

# Markscheme

**May 2022**

**Business management**

**Standard level**

**Paper 2**

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**The markbands and assessment criteria on page 3 should be used where indicated in the markscheme.**

<b>Marks</b>	<b>Level descriptor</b>
<b>0</b>	The work does not reach a standard described by the descriptors below.
<b>1–2</b>	<ul style="list-style-type: none"> <li>• Little understanding of the demands of the question.</li> <li>• Few business management tools (where applicable), techniques and theories are explained or applied, and business management terminology is lacking.</li> <li>• Little reference to the stimulus material.</li> </ul>
<b>3–4</b>	<ul style="list-style-type: none"> <li>• Some understanding of the demands of the question.</li> <li>• Some relevant business management tools (where applicable), techniques and theories are explained or applied, and some appropriate terminology is used.</li> <li>• Some reference to the stimulus material but often not going beyond the name of a person(s) and/or the name of the organization.</li> </ul>
<b>5–6</b>	<ul style="list-style-type: none"> <li>• Understanding of most of the demands of the question.</li> <li>• Relevant business management tools (where applicable), techniques and theories are explained and applied, and appropriate terminology is used most of the time.</li> <li>• Some reference to the stimulus material that goes beyond the name of a person(s) and/or the name of the organization.</li> <li>• Some evidence of a balanced response.</li> <li>• Some judgments are relevant but not substantiated.</li> </ul>
<b>7–8</b>	<ul style="list-style-type: none"> <li>• Good understanding of the demands of the question.</li> <li>• Relevant business management tools (where applicable), techniques and theories are explained and applied well, and appropriate terminology is used.</li> <li>• Good reference to the stimulus material.</li> <li>• Good evidence of a balanced response.</li> <li>• The judgments are relevant but not always well substantiated.</li> </ul>
<b>9–10</b>	<ul style="list-style-type: none"> <li>• Good understanding of the demands of the question, including implications, where relevant.</li> <li>• Relevant business management tools (where applicable), techniques and theories are explained clearly and applied purposefully, and appropriate terminology is used throughout the response.</li> <li>• Effective use of the stimulus material in a way that significantly strengthens the response.</li> <li>• Evidence of balance is consistent throughout the response.</li> <li>• The judgments are relevant and well substantiated.</li> </ul>

### Section A

1. (a) Define the term *economies of scale*. [2]

Economies of scale are the reductions in unit/average costs that result from an increase in output / increase in scale.

*Candidates are not expected to word their definition exactly as above.*

*Do not reward examples of economies of scale e.g. purchasing economies.*

*To be awarded [2] candidates must include references to both reductions in costs and the scale of output.*

*Award [1] for a basic definition that conveys partial knowledge and understanding.*

*Award [2] for a full definition that conveys knowledge and understanding similar to the answer above.*

**N.B.** *no application required. Do not credit examples.*

- (b) Using **Table 1**, calculate:

- (i) the contribution per unit (*show all your working*); [2]

Unit contribution = selling price – variable costs.

Selling price = \$0.15

Variable costs = \$0.05

Answer = \$0.10

*Award [2] for a correct answer with working.*

*Award [1] for correct answer without working.*

*Award [1] for correct method with an error in the calculation.*

- (ii) the break-even level of output (*no working required*). [1]

Correct answer = 50m

*Award [1] for correct answer without working.*

*Candidates that omit the million or m sign award [0].*

(c) If AXL produces 75 million cans in 2023, using **Table 1**, calculate:

(i) the margin of safety (*no working required*); **[1]**

MOS = current output – break even

= 75m – 50m = 25m

*Award [1] for correct answer without working.*

*Candidates that omit the million or m sign award [0].*

*If candidates have a dollar sign (\$) by the figure, award [0] (for example, the candidate writes \$25m).*

*Allow candidate own figure rule (OFR). A mark can be awarded if an error made in b(ii) is carried through to (c)(i).*

(ii) the profit (*show all your working*). **[2]**

Output = 75 million cans

TFC = \$5m

TVC = \$3.75m (75m x 0.05)

TC = \$8.75m

TR = 11.25m

Profit = \$2.5m

*Award [1] for the correct working and [1] for the correct answer.*

*Award [1] for the correct answer without working.*

*Answers that omit the m or millions cannot be awarded full marks – a correct answer without the m or millions can be awarded [1] if the method / working is correct.*

- (d) Explain the potential impact on *AXL* if it implements its planned increase in trade credit period. **[2]**

Trade credit is an agreement between businesses that allows the buyer of goods or services to pay the seller at a later date.

*Candidates need to show an understanding of trade credit for [1] and make use of the stimulus for [2].*

For example, this change may reverse the decline in sales that occurred in the first half of 2022, as now customers have longer to pay, which makes the business more competitive in an increasingly competitive market.

However, a comment such as “It may lead to an increase in sales but a reduction in cash inflows as *AXL*’s existing customers can now delay payment for an additional 30 days” has only nominal application, as the comment applies to almost all non-retail companies. In this instance, award **[1]**.

*Award [1] for only a partial/unclear explanation of the impact on *AXL*.*

*Award [2] for a clear explanation of the impact on *AXL* that makes use of the stimulus provided.*

2. (a) State **two** appropriate external sources of finance that *RE* could use to modernize its gas stations. **[2]**

*Award [1] for each appropriate source of finance up to a maximum of [2].*

Appropriate external sources include:

- share (capital)
- loan (capital) / bank loans
- retained profit
- debentures
- venture capital
- leasing
- equity finance

Do **not** award inappropriate sources such as:

- trade credit
- overdrafts
- grants
- subsidies
- debt factoring
- hire purchase
- business angels
- partners
- entrepreneur

- (b) (i) Construct a fully labelled balance sheet for *RE* as of 31 December 2021. [5]

**Balance sheet for *RE* as of 31<sup>st</sup> December 2021**

	\$m	\$m
Net fixed assets		50
<b>Current assets</b>		
Cash	1	
Stock	5	
Total current assets	6	
<b>Current liabilities</b>		
Overdraft	1	
Creditors	6	
Total current liabilities	7	
Net current assets (working capital)		–1
Total assets less current liabilities		49
<b>Long term liabilities (debt)</b>	15	
Net assets		34
Financed by:		
share capital	29	
accumulated retained profit	5	
<b>Equity</b>		34

**N.B.** if the candidate does not follow the IB prescribed format award a maximum of [3].

**N.B.** candidates should not be penalized for: omitting the row “Long-term liabilities (debt)”, or for writing “retained profit” omitting the word “accumulated”.

Award [1] if the candidate conveys some idea of what a balance sheet is.

Award [2] if the candidate constructs a largely recognizable balance sheet, but it does not balance, or it has two major problems of classification.



*Award [3] for a largely accurate balance sheet that correctly balances. (There could be one misclassification.)*

*Award [4] if the candidate constructs an accurate balance sheet (that balances) according to the IB prescribed format.*

*Award [5] if the candidate constructs an accurate balance sheet (that balances) according to the IB prescribed format and the balance sheet is dated.*

- (b) (ii) Calculate RE's gross profit margin (no working required). [1]

$$\$100\,000\text{m} - 80\,000\text{m} = \$20\,000\text{m}$$

$$\frac{\$20\,000\text{m}}{\$100\,000\text{m}} = 20\%$$

Correct answer = 20 % or .2

*If a candidate does not express the gross profit margin (GPM) as a percentage or as a decimal, the answer is incorrect.*

*Award [1] for the correct answer (no working required).*

- (c) Explain the potential impact of the increasing popularity of electric cars on RE's costs **and** revenues. [2]

*Award [1] for only a partial/unclear explanation of the potential impact of the increasing popularity of electric cars on RE's costs **and** revenues.*

*Award [2] for a clear explanation of the potential impact of the increasing popularity of electric cars on RE's costs **and** revenues.*

*To achieve [2] candidates must make it explicit that:*

- increase in popularity of electric cars is likely to lead to a fall in demand for gas and therefore revenues are likely to fall.
- with declining sales, RE will have to purchase less gas. Thus, total variable costs will fall. OR costs would increase if the business decided to install electric charging points.

*Answers that make no explicit reference to costs and why they might not change or might change can earn a maximum of [1].*

### Section B

3. (a) State **two** ways in which market share can be measured. [2]

The term market share refers to the percentage of a sales that one company has within a particular market, such as athletic gear.

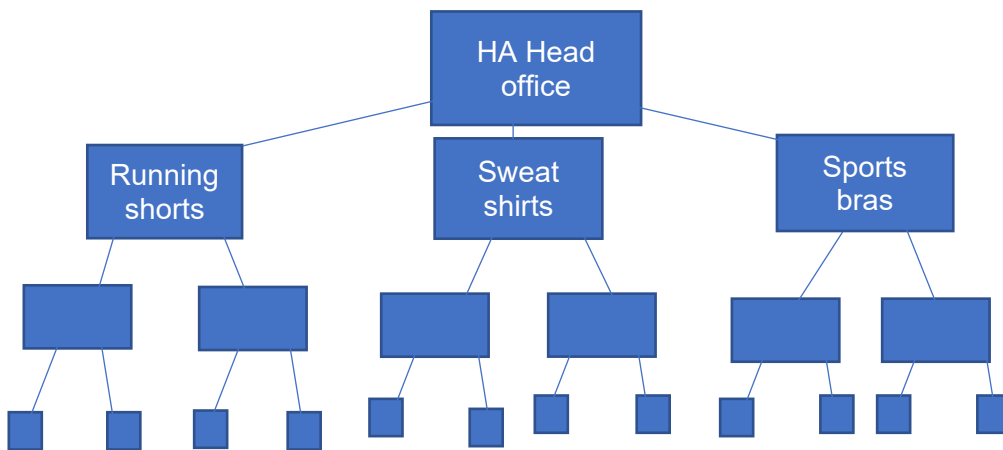
Ways that market share can be measured include:

- by revenue (value), in terms of currency (\$, €, ¥, etc.).
- by unit sales (volume).

***N.B.** candidates are not being asked how to calculate market share, and, thus, they are not expected to provide a definition. For [2], they have to convey the idea that two ways exists to measure it.*

*Award [1] for each correct way of measuring market share up to [2].  
Maximum award: [2].*

(b) Draw an organization chart for HA. [4]



*The chart does not have to be drawn exactly as above.*

*Award [1] for drawing an organizational chart and additional [1] for each of:*

- *information that conveys some understanding of “by product”*
- *information that conveys some understanding of hierarchy (must have at least four levels)*
- *information that conveys some understanding of a narrow span of control (two or three reporting units per manager).*

*Maximum award: [4].*

***N.B.** to convey the idea of organized by product, candidates may use the actual products (running shorts, sweat shirts, and sports bras) or generic products (product A, product B, product C) as long as they have exactly three products.*

(c) Explain:

- (i) the impact of price changes by foreign competition on *HA*'s break-even point; [2]

*HA* is selling more units of product, but sales revenue has not been rising as foreign competitors, using penetration pricing, have driven prices down. Thus, the average sales price per unit is falling. Further, the gross profit margin has been declining, which means that *HA* has not been able to reduce per unit cost as much as sales price per unit. With a declining contribution per unit, *HA* has seen its break-even point move to the right on the X-axis.

*Award [1] for stating that the break-even point moves to the right, and an additional [1] for an explanation with application to the stimulus.*

- (ii) why *HA* had to raise additional external finance to increase production. [2]

*Candidates may answer this question in one of three ways:*

1. One way puts emphasis on the word external in the question. If a candidate chose this emphasis, they need to say something like "Because foreign competitors have used penetration pricing to gain market share, *HA* has had to lower its prices, which is why gross and net profit margins have declined. As a result, *HA* has not been able to generate sufficient internal finance to support increased production and has had to turn to external finance."

Both of the other ways candidates can answer this question emphasize the increase in production:

2. Candidates may believe that *HA* needs more working capital to support increased trading activity. *HA* has had increased unit sales volume, which means that it has been manufacturing and selling more product, even if at lower margins. For most companies, increased trading means increased inventory and accounts receivable. The asset accounts must be financed. Increased accounts payable will fund some of that increased trading activity, but probably not all of it. With margins declining, *HA* probably cannot fund this need internally and, thus, has had to turn to external sources of finance.

3. Candidates may believe that *HA* needs property, plant, and equipment to support increased production. However, because of contracting margins, in the past few years, *HA* probably has generated insufficient funds internally to finance long-term assets. Thus, they have obtained finance externally.

*Award [1] for some understanding of one of the three issues above and an additional [1] for application to the stimulus. Up to a maximum of [2].*

***N.B.** In all three cases, the key is for candidates to link contracting margins or lower prices (which is why HA's margins are lower) to external finance (rather than internal) or to increased production (increased working capital requirements or more property, plant, and equipment).*

- (d) Recommend whether *HA* should choose **Option 1** or **Option 2**. **[10]**

Reasons for outsourcing include:

- Lower costs, which is usually why companies outsource overseas.
- Lower investment in fixed assets: no need to expand current manufacturing facilities and some possibility of selling off existing facilities.
- Lower fixed costs, which can be an advantage were sales to fall in the highly competitive market.

Reasons against outsourcing include:

- *HA* relies on high-quality manufacturing, which overseas manufacturers may not be able to deliver.
- *HA* exposes itself to additional risks, such as political risk of the home countries where the new manufacturers are located.
- Depending on where most of *HA*'s sales occur, it may lose the advantage of saying manufactured in the home country or in Europe.
- Outsourcing, if to developing countries, may raise ethical and environmental concerns.

*Accept any other relevant reason for or against outsourcing.*

Reasons for setting up online business-to-consumer (B2C) retail stores include:

- The online retail market is rapidly growing.
- Consumers have increasing expectations that goods will be available online.
- B2C eliminates links in the downstream supply chain that erode profit margins.

Reasons against setting up online retail stores include:

- *HA* has only operated in the secondary sector and has no experience in retail.
- Though capital outlays will be less than if *HA* started to build brick-and-mortar stores, setting up an online presence will require capital outlays at a time when the business is having to turn to external finance just to fund manufacturing operations.
- The online market is no less competitive than traditional approaches.

*Accept any other relevant reason for or against setting up online retail stores.*

Award marks as follows:

Candidate discusses one option with limited to no application to the stimulus	2 marks
One option with application but unbalanced	3 marks
One option, with application and balance	4 marks
Two options, both with application but neither with balance	4 marks
Two options, both with application, one balanced, one unbalanced	5 marks
Two options, both with application and balance but no real conclusion	6 marks
Two options, both with application and balance and a conclusion that is more than nominal like when a candidate has a short concluding paragraph that opens with “In conclusion, . . .” A real conclusion should flow out of the arguments presented and add summative force to them.	7–8 marks
Two options, both with application and balance and a conclusion that is more than nominal like when a candidate has a short concluding paragraph that opens with “In conclusion, . . .” A real conclusion should flow out of the arguments presented and add summative force to them.  The candidate uses rich business vocabulary and demonstrates depth of understanding of the issues.	9–10 marks

**N.B.** A balanced argument is one that has a reason for and a reason against the options.

Award marks according to the markbands on page 3.

4. (a) State **two** features of a cooperative. **[2]**

The main features of a cooperative include:

- An aim is to serve the members of the cooperative/members with a common interest.
- A cooperative is a type of corporation.
- A cooperative has a board of directors or trustees.
- Members of the cooperative have limited liability.
- Cooperatives have democratic or democratically spirited management.
- Legal existence is separate from the members themselves.
- Membership is usually open.
- Surpluses/profit are distributed except when needed for finance.
- The organization will not end if a member dies or withdraws.
- All owners have equal voting rights.

*Accept any other relevant feature.*

*Award **[1]** for each relevant feature identified up to **[2]**.*

- (b) With reference to *RS*, explain the importance of branding. **[4]**

Branding is a way for a company to distinguish itself from other organizations. Ideally, it succinctly delivers a message about your product, as *RS* hoped with the symbol of the red squirrel would symbolize environmental friendliness by reminding consumers of the dangers of invasive species and would symbolize health consciousness, as *RS* was promoting traditional juice, which has less sugar (and preservatives) than American-style beverages. In this way, *RS* hoped to build credibility with consumers – any beverage with the *RS* symbol would be healthy and would remind consumers of the environment. With these features, *RS* hoped to build goodwill.

Brands, and their symbols, run the risk of taking on a life of their own. Sometimes a famous brand, like McDonald's, enjoys decades of positive psychological associations but then, as culture and consumer trends change, the brand starts to generate negative associations. Such was partially the case with *RS*. Originally, the image of the red squirrel was at worst innocuous and at best heart-warming. As anti-immigrant groups co-opted the red squirrel for its own purposes, however, the cooperative faced risks of being associated with anti-immigrant sentiment. Some consumers may now be turned off by the brand as to them a red squirrel may symbolize a political position that they disagree with.

*Award [1] if the candidate demonstrates some understanding of branding. Award up to [2] if the candidate demonstrates a clear understanding of the importance of branding but makes no meaningfully reference to the stimulus.*

*Award up to [3] if the candidate demonstrates a clear understanding of the importance of branding and makes meaningfully reference to the stimulus, but the explanation is one-sided. Award up to [4] if the candidate demonstrates a clear understanding of the importance of branding, makes meaningfully reference to the stimulus, and points out both a benefit of branding and some risks inherent with it.*

*Maximum award: [4]*

**N.B.** *For application, just mentioning red squirrel is not enough. Candidates must link the response to the stimulus (for example, "appeal to environmentally aware and health-conscious consumers.")*

- (c) With reference to *RS*, explain the difference between capital expenditure and revenue expenditure. **[4]**

Capital expenditure is the purchase of assets whose life exceeds one year. Revenue expenditure is made up of expenses related to the trading cycle: purchasing raw material, processing, inventory, making payroll, etc. With respect to *RS*, capital expenditure refers to the bottling equipment needed to produce bottled apple juice to sell directly to consumers. *RS* experienced an increase in revenue expenditures when it started selling bottled apple juice, as it had increased labour costs (presumably to operate the bottling equipment) and increased costs for promotion.

*Award [1] for a theoretical understanding of capital expenditure and an additional [1] for reference to the bottling equipment.*

*Award [1] for a theoretical understanding of revenue expenditure and an additional [1] for reference to increases in labour expenses or increased costs in promotion.*

*Mark as [2] + [2]. Maximum award: [4]*

- (d) Discuss **two** possible areas of conflict between the interests of RS's stakeholders.

[10]

Possible areas of conflict between the interests of RS' stakeholders include:

- Between RS farmers and anti-immigrant political groups. The farmers in RS presumably were in some agreement with the cooperative's founders that the name and symbol of the red squirrel was to promote the environment and healthy beverages. With anti-immigrant groups' co-option of the symbol, "red squirrel" came to mean something else. This situation puts the cooperative's members against the anti-immigrant groups.
- Between RS farmers and the managers of the cooperative. The decision to open a second channel of distribution meant that RS had to increase fixed costs (for the bottling equipment) and add additional expenses, for labour and promotion. Whether this generates surpluses in the long run is unclear. In the short run, these capital and revenue expenditures almost certainly mean smaller surpluses and lower probability to have distributions to member farmers.
- Between RS management and beverage producers. When RS decided to open a new distribution channel, it started to compete with its customers, some of whom might object to two facts: (1) RS would have lower costs for apple juice than they would and (2) the RS symbol on their (the beverage producers') labels might be considered a form of free advertising for RS.
- Between beverage companies and the anti-immigrant political groups. Beverage companies saw an advantage of putting the red squirrel symbol on their bottles initially, as it conveyed positive associations about the environment and health. Now, the squirrel conveys some negative associations, at least to some residents of the country, with which the beverage companies may not want to be associated.

A further possibility exists that the disagreement could emerge *within* the essentially important stakeholder group, the farmer members. As the red squirrel symbol became politicized, some farmers may have supported that development (that is, been anti-immigrant themselves), while others may have been of a different political view and disapproved of the development.

*Candidates may talk about two different conflicts between the same two stakeholder groups provided that the issues (behind the conflict) are different.*



**N.B.** Accept the disagreement within the farmer members of the politics of the red squirrel symbol as a disagreement between two stakeholder groups.

**N.B.** Some types of cooperatives being a member is the same thing as being an employee. In other types of cooperatives, members are not employees but rather the cooperative hires employees who are not members.

Up to	
1–2	Conveys some understanding of what a stakeholder is but minimal/nominal application to the stimulus.
3 marks	Candidate discusses one possible area of conflict in an unbalanced way.
4 marks	Candidate discusses one possible area of conflict in a balanced way or discusses two areas of conflict, both in an unbalanced way
5 marks	Candidate discusses two possible areas of conflict, one in a balanced way and one in an unbalanced way.
6 marks	Candidate discusses two possible areas of conflict, both in a balanced way. No real conclusion
7–8 marks	Candidate discusses two possible areas of conflict, both in a balanced way.  Contains a conclusion that flows out of the arguments made in the response.
9–10 marks	Candidate discusses two possible areas of conflict, both in a balanced way.  Contains a conclusion that flows out of the arguments made in the response.  The candidate uses rich business vocabulary and demonstrates depth of understanding of the issues.

*Award marks according to the markbands on page 3.*

5. (a) State **two** features of a public limited company. **[2]**

The main features of a public limited company, some of which may apply to a private limited company, include:

- Government rules, laws, and regulations strictly govern public limited companies.
- Shareholders do not participate in the day-to-day management of the business of a company.
- Shareholders' liability is limited to their investment in the company.
- The board of directors has decision-making power, most of which it delegates to the chief executive officer. The board, nonetheless, makes policy and strategic decision by majority rule.
- The company has separate legal existence from its owners (shareholders).
- The company raises capital by selling shares.
- The shares of a company are freely transferable and do not require consent of other shareholders.
- Shares can be bought-sold only via a stock exchange.
- Anyone can purchase shares.
- Financial statements/accounts are made public and are easily accessible.
- Legal continuity.

*Accept any other relevant feature.*

*Award [1] for each relevant feature stated up to [2]. Maximum award: [2].*

- (b) (i) Explain, with reference to Maslow's motivation theory, how teleworking may damage employee motivation at FR's head office. **[2]**

Maslow's 3<sup>rd</sup> level, social needs / teamworking, will not be met as employees that choose teleworking will be working from home for all but one day per month and therefore will have little opportunities to meet with colleagues, to work as part of a face to face team.

Maslow's 4<sup>th</sup> level may also not be met due to the typical lack of a formal workplace among teleworkers. It may be difficult for remote workers to experience formal recognition of their accomplishments. In addition, the virtual nature of their jobs reduces direct / face to face input that signifies goal achievement and personal development, which affect employees' esteem. This may be further exacerbated by the fact that **40% of workers who chose not to telework** will continue to enjoy these benefits. This may cause resentment among teleworkers leading to problems with teamworking (3<sup>rd</sup> level).

*Award **[1]** for demonstrating an understanding of Maslow's motivation theory and a further **[1]** for a development with respect to FR. Award a maximum of **[2]**.*

***[2]** cannot be awarded if the response lacks either explanation and / or application.*

*For example:*

*For an identification or a description of one of Maslow's hierarchy of needs with or without application **[1]**.*

*For an identification or a description of one of Maslow's hierarchy of needs with no application award **[1]**.*

*For an identification or a description of one of Maslow's hierarchy of needs and application award **[2]**.*

**N.B.** *For application, candidates do not have to say "only one day per month" but they do need to convey the idea that teleworking employees are not coming to the office often.*

- (ii) Explain **one** disadvantage for *FR*, **other than** the impact on employee motivation, of introducing teleworking. **[2]**

Other disadvantages include:

- It will be more difficult for the business to complete 360-degree feedback appraisals, which have been a factor in improving staff morale and retention.
- It will be more difficult for line managers to assess the performance of their employees as they will not see them on a day-to-day basis as some employees are working from home for all but one day per month.
- Teleworking may introduce inefficiencies. For example, with 40% of workers still at head office and 60% working from home, communication may be more difficult.
- Communication issues may arise if teleworking employees have poor IT facilities at home. Informal communication will be more difficult as **40% of workers are still in head office**.
- The business may need to provide teleworking employees with improved IT facilities at home which will increase the business costs. This would reduce cost savings made by head office from introducing teleworking.

*Accept any other relevant disadvantage.*

*Award **[1]** for identifying or describing the disadvantage to *FR* and a further **[1]** for a development with respect to *FR*. Award a maximum of **[2]**.*

***[2]** cannot be awarded if the response lacks either explanation or application.*

*For example: For an identification or a description of the disadvantage without application, such as “productivity may decline as teleworkers have family distractions at home” award **[1]**.*

- (c) Explain **two** disadvantages for *FR* if it extends its 360-degree feedback appraisal system to its supermarket employees. **[4]**

Disadvantages with potential for application include:

- It will increase the business costs as collecting data and performing the appraisals for all employees will mean additional paper work and possibly hiring more managers and/or paying overtime for the extra work. Department managers are already complaining about their workload and this will make it worse. This is particularly relevant as there are far more supermarket employees **(6000) than head office employees (250)**.
- It will increase workload on department managers particularly as the business has hired an additional 1000 part-time staff. Department managers already have concerns about workload and doing 360-degree feedback appraisals on all employees will increase workload even more.
- The whole process is time-consuming for everyone involved and could reduce the efficiency of *FR*'s core activity, running supermarkets. (For application, candidates must refer to the number of employees).

Disadvantage where opportunity for application is limited include:  
Employees may select “raters” that are “fans”. This can lead to skewed results and department managers may disagree with an employee’s choice of raters, which may further increase staff **turnover of departmental managers**.

*Accept any other relevant disadvantage.*

*Award [1] for identifying or describing the disadvantage for FR and a further [1] for a development with respect to FR. Award a maximum of [2].*

*[2] cannot be awarded per disadvantage if the response lacks either explanation or application.*

*For example: For an identification or a description of a disadvantage without application award [1]. For an explanation of a disadvantage with no application award [1].*

*For explanation of a disadvantage and application [2].*

*Mark as [2] + [2]. Maximum award: [4]*

**N.B.** *the disadvantage has to be specific to a 360-degree feedback appraisal system, not to appraisal in general.*

- (d) Recommend whether *FR* should choose **Option 1** or **Option 2**. **[10]**

*There is no “correct answer”. Answers could include:*

### **Option 1**

#### **Pros**

This option is less expensive in the long-term. The business will need to raise \$17m (500 x \$34 000). Currently interest rates are very low and therefore the interest charges will only raise the business costs by a relatively small amount. *E.g.* 3 % per annum (\$510 000 in year 1).

At the end of the five-year period the business intends to replace the vans – as it owns them it can sell them to raise some finance towards their replacement.

As *FR* already has a \$50m bank loan it might be assumed they have a good relationship with their bank and further borrowing would not be a problem.

#### **Cons**

The business will need to negotiate an additional loan from its bank and may need to provide the bank with additional financial documents and possibly collateral. Should the business fail to repay the loan then the collateral would be seized by the bank.

It is not a cost-free option even when interest rates are low, as a \$17m loan would incur interest charges of 3 % per annum (\$510 000 in year 1). If using simple interest this totals \$19.55m over five years.

If the trend to buying online is not maintained and shoppers gradually return to shopping face-to-face, then *FR* may have a large number of vans that it no longer needs but is paying for over five years. Whilst these could be re-sold there would be a significant loss made as second-hand prices will be a lot lower than the \$34 000 purchase price.

*FR* would be liable for the maintenance and repair of vans.

## Option 2

### Pros

Leasing is more flexible. The business will need to lease the vans for at least 24 months. At that point if it finds that consumer trends have changed then it can either not renew the leases on 500 vans or lease a much smaller number, say 200. This will save the business money in the long run e.g. leasing just 200 vans will cost only \$2.6m per year.

If after 24 months demand is not seen to be there then the business could end the lease and purchase vans, saving money in the long run.

One of the tax advantages to leasing a van could include claiming up to 100 % sales tax back on the monthly payments. Also, leasing payments are expenses and, thus, lower pre-tax profits and income tax expense.

In addition, lessors are usually liable for maintenance and servicing of the vans on a regular basis.

***N.B.** Terms and conditions of fleet leasing vary. In some instances, lessors are not responsible for maintenance or service. In other cases, fleet lessors are responsible for service and maintenance, though they often contract out the management of the service and maintenance to a third company for a monthly fee.*

*Given the limited experience of our candidates, which could well inform their knowledge about vehicle leases, candidates can argue that FR will not be responsible for maintenance and servicing (a pro of leasing) or that FR might still be responsible for maintenance and servicing (a con of leasing).*

### Cons

This may have higher long-term costs. A lease of 500 vans will cost the business \$6.5m annually (500 x \$13 000). Over five years this would be \$32.5m which is almost twice the cost of the option A. This is a significant difference in terms of costs.

At the end of each lease period the business does not own the vans and has to negotiate a new leasing agreement.

The business will pay penalties at the end of the lease agreement if the leased vans are damaged in any way.

Maximum mark award	Option 1	Option 2	Judgments/conclusion
3	One argument related to only one option.		N/A
4	One argument for and one argument against either of the two options. OR One argument related to Option 1 and one argument related to Option 2.		N/A
5	One argument for and one argument against one option and one argument for or against the other option.		N/A
6	At least one argument for and one argument against both options.		No judgments/conclusions
7–8	Balanced arguments for both options.		Judgments/conclusions based upon analysis and explanation in the body of the response  Relevant business management tools (where applicable), techniques and theories are explained and applied well, and appropriate terminology is used.  Good reference to the stimulus material.
9–10	Balanced arguments for both options.		Judgments/conclusions based upon analysis and explanation in the body of the response.  Relevant business management tools (where applicable), techniques and theories are explained clearly and applied purposefully, and appropriate terminology is used throughout the response.  Effective use of the stimulus material in a way that significantly strengthens the response.

*It is expected that candidates provide a conclusion with a substantiated judgment.*

*Marks should be allocated according to the markbands on page 3.*



*If a candidate evaluates / addresses only one option, award a maximum of [5].*

*A balanced response is one that provides at least one argument for and one argument against each option.*

*Candidates may contrast one option with another for a balance as long as at least two arguments are given for each option.*

*Award a maximum of [6] if the answer is of a standard that shows balanced analysis and understanding throughout the response with reference to the stimulus material but there is no judgment/conclusion.*

*Candidates cannot reach the [7–8] markband if they give judgment/conclusions that are not based on analysis/explanation already given in the answer.*

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