IBO IB DIPLOMA PROGRAMME
PROGRAMME DU DIPLÔME DU BI
PROGRAMA DEL DIPLOMA DEL BI

BUSINESS AND MANAGEMENT
HIGHER LEVEL
PAPER 2

Tuesday 18 November 2003 (morning)

2 hours 30 minutes

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- Answer four questions.

1. 21st Century Investors

Socially responsible investors are growing in number. Such investors think that there is more to running a business than squeezing out every last cent of profit and increasing executive pay at any cost. They believe management should carry out their roles in a responsible way.

Socially responsible investing means to encourage companies to follow industry best practice and/or behave in an ethical fashion. It does not mean selling shares in offending companies or refusing to buy them in the first place. The idea is that shareholders have far more influence if they keep their shares and use the power that comes with them, by voting at annual general meetings and forcing policy changes.

The pay of those who manage socially responsible investments is below that of managers of funds without such investment restrictions. However, dividend returns from socially responsible investments, in many cases, match or exceed industry averages.

[Source: Adapted from: Julia Finch, *"The 21st century investor", The Guardian,* 1 May 2002]

(a) Explain how socially responsible investors can exert power over executives and company policy at an annual general meeting. *[4 marks]*

(b) Analyse **two** advantages and **two** disadvantages for investment trusts which decide to invest in a socially responsible manner. *[5 marks]*

(c) Describe and justify **four** policy changes that should be considered by the board of directors of an organization that wishes to act in a socially responsible way. *[4 marks]*

(d) Discuss potential conflicts between socially responsible investors of an organization and **two** of its other stakeholders. Evaluate the possible effects of these conflicts on the organization. *[7 marks]*

2. Car Making in Asia

The men and women assembling *BMW* cars in a factory in Thailand are cheap to employ and are educated, friendly, and committed. Following *Ford* and *General Motors*, *BMW* is the latest western car-maker to set up in Thailand.

Currently nine out of 10 cars and trucks sold in the South-East Asia region are Japanese. American and European car companies come to Thailand with a vision that differs from that of the Japanese car-makers that dominate the region. Japanese car-makers treat each South-East Asian country as a distinct market and re-create a supply chain to serve the local market, which complies with design requirements imposed by the local government. This strategy is inefficient and *Toyota*, for one, is losing money in the region.

The Americans and the Europeans are planning for a time when trade is free across the region. The goals for western car-makers are global markets and economies of scale and they are lobbying hard for the removal of trade barriers between countries and regions. The big hope is for an Asian Free Trade Area (AFTA) to take effect in 2003.

[Source: Adapted from *"Politics of Scale",* from The Economist printed edition, 22 June 2000]

(a) (i) Explain how the western multi-national (MNC) car-makers producing in the Asian region may benefit from the creation of an Asian Free Trade Area. *[3 marks]*

(ii) Outline **three** other reasons why car producers may have decided to locate in Thailand. *[3 marks]*

(iii) Analyse **two** benefits and **two** costs for local car producers if multinational car companies locate production plants in their country. *[4 marks]*

(b) Examine **two** ethical issues that the western car-makers might encounter when setting up production plants in South-East Asia. *[4 marks]*

(c) Assess the advantages and the disadvantages of the operational strategy of current Japanese car-makers in South-East Asia. *[6 marks]*

3. Stella

Stella is an Italian knitwear company that makes fashion wear for 16-25 year olds. They have recently moved into new market segments with a range dedicated to children and one targeting older people who are spending increasing amounts on clothing. *Stella* advertise only on billboards and in magazines and are famous throughout the world for their "shock factor" advertising, and for raising awareness of human rights. Several adverts produced by *Stella* were banned after publication, but the publicity surrounding them led to a boost in sales. Their adverts use few words and therefore are inexpensive to translate and produce globally. The emphasis is on creating brand and corporate awareness, rather than promoting particular products. Recently *Stella* has been criticised for employing young workers in the Middle East earning only $1 for a 10 hour day.

Stella's production process is highly advanced and uses a system of Computer Aided Design (CAD) and computerised knitting machines to make a completely seamless jumper in half an hour. Machines include the latest technology and give competitive advantage, but are expensive to maintain. They enable large scale production to be done by machines with employees able to specialise. They also allow transport and packaging process to be differentiated by geography and individual customer. All knitwear is produced using a grey wool, which is dyed later in the manufacturing process to meet demand and fashion trends more closely. *Stella* can buy one type of wool when they need it, rather than hold a large stock of different colours. This allows *Stella* to gain production economies of scale.

The introduction of the new technology has resulted in most work being done by machines and has cut down on labour. This combined with a recession in Europe and customers having less money to spend on products, has led to significant redundancies. Sales taxes have increased recently in several of its markets.

(a) Explain what is meant by economies of scale and give **two** examples of how *Stella* could benefit from operational economies of scale. *[4 marks]*

(b) Use PEST analysis as a framework to highlight the most significant external factors affecting *Stella*. *[8 marks]*

(c) (i) Analyse the decision by *Stella* to create brand and corporate awareness rather than promoting particular products. *[4 marks]*

(ii) Examine the commercial and ethical issues involved in advertising campaigns designed to shock, and possibly offend, some of the general public. *[4 marks]*

4. Scoot-by plc

Scoot-by plc is a respected manufacturer and distributor of leisure scooters and regarded as the market leader. At present its products only retail in its own chain of shops. Its strong brand image was established through strict production controls, a focus on quality and a reputation for safe and rugged products.

The scooter market is becoming increasingly competitive as cheaper, poorer quality imports flood the domestic market. *Scoot-by plc* is considering sub-contracting the production of its scooters to a very large industrial manufacturer located in the Far East, starting with its premium product and main seller, the Scoot-X17. This will allow *Scoot-by plc* to concentrate more on the marketing and distribution of its product range. Fewer examples will be required as a result.

The following production data for the Scoot-X17 has been provided to the board of directors:

Current production		**If production is sub-contracted**	
Current output:	20 000 units per year	Potential output:	30 000 units per year
Selling price:	$250 per scooter	Selling price:	$250 per scooter
Variable costs:	$150 per scooter	Variable costs:	$170 per scooter
Fixed costs:	$1 500 000	Fixed costs fall to:	$1 100 000

One other change under consideration is the selling of the scooter range through a website on the Internet. Some directors are concerned about maintaining brand image, following the proposed changes in production, marketing and distribution.

(a) (i) Calculate the current break-even level of output for the Scoot-X17 model. Show all your working. *[2 marks]*

(ii) Show the changes in the break-even level of output for the Scoot-X17 model if *Scoot-by plc* sub-contracts its production. *[1 mark]*

(b) Analyse the arguments for and against subcontracting production of the Scoot-X17 model and recommend to the board whether production should be sub-contracted. Justify your choice, if necessary suggesting measures to safeguard *Scoot-by plc's* position as market leader. *[9 marks]*

(c) Discuss how the move to Internet marketing and distribution may affect *Scoot-by plc's* brand image and operations. *[8 marks]*

5. Clean Air

Clean Air is a newly established company producing environmentally friendly household cleaning products which prides itself on:

- its rapid market growth
- being socially responsible and producing environmentally friendly products
- its ability to create a culture of mutual trust between management and employees
- a relaxed and friendly atmosphere.

These features have resulted in a highly successful company with motivated employees and a very low staff turnover.

However, *Clean Air's* cash flow budget suggests potential liquidity problems in the coming year. The finance manager is considering taking a bank loan for one of the following two investment options to increase the production capacity of *Clean Air*.

	Option A – "Speedy Machine"	**Option B – "Green Machine"**
Initial cash outlay:	$500 000	$550 000
Net return:	$000	$000
Year 1	200	200
Year 2	250	230
Year 3	220	210
Year 4	100	75
Scrap value	50	20

Option A will:
- result in a quicker and cheaper production process
- enable the company to reduce labour costs by replacing 10 employees.

Option B will:
- result in a quieter production process
- result in less emissions and reduce waste.

(a) For each machine calculate:

(i) the payback period *[2 marks]*

(ii) the net present value using 8 % discounting rate.
Remember to show your working.
(The discounting factors at 8 % rate of interest are
Year 1= 0.9259 Year 2 = 0.8573 Year 3 = 0.7938
Year 4= 0.7350) *[4 marks]*

(b) Analyse **two** advantages and **two** disadvantages for *Clean Air* of using payback and discounted cash flow investment appraisal methods. *[6 marks]*

(c) Evaluate each investment option and recommend to the finance manager of *Clean Air* which investment option to choose. *[8 marks]*

6. Video Box

Video Box is a Private Limited Company operating in 15 countries across South America. It is one of the market leaders in video rentals and currently has 150 outlets. The company expanded rapidly during the early and mid 1990s as economic growth accelerated within the member countries of the regional free trade area.

However, the late 1990s saw a less favourable economic picture as the growth of South American economies slowed. Regional recession is now forecast from 2005, especially in the country where *Video Box* is market leader.

It is predicted that governments will react to the potential recession by cutting interest rates, which is likely to lead to a sharp fall in the exchange rate of regional currencies.

***Video Box* Sales 1995 – 2003**

Year	Sales ($m)
1995	692
1996	665
1997	695
1998	714
1999	732
2000	758
2001	735
2002	721
2003	762

Video Box Management is now planning a growth strategy for the next four years.

(a) Using a five year moving average, calculate the sales trend and graph the actual sales and the trend line. *[5 marks]*

(b) Calculate the cyclical variation, extrapolate the trend and forecast the sales level for 2005. *[5 marks]*

(c) Explain the limitations of the above moving average forecasting method. *[4 marks]*

(d) Assess the possible effects of the predicted recession, low interest rate and lower exchange rate on *Video Box*. *[6 marks]*