

**BUSINESS AND MANAGEMENT  
HIGHER LEVEL  
PAPER 1**

Wednesday 8 May 2002 (afternoon)

2 hours

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**INSTRUCTIONS TO CANDIDATES**

- Do not open this examination paper until instructed to do so.
- Read the case study carefully.
- Section A: answer all questions.  
Section B: answer one question.

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**SECTION A**

Answer **all** questions in this section.

1. (a) Explain why customer questionnaires handed in at the end of holidays may not provide reliable research data for *Open Views*. [3 marks]
- (b) Analyse the customer satisfaction information provided in *appendix 2*. Comment on the trends shown and whether these should worry Joseph Obeng. [4 marks]
- (c) Suggest, with practical details, **three** courses of action to address any problems identified in your analysis. [6 marks]
2. (a) Describe, with relevant examples, **three** internal economies of scale and consider how these will apply to *Open Views* as it grows in size. [8 marks]
- (b) Using the information provided in *appendix 3*, and relevant ratio calculations, analyse *Open Views*' profitability, liquidity and efficiency, and discuss whether Joseph Obeng is satisfying his desire to maintain financial and cost control of his business. [10 marks]
3. (a) Applying your knowledge of motivation and leadership theory, analyse the likely effects on employees of Joseph Obeng's, Marc Leroux's and Peter Storm's management styles. [9 marks]
- (b) Assess the potential role of a trade union at *Open Views* in promoting the views of employees and in helping to resolve conflicts within the workplace. [4 marks]
4. (a) Examine the commercial advantages of firms acting in an ethical and socially responsible manner. [6 marks]
- (b) Produce a set of ethical and environmental guidelines to support Joseph and Manjit's application to expand *Warm Breezes*. Evaluate how your guidelines will address the local community's objections to the present operations and proposed expansion. [10 marks]

**SECTION B**

Answer **one** question from this section.

5. Peter Storm has conducted a financial analysis of the *Warm Breezes*' expansion projects. At this stage it would only be possible to fund one of the two proposed projects. Inflation in the Caribbean is a problem and the costs of capital comparatively high at 14 %. Peter presents the following figures to Joseph and Manjit for their consideration. Details of cash inflows have only been presented for 6 years as Peter considers that financial information after this date is likely to be highly inaccurate, especially as the Caribbean economies had been unstable in recent times. Predictions are based on an average occupancy rate of 75 % for the cottages for the first year, rising to 85 % in years 4, 5 and 6.

Peter has decided that the investments will only be considered if they meet the following criteria:

Payback	3.5 Years
Average Rate of Return	35 %
Net Present Value	\$ 2m

	<b>OPTION 1</b> Commercial centre	<b>OPTION 2</b> New cottages
	<i>\$m</i>	<i>\$m</i>
Initial Cost	8.4	4.4
Cash inflows at end of :		
Year 1	1.6	0.8
Year 2	2.8	1.4
Year 3	3.4	2.0
Year 4	3.6	2.4
Year 5	4.0	2.3
Year 6	4.2	2.6

Present value (PV) of \$ 1 receivable at an annual rate of 14 % at the end of:					
1 Year	2 Years	3 Years	4 Years	5 Years	6 Years
\$ 0.877	\$ 0.769	\$ 0.675	\$ 0.592	\$ 0.519	\$ 0.456

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*(Question 5 continued)*

- (a) From the information presented in the case study, identify **two** reasons why Peter has chosen such a short Payback period and high Average Rate of Return. *[2 marks]*
  
- (b) Using the information provided, calculate the Payback, Average Rate of Return and Net Present Value, for both Option 1 and Option 2, and state whether the options satisfy Peter's criteria for investment. *[8 marks]*
  
- (c) Using the investment appraisal information you have just calculated and additional financial and non-financial information provided in the case study, select an expansion option and justify your choice. *[5 marks]*
  
- (d) Using relevant examples, consider to what extent external factors may affect the accuracy of the figures presented by Peter Storm. *[5 marks]*

6. Peter Storm is concerned about the financial returns predicted for the *Warm Breezes* expansion plans. There are several external factors, which may affect the potential returns:
- most economists are predicting a slowdown of the world’s economies. This may affect demand for *Warm Breezes* as it is perceived as a luxury item. However, a minority of economists are suggesting the United States’ economy will continue to grow. Peter estimates that the chance of the economy improving is as low as 15 %. He believes that the chance of the economy remaining constant is 35 %, but the chances of an economic decline are the highest at 50 %;
  - the local government may block the development plans. Manjit believes that there is a 70 % chance that the commercial centre will be approved, but only a 60 % chance that planning permission will be given for the new cottages. In both cases, Peter has estimated that a failed bid, resulting in no expansion, will still cost \$ 0.2m in promotion and administration expenses;
  - following negotiations Peter predicts that there is an 80 % chance that permission would be given to build a second complex on the neighbouring island. If permission was refused it was estimated that the failed bid would cost \$ 1.5m:

**Development Costs**

	\$m
Commercial centre	8.4
New cottages	4.4
Second <i>Warm Breezes</i> complex	25.0

Peter put forward the following market research and profit information, based on a 6-year time frame, to Manjit and Joseph at their regular monthly board meeting:

Options \ Economic climate	Improve \$m	Constant \$m	Worsen \$m
No expansion *	4.2	2.5	0.8
Commercial centre	14.8	11.2	8.8
New cottages	9.5	7.3	4.8
Second <i>Warm Breezes</i> complex	49.8	35.2	15.0

**Elasticity results for *Warm Breezes***

	\$m
Price elasticity of demand	0.85
Income elasticity of demand	1.12

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\* This also applies if planning permission is refused.

*(Question 6 continued)*

- (a) Prepare a decision tree to represent *Warm Breezes*' options and calculate the expected values of each. [7 marks]
- (b) Which course of action is most desirable according to your decision tree? [1 mark]
- (c) To what extent would the additional financial and non-financial information provided in the case study support the course of action suggested by the decision tree? [6 marks]
- (d) (i) Explain what is meant by price and income elasticity of demand. [2 marks]
- (ii) By reference to information in the case study, including *appendix 1*, analyse and explain the significance of the elasticity results established for *Warm Breezes*. [4 marks]
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