the potential to earn higher profits and make a bigger return on his capital. He is ambitious – which is a useful characteristic for an entrepreneur. Analyse the risks: he will need additional finance; expansion will only be successful if there are sufficient customers. Is Sadiq confident that there is a big enough market for a larger business to be successful. He might be best advised to discuss his plans with a bank manager or accountant or potential investor in his business before taking a final decision.

### Improve this answer

Missing skill has been annotated.

#### Paper 2 Q2:

Location is important for any business. If the site is too expensive it can mean that costs are too high and no profit is made. Sadiq must have chosen a cheap location on the harbour side so that it is accessible to the boat owners who will become his customers. **[Ap]**

All new businesses need customers and the quicker customers are gained, the more successful the business is likely to become. Sadiq’s customers will pay money to the business and this can then be used to pay the costs of the business and pay back any loans that were needed to set it up. He is a member of a sailing club and this helped to build a customer base quickly as he knew many owners of small boats. **[Ap]**

## 2 Business structure

### Key skills exercises

- 1** Student’s own answer (e.g. coal mining).
- 2** Student’s own answer (e.g. computer assembly).
- 3** Student’s own answer (e.g. insurance).
- 4** Public transport; postal service; public libraries.
- 5** In the private sector – they are not owned by the state.
- 6** See textbook.
- 7** No – it is still owned by one person.
- 8** All partners are able to contribute their capital as finance for the business. Partners might bring different skills and experiences to the business.

- 9** Able to sell shares to public to raise capital.  
Shareholders are encouraged to invest as they can sell their shares easily as the companies are 'listed' on the Stock Exchange.
- 10 Disadvantage:** Less control than if a completely independent business.  
**Advantage:** Support of a much larger business (e.g. in marketing the business).
- 11** She seems to be dependent on 'her own savings' for replacing capital equipment.
- 12** Partner will bring in extra capital that could be used to buy a new sewing machine.  
Partner will take some work load off Gill (e.g. selling dresses in the markets) to give Gill more time to make them.
- 13** Private sector – it is not owned by the state.
- 14** Secondary – she converts material into finished dresses, which is a manufacturing activity.
- 15** She is no longer completely independent. The partner will expect a say in making decisions especially as she 'knows a lot about fashion'.
- 16** The benefit would be that both Gill and her partner will have limited liability. **[K]** Her business partner plans to 'put a substantial amount of capital into the business'. **[Ap]** To protect their other assets from being liquidated if the business fails, Gill and her partner would benefit from only risking the capital they invested in the business. **[A]** The drawback could be that the partners will have to disclose and publish accounts of the dressmaking business and they might not want to make public how much profit they make
- 17 Outline:** Use your answer to Q16 as the basis for this answer. Add at least one paragraph which explains why you think they should form a private limited company or not. It could depend on whether they have plans for major expansion; whether they are prepared to risk losing all of their personal assets if the business fails; whether continuity is important to either of them if the other one dies. Overall conclusion necessary.
- 18 Outline:** Define joint venture. Analyse benefits (e.g. acting with a specialist retailer) – marketing would be less of a problem for Gill and partner; risks and cost of venture would be jointly undertaken. Analyse disadvantages (e.g. shared control might lead to problems; who would decide on pricing and other marketing issues?). Have Gill and partner the production capacity to produce the dresses required? Overall conclusion needed.

## Exam-style questions

### Paper 1

- 1** See textbook. Include examples of both.
- 2 Outline:** Select any two benefits and explain why they are a benefit to a new entrepreneur.
- 3 a Outline:** Identify and analyse three to four benefits of 'taking on a partner'. Note: The question does not ask for disadvantages.
- b Outline:** Analyse the advantages of public limited companies compared to private limited companies. Analyse why owners of a private limited company might not consider converting the business to a public limited company, for example a small family business that wants to keep control; no need for additional capital as the aim of the business is not to grow – so why take the risk of losing control? Overall conclusion needed – probably suggesting that only if major expansion plans that require substantial finance are being considered should the statement be considered as being accurate.

### Paper 2

- 1 a** See textbook.
- b** See textbook.

- 2 **Outline:** for example, insurance to provide cover for expensive jewellery in the shop; bank – to provide finance and banking services required.
- 3 **Outline:** Analyse problems: cost of legal conversion of the business; disclosure of information (e.g. annual accounts); have to agree on the roles of each of them as directors; Sajiv would own more shares than Cassy – gives him more control over decisions.
- 4 See ‘Improve this answer’ as follows.

### Improve this answer

Missing skill(s) has been annotated.

#### Paper 2 Q4:

A franchise means buying a licence to trade under the name of another business. If this business is well known with a good brand name it can reduce operating risks. This is because consumers will already know about the business and its profits and this might reassure them. **[A]** MGC is a large company and appears to have a good brand name. This will mean that marketing costs for Cassy and Sajiv might be quite low as the business and its products are already well recognised. So Cassy and Sajiv would not have to spend much on advertising as customers will already know about MGC jewellery designs. **[A]**

Risks will be reduced as MGC will have much experience in operating retail stores and will be able to pass this on to Cassy and Sajiv. They are both ambitious and want new challenges. Setting up a new shop and making well-known jewellery designs will give them these challenges. The franchise is likely to be very profitable but Cassy and Sajiv need to check on this by asking if they can inspect the accounts of other MGC franchise operations. This will indicate to Cassy and Sajiv whether they will make more profit from either a franchised shop or their own existing operation. **[A]** This is a very important factor because before taking a franchise, the expected profit for the franchisee must be considered and compared with the opportunity cost. **[E]**

The cost of the licence ‘is high’. Cassy and Sajiv need to compare this cost with the likely sale price of their existing business. If the sale of C and S Gems raises more than the cost of the licence then this could be a good decision. **[Ap/E]** Perhaps the most important factor to consider is how much Cassy and Sajiv want to keep their complete independence over business decision-making. If they do, then they would be advised not to take up the franchise as they will lose some decision-making powers such as those over products and product ranges and marketing such as price levels. **[E]**

## 3 Size of business

### Key skills exercises

- 1 Total value of sales of a business in a given time period.
- 2 Market value of all of a company's issued shares.
- 3 See textbook.
- 4 It might be a capital intensive business.
- 5 See textbook.
- 6 Economies of scale.  
May be more diversified and able to spread risks more.  
More likely to be able to afford research and development.
- 7 Commitment, continuity, pride.
- 8 Succession problem, conflict, traditional.
- 9 Organic growth achieved by expanding the businesses own resources – not by merger/takeover.

**10 Worked example:**

$$\begin{aligned}\text{Market share \%} &= \frac{\text{Sales revenue of this business}}{\text{Total market sales}} \times 100 \\ &= \frac{\$123 \text{ m}}{\$354 \text{ m}} \times 100 \\ &= 34.7\%\end{aligned}$$

$$11 \quad \frac{\$128 \text{ m}}{\$389.4 \text{ m}} \times 100 = 32.9\%$$

**12** It is a very competitive market and RCE's prices might now be uncompetitive – so its sales rose by a smaller proportion than the other businesses in the market.

**13** Employees.

$$14 \quad \frac{1,800}{5,100} \times 100 = 35.3\%$$

**15** They mainly sell online – this requires fewer workers than selling through retail outlets.

**16** It is a good measure of how RCE is doing when compared with other businesses in the market. Total revenue might be rising but if market share is falling then RCE is less competitive than it was.

**17 Outline:** Benefits: increases market share; opportunities for further economies of scale. Disadvantages: Cost of new premises; online selling might be more attractive to increasing number of consumers.

**18 Outline:** Yes: it indicates that the business is so large in the industry that it employs more workers than its rivals. No: This is not a good indicator of success; more workers but lower sales, for example, suggests falling competitiveness/efficiency. Overall: Better to aim for higher market share (e.g. by adopting e-commerce)?

**19 Outline:** Yes: They can be innovative, create jobs and increase total GDP; can act as effective competitors to larger firms and force them to become more efficient; smaller retailers have, in this case study, been performing much better than larger, older established businesses. No: Unfair to larger business; opportunity cost of finance used; not that expensive to set up online marketing operations – do small businesses need support for this? Overall conclusion needed.

## Exam-style questions

### Paper 1

**1** See textbook.

**2** See textbook – but apply to car manufacturing.

**3 a Outline:** This is an example of internal growth. Can the family manage a larger business? If not, professional managers might need to be recruited for each section of the beauty salon. Is the finance available? If not, are the family members prepared to put in more of their savings? Creates a larger business to be passed down to future generations.

**b Outline:** Assess the relative advantages of large and small business. Should government support any businesses? Should they support small or large businesses? Do the benefits that large businesses have mean that they do not require support? Include examples of small/large businesses. Overall conclusion needed.

### Paper 2

**1 a** See textbook.

**b** See textbook.

- 2 Able to finance growth from internal sources – external/inorganic growth often requires external finance and this can be expensive.  
Family has been able to manage the gradual internal growth – family might have lacked the skills/experience to manage rapid external growth.
- 3 See ‘Improve this answer’ following.
- 4 **Outline:** Analyse the advantages and disadvantages of RTE being a family business using the evidence/clues contained in the case study. Do you think that Sadiq’s son will be successful at managing the business once Sadiq retires? Will professional managers be needed? Should the business try to remain a family business? These are some of the issues to consider in the conclusion.

### Improve this answer

Missing skill(s) has been annotated.

#### Paper 2 Q3:

Small businesses such as RTE can be very important suppliers to larger businesses in the same industry. **[K]** For example, RTE supplies motors to two washing machine manufacturers allowing these businesses to focus on what they do best – assemble washing machines. **[Ap/A]** If RTE did not produce these electric motors the manufacturers might have to import these components and this would worsen country Y’s balance of payments. **[A]**

Supporting small businesses can reduce imports and increase exports, improving the balance of payments. **[A]**

RTE employs 45 workers. **[Ap]** If these workers were not employed by RTE they might not have a job at all. **[K]** They would then be unemployed and they would claim benefits from the government. This would cost the government a lot of money. **[A]** GDP would also fall as the 45 workers would not be producing any output. So government support for small businesses can increase employment and national output. **[A]**

## 4 Business objectives

### Key skills exercises

- 1 Achieve a 10% rate of return on capital.  
Become the largest business in the national market in terms of market share.
- 2 See textbook.
- 3 See textbook.
- 4 See textbook.
- 5 Mission statements are broad general statements regarding the long term core values and principles of the business. The corporate objectives should support this mission. They are specific and measurable targets that should, if achieved, help the business realise its ‘mission’.
- 6 Cleaning the environment around its factory.
- 7 See textbook.
- 8 Shareholders: annual report and accounts; Annual General Meeting.
- 9 Give all employees a very clear message about what types of behaviour are unacceptable to the business.
- 10 Survival to growth.

- 11 Increase total annual revenue by 15% next year.
- 12 CSR can be shown by improving sustainability of production method. Rejecting supplies using non-sustainable timber.
- 13 Student's own answer.
- 14 If JDT does open other stores, then setting clear objectives to the new store managers, which are then communicated to the shop staff will help to ensure that all employees are focused on the overall objective of the business.
- 15 Decision-making needs a focus or otherwise the decisions will not achieve the required objectives. **[K]** JDT wants to increase sales by 10% each year. **[Ap]** So the plan to open a new shop is appropriate as the new shop should increase sales of furniture. **[A] Outline:** Sketch this model. Helps Jacques to consider all possible options; encourages him to analyse all data; he should use appropriate decision-making techniques; implement and control his decisions.
- 16 Student's own answer.
- 17 **Outline:** Explain ethical decisions – using examples from case study and others related to this business. Analyse how ethical decision-making can have an impact on costs. Analyse how ethical decision-making can have an impact on revenue. You need to give an overall conclusion/judgement which is supported by the arguments that you use.
- 18 **Outline:** Explain what CSR means. Give examples from case study and others that could be related to this business. Analyse how CSR might be important to the company's success. Weigh up these advantages against the possible costs of CSR. Also, judge the significance of CSR against other factors that might be important to JDT's overall success. Overall conclusion needed.

## Exam-style questions

### Paper 1

- 1 See textbook.
- 2 One based on a moral code of conduct. Give an example.
- 3 **a Outline:** Explain SMART and other clear/measurable objectives. Analyse at least two benefits to a business of having such objectives (e.g. focus; motivation; coordination between department/divisions; used to assess actual performance).
- b Outline:** Define 'socially responsible'. Analyse why being socially responsible can add to businesses costs – give some business examples. Analyse the costs of not being socially responsible – including poor publicity and potentially lost customers. Weigh up the statement – does it apply to some types of business more or less than others? Could being socially responsible benefit all businesses in the long term? Overall conclusion needed.

### Paper 2

- 1 **a** See textbook.
- b** See textbook.
- 2 **Outline:** Use the example in the case study – or think of another scenario that could apply to CCT. Analyse the costs/consequences of employees not being aware of the company's objectives.
- 3 **Outline:** Explain two or three reasons why objectives might have to change, for example, in this case, will the arrival of new competitors mean that survival becomes more important than growth/profitability? Analyse the possible consequences of not changing objectives (e.g. inappropriate strategies might be decided on).
- 4 See 'Improve this answer' below.

**Improve this answer****Paper 2 Q4:**

Missing skill(s) has been annotated.

Ethical decisions are those based on a moral code of conduct. This means that the business is trying to do the 'right thing' by not taking bribes, not employing child labour, not using misleading advertisements and so on. Ethical business decision-making can lead to higher costs. For example, using cheap immigrant or child labour and not offering employment contracts can result in very low labour costs. These low costs can either be used to keep prices low or raise profit margins. In CCT's case, a purchasing manager of a mining company might offer a contract for new trucks if he receives a bribe from CCT. **[Ap]** If CCT rejected this offer as being completely unethical it could lose a major contract – but, perhaps more importantly in the long term, it avoids the huge risk of being taken to court for an illegal action and the very bad publicity that would result from this. **[A]** Offering bribes can increase the sales revenue of a business. By not offering bribes as company policy, important orders can be lost in countries where this kind of, usually illegal, financial incentive is expected by business people or government officials.

This dilemma for CCT will become greater if new entrants to the market for large trucks start to accept bribes – CCT's market share could fall but it would still be able to build up long-term relationships with customers based on trust and ethics and this could become much more significant. **[E]**

CCT seems to treat its workers very fairly and offers them good working conditions. **[Ap]** This is another example of ethical behaviour especially if the working conditions are better than the legal minimum. This policy leads – as in CCT's case – to low labour turnover and worker loyalty. It also reduces the costs of constant recruitment and selection of new workers. So, although it can be costly to treat workers ethically the long-term benefits of loyalty and high motivation can soon outweigh the short-term costs. **[An]**

By following an ethical code and using ethics as a basis for decision-making then CCT will make lower profits in the short term – especially as the market becomes more competitive. However, by acting ethically it can build up a long-term relationship with customers, workers and suppliers that can lead to higher profitability in the years to come. **[E]**

## 5 Stakeholders in a business

### Key skills exercises

- 1 See textbook.
- 2 Increase pay.  
Improve job security.
- 3 To collect correct amount of tax on profit.  
To ensure that jobs are available for the country's residents.
- 4 Jobs, incomes spent locally, environmental issues (e.g. traffic).
- 5 Legal rights – these usually include: safe products, accurate advertising, ability to change goods or have money returned if not up to standard or as advertised.
- 6 Bank wants the security of being repaid if it has lent finance to the business.
- 7 Yes.
- 8 Workers – higher pay – which will increase costs and possibly prices. Consumers – lower prices.

- 9** Changing from profit maximisation to increasing market share (perhaps because new rivals are threatening to take sales from the business) is likely to benefit customers as prices might be reduced; workers will have more to produce/sell so they might believe that their jobs are more secure, but shareholders will be concerned that increased sales/market share resulting from lower prices might reduce overall business profitability.
- 10** They are owed money by SCT – and want to try to make sure that they are paid.
- 11** Receive regular interest on loans.  
Be repaid at due time.
- 12** Shareholders – higher profit from higher prices. Customers – higher prices raise their cost of living.
- 13** Purchase less polluting trains.
- 14** It can lead to less conflict with stakeholders and a reputation for acting responsibly. This might mean: easier to obtain credit; more chance of customer loyalty; less chance of bad publicity and so on.
- 15 Outline:** More likely to receive loans/trade credit in future, which could be very important as SCT plans to buy new trains. But reducing cash by paying loans and creditors early might reduce liquidity of the business; opportunity cost of cash used for rapid repayment of debts.
- 16 Outline:** SCT could act responsibly by not taking advantage of the road works to increase train fares. This would create more customer loyalty and more people who had to switch to using the trains might decide to continue using them even when the road works are finished.
- 17 Outline:** Short term profits (e.g. by increasing prices during road works) might result in poor customer loyalty. Using polluting trains might result in costly legal action against SCT. Would acting more responsibly actually increase profit for shareholders in the long term?
- 18 Outline:** Analyse how acting responsibly could increase costs for SCT in short term but lead to higher profits/improved customer loyalty/better motivated employees in the longer term. It might also help SCT gain an extension of its licence from the government. Without this licence, it would not be able to operate train services at all. Future success might also depend on the impact of the road system on demand for train travel and the state of the national economy, which will impact on demand for train travel.

## Exam-style questions

### Paper 1

- 1** See textbook.
- 2** See textbook.
- 3 a Outline:** Identify two groups. Explain their likely objectives. Analyse how they might affect business policy and how they could conflict.
- b Outline:** Explain several stakeholder groups and their objectives. Analyse likely causes of conflicts between them – use business examples to illustrate these. Analyse whether conflicts can be reduced. Can they ever be eliminated? Could other stakeholder groups benefit from a profitable business – is it only shareholders? Why might focusing on shareholders in the short run lead to lower profits in the long run?

### Paper 2

- 1 a** See textbook.
- b** Meeting the needs of stakeholders other than shareholders. Give an example.
- 2** See ‘Improve this answer’ as follows.

- 3 Outline:** Shareholder profit objective means wages are kept low. Shareholder profit objective puts workers/local residents' health at risk with use of weedkillers.
- 4 Outline:** Explain social responsibility. Factors that could make DFF more socially responsible: legal changes (e.g. to weedkiller use); pressure group activity (e.g. trade unions or local residents/environmental groups); consumer boycotts. Analyse how these could force DFF to change its policies. Could DFF maintain existing policies despite these factors. Is it in a strong position against these groups?

### Improve this answer

Missing skill(s) have been annotated.

#### Paper 2 Q2:

A profit objective means making profits for shareholders. They invest in the business and expect a return on their investment. **[K]** Higher farm output can lead to higher profits for DFF and its owners – its shareholders. **[Ap]** If farm harvests are increased by using weedkillers then the revenue and profit of the business will increase and more profit will be available to give to shareholders as dividends. **[Ap/A]**

However, the impact on the local wildlife could be harmful and the weedkiller might damage the health of local residents too. So, by trying to increase profits which benefits shareholders, using weedkillers will leave the local community and environment worse off than before and they suffer from the objective of higher profits. **[Ap/A]**

## 6 Business structure (A Level)

### Key skills exercises

- 1** Fewer restrictions on trade and capital investment between countries. Markets in developed countries are often saturated/mature.
- 2** More consumer choice.  
Larger markets for businesses to exploit.  
More competition which should help to keep prices for consumers low.
- 3** More competition in local/national markets, forcing price reductions.  
Large MNCs may make it very difficult for small local/national businesses to survive, e.g. craft businesses.  
New start-up businesses will not have government or tariff protection and survival becomes more difficult.
- 4** Trade between nations with no barriers.
- 5** Using barriers to trade to protect local industries.
- 6** Local – in one area/region.  
National – has branches in many parts of the country.
- 7** National business only has operations in one country.
- 8** Student's own answer.
- 9** Adds to national output.  
Increased tax revenue.  
Increased employment.
- 10 Advantage:** Only commercial decisions will be taken not political ones.  
**Disadvantage:** Profit motive might lead to higher electricity prices especially if little competition.

- 11** ATC used to be a local business operating 'from one location'. **[K/Ap]** It is now a national business as 'it has opened other bases in other parts of the country too'. **[K/Ap]**
- 12** Further domestic expansion is limited.  
Free trade access with six other countries.  
Market potential – most of these countries do not have good internet access.
- 13 Outline:** Language; different technical systems; different laws (e.g. access to the internet).
- 14** More opportunities to expand abroad.  
More competition.
- 15** Customers – creates a more competitive environment and prices might fall.  
Competitors – legal controls allowing StatCom from monopolising internet services will allow competitors access to this market.
- 16** Workers – jobs might be lost if the state was financially supporting StatCom.  
Government – if StatCom becomes very profitable then the Government will lose out on owning these profits.
- 17 Worked example:**  
One way other businesses will be affected is increased competition if these businesses are in the internet/satellite installation industry. **[K/Ap]**. The existing businesses installing internet/satellite connections will now have a new competitor and ATC might offer lower prices to customers to get established in the new country. This could make existing businesses lower their prices too, reducing their profits margins. **[A]**  
  
The other way is that suppliers will be affected. Suppliers to internet industry (e.g. technical equipment) benefit from another business which might succeed in expanding the overall market size.
- 18 Outline:** Increased output, jobs, tax revenue – some threat to existing businesses as the least competitive of them might be forced out of business.
- 19 Outline:** Analyse benefits of ATC becoming a multinational (e.g. limited growth in country X). Analyse the costs/risks to ATC of becoming a MNC (e.g. do other countries have the same infrastructure to support the internet as in X?). Weigh the arguments for with the arguments against. Overall conclusion needed.
- 20 Outline:** Define privatisation. Analyse the groups that will benefit from privatisation of StatCom and how; analyse the groups that might lose out – and why. How will the government, in particular, be affected by its own decision? Overall conclusion needed.

## Exam-style questions

### Paper 3

- 1 Outline:** Analyse the benefits (e.g. increased output, jobs, tax revenue). Analyse the potential drawbacks (e.g. local businesses forced out; job losses might be greater than job gains, will SEC create a monopoly 'to dominate the market' and then raise prices?). Overall balance of impact depends on several factors e.g. whether the government encourages SEC to invest in country Y but limits the number of small local businesses that it is allowed to take over.
- 2** See 'Improve this answer' below.

### Improve this answer

Missing skill(s) have been annotated.

### Paper 3 Q2:

Privatisation means selling a state-owned business to the private sector. Governments can sell to the private sector state-owned businesses when they are short of money or when they believe that a competing free market works better than a state-operated monopoly.

SEC's workers will not want the privatisation to go ahead. They might lose their good pay level and secure jobs as a privatised energy business will focus on raising profits perhaps at the expense of workers.

Customers might also lose out as the privatised business will want to turn a loss into a profit to give a return to investors. The decision might be made to increase energy prices even further. As there are no really close substitutes for electricity in the home or in factories, customers will have to pay the higher prices as demand is likely to be relatively inelastic. **[Ap/A]** However, if privatisation also leads to new competitors entering the market that was originally controlled by the state monopoly then this could give consumers more choice about energy suppliers and help to reduce prices. **[Ap/E]**

The local community and environmental pressure groups might also lose, as the privatised business will probably make cost cutting a priority not the environment. It might be more expensive to use non-polluting sustainable energy methods than just burning oil or coal. So a privatised SEC might damage the environment and put people's health at risk. However, the government might, when it privatises SEC, introduce legal controls over the proportion of energy that should be produced using sustainable energy sources.

So the overall impact on the new shareholders of SEC is likely to be beneficial as high energy prices can be very profitable. The impact on the other stakeholders will depend greatly on whether the government introduces any legal controls over SEC's operations once it is privatised. If it does not, then workers, consumers and environmental groups could all lose out from this privatisation. **[E]**

## 7 Size of business (A Level)

### Key skills exercises

- 1** Internal (organic) is from growth of the number of branches, factories and so on opened and operated by the business.  
External (inorganic) is from mergers or takeovers.
- 2** See textbook.
- 3** See textbook.
- 4** See textbook.
- 5** See textbook.
- 6** The benefits that can result from two companies 'coming together' to form a larger business.
- 7** Loss of effective management control  
Over-trading – lack of working capital to finance expansion.
- 8** External – mergers/takeovers e.g. taking over bus manufacturer.
- 9** Merger – it was an agreed union between the two businesses.
- 10** Takeover – it was 'bought out'.
- 11** When FT bought out a bus manufacturing business this was an example of backward vertical integration because the bus manufacturer is a supplier to FT. **[K/Ap]**  
Merger with Company A was horizontal integration – both businesses operate bus routes.
- 12** Finance – FT has bought out Company B but it will also need to invest in the new bus design. Is this finance available?  
Management – does FT have enough good managers to control the rapidly expanding business?

- 13** Reduced frequency of buses on some routes to save on costs.  
Higher fare prices now there is less competition.
- 14** Better-designed buses as customers' needs will be better understood by the bus manufacturer.  
Lower fares if there are substantial cost savings from buying buses.
- 15 Outline:** Define the type of integration. Analyse benefits to, for example, shareholders (potential profits and cost savings through synergy) and workers (potential career opportunities in a larger bus company).
- 16 Outline:** Define the type of integration. Analyse disadvantages to, for example: shareholders (if there is no synergy, culture clash, inefficiencies and possible diseconomies of scale).  
Managers in Company B (job losses if they are replaced with managers from FT).
- 17 Outline:** Analyse two of these points: economies of scale; market dominance; control over prices.
- 18** One reason is this backward vertical integration will ensure a supply of buses to FT in future.  
**[K/Ap]** It will mean that FT can control the manufacture of buses to its own design and it can obtain the buses more cheaply than if it were buying them from an independent manufacturer. **[A]**  
Another reason is that FT might be able to develop better buses as it has direct feedback from customers. These buses might give FT a competitive advantage.
- 19 Outline:** Analyse two of these: diseconomies of scale, especially management coordination/communication problems; lack of synergy; culture clashes possible government action (e.g. to control bus fares on routes dominated by one operator).
- 20 Outline:** Define horizontal integration. Yes: economies of scale; dominance over market; more control over fares; bigger bus operator and the publicity that comes from this. No: no diversification at all – if government-controlled bus fares, then all of FT's revenue would be affected; diseconomies of scale. Overall conclusion needed.
- 21 Outline:** Define the two types. Backward integration is possible for FT – forward is not possible as it already deals directly with consumers. Yes: more control over supplies and costs; more influence on design; No: no diversification away from buses; difficult to manage a manufacturing business with managers whose experience is in providing bus services; lack of synergy. Overall conclusion needed.

## Exam-style questions

### Paper 3

- 1** See 'Improve this answer' below.
- 2 Outline:** Shareholders – higher profits earned quickly – but only if management can control rapid growth effectively; customers – more availability of computers (but is CC gaining monopoly control and will it be able to control prices?); workers – more job security as the business is larger and should be more secure – but if CC runs into financial problems due to over-expansion, jobs and wages might have to be cut. Overall conclusion needed (e.g. much depends on the ability of the management to manage rapid growth). Consideration of other stakeholders is possible as a form of evaluation.

### Improved answer

Missing skill(s) have been annotated.

### Paper 3 Q1:

A joint venture exists when two businesses agree to put in capital and management resources to operate a new business opportunity. It is not a merger or a takeover. This joint venture would be between a manufacturer (CC) and a marketing business (WML).

It would allow CC to concentrate on making the computers and tablets as efficiently as possible and not worry about selling them in another country. **[Ap]** WML will have experience of operating in country Y and will have contacts there with major transport and retailing businesses. CC will not have this experience or these contacts so creating a joint venture will reduce the risks and costs of selling CC products in country Y. **[A]**

One disadvantage is that WML will control marketing in country Y and take 60% of the profit. **[Ap]** This would leave less profit for CC. If CC set up its own subsidiary in country Y, it would have complete control over the marketing, pricing and branding of its own products. This control might be very important for the business especially if it plans to expand into other countries in the future. In addition, CC is giving up 60% of the profits of the joint venture to WML, which might mean that it only has 40% management control too over this new venture. **[A]**

## 8 External influences on business activity (A Level only)

### Key skills exercises

- 1 Student's own answer but could include health and safety at work and minimum wage.
- 2 Student's own answer but could include laws against inaccurate advertising and selling of dangerous products.
- 3 Student's own answer.
- 4 IT use in communications.  
New product innovations.  
New process innovations.  
Use of viral marketing (e.g. social media).
- 5 Ageing population.  
Mass immigration.
- 6 Legal necessity – subject to legal sanctions if it does not protect the environment.  
Social responsibility – it plans to protect the environment because it considers it is its social responsibility.
- 7 Social audit covers a wider range of issues than an environmental audit, such as health and safety at work record, number of jobs created, charitable giving, volunteer work by employees.
- 8 Minimum wage – higher wages mean higher costs.  
Advertising controls – no more misleading adverts.  
Health and safety – buy safer equipment; better training.
- 9 One benefit of new technology equipment is that it should be safer than the dangerous equipment used now. **[K]** New cutting machines which automatically stop when the operator lets go of it will improve safety in the forests. **[Ap]**  
New machines might be more flexible – able to make a range of styles and sizes of furniture.
- 10 Demand patterns will change, e.g. fewer units of wooden furniture for children's bedrooms.  
Less immigration – fewer potential workers for TP to employ.
- 11 Issue press releases that criticise TP action.  
Lobby for a change in the law to make sustainable forestry a legal requirement.  
Customer boycott – until TP changes its 'no replanting' policy.
- 12 Increase production costs e.g. higher wages and health and safety training – TP might have to raise prices BUT it could lead to better motivated employees.  
Advertising – only accurate claims can be made in future.

- 13** Higher wage costs might encourage the managers to purchase more labour saving equipment. New advertising controls – change the slogans and claims made about the lower-quality furniture. Health and safety – spend more on better employee training.
- 14** Capital cost of the machinery.  
Cost of training employees to operate the advanced equipment.
- 15** One benefit would be good supply of timber in future if TP replaced cut down trees with newly planted ones. **[K/Ap]** The forests are so large that TP does not bother to plant new trees to replace those cut down. This can cause soil erosion problems that damage the environment. By planting new trees TP will benefit the environment as well as increasing its supply of timber for the future. **[A]**  
Another benefit is better public image and no risk of consumer boycott.
- 16 Outline:** Use your answers to Q12 and Q13 to build arguments for the costs to TP of introducing these legal controls and the effects they might have on its operations. Analyse the potential benefits of TP adopting these legal controls: better motivated workers, better health and safety record, improved public image; no risk of legal action because of unfair advertising claims. Conclusion needed about the overall impact of these changes on TP.
- 17 Outline:** Should the company try to avoid introducing them? e.g. recruit only workers without a contract of employment to avoid the minimum wage? Continue with inaccurate advertising claims? Make no improvements to health and safety continue with same products? Compare the risks and costs of this approach with the costs and benefits of accepting fully the changes in legislations and other external influences.

## Exam-style questions

### Paper 3

15

- 1** See ‘Improve this answer’ below.
- 2 Outline:** Analyse the impact of these changes on BM (e.g. higher immigration means that a higher proportion of the population is no longer interested in BM’s old-fashioned recipes). Should BM change its recipes to reflect cultural differences? Cost of this? Impact on existing image? Discuss how BM should respond to this and the other changes outlined in the case.

### Improve this answer

Missing skill(s) has been annotated.

#### Paper 3 Q1:

Technological change is being introduced in many industries. It often involves the use of computer-controlled equipment which aids either the design or the manufacturing process. One problem with introducing new technology is it can be very expensive. Many businesses can find it difficult to finance it. If finance is borrowed then this adds to interest costs for several years which will reduce the profits of the business. BM’s sales and profits have been falling in recent years and the business might have problems financing new technology from internal sources. Instead of borrowing the finance needed the equipment might have to be leased as BM’s profits might be too low to pay outright. **[Ap]**

Another problem is the resistance of the workforce and – sometimes – management to technological change. It can lead to job losses as it is often more efficient. Workers who remain will need new skills and training. This can be expensive and workers might worry about whether they are able to learn the skills. Managers might be worried about not understanding the new machines too. BM has been using the same production methods for years and workers might be very set in their ways. **[Ap]** BM’s managers too might be resistance to changes as they might fear the technical complexity of new equipment. They will have to train BM’s workers in using these machines and they might not feel competent to do this. There is also the risk of job losses as the machinery will operate ‘automatically’ and this lack of job security will reduce motivation of BM’s workers. **[Ap]**

Thirdly, new technology can change the way the product is made. This can mean that ‘handmade’ products are no longer made using traditional methods or materials. This can have a negative impact on consumers who might only have bought the products originally because of the traditional methods of manufacture which can help to give a product a quality image. BM’s reputation seems to be built on its home cooked food and using machines to do most of the food preparation, cooking and packaging might make it taste like ‘everybody else’s food’ thus damaging the brand name of BM. **[Ap/A]**

## 9 External economic influences on business behaviour (A Level only)

### Key skills exercises

- 1 See textbook.
- 2 Boom – rapidly increased economic growth.  
Recession – economic growth is negative.
- 3 Incomes are likely to be increasing – focus production on income elastic products.  
Invest in expanding capacity to cope with likely increases in demand.
- 4 See textbook.
- 5 See textbook.
- 6 Lower demand as incomes are lower.  
Higher supply of potential workers – may be able to reduce wage rates.
- 7 £1:\$1 becomes £1:\$1.5 is an appreciation of £.  
£1:\$1 becomes £1:\$0.90 is a depreciation of £.
- 8 Direct tax (e.g. income tax).  
Indirect tax (e.g. sales tax).
- 9 Changes in interest rates and the supply of money.
- 10 Income elastic as a 10% increase in income results in a 30% increase in demand.
- 11 Boom.
- 12 Higher cost of borrowing – interest costs on EH loans could rise.  
Consumers will have less discretionary income after paying interest – less likely to visit hotels.
- 13 Lower inflation rate.
- 14 An appreciation of the currency will make imported food and drink cheaper. **[K/Ap]**  
Demand from foreign tourists to stay at the hotel will fall.
- 15 Recession means negative growth. Unemployment rises, consumer incomes fall. Hotel services are income elastic – fall in incomes will lead to a greater proportionate fall in demand for hotel services.
- 16 Higher prices for food, drink and other materials needed by hotel might force it to raise its prices. If workers demand pay rise to try to maintain real living standards, this will raise costs even further if the pay demand is awarded. Higher costs will mean higher prices and EH will have to accept lower profit margins.
- 17 **Outline:** Increased demand as incomes rise.  
Reduces supply of labour – gives employers less choice of workers; wage rates could rise as supply of unemployed workers falls
- 18 One benefit of economic growth to EH is that it often leads to increases in consumer incomes. **[K]** As hotels and catering are usually an income elastic product **[Ap]** any increase in consumer incomes is likely to lead to an even greater relative change in demand for these products. Increased demand will result in higher revenue for EH and higher profit. **[A]**
- 19 **Outline:** It could lower prices to try to keep hotels full as higher income tax rates will reduce consumers’ disposable incomes. Lower prices reduce profit margins though. Promote hotels more

in other countries – try to attract more foreign tourists but they will have less spending power due to appreciation of country X's currency. Cut debt to reduce interest costs – sell more shares to raise finance but this is probably not a good time to sell more shares. Make an overall recommendation.

- 20 Outline:** Extend EH brand into less luxurious hotels with lower prices – but will this damage the EH brand? Might have to operate cheaper hotels under another name. Open hotels in other countries – these countries' economies might be at different stages of the business cycle but there are always risks and costs to expanding overseas for the first time. Overall conclusion/recommendation needed.

## Exam-style questions

### Paper 3

- 1 Outline:** Depreciation of exchange rate: higher import prices for bike components – higher costs might lead to BFA having to raise prices. Demand impact will depend on PED. Unemployment – people losing their jobs will experience income reductions – fall in demand for bikes; depends on income elasticity of demand but the two expensive models could experience a bigger fall in demand than the other two. Higher supply of workers – less pressure to increase wage rates – these could actually fall if there are many bike workers in other businesses made unemployed.
- 2** See 'Improve this answer' below.

### Improve this answer

Missing skill(s) has been annotated.

#### Paper 3 Q2

BFA is going to be greatly affected by these changes in the external economic environment – if the forecasts turn out to be true. As country Y's economy is forecast not to expand in 2020 the consumer incomes will not be growing. As there is forecast to still be inflation by then, real incomes could fall.

A depreciating exchange rate will make imported components more expensive and these could reduce BFA profits. Higher taxes will also reduce consumers' disposable income. With all of these changes in the external economic environment, it will be important for BFA to respond quickly.

Firstly, the company could expand production of its cheaper bicycles as these are likely to have a lower income elasticity of demand than the two more expensive models. They might be 'inferior' goods, certainly compared to cars which many consumers might not now be able to afford. If demand for the two cheaper models increases then BFA could move resources from making the e-bike and the racing model to the two cheaper designs.

However, the profit per bicycle could be much less with these two models and BFA might have planned to develop its brand image more effectively in the higher priced segments of the market. **[E]**

BFA could start exporting all of the other three designs that it currently does not sell abroad. Other country's economies might not be at risk of recession as that of country Y appears to be. In addition, the depreciation of the currency gives BFA the chance to offer its bikes at a very competitive price in foreign markets. Demand for bicycles might be high as a result of this and BFA could replace some lost sales in country Y with these new markets. In this way, output might not have to be reduced and jobs could be saved. However, BFA would have to be aware of any differences in consumer protection rules between these countries and country Y as well as different laws about bicycle construction and safety. **[E]**

On balance, BFA should go for market development and expand sales of its bikes in foreign markets. This will spread market risk as their economies are unlikely to be at the same stage of the economic cycle so as country Y heads for a possible recession then other countries' economies could be expanding. Perhaps the best way for BFA to expand into foreign market is to set up a joint venture with a sport good retailer in these countries as this would prove to be cheaper and less risky than exporting directly and the foreign-based retailer would know the local culture and laws relating to bike constructions. **[E]**

### 10 Management and leadership

#### Key skills exercises

- 1 See textbook.
- 2 See textbook.
- 3 See textbook.
- 4 See textbook.
- 5 See textbook.
- 6 Democratic – participation and two-way communication encouraged.  
Laissez-faire – workers are given much delegated authority and able to work within very wide limits.
- 7 Managers have responsibility for resources including directing and motivating employees and undertake a decision-making role.  
Supervisors do not have a decision-making role and have responsibility for leading a team of workers.
- 8 Workers dislike work.  
They are not prepared to accept responsibility.
- 9 Workers can be creative at work.  
They are willing to accept responsibility.
- 10 See textbook.
- 11 Autocratic – he takes major decisions with no participation of employees.
- 12 Fred ‘sets objectives and targets’ and this is a function of management. **[K]**. The case states that Fred has set all store managers ambitious targets for sales increases. **[Ap]**  
He coordinates the work of departments and stores in different countries (e.g. pricing and product decisions).
- 13 Decisional role.
- 14 Two-way communication with workers might result in useful feedback about customers’ reactions to products.  
Greater participation of workers can help to increase motivation.
- 15 **Outline:** Define leadership. Effective leadership needed to give business direction and a sense of purpose – new direction might be needed for AR given falling sales and profit.  
Leader of AR will need to take clear decisions about how to improve the performance of the business (e.g. online selling) but these decisions might be more effective if participation was encouraged from workers.
- 16 Fred seems to be using an autocratic style of leadership. **[K]** He ‘stands for no nonsense’ and cancelled weekly meetings with shop staff which was an opportunity for them to participate. **[Ap]**. This means that he will not get the benefit of the workers’ opinions on, for example, what customers seem to most want to buy which could lead to poor decisions about items sold in the shops. **[A]**  
Demotivating for junior managers and workers – this is a problem at a time when the business needs to improve customer service and sales.
- 17 Disseminator – Fred should communicate with employees and collect/give out information before decisions are taken (e.g. online selling decisions).  
Spokesperson – any change in direction for AR will need to be communicated to stakeholders (e.g. shareholders).

- 18 Outline:** Think about at least three different business situations for AR such as a flood at the warehouse, a meeting of all shop managers trying to think of new methods of promoting AR and its products; shop managers trying to improve sales needing the cooperation of workers. Explain which leadership style would be most suitable in each case. Evaluate need for different leadership styles at different times.
- 19 Outline:** Explain what EI is and what the EI competences are. Analyse how EI competencies will improve management within AR. Analyse what other factors will result in good management. Could these be more important than EI competences? Overall conclusion needed. Evaluate need for different leadership styles at different times.

## Exam-style questions

### Paper 1

- 1** See textbook.
- 2** See textbook.
- 3 Outline:** Define democratic leadership. Analyse examples of how this can be beneficial (e.g. when needing communication/feedback from workers; allowing workers to contribute to decisions as they might have knowledge and experience that is more relevant than managers have; need to discuss with employees how change can be brought about in an organisation). Analyse the benefits of democratic leadership in these or similar situations. Evaluate democratic leadership. When might it not be most effective (e.g. in a crisis). Overall conclusion needed.

### Paper 2

- 1 a** See textbook.
- b** See textbook.
- 2** 'I am good at telling workers what to do' suggests an autocratic style of leadership – no discussion or two-way communication seems to be encouraged. 'I do not let them worry about taking decisions' suggests a Theory X/autocratic leadership approach.
- 3 Outline:** Define EI; explain four main EI competencies. Apply at least two of these to RP and Mohamed. Analyse how the business would benefit from him using EI (e.g. social awareness – sensing what his workers are feeling as he uses the autocratic leadership style – it would help him to understand why his workers are not as well motivated as he is).
- 4** See 'Improve this answer' below.

#### Improve this answer

Missing skill(s) has been annotated.

#### Paper 2 Q4:

Mohamed seems to use the autocratic style as he tells workers rather than asking them (democratic style) or letting them get on with work themselves (laissez-faire).

If he used the democratic style, he could benefit from the worker's own experience. For example, the delivery drivers are the workers who have direct contact with customers when they take pizzas to their homes. They might be told about which toppings customers would most like to try on the pizzas and the workers could tell Mohamed this. If he responded to what customers actually want, then he might have a greater chance of reaching his 10% sales increase objective.

If he let workers 'get on with their work', then he might find that because they are being trusted they become more responsible and motivated. Some workers might know the town better than Mohamed and so letting them decide on the best route to take could mean that the pizzas are delivered more quickly and are fresher when the customers come to eat them.

At times it might be better for Mohamed to use autocratic leadership when dealing with a crisis such as an accident involving one of his delivery drivers. **[E]** He needs to contact their relatives, deal with the police and possibly the media. These are management roles that he does not have time to delegate or discuss with other workers. **[E]** When taking decisions that affect his products or customer service he would be advised to use a more democratic approach. This would not only improve the motivation level of his employees – which he is worried about – but it would also lead to products that are more likely to be liked by customers and better customer service. So the leadership style he should use depends on the situation. **[E]**

## 11 Motivation

### Key skills exercises

- 1 See textbook.
- 2 Low productivity.  
High labour turnover.
- 3 See textbook.
- 4 Economic man; select right people, observe performance, establish best method for doing each job; piece work pay.
- 5 Team spirit important, some control over working lives can be motivating, working conditions not that important for determining motivation.
- 6 Hygiene – factors that can cause dissatisfaction at work if they are not adequately provided.  
Motivating – factors that can create job satisfaction and are therefore motivating.
- 7 A person with a strong motivational need for achievement will seek to reach realistic and challenging goals and job advancement.
- 8 The degree to which people believe that putting effort into work will lead to a given level of performance.
- 9 Time-based wage rate, piece rate, profit sharing.
- 10 Job enrichment, quality circles, worker participation.
- 11 Worker directors.  
Being involved in quality circles.
- 12 Good quality product – very few customer complaints.  
Low rate of labour turnover.
- 13 Teamwork.  
Involvement/participation.
- 14 Agreed targets are set – there is participation involved in setting these targets.  
Rewards employees for extra effort/achievement so may motivate employees to achieve targets.
- 15 PRP depends on effective target setting and regular appraisal as pay is related to meeting targets. **[K]**  
It might be difficult to use PRP in this case if one dress is made by several different workers each performing a different task. If one worker is slower than the rest, all workers might fail to meet targets and receive less pay. **[Ap]** It might be difficult to measure and compare the performance of production workers as some dress styles might take longer to make than others.
- 16 Pensions.  
Health insurance.

- 17** The focus should be on quality, not speed of making dresses – high output of low-quality dresses could be disastrous for SD.  
Each dress might involve several workers so individual piece rate is inappropriate.
- 18** More highly motivated workers.  
Increases their sense of responsibility and esteem – good for training future supervisors/managers.
- 19 Outline:** Taylor – payment by results is in accordance with ‘Economic man’.  
Herzberg – pay is much less important than the ‘nature of the job itself’ in influencing motivation levels.
- 20 Outline:** Explain the essential features of both theorists’ views on motivation. Apply them to the context of a dressmaker. Assess whether one theorist’s ideas are more useful in this case – this would be a form of evaluation.
- 21 Outline:** Explain both payment systems and analyse their advantages and disadvantages (e.g. salary offers more security of pay (which workers in SD were concerned about) but it offers little incentive to reach agreed targets, unlike PRP). Might be best to involve employees in discussing the most suitable payment system? They could put more emphasis on non-financial methods. Overall judgement needed.

## Exam-style questions

### Paper 1

- 1** See textbook.
- 2** Commission on sales for sales employees – might motivate to try to sell ‘harder’ to customers.  
Profit sharing – if the business has high sales and profit then sales workers will gain a share of profits.
- 3 a Outline:** Explain economic man – motivated only by financial gain. Productivity and employee effectiveness can be improved by: select right person for each job and select the best method for each job, record performance and pay by results (piece rate).
- b Outline:** Define motivation. Explain common methods of paying teachers, for example salary (permanent teachers) or wage rate (temporary/tutorial staff) and, possibly, payment by results (bonus). Analyse how these methods might motivate (e.g. Taylor) but why they might not (e.g. Herzberg hygiene factors). Consider possible non-financial methods (e.g. participation in school management; team teaching). Assess likely effect of these methods (e.g. Herzberg motivational factors or Maslow’s hierarchy of needs). Overall conclusion needed.

### Paper 2

- 1 a** See textbook.
- b** See textbook.
- 2 a** Commission – 20% of \$10,000 = \$2,000.  
Divided by six workers = \$333.33.  
Difference is \$93.33 per week.
- b** Workers will benefit from higher wages in the high season – especially if they are encouraged to offer better customer service to attempt to increase sales.
- 3 Outline:** Explain main methods of non-financial motivation and suggest how they might operate in DK.
- 4** See ‘Improve this answer’ following.

**Improve this answer**

Missing skill(s) annotated.

**Paper 2 Q4:**

Two motivational theorists whose ideas that Dan might find useful are Taylor and Herzberg. Taylor believed in 'economic man'. This means that he believed that workers only work for money and they will work harder if more money can be earned. If Dan was to offer higher wages then café employees would work harder and they would not leave the business so often as other jobs would now be paying relatively less. **[Ap/A]** Piece work would be the best pay system to adopt, according to Taylor. Workers should be paid for each unit they produce and then they will increase output. **[A]** According to Taylor, workers also need to be told what to do and do not like thinking for themselves. However, this would not work in a café as piece work is not easy to measure in this context. What is missing from DK is not 'output' but good customer service and teamwork and higher pay will not provide these. **[E]**

Herzberg's two-factor theory is quite different. He believed that there were two types of factors that could influence work effort. Firstly, hygiene factors remove dissatisfaction but they do not actively motivate employees. So pay and working conditions, for example, have to be good enough to remove dissatisfaction but after that point then the motivator factors need to be introduced. These are things like 'complete units of work', responsibility, feedback from managers and so on. Once these factors have been put in place then employees will be much more motivated to work harder as they have been shown more responsibility and trust. Job enrichment would help DK by Dan spending much longer training each worker in a range of café skills so that they could benefit from job rotation and use teamwork much more effectively. This would help to reduce the many complaints from customers. **[E]** So, out of these two theories, the ideas of Herzberg and job enrichment are likely to be much more useful for Dan than Taylor's theories. **[E]**

## 12 Human resource management

### Key skills exercises

- 1** Workforce planning; recruitment and selection; developing employee; employee contracts.
- 2** See textbook.
- 3** See textbook.
- 4** A wider range of potential applicants than internal recruitment.  
May bring new ideas and initiatives to the business.
- 5** See textbook.
- 6** See textbook.
- 7** See textbook.
- 8** See textbook.
- 9** Induction training (e.g. into the structure and practices of the business).
- 10** See textbook.
- 11** Balancing the demands of employment with the opportunity to have leisure time and time with family.
- 12** Practices and policies to ensure that all employees are treated in the same way and given equal chances to fulfil potential.

**13 Worked example:**

$$\begin{aligned}\text{Labour turnover \%} &= \frac{\text{Teachers leaving}}{\text{Number of teachers employed}} \times 100 \\ &= \frac{12}{44} \times 100 \\ &= 27.3\%\end{aligned}$$

$$\mathbf{14} \frac{19}{46} \times 100 = 41.3\%$$

- 15** Rapid increases in the proportion of teachers leaving in a year. Management may need to investigate causes and deal with consequences of this.
- 16** Dismissed – threat of physical violence or damage to property is usually an offence that leads to dismissal.
- 17** Offers some security of employment.  
Teachers know what their terms and conditions of employment are.
- 18** Mistakes can be made by new recruits (e.g. in case of a fire if they have not been told about fire drill and emergency exits).  
New recruits may take longer to be effective workers as they do not know how the business structure/administration works.
- 19** Business – internal as he has been teaching at CC for several years.  
Science – external – has been teaching at another school.
- 20** Induction training for all employees – explain benefits of this.  
Training in latest teaching methods for some teachers (e.g. new Head of Business – could be off-the-job training at an Education college).
- 21** Discuss workload and whether this is evenly distributed among staff, management of time training, need to help each other and allow for breaks for all teachers.
- 22** Employment of women – by deliberately not employing women CC is missing the opportunity to recruit potentially good teachers.  
By recruiting his 'golf partner' this may be seen as favouritism and not treating everyone equally – may cause bad feeling and lack of motivation if a better qualified Business teacher was not appointed Head of Department.
- 23** A high labour turnover results in high recruitment and selection costs. **[K]** This means that CC will have to spend more on this important HR function so less finance will be available in other areas of the school such as textbooks for Business students. **[Ap]** This is the opportunity cost resulting from a high labour turnover.  
Creates a bad impression with students/parents as classes will often have different teachers with different teaching methods. No consistency for students.
- 24 Outline:** Think about whether one method is preferable to the other one in this case – this would be a form of evaluation. You might consider that it 'depends' on knowledge of the subject or the experience of internal candidates.
- 25 Outline:** Yes: increases costs of recruitment/selection and ties up Principal's time; no continuity for students – many will be anxious about this; some good teachers and experienced Heads of Department's leave and may be difficult to replace with teachers of similar quality; new teachers are poorly trained so problems might arise because of this.  
No: new ideas and new teaching methods being introduced; if weak teachers leave, then they can be replaced with better ones; keeps pay low as new CC recruits are often young and keen to gain a job.  
Overall conclusion needed.

## Exam-style questions

### Paper 1

- 1 See textbook.
- 2 Recruiting from internal employees only – they will know the products the business is selling well and possibly the customers too. Provides greater continuity, which might be appreciated by customers.  
Reduces induction training costs and staff will not need to be taken off the shop floor to conduct this training.  
Encourages existing sales staff to work harder as opportunities for promotion exist.
- 3 **a Outline:** Induction training – new employees able to be more effective right from the start, reduces major risks of having untrained new employees.  
On-the-job – cheaper than off-the-job usually, and allows employee to continue working. They learn from other experienced colleagues. Training is focused specifically on this business.  
Off-the-job – introduces latest ideas and practices in the industry. Meet people from other businesses – may be some exchange of ideas. Employees not working at same time – able to focus just on training.
- b Outline:** High labour turnover is a common problem with many hotels. Cost of recruitment/selection/training can be high. Training of new staff very important in this industry (e.g. food hygiene and customer service). Need to recruit/select best employees possible as they are in direct contact with the public and could create a very bad impression, damaging hotel's reputation.  
Internal – if staff with enough experience exist, this might help to reduce labour turnover as job promotion prospects exist. External – might bring in recruits with experience of latest industry practices and ideas. Selection – chefs might need to demonstrate competence in kitchen; receptionists – might depend on interview as personal skills very important.  
Conclusion: recruitment/selection very important – but pay levels and other conditions of employment might be just as important.

### Paper 2

- 1 **a** See textbook.
- b** Managing the employees of a business to help it achieve its objectives. This involves planning for workforce needs, recruiting and selecting employees, developing them and negotiating contracts of employment.
- 2 **Outline:** Benefit to TM – indicates what is expected on employees (e.g. preparedness to travel to foreign locations).  
Benefit to employees – details of pay and conditions of employment (e.g. holiday entitlement after long overseas appointment).
- 3 See 'Improve this answer' following.
- 4 **Outline:** Explain the main types of training. If experienced, perhaps only induction training is needed. If inexperienced, then other forms of training might be needed (e.g. journalists need training in cultural differences that might affect their jobs; camera crews will need training in use of equipment especially in conditions in other countries, perhaps desert conditions). Would off-the-job or on-the-job be preferable in these cases? Could inexperienced journalists and camera crew be sent to a foreign news story to learn 'on-the-job'? Conclusion needed.

**Improve this answer**

Missing skill(s) has been annotated.

**Paper 2 Q3:**

A diversity policy means that TM has practices and processes in place to make sure that its employees are very mixed in terms of race, gender, religion and age.

One reason for TM wanting to have a diversity policy is to make its news reports more acceptable to its customers – national TV broadcasting companies. If all TM reporters were the same gender, age, colour and race then the news reports would not be accepted as being truly representative or unbiased and would be unacceptable to TV viewers in most countries.

The second reason is to ensure that all new applicants for jobs within TM are selected on the basis of ability not race, gender, age and so on. **[K]** In this way TM will recruit the best people as journalists and camera crew and will not show favouritism to any particular group. This improved quality of employees should help TM to become well known for its professionally produced broadcasts. **[Ap/A]**

## 13 Further human resource management (A Level only)

### Key skills exercises

- 1** Hard – focusing on keeping employment costs as low as possible – this reflects the company's overall objective of minimising costs/maximising profit.  
Soft – developing employees to their full potential so that they can contribute fully at work and be more motivated and not leave.
- 2** Full time – working the total hours per week as specified by the business as being a full-time employee (e.g. between 35 and 40 hours per week).  
Part time – working a proportion of a full working week.
- 3** See textbook.
- 4** See textbook.
- 5** See textbook.
- 6** Core – key to the operation of the business (e.g. strategists, senior managers).  
Peripheral or flexible workers – less important to the future of the business and who can be offered temporary, part-time contracts as required by the business.
- 7** Output per time period/number of workers employed.
- 8** One way is:  $\text{Absenteeism \%} = \frac{\text{No. of employees absent}}{\text{Total no. of employees}} \times 100$
- 9** To prevent exploitation of employees by large, powerful employers.  
To control power of trade unions.
- 10** See textbook.
- 11** Unions negotiating on behalf of all of its members – possibly with an employers' association negotiating on behalf of a number of employers.
- 12** See textbook.

- 13** Strike.  
Work to rule.
- 14** Coordination of objectives between all departments/divisions as they should be focused on the overall company aim.  
Each team/person has a clear target to work towards that is part of the overall objective of the business.
- 15** Hard – focus is on keeping costs low by using flexitime contracts and keeping training to a minimum.
- 16** Demand for fruit/fruit products.  
New machinery will increase labour productivity and this will reduce number of workers required.
- 17** Worked example for 2016:  
Labour productivity =  $\frac{\text{Output}}{\text{No. of workers}}$
- $$\frac{150,000}{60} = 2,500 \text{ kilos per year per worker}$$
- $$2017: \frac{145,000}{64} = 2,265.6 \text{ kilos per worker per year}$$
- 18** Worked example for 2016:  
Absenteeism (%) =  $\left( \frac{\text{No. of workers absent}}{\text{Total workforce}} \right) \times 100$
- $$\left( \frac{6}{60} \right) \times 100 = 10\%$$
- $$2017: \left( \frac{4}{64} \right) \times 100 = 6.25\%$$
- 19** **Outline:** Worse labour productivity – might have been caused by less motivated workers, problems with machinery, fruit more difficult to pick (e.g. not such a good harvest).  
Better absenteeism – there might have been a bonus payable for good attendance rates.
- 20** Reduces the overhead costs of permanent contracted workers who will have to be paid all year.  
Fruit picking is seasonal and some harvests are better than others – more efficient to call in more workers during a good harvest period.
- 21** Zero-hours contracts mean that there is no security of hours or pay for employees. **[K]** One week they could work 40 hours and the following week no hours at all. Workers will not be loyal to FF if they can get a better employment contract with another business. **[A]** This will mean that during the harvest season FF is short of workers and fruit rots on the trees as not enough workers can be attracted to work for FF with zero-hours contracts. **[Ap/A]**  
Zero-hours contracts can result in low motivation (e.g. Maslow's security needs not being met). This is likely to lead to lower labour productivity.
- 22** Forecasts the number of workers needed and the skills required for a future time period.  
Reduces the risk of not having sufficient workers to pick the harvest and the cost of letting fruit rot in the fields.  
The demand for FF fruit juices is growing so to meet this demand an increase in labour should be planned for – unless new machinery actually reduces the number of workers needed.
- 23** **Outline:** Explain single union deal; only one team of union negotiators to bargain with – saving time in negotiations.  
All workers covered by the same pay and conditions deal so there will be no bad feeling caused by one union's members having a better deal than others.

**24 Outline:** Think about whether a different approach should be used for different types of workers – hard for seasonal workers but soft for full time/permanent fruit juice workers? Is it ethical to use ‘hard’ HRM for some workers but not others? Make sure that there is an overall conclusion based on the context of this business.

**25 Outline:** Define workforce planning; explain how it can reduce costs (e.g. not having too many workers in the fruit juice factory but not having so few on the farm that fruit is left to rot). New machinery will reduce labour needs. So it is important in reducing costs and the right skills are needed (e.g. the skill of maintaining the new machinery in the factory). This will need to be planned for. However, this is not the only factor affecting success – weather, demand for fruit juices and number of competing businesses will all impact on success of FF.

## Exam-style questions

### Paper 3

**1 a i**  $A = \frac{300,000}{2,000} = 150$  per worker

$B = \frac{600,000}{3,000} = 200$  per worker

**ii**  $A = \frac{135}{2,000} \times 100 = 6.75\%$

$B = \frac{150}{3,000} \times 100 = 5\%$

**b Outline:** Appears to be close correlation – less secure, temporary, part-time contracts seem to result in inferior employee performance as workers are less motivated and want to come to work less willingly. Use a motivational theorist (e.g. Maslow) to explain why (e.g. security needs not being satisfied in Factory A). But may not be the only factor – we are not told about differences in pay systems or pay levels – these might be causing the differences in performance. Conclusion needed.

**2** See ‘Improve this answer’.

### Improve this answer

Missing skill(s) has been annotated.

### Paper 3 Q2:

Trade unions are organisations that aim to improve pay and working conditions for their members. **[K]** TU membership can benefit workers because TU representatives can now bargain or negotiate on their behalf ‘collectively’. This means that the TU represents the interest of all members employed within a business and the combined influence of these workers will be greater than if they were not members and tried to bargain individually. This is what some ADM managers are worried about, especially if there was a single union deal. The ADM managers are worried about the power that this might give the union in negotiations with the company. It could mean that the ‘hard’ HRM strategy in factory A would have to change. **[Ap]**

Members can also gain from improved communication from the business. Managers are likely to communicate frequently to TU representatives about the decisions that will affect its members. This information can then be transmitted to the members. This information might not have been given by the business to individual workers without a TU being present. Members can also gain from being represented legally in the event of a dispute between themselves and the employer – for example, about claimed unfair dismissal. **[K/A]** The CEO of ADM wants to improve communication with employees and using union representatives might achieve this. **[Ap]**

Employers can also benefit from their employees belonging to a responsible TU, especially if it is a single TU representing all workers. The business will be able to use the TU as an effective channel of communication. It can now negotiate pay and conditions for all workers with just one (or a few) TU representatives rather than all individual workers and this will save managers time. If there is a single TU, the pay and conditions deal will apply to all members with no danger of another TU trying to get an even better deal for its members. Of course, there might be a greater risk of strike action with TU membership. Strike action is likely to be more effective because workers are TU members as if all members take strike action it will stop business operations completely. However, it is possible for employers to establish a no-strike clause with a single union if some degree of worker/TU participation is allowed. This participation might even be to the advantage of the business if it leads to better decisions and a more committed workforce. A single union would certainly not accept the big differences in employment contracts between the 2 factories and might call a strike if ADM does not apply full-time contracts and other benefits to factory A workers. This could cause a disruption in output and hold up supplies to important customers. **[Ap]**

On balance, ADM should only offer TU membership to its employees if there is much feeling amongst workers that this should be allowed. TU membership is likely to lead to a more expensive HR strategy being introduced in factory A, which could damage competitiveness. On the other hand, it could lead to improved communication with workers and a more motivated workforce if they feel that they are all being treated equally. On this basis ADM should allow workers to join trade unions **[Ap/E]**

## 14 Organisational structure (A level only)

### Key skills exercises

- 1 Levels of hierarchy with each level, in descending order, with less authority than the one above.
- 2 A horizontal section of an organisational structure on which all managers have the same level of authority.
- 3 Matrix – project teams that cut across traditional hierarchical functional departments.  
Hierarchical – no linking of departments into project teams.
- 4 A manager has direct responsibility over five subordinates – all of whom report directly to this manager.
- 5 Route through which authority is passed down an organisation.
- 6 The delegator.
- 7 Should lead to coordinated/consistent decisions and strategies of all departments.  
Reduces risk by keeping delegation to a minimum.
- 8 Decisions are taken ‘lower down the organisation’, which allows for delegated authority and empowerment.  
Decisions might be taken that allow for local cultural differences to be considered (e.g. marketing decisions taken by foreign division of the business).
- 9 See textbook.
- 10 See textbook.
- 11 **a** 2  
**b** 4
- 12 7
- 13 Marketing manager B.

- 14** Regional Marketing Manager D.  
IT Director.
- 15** NDS is structured as a hierarchy along departmental lines and each manager only ever seems to have experience of one department. **[K/Ap]** Matrix structures would bring teams together drawn from different departments. **[K]**
- 16** Quicker communication of decisions through the chain of command as this chain has been shortened by the removal of a level of hierarchy – and quicker feedback too (e.g. about the ‘outdated clothing designs’).
- 17** A matrix structure creates a ‘team-based’ organisation. Each team will have representatives from each major functional department and this will improve communication and coordination between departments. **[A]** In the case of NDS, each shop could be treated as a ‘team’ with representatives from each department within each shop and employees will not feel as if they ‘are not part of the shop itself’. **[Ap]**  
Matrix structures can increase motivation by the use of team work to solve problems and bringing together people with different experience/departmental knowledge can lead to more effective solutions.
- 18** Greater authority and empowerment – leading to job enrichment and greater motivation. Less direct supervision from line managers – must accept the initial accountability of their actions/decisions.
- 19** Delegation without training can be disastrous – junior managers will need training in how to exert authority and take effective decisions.  
Less control over junior managers’ actions.
- 20 Outline:** Explain the benefits and limitations of product-based departments not management functional departments, matrix organisation, delayering and any other changes you can propose. Will these changes improve communication, motivation and decision making within NDS? Make sure that there is a clear final recommendation that is likely to be suitable for NDS.
- 21 Outline:** Define decentralised organisation. Analyse the potential benefits and limitations of this to NDS. Will it help to overcome the apparent problems in NDS? The greatest constraint is probably Chuck himself. Will he be able to release some power towards less senior managers? Requires a change of leadership style If this is changed – is decentralisation recommended in this case?

## Exam-style questions

### Paper 3

- 1** See ‘Improve this answer’.
- 2 Outline:** Explain the potential problems with the existing structure. Analyse the potential advantages and limitations of a country-by-country structure, of a matrix organisation or even of just delayering the hierarchy. In the context of WS, make a final supported recommendation – you might want to include a sketch of your proposed structure.

### Improve this answer

Missing ‘disadvantages’ have been added and skills annotated.

#### Paper 3 Q1:

A centralised structure or organisation means that all of the important decisions are taken by senior managers at ‘Head Office’. **[K]** There is very little delegation to lower levels of management or supervisors. **[K]** This has several advantages to WS. By centralising the purchase of leather and other materials used in shoes, **[Ap]** the cost per shoe will be lower. The suppliers will be willing to reduce their prices knowing that they are supplying a large quantity. This is called an economy of scale. This will help to make WS’s shoes more competitive. **[A]**

Secondly, taking decisions at the centre means that all factories and all shops owned by WS will be operated in the same way. The shops will all have the same shoes for sale, the same displays and products will be sold at the same prices. **[Ap]** This will help to achieve consistency and a clear brand image for the company. Customers in all countries will know 'what to expect' from a WS shop. **[A]**

In the factories, the same HR policies will be used and there will be no feeling from one group of workers that those in another factory are being better paid or better treated. This will help to build a united and cohesive workforce. If a junior manager from one WS factory was promoted to a senior position in another factory he/she will know exactly how the new factory operates. No induction training will be needed. **[A]**

One disadvantage is that WS operates in 20 different countries. **[Ap]** The customer tastes and local cultures will be very different between these countries. Taking centralised decisions might mean that the advertisements used or the products sold might not be at all suitable for every country. **[A]** If advertisements offend a local culture or if shoe products are unsuited to climate and local customer preferences then sales will be disappointing. **[A]** In this situation, a centralised structure will be a considerable disadvantage.

## 15 Business communication (A Level only)

### Key skills exercises

- 1 Responding to a message – letting the sender know that the message has been received and understood.
- 2 Communication from customers about an urgent order which must be met in the next 24 hours – poor communication would mean the deadline was not met.  
Communication with workers about a new pay system – this must be clear and unambiguous and should allow feedback to increase the chances of a new pay system being accepted.
- 3 Telephone call, one-to-one meeting.
- 4 Letter, notice.
- 5 e-mail, mobile phone call.
- 6 Misleading message, poor attitudes, physical/technical problem.
- 7 Message – must be clear and unambiguous – avoiding use of jargon.  
Attitudes – sender needs to be trusted and receivers must be motivated to understand and act on the message.  
Technical problem – send message using an alternative medium.
- 8 See textbook.
- 9 See textbook.
- 10 See textbook.
- 11 Written media are used (e.g. emails and notices on board).
- 12 **Worked example:**  
There seems to be too much reliance on written communication – emails and letters – **[Ap]** and letters in particular to not allow quick and effective feedback which is a major barrier to effective communication. **[A]**  
  
Second barrier: Sender (management) appear not to be trusted by receivers (workers) as they expect not to be told and 'kept in the dark'.

- 13** Vertical chain – downwards only.
- 14** ‘Shop workers started to discuss the news story one lunchtime’.
- 15** One way – no opportunity for feedback is being given.
- 16** No chance of feedback – an essential part of effective communication.  
No way of checking that the messages on the noticeboard have been read/understood.
- 17 Worked example:**  
One way in which NDS is made less efficient by ineffective communication is lack of feedback, which makes the business less well informed about employees’ feelings and level of morale. **[K]** By not being allowed to discuss issues, workers are not shown any trust and have no responsibility given to them. This does not meet with Herzberg’s ‘Motivators’ at all and a demotivated workforce will reduce employee motivation and efficiency. **[A]** Employees could have told managers some reasons why sales were so bad in the under-performing shops as they have contact with customers. **[Ap]**
- 18** Effective two-way communication can be a form of job enrichment as it allows participation and reaction to manager’s communications. By giving workers a chance to respond and question messages, they will feel more involved in the organisation and feel that they are being trusted. Reference to Mayo/Herzberg can be made.
- 19 Outline:** Explain the difference between one-way and two-way communication; analyse whether two-way communication might be better and which media could best bring this about in this case. Analyse the link between communication methods and business efficiency and give a supported final recommendation – which might suggest different methods used for different types of messages and different groups of receiver.
- 20 Outline:** Analyse how poor communication with serious barriers can reduce efficiency (e.g. misunderstood message; late delivery of messages; unwillingness of workers to understand message; no written record). Apply these clearly to NDS. Overall conclusion needed – is improved communication perhaps the single most important factor that could improve this company’s efficiency? Is the use of IT based communication methods the best way to improve communication and efficiency in this business?

## Exam-style questions

### Paper 3

- 1** See ‘Improve this answer’.
- 2 Outline:** Explain the main causes of communication barriers within WS and between WS and external stakeholders. Analyse the benefits and limitations of alternative methods of communication, which would allow more two-way interaction, for example, emails with suppliers (quick and easy to respond to and a written record kept); meetings/team briefings with employees; face-to-face meetings between senior managers and shop managers. Give an overall supported conclusion.

### Improve this answer

Skills are shown in brackets to help you.

#### Paper 3 Q1:

Ineffective communication can occur for a number of reasons – unclear message, no feedback, wrong receiver, untrusted sender are just some of these causes. **[K]** In the case of WS one of the causes is the complete lack of feedback from the receiver. The supplier was not asked to send confirmation of the original order for leather before the leather was delivered. **[Ap]** If an email confirmation of the order had been sent by WS then a reply could have been asked for which agreed to the amount and colour of leather to be delivered. **[A]**

The lack of two-way communication with shop manager and shop workers is leading to ineffective marketing with inappropriate shoes being sent to some shops. **[Ap]** If meetings between shop workers and shop managers were encouraged then the customer reaction to certain styles of shoes could be discussed. If, then, marketing managers and shop managers were to hold meetings it would reduce the length of the lines of communication – ‘messages seem to pass through so many people’ – and speed up communications. **[Ap/A]** Crucially it would allow feedback, which would let the shop managers explain which styles of shoes sell well and which don’t in their shops. **[A]** So, the two major causes of poor communication are inappropriate media not allowing feedback and long lines of communication – ‘they take too long to reach the person they were intended for’ – perhaps caused by a tall organisational structure. **[Ap/A]**

### 16 What is marketing?

#### Key skills exercises

- 1 Research the market.  
Price products.  
Promote products.
- 2 Selling is only one aspect of marketing – satisfying customers' needs profitably requires a number of important functions to be carried out.
- 3 Increase sales volume.  
Increase market share.
- 4 The marketing department should be aiming to help the business achieve its overall long-term aims.
- 5 Basing product decisions on research evidence about customer need/preferences.
- 6 Designing and making a product and then attempting to promote and sell it.
- 7 See textbook.
- 8 The total level of sales of all producers within a market in a given time period.
- 9  $\frac{\text{Sales of business}}{\text{Total market sales}} \times 100$  [in a given time period]
- 10 See textbook.
- 11 It helps make a product 'stand out' and customers are more likely to buy products which are, in their perception, distinctive.
- 12 Geographical differences.  
Demographic differences.
- 13 Product orientation as the change to the recipe was not in response to customer demand but cost saving considerations.
- 14 Consumer market – the customers of Sodacola drink it so they are the final consumers.
- 15  $\frac{\$15\text{bn}}{\$120\text{bn}} \times 100 = 12.5\%$
- 16 **Worked example:**  
$$\begin{aligned}\text{Market share \%} &= \frac{\text{Sales of business}}{\text{Total market sales}} \times 100 \\ &= \frac{\$30\text{b}}{\$120\text{b}} \times 100 \\ &= 25\%\end{aligned}$$
- 17  $\$30\text{bn} + 15\% = \$34.5\text{bn}$   
$$\frac{\$34.5\text{bn}}{\$135\text{bn}} \times 100 = 25.6\%$$
- 18 By targeting the youth market with a junior version with less sugar and different packaging.

- 19** 'Secret recipe' gives a sense that no one else can use the same ingredients as they do not know the correct 'formula'; promotion campaigns with famous celebrities – suggesting it is the product chosen by famous people.
- 20** May be competing with many other drink businesses and profit margins might be low. It is not exploiting many potential segments of the drinks market (e.g. sports/energy drinks).
- 21** Product decisions will be more focused on customer needs. Less chance of inappropriate product decisions and sales disaster (e.g. changing the recipe).
- 22 Worked example:**  
Market leader means having the highest market share of a particular product market. **[K]** Sodacola is the market leader in many countries it operates in as it has a well-known brand name. **[Ap]** GDC will benefit from supermarkets and other retailers wanting to make sure they hold inventories of this popular drink and they might place it in the most visible and prestigious places in their stores for customers to see it easily. **[A]**
- Second benefit: Can use this in advertising – 'the world's most popular drink'. 'This will help support the popularity of the Sodacola brand'.
- 23** Sports/energy drink – produce a high-energy drink for customers interested in energetic sports. Promote as 'aiding performance'.  
Healthy version (e.g. low sugar or with special organic ingredients – appealing to 'green consumers' who want natural products).
- 24** Change of recipe – operations management decisions that needed to be well coordinated with the marketing department – might have prevented the negative reaction.  
The projected increase in sales needs to be communicated from the marketing department to the operations department to ensure that sufficient output of Sodacola is available.
- 25 Outline:** Consider two or three ways in which GDC could segment its market and the possible costs and benefits of segmenting in these ways. Give an overall conclusion (e.g. the 'best' way to further segment the market). Would it be better for GDC to continue with a mass marketing approach or should it segment this market further?
- 26 Outline:** Existing approach of basing the produce on one basic recipe seems to be working well in terms of sales – need to avoid any cost-driven changes to recipe though. Market orientation based on market research would allow more market segmentation; any changes in consumer taste towards the existing products could also be forecast. Market orientation requires detailed market research, which must be updated. Overall conclusion needed.

## Exam-style questions

### Paper 1

- 1** See textbook.
- 2** Consumer markets – selling goods and services to final consumers such as chocolates in a candy shop.  
Industrial markets – selling goods and services to other businesses, which will use them to produce other products (e.g. selling coal to a power station).
- 3 a Outline:** Market or consumer orientation – basing product and other marketing decisions on market research data (e.g. deciding to make red jeans not just blue jeans after many consumers asked for these). Leads to greater chance of marketing success.  
Product orientation – basing product decisions on what the business is able to make or, perhaps, on the basis of a new invention. The product is technically feasible – it might be very advanced – but the market for it has not been researched so it might not be bought in sufficient numbers for it to be profitable.

- b Outline:** Explain distinction between niche marketing and mass marketing. Analyse the benefits to the manufacturer of just using mass marketing to sell same basic model. Analyse the benefits of identifying market niches, e.g. electric cars for disabled drivers; convertible 4 × 4 vehicles for high-income consumers who value style above rugged styling. Assess whether the costs and risks of niche marketing are likely to be greater than the sales/profit gained. Overall conclusion needed.

## Paper 2

- 1 a** See textbook.  
**b** See textbook.
- 2 a**  $\frac{\$3.2\text{m}}{\$14\text{m}} \times 100 = 22.9\%$   
**b** It is falling – not because CC's sales are falling but because the market growth is at a faster rate than the rate of growth of CC's sales.
- 3 Outline:** Increase in consumers' incomes could lead to increased demand for confectionery/ cakes and so on. This will increase demand for sugar. Show with new demand curve/schedule. Poor weather conditions might reduce the sugar that is harvested. This will reduce supply – show new supply curve/schedule.
- 4** See 'Improve this answer'.

### Improve this answer

Improved student answer.

#### Paper 2 Q4:

Market segmentation is when a business identifies different groups or segments of consumers and selling different products to these groups. **[K]** The alternative to market segmentation is trying to sell the same type and design of product to all customers. CC has a limited range of cakes, which are sold in the mass market. If the business identified segments of the market that require special cakes, e.g. weddings, birthdays, sugar free cakes for people with certain medical conditions, then CC could produce cakes or biscuits that meet the consumers' needs in these segments. **[Ap/A]** If these were marketed effectively directly towards the consumers in each segment, this could be a profitable strategy. However, there are costs to market segmentation even in the cake market. Market research must be done to gain data to be able to split up customers into different groups. Each group should share the same common characteristics, e.g. age, gender, income level, social class and so on. A wider range of cakes will need to be made so bakers with special skills might need to be employed and more inventories held. **[Ap]** So, the costs of segmenting the market could be greater than any increase in revenue so this strategy could make a loss.

Designing and producing different products for these different groups can also be expensive, e.g. producing no-sugar soft cakes for people who are dieting as well as the standard sweetened cakes. **[Ap]** Different promotion campaigns to appeal to different segments of the market might also be needed and this will add to costs compared to just having one standard type of advert and promotion.

Another disadvantage to market segmentation is that by focusing on small segments of the main market, sales might not be high enough to cover all the costs of operating the business so an overall loss might be made.

However, cake production could benefit from market segmentation and sales and profits might increase. By selling different products to different types of consumers, sales could increase. Not everyone wants the same 'standard' product and consumers might buy a special cake from another bakery business if they consider that their particular needs and tastes are not being satisfied. As consumer incomes increase with economic growth, consumers want to be seen with products that are differentiated and 'aimed' directly at them. **[An]**

So, market segmentation can be very profitable for CC especially as existing sales are rising but more slowly than the total cake market. Cathy needs to make sure that the costs of segmenting the market into different distinct groups are not greater than the extra sales revenue that can be gained. [E]

## 17 Market research

### Key skills exercises

- 1** Helps him/her decide on what products to sell.  
Details of market research would be important to include in a Business Plan to show to lenders/investors.
- 2** Up to date.  
Specifically relevant for the business's needs.
- 3** Often available quickly.  
Often cheaper to obtain than primary research data.
- 4** Government publications.  
Internet.  
Library sources.
- 5** Quantitative – asking questions the results of which are measurable (e.g. the number of people who said 'Yes').  
Qualitative – asking questions that find out the reasons behind consumer decisions – results not measurable.
- 6** Launching a product in a distinct region and analysing the results before deciding on a national launch.
- 7** Discussions can achieve results that would not be possible with one-to-one questions.  
Can be a quicker way of obtaining information compared to individual interviews.
- 8** Interviews.  
Postal/online questionnaire.
- 9** See textbook.
- 10** See textbook.
- 11** Using internet sources to search appropriate secondary data.  
Online surveys (e.g. customer satisfaction surveys after a product has been purchased) can be sent to many people for a fraction of the cost of interviewing them.
- 12** See textbook.
- 13** Stratified.
- 14** Quick – some replies will be received in a very short time period.  
Relatively inexpensive (e.g. compared to a postal questionnaire).
- 15** Six drinks per week – the most frequently occurring result.
- 16 Worked example:**  
Total fx = 278

$$\text{Mean} = \frac{278}{50} = 5.56 \text{ cans per week}$$

- 17** Relatively cheap – a ‘detailed market research report’ would take Asif a long time to prepare himself and would cost more than purchasing one already written by a market research consultancy.  
Quick to obtain – for example, population data about a country is usually available online or in a library.
- 18** Sampling bias – there will always be an element of doubt about the accuracy of market research when a sample is being used. Asif seems to select his sample carefully – but is it large enough to give accurate results?  
Questionnaire bias – Asif might ask ‘leading’ questions.
- 19** Pie graph/chart, for example, to show what proportions of the sample prefer particular drink brands.  
Bar chart – to show the numbers of people in the sample prepared to pay different prices.
- 20** **Worked example:**  
One drawback of the secondary data is that one of the sources Asif used, a market research report, was out of date. **[K]** It was published last year and the surveys on which it was based might have been done two years ago and out of date data can be inaccurate. **[A]** Consumer tastes can change quickly in the soft drink market so up-to-date market research data is essential. **[Ap]**  
  
Second drawback: Population data might not have been as detailed or as specific to Asif’s needs as he would have liked (e.g. proportion of each age group in different income bands).
- 21** Results returned in electronic format – easier to present/analyse.  
Cheaper and easier to ask a large number of questions.
- 22** Pie graph/chart – very good for showing relative proportions.  
Bar chart – actual results can easily be read off the y-axis scale.
- 23** The use of mobile phones and social media already allows him access to large numbers of potential customers in the age brackets he is most interested in – follow-up questionnaires could use the same methods.  
IT (e.g. spreadsheets) could be used to record the results and present them graphically.
- 24** **Outline:** Consider sample size, whether the sample is likely to be truly representative, potential bias, suitability of the questions. Suitability of methods (e.g. mobile phones and social media). Will these achieve a high enough success rate for the results to be meaningful? Come to an overall conclusion – could other methods lead to more accurate data? Would they be cost effective?
- 25** **Outline:** Cost effective research – appropriate data at the lowest possible cost. Analyse different methods of undertaking market research – consider the expensive methods (e.g. contracting a market research agency to undertake detailed primary research) and the low-cost methods (e.g. using the internet to research competitors). Assess the methods most likely to give the most relevant data for the lowest cost – likely to be IT-based. Conclusion needed.

## Exam-style questions

### Paper 1

- 1** See textbook.
- 2** One is a measure of ‘central tendency’ (i.e. the mean is one measure of the average of all data). The range is a measure of ‘spread’ of the data – the difference between the greatest and smallest.
- 3 a** **Outline:** Consider: cost; speed of replies; quantitative or qualitative style of questions; wide geographical coverage. Limitations: access to young consumers might be easier than older consumers; scope for discussion might be limited; how is sampling being conducted? Secondary data often undertaken using internet.

- b Outline:** Explain both forms of data. Analyse benefits/limitations of using secondary research (e.g. number of people in the country who play sports, the relative popularity of each sport). Analyse benefits/limitations of using primary data (e.g. which brand of sports clothing consumers prefer); what features of the most popular brand they like. Conclusion – both types of data are probably needed – final decision might depend on finance available. Which type of research should be done first?

## Paper 2

- 1 a** See textbook.  
**b** See textbook.
- 2 a** 9 (30% of 30)  
**b** Very easy to see which is the most and least popular gym facility – the relative size of each segment represents the proportion out of the total sample size.
- 3** See ‘Improve this answer’.
- 4 Outline:** Analyse the benefits of market research for this business (e.g. building and opening facilities that potential new members are most likely to use). This could increase revenue and profit for GFG. Research data itself will not guarantee success of any business (e.g. results could be biased); poor decisions might be taken even on the basis of accurate results; limited resources could prevent the best decisions from being taken; external factors could change to make data out of date. Overall conclusion needed.

### Improve this answer

Improved student answer.

#### Paper 2 Q3:

Suzi used a face-to-face interview with each of the sample of 30. She could ask them the questions when they visited the gym and note their answers. They would not have to fill out a questionnaire themselves. This can lead to a much higher response rate than a postal questionnaire. If Suzi asked appropriate questions, an interview can lead to effective quantitative and qualitative research data. The former will allow for effective visual presentation and statistical analysis, such as mean/modal results. Qualitative answers will allow Suzi to gain an insight into the reasons behind gym members’ decisions. **[A]**

She then formed them into 3 focus groups to allow them to discuss qualitative issues that would interest Suzi. These could include ‘why some friends have left GFG’; ‘what the other gyms offer’; ‘how much they charge’ and similar issues. This form of research would gather qualitative information for Suzi and can be very effective as a group of people often discuss issues that would not be raised in an interview. **[A]**

The sample was small – only 30 out of over 2,000 members – so she could have done this quite quickly, which might be important if she wants to take rapid action to stop membership falling further. **[A]**

## 18 The marketing mix – product and price

### Key skills exercises

- 1 See textbook.
- 2 Product – customer solution.  
Price – cost to customers.  
Promotion – communication with customer.  
Place – convenience to customer.
- 3 To build/maintain customer loyalty.
- 4 Measurable/observable features of a product (e.g. size, colour).
- 5 See textbook.
- 6 See textbook.
- 7 See textbook.
- 8 See textbook.
- 9 See textbook.
- 10 This is a relatively elastic demand response to a change in price – for every 10% change in prices, demand changes by 20% in the ‘opposite direction’.
- 11 Cost of manufacture, PED, competitors’ prices.
- 12 Main difference is that full-cost pricing makes an attempt to cover all of the costs of production including an allocated overhead cost rather than just the variable costs.
- 13 See textbook.
- 14 See textbook.

#### 15 Worked example:

$$\text{PED} = \frac{\% \text{ change in demand}}{\% \text{ change in price}}$$

$$\% \text{ change in price} = -10\% = \left( \frac{-10 \text{ cents}}{\$1} \right) \times 100$$

$$\% \text{ change in demand} = 20\% = \left( \frac{300}{1,500} \right) \times 100$$

$$\text{PED} = \frac{20}{-10} = -2$$

- 16 This is relatively elastic and if the price was raised by 10%, then demand would fall by 20% – if all other factors remained constant.
- 17 10% change in price  
5% change in demand  
$$\text{PED} = \frac{5}{-10} = -0.5$$
- 18 This means demand is relatively inelastic in response to a price change – an increase in prices could lead to higher revenue.
- 19 Yes – distinctive features (mountain water; vitamins and minerals) that the business hopes will help the products be differentiated from rivals’ products.
- 20 Maturity/saturation stage.
- 21 Market skimming – SportSoda.  
Market penetration – Top-Pop.

- 22** Income levels of main target market – the potential young consumers must be able to afford the drink.  
Costs – how much will the transport of the mountain water add to the cost of making the drink. The price will need to cover this cost.
- 23** PED is helpful when making pricing decisions – high PED (relatively elastic demand) tends to lead to lower prices to increase revenue. Low PED (relatively inelastic) tends to lead to higher prices.
- 24** If the export of this drink is well controlled by GDC (e.g. a retailer does not try to sell their supplies of the drink to more than one country), then GDC could possibly charge higher prices for this drink in high-income countries with many professional sports people (low PED) – leading to increased revenue. Lower prices could be charged in lower-income countries where consumers might have higher PED – increasing revenue.
- 25** Could raise the price during the growth stage as sales rise – young consumers may be very keen to buy this new product so a higher price might be acceptable to them at this stage.  
Lower the price during the decline stage (e.g. to sell off inventories of the drink when sales have been falling).
- 26 Worked example:**  
One way in which the product life cycle will affect promotion decisions for SportSoda is during the introduction phase. **[K]** The product is being sold to the market for the first time so potential customers will need informative adverts about this new product. **[A]** As the soda market has so many brands and is so competitive, the informative advertising will have to be extensive and wide ranging. **[Ap]**  
  
Second way: Additional promotion/different types of promotion campaign might be needed as a part of an extension strategy as the product enters the decline stage (e.g. to support some adaptations to the product such as additional flavours).
- 27 Outline:** Consider the way in which the PED results could be used (e.g. pricing decisions) but also the limitations of the PED calculation and the fact that many other factors can influence price including costs, market conditions, competition). Sales will be influenced by prices and PED is important to setting price – but other factors might be more important.
- 28 Outline:** SportSoda: Yes, important because: a high price will help to reinforce the exclusive and healthy/performance improving qualities of this product. A high price should be part of the overall integrated marketing mix. A low price might confuse serious sports players – is this drink really any good? Does it contain the vitamins/minerals it is claimed to contain? No, not that important because: 'Product might be successful at any price if it is perceived to 'aid performance'; if it is seen to be a unique product, perhaps the price is less important than the performance of the product and the attractiveness of the promotion. Overall conclusion needed.

## Exam-style questions

### Paper 1

- 1** See textbook.
- 2** See textbook.
- 3 a Outline:** Explain/draw a typical product life cycle; explain the different tactics a business can use to extend the maturity stage of the product life cycle – give actual business/product examples. Analyse the impact of these tactics on sales and the life span of products.
- b Outline:** Explain the importance of the pricing decision (e.g. to cover costs; to be an integrated part of a marketing mix; to encourage potential customers to buy – and others). Analyse the benefits of competitive pricing; analyse the benefits of cost-based pricing. Assess which business situation best suit both of these pricing approaches. Conclusion needed (e.g. a business should perhaps use a variety of pricing methods, depending on market conditions for its products).

## Paper 2

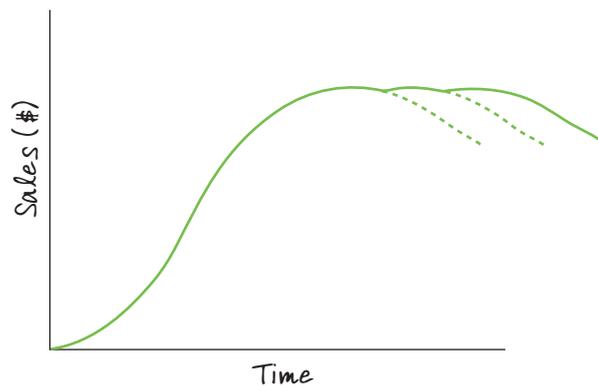
- 1 **a** See textbook.
- 1 **b** See textbook.
- 2 **a** Average cost =  $\frac{\$250\text{m}}{20,000} = \$12,500$   
Price =  $\$12,500 + 100\% = \$25,000$
- 2 **b** If the number of cars made/sold falls, then the average cost rises (due to fixed costs not changing) and the price per car should be increased too – which will reduce sales further below expectations.
- 3 **Outline:** Less promotion expenditure; prepare for adaptations to product to extend its life; possible reductions in price or ‘special offers’.
- 4 See ‘Improve this answer’.

### Improve this answer

Improved student answer.

#### Paper 2 Q4:

Extension strategies are decisions taken by a business to try to extend the life cycle of a product. **[K]** They are introduced towards the end of the ‘maturity stage’ of the life cycle or very early on in the ‘decline’ stage. The effect of these extension strategies is shown below. **[K]**



VC could make the Genie available in new exciting colours **[K]** which would appeal to young consumers, such as students. Just making it available in a limited range of boring colours is certain to be a cause of falling sales, especially as this is a competitive market segment. VC could use market research amongst university students to find out what colour cars they really prefer. This information could then be used to decide on the new colours for the Genie. Producing the car in different colours is advisable as this would be a reasonably cheap and quick extension strategy to introduce and could be used to test consumers’ willingness to buy a slightly adapted product. **[E]**

VC could also fit a larger engine and adapt the product more to its ‘up-market’ objective. This model would then fit in better to the VC product portfolio, especially with the Lynx sports car. The car would appeal to a wider range of potential consumers who wanted more than just a ‘cheap to run’ car. Developing a new engine for the Genie will take some time and cost much more than just using new colours. This strategy might only have limited appeal. As it is 5 years old, the reason why sales are declining might be because of the design of the car rather than the engine it is fitted with. **[E]** These two strategies might extend the life of the Genie model and reverse the recent decline in sales but sooner rather than later it might be essential for VC to replace the Genie model with a completely new redesigned model because extension strategies are really only a short term policy. **[E]**

# 19 The marketing mix – promotion and place

## Key skills exercises

- 1 See textbook.
- 2 Increase sales.  
Encourage consumers who currently do not buy the product to buy it for the first time.
- 3 See textbook.
- 4 Above-the-line – a paid for means of promotion.
- 5 Cost and the finance available.  
Target market (e.g. what this market reads/which programmes watched).  
Type of product – does it present well visually?
- 6 See textbook.
- 7 See textbook.
- 8 Establish a clear identity for a product.
- 9 The sum of money to be spent on promotion in a future time period.
- 10 Industrial trade fair.  
Personal selling to director/senior manager.
- 11 Only one business (e.g. retailer) between the manufacturer and the customer.
- 12 Selling products online.
- 13 See textbook.
- 14 Ensuring that all four main elements of the marketing mix support each other and ‘tell customers the same story’ about the product.
- 15 Colour, shape, designs, name on packaging can help to reinforce its image.
- 16 A stated % market share within a certain time period.  
Brand recognition among car consumers to reach a certain level
- 17 Budgeted revenue =  $20,000 \times \$25,000 = \$500\text{m}$   
5% of  $\$500\text{m} = \$25\text{m}$
- 18 Explain the difference between these two approaches. Above the line – 60% on paid for advertising.
- 19 Build an identity – help in recognising the name of the car on the road and in promotions.  
May help to increase customer loyalty – repeat customers might buy another new EcoStar.
- 20 **Outline:** Market research (e.g. market share of competitors).  
Viral marketing/promotion – social media can be relatively cheap and effective.
- 21 **Worked example:**  
One way to analyse the success of this promotion is to survey potential customers. **[K]**  
They could be asked if they have heard of this new car and whether they thought it had a ‘differentiated identity’ from other car brands. **[Ap]** If they do think it has a distinct brand they might be more likely to buy it. **[A]**  
  
Second way: Have sales (or market share) reached target/budgeted level within a certain time period?
- 22 Retailer holds inventories – reducing costs to VC.  
Retailer is specialist in selling and dealing with customer enquiries.

- 23** Retailer will absorb some of VC's profit margin.  
Retailer might be selling other manufacturers cars too.
- 24 Outline:** Explain why the methods and types of promotion will change over the life cycle of this product (e.g. create product awareness, encourage consumers to try the vehicle); build brand name; advertise new developments to the car when its life needs 'extending'. Explain and support your recommendations, in the context of electric cars, to improve the quality of your evaluation.
- 25 Outline:** Explain marketing mix; a consistent/integrated mix means giving the same image for the product through all 4 P's; decide on a pricing strategy, promotion message/media; distribution channel that will be consistent with the image of the EcoStar product. Justify your decision.
- 26 Outline:** Internet marketing can save costs – the amount saved can be used to reinvest back in the business to develop further new products. Analyse the benefits of using the internet to research the market; promote the product and sell it (e-commerce). EcoStar's success will depend on more than the use of the internet – quality and reliability of the product? Government policy towards environmentally friendly vehicles? Conclusion needed.

## Exam-style questions

### Paper 1

- 1** See textbook.
- 2** See textbook.
- 3 a Outline:** Define brand/branding; identify the image that needs to be created (e.g. organic); caring for society by using non-harmful ingredients; luxury and exclusive. How to project the image/brand chosen? Advertising? Positive PR/publicity? Focus of the answer should be on 'differentiation'.
- b Outline:** Explain promotion; advertising and sales promotion; explain the main focus of promotion campaigns at different stages of the product life cycle (e.g. introduction = informative advertising; growth – brand building and developing customer loyalty with sales promotion; decline – using promotion to support extension strategies). Promotion can be of great importance – but with this type of product are the features/technology of the product itself likely to be even more important? Also, price will be important as it is a competitive market. Overall conclusion needed.

### Paper 2

- 1 a** See textbook.
- b** See textbook.
- 2 a**  $\frac{\$125,000}{\$500,000} \times 100 = 25\%$
- b** Comparing current sales level with the sales level after the promotion – although other factors are working to affect demand too such as use of social media by consumers.
- 3** See 'Improve this answer'.
- 4 Outline:** Analyse the benefits and costs of using the internet to promote and sell cameras. Is e-commerce the best way to sell cameras? Are lower costs of e-commerce more important than giving face-to-face information and advice to customers? How could social media be used to promote products such as this? Assess the factors that will allow MC to use the internet to its best advantage. Overall conclusion.

**Improve this answer**

Student's improved answer.

**Paper 2 Q3:**

Using a wholesaler and retailer has big benefits. It means that the manufacturing business does not have the cost of keeping inventories. **[K]** Cameras can be expensive items and the cost of holding inventories – including the opportunity cost – can be substantial. **[Ap]** If MC is able to reduce inventories it will free up capital and space which can be devoted to making the camera. Retailers are specialists in marketing to customers face-to-face. They will spend money on making the shop look attractive and will display the cameras attractively, which will help to reinforce a quality image for the cameras. Retail shop workers can answer any technical questions that customers will have about the cameras and this will give consumers confidence in the product. **[Ap]** Manufacturers are not always experienced in selling to consumers and they would have to employ specialist sales staff e.g. to answer online queries from customers, if they did not use retailers.

One disadvantage is the profit margins that intermediaries will absorb for providing their services. If MC were to sell directly to customers, online for example, these profit margins would now be available to MC – less the cost of packaging and delivery. If the camera market is highly price sensitive – PED high – then being able to offer lower prices by a direct channel of distribution could be more important to MC than having wholesalers hold inventories and retailers provide technical information to customers. **[Ap/A]**

## 20 Marketing planning (A Level only)

### Key skills exercises

- 1 Situational analysis, marketing objective, marketing mix, marketing budget.
- 2 See textbook.
- 3 A 10% increase in promotion spending should result in a 20% increase in sales.
- 4 The two products appear to be complementary goods.
- 5 See textbook.
- 6 Innovative product could be patented to give 'monopoly power'.  
USP of new product might allow higher prices to be charged.
- 7 No new invention/innovation is developed by the R and D department.  
Competitors release a product earlier that consumers prefer.
- 8 See textbook.
- 9 Mean of time series data calculated by dividing the moving total by the number of time periods.
- 10 Based on past sales results – future sales might not follow same trend.  
Might be inadequate data available for a trend to be established.
- 11 Marketing strategy – product development.  
Tactics – 'promoting Tropical Fruits Ice heavily'.
- 12 Based on external consultant's report from last year – does this contain enough relevant and up to date data?  
Failed to plan for Ice Cream Cookie (e.g. perhaps there was no situational analysis which is why the product failed).

**13 Worked example:**

$$\text{Income elasticity} = \frac{\% \text{ change in demand}}{\% \text{ change in income}}$$

$$\% \text{ change in demand} = \frac{-0.6\text{m}}{12\text{m}} \times 100 = -5\%$$

$$\% \text{ change in income} = -\frac{\$200}{\$10,000} \times 100 = -2\%$$

$$\text{Income elasticity of demand for MI ice creams} = \frac{-5}{-2} = 2.5$$

**14** This is high and positive – suggest that this is a luxury product which will experience a substantial increase in demand when consumers' incomes rise.

$$\mathbf{15} \frac{\% \text{ change in demand}}{\% \text{ change in promotion spending}} = \frac{20\%}{10\%} = 2$$

**16** This is above 1 and positive – when promotion spending increases by a given %, the demand for this desert increases at twice this rate.

**17** Sales of existing products seem to be saturated.  
Opens up new market opportunity through product development.

**18** Test marketing of Iced Desserts.  
Ice Cream Cookie – forecasting seemed to be based on the success of previous products.

**19** Sets clear marketing targets – can monitor progress against these.  
Establishes an integrated mix to achieve these targets – increase chance of success.

**20** Time consuming – business might want to introduce products quickly (e.g. during summer months while demand is potentially highest).  
May become inflexible despite the need to change (e.g. during changing economic conditions).

**21** Helps to plan resources (e.g. output levels should be planned to meet future sales forecasts).  
Action can be planned for if the forecasts seem disappointing (e.g. additional promotion).

**22** A consistent image is given to customers as four main elements of the mix are 'telling the same story' about the product.  
All four elements should then be directed towards achieving the agreed marketing objectives.

**23 Outline:** Try to compare the benefits of planning (e.g. coordination, focus, undertaking situational analysis, with the costs/limitations of market planning in this case). Also, consider what other factors might influence the success of this new product – competitors' new products; seasonal factors; economic conditions – as this is not an essential product and is likely to have high income elasticity of demand. Does a marketing plan guarantee the success of a new product?

**24 Outline:** Define sales forecasting and explain two or three methods. Analyse how these could be applied to MI – and the benefits to MI of having sales forecasts (e.g. identifying seasonal demand patterns will allow more accurate workforce planning and operations planning). Assess the reasons why sales forecasting might be difficult/inaccurate. Overall conclusion needed.

## Exam-style questions

### Paper 3

$$\mathbf{1 a} \quad x \left( \frac{750}{8} \right) = 93.75$$

$$y (80 - 95.625) = -15.625$$

Note that the '750' in this answer is taken from Table 20.3, Year 2018, Quarter 2, '8-period moving total'.

**b** \$99.7m (\$102m – \$2.3m)

**c** See 'Improve this answer'.

- 2 Outline:** Define R and D. Analyse data in Table 20.2. Does it show a close correlation between R and D spending and successful innovative medicines?  
Analyse the benefits of successful new innovative medicines. Analyse the reasons for – and the costs resulting from – the failure of R and D to develop new medicines. Overall conclusion needed – state clearly whether the business should or should not invest in further R and D and justify your answer.

### Improve this answer

Student's improved answer.

#### Paper 3 Q1c:

Sales forecasts such as the moving average method can be useful. They tell a business what sales will be in the future and this makes planning much easier. **[K]** By knowing what sales will be, MDI will be able to make sure that the factory is large enough to cope with increased demand for medicines. **[A]** It can employ more workers if the sales forecasts show that demand is increasing. **[K]** Sales forecasts can be a key element of workforce planning and especially for MDI, which might need to recruit and train specialist workers who understand scientific methods planning.

Sales forecasts that provide statistical evidence of seasonal demand patterns – such as the moving average method – will help MDI hold adequate inventory levels of certain medicines at certain times of the year e.g. in Q1. This could be very important for the health of the nation and MDI will suffer bad publicity if it has not foreseen with some accuracy the likely seasonal demand for its medicines. **[Ap/E]**

However, the time series analysis method of sales forecasting only uses past results so would be inappropriate for any new medicines that MDI might be about to launch. In these cases, MDI would have to do some market research amongst doctors to find out the likely demand for new medicines. Sales forecasting based on time series cannot take into account changes in government policy towards health. An unforeseen cut back in government spending on health and medicines would cause a fall in demand for MDI's products that would not have been forecast by the time series method. **[Ap/A/E]**

So, some attempts at sales forecasting by MDI – including time series analysis – is essential but it will not provide 100% accurate sales forecasts. Other methods might need to be used – such as market research – and MDI will be advised to try to make its operations as flexible as possible to meet unforeseen changes in demand for its medicines. **[E]**

## 21 Globalisation and international marketing (A Level only)

### Key skills exercises

- The trend towards free trade in goods and services and freer movement of capital and workers between nations.
- Freer trade – fewer barriers to trade.  
Freer movement of workers/managers.  
Freer movement of capital.
- It has increased trading links between countries and led to a substantial increase in world trade.
- Home market is 'mature'.  
Too much competition in home market.  
Spread marketing risks (e.g. recession in home market will hit sales but this might be balanced out by economic growth in the other countries the company sells to).

- 5** Custom and culture difference.  
Economic and social differences.  
Political differences.  
Business practice differences.
- 6** Direct exporting to own subsidiary (e.g. retail shops owned by the business).  
Joint venture.  
International franchising.  
Exporting through an agent or wholesaler.
- 7** Pan-global – same marketing mix in most countries the business sells too.  
Global localisation – adapting certain features of the marketing mix to suit local conditions.
- 8** Product – different laws, customs, culture around frozen foods.  
Price – average incomes might be very much lower than in home market.  
Promotion – using local actors in advertisements, not breaking local laws re advertising images/claims about frozen food products.
- 9** Direct exporting to own retail shops.
- 10 Worked example:**  
VC can benefit from the greater sales potential in country Y **[K]** as it has high average income levels. **[Ap]** The market is not growing in country X so to start selling clothes to country Y will give a chance of increased total sales. **[Ap]**  
  
By increasing sales beyond its own national boundaries VC is increasing its overall sales level. This is an increase in scale of production and should lead to average cost reductions – economies of scale.
- 11** Seems to be planning to use ‘pan-global’ as it is ‘selling our clothes in country Y at the same low prices’.
- 12** Use franchised retailers with some knowledge of the market.  
Joint venture with a retailing business based in country Y that has local knowledge relevant to VC’s products.
- 13** Inappropriate products (e.g. not suitable for consumers with average incomes that seem to be higher in country Y or clothes that do not conform with local customs and cultures).  
Promotion materials might not be acceptable to consumers in country Y (e.g. if they use photos of women or men and women together).
- 14 Worked example:**  
One problem would be higher costs. **[K]** A global localisation approach will mean undertaking detailed market research to find out the needs and tastes of local consumers to allow appropriate product decisions to be taken. **[A]** VC seems to make traditional clothes and these are unlikely to be popular in country Y with a ‘youthful’ population. **[Ap]**  
  
Takes longer to develop this strategy compared with pan-global strategy – VC might experience more competition if it had to delay its decision to sell in country Y.
- 15 Outline:** Try to weigh up whether VC’s approach to marketing in country Y for the first time is likely to be successful. Is it more ‘pan-global’ than ‘global localisation’? How should ‘success’ be measured? By level of sales and/or profits? By market share? Also consider what factors might influence the success of this strategy (e.g. has VC undertaken sufficient research to support its marketing strategy?) If not, it is unlikely to be successful.
- 16 Outline:** Explain the two main international marketing strategies – pan-global and global localisation. Analyse the likely advantages and disadvantages of each to VC – based on the different market conditions that seem to exist in country Y. Market research will be essential to support the strategy chosen. Which method of selling should be adopted? Overall supported conclusion needed.

## Exam-style questions

### Paper 3

- 1 See 'Improve this answer'.
- 2 **Outline:** A is largely 'pan-global' marketing, which is likely to be lower cost and likely to be quicker to put into effect than B. B is 'global localisation' as the mix part of the strategy is geared towards local market preferences and culture. This could be more expensive (e.g. adopting products and promotional materials). Final decision will depend on other information (e.g. which market segment is being aimed at?); what are consumer preferences for food products in this country – has AFP undertaken sufficient research? Justified recommendation needed.

### Improve this answer

Student's improved answer.

#### Paper 3 Q1:

Globalisation is when countries agree to trade with no trade barriers and allow the free movement of capital and, increasingly, workers.

Globalisation is both helping AFP and acting as a constraint. AFP is experiencing more competition in country P's market. This is as a consequence of the Government's decision to join a large free trade area. This means that other food producers based in countries within this area can now export products to country P without any trade barriers such as import tariffs and quotas. **[A]** This increased competition for AFP, especially in 'ethnic' food products might force the business to lower its prices and reduce profit margins if the foreign competitors can sell products in country P more cheaply than AFP can. **[A]** However, it will be able to import food ingredients more cheaply without tariffs and this will help AFP to keep its own costs down and remain competitive. **[Ap/A]**

AFP will be able to sell its own products more cheaply to other members of the free trade area. This will open up new markets for AFP, which is particularly important as the food market in country P is saturated. **[Ap/A]** The company can raise capital more easily from other countries as it did in this case when the banks in country P were reluctant to lend to the business. AFP can employ more migrant workers as a result of globalisation as there is freer movement of workers between many countries. This will mean that AFP can continue to employ migrant workers who seem prepared to work for the company for the minimum wage. Without this increased supply of labour AFP might have to offer higher wage rates to encourage country P's own workers to transfer to AFP. **[A]**

### 22 The nature of operations

#### Key skills exercises

- 1 See textbook.
- 2 Materials, labour, land.
- 3 Capital is physical and visible (e.g. computer system). Intellectual capital is neither physical or visible but it is important – it includes employee knowledge/experience.
- 4 By improving quality and allowing a higher price to be charged.  
By improving efficiency and reducing unit cost of production.
- 5 More resources are used but less efficiently.
- 6 See textbook.
- 7 Improve labour training so that fewer errors are made.  
Invest in more efficient machinery that uses less labour per unit of output.
- 8 Effective – using resources to meet customer needs; efficiency – using resources more productively to reduce unit cost.
- 9 Student's own answer.
- 10 Labour productivity often low.  
Can be difficult to recruit sufficient numbers of trained/experienced workers.
- 11 Level of demand (might need to be high to justify expense of capital equipment).  
Cost of capital equipment.
- 12 Initial cost of purchasing equipment.  
Unit costs can be high if output is low.
- 13 **Worked example:**  
Labour productivity per time period =  $\frac{\text{Output in time period}}{\text{Number employed}}$   
Month 2 labour productivity =  $\frac{21,000}{11} = 1909$  meals per month per employee
- 14  $\frac{26,000}{14} = 1,857$  meals per month.
- 15 It is on a downward trend, this will raise unit production costs.
- 16  $\frac{5,000}{21,000} \times 100 = 23.8\%$
- 17 Labour intensive – only simple and inexpensive equipment is used.
- 18 Higher unit costs.  
Prices might have to rise to maintain profit margins – demand could fall.
- 19 Newly recruited workers may not yet be fully trained or experienced.  
Too many workers in a kitchen that is not made any bigger than before can reduce efficiency.

**20 Worked example:**

One problem is that capital equipment is expensive and requires finance. **[K]** The purchase of an 'automatic burger-making machine' will require finance **[Ap]** This could be a problem for FFK as profit is falling so there might be less cash available in the business for capital equipment. **[Ap/A]** FFK might have to take out a loan to make the business capital intensive and the interest on the loan could reduce profit further. **[A]**

Second problem: Will quality fall if made by machine rather than handmade/cooked? This could damage reputation of FFK.

**21** Use labour specialisation so that each worker concentrates on just one job and becomes quicker at that.

Employee training to speed up some of the slower workers (e.g. cutting skills can be taught to improve speed and safety).

**22** By helping to create the image of the product as a hand-produced, home-cooked product that will allow FFK to price products at a higher level than might be the case with a mass-produced production process – even though the cost of the bought in ingredients would be the same.**23 Outline:** Weigh up whether FFK could lose some of its appeal to customers if meals are not fully 'home-cooked' and not prepared by hand. The cost of the equipment is important. Will kitchen workers be made redundant? Will this impact on motivation for those who remain? Will capital intensive production solve the poor service problem? Could efficiency increase but effectiveness decline? Overall conclusion needed.

## Exam-style questions

### Paper 1

- 1** See textbook.
- 2** The process of converting the raw materials, labour, land and any other resources into products to be sold to customers.
- 3 a Outline:** Production level refers to the total level of output produced in a given time period (e.g. 1,500 cans of soft drink per hour). This can rise or fall if more or fewer resources are used in production. For example, if another soft-drink production line is opened than the production level could rise to 3,000 cans per hour.  
Productivity compares inputs to outputs – it is a relative not an absolute measure. It is measured in terms of output per unit of resources – labour productivity is the quantity of output produced per worker in a given time period (e.g. 15 clay pots per worker per hour). If this increases and the total number of employed workers remains constant, then the total production level will increase.
- b Outline:** Define both capital intensive production and labour productivity. Explain how using more machines (i.e. higher capital intensity) can result in higher labour productivity. High labour productivity can reduce unit labour costs – but there will be the costs of buying the equipment and training the workers to use it. Is this suitable for hand-built racing bikes – these might be very expensive, each one made for a racing cyclist who may want the prestige and quality image provided by having a hand-built bike. Which is more important – lower unit costs/higher output or hand-built quality and image?

### Paper 2

- 1 a** Using a certain number of resources (inputs) to achieve a high level of output.
- b** Using resources to make products that customers want and can afford.

$$\begin{aligned}
 2 \quad \mathbf{a} \quad \text{Labour productivity} &= \frac{\text{Output per time period}}{\text{number of workers}} \\
 &= \frac{192}{55} \\
 &= 3.49 \text{ carpets per worker per month}
 \end{aligned}$$

**b** It is falling from 4 to 3.49. This will raise the unit cost of each carpet.

**3 Outline:** Train new workers using off-the-job training and then allow them to make rugs with fewer errors.  
Change pay method to encourage increased output per time period.

**4** See 'Improve this answer'.

### Improve this answer

The missing skills are annotated.

#### Paper 2 Q4.

Capital intensive production means using a lot of machinery to produce a product – and not very many workers. **[K]** A car assembly line using automatic robots would be a good example of capital intensive production. This method of production increases output and more importantly it increases labour productivity. **[A]** Each worker can now produce many more cars or units of output per week with machines than they could have done using labour intensive production process. **[A]** SCR makes handmade carpets so using machines would mean that this important selling point for SCR will be lost. Unit costs might fall – but sales could fall too making the decision an unwise one.

#### [Ap/A/E]

High labour productivity will reduce the labour cost per unit and make SCR much more competitive as well as increasing output. **[A]** Machines can work all day and a new shift of workers can be called in and this will increase output. This is what the Operations Manager wants. Increased output will reduce the waiting lists so of course SCR should switch to capital intensive methods of production if efficiency is the only objective. **[E]**

However, this may not be productively effective if customers now decide not to buy SCR carpets because they are no longer original and handmade. **[E]** On balance, I think that SCR should focus on other methods of improving productivity which will not harm the company's USP. **[E]**

## 23 Operations planning (AS and A Level)

### Key skills exercises

- 1** See textbook.
- 2** See textbook.
- 3** Welding robots used in car manufacture.
- 4** Uses less labour and reduces labour costs.  
Often more flexible than other types of machinery and production methods – allowing more product variations.
- 5** Low unit costs as mass/flow production methods are used.  
Product variations are possible matching customers' different requirements.
- 6** Site rental costs.  
Labour costs in an area may be higher than in another location.
- 7** Prestigious address for top class fashion retailer  
Management preferences (e.g. where they would like to live).

- 8** No spare capacity.  
Lower costs of production.
- 9** See textbook.
- 10** Financial economies.  
Purchasing/bulk buying economies.
- 11** The range of suppliers and distributors used to get a finished product to a customer.
- 12** See textbook.
- 13** Unit cost is falling improving FBC's competitiveness.
- 14** Economies of scale.  
Fixed costs spread over a higher output level that reduces average/unit fixed costs.
- 15** Faster production – able to meet demand quicker.  
More flexible production (e.g. producing bikes of different colours with same equipment).
- 16** Job production.
- 17** Cheaper unit cost of buying in specialist metals used in bike manufacture.  
Lower finance costs (e.g. lower interest rates as business is may be more secure and may be borrowing larger sums).
- 18 Worked example:**  
One example of flexibility is the use by FBC of a computer-controlled production line (CAM).  
**[K]** This allows the business to introduce 'individual variations in bike design'. **[Ap]**
- Second example: Some production offshore to meet demand peaks.
- 19** This production approach uses techniques of mass production so FBC could keep unit costs low by using technical production equipment to a high level of capacity.  
By allowing flexibility in production FBC can meet customers' different demands for styles, colours and special features on their bikes.
- 20** This allows lower prices to be charged and profit margins can still be maintained – increases competitiveness.
- 21 Worked example:**  
One benefit is that CAM is making FBC more flexible. **[K]** By showing customers what a new bike design looks like on computer screen or by drawing on the screen the style of bike the consumer is asking for, different models can be introduced more quickly. This makes FBC more competitive compared to bike makers that do not use CAM. **[Ap/A]**
- 22** Offshore production allows for the flexibility of increased output at times of higher demand – avoids disappointing customers.  
CAD allows rapid changes in design to be made and incorporated into the production process – meeting rapid changes in customer tastes.
- 23** Quality issues – is the overseas producer able to maintain quality standards that are so important to FBC?  
Will there be transport hold ups with the increased distance for bikes to be transported to market?
- 24** Integrated information. Instead of having data in separate databases, all information is now located in a single location. Data about customers' bike orders and special feature requests is also kept consistent and up to date.  
Customer service. Easier for FBC to provide high-quality customer service using an ERP. Sales and customer service people can interact with customers better and improve relationships with them, through faster, more accurate access to customers' bike order information and past order history.

- 25 Outline:** Analyse the advantages and potential drawbacks to FBC from offshoring more output such as the quality of the rubber, metal components and other raw materials used by an outsourced supplier and the possible reduction in unit costs – and come to a reasoned conclusion/recommendation.
- 26 Outline:** Explain the importance to FBC of the best location possible – costs, access to suppliers and markets, labour supply and labour costs, qualitative factors. Weigh these up from the viewpoint of FBC using data from Table 23.2. Make a final and justified decision. Would other information have been useful in making this decision? What and why?

## Exam-style questions

### Paper 1

- 1** See textbook.
- 2** See textbook.
- 3 a** See 'Improve this Answer.'
- b Outline:** Site costs might be important if government finance is very limited; availability of trained nurses and doctors in the area; access for patients and ambulances; revenue potential is unlikely to be of an concern – this is state financed not financed from revenue gained from sale of services. Which factors could be most important – and why?

### Paper 2

- 1 a** See textbook.
- b** See textbook.
- 2 a**  $\frac{25}{250} \times 100 = 10\%$  – a fall in unit cost of 10%.
- b** It rises – this suggest that diseconomies of scale may have led to reduced efficiency and higher unit costs.
- 3 Outline:** Define batch production; analyse benefits of producing identical items in batches compared with the job production method used for other shoes; analyse the likely impact on unit cost. Will SSS be able to charge lower prices for the SX3 as a result – important as it is to be sold to mass market.
- 4 Outline:** Need much more information to make a final judgement (e.g. rental costs compared with other sites). New location means SSS is close to suppliers, which should reduce need for inventories and make supply more consistent. Good transport network – able to deliver quickly. Possible shortage of production workers – important for SSS to maintain quality and supply standards. Overall judgement needed.

### Paper 3

- 1 Outline:** Define ERP. Explain benefits to SSS – able to computerise the whole supplier/ production process; can monitor inventory levels (e.g. leather, production progress of special customer shoe orders, and number of orders still to be met – and other factors). Should make production more reliable and help to reduce wasted time and resources.

**Improve this answer**

The missing skill(s) has been annotated.

**Paper 1 Q3a:**

Economies of scale are factors that lead to a fall in average or unit costs of production when a business expands its scale of operation. These cost reductions therefore help to make the business more efficient and competitive. One example is a technical economy of scale. A large furniture-making business is able to purchase and fully employ a large, automated piece of equipment which will reduce unit production costs. This would not be possible for a small business using job production as the level of output would not justify the purchase of the efficient machine. **[Ap/A]**

Diseconomies of scale lead to higher average or unit costs when a business increases its scale of operation. This means that the business becomes less efficient and less competitive. A multinational clothing retailer may have poor communication between its many subsidiaries and this could result in the wrong styles being sent to countries that do not have a high demand for them. A smaller retailer would be better able to coordinate its activities and communicate with different parts of the business, reducing wasteful decisions. **[Ap/A]**

So some factors can lead to lower average costs and others can lead to higher unit costs.

## 24 Inventory management

### Key skills exercises

- 1 See textbook.
- 2 Opportunity cost.  
Cost of space.  
Cost of wear and tear.  
Depreciation of inventories.
- 3 Lost customers.  
Having to place a special order with suppliers which might be expensive.
- 4 Materials, work in progress, finished goods.
- 5 See textbook.
- 6 This gives more time for unforeseen changes in customer demand to put pressure on existing inventories.
- 7 See textbook.
- 8 Reliable suppliers.  
Reliable transport.  
Good communication links with suppliers.
- 9 Less than 1 week as an order was placed during week 1 and it arrived at the end of week 1.
- 10 Demand higher than normal.
- 11  $\frac{500 + 420}{4} = 230$
- 12 Borrowed finance to pay for inventories, there will be interest costs; storage costs.
- 13 **Worked example:**  
500 tyres. 600 tyres at maximum inventory level at the start of the week and this was reduced to 100 tyres (buffer inventory level) at the end of the week.

- 14** Opportunity cost **[K]** – tyres are quite expensive items **[Ap]** and the total value of the inventories of tyres will amount to a considerable sum – this is capital that could be used elsewhere in the business. **[A]**
- Storage costs **[K]** – tyres are quite bulky items and will need a large warehouse. **[Ap]** This warehouse will either be expensive to purchase or the rental will be high, increasing FBC's annual costs. **[A]**
- 15** It prevented 'inventory out' in week 5 as the higher usage rate meant that inventories fell to zero just as the new supplies arrived. Without buffer inventories, there would have been a production delay.
- 16** Inventories would have fallen to zero and stayed at zero until the supplier delivered. Hold up in production.
- 17** Production need to keep inventory manager well informed of any foreseen changes in demand/production that might require more or less inventories to be held for a certain time period.
- 18** **Worked example:**  
One benefit is that supply problems could occur as FBC imports the tyres and other parts **[Ap]**. Transport problems will delay delivery **[K]** especially as FBC is a long distance from a port so high inventories reduce the risk of transport problems leading to production stopping with no tyres or other parts **[An]**.
- Second outline answer:** Demand and production for some types of bicycles might vary **[K]**. This makes holding low inventories risky if demand/production is high **[An]** especially as the bicycle using the tyres in the chart seemed to be produced in large numbers in week 5.
- 19** **Outline:** Analyse the advantages and potential disadvantages of JIT as well as the conditions for JIT to operate effectively. Discuss whether those conditions are met in the case of FBC and whether the advantages of JIT in this case exceed the risks. Overall conclusion needed.

## Exam-style questions

### Paper 1

- 1** See textbook.
- 2** Steady demand or demand that is easy to forecast.  
Reliable suppliers and transport systems.
- 3** **Outline:** Explain the three types of inventories that a manufacturing business could hold (suggest a particular product being manufactured). Analyse why inventories of these are often essential for continuous production or to meet customer demand. Analyse the costs of holding inventories – again in the context of a particular manufacturer. Analyse why managing the lowest level of inventories that can be attained while maintaining continuous production is the optimum approach.

### Paper 2

- 1**
  - a** See textbook.
  - b** See textbook.
- 2**
  - a** Re-order level = 10 tonnes; buffer level = 4 tonnes; lead time two weeks;  
weekly usage =  $\frac{10 - 4}{2} = 3$  tonnes per week
  - b** Cost of purchasing might rise as each order is smaller – fewer economies of scale.  
Administration re-ordering costs.

- 3** Materials – little or no risk of no inventories unless huge disruption in supply chain/transport system.  
 Work-in-progress – inevitable that there will be some in a manufacturing business – the longer it takes to produce quality hand-stitched shoes, the greater the value of work-in-progress.  
 Finished goods – offers customers more choice of shoes that are immediately available.
- 4** See ‘Improve this answer’.

### Improve this answer

The missing skill(s) has been annotated.

#### Paper 2 Q4:

SSS should not use JIT for all of its supplies of shoe materials as it would be very risky for the business. **[E]** Running out of inventories would lead to a real crisis and this could put the whole business at risk. Customer service is a vital part of the SSS business and customers who are having specially designed shoes made for them may not wait until supplies of special leather arrive. **[Ap]** This could damage SSS’s reputation for customer service and sales could fall.

There could be many reasons why suppliers fail to deliver on time. There might be heavy traffic on the motorway or there could be a truck drivers’ strike. Any problems like this would mean that the lead time is longer than usual and then inventories could fall to zero. Production would have to stop, workers would have nothing to do and customers would be disappointed. These problems could damage the good name of the business and lead to customers buying products from competitors. This is particularly true of the SX3 sport shoe which is being sold in a mass market with many competitors. **[Ap]**

However, SSS is located close to many of its suppliers and as they are very reliable it could operate a JIT system with these suppliers. **[Ap]** It will need effective communication links between SSS and suppliers though. **[E]** With the leather that is imported with more potential for transport problems it is far too risky to use JIT so SSS should always hold high inventory levels ‘just-in-case’ something unforeseen happens to the next delivery. **[E]**

## 25 Capacity utilisation (A Level only)

### Key skills exercises

- 1**  $\frac{\text{Current output}}{\text{Maximum output}} \times 100$ .
- 2** Output is currently less than maximum output.
- 3** Increased demand beyond the level of a firm’s maximum output.
- 4** By cutting back on resources used in production, maximum output level will be reduced.
- 5** Machines and employees are ‘working flat out’ so there is more potential for breakdowns or staff absences.
- 6** Allows an increase in production without the fixed costs associated with increased capacity.  
 Can be used to increase output on a temporary basis (e.g. during periods of exceptionally high demand).
- 7** Quality issues.  
 Reliability of supply issues.

**8 Worked example:**

$$\begin{aligned}\text{Capacity utilisation (\%)} &= \frac{\text{Current output}}{\text{Production capacity}} \times 100 \\ &= \frac{1,000}{1,200} \times 100 = 83.3\%\end{aligned}$$

$$9 \quad \frac{1,150}{1,200} \times 100 = 95.8\%$$

**10** It is increasing rapidly and will soon reach 100%.

**11** Increased demand as a result of competitor leaving the industry. EAC has increased production so that it can hold increased inventories in anticipation of increased demand.

**12** Might not be of the same quality – faulty electrical products could damage EAC's reputation. Distance of outsourced supplier from EAC might result in supply/transport problems.

**13** Machines will be fully used with little or no time for maintenance and safety checks – this could lead to breakdowns and production disruption in future. Employees will have little spare time for training, checking, discussing issues such as quality – there could be rise in absenteeism if employees feel 'overworked'.

**14 Worked example:**

One advantage to EAC of a high level of capacity utilisation is that unit costs should be quite low. **[K]** Fixed costs are \$18,000 per month and when output rises from 850 to 1,150 per month, the unit fixed cost falls from \$21.2 to \$15.65. **[Ap]** This will make EAC much more competitive and means that the business could afford to lower prices leading to increased demand. **[A]**

Second **advantage:** Employees will feel that their jobs are secure and this can create feelings of motivation (Maslow's safety needs). This might mean that few workers leave EAC – which is important as training costs are high.

**15 Outline:** Analyse the advantages and disadvantages of both ways to solve the capacity problem (e.g. the cost and time to build a factory extension – but the control over quality that a factory extension will give and the cost of transporting goods from the outsourcing business). Make a reasoned and supported conclusion.

## Exam-style questions

### Paper 3

**1 a** See textbook.

**b** See textbook.

$$c \quad \frac{810}{1,100} \times 100 = 73.6\%$$

**d** Down for 2 months but some improvement in months 3 to 6. Most recent trend is upwards.

**2 Outline:** Low-capacity utilisation means a high level of excess capacity. This means that the fixed costs of operating the van hire business (e.g. van leasing charges and the site cost of the van depots) is being 'spread' over relatively few van hirings – this raises unit fixed costs. May be lack of security among employees – they know that one business has failed recently as well. May reduce motivation levels. Good employees might leave before they lose their jobs, if rationalisation occurs.

**3** See 'Improve this answer'.

**Improve this answer**

The missing skill(s) has been annotated.

**Paper 3 Q3:**

Rationalising means reducing resources in the business so that capacity is cut. This will reduce the overhead or fixed costs of the business. IVH's monthly fixed costs of \$450,000 would be reduced so the losses of the business will be reduced too – or the profits increased. Rationalisation in this case would be to cut the number of outlets. This could be done by closing one of two branches that are closest to each other. Customers would still be able to hire vans from the other branch. The number of vans would have to be reduced too. So if 100 vans were sold off or returned to the leasing company, the capacity utilisation in month 6 would rise to 81% helping to reduce the average cost of each van hired out.

Workers would probably have to be made redundant when one or more branches close and this will further reduce cost. This might upset the Trade Union and they might call industrial action. This might be unlikely though as the economy is not doing very well and the Trade Union would worry about IVH having to close even more branches. IVF might be able to avoid redundancy if they introduced more flexible labour contracts for existing workers as these would cut back on fixed costs too as the hours of each worker could be reduced.

It might be too early to rationalise operations. **[E]** Capacity utilisation has increased in the last 4 months. If this continues and IVH had already closed one of its branches it could be expensive to re-open it and lease additional vehicles and re-employ workers. If the economy starts to grow again then the demand for van hire will increase and a 'smaller' IVH could reach full capacity quickly. The best option **[E]** is to wait for 3 more months before taking this major decision. If other van hire businesses close or the economy grows, the demand for IVH will rise and this will reduce the excess capacity problem. If the problem has got worse after 3 months then the management should rationalise by closing at least one branch. **[E]**

## 26 Lean production and quality management (A Level only)

### Key skills exercises

- 1 Reduce waste.
- 2 Less employee and machine time is taken up if a number of activities can be performed at the same time.
- 3 One way is by allowing different styles/variations of products to be produced rather than producing large quantities of the same style/model which could result in unsold inventories building up.
- 4 See textbook.
- 5 Saves time.  
Reduces waste/improves quality.  
Uses fewer resources (production also becomes more sustainable as a result).
- 6 If holding inventories is vital to ensure supplies (e.g. life-saving medicine in a hospital).  
If the cost of introducing lean production (e.g. flexible machinery, training of employees) outweighs potential cost savings.  
If it is just seen by managers as a way to cut employee numbers – this could create poor industrial relations.

- 7** It fully meets customer expectations.
- 8** QC – checking quality at end of each stage or at finished good stage (by QC inspectors).  
QA – pre-set quality targets give to each section/team and they are responsible for own checking.
- 9** See textbook.
- 10** Comparing with the ‘best’ in the industry.
- 11 Worked example:**  
One example of waste in EAC is the use of expensive storage space and the opportunity costs associated with this resulting from high inventory levels. **[K]** At EAC there is ‘no more space in the warehouse’ as rising output led to more components held in inventory. **[Ap]**  
Second example: Faulty electrical products – this causes waste as products either have to be rejected to ensure consumer safety or ‘re-worked’ to correct faults – both are wasteful.  
Third example: No participation from employees to help solve production problems – this is a waste of a labour resource (i.e. workers can offer much more to a business than just doing ‘their job’).
- 12** Increased legal controls over faulty products – especially for electrical goods, which can be very harmful to consumers.  
Increased globalisation has increased competition in consumer goods markets such as electrical goods – low quality will lead to low sales.
- 13** No participation – no job enrichment; low esteem; no opportunity for being recognised for offering good ideas – motivational theorists such as Herzberg would link these points to low motivation.  
Low motivation means that workers are not committed to quality production – this could explain the high number of faulty products.
- 14** QC – as workers are not directly employed in checking for quality and inspectors are employed.
- 15** Higher costs – or high inventories, of waste, faulty products, slow product development times. Each of these makes the business less competitive.
- 16 a** Quicker product development times – a project to develop a new electrical product can be achieved more quickly by undertaking some activities simultaneously.
- b** Groups of workers discussing how small but frequent improvements in production methods can lead to higher quality and efficiency.
- 17 Worked example:**  
By focusing on quality control EAC employs quality control inspectors. **[K]** There has been an increase in the number of faulty products identified by these inspectors. **[Ap]** As employees are not held responsible for quality and there appear to be no quality assurance standards, the cost of increased numbers of faulty products is rising. **[A]**  
Low levels of motivation as workers are not trusted with quality assurance checks and therefore they have a feeling of not being given responsibility. This low motivation can reduce quality and productivity levels.
- 18 Outline:** Analyse the benefits of some lean production techniques for EAC (would it mean allowing for an increase in production without spending money on a factory extension?), then analyse some of the potential limitations, for example, cost (could the business afford to train for lean production techniques to be introduced at same time as a factory extension?); finally, give a supported conclusion/decision.

- 19 Outline:** Define lean production. Two techniques could be JIT and Kaizen. Explain the benefits of both of these in terms of the problems that EAC is experiencing. Consider potential costs/limitations. E.g. workers will need training to take part effectively in Kaizen groups and will respond better if the leadership style becomes more democratic; JIT might require investment in improved communication links with suppliers and flexible production methods. Is EAC management able to introduce these changes effectively? Overall conclusion about likely impact of these techniques on EAC.
- 20 Outline:** Define TQM. Analyse the potential benefits to EAC – quality, no inspectors to employ; improved employee motivation as they are being made to feel more responsible and accountable; have clear assurance targets to meet; Analyse limitations; employee training, need to keep assurance standards up to date; needs a different leadership style that is prepared to allow more participation of employees. Overall conclusion in context of EAC required.

## Exam-style questions

### Paper 3

- 1 Outline:** Define TQM; explain how TQM is operated at RSH; explain the impact of TQM on employee motivation (Herzberg's job enrichment concept could apply here) and cost efficiency.
- 2** See 'Improve this answer'.

#### Improve this answer

The missing skill(s) has been annotated.

#### Paper 3 Q2:

Lean production means reducing waste in all areas of production whilst maintaining quality. Waste can occur in manufacturing e.g. too many faulty products, but it can also occur in hotels. For example, food and drink can be wasted if over-ordered and allowed to go past its 'use by date'. Low productivity in cleaning rooms, preparing food, checking out clients and so on can waste labour resources. Lack of flexibility amongst employees can mean that when a worker is absent, such as a lobby porter, no one is available to do the job.

Lean production at RSH could include JIT and flexible working. With JIT, only sufficient food and drink will be held in inventory to meet immediate needs. Inventories will only be sufficient to cover the time period of re-ordering and delivery. This will save on costs of inventory holding, reduce opportunity costs of finance held in inventory and help to keep food as fresh as possible. This will improve the customer's experience in the restaurants of the hotels as well as reducing costs.

Flexible working requires a multi-skilled workforce which is prepared to undertake a variety of different jobs in the hotel. This will mean that no one should be left idle, no vacancies caused by absenteeism left uncovered by someone else and really busy periods, such as in the kitchen, will have extra workers available to help. A smaller number of employees will be required and labour productivity will increase – reducing costs and allowing RSH to become more price competitive. **[A/Ap]** Employees may feel more motivated due to the team working spirit that this system encourages and by the variety of being able to undertake a large number of different jobs.

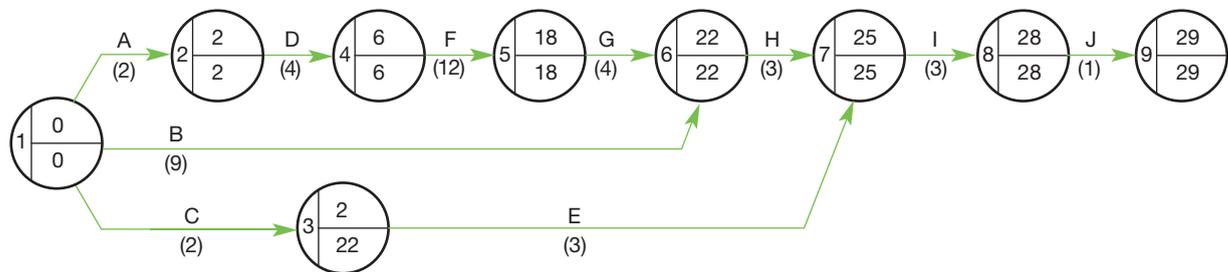
There might be limits to lean production within a service industry such as a hotel business, however. **[E]** It is true that some hotels are almost unstaffed – entry is by electronic code or tag, no one is at reception, breakfast might not be offered or it is only 'self-service'. **[Ap]** This lean method of providing hotel accommodation might suit the low-cost end of the market. **[E]** However, RSH operates luxury hotels – charging, no doubt, high room rates – so guests will not take kindly to taking their own luggage to their rooms because of 'lean management' decisions to cut back on staff. **[Ap/E]** So there must be a limit to lean methods for RSH – the management do not want to achieve high levels of efficiency if the quality of the service offered does not meet with customers' expectations i.e. quality of service falls below acceptable levels or if some menu food items are not available due to no inventories being held. **[E]**

## 27 Project management (A Level only)

### Key skills exercises

- 1** Define the project/setting objectives.  
Divide into manageable tasks.  
Give each team member a clear role.
- 2** Poor management of resources.  
Lack of a clear plan of action.  
Frequent changes in the specification of the power station.
- 3** Penalty payments for not keeping to schedule.  
Bad reputation for project management/construction.
- 4** Node number.  
Earliest start time.  
Latest finish time.
- 5**  $LFT - duration - EST$ .
- 6**  $EST(\text{next}) - duration - EST(\text{this activity})$ .
- 7** Gives the spare time available for this activity without delaying subsequent activities.
- 8** The activities that must be completed on time for the project to be completed on time.
- 9** Shows sequential and simultaneous activities.  
Extra resources can be allocated to critical activities if they seem to be over running.
- 10** Durations can just be estimates if similar projects have not been undertaken before.  
Does not guarantee success as unforeseen events can still occur to delay a project – but this does not mean that CPA has been a waste of time.

**11 Worked example:**



- 12** See network diagram.
- 13** A, D, F, G, H, I, J
- 14**  $B = 22 - 9 - 0 = 13$   
 $E = 25 - 3 - 2 = 20$
- 15** The critical path time would be extended from 29 weeks to 31 weeks.
- 16** Time could be saved on subsequent activities (e.g. G, H, I or J).
- 17** Yes, in 29 weeks, if none of the critical activities are delayed.
- 18** Allows Project Manager to see that B, C and E can be undertaken simultaneously with other activities – saving overall project time.  
Project Manager can see the logical sequence of activities so they will be undertaken in the correct order.

**19** Not clear how estimates have been obtained – are these just the Project Manager’s estimates or were they obtained after discussion with the construction company?

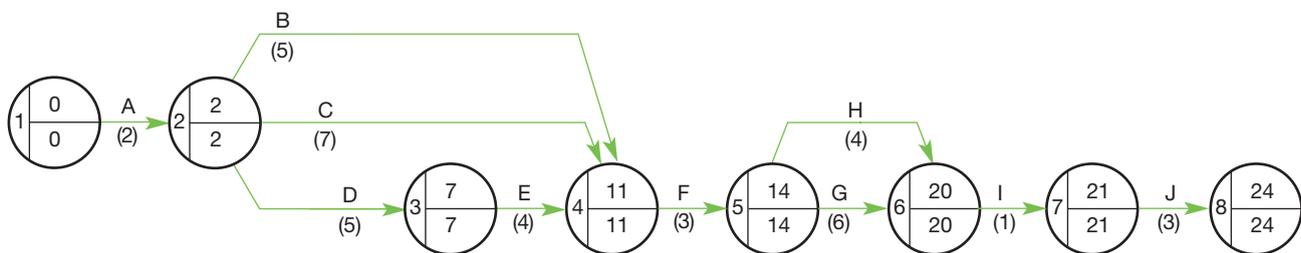
The activities are not very detailed and a more complex plan might be necessary (e.g. ‘construct new building’ has many activities and tasks associated with it and it would be more helpful if these were detailed on the network diagram).

**20 Outline:** Consider the network diagram, the likelihood of all activities keeping to time, the lack of experience of the Project Manager, the lack of detail provided for many of the activities such as ‘construction of the building’ and any other factors that might influence the outcome of this project. Remember to include a clear, supported conclusion.

## Exam-style questions

### Paper 3

#### 1 a i



ii See network diagram.

b See Annotated answer below.

#### Improve this answer

The missing skill(s) has been annotated.

#### Paper 3 Q 1b:

CPA is a planning technique that uses a network diagram of project activities. **[K]** The CP is made up of activities A, D, E, F, G, I and J. **[Ap]** The length of this critical path is 24 weeks which is just less than the 6 months target time. **[Ap/A]** This suggests that the project should be completed in time for the launch of the online selling of HQ products. **[E]** If there is a delay in any of the critical activities – such as D for example – then this might extend the completion time to over 6 months. **[Ap/A]** In this case, more resources would need to be devoted to one of the later (subsequent) critical activities such as G to reduce the estimated duration time. **[Ap/A]** In this way the completion time could be kept down to 6 months. It might be possible to switch some employee resources from one of the activities with a float time, such as H, to help complete G in less than the estimated duration time. **[Ap/A]**

The CP analysis and the network diagram will help HQ complete this project on time. **[E]** It shows the main activities, the logical relationship between them and the critical activities. These must be focused on by the project team within HQ to try to make sure that the durations are not exceeded. Using the diagram allows resources to be switched from non-critical to critical activities, as explained above. **[A]**

The CP analysis and the diagram will not guarantee success of this project or its completion within 6 months, however. **[E]** This is a ‘one-off’ project, not undertaken by HQ before, and there might be considerable inaccuracies in the estimated duration times. The project is also larger than anything HQ has attempted before, in terms of IT. It could be that the IT employees in the business are just not capable of managing such a complex project and it might have been wiser to outsource this to IT specialists, even though this would have been more expensive. **[Ap/E]**

On balance, I think there are too many uncertainties about this project and HQ’s ability to manage it. Yes, the CP analysis and the network diagram will be useful in the ways analysed but only up to a point. **[E]** What would be much more useful is a skilled externally appointed IT expert with knowledge of this type of project to help manage and see it through to completion within 6 months. **[E]**

### 28 Business finance

#### Key skills exercises

- 1** Capital to buy equipment such as chairs and tables.  
Working capital to pay for inventories of drinks.
- 2** See textbook.
- 3** By reducing the capital tied up in inventories and accounts receivable – this will make cash available.
- 4** See textbook.
- 5** It would have no liquid assets to pay accounts payable (suppliers) or to repay loans so creditors might insist that the business and its assets are liquidated so that they can be paid.
- 6** See textbook.
- 7** No large initial cash payment required as with buying these assets.
- 8** See textbook.
- 9** Public issue.  
Rights issue.
- 10** External – shareholders are external providers of finance to a limited company.
- 11** See textbook.
- 12** See textbook.
- 13** Small sums are lent that would not be lent by traditional banks as sums are too small and businesses often considered too risky.
- 14** See textbook.
- 15** Small sums from large number of ‘investors’ for potentially risky new business start-up – unlikely to be funded by traditional banks.
- 16** If existing loans are very high (gearing is high), then banks will be much less likely to lend further finance.
- 17** The debt factor buys the right to collect funds from ‘accounts receivable’ and this money is likely to be used to buy additional inventories.
- 18** HP – asset belongs to the business; leasing – the asset belongs to the leasing company.
- 19** A grant does not usually have to be repaid.
- 20** Partnership – most finance likely to be provided by partners.
- 21** Available quickly.  
No interest payable (though lost interest on savings is the ‘opportunity cost’).
- 22** Has not set up a limited company.

**23 Worked example:**

Capital expenditure is on assets that last for more than one year. The vans and electric cleaners last for more than one year.

Revenue expenditure is on costs or assets that last less than one year. In this case it includes cleaning materials and cleaner's wages.

**24** Often high interest charges.**25** Bank loan.

Take on a partner.

**26** Both external.**27** Bank loan – interest.

Partner – some loss of control.

**28** One benefit of selling shares in the business when it is converted into a private limited company is share capital is permanent and will not have to be repaid.

Second benefit: No interest payable – just a share of profits as dividends. Jason can decide each year on the level of dividends.

**29** Interest rates could rise making loans more expensive.

Existing loans might be high already and further loans will make the business too risky (e.g. if revenue falls, the interest and loan repayments will still have to be made).

**30 Worked example:**

Reason 1: A big loan implies a large risk for the bank **[K]** – they will want reassurance from a business plan that Jason has thought carefully about how much capital he needs and what he intends to spend it on especially as BBC is still quite a small business. **[An/Ap]**

Reason 2: The business plan should include a cash flow forecast, which will indicate whether Jason will be able to pay interest and repay the loan.

**31 Outline:** Consider what Jason will need the finance for – revenue expenditure or capital expenditure giving examples of both in the context of BBC. If both, then different sources might be needed. Analyse the advantages and disadvantages of two or three sources of finance (e.g. converting the business to a limited company and make a supported final recommendation).

## Exam-style questions

### Paper 1

**1 Outline:** own savings; family/friends; bank loan.

**2** See textbook.

**3 Outline:** What finance is needed for. Size of existing loans; share price – if low, then a further sales of shares might not be advised; rights issue; risk of existing owners losing control. Potential for selling existing assets? Or selling and leasing back? Final recommendation cannot be made without more information – but an overall assessment of advantages and disadvantages can be given.

### Paper 2

**1 a** See textbook.

**b** See textbook.

**2** Reduces initial capital cost.

Maintenance of buses might be the responsibility of the leasing company.

**3** See 'Improve this answer'.

- 4 Outline:** Loan – interest payable and must be repaid – but if interest rates are low, this could be an appropriate source of finance. Shares – permanent but some loss of control. Dividends will be expected. Possible loss of control? Is Sarlat family prepared to see ownership fall below 40%? Current TT share price? Size of existing loans? Explain why this other information is essential before a final decision can be made.

### Improve this answer

The missing skill(s) has been annotated.

### Paper 2 Q3:

Working capital is the finance needed for the day to day operation of the business. It is used to buy inventories and pay bills. It is also needed for the materials used and wages paid in making products that are sold on credit – before customers pay for them.

An expanding transport business such as TT will usually need to hold more inventories of fuel, spare parts and materials. **[Ap]** These will need to be financed so increasing the need for working capital.

Secondly, expanding businesses need more customers. Many customers demand credit terms before buying products, especially expensive ones. By making products, selling them but not being paid for them yet requires additional working capital finance. TT provides bus services to companies and schools. These customers are unlikely to pay cash. By delaying payment these accounts become ‘accounts receivable’ and this amount will have to be financed by TT’s working capital. **[Ap]**

## 29 Costs

### Key skills exercises

- 1** Set prices.  
Calculate profit/loss.  
Decide on new contracts.
- 2** See textbook.
- 3** See textbook.
- 4** Yes – a fixed cost to the packaging department of a breakfast cereals factory is the box-making machine – this is also a direct cost as it is only used by this department.
- 5** Marginal cost – cost of making one extra unit; average cost is total cost divided by output.
- 6** Level of output at which revenue = total costs.
- 7** It will rise.
- 8** See textbook.
- 9** See textbook.
- 10** Declines.
- 11** Conference equipment (e.g. projector).  
Wages of employees who work in the conference division.
- 12** Projector – no.  
Wages – possibly, if more workers are needed for a large conference.
- 13** Rent of premises.  
Insurance of hotel.
- 14**  $(350 \times \$30) + \$21,000 = \$31,500$

$$15 \frac{\$31,500}{350} = \$90$$

**16 Worked example:**

$$\begin{aligned} \text{Break-even} &= \frac{\text{Fixed costs}}{\text{Contribution per unit}} \\ &= \frac{\$21,000}{(\$100 - \$30)} \\ &= 300 \text{ delegates per average week (for one day each)} \end{aligned}$$

- 17** 5% increase in price leads to price of \$105  
Contribution now \$75.

$$\text{New break-even point} = \frac{\$21,000}{\$75} = 280.$$

- 18** Higher prices leads to lower break-even point (assuming no other changes).  
This increases the safety margin from 20 to 40 customers per week (assuming number of customers does not change).

- 19 Outline:** Could use it to calculate average cost and use cost-plus pricing – give example.  
Could use it to decide whether to accept a conference proposal from a new customer for 50 delegates for one day at a price of \$90 per delegate (the average cost at SH's current output level) – give worked example.

- 20** To analyse which costs will rise if a new customer order for a 50-delegate conference was received.

**21 Worked example:**

One limitation in this case is that the variable cost line is a straight line because the cost of \$30 per delegate for food and drink is constant. **[K/Ap]** It might be possible, with a larger number of delegates to obtain economies of bulk purchasing, in which case the variable cost line would not be of a constant gradient – and neither would the total cost line. **[An]** This would reduce the break-even number of delegates needed to break even. **[Ap/An]**

Second limitation: Assumes no change to number of delegates if price is raised (e.g. to \$105).

- 22** The average cost includes the average fixed costs – but an extra delegate would not lead to any higher fixed costs – only higher variable costs.
- 23 Outline:** Analyse the impact of the three different decisions (higher prices; lower food and drinks costs; higher fixed advertising costs) that could be taken by calculating break-even point, weekly profit (at average number of delegates per week of 320) and safety margin. Using your results, recommend which decision to take – at the same time, identify the limitations of break-even analysis when considering these decisions (e.g. will delegate numbers increase as predicted with increased advertising?).

## Exam-style questions

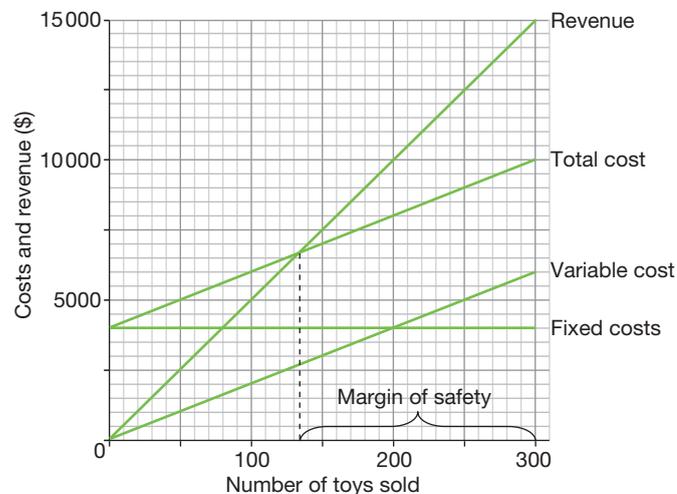
### Paper 1

- 1** Petrol station variable costs – the fuel sold; fixed costs – insurance of the petrol station site and inventories of fuel.
- 2 Outline:** Sketch a typical break-even chart; explain how it could be used to show the effect of one change (e.g. lower variable costs, explain the benefit of using this technique).
- 3 a Outline:** Direct costs can be easily allocated to each product (e.g. the machine costs of machines that are only used for one particular product). These costs have to be covered by the revenue of the relevant product. Indirect costs cannot easily be allocated (e.g. rent of the factory), so should not be allocated to each product when calculating the 'profit' of each product as this allocation could be wrong. Use an actual example of a business/product in answer.

- b Outline:** Explain break-even analysis – perhaps by including a sketch of a BE chart. Could be used to compare profits/losses; safety margin of each retail shop. Helps to see what impact decisions might have on these BE charts for each shop (e.g. relocating one of them to a cheaper site with lower fixed costs). Evaluate the usefulness of BE analysis (e.g. can all business costs be allocated accurately to each shop?) Will variable costs and revenue increase in a linear way with increased sales?

## Paper 2

- 1 a** See textbook.  
**b** See textbook.  
**2 a i and ii**



- b** The break-even level of output falls from 200 toys per month to 133 and the margin of safety is much greater. Profit rises at 300 toys per month to \$5,000 but this assumes that the revenue line remains unchanged. If demand falls, the revenue line will not extend to 300 toys or \$15,000.
- 3** See 'Improve this answer'.
- 4 Outline:** Explain break-even analysis – formula/sketch diagram. Can be used to aid decision-making such as: raising price/lowering price of dragon toy; reducing variable costs (e.g. by using cheaper paint); reduce fixed costs by reducing the allocation of overheads to this product. Break-even can show what happens to break-even point, safety margin and maximum profit with these changes.  
 Explain assumptions behind break-even analysis. Overall conclusion needed (e.g. very useful as long as the assumptions are considered and break-even analysis is combined with other forms of analysis).

### Improve this answer

Missing skill(s) has been annotated.

### Paper 2 Q3:

The break-even level of production depends not just on price but also variable and fixed costs – which add up to total costs.

One way to reduce the break-even point and increase profit is to reduce labour costs. These are likely to be variable costs and a reduction in wages will make the variable cost line on the break-even chart rise less steeply. Total variable costs are currently \$6,000 at an output of 300 = \$20 per dragon toy. **[Ap]** A reduction in variable costs – such as labour or using less expensive paint – will

reduce this and increase the contribution made per toy even if the price is kept at \$40 per toy ( $300 \times \$40 = \$12,000$ ). **[Ap]** As total costs also depend on variable costs, this line will rise less steeply too, meaning that it crosses the revenue line (break-even point) at a lower level of production.

Another way to reduce the break-even point is to reduce fixed costs. This could be done by moving to a cheaper factory and cutting rent costs. This will lower the horizontal fixed cost line and total costs will fall too. By reducing total cost, the line will cut the revenue line at a lower output level. In this case, the specialised tool is essential to the making of the dragon but perhaps the overhead costs of the business – such as factory rent – have been unfairly allocated to the dragon toy. **[Ap]** A reduction in these overheads will cut fixed costs, reduce total costs and reduce the break-even level of production. The safety margin at an output and sales level of 300 will also increase.

## 30 Accounting fundamentals

### Key skills exercises

- 1** Calculate profit/loss.  
Make comparisons of business performance over time.  
Keep records of who owes money to the business – and who the business owes money too.
- 2** Shareholders/owners; customers; lenders (e.g. banks).
- 3** Customers – is business secure and likely to survive in future?  
Banks – is business able to pay interest/repay debts?  
Shareholders – to monitor sales and profit levels.  
To check on dividend payments.
- 4** Cost of the goods sold/service provided during a given time period.
- 5** Expenses/overheads are deducted from gross profit to give net profit/operating profit.
- 6** Reduce retained earnings as profit for the year can either be paid in dividends or kept as reserves in the company.
- 7** Income statement – as this records the value of flows of revenue and costs over a period of time.
- 8** See textbook.
- 9** See textbook.
- 10** Inventories – as these are goods that have not been sold yet and it cannot be assumed that they will be sold quickly.
- 11** Liability – these are amounts owed to creditors.
- 12** Long-term loan.
- 13** Overdraft.
- 14** Share capital; reserves (e.g. retained profit reserves).
- 15** Increase price.  
Reduce cost of sales e.g. variable cost per item sold.
- 16** Inventories are included in current assets but not in liquid assets.
- 17** Sale of non-current asset for cash.
- 18** Only as accurate as the accounts they are based on.  
Difficult to compare with other companies unless the same accounting methods and dates have been used.

- 19** They are not completely up to date – may cover a period that ended several months ago when they are first published.  
May have been ‘window dressed’.
- 20** Relative company performance is important (e.g. the other company might have a much higher net profit margin. Why might this be?).
- 21 Worked example:**  
Gross profit = Revenue – Cost of sales = \$1.4m
- $$\text{gross profit margin \%} = \left( \frac{\text{Gross profit}}{\text{Revenue}} \right) \times 100$$
- $$= \frac{\$1.4\text{m}}{\$5.2\text{m}} \times 100 = 26.9\%$$
- 22**  $\frac{\$1\text{m}}{\$5\text{m}} \times 100 = 20\%$
- 23** Gross profit margin is falling – either due to higher cost of sales per unit or lower price per unit.
- 24 Worked example:**
- $$\text{Operating profit margin \%} = \left( \frac{\text{Operating profit}}{\text{Revenue}} \right) \times 100$$
- $$= \frac{\$0.6\text{m}}{\$5.2\text{m}} \times 100 = 11.5\%$$
- 25**  $\frac{\$0.2\text{m}}{\$5\text{m}} \times 100 = 4\%$
- 26** Substantial fall in operating profit margin caused by i) fall in gross profit margin and ii) overhead expenses have remained constant despite the fall in revenue.
- 27** See answer to Q26.
- 28 Worked example:**
- $$\text{Current ratio} = \frac{\text{Current assets (inventories + cash + accounts receivable)}}{\text{Current liabilities}}$$
- $$= \frac{\$2\text{m}}{\$1.6\text{m}} = 1.25$$
- 29**  $\frac{\$1.7\text{m}}{\$2\text{m}} = 0.85$
- 30** Rapid decline in current assets might raise doubts about the company’s liquidity.
- 31 Worked example:**
- $$\text{Acid test} = \frac{\text{Liquid assets}}{\text{Current liabilities}}$$
- $$= \frac{\$1.2\text{m}}{\$1.6\text{m}} = 0.75$$
- 32**  $\frac{\$0.7}{\$2} = 0.35$
- 33** Further evidence of declining liquidity as this ratio has fallen by over 50% in one year.
- 34** Substantial increase in current liabilities – perhaps an increased overdraft? Much lower levels of cash being held.
- 35** Competition might have forced SH to reduce prices which, without a fall in variable costs, will reduce gross profit margin.  
Despite lower revenue, overheads have not fallen so overheads now form a higher proportion of revenue.
- 36** Investors will be less willing to invest as the prospect of lower profitability is likely to reduce dividends.  
Lower profitability will result in reduced retained profit – business might become more dependent on borrowed or external finance.

- 37** Able to identify potential problems areas so that action can be taken to improve performance/liquidity (e.g. reduce overheads).  
Able to compare with other similar businesses – if other hotels are experiencing similar problems then SH might not be under-performing compared to industry average. In fact, SH doing better than hotel group that went out of business!
- 38** The decline in acid test is the bigger problem – increased current liabilities such as overdraft and accounts payable.  
Lower cash is a potential problem area – might be caused by use of cash to purchase non-current assets or to pay dividends – which perhaps the business can no longer afford?
- 39** Sale of assets (e.g. spare land, catering equipment no longer required, for cash).  
Obtain long-term loan to pay off short-term debts – might be difficult to arrange given the worsening performance of the business.
- 40 Outline:** Analyse the uses to which these ratios results can be put but also consider the limitations. Are enough years' results being used? Would comparisons with other hotels be useful? Would profit ratios for each division be useful?
- 41 Outline:** Can be increased in a number of ways (e.g. raise prices without any increase in costs – but will guests pay higher prices – economic conditions seem not to be good for this strategy). Reduce variable costs (e.g. cheaper food/drink/fewer staff providing guest services such as porters/cleaners but without reducing prices) but will guests notice the change in quality of service offered and could this reduce demand and revenue for SH? Reduce overheads – these have been a major factor contributing to the decline in net profit margin – perhaps reduce management numbers or cut back on advertising – but how will these changes affect the efficient running/promotion of the hotel and demand?

## Exam-style questions

### Paper 1

- 1** See textbook.
- 2 Outline:** May be out of date – especially in fast-changing market/economy.  
May have been window dressed – made to look more favourable in the short term.
- 3 a** See 'Improve this answer'.
- b Outline:** Explain which the major profitability and liquidity ratios are; explain what they show. Usefulness: Compare over time and with other similar businesses. Highlight worsening/improving profitability and need for action (perhaps). Highlight worsening/improving profitability and need for action (if any). Limitations: Accuracy of accounting data on which they are based; comparisons have problems too; more useful if profit data available for each individual shop – so each of the shops' budgets and variance analysis might be more useful for this particular business.

### Paper 2

- 1 a** See textbook.
- b** See textbook.
- 2 a** 
$$\text{OPM \%} = \frac{\text{OP}}{\text{Revenue}} \times 100$$
  
$$\frac{1.5}{15} \times 100 = 10\%$$
- b** This difference is caused by overhead costs – if the gross profit margin remains constant between two years but the operating profit margin falls, this would indicate that overheads must have increased as a proportion of revenue.

- 3 Outline:** Increase gross profit margin (raise prices and/or reduce variable costs) or reduce overheads as a proportion of revenue. Give examples in context.
- 4 Outline:** Explain the concept of liquidity and explain why important. Sell the largest house for cash – will reduce finished goods inventory but increase cash balance so acid test ratio will increase. But less profit will be made on this house as cash buyer wants a discount. Encourage debtors to pay more quickly or use debt factor – will reduce profit made on this contract if a debt factor is used. Encourage suppliers to allow longer credit periods – but some suppliers might be unwilling to supply further goods until debt had been paid. Hold fewer inventories – but some will still be needed to maintain the rate of construction.

### Improve this answer

The missing skill(s) has been annotated.

#### Paper 1 Q3a:

Stakeholders will include workers and the lending bank. **[K]** These groups will be interested in published accounts for the following reasons.

Workers will want to see if the company's published accounts – which have to be published, by law, **[Ap]** show that the business is profitable and possibly compare this profit with other similar businesses. They might use this information as a basis for a wage increase if their company is very profitable. **[An]**

Banks will want to know for sure whether the company will be able to pay them back the loans in the future. **[K]** In a company, the shareholders will have limited liability so the bank will only receive the repayment of loans if the business has the resources to pay **[Ap]** – because the shareholders cannot be asked to pay off the company's debts. The liquidity ratios can be calculated and these will show the bank whether enough liquid assets are currently being held to pay back the total loan the company owes them. **[An]**

## 31 Forecasting and managing cash flows

### Key skills exercises

- 1** Cash inflows – cash outflows.
- 2** Goods might have been sold on credit.  
Non-current assets might have been bought for cash.
- 3** A business which is illiquid – runs out of cash – will have to stop trading. Losses can be made in short term as long as business still has sufficient cash.
- 4** Sales of goods for cash.  
Payments from debtors.  
Injections of capital from owners.
- 5** Payment of wages.  
Payment of creditors.  
Payment of rent.
- 6** Opening balance is cash in tills/bank at start of time period (e.g. week or month), closing balance is cash held in tills/bank at end of period.
- 7** Debtors delay payment.  
Machine breakdown requires speedy replacement – perhaps paid in cash.

- 8** Encourage debtors to pay more quickly.  
Sale of non-current assets.
- 9** Delay payment to creditors.  
Delay capital expenditure.
- 10** Based on forecasts of sales – could be affected by economic factors.  
Unforeseen events could affect outflows (e.g. landlord increases rent on premises).
- 11** It is a start-up business – only been operating for three weeks – so a cash flow forecast would have helped convince lenders to lend and would have alerted the owners to potential cash flow problems – and action could have been taken to avoid these.
- 12** A substantial increase in payment to food suppliers – might be adding to inventories rather than selling all of these in month 8. There is also an increasing amount owing from business customers – so food has been sold at a profit but not yet been paid for.
- 13** Calculate values (\$000):  
X = (3.6)  
Y = (3.5)  
Z = 10.1
- 14** May be short of cash to pay suppliers in month 10.  
Bank might refuse to increase overdraft unless there is evidence that the cash flow will improve.
- 15** Too much credit offered to business customers.  
Have to pay cash to food suppliers.
- 16** Increase cash sales (e.g. by reducing prices if PED is high).  
Capital injection from owners.
- 17 Worked example:**  
Advertising and promotion costs could be to reduce (e.g. in week 9 it is planned to spend \$2,000. **[K/Ap]** This seems unnecessary as CF already has a good customer base. **[Ap]**  
  
Ask for credit from suppliers.
- 18** If PED is low, cash sales revenue will fall and profit margins will fall.  
Owners might have invested all of their capital already.
- 19 Worked example:**  
By reducing advertising and promotion spending CF could see sales fall in future weeks. **[K]**  
We do not know how many of the regular customers are attracted by ‘promotions’ such as ‘a free drink with a fajito’. **[Ap]** By cutting advertising and promotion spending so early in the life of the business could put at risk its future sales success. **[A]**  
  
Suppliers might be unwilling to offer credit to such a new business and credit only ‘delays’ payment and does not reduce cash outflows in the long term.
- 20 Outline:** Capital injection from owners – perhaps CF started off with too little cash – have they got savings to inject into the business? Increase overdraft limit from bank – this is expensive and does not ‘solve’ a cash flow problem but only finances it. Ask business customers to pay more quickly – but will they still use CF? Ask suppliers for credit – but will they still be willing to supply such a new business? Any other reasonable suggestions. Overall conclusion/judgement needed.
- 21 Outline:** Explain the benefits of cash flow forecasting to CF making reference to Table 30.1. Explain the limitations of cash flow forecasting, for example it may be inaccurate. Consider other factors that will influence future success, such as how pleased the business customers is with the party for week 8; whether new competitors start up; the state of the external environment (e.g. economy). Come to an overall conclusion about the importance of cash flow forecasts compared to these other factors.

## Exam-style questions

### Paper 1

- 1 a** See textbook.
- b** Unforeseen change in fashion reduces sales.  
Increase in cost of cloth to make clothes, which was not predicted.
- 2 a** See 'Improve this answer'.
- b Outline:** Define cash flow/cash flow forecast. Social media businesses might be seen as rather risky ventures due to competition and fast-changing customer trends. Lenders will need reassurance that cash flows have been forecast and planned for. Managers will need to plan for injections of capital and loans as and when needed. However: difficult to predict costs and cash inflows (e.g. from advertisers for this new type of business). Overall conclusion needed (e.g. these forecasts essential but they need to be updated very frequently due to the uncertain nature of many revenues and costs of this type of business).

### Paper 2

- 1 a** See textbook.
- b** See textbook.
- 2 a**  $X = 8, Y = (14), Z = (25)$ .
- b** Unless bank is prepared to allow this size of overdraft, HCR will be unable to pay suppliers/rent next month.
- 3 Outline:** Raising prices to cash customers will increase cash inflows if sales are unaffected – but customers might go elsewhere if HRC is now much more expensive than competitors. Reduced promotion costs will have an immediate impact on reducing cash outflows – but might impact on sales in future.
- 4 Outline:** Suggest, analyse and evaluate at least three ways of improving cash flow (e.g. reducing capital expenditure – but will this reduce HRC's efficiency and customer service in future?) Ask business customers to pay cash – but they may take their orders to a competitor business that still offers credit. Reduce employee bonuses until cash position improves – but skilled workers might leave especially if competitors have job vacancies – and this will reduce HRC's customer service. Conclusion/judgement needed.

### Improved answer

All skills have been annotated.

#### Paper 1 Q 2a:

Profit is revenue less costs. Net cash flow is cash in minus cash out. In a business where all payments and revenue are in cash, profit and cash flow could be the same. **[K]** In most businesses there will be some sales on credit and some suppliers will offer credit too. Credit can be offered by suppliers where supplies arrive but do not have to be paid for immediately. Credit can be offered to customers where products are delivered but the customer is given time to pay. **[K]** So a profit or loss might be made on sales in one month but the cash flow figure might be very different because of the credit sales and credit purchases. **[A]** If credit customers for a petrol station take long to pay than expected then a cash flow problem might arise, especially if the petrol station has to pay for its supplies as soon as they are delivered. **[Ap/A]**

If a business makes substantial purchases of non-current assets – for example, a restaurant buying new kitchen equipment – then cash will be low when it is paid for (assuming paid in cash) but profit will be unaffected as the equipment will be depreciated over a number of years. **[Ap/A]**

## 32 Costs (A Level only)

### Key skills exercises

- 1 See textbook.
- 2 It is never clear, especially with a business producing several products or services and with several departments, what 'proportion' of each overhead should be allocated to each product or department.
- 3 The single product will – from revenue earned from it – have to cover all overheads for the business to make a profit.
- 4 It forces managers to consider the importance of overhead costs.
- 5 Costing a product by only considering its direct costs – and comparing these to revenue to allow contribution to be assessed.
- 6 It makes a contribution and this can be used to help pay overheads and contribute towards profit.
- 7 If the overheads costs allocated to this product still have to be paid by the business – so the cost savings will only be the direct costs.
- 8 It makes a contribution.
- 9 Rent.  
Advertising/promotion.
- 10 Unsure how, if at all, the new business contract will affect overheads – as they are not easily identifiable/allocated such as direct costs.

#### 11 Worked example:

$$\begin{aligned} \text{Full cost} &= \text{Variable} + \text{Allocated overheads} \\ &= [(\$12 \times 40) + \$360] + \$240 = \$1,080 \\ \text{Unit full cost} &= \$27 \text{ per client } \left( \frac{\$1,080}{40} \right) \end{aligned}$$

#### 12 Using full cost:

$$\begin{aligned} 40 \times \$25 &= \$1,000 \\ \text{Total cost} &= [\$12 \times 40] + \$600 = \$1,080 \\ \text{Loss of } &\$80 \end{aligned}$$

$$\begin{aligned} \text{13 Contribution} &= \text{Revenue} - \text{Direct (variable) cost} \\ &= \$1,000 - \$840 = \$160 \end{aligned}$$

- 14 Has the café got the capacity to deal with this order efficiently?  
Have any other businesses offered to use CF facilities and would they pay a higher price?
- 15 May be inaccurate/inappropriate allocation of overhead costs.  
If inaccurate, then inappropriate decisions might be made on the basis of this allocation.

#### 16 Worked example:

For this type of decision we ignore overhead costs. As they are indirect they will not have been incurred as a result of accepting this contract and they will not increase if the contract is accepted. **[K]** Contribution costing is therefore used. If the contract makes a positive contribution to overheads and profit then the total profit of the business will increase. **[A]**

The contribution from accepting this contract will:

$$\begin{aligned} &= \text{Total revenue} - \text{Total variable costs} \\ &= [40 \times \$25] - [(\$12 \times 40) + \$360] \\ &= \$1,000 - \$840 \\ &= \$160 \text{ per event} \end{aligned}$$

$$24 \text{ events per year (2 per month) so total contribution} = 24 \times \$160 = \$3,840 \text{ [Ap]}$$

If there are no other direct costs incurred as a result of this contract (special equipment? overtime for employees?) then CF's annual profit will increase by \$3,840 from accepting the contract. **[A]**

- 17 Outline:** Will the contract increase or reduce CF's profit? Explain the distinction between full costing and contribution costing and explain why contribution costing is more appropriate in this case. Use the results obtained to questions above. What other factors should be considered before the brothers make this decision?

## Exam-style questions

### Paper 3

- 1 a** Outsourcing TV speakers to the foreign supplier seems to be cheaper – \$34 per unit rather than the full cost of making in STV factory of \$44. **[K/Ap]** However, the overhead costs allocated to the speaker division will still have to be paid - they are fixed costs. **[Ap/An]**

They should therefore be ignored when considering the impact on profit of this offer. So the direct cost of STV making speakers is only \$32 per unit which is less than the offer by the foreign supplier. **[An]** So the impact on costs of accepting this outsourcing offer will be an additional direct cost of \$2 per unit – or \$1600 per month. Profit will be reduced by this amount if the outsourcing offer is accepted. **[An]**

I have assumed that the allocation of overhead costs is accurate and that these costs e.g. factory overheads, cannot be quickly allocated to another product e.g. the new proposed home cinema screen division. **[Ap]**

- b** Outsourcing to a foreign supplier will not save on direct costs and allocated overhead costs will still have to be paid. **[K]** The overhead costs allocated to this division will still have to be paid so cannot be included in the 'total costs saved' from accepting the offer. **[An]** It is also not clear which business will pay for the transport cost of the speakers. **[Ap]**

The reduction in profit of \$1,600 per month suggests that the offer should not be accepted and STV should continue to make its own TV speakers. **[Ap/E]**

However, STV is planning to create a new division for home cinema screens. The factory space released from not making speakers could be used for this new project. This means the allocated overhead costs would be transferred from speakers to home cinema screens, making the outsourcing offer appear more beneficial. **[An]** If the \$12 unit overhead costs are now reallocated, then it becomes more likely that the outsourcing offer can be accepted – if it is prepared to lower price by at least \$2. **[E]**

Much depends on the quality of the speakers and the reliability of the foreign supplier. If the speakers' quality is poor then STV's reputation will be damaged and if supply interruptions occur there will be production delays. **[An]** If the CEO can make certain that the foreign speakers will be delivered on time and up to STV's quality assurance standards then the offer could be accepted and the home cinema division could go ahead in the long term.

To make this offer profitable to STV in the short term, however, the CEO must renegotiate the price of the speakers to below the direct cost of STV making them – less than \$32 **[Ap]** and this will then make outsourcing profitable in the short and long term. **[An/E]** If this cannot be done, STV should continue producing the speakers. **[E]**

- 2 a** Direct cost per unit = \$585  
 Revenue per unit = \$900  
 Contribution per unit = \$315  
 Total contribution from order =  $200 \times \$315 = \$63,000$  per month  
 Overhead costs should be ignored in this case as they would have to be paid even if the order was not accepted.  
 Profit will therefore increase by the amount of contribution.

- b Outline:** Yes: contribution made which adds to profit; new contract with retailer – this might lead to subsequent orders; keeps factory busy – increases capacity utilisation; secures workers' jobs; contract will be lost to other manufacturers if STV do not accept it. No: other retailers might want similar deal and if \$900 is lower than the normal price at which STV sells to retailers then overall profit might be reduced. Is there sufficient excess capacity – if not, then overheads will rise to increase capacity. Transport costs – not clear who pays these. Overall conclusion and judgement needed.

## 33 Budgets (A Level only)

### Key skills exercises

- 1 Budget is a planned figure, forecast is a predicted one.
- 2 Helps to allocate effectively the scarce resources that a new business usually has.
- 3 Gives the budget holder and sense of ownership and thus more likely to want to achieve budget.
- 4 No coordination – they might collectively budget total expenditure way in excess of the company's resources.
- 5 By departments discussing and coordinating needs so that resources are allocated on the basis of where they can be best utilised.
- 6 Budgets can become targets for a given future time period – at the end of the time period, the performance of the profit/cost centre against the budget targets can be measured.
- 7 Zero budgets – starting each accounting period with zero budget and then justifying each amount. Flexible budgets – adjusting an existing budget to take into account different circumstances.
- 8 Lower.
- 9 Actual cost lower than budgeted.
- 10 Fixed costs higher than budgeted (e.g. unplanned rise in rents).
- 11 Promotion proved to be more effective than expected and revenue above budget.
- 12 Calculate the variances for the last 12 months.

	Budget \$000	Actual \$000	Variance \$000
Revenue	528	505	23
Direct labour cost	335	346	11
Direct material cost	73	70	3
Allocated overheads	45	48	3

**13 Worked example:**

The revenue variance is (\$23,000), which is adverse as it has the effect of reducing the contribution/profits made by this department. **[K/Ap]**

Labour cost = Adverse.

Material costs = Favourable.

Overheads = Adverse.

- 14 Fewer students enrolled for science courses than expected.

- 15** Fewer students led to lower expense of buying in chemicals and other materials used in experiments.
- 16** Higher wages had to be paid to a good teacher of science in order to stop her leaving the college.
- 17** Helps to allocate scarce resources to the different subject departments.  
Can be used to monitor/assess the efficient operation of each department.
- 18** Incremental as the Principal bases each budget on the performance of each department over several years.
- 19** Too much based on past data – rather inflexible to recent changes.  
No input from Heads of Department.
- 20 Worked example:**  
Zero budgeting means ‘starting from zero’ and the explaining or justifying the budgets for the next future time period. **[K]** This could help GC as last year’s budget might not be a good basis for setting budgets for the next year. If a new Technology department has opened within RC then this could take students away from Science so it would be misleading to just base budgets on last year’s figures. **[Ap]** It would be more accurate to assess, from the new situation, what the demand for and needs of the Science department are now likely to be. Its performance could be monitored more accurately. **[A]**
- 21** Delegate budgeting to Heads of Department is likely to be more accurate. They know the likely costs of e.g. science equipment used in their department.
- 22 Outline:** Explain adverse variances; explain the likely causes of adverse variances in this case; discuss zero budgeting, flexible budgeting and delegated budgeting as ways of making budgets more realistic and accurate. Give an overall conclusion/judgement.
- 23 Outline:** Assess the problems with the current GC budgeting system, and analyse how changes might improve it (consider: zero and/or flexible budgeting; whether Heads of Department should be involved in setting budgets; should GC have monthly budgets that allow changes to be made before the year end?). Finally, make clear recommendations.

### Paper 3

- 1 Outline:** Explain budgets/budgeting; explain benefits – allocating resources between the different supermarket departments; assessing performance against targets; providing targets for departmental managers and employees to work towards, helps achieve coordination between departments. Explain at least two of these in the context of BS (e.g. helping to overcome some of the problems that currently exist).
- 2** See Annotate this answer below.

#### Annotate this answer

##### Paper 3 Q2:

BS now has a system of budgeting which is better than not having budgets at all. However, several improvements could be made to ensure the budgets are even more effective at measuring and monitoring performance. **[K]** Joe and Ros do not seem to involve the departmental managers when setting budgets. **[Ap]** Ros and Joe seem to decide on the budgets and just hand them out to each department as targets to be met. **[AP]** Having targets can be beneficial as it gives a clear focus to each department to work towards. **[A]** However, if it is thought that targets are very difficult or impossible to achieve then they just demotivate. **[A]** This seems to be the case at BS. According to the Frozen Food Department Manager, it was going to be impossible to meet the revenue target for last month because of the planned maintenance programme for the freezers. If the manager had been consulted and had participated in the budget setting then the targets set could have been more realistic and more motivating. **[Ap/A]**

Similarly, if Ros and Joe had bothered to ask, they would have found out that labour costs were going to be higher last month due to maintenance costs for the freezers, which are clearly a direct cost as they do not apply to any other department. **[Ap/A]** It seems unreasonable to criticise the Frozen Food Manager and his department for not meeting a profit target when two factors could have been discussed with Joe and Ros before the budget was set. **[Ap/E]**

Perhaps the most important change that should be made with the BS budgeting system is to encourage participation with managers in setting these monthly targets. **[E]** The managers and their departments will then be much more motivated in trying to achieve them as well as the involvement leading to much more realistic budgets to start with. **[A]**

Other changes that would make budgeting at BS more effective would be to break them down into smaller units. For example, having one big budget for frozen food is less helpful than having budgets for each major range of frozen foods – such as meat, pizzas, vegetables and so on. **[Ap]** This would allow much more accurate monitoring of the sales performance of each type of frozen food and corrective action could be directed to that range of food that was underperforming. This would save managers' time by directing their attention to the range of products that are underperforming. **[A/E]**

The other main change that should be made is the use of zero budgeting for some products rather than 'take last month's figure and add some on' as the Frozen Food Manager seems to be suggesting. This means that the existing budgets will not take into account new ranges being introduced in the shop – which should increase sales. **[Ap/A]** It also means that the monthly budgets ignore seasonal effects and more frozen food might be bought by consumers in the winter as fewer fresh products are available. Again, participation by each departmental manager in the setting of budgets would have allowed these seasonal variations to be reflected in the budgets – which suggests that involvement and participation in the setting of budgets is the key improvement that BS should make. This change should be easy to make at BS because the employees seem loyal and are well respected by senior managers so the introduction of participation should be easy to achieve. **[E]**

## 34 Contents of published accounts (A Level only)

### Key skills exercises

- 1 Wear and tear, obsolescence.
- 2 See textbook.
- 3 It increases.
- 4 Reduces annual profit by the amount of depreciation.
- 5 It reduces it.
- 6 **i** Profit in this year would be low but in later years it would be higher than if annual depreciation was charged against profits.  
**ii** Profit would be low in the year of disposal but higher in other years because depreciation is not being charged against profit.
- 7 Reduces profit and reduces book value of inventories.
- 8 Appears under intangible non-current assets (e.g. when another business is bought for more than net asset value) but is then removed as soon as possible from the accounts (reducing shareholders' equity).

9 See textbook.

10 This would assume that a profit had already been made on them – and profit is only recorded when products have been sold for a price higher than their cost.

11 X = \$700, Y = \$300, Z = \$80. (All figs in 000)

12 **Worked example:**

$$\begin{aligned} \text{New truck: Straight line annual depreciation} &= \frac{\text{Purchase price} - \text{Residual value}}{\text{Length of useful life}} \\ &= \frac{40,000 - 8,000}{4} \\ &= \$8,000 \end{aligned}$$

13		\$000
	Revenue	1,500
	Cost of sales	800
	Gross profit	700
	Expenses (inc. depreciation)	408
	Operating profit	292
	Tax (@40%)	116.8
	Profit for the year	175.2
	Dividends	80
	Retained earnings	95.2

14 Profit is reduced as a result of depreciation – less profit tax too. This profit figure is now more realistic as it includes the depreciated cost of the truck.

15 Tablets are now thought to be worth \$40 (\$160 less 75%) each, not \$120.  
 This value should be used for inventories on the statement of financial position.  
 $500 \times \$40 = \$20,000$  not  $500 \times \$120 = \$60,000$   
 Cost of sales must rise by \$40,000 (as cost of closing inventories is now lower) = \$840,000

16		\$000
	Revenue	1,500
	Cost of sales	840
	Gross profit	660
	Expenses (inc. depreciation)	408
	Operating profit	252
	Tax (@40%)	100.8
	Profit for the year	151.2
	Dividends	80
	Retained earnings	71.2

17 Does not give a misleading value of net book value of non-current assets – use example from above.  
 Makes the declared profit figure and profit tax paid more realistic/accurate – use example from above.

**18 Worked example:**

If the original purchase price of these tablet computers had been used on HC's published accounts then this would have been higher than the NRV **[K]** by \$80 per unit or \$40,000 in total. **[Ap]** This would have led to the cost of sales being too low, tax paid too high and annual recorded profit for the year too high. **[A]** This higher profit figure could mislead stakeholders into believing that the business is performing better than it actually is and could lead to the share price being overvalued. Once the tablets are sold, a loss would have to be recorded on them, 'surprising' stakeholders and possibly resulting in a lower share price. **[A]**

**19 Outline:** Explain how current and non-current assets should be recorded. Analyse the problems of accurate valuation (e.g. depreciation is based on assumptions about realisable value and useful life of asset) and NRV of inventories is based on estimates of the likely selling price of these (when thought to be lower than cost price). Value of intangible non-current assets is also uncertain – only goodwill purchased after buying another business has a certain value – and this can be reduced very quickly as a result of bad publicity, for example. Evaluate whether stakeholders can rely on published accounts based on these points.

## Exam-style questions

### Paper 3

**1 a** Annual straight-line depreciation =  $\frac{\$5m - \$0.5m}{5} = \$0.9m$ .

- b** Useable life of the printing press might be short or longer than five years.  
Realisable value might be more or less than \$0.5m.

**2** See 'Improve this answer'.

### Improve this answer

Missing skill(s) has been annotated.

#### Paper 3 Q2:

Non-current assets are those that are expected to be owned and used for more than one year. They include property, machinery and vehicles. **[K]** Current assets include trade receivables and inventories. The valuation of most of these assets can never be entirely accurate. How much is a plot of land or a building worth? The only way to find out is to sell these assets which PBP presumably does not want to do. **[A]** Therefore, estimates have to be made each year when the accounts are published. With PBP's site, bought 30 years ago, it would be really misleading if the original purchase price was still being used on the accounts. **[Ap]** The value has probably appreciated greatly – but by how much? Any estimate used on PBP's accounts might be inaccurate and HZP might have some property experts who believe that the site is worth more than PBP's accounts actually state. **[A]** If PBP wanted to relocate, it could sell the city centre site for a high price and find a cheaper site out of town – this would give a once and for all profit on the published accounts if the city centre site had not been revalued to keep up with inflation. **[Ap/A]**

Equipment and machinery depreciates. As the CEO said, with the pace of change, depreciation is now more difficult to predict. If assets such as a printing machine go out of date more quickly than expected, it might have to be replaced 'early' and this means that the annual depreciation and net book value have been calculated inaccurately. By not recording sufficient depreciation each year, the machine might have to be sold before 5 years for less than its net book value – so resulting in a loss being recorded on the accounts. **[Ap/A]**

Intangible assets are difficult to value. PBP has a patent on a printing process and it is not clear how this has been valued. If it would cost a rival business more than \$1m to develop a similar process, then PBP has probably under-valued its intangible assets. **[Ap]** This means that firms that potentially might want to take over PBP in future would be bidding too at a price less than the value

of the business – which would be serious for the current shareholders. [A/E]

Current assets are also difficult to value accurately especially debts which might turn out to be ‘bad’ and inventories. PBP might have some paper inventory which has been damaged in a water leak – how should this paper now be recorded on PBP’s accounts? It would be misleading, perhaps, to record it as being valued at its original purchase prices – as shareholders and others would be given a misleading profit figure which could lead to dividend payments being higher than the business could afford. [A/E]

The valuation of all of these assets obviously affects the total value of the business, the value placed on it by shareholders and other stakeholders and the annual recorded profit. So, it is very important that PBP make every effort to record the value of these assets as accurately as possible. [E]

## 35 Analysis of published accounts (A Level only)

### Key skills exercises

- 1 Operating profit lower than last year.  
Capital employed has increased but this has not yet led to a higher profit figure.
- 2 It means that inventories are not left lying idle for a long time – they are quickly used/sold after they arrive from suppliers.
- 3 The production process might be very different (e.g. shipbuilding will have much ‘work-in-progress’ yet a small pottery business will have a much lower value of work-in-progress inventories).
- 4 Reduce it.
- 5 Dividend per share increases.  
Share price falls.
- 6 This suggests that the management are keeping a high proportion of profit for the year as retained profit to finance expansion of the business.
- 7 See textbook.
- 8 Earnings per share falls.  
Share price increases.
- 9 Use JIT to manage inventories more efficiently.
- 10 By repaying long-term loans with finance raised from a rights issue of shares.
- 11 **Worked example:**  

$$\text{RoCE \%} = \frac{\text{Operating profit}}{\text{Capital employed}} \times 100$$

$$= \frac{7}{35} \times 100$$

$$= 20\%$$
- 12  $\frac{6}{38} \times 100 = 15.8\%$
- 13 Lower operating profit.  
Higher capital employed.
- 14  $\frac{16}{35} \times 100 = 45.7\%$

- 15**  $\frac{19}{38} \times 100 = 50\%$
- 16** Gearing ratio quite high at 50% – caused by increase in non-current liabilities at faster rate than capital employed.
- 17** Cost of goods sold/inventories.  
2016 = 19  
2017 = 10
- 18** Value of inventories has doubled – perhaps because the latest design of sports show has not sold well.
- 19** Trade accounts receivable  $\times$  365/revenue.  
2016 =  $\frac{3 \times 365}{40} = 27$  days  
2017 =  $\frac{4 \times 365}{42} = 35$  days
- 20** Customers being given longer to pay.  
Poor credit control.
- 21** 2016 =  $\frac{2}{15} \times 100 = 13.3\%$   
2017 =  $\frac{2}{12} \times 100 = 16.7\%$
- 22** Higher in 2017 because dividend per share remained the same but the share price had fallen.
- 23** 2016 =  $\frac{15}{4} = 3.75$   
2017 =  $\frac{12}{3} = 4$
- 24** This has increased despite the fall in earnings per share because the share price has fallen by relatively more.
- 25** Share price has fallen by 20% perhaps because of the worsening performance of the business.
- 26** Interest rates might increase – this will increase the finance expenses of the business as they have relatively high debts.
- 27** Increase revenue at a faster rate than inventories.  
Reduce inventories by better management of them.
- 28 Worked example:**  
One way in which RoCE could be improved would be to sell off under-performing assets or assets no longer required by SG and use the finance raised to pay back some loans. **[A]** This would reduce the capital employed in the business and if operating profit was not affected, the RoCE would increase. **[A]** Although the land for the factory extension has only just been purchased, sales of the latest shoe design are disappointing so additional factory space might not be required so the land could be resold. **[Ap]**  
  
Second way: Take measures to increase operating profit. Apply this suggestion to SG and analyse how it will increase RoCE
- 29 Outline:** Explain the most significant changes to the accounting results; explain how profitability could be improved; how gearing could be reduced; how inventory turnover could be raised and accounts receivable reduced. Evaluate these measures. Conclude with a justified statement about which ratios need to be improved most rapidly and how this might be achieved.
- 30 Outline:** Consider what the two stakeholder groups are looking for in accounts. Would more years' results be useful? Comparison with other companies – but which ones? Would other ratios be useful too? Are the accounts 'window dressed'? The Finance Director seems to be considering this for next year. You will need to give an overall conclusion.

## Exam-style questions

### Paper 3

- 1 a  $\text{Dividend cover} = \frac{\text{Profit for year}}{\text{Total dividends}} = \frac{\$10\text{m}}{\$5\text{m}} = 2$
- b See 'Improve this answer'.
- 2 **Outline:** Explain what the two ratios show and how they are calculated. RoCE can be increased by taking measures to increase operating profit and/or reducing capital employed while keeping operating profit constant. Inventory turnover can be increased by managing inventories better (JIT – would this be workable in this context?) and by increasing sales/cost of sales but keeping inventories constant. Assess the suitability/possibility of these measures and make an overall judgement/conclusion in the context of ABL.

### Improve this answer

Missing skill(s) has been annotated.

#### Paper 3 Q1b:

Shareholders might have mixed feelings about the performance of ABL but, generally, they will be disappointed. Dividend payments were higher this year than last and shareholders want high dividends – as long as this does not reduce the company's ability to invest and expand for the future. **[A]** High dividends can reduce retained earnings – an important source of internal finance and the low dividend cover ratio is a potential problem for the business as the level of dividends leaves a low level of retained profit. It could be that ABL are trying to 'keep shareholders quiet' by increasing dividends even though other aspects of the company's performance – such as lower RoCE and financial performance ratios – is much weaker than last year. **[Ap]** A higher PE ratio is usually a good sign for shareholders but not if it is caused by a lower earnings per share figure, which could be the case here as the share price is likely to have fallen. **[Ap/E]**

Shareholders also want high share prices. We are not told what the share price is and this is essential information before a final assessment of shareholder satisfaction can be made. **[E]** They will not be pleased about the lower RoCE or the higher gearing and lower inventory turnover.

So, on balance, the shareholders are unlikely to be satisfied with ABL's performance but a full judgement can only be given when more than two years' results are considered and if comparisons are made with other similar businesses. If they have all suffered from a worsening performance then this makes ABL's ratios less of an immediate concern. **[E]**

## 36 Investment appraisal (A Level only)

### Key skills exercises

- 1 The net cash flows, when added together, will exactly equal the investment cost of the project at the end of the third year.
- 2 Less risky, reduces interest costs, reduces opportunity cost of finance tied up in project.
- 3 Makes no attempt to calculate the profit of a project.
- 4 The annual average rate of return on the initial investment is 13%.
- 5 Investors generally want to make a high return on their investment – it is a reward for risk-taking.
- 6 Does not include the timing of cash flows.

- 7 Reducing the value of a future cash flow to its present day value.
- 8 Total discounted net cash flows less capital cost = \$3.6m.
- 9 It would be lower – the discounted net cash flows would have lower value.
- 10 Difficult to compare returns from projects that cost very different amounts.
- 11 The net cash flows, when discounted and added together, equal the initial capital cost after two years.
- 12 It would be longer than two years.
- 13 This is the rate of discount that when applied to the net cash flows, leads to the sum of them being equal to the capital cost of the project.
- 14 Environmental impact.  
Ethical impact.  
Degree of risk that is acceptable to managers.

**15 Worked example:**

1 year and  $\frac{10}{12} \times 12$  months  
= 1 year and 10 months

**16** 1 year and  $\frac{6}{8} \times 12$  months = 1 year 9 months

- 17** Reduces interest costs on borrowed funds.  
Releases capital more quickly for reinvestment.

**18** A: Average net cash flow =  $\frac{32}{4} = 8$

ARR =  $\frac{8}{20} \times 100 = 40\%$

B:  $\frac{20}{4} = 5$

$\frac{5}{12} \times 100 = 41.7\%$

- 19** Very little difference – as there is always an element of doubt about the accuracy of net cash flow forecasts, these results are virtually the same.

20	Year ending	Site A	DCF	Site B	DCF
	0	(20)	(20)	(12)	(12)
	1	10	9.1	6	5.46
	2	12	9.96	8	6.64
	3	14	10.5	8	6
	4	16	10.88	10	6.8

Net present value of A = \$20.44m

Net present value of B = \$12.9m

Year	1	2	3	4
Discount factor at 10%	0.91	0.83	0.75	0.68

Net present value of A = \$20.44m

Net present value of B = \$12.9m

- 21**  $A = 2 \text{ years} + \frac{0.94}{10.5} \times 12 = 2 \text{ years } 1 \text{ month}$   
 $B = 1 \text{ year } 11.8 \text{ months}$
- 22** These are both longer than the non-discounted payback because discounting reduces the value of net cash flows to their present-day value.
- 23 Outline:** There is little to choose between these two sites – if management want a quicker payback (perhaps interest rates are very high), then B is preferable. This applies with ARR too as the rate of profit is higher for B. NPV is greater for A but the costs of the two projects are different so it is difficult to compare NPVs.  
 Need to compare with criterion rate and calculate IRR.
- 24 Outline:** NPV allows an analysis of the profit from these projects using discounted returns. This is more useful than using ARR when the projects' cost about the same as it is important to consider that returns in the future have a lower value than the present-day cost of the projects. NPV takes both the speed of return and the value of next cash flows into account. The problem here is that the cost of the projects is too different for NPV to be a crucial factor – although it does show that both projects will be profitable at a discount of 10%.
- 25 Worked example:**  
 IRR is the discounted rate of return on an investment. It is that rate of discount which, when applied to the future net cash flows, will give a result of zero. The higher the IRR the more profitable the investment project is. **[K]** As Site B has a slightly quicker payback and a slightly higher ARR it might seem best to opt for this site. **[Ap]** However, it has a lower NPV – but this is not surprising given that it is a much cheaper project. IRR is not distorted by the cost of the project and it gives the true discounted rate of return, taking both the cost and future next cash flows into account. In this case it would allow a better way of comparing the profitability of these two projects. **[A]**
- 26 Outline:** Calculate NPV (\$m) too –  $A = 20.44$ ;  $B = 12.9$   
 Analyse these results. Explain why criterion rates should be compared with actual results. Analyse the qualitative data. Are the NPV results the most useful of all? But the cost of the projects is different. Discuss the importance of this and suggest what other data would have been useful and why. Overall conclusion/judgement.
- 27 Outline:** Consider the likely accuracy of the forecasts, the relative importance of qualitative factors, and how IRR might help in the decision. Justify any additional information you think might be useful.

## Exam-style questions

### Paper 3

- 1 a** Discounted payback for A =  $2 \text{ years} + \frac{16.62}{71.46} \times 12 \text{ months} = 2 \text{ years } 2.8 \text{ months}$ .  
 Discounted payback for B =  $2 \text{ years} + \frac{4.765}{35.73} \times 12 \text{ months} = 2 \text{ years } 1.6 \text{ months}$ .
- b A** Annual average =  $\frac{320}{5} = 64$   
 $\text{ARR}\% = \frac{64}{150} \times 100 = 42.7\%$
- B** Annual average =  $\frac{155}{5} = 31$   
 $\text{ARR}\% = \frac{31}{85} \times 100 = 36.5\%$

**c** A NPV = \$217,300

B NPV = \$105,115

**d** Very little difference in the discounted payback results – but a faster payback is always an advantage. ARR of A is higher than B – suggesting a slightly more profitable investment project – so if the qualitative factors are similar, this could be a crucial factor. NPV of A is much higher – and they both appear to be profitable investment projects at a rate of discount of 8% – but this is to be expected as A costs so much more than B.

**2** See ‘Improve this answer’.

### Improve this answer

Missing skill(s) have been annotated.

#### Paper 3 Q2:

The discounted payback is slightly quicker for B and if the finance is to be borrowed then this makes it a better investment as slightly less interest will have to be paid on each \$ borrowed as it will be paid back faster. **[K/A]** However, the difference is very small and may not influence the final decision. **[E]**

The ARR for A is higher but we are not told what SCC’s criterion rate of return is. This is crucial as the ARR needs to be compared with the minimum rate of profit that the business is prepared to accept. **[E]** It is likely to be less than the 42.67% ARR result – which seems very high so the forecasts might be inaccurate. However, NPV is less useful than ARR/IRR when the cost of the two projects being compared is so different. **[E]** More information about how these forecasts were obtained by Pat’s brother would have been very useful. **[Ap/E]**

The NPV is much higher for A – but then we would expect this as it costs twice as much. The question is, what is the discounted rate of return – the IRR? This would have given a more realistic assessment of the future profitability of these two machines compared to the cost of buying them. **[A/E]** Qualitative factors need to be considered too before a final decision can be taken. We are not told about the level of risk that the brothers are prepared to accept or whether the demand is sufficient to justify the fully automated machine. **[E]** Will either machine have any impact on the quality of the finished product? More information about this would be important. **[E]**

On balance, I would recommend opting for machine A as it is much more of a technological leap than machine B so it is likely to keep the business more competitive for longer. **[E]** However, one final issue needs to be considered and that is the availability of finance for this much more expensive machine. If SCC would struggle to afford this machine or if it would raise the gearing ratio too much if the finance was borrowed, then Machine B should be chosen. **[E]**

### 37 What is strategic management?

#### Key skills exercises

- 1 See textbook.
- 2 Tactical – which payment method to use for employees.  
Strategic – whether to take over a rival social media business.
- 3 Market development abroad – this will require a new structure for overseas operations – possibly decentralised.
- 4 Low-cost advantage or product differentiation.
- 5 Open a new route between two airports not currently linked.
- 6 For example:  
Tactical – pricing of shirts and dresses – easy to reverse these decisions.  
Strategic – cutting production costs by switching production to low cost countries – difficult to reverse this decision.
- 7 Low-cost strategy – trying to undercut rivals.
- 8 **Worked example:**  
Finance is one of the sources that will influence OC's future strategies. **[K]** Strategy C might be expensive and OC's profits have been falling – so internal finance might not be available. **[Ap]**  
Green/ethical consumerism – will low-cost producers who do not pay workers in low-cost countries reasonable wages suffer a consumer backlash?
- 9 **Worked example:**  
OC is organised along functional departments and seems to have a hierarchical structure. **[K]** We know this because outsourcing HR responsibilities will involve the loss of many middle and junior managers' jobs. **[Ap]** Strategy B will require a structure that manages the operations in country Y. One option is to have a team of managers from each functional department with responsibility for managing operations in country Y. This geographical structure could be semi-independent to increase delegation and to ensure that the marketing and cultural differences in country Y are reflected in OC's operations in that country. **[A]**
- 10 For example: Operations – the company will have to hold higher inventories itself.  
HR – additional workers will be needed to pack and despatch products to customers.
- 11 For example: takeover another low-cost producer to gain even further cost advantages.  
Merge with a well-known fashionable clothing brand which might allow OC's products to be promoted to higher-income market segments.
- 12 **Outline:** Analyse the nature of strategy and strategic management, why it is important to this business's future and why the uncertain business environment might mean that any strategic decision does not guarantee future success. Assess whether the success of OC will be limited by failure of Rajev to use strategic analysis. However, is his 'strategic vision' important to OC's success?

## Exam-style questions

### Paper 3

- 1 See 'Improve this answer'.

#### Improve this answer

The missing skill(s) has been annotated.

#### Paper 3 Q1:

The world's markets are becoming increasingly competitive due to globalisation which is mainly encouraged by free trade agreements. A business must take important business decisions to survive. Very often these decisions are strategic in nature – such as selling in other countries, diversifying or increasing product differentiation. According to Porter the two main ways in which a business can gain or retain competitive advantage is through either low costs or effective product differentiation.

Strategy A would increase OC's profit margins as long as the additional costs of holding inventories and despatching goods to individual consumers did not exceed the profit margin taken by retailers. This would then allow OC to offer even lower prices and be more competitive – but it would have to allow for the cost of 'returns' from customers. Also, many other businesses are adopting this strategy so would OC actually gain a real advantage or would it just avoid losing competitiveness? **[E]** However, lower costs should allow OC to keep prices very low and stay competitive that way.

Differentiation – e.g. by means of Strategy C **[Ap]**– means making the product so different and so desirable that prices becomes much less important. Low costs of production are not necessary with this second strategy so even if Weartex is expensive to produce, OC should be able to charge much higher prices for products made using this innovative material. Differentiation is used by Swiss watch makers, for example, but they already have an excellent reputation. Would OC be able to build up its brand image sufficiently with the new material and the products made from it to allow for higher prices to be charged? **[Ap]** This will be essential for this strategy to be profitable. **[E]** However, it can be expensive to differentiate products and services as the cost of buying the rights to Weartex might exceed the additional revenue. OC would also have to spend money on promoting these new clothing products to gain sales and improve its brand image.

Strategy B could be the most successful of these alternatives. The market conditions seem favourable – although more information about country Y would have been useful. For example, is the age profile of the population suitable for the products that OC produces? The rising incomes and falling unemployment seem to be good economic conditions for OC's products as the demand for them is likely to be income elastic. As country Y's currency exchange rate is appreciating, this is favourable to importing businesses **[Ap]**– as OC would become if it sold to Y. OC could gain a very important competitive advantage in country Y if it ensures that its products are suited to the market tastes and cultural demands of this country. If it is one of the first multinational clothing businesses to set up a marketing division in country Y then this is the strategy most likely to result in a competitive advantage – in country Y at least. **[E]**

## 38 Strategic analysis (A Level only)

### Key skills exercises

- 1 Before an important decision can be made, the internal strengths and weaknesses and the external business environment need to be analysed to help increase the chances of an appropriate strategy being devised and decided on.

- 2** To indicate to stakeholders what the business hopes to be like and hopes to achieve in future.
- 3** To indicate the stakeholders what the primary purpose of the business is.
- 4** Strengths and weaknesses.
- 5** Strength – number of followers/subscribers; weakness – may lack sufficient numbers of creative and innovative employees; opportunity – to increase revenue from sale of advertising; threat – bigger social media firms exist.
- 6** See textbook.
- 7** Buyer power, supplier power, ease of substitution, ease of entry.
- 8** See textbook.
- 9** Seems to have a dynamic CEO with strategic vision.
- 10** Use of low-cost countries to produce clothes could result in consumer backlash if workers are treated unethically.
- 11** Legal controls over wage levels, even in low-cost countries; changes to patent laws if Weartex is purchased.
- 12 Worked example:**  
One economic factor could be exchange rates. As Strategy B involves selling OC products to country Y for the first time, a depreciation of country Y's exchange rate would make OC products more expensive there than originally planned.  
  
Second factor – Changes in profit tax – reduces retained profit which could have been used to buy Weartex.
- 13** The innovative material could be used for a range of clothing products and perhaps even for products other than clothing (e.g. car covers, umbrellas). This will help to distinguish OC in the market place.
- 14** Student's own answer.
- 15** 'Problem child'.
- 16** Depends perhaps on student's answer to Q14 but in general terms a mission statement should provide focus and direction for the business and its employees and indicate to external stakeholders the central purpose of the business.
- 17** Subjective – a different director might arrive at a different set of factors and weight them differently.  
Outdated quickly (e.g. the competitor coming to market with the new synthetic material will change the threats to OC).
- 18** Age distribution – could affect demand for outdoor/ski clothing.  
More women working – OC could now choose from a wider 'pool' of potential employees when recruiting for staff (e.g. to help manage its online selling operations).
- 19 a** Buyer power increases and this increases the degree of competitive rivalry for OC.
- b Worked example:**  
This increases the threat of substitute products from being developed and it might also reduce barriers to entry. **[K]** If buyers of outdoor clothing now prefer the clothing ranges produced using this cheaper material, then competitive rivalry increases for OC. **[Ap]** If new businesses are encouraged to come into this market because it is now cheaper to produce and use synthetic materials in outdoor clothes then, again, competitive rivalry increases for OC. As this market becomes more competitive, OC might consider other strategies to improve its competitive position. **[A]**

- 20** Explain Boston Matrix and use data in table to identify which category each product seems to be in. OC could stop selling leisure trousers (divest) – but would it be better to redesign them? OC could use cash from ‘Sun stop’ shirts to invest in promoting Snow Coat jackets more effectively.
- 21 Outline:** Explain the purpose of strategic analysis and how two or three techniques of strategic analysis could be useful for OC in this case. Evaluate the effectiveness of these techniques; for example, are they subjective? Does the data they collect become out of date quickly? Would Rajev really benefit from strategic analysis in this case?
- 22 Outline:** Explain both of these models; apply them to OC (e.g. will Weartex become a core competence; are there any other features of OC that could become a core competence? How are buyer power and supplier power likely to change over time and will the new synthetic material reduce entry barriers?) Analyse how these points could affect future strategic choices for OC. Evaluate the models (e.g. the analysis of both must be kept up to date in a fast-changing market; consider that other models might be even more useful).

## Exam-style questions

### Paper 3

- 1** See ‘Improve this answer’.
- 2 Outline:** Consider Porter's Five Forces and the Boston matrix. Explain these techniques/models. Apply them carefully to HPS. Assess the advantages and disadvantages of them in the context of HPS. Weigh up whether they are likely to be more or less useful than SWOT and PEST.

### Improve this answer

The missing skill(s) has been annotated.

#### Paper 3 Q1:

SWOT analyses the internal and external factors that will influence the future direction and success of a business. It helps to suggest or formulate appropriate strategies for the future. SWOT is useful in this case for identifying key internal strengths of HPS such as the committed workforce. This can be really important specially to the maker of a technological product where motivated employees and a low labour turnover can increase labour productivity. On the other hand, the ageing workforce is a problem as to replace skilled workers who retire could prove difficult. This might make a joint venture operation in an African country, with a large and youthful population, a good strategy to adopt.

The external opportunities also indicate potential future strategies especially developing hybrid power systems for cars. This could use the ‘core competence’ of HPS in another sector of the vehicle market and would appear to be a viable option for the future. The external threats are serious and HPS may need to protect itself from these by, for example, insisting that patents are observed and intellectual capital retained in the business. This might need to be done before considering any future strategies for growth to allow existing operations to remain profitable. So SWOT analysis would help to indicate which future strategies HPS might adopt. However, in assessing SWOT there is often an element of opinion and subjectivity because no two managers are likely to have the same opinion about these factors. However, it is a widely used form of strategic analysis and would be a good starting point for HPS. **[E]**

PEST analysis looks beyond HPS and analyses market and ‘macro-environment’ conditions. It seems that pressure group activity and possible legal changes will continue to increase the demand for the most environmentally friendly engines – but complete vehicle bans would be bad for HPS.

The economic conditions have rather a conflicting effect on HPS. Higher interest rates will increase the cost of loans for a new strategic option. However, as the business is a public limited company it might be able to raise capital from sale of shares and reducing the company’s dependence on loans. A currency depreciation will make country X’s exports cheaper abroad so the export of hybrid

power systems to a BRICS country will make that bus operation more profitable. PEST analysis can be quickly overtaken by events, however. It needs to be updated frequently to be of much value as, for example, significant economic or technological changes that were not forecast could have a substantial impact on the most appropriate future strategies for HPS. [E]

So it is clear that the SWOT and PEST analysis provide really useful data that allows HPS directors to consider a range of strategic options for the future. These are not the only techniques that could be used, however. Porters 5 forces, in particular, would allow HPS to assess the likely competitive rivalry in both bus manufacturing and hybrid engine markets. If it could be established that, for example, hybrid engine technology was less competitive and offered HPS fewer potential rivals than bus manufacturing then this could prove to be a more useful form of strategic analysis than either SWOT or PEST. [E] Strategic analysis such as this is essential before the choice of appropriate strategies is made as the options being considered by HPS involve substantial resources and would be very difficult to reverse once a decision was taken. [E]

## 39 Strategic choice (A Level only)

### Key skills exercises

- 1 Resources will usually not allow all possible strategies to be pursued.
- 2 See textbook.
- 3 Diversification – new markets and new products.
- 4 Student’s own answer.
- 5 See textbook.
- 6 Putting a quantitative value of each driving or restraining force can be subjective.
- 7 Because the likely chance of success/failure is an important consideration in decision- making and probabilities therefore affect the ‘expected monetary values’.
- 8 See textbook.
- 9 Assessing the probabilities is subject to inaccuracy.
- 10 A = market penetration; B = market development.
- 11 Taking over a food retailer.
- 12 Diversification.
- 13 These are very difficult to predict and they are one of the main uncertainties and potential inaccuracies of decision trees. A lower ‘chance of success’ will reduce the final Expected Monetary Value of any one of these strategies.
- 14 **Worked example:**  
 Node 1 =  $(\$20\text{m} \times 0.8) + (\$4\text{m} \times 0.2) = \$16.8\text{m}$   
 Node 2 =  $(\$12\text{m} \times 0.6) + (\$2\text{m} \times 0.4) = \$8\text{m}$   
 Node 3 =  $(\$40\text{m} \times 0.7) + (\$2\text{m} \times 0.3) = \$28.6\text{m}$
- 15 A – Cut advertising costs even further.  
 B – Ensure that income elastic products are made available in country Y as soon as possible.  
 C – Takeover competing business with similar material to reduce competition.
- 16 A – Sales representatives offered other jobs.  
 B – Improve language training for employees.  
 C – Try to reduce cost of buying patent.

- 17** Classify products according to market share and market growth.  
Take decisions about the product portfolio based on this analysis (e.g. should any action be taken with Ski jackets?).
- 18** Estimates of probabilities may be subjective and likely to be inaccurate.  
Estimated payoffs or financial outcomes are not based on previous similar decisions so could also be inaccurate.
- 19** Identify the constraining forces that could be reduced most easily.  
Identify the driving forces that could be increased most easily.
- 20 Worked example:**  
One limitation is that the allocation of values to each constraining or driving force can be subjective. **[K]** Why did 'language barriers' obtain the value it was given? **[Ap]** If these values prove to be inaccurate then the benefits of using force-field analysis are much reduced and other techniques become more important. **[A]**
- Second limitation: Have all of the constraining and driving forces been correctly identified (e.g. transport issues with Strategy B)?
- 21 Outline:** You need to select data carefully and you should refer back to Chapter 37 – do not try to comment on all data available. Analyse the significance of some data for all three strategies. Compare the results (expected monetary value of A = \$6.8m; B = \$2m and C = \$13.6m). Evaluate the data and the techniques used. Make an overall decision – explain why you have made this decision and why you reject the other strategies.

## Exam-style questions

### Paper 3

- 1** See annotated answer below.

#### Annotated answer

The missing skill(s) has been annotated.

#### Paper 3 Q1:

Strategic choice is a very important part of strategic management. Taking poor strategic decisions can result in business failure. **[K]** Much is at risk with HPS as failure to respond effectively to increasing environmental concerns and the threat of 'hydrogen' engines could lead to years of low growth and low profit. **[Ap]** The capital cost is \$50m higher for Strategy 1 and this could cause financing problems for HPS. **[Ap]** If cash is not available internally then a share issue or a loan will be required. A share issue could dilute control of existing owners and a loan will increase the gearing ratio, adding to the risk of the investment. **[A]** It would have been helpful to have investment appraisal results other than IRR as if the payback is quicker for Strategy 1 than 2, then the additional initial investment might not be that significant for this plc. **[E – explaining why additional information would have been useful]**

Risk is a key element in this case as neither option is market penetration – the least risky growth strategy. **[K]** A high risk reduces expected values on the decision tree and this could be why the expected value is less for Strategy 1 than 2. Although buying a bus manufacturer keeps HPS in a related industry to hybrid power systems, building buses in a low-cost country, thousands of kilometres away from the base country, is a completely different operational situation to building complex power systems in Europe. **[Ap/A]** The fact that 'lack of synergy' is the biggest constraining factor in force field analysis suggests that there is a real risk that these two manufacturing businesses, when integrated, will not offer the cost or marketing benefits that might be expected. **[Ap/An/E]**

There are risks and uncertainties with Strategy 2 as well. US and European management cultures are not the same and there is a real danger that there could be a clash of management styles that prevents this new joint venture from working. For example, each group of managers might assume that they are the ones in overall charge of this new engine project. **[Ap/A]** Setting up operations in an African country might offer a keen and youthful potential workforce but it will need training to be effective and there might not be any local suppliers of components. This might add to the overall cost of the project. **[A]** In addition, product development is always potentially risky. It might not be physically possible to devise a new type of engine which is even more efficient and environmentally friendly than the new hydrogen-powered one being developed by competitors. In such a case, the investment will be largely wasted. Innovative products do not always result from research and development. **[E]**

Overall, I would recommend OC to choose Strategy 2. **[E]** It is cheaper, has a higher discounted rate of return (IRR) and offers a higher monetary value, after deducting the initial cost. The data in Table 2 contains some of the most convincing evidence. Although the demand for BRICS built buses is forecast to grow, environmental pressures (especially in the EU) mean that these new buses will need even more efficient and 'greener' engines than the current hybrid ones. These engines could come from Strategy 2. Also, the rapid growth in EU labour rates suggests that an African manufacturing base for a newly developed power system will offer significant cost savings. **[Ap/A]**

However, before making a final decision I would expect more detailed information such as the estimated payback period of both projects and much more information about how the risks and financial data were estimated. **[E]** These techniques are only as accurate as the data they are based on. I am not confident that these forecasts from the Operations Director are totally reliable – especially as he seems in favour of Strategy 2 to start with. **[E]**

## 40 Strategic implementation (A Level only)

### Key skills exercises

- 1 Making strategic choices is not the end result of strategic management – putting these strategies into effect and managing/leading the changes they involve is the vital last stage – as well as assessing the success or failure of the strategy.
- 2 See textbook.
- 3 Helps make sure that resources are available.  
Makes managers consider the future.
- 4 Can become outdated quickly with external environmental changes.  
Managers may become too tied to the plan and it becomes inflexible.
- 5 See textbook.
- 6 See textbook.
- 7 See textbook.
- 8 Leading change – providing the vision that makes people want to follow and accept change;  
managing change – ensuring the resources and processes needed for change are in place.
- 9 Student's own answer.
- 10 See textbook.

- 11** Resources need to be made ready (e.g. finance, employees, operational resources).  
Helps to ensure that functional departments are coordinating their work towards the goal of each strategy.
- 12** Operations management seems to have a power culture; Clothing design seems to have a person culture.
- 13** If Strategy A were chosen the CEO could lead the changes by: Explaining to all employees the need for change and how the impact on sales representatives would be managed.  
Providing a clear vision about what this change to online selling will lead to.
- 14 Worked example:**  
One reason why the crisis was badly handled is that there appeared to be no contingency planning. **[K]** 'We were taken by surprise' suggests that OC's managers never even considered the possibility of a factory fire and therefore did not plan for this contingency. **[Ap]**  
Contingency planning would have given managers experience in what to do and they would have reacted much more quickly than they did. **[A]**  
  
Second reason: Failure to communicate with workers and suppliers led to confusion and uncertainty. An effective contingency plan would allow for communication with stakeholders.
- 15** Need to explain to stakeholders and inspire them about what the future holds for the business after buying this important patent and 'where it is likely to be'.
- 16** It is not just about ensuring that resources are in place to sell to another country. There needs to be a vision about what this means for the business.  
There also need to be clear reasons given why this change is considered necessary.
- 17** Financial costs (e.g. having to reproduce all of the records lost).  
Reputational damage – being seen as unprepared for the crisis caused by the fire.
- 18 Worked example:**  
Benefit 1: Under Rajev's leadership OC's culture seems more interested in cutting costs and increasing returns to shareholders than looking after other stakeholders. **[K/Ap]** Factory workers are paid low wages, some marketing employees might lose their jobs with Strategy A and customers might be misled by the 'sale' pricing claims. **[Ap]** A corporate culture that put people first and not profit might lead to good publicity, a positive brand image and a quicker response to crises. **[A]**  
  
Benefit 2: Perhaps a more task-based culture would be appropriate (e.g. teamwork to analyse the impact of these three new strategies and to help decide which one to adopt). This will give a greater sense of 'ownership' of the changes that need to be made.
- 19 Outline:** Explain the business changes needed within OC if Strategy A is chosen (e.g. large increase in IT employees, bigger warehouse as retailers will not be holding inventories, loss of jobs of selling staff who used to sell to and communicate with retailers, direct contact with customers so OC must have, for example, social media systems in place to deal with these contacts). Vision needed, resources needed, keep employees informed, get them to accept need for change, re-employ sales staff. Rajev's culture would probably have led to poor leadership – will the new CEO have the qualities needed to change culture too?
- 20 Outline:** Explain business culture and why a change in business culture is often necessary.  
Explain why a change in culture might be important to the future success of OC – what problems might the business experience in future if the culture created by Rajev was not changed? Is it the first priority: Yes: needs to reassure all stakeholders that things 'will be different from now on'; this will help to retain employees and stop investors from selling shares (for example). No: Need to rebuild the factory as first priority to get production going again. Overall conclusion/ judgement required.

## Exam-style questions

### Paper 3

- 1 See annotated answer below.
- 2 **Outline:** Explain the potential consequences of a crisis such as this, which is not well managed by, for example, trying to cover up the incident (e.g. the impact on the image of the company and potential bad publicity). Analyse how effective contingency planning/crisis management seems to have reduced the impact of this crisis – could it even have reduced the chance of it occurring? What impact would the new power supply invention have on HPS? Would it lead to a new core competence? Could inadequate management of this crisis put the business in such a risky position with consumers and government (if laws have been broken) that even a new power supply invention will be insufficient to lead the company towards future success?

### Annotated answer

The missing skill(s) has been annotated.

#### Paper 3 Q1:

Strategic implementation means putting a strategy into effect in a planned way with the purpose of reaching a desired objective. **[K]** Both of these options are major strategic decisions involving significant change and substantial resources. Detailed corporate and departmental planning will be needed including contingency planning. **[K]** For example, a political crisis in the country where the buses are manufactured could prevent production from continuing. HPS will need to plan for this and other eventualities and the distance between the country and where HPS is based will make handling ‘disasters’ more difficult. **[Ap/A]**

Adequate resources must be prepared especially finance and people. Both options will require much finance and HPS must plan for this or it might face liquidity problems later. **[K/Ap]** A share issue, as it is a plc, could possibly be sufficient to provide the finance needed for either option. Employees with foreign language skills might be required for either option e.g. the language spoken in the BRICS or African country might not be the same as the language spoken within HPS. **[Ap]** HR recruitment strategies must take this into account. HR could undertake a workforce audit to see if any existing employees have foreign language skills or have expressed an interest in working overseas. **[Ap]**

These options may take away vital resources from HPS’s existing operations which could be damaging especially as the business is getting over the hybrid engine explosion. **[Ap/A]**

Managing these resources will be important. However, of even greater importance will be the need to lead the change. **[E]** A clear vision will be needed to reassure workers, shareholders and other stakeholders that HPS has a clear objective and sense of purpose for whichever option is chosen. **[A]** The directors will have to explain the reasons for the chosen strategy and the objectives of it – to employees and other stakeholders. For example, Strategy 2 seems to fit in best with the original mission statement of HPS so the vision for this strategy would be well understood by most stakeholders. **[Ap/A/E]**

Successful implementation of either strategy will be vital to success of HPS as failure could put at risk the entire business given that it faces increasing competitive rivalry from the company developing the hydrogen engine. **[E]**