M05/3/BUSMT/HP2/ENG/TZ0/XX

22055012

BUSINESS AND MANAGEMENT
HIGHER LEVEL
PAPER 2

Tuesday 17 May 2005 (morning)

2 hours 30 minutes

INSTRUCTIONS TO CANDIDATES

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

1. AOL-Time Warner

In 2001, the merger of *AOL* and *Time Warner* was thought to be a vision of the future; a company with the ability to deliver all manner of entertainment over the world wide web. Everything from magazines to popular TV series would be accessible from people's desks, their homes and their hand held computers. It was a $125 billion deal merging the magic of Hollywood films *(Time Warner)*, and the cutting edge technology of the Internet *(AOL)*. It also brought together two billionaire entrepreneurs, Steve Case of *AOL* and Gerald Levin of *Time Warner*.

Two years later, the company formed from the world's biggest business merger reported losses of an astonishing $110 billion, a sum equivalent to the total wealth of a medium sized country like Ireland. In fact, 75 % of *AOL-Time Warner's* sales still came from its core traditional businesses of publishing, film-making and cable subscriptions. Overvalued Internet shares, including *AOL*, fell dramatically worldwide. More damaging was that revenues in many areas of the new conglomerate were significantly affected by illegal downloading of films and music using Internet sites, often provided by *AOL*!

Large mergers almost never fulfill their promise. Research shows that, more often than not, they destroy the value which comes with more focused management. By bringing together two very different corporate cultures, the creativity was certain to result in a clash of empires and egos. *AOL* has now admitted it overstated its sales in its accounts and is under criminal investigation. *AOL-Time Warner* will be remembered as a star that burned itself out in record time.

[Source: adapted from *End of the empire of mighty egos*, *Daily Mail* 31 January 2003]

(a) (i) Explain why *AOL-Time Warner* was described as a conglomerate. *[2 marks]*

(ii) Explain the problems that *AOL-Time Warner* may have faced in merging two different corporate cultures. *[4 marks]*

(b) With reference to *AOL-Time Warner*, analyse the advantages **and** disadvantages of organizational growth through mergers and acquisitions. *[6 marks]*

(c) Evaluate methods of making mergers more successful by effective change management. *[8 marks]*

2. The Segway

The *Segway*, a “mystery” invention described as the “next best thing” in the USA before its launch, was revealed in 2002 to be a super hi-technology, environmentally-friendly scooter, which would be operated on pavements (sidewalks). The launch was delayed by the need to patent unique aspects of the scooter’s design.

This revolutionary urban vehicle ran into considerable difficulties after concerns were expressed about health and safety issues. An overweight nation would be offered another excuse to stop walking, and injuries to old and disabled people might be caused by collisions with the scooter. San Francisco, the first city in the USA to offer government workers, notably postmen, the opportunity to try the *Segway*, later banned its use on pavements.

There is no disputing the advanced nature of the machine’s technology that keeps the rider balanced, but with speeds of up to three times that of other pavement users, it threatens injuries that some government authorities will not risk. Despite this, the product was launched by its entrepreneurial inventor on the Internet and early sales were encouraging.

Eight out of ten new products fail within the first two years of their life. The rocky path of this new product brings memories of other inventions that failed in the early stages of their life cycle such as the *Sinclair C5*, a battery powered tricycle that proved far too small and dangerous to operate, as intended, on public highways.

[Source: adapted from *Revolutionary Segway pavement scooter runs out of road amid fears for America's health, The Independent*, 21 January 2003]

(a) With reference to the *Segway*, describe the stages of new product development before its launch onto the market. *[4 marks]*

(b) (i) Explain why the failure rate of new products is so high in the early stages of their life cycles. *[3 marks]*

(ii) Analyse suitable methods to minimize the risks of market failure of the *Segway*. *[5 marks]*

(c) Evaluate the potential sources of finance available to developers of innovative products, such as the *Segway*, and explain why finding such finance may be difficult. *[8 marks]*

3. Back to basics

The commercial environment since the millennium is more challenging than it has been for years. Companies in almost every sector are struggling to show any increase in profit, in contrast with the dramatic increases of the 1990s. A significant number of multinationals have reached the limits of traditional growth. No longer is it enough to invent new products and market these globally. Many went from selling 15-20 % of their products abroad in 1993 to selling 50 % in 2003. Most global markets are now saturated. At the same time, companies are finding it harder to develop new products. How much demand is there for razors with four blades rather than three, or for yet more flavours of diet cola?

Saturated markets and fewer new products, result in lower profits. One way for companies to grow is to deepen their relationships with their customers. The problem is that most companies are already trying this. Instead, profit growth will probably come from seeking cost reductions or finding ways of hiding price increases. Lower costs can be achieved through mergers and acquisitions, the use of new technologies, the rationalization of resources and by taking advantage of greater economies of scale. Hiding price increases or "sneak pricing" involves attracting potential customers with eye catching low price offers and then persuading them to buy expensive extras.

[Source: adapted from *Back to Basics, The World in 2003, The Economist*]

(a) Describe **three** potential pricing strategies that a firm may adopt when entering a new market. *[6 marks]*

(b) Analyse methods by which organizations can deepen their relationships with their domestic and overseas customers. *[6 marks]*

(c) Using a model, such as Ansoff's matrix, evaluate the strategic options available to companies seeking future growth in saturated markets. *[8 marks]*

4. Jaguar

When the US car manufacturer, *Ford*, acquired *Jaguar* in the early 1990s, it decided to produce its new model, the Jaguar X' Type in a dedicated plant located in the UK. The Halewood factory was chosen to produce the X' Type because the "Britishness" associated with *Jaguar* made overseas production inappropriate. $300 million was invested by *Ford* to upgrade Halewood to deliver exceptional quality products using highly efficient "lean manufacturing". Totally new production lines were installed allowing complete production in a single location. Production efficiency was further improved by locating all major parts' suppliers alongside the factory allowing for just-in-time production system.

The "Halewood Vision" is a statement of principles aiming to create a world-class manufacturing facility. A new set of working relationships was agreed with employees. Production line workers were given responsibility for identifying continuous improvements and were organized into smaller teams working with a group leader. These teams were given considerable responsibility for implementing change. This led to dramatic increases in productivity, and increased pride and commitment within the workforce.

Implementing the total quality culture involved workshops for managers, union representatives, supervisors and production line workers based on participation and empowerment. The production process and working culture at the plant was transformed by over a million hours of training; an average of approximately 350 hours for each employee.

[Source: adapted from *www.jaguarcars.com*]

(a) Explain the advantages and disadvantages for *Jaguar* of using just in time (JIT) production rather than the more traditional just-in-case stock systems. *[6 marks]*

(b) Using appropriate motivational theory, analyse how *Jaguar* has managed to increase the pride and commitment of its employees. *[6 marks]*

(c) Evaluate methods for achieving a total quality culture in large organizations like *Jaguar*. *[8 marks]*

5. Sport's investment

Lev Yashin and Alexi Kirov are partners and racehorse owners. They are looking to expand into new sports' ventures. Business contacts have suggested that ownership of a football team would provide opportunities for commercial success. An agent working on their behalf has identified two public limited companies, which may provide investment opportunities. She has prepared financial estimates of returns for each of these potential investments:

Football Club A
A European club, which won national titles three times in the last ten years. It has qualified for the Champions League, which is the most important and profitable football competition in Europe. It presently has substantial debt, but there is considerable interest from sponsors. If the club makes progress in the Champions League it is likely to be able to repay at least 50 % of its debt. The cost of a takeover would be approximately $200 million.

Football Club B
An Asian club, which is the most successful team in the region. It has consistently been in the top three in its league. It has a new ground built for a recent world athletic event. The stadium is rarely full, but the club is well run and profitable. There is the opportunity to develop shopping, leisure and entertainment facilities surrounding the ground. The cost of a takeover would be approximately $70 million.

Expected Incomes

Figures in millions of $	**Football club A**	**Football club B**
Year 1	–30	15
Year 2	–2	18
Year 3	76	21
Year 4	96	24
Year 5	150	30

Lev Yashin is looking for a quick, low risk return. Alexi Kirov is prepared to accept a higher level of risk. The estimates presented rely on the two teams, performing well in leagues and competitions.

(This question continues on the following page)

(Question 5 continued)

(a) Explain how the two partners could take control of a public limited company. *[2 marks]*

(b) For each investment opportunity, using the information on expected incomes, calculate *(to 2 decimal places)* the

(i) payback period; *[3 marks]*

(ii) accounting rate of return; *[3 marks]*

(iii) net present value using the discount factors for 6 % below.

Year 1	0.9434
Year 2	0.89
Year 3	0.8396
Year 4	0.7921
Year 5	0.7473

[4 marks]

(c) Based on your calculations and on any other relevant factors, advise the partners on the advantages **and** disadvantages of each investment opportunity. *[8 marks]*

6. Moving jobs overseas (offshoring)

Downsizing organizations was the 1990s answer to recession. Moving jobs to overseas locations where labour is cheaper, is the newest trend in cost cutting, encouraged by improving technology and accelerating globalization. The world's top 100 financial institutions will save $138 billion over the next five years by moving operations overseas. In America, three million jobs have been lost since 2001. European and American executives fear that the process will result in a job market that consists of the very rich and the very poor, with little in between.

Middle managers in the West are now competing for jobs in a global market with skilled and educated workers from China and India, who earn a fraction of their salary. Data processing and administrative functions are now being outsourced to India. It is believed that jobs in the pharmaceutical (medicinal drugs) industry and in research and development will soon follow. India took the economic decision some years ago to invest in education and now has 1.5 million English-speaking graduates.

"There is no limit to what can be outsourced to India" says the Confederation of Indian Industry. Already American politicians are campaigning against offshoring as they believe this will have a significant social and community impact in the USA. Two million jobs are expected to move from the West to India by 2008. Political pressure groups, trade unions and other employee associations are discussing ways to oppose those firms planning to move their operations overseas.

(a) Using a PEST framework, analyse the advantages **and** disadvantages of moving some jobs and activities overseas to those firms planning such a change. *[8 marks]*

(b) Assess the effects of moving jobs overseas on **four** stakeholder groups. *[6 marks]*

(c) Discuss how firms moving all operations overseas, may manage the process and reduce potential conflict. *[6 marks]*