

MARKSCHEME

May 2004

BUSINESS AND MANAGEMENT

Higher Level

Paper 2

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1. (a) (i) **Explain the term *corporate culture* with reference to *IBM*. [3 marks]**

Corporate culture is a collection of shared norms, customs, values, beliefs, attitudes and approaches that moulds and shapes the behaviour of employees within an organization. It may be a predictor of how an organization responds to change. It could be considered as the personality or character of a business that underpins its strategy and public image.

According to Gerstner, *IBM* was considered in the 1990s to be traditional, ordered (regimented may be more negative) and conservative, but reliable. The image of dark suits and white shirts refers to being businesslike and formal, but also traditional and potentially “old-fashioned”, especially in the context of a high technology industry.

[3 marks]

Corporate culture is well explained and referenced to *IBM*. There is an attempt to extend the answer beyond a brief response.

[2 marks]

Corporate culture is explained and referenced to *IBM*. Some aspect of the answer is brief.

[1 mark]

Either corporate culture is explained or there are illustrative references to *IBM*, but not both.

(ii) **Examine why Louis Gerstner felt it necessary to change *IBM*'s culture. [3 marks]**

Gerstner was aware that the existing culture was restricting *IBM*'s growth and affecting its image as a high-tech company. The attempt to create a vision for the firm or to put in place financial and marketing strategies was being hindered by a company culture born in a different age. The culture of *IBM* had begun to lose the connection to *IBM*'s purpose. It had become bureaucratic, with internal competition between departments. There was a lack of trust in the organization. The firm was not adapting to changes in the external environment. Conflict was not being managed. In the end this was affecting sales and profit.

[3 marks]

The examination refers in some depth to culture. There is a clear recognition that the culture was not appropriate to a high-tech firm trying to compete in a global market.

[2 marks]

The examination shows an understanding that the culture was inappropriate in several areas, and uses references from the text.

[1 mark]

There is a brief and/or limited examination of issues, or a list.

- (b) **Evaluate the conditions that could be created and incentives that could be introduced, to reduce employees' resistance to change.** [8 marks]

The question refers to both “conditions” and “incentives”.

Conditions: could include some of the following

- better training and more reskilling with an expectation of change
- passing of responsibility for change to employees, *e.g.* Kaizen
- more participation in decision making and the setting up of improved communication channels to keep people informed of proposed change
- more empowerment, possibly through the flattening of the organization
- greater delegation
- review of leadership styles
- better teamworking
- job rotation between divisions and functions
- less formal structures
- clearer explanation of the shared purpose of *IBM* *e.g.* clearer objectives linked to the firm's mission
- better planning of change and involvement of those affected *e.g.* Ringi
- clearer identification of outcomes of change emphasizing benefits
- review recruitment procedures
- allow time for innovation and place an emphasis on research.

Incentives: could include

- linking output and profit improvements directly to pay and conditions *e.g.* bonuses (PRP)
- suggestion bonuses
- linking bonuses to teamwork
- share options
- promotion criteria more closely linked to performance
- greater recognition of performance through awards and honours
- flexible pay structures *e.g.* broadbanding
- fast track promotion.

Putting structures in place may not mean that employees are willing to change as a result. The fear of change is caused by the fear of loss, *e.g.* job, power, remuneration. It also assumes that individuals are flexible and will undertake training. Training may be expensive and time consuming. Managers may find it difficult to change style or approach. Organizations have found in the past that change is a very long process. However, in a high tech industry change is fundamental to competitive advantage and *IBM* needed to develop the conditions appropriate to its growth needs.

Similarly there are difficulties in adjusting reward structures. Individual rewards may lead to increased rivalry. Team bonuses may not take into account individual contributions. Do higher rewards motivate or is this merely a Theory X approach? Profit sharing and share ownership may link more directly performance to company success or failure. Non-monetary incentives may prove very successful if they allow the individual to achieve higher level needs such as recognition, ego and esteem needs.

[6 to 8 marks]

Relevant conditions and incentives are identified and illustrated and linked to reducing resistance to change. Evaluation makes use of appropriate business theory and terms. Some sensible judgments are made and supported.

[3 to 5 marks]

Some conditions and/or incentives are identified, although these may not be clearly linked to reducing resistance to change. The attempt at evaluation makes a more limited use of business theory and terms.

[1 to 2 marks]

The answer may be little more than a brief list, with little overt connection to change.

- (c) **Analyse the factors that influence the degree of centralization and decentralization in multinational companies like IBM.** **[6 marks]**

Centralization means that all or most major decisions are made at the top levels (or centre) of the organization. These decisions are imposed on the rest of the organization leaving little room for discretion or autonomy. Decentralization implies delegation and autonomy in the lower levels of the organization.

The degree of centralization is influenced by

- cost and consequences – generally decisions that entail considerable risk and cost will be made at the centre
- desire for a uniform policy – if consistency and uniformity is required
- the culture and history of the firm – the prevailing culture will influence expectations
- the size of the firm – the larger and more diverse the firm, the more the need for some central control
- the nature of management – the outlook, character and background of the management will affect the amount of delegation. Those managers wishing to retain control or status will delegate little.
- the quality of middle and junior management – well qualified and experienced middle and junior ranks will encourage and demand delegation
- the geographical dispersal of the organization – the more dispersed, the greater the need for some centralization
- availability of control mechanisms – new information and communication technologies have encouraged greater decentralization of decision making
- the desire for flexibility – firms needing to adapt to fast changing or localized environments may need more decentralized policies
- the need for innovation – enterprise may be stifled by too much bureaucracy and control.

In *IBM's* case they are in a fast moving environment and one would expect a fair degree of delegation. However, as it says in the text, coordination was crucial as *IBM* spread geographically, but their global clients required compatibility in standards and products worldwide.

[5 to 6 marks]

The analysis is balanced with detailed assessment of the factors influencing the degree of centralization and decentralization. There is an attempt to link the discussion to the requirements of multinational corporations such as *IBM*.

[3 to 4 marks]

The analysis is sound and appropriate to *IBM*, but may lack detail and/or balance, especially at the lower end of the band.

[1 to 2 marks]

A brief, generalized and probably unbalanced answer, which tends to description or listing.

2. (a) (i) **Examine the links between a firm's logo and its mission statement with reference to *BP*.**

[3 marks]

The logo is a visual representation of the firm, which may become a shorthand for what it stands for, such as its values and attitudes. Millions are spent on logos which are intended to be memorable. It may confer meaning, attributes or status and may be reproduced on products, company materials and in promotional campaigns. The logo is another form of branding.

The mission of a firm is a statement of values and the overall philosophy of an organization. It is intended to be a guiding hand for all that the firm and its employees do. It may be the creation of a USP, which again may be part of a promotional approach to create competitive advantage. The mission is not specific.

The logo and the mission must fit. The values and ideas enshrined in the mission should be incorporate in the visual representation of the logo, especially as the logo often becomes a replacement for any slogan or promotional copy. *BP*'s mission is to be socially responsible and to enhance the environments and communities in which it operates. Clearly the green colour and the design should emphasize the approach in a visual manner.

[3 marks]

There is a clear understanding of both a mission statement and logo and an examination of their links with some reference to *BP*.

[2 marks]

There is some understanding of the terms, but the links may not be clearly stated and/or there is no reference to *BP*.

[1 mark]

There is a brief and/or limited examination of terms.

- (ii) Identify *three* policies that *BP* could implement in their new plant in West Papua to put their mission statement into practice.

[3 marks]

Possible policies

- support for education and training, adult literacy
- fair and competitive terms and conditions of employment
- care for the environment, reduction of pollution and
- use of recyclable materials and sustainable development
- use of non polluting and renewable energy resources, such as solar power
- care and attention paid to effective health and safety measures and education
- a range of services for their employees and families such as health care
- urban renewal and regeneration schemes
- sponsorship of sport, art, local culture
- environmental conservation schemes
- technology transfer
- respect for cultural diversity among the workforce
- investment in local suppliers
- emission targets.

Any three policies could be identified as long as they represent *BP's* desire to bring economic regeneration, greater opportunities, sustainable development and urban renewal to the communities in which it operates.

[3 marks]

Three appropriate policies are identified which fit the criteria outlined in the article.

[2 marks]

Two appropriate policies are identified which fit the criteria outlined in the article or three policies not well developed.

[1 mark]

One appropriate policy is identified which fits the criteria outlined in the article listed, or a list of policies with no explanation.

- (b) Evaluate whether acting ethically and with social responsibility can provide *BP* with commercial and competitive advantage.

[8 marks]

Potential areas of commercial and competitive advantage

- easier recruitment of staff and improved retention
- greater employee satisfaction and improvement in morale and motivation
- enhancement of corporate and brand image providing USP and differentiating products and services
- the ability to charge a premium price for services as a result of better customer loyalty
- longer term improvements in sales and profits
- reducing opposition from pressure groups such as *Greenpeace*
- pre-empting potential legislation and allowing the company to be the first to market
- improved relationships with local and national governments who may be more prepared to look favourably on the company in issues such as location and planning
- local communities may welcome the firm or may oppose it less.

The introduction of ethical and socially responsible policies is likely to bring with it additional costs. It is said in the article that solar power is yet to make the company a profit. Some of its stakeholders may oppose these policies as they reduce profits. Others such as the media may be cynical about *BP's* actions and if competitors respond in a similar fashion, competitive advantage may not accrue, but higher costs remain. In this case a firm may actually go out of business if price is the fundamental deciding factor in customer choice. It also has to be considered whether the customer genuinely cares about a firm's ethics and social responsibility.

However, all firms are being scrutinized more closely in business, so a firm may need to adopt more ethical practices to maintain competitive advantage. With many adverse stories in the oil industry such as *Shell* in Nigeria and Brent Spar, then a "whiter than white" approach is necessary. Oil is primarily a homogeneous product, so it is necessary to consider approaches that provide a unique selling point or provide value added.

[6 to 8 marks]

Several potential areas of commercial and competitive advantage are identified and there is detailed evaluation of the advantages and disadvantages of implementing an ethical and socially responsible approach. There is use of appropriate business theory and terms. Sensible judgments are made and supported and there must be considerations of negative aspects for **[8 marks]**.

[3 to 5 marks]

There is an attempt to identify some commercial and competitive advantages, although these may not be clearly linked to developing an ethical and socially responsible approach. More limited use of business theory and terms.

[1 to 2 marks]

The answer may be little more than a brief list, with little overt connection to implementing an ethical and socially responsible approach.

(c) Analyse why *BP* might find it difficult to satisfy all its stakeholders. [6 marks]

Stakeholders are individuals affected by the behaviour of businesses or those people who can influence their behaviour. These may be internal or external to the business. These include

- owners/shareholders
- employees
- managers
- directors
- customers
- suppliers
- creditors
- trade unions
- competitors
- general public
- the government.

Stakeholders of *BP* have many different objectives. Shareholders for instance want to maximize their dividends and therefore want *BP* to maximize sales and profits. This may mean they would want lower costs. This could be achieved through employing fewer employees, offering lower wages *etc.*, or paying suppliers lower prices for their goods. This would of course, not be in the interest of the employees or suppliers.

BP Customers are looking for good value for money or the lowest possible prices for goods and services. *BP*'s suppliers are looking to receive high prices. Other possible conflicts exist between the firm and the local communities in which they operate if production leads to negative externalities such as pollution and accidents.

Governments may wish to control the activities of firms, possibly by additional legislation. This may reduce the entrepreneurial opportunities available. They may also wish to maximize tax revenues, whereas firms like *BP* may seek to avoid tax wherever possible.

There are many other examples of dissatisfactions and/or conflict that could arise.

[5 to 6 marks]

The analysis is balanced with detailed assessment of potential dissatisfactions and/or conflicts between stakeholders. There is a link to the operations of *BP* through relevant examples.

[3 to 4 marks]

The analysis is sound and appropriate, but may lack detail and/or balance, especially at the lower end of the band. There may be little or no reference to *BP*.

[1 to 2 marks]

A brief, generalized and probably unbalanced answer, which tends to description or listing.

3. (a) (i) Describe *three* barriers to trade that countries like China may use to protect their domestic firms and industries from foreign competition. **[3 marks]**

Possible barriers to trade include

- quotas – restrictions on the numbers of goods that can be imported
- tariffs – additional taxes placed on foreign imports to increase price and
- embargoes - total bans on certain goods and services
- unfair trade restrictions such as discriminatory legislation *e.g.* health and safety legislation
- administrative barriers *e.g.* documentation required by foreign firms only
- restrictions on movements of capital, labour, goods *etc.*, *e.g.* refusal of work permits or visas
- language barriers if these are intentionally used against foreign firms
- requirements to have local partners, *e.g.* Bumiputra policy in Malaysia
- subsidies given to local producers.

[3 marks]

Three relevant barriers to trade are described.

[2 marks]

Two relevant barriers to trade are described or three listed.

[1 mark]

One relevant barrier to trade is described or two listed.

- (ii) Examine *two* reasons why the World Trade Organization (WTO) pushes for these barriers to be reduced or removed. **[4 marks]**

Possible reasons

- enables countries to consume some goods and services more cheaply by importing them – offers consumer more choice
- provides access to some products that would otherwise be unavailable
- allows countries to specialize in the production of goods where they have a cost advantage
- encourages structural and economic change in previously protected economies – by reallocation of resources to more efficient sectors
- increases world output and reduces waste
- allows international flows of capital and technology transfer between countries
- can lead to better political and social relationships and cultural understanding
- generates faster economic growth
- some may argue it is a political and economic ploy to make MEDCs richer at the expense of the producing nations and LEDCs
- breach of patents and copyright.

Award up to **[2 marks]** for each appropriate reason examined up to a maximum of **[4 marks]**.

Award **[1 mark]** for each reason listed up to a maximum of **[2 marks]**.

- (b) Evaluate the extent to which globalization is encouraged by the development of new ICT (information and communication technology).

[7 marks]

Globalization is used to describe the growing integration of the world's economy, whereby barriers between national markets and the international community are broken down, creating a single "global market place" with similar characteristics.

As a result decisions taken in one part of the world will have ramifications in others as firms operate multi-nationally.

One of the factors facilitating this trend is the increase in the use of modern information and communication technologies. This has had the following consequences

- integrated computer systems allowing the transfer of data almost instantaneously and extremely cheaply
- 24/7 operations
- knowledge of firms, products and services worldwide
- technology transfer between countries
- access to markets previously unopened, which may encourage greater trade between countries and expansion by multinationals
- cross-cultural transfer, although some may say increased westernization
- access to world markets creating larger economies of scale
- global marketing and promotion opportunities
- easier transfer of capital.

This has been brought about many ICT technologies such as the world wide web, the Internet, satellite communications, global media networks such as *Sky*, mobile telecommunications, video-conferencing, wide area networks.

Each successive technology seems to be cheaper, faster and more complex than the last opening up further possibilities of global links and new products and services. Language and culture transfers can break down barriers to trade.

However, these factors can be exaggerated. Countries still retain their national characteristic, language and culture. Product and service adaptations are still necessary, from one country and another. The cost of the technology may be beyond the poorest countries leading to a further widening of the wealth gap. Ironically the same technologies that encourage globalization have also allowed the mobilization of anti-globalization pressure groups.

The extension of free trade associations, such as the European Union may partially be as the result of new technologies and their integrating effects.

[6 to 7 marks]

The nature of globalization and the concept of ICT is well understood. There is a detailed evaluation of the extent to which globalization is encouraged by ICT. There is use of appropriate business theory and terms. Sensible judgments are made and supported with relevant illustration.

[3 to 5 marks]

The nature of globalization and ICT is examined, although this may be brief or unbalanced. There is some discussion of the extent to which globalization is encouraged by ICT. At the lower end of the band there is limited use of business theory and terms.

[1 to 2 marks]

The answer may be little more than a brief list, with little overt understanding of globalization and/or ICT.

- (c) **Using a PEST framework analyse the potential advantages and disadvantages to foreign firms of locating in China.** **[6 marks]**

Political – legal

Advantages

- membership of the WTO guarantees the future extension of free trade in China
- apparent commitment to economic reform opening markets shown as tariffs removed or cut
- fewer restrictions / laws placed on business activity.

Disadvantages

- a command economy works against capitalist approaches and entrepreneurship, flexibility *etc.*
- barriers to trade increasing in some areas, *e.g.* health and safety legislation
- illegal copying of products and ideas tolerated which may discourage transfer.

Economic

Advantages

- significant growth in GDP and therefore standard of living/disposable incomes, leading to higher demand and profits
- dynamic market places, particularly along the coast *e.g.* Shanghai
- location of many multinationals in the region providing improved infrastructure and market opportunities and technology transfer
- lower costs of production such as wage rates
- potential market of 1.3 billion people offers huge profit potential.

Disadvantages

- gap between rich and poor widening reducing growth potential and economic stability
- unemployment as local firms lose their protection, possibly leading to lower incomes and demand.

Social-cultural

Advantages

- desire for material goods
- access to new technology is developing a desire for imported goods and services
- well educated workforce available in large numbers providing necessary skills.

Disadvantages

- social discontent as wealth gap increases, may lead to instability
- language barriers and/or culture clashes.

Technological

Advantages

- increasingly technologically aware population eager for new products
- technology transfer possible
- presence of the world's largest technology firms such as *Dell* and *Sony* improves climate and dynamism.

Disadvantages

- technologies are illegally copied which reduces profits and leads to more protection of ideas.

[5 to 6 marks]

A PEST framework is presented with at least one entry in each category. Advantages and disadvantages should be analysed in at least three of the categories. The issues are relevant to China with examples from the stimulus materials. Appropriate business terminology is used.

[3 to 4 marks]

The analysis is sound and appropriate, but there may be gaps in the content of the PEST and format may be less structured. The entries may lack detail and/or balance, especially at the lower end of the band. There may insufficient reference to the stimulus materials.

[1 to 2 marks]

A brief, generalized and probably unbalanced answer, which tends to description or listing. There may be no attempt to use a PEST framework.

4. (a) (i) **Explain why *Dyson* was able to set a high price of \$2 000 in Japan for its first bagless vacuum cleaner.** [2 marks]

Premium pricing or price skimming was possible because the product contained new technologies and a level of design not seen before and was legally protected. It was considered a status symbol and came with the kudos that it had won a prestigious award.

There was no direct competition in the early stages of the lifecycle. Innovators and early adopters are prepared to pay higher prices.

[2 marks]

There is reference to innovation/new technology and/or some attempt to relate the willingness to pay a high price to its status, reputation, or stage in the product life cycle.

[1 mark]

The answer is fairly generalized, but contains at least one solid reason to justify the high price.

- (ii) **Examine how and why *Dyson's* pricing strategy will change as its products move through their life cycles.** [5 marks]

Initially the product has no competition, as it is first to market. The production level is relatively low as the sales are also low. Economies of scale are not possible and therefore costs are high. These are passed on in higher prices. The image of the product also requires a high initial price to match its promotion and exclusivity. High research and development costs must be repaid.

As sales grow, so does production, allowing greater economies of scale. Costs fall and so can price levels. To promote further growth, new consumers must be attracted. These are less prepared to pay skimming prices. "Me-too" products begin to appear and so prices must fall to be competitive.

As the product matures, so the company maximizes economies of scale. Additional customers, such as late adopters and laggards may only be prepared to pay reduced prices. Newer technologies may start to appear, so premium prices are less justified. However, regard must still be held for image and it is unlikely that prices will fall to "bargain levels".

As the product declines, so price cuts are necessary to reduce stocks and persuade some customers to replace older products.

[5 marks]

There is a detailed examination of how and why *Dyson's* pricing strategy will change as products move through their life cycles. It is recognized that pricing is part of the marketing mix and reflects present market position at different stages of the life cycle. There is good use of business terms and theories and reference to *Dyson*.

[3 to 4 marks]

There is some examination of the reasons why price will change through the life cycle. There may be less use of business terms and theories and there is a tendency for description.

[1 to 2 marks]

A brief, generalized and probably unbalanced answer, which is essentially descriptive with little use of relevant business terms.

(b) Evaluate methods by which small firms like *Dyson* can compete against larger firms and grow in international markets.

[8 marks]

Small firms like *Dyson* must create unique selling propositions or product differentiation as they are unlikely to be able to gain a cost advantage over bigger competitors. Design may provide one aspect of differentiation. This can then be protected by patents, which can be used to fend off competition such as *Hoover*. They will also need to aim their product at smaller segments of the market or niches, at least initially. These niches may be too small to attract competition from bigger firms. This corresponds with Porter's strategic approach that is differentiation within a focused market segment. *Dyson* managed to change the concept of a product from a functional machine to a design icon customers would be proud to leave on display.

Big firms like *Hoover* may not be able to offer the same levels of personal service and may be less flexible and able to react to changing market conditions. It is unlikely that they could create a premium offering under their existing brand name. This is a reason why big firms often set up subsidiaries to create different images, such as *Nissan* and *Toyota*. *Dyson* is small enough for the business to retain the entrepreneurial approach brought by James Dyson himself and to build on its existing image. Concentration on his image is important to create an international appeal. This may mean that the firm emphasizes its national roots.

However, it is when small firms wish to expand rather than focus on niches that the problems, such as cash flow problems, may begin. *Dyson* may be held back as it may lack the funds to market effectively in other countries. Distribution channels may be blocked or inaccessible. It may be necessary to find joint ventures to establish distribution channels or to look for more permanent partnerships or mergers. For example, *Haagen-Dazs* eventually gave way to commercial pressures and sold out to *Unilever*, who were able to internationalize the brand using their existing supply chains.

Another alternative is to grow through product or brand extension. This is possible on the back of *Dyson's* reputation for design. The move into washing machines and robots are examples of focusing on core competencies rather than expanding in new product areas. Diversification is therefore an approach not available to small firms like *Dyson*. A big firm may be a multiplication of niches rather than serving a large market segment.

[6 to 8 marks]

It is clear that the methods of expansion available to small firms are well understood. There is a detailed evaluation of expansion methods, such as differentiation and focus. There is use of appropriate business theory and terms. Sound judgments are made and supported with relevant illustration. The candidate may refer to Ansoff or Porter.

[3 to 5 marks]

Some methods of expansion available to small firms are evaluated at the upper end of the band. There is more description at the lower end. There is some understanding of expansion methods. There is some use of business theory and terms at the upper end of the band.

[1 to 2 marks]

The answer may be little more than a brief list, with little understanding of the particular needs of small firms.

- (c) **Analyse how and when in the process of new product development, market research will assist *Dyson*.** **[5 marks]**

Given the high failure rate of new products in the marketplace, market research is a crucial element of new product development. It is necessary to identify and evaluate new product opportunities and test the viability and marketability of new innovations. As a result certain ideas will be rejected at an early stage before significant money is spent. Market research will be used in the screening process where ideas are put to consumer panels through primary research, such as focus groups. *Dyson*'s engineering team will want to know how the product being developed is perceived by the market especially in relation to existing and competitor products. The concept of perception of the firm itself is also crucial if image is integral to the USP.

Customer requirements will be uppermost in the minds of *Dyson*'s designers. They want to know what functions and aesthetics are required, and whether these are economic in production. The research will also allow *Dyson* to set the elements of the marketing mix such as price and promotion. Identification of potential markets and customer profile is crucial for targeting promotion.

Primary research can be used to establish customer requirements. Secondary research will be useful to establish market trends and preferences.

After the design phase is complete, *Dyson* will need to test market their new product, often by launching the product on a limited scale, possibly in a limited geographic area. Customers' reactions to the product now need to be assessed to see if it is necessary to amend the product itself or the elements of the marketing mix, such as price or packaging. Even after launch, market research will need to be maintained to see if initial perceptions are proved true.

[5 marks]

There is a detailed analysis of the stages of new product development and the crucial part market research plays in these. There is good use of business terms, examples and reference to *Dyson*.

[3 to 4 marks]

There is some analysis of the stages of the new product development and the role market research plays in some of these. There is some reference to *Dyson* for **[4 marks]**.

There is a tendency to describe for **[3 marks]**.

[1 to 2 marks]

A brief, generalized and probably unbalanced answer, which is essentially descriptive.

5. (a) (i) **Showing full working, calculate the total weekly profit/loss being made by *Wholeheart Bakery* at the present levels of output.** **[3 marks]**

Present output data

| | Wholeheart wheat flakes | Max-Mart wheat flakes |
|-----------------------------|--------------------------------|---------------------------------|
| <i>Weekly production</i> | 60 000 units | 60 000 units |
| Unit price received | \$1.30 | \$1.10 |
| Variable cost per unit | <u>\$0.40</u> | <u>\$0.40</u> |
| Contribution per unit | \$0.90 | \$0.70 |
| Product contribution | | |
| 60 000 × \$0.90 | \$54 000 | 60 000 × \$0.70 \$42 000 |
| <i>Total contribution</i> = | \$54 000 + \$42 000 = | |
| <i>Less Fixed costs</i> | <u>\$56 000</u> | |
| Total weekly profit | <u>\$40 000</u> | |

[3 marks]

The calculation of total profit is accurate and working is shown in detail.

[2 marks]

The calculation of total profit is accurate, but full working is not shown or there are up to two errors in calculation.

[1 mark]

The method is appropriate, but no working is shown at all, or there are up to three errors in calculation.

- (ii) Calculate the change in profit/loss if *Wholeheart Bakery* accepts the offer to manufacture exclusively for *Max-Mart*. **[1 mark]**

Max-Mart wheat flakes

| | |
|----------------------------------|-----------------------|
| <i>Weekly production</i> | 150 000 units |
| Unit price received | \$1.10 |
| Variable cost per unit | <u>\$0.40</u> |
| Contribution per unit | \$0.70 |
| Total contribution | |
| 150 000 x \$0.70 | \$105 000 |
| <i>Less</i> Fixed costs | \$56 000 |
| Total weekly profit | \$49 000 |
| Therefore the change in profit = | <u>\$9 000</u> |

Award **[1 mark]** if the calculation is correct.

N.B. the change **not** the new weekly profit must be shown.

- (iii) What price per box would *Wholeheart Bakery* need to charge *Max-Mart* to achieve the required 30 % increase in profits over present levels? Show your working. **[3 marks]**

Present level of profit = \$40 000
 An increase of 30% = \$40 000 × 130 % = \$52 000

The proposed offer does not meet the target. What price will meet the target?

$$\begin{aligned}
 \text{Profit} &= \text{Total Revenue} - \text{Total Cost (Fixed costs + Variable costs)} \\
 \$52\ 000 &= 150\ 000\ X - [\$56\ 000 + (150\ 000\ X\ \$0.40)] \\
 \$52\ 000 &= 150\ 000\ X - [\$56\ 000 + \$60\ 000] \\
 150\ 000\ X &= \$52\ 000 + \$56\ 000 + \$60\ 000 \\
 150\ 000\ X &= \$168\ 000 \\
 X &= \frac{\$168\ 000}{150\ 000} = \underline{\underline{\$1.12\ \text{per box}}}
 \end{aligned}$$

[3 marks]

The calculation of price is accurate and working is shown in detail.

[2 marks]

The calculation of price is accurate, but full working is not shown or there is one error in calculation.

[1 mark]

The calculation of price is accurate, but no working is shown at all, or there are two errors in calculation.

N.B. Do not double penalize if the profit calculated in part (i) is used as the basis of a 30 % increase, provided this calculation is carried out accurately.

- (b) **To what extent should the decision to accept or reject *Max-Mart's* order be based on the financial data provided by the production manager?**

[6 marks]

The use of financial data has several problems if used solely to make decisions. It appears that accepting the order at the existing price would not generate the 30 % target growth in profit required. However, the calculations do not reflect the possibility that costs may change at any time, nor that economies of scale may operate more fully.

The production manager has indicated that problems may arise if the firm produces at full capacity. This may be because

- machinery may not be maintained correctly as taking a machine out of manufacture will mean production requirements are not met
- staff may be working under increasingly stressful situations to maximize output
- existing staff may be required to work longer hours or change shift patterns
- new staff may need to be recruited with all the costs associated with this process and training requirements later.

In addition, what would happen if *Max-Mart* decided to change suppliers in the future? *Wholeheart Bakery* would have to now rely totally on *Max-Mart*. If *Max-Mart* changed their suppliers there would be a risk that *Wholeheart Bakery* would go into receivership.

There is also a question of objectives. It is mentioned that the firm has a good reputation. Would demand for other products be affected by the removal of the *Wholeheart* brand from the wheat flake market? If they became associated with *Max-Mart* would this enhance or damage their image?

However, the figures clearly show higher profits, which may let the company expand in the future. *Max-Mart* may increase their orders further. Non-acceptance of the order is also a problem, because if *Max-Mart* went elsewhere, *Wholeheart Bakery* may not be able to manufacture wheat flakes in the future as producing their brand alone is not sufficient to cover the costs of production and the firm will be in a loss making position.

$$\text{Break-even} = \frac{\text{Fixed costs}}{\text{Contribution}} = \frac{\$56\,000}{\$0.9} = 62\,222 \text{ units}$$

As a result the Falconwood factory might close.

[5 to 6 marks]

The discussion is balanced with a detailed assessment of the problems relying on the financial data alone. There is exploration of other potential factors in the decision-making process and a judgment is made.

[3 to 4 marks]

The discussion considers some problems relying on the financial data alone. There is limited exploration of other potential factors in the decision-making process.

[1 to 2 marks]

A brief, generalized and probably unbalanced answer, which tends to description or listing.

- (c) **Analyse the reasons for the growth of own brands (supermarket/private brands) and suggest how manufacturers can maintain market share.**

[7 marks]

Supermarket brands are rarely made by supermarkets themselves, but are produced on their behalf by existing manufacturers. In many cases they are simply cheaper versions of well-known brands, which may be placed on the shelves. For the supermarket this is an attempt to create customer loyalty for the shop and its brand rather than for the product itself. It also allows the supermarket to assert greater control over the manufacturing process and the supply chain.

Own brands are cheaper than their branded rivals, because the shop is able to buy in such bulk that it can command cheaper prices from the suppliers. Sales have grown as consumers came to trust own brands in the same way that they trust other major brands. Supermarkets are now even differentiating between their own brands by creating economy and premium versions of these.

Manufacturer brands can only protect market share by convincing the consumer that the price premium is justified. Some producers such as *Kelloggs* and *Heinz* refuse to own-brand their products and publicize this so that the consumer is aware that products are different. Additional promotion of manufacturer brands to create greater brand loyalty is another alternative as is the reduction in price to make the brand more competitive with its supermarket rival. Some manufacturers have also taken legal steps to protect their brand identity when they feel that a supermarket rival is copying the format or logo/brand.

[6 to 7 marks]

The analysis is balanced with a clear understanding of the process of own branding. Sound suggestions are made as to how manufacturers can attempt to protect their own brands.

[3 to 5 marks]

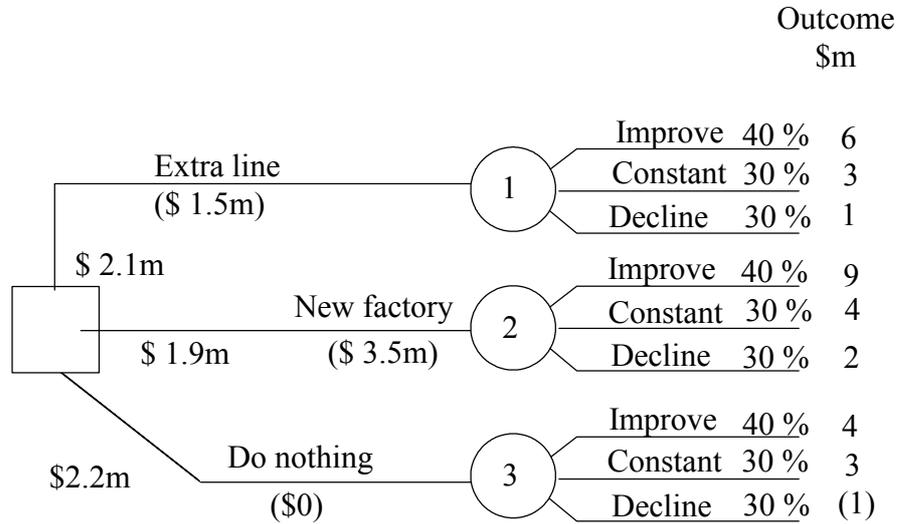
The analysis shows some understanding of the process of own branding. Some suggestions are made as to how manufacturers can attempt to protect their own brands.

[1 to 2 marks]

A brief, generalized and descriptive answer, which may show limited understanding of concepts of branding.

6. (a) (i) Construct a fully labelled decision tree showing *Primature Inc's* options with the financial costs and outcomes for each option. [3 marks]

Decision Tree showing *Primature Ltd's* Options



Key:

- decision node
- chance node

[3 marks]

The decision tree is accurately presented and fully labelled, and includes financial costs and outcomes.

[2 to 3 marks]

There are some inaccuracies in presentations and/or the diagram is not complete.

[1 mark]

The decision tree contains several errors and is poorly presented.

- (ii) Using your decision tree, decide which option *Primature Inc* should select on purely financial grounds. Show full working to support your choice. **[4 marks]**

| | | <u>Working</u> | |
|---------------|------------------|----------------|--|
| Node 1 | \$ 6m × 40 % = | \$ 2.4 | <u>Expected value less costs</u> \$ 3.6m – \$1.5m = \$2.1m |
| | \$ 3m × 30 % = | \$ 0.9 | |
| | \$ 1m × 30 % = | <u>\$ 0.3m</u> | |
| Node 2 | \$ 9m × 40 % = | \$ 3.6 | \$ 5.4m – \$ 3.5m = \$1.9m |
| | \$ 4m × 30 % = | \$ 1.2 | |
| | \$ 2m × 30 % = | <u>\$ 0.6</u> | |
| Node 3 | \$ 4m × 40 % = | 1.6 | \$ 2.2m – \$ 0 = \$ 2.2m |
| | \$ 3m × 30 % = | 0.9 | |
| | \$ (1m) × 30 % = | <u>(0.3)</u> | |

On the basis of the decision tree, *Primature Inc* should **not** expand its production.

[4 marks]

The calculations are accurate and well laid out, supporting the decision not to expand.

[2 to 3 marks]

The calculations are mostly accurate. There are minor errors in calculation or the calculations are not fully presented.

[1 mark]

There is an attempt to select an option but the figures and calculations used are predominantly inaccurate and/or the calculations are missing.

N.B. Accept answers where some of the details and working are included in part (i).

- (b) Describe *three* benefits of using decision trees. [3 marks]

Benefits

- constructing a decision tree will require a formal and detailed analysis of the present situation, which may throw up options not previously considered
- financial costs and outcomes must be fully considered
- there is an assessment of risk and the likelihood of certain economic and financial circumstances
- may be very useful in tactical decision making.

Award [1 mark] for each benefit from the above list or any other relevant benefit accurately described, up to a maximum of [3 marks].

- (c) Evaluate the extent to which additional non-financial and financial factors may support, or not support, the choice of option selected for *Primature Inc* in your answer to question (a)(ii). [10 marks]

The decision tree suggests that *Primature Inc* should increase prices but not capacity. This may not prove to be wise for a number of reasons

- operating at 98 % capacity has dangers if machines need maintenance or malfunction. Staff and managers may feel stressed being under such pressures
- failure to meet orders as a result of machine downtime may upset customers
- quality may suffer as a result of the stress of running at such a high capacity
- improved economic conditions may lead to further increases in orders, which if not accepted may lead customers to find other suppliers
- the acquisition of additional capacity may lead to higher profits in the future
- cell production and JIT may improve efficiency and allow for further expansion in the future. The flexibility provided may also reduce the possibility of obsolete stock
- new production practices may enhance the working environment for the employees
- failure to modernise may jeopardise the firm's future competitiveness
- *Primature Inc* may be regarded as a high price supplier. If this is not matched by quality, customers may go to other cheaper suppliers.

However, prudence may be the correct path. The majority of economists see the economy growing or remaining constant, which will allow the firm to increase its prices and revenues. However, if the economy contracts in the short or long run, the firm will not be left with overcapacity and obsolete stock. Financial decisions may be more accurate if the firm waits and sees. Further research may be carried out to support expansion or the status quo.

[8 to 10 marks]

There is detailed analysis, which uses the information provided in the text and reaches some judgments based on the discussion. The concepts of cell production and JIT are considered in relation to flexibility and human resource improvements. Both quantitative and qualitative factors are considered. There is a recognition that the choice is subject to uncertainty. Further research may be suggested.

[5 to 7 marks]

There is an analysis using the information provided in the text. References to cell production and JIT may be made although their impact may not be well considered. For ***[7 marks]***, there must be an attempt to reach at least one judgment.

[3 to 4 marks]

A brief discussion of the issues. There may be a recognition of conflicting issues at a basic level. Any judgments made may lack supporting evidence.

[1 to 2 marks]

A very general and limited response, which is unlikely to make any supported judgments.

N.B. *The candidate's response will be different if they select a different option in their answer to part a(ii). It would still be expected that the analysis and judgments made are to the same depth as in the above levels.*
