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# **MARKSCHEME**

**November 2003**

**BUSINESS AND MANAGEMENT**

**Higher Level**

**Paper 2**

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

In AGM shareholders are invited to:

- vote on resolutions and the re-election / election of a board of directors
- have opportunities to ask the CEO, directors, chairperson questions
- approve the year's accounts.

Given the above, socially responsible investors can more than just engage in dialogue with the company. They potentially can:

- draw attention to unacceptable practices and suggest new practices
- vote against proposed policies / objectives / resolutions that are perceived as being socially irresponsible
- vote against the current board of directors and replace them.

**[3 to 4 marks]**

For a relevant discussion of at least two options from above. The discussion has to refer to the AGM role.

**[1 to 2 marks]**

For a limited discussion with no reference to AGM role.

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

The possible advantages may include:

- in the longer term, socially responsible companies can become more profitable – and give a higher return for the investors
- USP for the investment funds. May attract the growing number of socially responsible investors. More funds result in more power for the investment trusts
- fund managers may be perceived as trustworthy by the investors.

The possible disadvantages may include:

- lower salary for the fund managers
- greater selectivity in choosing the companies in which to invest may result in choosing socially responsible companies that make lower levels of profit and, consequently, lower dividends for the shareholders. This is more of a short-term consequence
- costs of administration and involvement may be higher due to *active shareholding*
- more limited sources of funds, as profit-seeking investors may not come forward.

**[4 to 5 marks]**

For a clear analysis of two advantages and two disadvantages.

**[2 to 3 marks]**

For an analysis of fewer than two advantages and fewer than two disadvantages or for an unbalanced analysis.

**[1 mark]**

For a limited description.

- (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]**

Possible policy changes may include:

- fair employment, health and safety practices
- payment and perks to the board of directors and other executives
- consumer issues
- the impact on the environment
- testing on animals
- methods of competition
- misleading advertising
- duties to local communities / involvement / donation
- accuracy of records
- *any other relevant policy.*

Allocate **[1 mark]** for each policy described and justified, up to a maximum of **[4 marks]**.

Allocate no more than **[2 marks]** for a relevant list provided without justification.

- (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]**

The conflicts may be substantial if stakeholders perceive a change in policy as damaging to profits. However, if a positive effect on sales is evident, conflicts may disappear.

The other possible stakeholders:

**Shareholders:** *Interest:* higher level of profit, quick and higher dividends.

*Effects:* dissatisfied shareholders may sell their shares, which could lead to a fall in the price of shares and greater vulnerability to takeover. This group of investors can be in direct conflict with the socially responsible shareholders who do not put profit first. Shareholders may also conflict with directors regarding dividend payments.

**Directors:** *Interest:* higher market share, growth, profit. Better status, salaries and perks. Trouble-free running of the company. Power to take decisions.

*Effects:* directors behaviour / ability can affect the operation of the company both positively and negatively to a large extent.

Directors may be in conflict with any of the groups discussed regarding policies, costs / efficiency, level of dividends, their salaries and code of practice.

**Pressure groups:** *Interest:* to protect the environment / customers: to modify the behaviour of the firm.

*Effects:* create bad reputation / a fall in sales; initiate government intervention; may lead to closure.

Pressure groups can be in agreement with the socially responsible investors but may be in direct conflict with the other shareholders and directors.

**Residents / consumers:** *Interest:* improve product quality and safety.

*Effects:* create bad publicity which results in a significant fall in demand.

May be in agreement with the socially responsible investors but may be in direct conflict with the other shareholders and directors.

Other possible stakeholders for the analysis: the government, employees, managers, and competitors.

**[6 to 7 marks]**

A clear identification of two other relevant stakeholders and a detailed evaluation of the potential conflicts and their likely effects.

**[4 to 5 marks]**

A clear identification of two other relevant stakeholders, but with an evaluation of conflict areas and the effects.

If only one other stakeholder is identified a maximum of **[4 marks]** should be awarded if the evaluation is detailed.

**[2 to 3 marks]**

Only one stakeholder is identified with limited evaluation or two stakeholders are identified with no or very limited discussion. No judgments may be made.

**[1 mark]**

A very limited response.

2. (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]**

The possible benefits arising from the creation of AFTA are:

- western MNCs can locate in Thailand and export without trade barriers to other member countries
- the MNC's will gain access to a larger and possibly more affluent market due to the reduction of tariffs, quota and any other restrictions
- western cars should be cheaper / more competitive.
- fewer regulations

**[3 marks]**

For a clear explanation of AFTA and its benefits and an explanation of the points mentioned above, or other relevant benefits.

**[1 to 2 marks]**

For a more limited explanation or for provision of a short list.

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

Three **other** possible reasons may include:

- good infrastructure
- access to motorways, railways, ports
- availability and quality of land – the amount of space, price, opportunities for expansion
- financial incentives like government grants, tax breaks, subsidies
- *any other relevant reasons.*

Allocate **[1 mark]** for any relevant reason up to a maximum of **[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]**

The two possible benefits may include:

- external economies of scale
- transfer of technology and knowledge
- some form of joint venture regarding supply of material or distribution
- improved efficiency as competition intensifies.

Two possible costs may include:

- a fall in the market share as competition intensifies
- financial difficulties as local businesses are forced to reduce price or increase investment
- takeover threat
- the collapse of the business.

**[4 marks]**

For an analysis of both two costs and two benefits.

**[2 to 3 marks]**

For an analysis of fewer than two costs and two benefits – but mention of both a cost and a benefit. **[2 marks]** for provision of a list.

**[1 mark]**

For a vague, limited answer.

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

The relevant ethical issues may include:

- fair business practice – fairness in dealing with local firms and employees
- labour – pay and conditions, treatment of local workers and promotion opportunities for local workers, perks-offer to executives suppliers
- customers – the price that should be charged in the Asian market
- effects on the physical environment that result from the production process
- political lobbying by companies. Corporate donation to local parties
- advertising methods and content
- methods of gathering information about the competitors
- *any other relevant issues.*

**[3 to 4 marks]**

For a clear examination of two relevant ethical issues with clear application to car-makers.

**[1 to 2 marks]**

For an explanation of one relevant issue or **[1 mark]** for each issue listed up to a maximum of **[2 marks]**.

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

The current strategy can be classified as “adaptation” to local needs / requirements as well as using local suppliers / components (as opposed to “standardization”).

Possible advantages:

- being a more customer-focused and flexible organization – marketing advantages
- better relationship with customers, suppliers and governments, which can result in increased market share and possible government financial incentives or less intervention.

Possible disadvantages:

- higher costs of production, inability to reach global or regional economies of scale
- lower car quality and higher prices as the companies cannot shop globally for better / cheaper components.

**[5 to 6 marks]**

For a clear explanation of the current strategy and a clear assessment of relevant advantages and disadvantages.

**[3 to 4 marks]**

For some explanation of the current strategy with an assessment of advantages and disadvantages that may be unbalanced and/or limited in scope.

**[1 to 2 marks]**

A limited answer in terms of explanation and/or assessment.

3. (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]

Economies of scale – advantages of large-scale production, the reduction in average costs as the scale of production increases.

*Stella* could benefit from economies of scale in terms of the unit cost of production falling as the scale of production increases. As the size of the *Stella* plant grows, they benefit from economies of scale in terms of labour (better use of specialised labour), capital equipment (specialist equipment) and stocks of materials (lower stock levels and storage space).

Purchase economies will result due to discounts.

Finance economies from access to lower cost finance.

Marketing economies – can advertise cheaply in relation to sales.

Research and development – classic jumpers and late dyeing lead to low risk and lower R&D costs.

[4 marks]

The answer gives a full explanation of what is meant by economies of scale and two relevant examples are given of benefit to *Stella*.

[2 to 3 marks]

The answer explains what is meant by economies of scale, though the explanation may lack detail. Two examples are given but the benefits to *Stella* may not be clear, or one example is well explained.

[1 mark]

A simplistic and general response.



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

|  |   |
|--|---|
| <p><b><u>Legal and political</u></b></p> <ul style="list-style-type: none"> <li>• raised awareness of human rights</li> <li>• tighter legislation on wages and working conditions</li> <li>• bans on advertising</li> </ul>  | <p><b><u>Economic</u></b></p> <ul style="list-style-type: none"> <li>• recession in Europe</li> <li>• less money to spend on products</li> <li>• high taxes</li> </ul>  |
| <p><b><u>Social and cultural</u></b></p> <ul style="list-style-type: none"> <li>• new market segments</li> <li>• growing interest in children’s clothes</li> <li>• aging population</li> <li>• greater brand awareness</li> <li>• globalization of markets</li> <li>• customers more open to approaches that appear to be innovative</li> <li>• cheap labour available in production countries.</li> </ul> | <p><b><u>Technological</u></b></p> <ul style="list-style-type: none"> <li>• availability of CAM and CAD and computerised knitting machines</li> <li>• new dyeing process available</li> <li>• increasing costs of maintenance of modern machinery</li> <li>• lower labour costs.</li> </ul> |

Candidates should explain each point included.

***[7 to 8 marks]***

The PEST analysis is detailed and covers legal and political, economic, social and cultural and technological factors. Examples should be related to the case study.

***[4 to 6 marks]***

The PEST analysis attempts to include legal and political, economic, social and cultural and technological factors though some of the elements may lack detail. At the lower end one of the elements may be missing.

***[2 to 3 marks]***

The answer attempts to produce a PEST analysis though the detail may be limited and some elements missing.

***[1 mark]***

For simplistic, muddled and general responses.

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

*Stella* clearly believe that there is no such thing as bad publicity. Their products are classics, e.g. jumpers and sweatshirts and there would be little to be gained in focusing on them or the company.

Some of the reasons for concentrating on brand and corporate awareness include:

- strong branding may allow premium pricing and may reduce elasticity
- short product life cycles in the fashion industry
- marketing economies of scale
- increased brand recognition and awareness.

[4 marks]

The decision to advertise the company rather than the product is analysed in detail.

[2 to 3 marks]

The decision to advertise the company rather than the product is analysed, but may not be entirely relevant or detailed.

[1 mark]

A simplistic and general response.

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

Ethics – code of behaviour that is acceptable to a person or organization to follow in a given society.

*Stella* believes in the “shock factor” and its controversial advertising could prove damaging to the company. However it appeals to a classic teenage market that is unlikely to be affected by such marketing. If they decided to target a different segment then the company would experience problems with more discerning customers who were not label conscious. It is not ethical to exploit in this way.

[4 marks]

The ethical and commercial issues surrounding marketing are examined in detail and applied to *Stella*.

[2 to 3 marks]

The ethical and commercial issues are examined, but may lack relevance to *Stella* and may be discussed in less detail.

[1 mark]

A simplistic and general response.

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

$$\begin{aligned}
 \text{Break-even} &= \frac{\text{Fixed costs}}{\text{Contribution to fixed costs}} = \frac{\$1\,500\,000}{\$250 - \$150} = \frac{\$1\,500\,000}{100} \\
 &= \underline{\underline{15\,000\ \text{units}}}
 \end{aligned}$$

Award [1 mark] for the correct answer, and [1 mark] for clear layout and explanation of working.

- (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]

$$\begin{aligned}
 \text{Break-even} &= \frac{\text{Fixed costs}}{\text{Contribution to fixed costs}} = \frac{\$1\,100\,000}{\$250 - \$170} = \frac{\$1\,100\,000}{\$80} \\
 &= \underline{\underline{13\,750\ \text{units}}}
 \end{aligned}$$

Award [1 mark] for the correct answer, and clear layout and explanation of working.

- (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]

**Arguments for sub-contracting**

- lower break-even point
- lower fixed costs
- lower, more competitive price and/or higher profits
- focus on “core” activities e.g. free up resources for marketing
- reduce risks of stockholding
- closer match of supply and demand, increased flexibility
- possibility of JIT
- technology in Far East may be better
- improved quality due to Kaizen, continuous improvements etc.
- economies of scale and possibility of larger output e.g. 30 000 units
- improved liquidity
- higher margins of safety.

**Arguments against sub-contracting**

- loss of control over production
- fear that image will be worsened by poorer quality or perception of lower quality (remove USP)
- longer distribution chain and possible delays
- currency fluctuations
- possible external constraints e.g. war, inflation, recession
- may involve redundancies and downsizing with effects on morale
- fewer job opportunities within firm.

The student may recommend either option provided it is well supported by discussion. Better answers will place provisos on their recommendations. Reward should be given to imaginative, intelligent and well-focused responses. If sub-contracting is recommended then it may be suggested that quality control measures are clearly put in place. Alternatively, discussion of issues such as penalty clauses may be added to the analysis.

If sub-contracting is rejected, answers may refer to the need to cut costs or improve technology to ensure retention of market leadership. Additionally, marketing may need to concentrate on differentiation strategies.

**[7 to 9 marks]**

The advantages and disadvantages of each option are identified well with reference to the information provided in the question. The analysis includes a well-argued and supported judgment.

**[3 to 6 marks]**

The advantages and disadvantages of each option are considered, although they may not be comprehensive. There is some reference to the information provided. At the upper end of the band, a judgment must be given, although it may not be well supported.

**[1 to 2 marks]**

The answer is highly generalized and possibly brief.

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

**Benefits of the Internet**

- cheaper access to world markets with a significantly larger market
- economies of scale from a mass market
- the firm has total control of the "below the line promotion" over the message and image
- adverts can be easily and speedily updated and targeted at specific, potential customers.

**Problems and issues**

- customers may not have access to the world wide web
- it can be slow to connect and use and disconnection may be an irritant
- security of payment. Encryption may be broken and hackers may access personal details
- distribution networks may have to be adjusted. Overseas sales and distribution networks may be very expensive
- dedicated order centres need to be set up
- costs of setting up servers and communication systems
- technical issues may affect reliability of process
- Internet may not provide simplicity of access
- may negatively affect exclusive image.

Brand image may change voluntarily or otherwise. It may be difficult to maintain an exclusive image if the distribution is to a mass market. Expansion into new markets nationally or internationally may require an adaptation of image to meet the new market situations and cultures encountered along the way. The Internet may not be the only form of promotion so it will be necessary to maintain a consistent approach to marketing. The move from its own retail shops may affect their future, positively or to marketing. It may be that new shops may open overseas as the result of marketing through the Internet, or the company may simply close its existing retail network.

Operationally, as a result of these benefits, problems and issues, *Scout-by plc* may have to change their organization radically in light of the new marketing and distribution approaches. Human resources may have to be modified through the introduction of new staff and new skills, with the ensuing training issues. Additional markets will need new distribution channels to be established. This may require expansion into new markets or joint ventures or partnerships.

***[7 to 8 marks]***

The discussion clearly addresses the impact on both brand image and operations as a result of the move to Internet marketing and distribution. The answer recognizes the functional consequences in terms of HRM, finances *etc.*

***[3 to 6 marks]***

The discussion addresses the impact on both brand image and operations as a result of the move to Internet marketing and distribution, although this may not be balanced. At the top of the band the answer recognizes some functional consequences in terms of HRM, finances *etc.*

***[1 to 2 marks]***

The answer is highly generalized and possibly brief.

5. (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]

(i) Payback period

A = 2 years 3 months

B = 2 years 7 months (6.85 months)

Allocate [1 mark] for each correct answer. The answer may specify the exact number of months or be given in years e.g. 2.23 years or 2.57 years.

(ii) Net present value

Discounted Cash Flow

|        | <u>Option A</u> |   | <u>Speedy Machine</u> |  | <u>Option B</u> |   | <u>Green Machine</u> |
|--------|-----------------|---|-----------------------|--|-----------------|---|----------------------|
|        | <u>\$000</u>    |   | <u>\$000</u>          |  | <u>\$000</u>    |   | <u>\$000</u>         |
| Year 1 | 200 × 0.9259    | = | 185.18                |  | 200 × 0.9259    | = | 185.18               |
| Year 2 | 250 × 0.8573    | = | 214.33                |  | 230 × 0.8573    | = | 197.18               |
| Year 3 | 220 × 0.7938    | = | 174.64                |  | 210 × 0.7938    | = | 166.70               |
| Year 4 | 100 × 0.7350    | = | <u>73.50</u>          |  | 75 × 0.7350     | = | <u>55.13</u>         |
|        |                 |   | <u>647.65</u>         |  |                 |   | <u>604.19</u>        |
| Scrap  | 50 × 0.7350     | = | <u>36.75</u>          |  | 20 × 0.7350     | = | <u>14.7</u>          |
|        |                 |   | <u>684.40</u>         |  |                 |   | <u>618.89</u>        |

NPV = Present value of return – Costs

Option A

Option B

\$000

\$000

\$000

\$000

684.40 – 500 = 184.40

618.89 – 550 = 68.89

*N.B. The answers may be slightly different if the candidate does not round to 2 decimal places. Credit should be given to different but correct answers.*

(ii) **[4 marks]**

The answer is entirely correct with full, clear working.

**[2 to 3 marks]**

One or two errors (although these may occur twice if applied to both options e.g. scrap is omitted or not discounted for both Option A and B), and/or working is poor.

*N.B. If working is totally omitted a maximum of [2 marks] are available.*

**[1 mark]**

There are up to three errors or two errors with poor or no working.

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

**Simple payback** will enable *Clean Air* to use a quick and a very simple method, which stresses the early return. It might be very important for *Clean Air* as the company is likely to experience some liquidity problems.

Also, short term forecast is likely to be more accurate.

However, this method ignores the return after the payback period and discriminates against projects that involve a long-term payback period.

**The discounting method of the NPV**, despite being more complicated, based on expectations and predictions of future inflow and possible discounting factors, takes timing into account and all cash flow are included. As it is a major investment for *Clean Air*, it might want to consider all future returns before making an investment decision.

*Accept any other relevant factors.*

**[5 to 6 marks]**

For a relevant analysis of two advantages and two disadvantages of each method. For **[6 marks]** the analysis refers to *Clean Air's* particular situation.

**[3 to 4 marks]**

Fewer than two advantages and disadvantages have been identified, or there is full analysis of one method **[3 marks]**.

**[1 to 2 marks]**

For a limited answer in scope and accuracy.

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

The evaluation should incorporate:

- Comparison of the payback period and possible conclusions that the four months difference is not really a significant factor especially when cash flow problems are forecasted for the coming year.
- The NPV is significantly higher for proposal A. Choosing this option will also add the benefits of a quicker production process and possible cost cutting on operation and labour.
- Option A requires less initial cash borrowing which might be beneficial for *Clean Air* especially due to the forecasted short-term liquidity problems.
- Option B will enable *Clean Air* to maintain its ethical stance, act as a USP, as well as maintaining and even reinforcing the very supportive human relations.
- Opting for the Speedy Machine might result in deterioration of human relations, reduce motivation and, therefore, long term productivity as well as putting off ethical consumers.
- The overall strategy of *Clean Air* also has to be looked at before a final decision is made.
- Taking the long-term view, option B should probably be recommended.

However, credit an answer that fully justifies opting for option A.

**[7 to 8 marks]**

For evaluation of the above factors or other relevant ones. Relevant financial and non-financial factors based on the information given in the case study have been analysed. A clear, well-substantiated recommendation is provided.

**[5 to 6 marks]**

For evaluation of some but a more limited number of above factors or other relevant ones. Relevant financial and non-financial factors based on the information given in the case study have been analysed.

**[3 to 4 marks]**

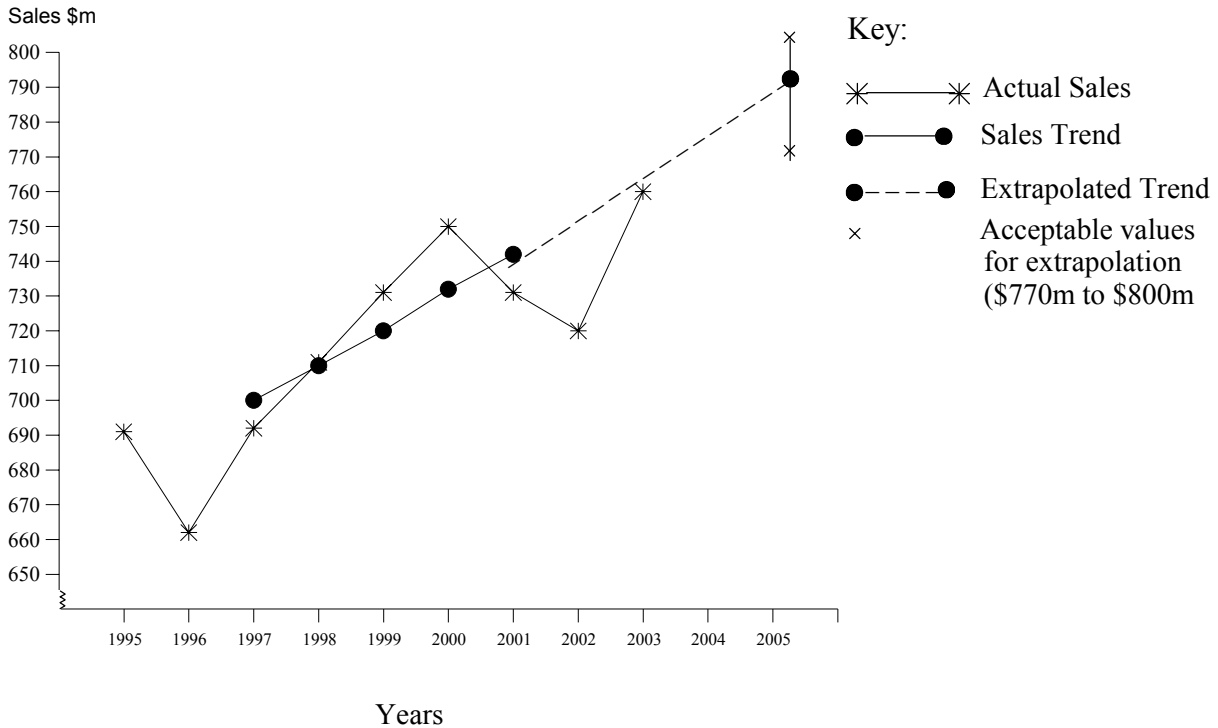
For a description / discussion of some relevant financial and/or non-financial factors for consideration. Limited references are made to the case study. Recommendation is not provided or is unsubstantiated.

**[1 to 2 marks]**

For a very superficial answer.



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



| Year | Sales (\$m) | Trend | Cyclical variations |
|------|-------------|-------|---------------------|
| 1995 | 692         |       |                     |
| 1996 | 665         |       |                     |
| 1997 | 695         | 699.6 | (4.6)               |
| 1998 | 714         | 712.8 | 1.2                 |
| 1999 | 732         | 726.8 | 5.2                 |
| 2000 | 758         | 732   | 26                  |
| 2001 | 735         | 741.6 | (6.6)               |
| 2002 | 721         |       |                     |
| 2003 | 762         |       |                     |

**[5 marks]**

For clear and accurate calculations, drawing and identification of the trend.

**[3 to 4 marks]**

For largely clear and accurate calculations, drawing and identification of the trend. Some small inaccuracies may occur.

**[1 to 2 marks]**

For a minimal, superficial answer where the calculations and consequently the identification of the trend are largely inaccurate and/or missing.

- (b) Calculate the cyclical variation, extrapolate the trend and forecast the sales level for 2005.**

**[5 marks]**

Average cyclical variation  $\frac{\$21.2\text{m}}{5} = \$4.24\text{m}$

Extrapolated trend is not necessarily an accurate line. Forecast sales may range from \$775m to \$800m depending upon the line of best fit. Whatever extrapolated figure is graphed, the candidate should add \$4.2m.

**[5 marks]**

For correct calculations and extrapolation within acceptable range.

**[3 to 4 marks]**

For a largely correct calculation and extrapolation.

**[1 to 2 marks]**

For a superficial, minimal response which is largely inaccurate.

- (c) Explain the limitations of the above moving average forecasting method.**

**[4 marks]**

Limitations

- the number of annual points for the trend is limited to five points
- the trend line is not completely straight / smoothed, meaning that the extrapolation has an element of inaccuracy, based on a line of best fit
- extrapolation assumes that existing conditions apply into the future; this may not be the case
- previous years sales have been erratic and the environment appears unstable, making forecasting into the future possibly little more than a guess
- the moving average calculation takes no account of data outside the period of the average.

**[4 marks]**

There is a clear explanation of at least three points.

**[2 to 3 marks]**

There is a clear explanation for two points for **[3 marks]**. If the candidate merely lists, then **[1 mark]** should be given for each relevant point up to a maximum of **[3 marks]**.

**[1 mark]**

The answer has an element of relevance, but without depth, or merely a single listed limitation.

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

**[6 marks]**

**Effects of recession**

- lower levels of demand, particularly for luxury goods
- higher levels of unemployment
- firms cut back on output
- firms may go into liquidation
- falling profits and wage levels.

For *Video Box*, this is likely to mean a reduction in demand for their videos in their shops. This may have a serious effect on sales revenue and profits. The result may be that *Video Box* is forced to lay-off staff and/or close outlets.

**Effects of low interest rates**

- the cost of borrowing falls and the interest on existing loans reduces
- the rewards for savings fall
- if comparative interest rates are lower than other economies, exchange rates are likely to fall
- new investments may appear more profitable.

**Effects of lower exchange rates**

- imports become more expensive – possibly more demand for domestic goods
- exports appear cheaper to overseas purchasers
- falling confidence in the economy.

For *Video Box*, the cost of buying in films from outside the region may become more expensive. It is unlikely that they export, so the effect is likely to be negative. However, they may be encouraged to borrow money to further expand as it would be cheaper, but this would be tempered by possibly falling demand.

**[5 to 6 marks]**

There is a clear understanding of the economic concepts, which are effectively applied to *Video Box*.

**[3 to 4 marks]**

There is some understanding of the economic terms and an attempt to apply these to *Video Box* for **[4 marks]**.

**[1 to 2 marks]**

There is a very limited understanding of the economic terms and possibly no attempt to apply to *Video Box*.

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