MARKSCHEME

May 2005

BUSINESS AND MANAGEMENT

Higher Level

Paper 2

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

A conglomerate is a firm, which comprises of a series of disconnected businesses, in that the subsidiary companies may be in different industries and different stages of production.

AOL-Time Warner comprised of firms as diverse as film production to Internet operators.

[2 marks]
A clear understanding of the concept of a conglomerate linked to examples relating to *AOL-Time Warner*.

[1 mark]
There is some understanding of the concept of a conglomerate shown through a definition not linked to *AOL-Time Warner*, or a relevant use of examples.

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

AOL is at the cutting edge of technology. As such it is likely to have an adventurous and risk taking environment, where mistakes may be tolerated and even encouraged if they produce ground-breaking approaches and products. The employees may "play hard", working long hours with their leisure and work intermingled, providing a person culture. The workforce may be younger than in other industries.

Time Warner consists of more traditional companies based on films and entertainment. It is possible that the organization is more conservative and bureaucratic with a greater emphasis on role and task. Like *AOL* the nature of entertainment may also have encouraged a person culture in some of the group's activities.

The interests of the two sets of employees may be different and the skills required for promotion may also differ. Strategies and objectives may be contrasting. More traditional companies may be longer term in approach. The article refers to a clash of "egos and cultures".

[3 to 4 marks]
A clear identification of cultures that might have existed in the two organization prior to the merger. The answer is well explained and supported with business ideas.

[1 to 2 marks]
The answer is relevant but brief and may lack depth and some clarity.

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

Mergers and acquisitions involve the joining of two different firms, either voluntarily or forced. In a merger the two organizations agree to join together. An acquisition may be opposed as it may involve the existing management of the firm being acquired losing control and/or their jobs.

Advantages
- the growth of the organization is instantaneous
- cost savings may accrue from rationalization and economies of scale
- output will be larger allowing for greater market share and power
- diversification decreases dependence upon certain markets and spreads risks
- time is saved in research and development
- synergies (1 + 1 = 3) may occur where the fit of the two firms provides enhanced advantages over the independent operations of the two organizations
- competitiveness in markets increases and the firm may use its additional muscle to force competitors out of the market
- brand name enhanced.

Disadvantages
- larger organizations are more prone to diseconomies of scale
- synergies only occur if the two firms integrate after merger. Mergers may be hampered by resistance to change from one or both of the sets of employees involved
- diversification may be unwise if it moves the management away from their core competence
- key employees may be forced out or resign, following the merger, weakening the pool of labour available to the new organization
- share values of the joined firm may be lower than the combined values of the previous independent share values
- corporate cultures may clash leading to conflicts in the workplace and possibly internal competition
- customers may not approve of changes diluting brand loyalty.

Whether or not mergers are successful probably relates to the level of planning involved, the consent of the two firms' employees and the closeness of the fit. In the case of *AOL-Time Warner*, the firms forming the merged organization, were led by individualistic entrepreneurs, who were probably used to getting their own way. The cultures of the two were likely to be quite different and *Time-Warner* was actually undermined by the operations of *AOL* in pirating music and videos. It appears that the move from core competence was significant.

[5 to 6 marks]
There is a detailed, balanced and well illustrated analysis of the advantages and disadvantages of mergers and acquisitions using a range of relevant business terminology and ideas. A clear understanding of the difference between a merger and an acquisition is shown for ***[6 marks]***.

[3 to 4 marks]
There is a reasonable analysis of the advantages and disadvantages of mergers and acquisitions using some business terminology and ideas. The analysis is brief and unbalanced at the bottom end.

[1 to 2 marks]
The answer is generalized, and possibly little more than a list of ideas, which may be imbalanced and possibly inaccurate.

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

Change management is crucial to improve the success of any merger. The process must ask the three questions
- where are we now
- where do we want to get
- how do we get there

Any change is likely to be resisted by some employees of an organization, who may fear loss of income, power or even employment. Social and psychological factors will also arise, especially if existing working groups and associations are split up and expectations of individuals change radically. The process may need to address different cultures and objectives. Individuals from both firms must be involved and empowered.

Six strategies may be used to manage change and overcome resistance:
- *Education and communication:* the need for change is explained and people are informed and consulted from the beginning of the process. Trust is built up and leads to commitment of individuals to decisions
- *Participation and involvement:* referred to as "ringi" in Japan, all those affected by a decision are consulted and their views elicited. Employees are involved in the planning. This may be time consuming
- *Facilitation and support:* affected employees receive additional training or full retraining if required. Those badly affected by the fear of change may seek counselling
- *Negotiation and agreement:* those involved are provided with incentives to accept change. Management is willing to compromise in some circumstances
- *Manipulation and cooption:* often involved dividing and ruling by playing off one faction against another or identifying key resistance and either buying it off or eliminating it
- *Explicit and implicit threat:* although this may work in the short run it may lead to a build up of resentment and high staff turnover in the future.

The key issues are therefore: communication, clear goals, compromise, participation, training, shared objectives and incentives. If these do not work, a more negative approach of threats may be used. The success must be judged in terms of future performance by the merged firm. Too many compromises during the change process may threaten this.

[6 to 8 marks]
Methods of change management are evaluated, using appropriate business terminology and ideas and clearly focused on the issues of merging. Judgments are made.

[3 to 5 marks]
Change management is discussed, although the answer may lack some structure and application to mergers. There is an attempt to use relevant terminology and business ideas. Judgments may not be present, or may lack depth.

[1 to 2 marks]
The answer is limited and general, with a lack of focus and detail.

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

New product development involves some or all of the following stages (more recent approaches may involve simultaneous engineering, where some stages are done concurrently rather than consecutively):

- the idea needs to be identified and evaluated. This may be done creatively through brainstorming or using more formal techniques
- market research must be carried out to establish that there is a clear market or customer need and that this product meets it. This screening process may involve primary and secondary research
- product research and development. The product is designed and activities such as value analysis are conducted. Patents are applied for
- small-scale pilot production involving prototypes to aid further research and testing. Production problems will be addressed
- test marketing: The product is launched into a limited market, usually geographically selected to meet the demographic profile of the target market
- full scale production if the previous stages have proved successful
- market mix planning. Aspects like pricing and packaging are confirmed
- national market launch.

In terms of the *Segway* the research is more likely to be primary as there are no other similar products. Customers' views will be vital and the prototype must be more thoroughly tested to ensure it functions as planned. Setting the marketing mix may be problematic.

[4 marks]
At least four key stages are described. Business terminology is employed and there is detailed reference to the *Segway*.

[2 to 3 marks]
The description is relevant, but omits several stages and may lack business terms. There is some reference to the *Segway*.

[1 mark]
A simplistic and possibly mostly inaccurate answer, which describes the process in the briefest of manner.

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

New products lack customer recognition and loyalty. Often the basis for their introduction is hunch, or at best, flawed market research. Potential customers may indicate a desire for such a product, but when it is on the market they may fail to purchase. Distribution of new products may be restricted by lack of access to outlets. Shops may be unwilling to replace facings of well-established products by less well known ones. Customers may have considerable choice, and unless a new product has a noticeable USP or is exceptional value for money, customers may not switch allegiance.

Even if the product has potential that may be realized, the producing firm or individual may experience cash flow problems, which may put them out of business. "Problem children" require substantial cash flow to finance initial R&D, promotion, distribution *etc.*

In addition, inventors, or those with original ideas, may lack business acumen or may not have the finance to hire professional help. As far as the *Segway* is concerned, issues of health and safety may affect confidence and restrict loyalty.

[2 to 3 marks]
A good explanation, which identifies relevant reasons for the failure rate of new products using appropriate business concepts and terms.

[1 mark]
An answer that tends towards description or listing. The answer may lack depth and business terminology.

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

The firm could undertake primary and secondary research.

Primary research will need to concentrate on the potential demand for the *Segway* from its target customer. This will be used to establish a suitable marketing mix, based on the responses received. As the *Segway* is original, it will be necessary to identify those customers with similar innovative products or the psychographic profile identified for purchasers. These could be customers with high environmental concerns or merely those who enjoy purchasing new technologies.

Those individuals who are likely to be early adopters may be approached for their opinions. These may be innovators themselves or simply those who are able to buy on behalf of institutions such as government agencies. Surveys and interviews will need to be conducted with potential customers. These may take the form of focus groups. Alternatively, environmental groups may be consulted to try to acquire product endorsement.

The marketing of the product needs to be appropriate and patents need to be enforced. A market analysis, such as Porter's 5 forces, might be undertaken. Product safety could be improved.

Secondary research will need to ensure that the product fulfills legal requirements upon its use. Demographic profiles may be used to identify potential markets. Lists may be purchased identifying target customer groups. Products like the *Segway* are likely to be income elastic, so economic data would be useful to estimate likely demand patterns. Additional information on price elasticity will help prepare a suitable product pricing strategy.

[5 marks]
The analysis covers both primary and secondary research and focuses on the particular market targeted by the *Segway*. The answer employs suitable business terms and concepts.

[3 to 4 marks]
The analysis may refer to market research at some point, although primary and secondary research may not be specified or the approach may be unbalanced. For ***[4 marks]*** the answer must refer in some way to the *Segway*.

[1 to 2 marks]
The answer is likely to be descriptive rather than analytical and although some appropriate market research may be identified, it is limited. There may be no specific reference to the *Segway*.

(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]***

Finance may be external or internal and may relate to different periods. The risks associated with new products are very high and this may put off lending institutions, in particular, banks who are often accused of being risk aversive. Any institution that has shareholders will be constrained in the risk they may undertake.

Many small new businesses rely on personal capital from savings or family loans. These have the advantage of low cost, but the amount available may be restricted. There are specialist sources of finance offered to new innovative businesses. Special government grants may be available and venture capital companies may be willing to take high risks to achieve high returns and a minority shareholding. Sponsorship from larger firms, such as vehicle companies, might be a possibility.

Partnership or joint venture arrangements may offer additional sources of income. The down side may be loss of control and a potential block on entrepreneurship.

It is unlikely that small firms will be able to float their business, but selling shares as a private limited company is feasible. Again the higher levels of risk may put off potential investors and those that are willing to take the risk and invest may wish for a level of return (dividend) not compatible with the reinvestment required to maintain a research programme.

Ultimately, it is likely that small firms will use a combination of sources including personal funds and look for top ups from grants and venture capital organizations. These will not lead to demands for instant returns or dividends, which will restrict the entrepreneurial process. Risk tolerant investors would be ideal.

[6 to 8 marks]
The answer considers a range of financial sources and evaluates these in relation to the needs of innovation. A judgment is made about the possible balance of sources.

[3 to 5 marks]
There is some consideration of at least two sources of finance. These may be in a general sense, but at the upper end there must be a discussion of risk and the effect on the selection of sources. At the lower end of the band, a judgment may not be made.

[1 to 2 marks]
The answer is generalized, with only a brief examination of sources, or a source. There may be little or no attempt to relate these to an innovative firm.

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

Potential strategies may include

- *Market penetration pricing:* Here prices are initially set low to encourage purchase with the hope that brand and customer loyalty may result. This is only likely for big companies who are able to generate significant sales
- *Market skimming/creaming:* This is a strategy where prices are set at a premium level to reflect new technologies that other firms are yet to exploit. The high price helps pay back some of the research and development costs involved in new product development
- *Cost based pricing:* This is only likely if the market is not particularly competitive and this approach is adopted as an industry norm. Alternatively, it may apply if the firm has a particular USP, which means that price elasticity is low
- *Competitive pricing:* This may be necessary to allow a firm to establish itself in the market. It may be required if the product offers little in terms of added value. Like penetration pricing it may be more difficult if the costs of entering the market are higher than those of competitors
- *Psychological pricing:* This may include the choice or particular price points which will create an image of value among potential purchasers. The price must certainly reflect other elements of the marketing mix, such as “foreign exclusivity” and “chicness”
- *Price discrimination:* if markets consist of distinct subsets and consumers can be kept separate, then different prices can be charged for the same product. This could easily operate between countries
- *Sneak pricing:* offering products at a relatively low price to encourage sales, but making accessories and parts expensive.

[5 to 6 marks]
Three appropriate pricing policies are described supported by the use of relevant business terms.

[3 to 4 marks]
At least two appropriate pricing policies are described, with some use of business terms.

[1 to 2 marks]
The answer is limited in number or relevance, and/or may be a list.

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

Essentially customer relationships can only be enhanced by providing what customers require and in a way which creates satisfaction, generating brand or customer loyalty. More recent marketing techniques emphasize the need for relationship marketing where the needs of a customers are carefully examined and the offering adjusted to follow family life cycle needs and purchasing behaviour. If customers feel that a business is offering products and services which are relevant to their lifestyle and purchase behaviour, then it is less likely that any communication from the firm will be regarded as "junk mail".

In term of overseas markets, this may be more difficult as the volume of research about, and knowledge of, customers may be less and not so accurate. It will be essential that firms are culturally aware and attempt to adapt products to local tastes and requirements.

It may be necessary for firms to make local partnerships to provide market penetration or to use agents who have local knowledge. If a firm can persuade the market that it is a local firm itself, then loyalty levels are likely to rise. It is quite common for MNCs to operate in a manner where local consumers are unaware of their foreign credentials.

Non-core activities may also create additional customer loyalty. Community action, such as contributing to education, charities or other social institutions may create an image more acceptable to the local community. Care for the environment may also help deepen relationships with customers, as well as acting ethically in all operations. Communication with customers, such as newsletters, meetings, focus groups, special evenings and e-mails may make customers feel special. After sales services and customer satisfactory surveys, with helplines for immediate assistance, will help develop the idea that the company "cares".

[5 to 6 marks]
Several methods for developing deeper customer relationships are analysed and specific examples given as to how they may operate. These methods are focused on firms operating overseas as well as in local markets.

[3 to 4 marks]
At least two methods for developing deeper relationships are analysed, although there may be little or no discussion as to how these may differ in overseas markets.

[1 to 2 marks]
A simplistic answer, which may lack depth and/or distinctions between domestic and foreign markets.

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

Ansoff's matrix identifies the only four possible methods of growth. These are

- market penetration
- product extension
- market development
- diversification.

It is going to be very difficult to further penetrate a saturated market. Only the largest of firms will possess the economies of scale necessary to offer the low prices required to encourage existing customers to purchase even further. It is suggested that "sneak pricing" is being used, but ultimately this may upset customers and brand loyalty may be lost as a result. Cost cutting through rationalization and mergers appears to have already been utilized.

Product extension may offer further expansion by relating new products to existing ones and basing demand on customer loyalty. Again the article suggests that this option has been almost exhausted.

Market development by multinational corporations normally entails opening new markets in countries previously unexploited. There appears still to be potential in this approach with markets, such as Eastern Europe and China, developing rapidly. However, these are still moderate markets in terms of present disposable incomes and subject to bureaucracy and government interference. A "global local" approach may prove to be more successful than merely exporting existing products. Adaption to local taste and culture may prove effective in stimulating additional demand.

Diversification by offering new products to new markets may offer the last possible significant market gains, but at considerable risk. This approach moves firms away from their core competence and experience and may risk the whole future of the business.

Given the facts outlined in the article it appears that options for growth are severely limited. The most likely route for growth is in newly opened markets of Europe and Asia. These may not be able to provide the market returns required, so riskier diversification may be necessary.

[6 to 8 marks]
Options for growth in saturated markets are identified and the issues related to these are examined using appropriate business terms and concepts. Those options offering the highest chances of success are identified and the choice supported. Judgments are made.

Credit other models such as the Boston Matrix if used appropriately to examine strategic options.

[3 to 5 marks]
Options for growth are identified, but may not include specific marketing models. There is some attempt to support these choices.

[1 to 2 marks]
The answer is simplistic and/or general.

4. (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]***

Just in time (JIT) is a manufacturing system designed to minimize stocks of raw materials, work-in-progress and finished goods, by planning the arrival and flow of resources through the factory.

Advantages
- reduces waste and stocks lying idle and tying up capital
- by reducing stocks it may improve cash flow
- stocks are only ordered when they are needed as production only takes place when there is demand for the finished goods. The right quantities are purchased at the right time
- reduces space requirements
- improves customer service
- leads to increased employee participation
- reduces manufacturing lead time
- simpler planning systems
- emphasis on continuous improvement
- better use of machinery and equipment.

Disadvantages
- requires a change in culture with less control and more delegation
- the advantages of bulk buying are lost
- more vulnerability to breakdowns in the supply change *e.g.* Kobe earthquake shut Toyota's factories
- more vulnerability to breakdowns in machinery
- requirement for reliable and flexible suppliers
- requires close cooperation with the workforce as they can easily shut down the line.

Just-in-case requires production even when no order exists and the maintenance of buffer stocks to meet unexpected levels of demand. EOQ (economic order quality) stock ordering is used, which may allow for higher discounts and order quantities are larger than with JIT. The factory is less vulnerable to closure. However, capital is tied up in stock.

[5 to 6 marks]
Relevant advantages and disadvantages to *Jaguar* of using JIT production are explained, using suitable illustration. The depth of answer will distinguish between ***[5 marks]*** and ***[6 marks]***.

[3 to 4 marks]
Advantages and disadvantages to *Jaguar* of using JIT production are explained, although they may be limited in number and/or those explained may not be accurate or relevant. If advantages and disadvantages are merely listed, a maximum of ***[3 marks]*** may be awarded.

[1 to 2 marks]
A limited, and probably unbalanced, answer, which tends to description or listing. Few advantages and disadvantages are identified.

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

Jaguar's introduction of lean production and JIT has meant that the culture of the business has had to be adjusted to one, which requires delegation and empowerment. *Jaguar* has implemented workshops for managers and employees to promote participation. Training of the workforce is substantial to support continuous improvement. The focus is on individuals working in self-contained groups identifying a need for change and driving it through. These centres of excellence have led to increases in productivity, pride and commitment.

In terms of motivation theory, *Jaguar* is allowing their workforce access to higher levels of needs in Maslow's hierarchy of needs, such as social and esteem needs. Leadership approaches have been focused to McGregor's theory Y approaches, allowing participation. Mayo showed at Hawthorne that motivation increases as employees feel more valued and involved. Other motivation theories are relevant. Vroom said that if employees believe they can achieve the rewards on offer, they will be more motivated. It appears that *Jaguar* is setting up systems that provide appropriate expectations. The ability to work in teams also sets up the opportunity for group benefits and motivation.

[5 to 6 marks]
There is a detailed analysis of how *Jaguar* has managed to increase the pride and commitment of its employees. Appropriate motivational theory is used to support the analysis and examples used from the stimulus materials.

[3 to 4 marks]
There is some analysis of how *Jaguar* has managed to increase the pride and commitment of its employees. Some motivational theory is used to support the analysis, although specific theorists may not be named.

[1 to 2 marks]
There is a very limited analysis of the factors improving commitment. No motivation theory may be attempted, but generalized statements are made.

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

A total quality culture is where managers ensure that all activities are planned to meet customer requirements with quality as the core focus. Quality is the responsibility of every employee not just the traditional quality control department. Every employee is empowered to take action if quality is unacceptable. The objective is zero defects and all procedures should be monitored to ensure they meet set standards. Employees work in teams to share skills and ideas. They should regard all the people they work for and deal with as customers, even if they work for the same organization. The object of a total quality approach is to provide a competitive edge.

How can this be achieved? Possible methods
- benchmarking
- statistical process control techniques
- quality assurance procedures and performance targets
- continuous improvement/Kaizen
- prevention rather than cure – aim for zero defects
- quality circles/Kaizen groups
- total quality management (TQM)
- training
- empowerment
- appropriate mission statement and policy statements
- audits
- participation in decision making
- flat organizational hierarchy/re-engineering
- group work
- identifying consumer needs
- top management support and guidance
- commitment of the whole workforce
- seeking quality standards
- investment in people
- cell production.

Kaizen should not be perceived as a fix-all. Some commentators believe it is a fad. There are considerable expenses involved in training the workforce to be able to take the necessary responsibility and to maintain the process. A potential problem may be increased bureaucracy. This is an ongoing process and must be maintained through appropriate recruitment and training. Some say that the diminishing returns operate with Kaizen approaches. It may be necessary at times to look at underlying principles rather than just incremental improvements. Total re-engineering may be a more radical approach.

Stakeholders must also support the process so that short term demands for example, for higher dividends, do not risk quality gains.

[6 to 8 marks]
A total quality culture is accurately described and methods for introducing and maintaining a quality focus in large organizations evaluated with reference to large firms and business processes such as Kaizen. Some judgments are made.

[3 to 5 marks]
A total quality culture is described in general terms and methods for introducing and maintaining a quality focus in large organizations are examined with reference to large firms and business processes such as Kaizen.

[1 to 2 marks]
A brief, generalized and descriptive answer, which may show limited understanding of the concept of total quality culture.

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

Public limited companies may be acquired by the two partners, if they purchase more than 50 % of the authorized share capital. As each share entitles the holder to one vote at an AGM and other shareholder meetings, anyone holding more than 50 % of shares would be able to elect a board of directors who would operate the business on their behalf. They might even elect themselves. In practice, control may occur at lower levels if large shareholders vote while small shareholders do not.

[2 marks]
There is a clear link between ownerships of shares, votes and the election of directors.

[1 mark]
There is just a statement relating to a majority shareholding or even 100 % shareholding.

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

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

PAYBACK

Football club A
$-30+-2+76+96=140$ (after 4 years)

$200-140=60$

$\frac{60}{150}\times 12=$ 4.8 months (146 days)
Payback period = 4 years 4.8 months (accept 5 months)

Football club B
$15+18+21=54$

$70-54=16$

$\frac{16}{24}\times 12=$ 8 months (243 days)
Payback period = 3 years 8 months.

[3 marks]
The calculations are accurate and there is clear, full working.

[2 marks]
There is one error, but full working is shown.

[1 mark]
The answers are accurate but the working is missing or unclear, or the answer is inaccurate, but there is some understanding of method.

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

Football club A

ARR =

\$290m – \$200m = \$90m

$$\frac{\$90\text{m}}{5} = \$18\text{m per annum}$$

$$\frac{\$18\text{m}}{\$200\text{m}} \times 100 = 9\ \%\text{ on investment}$$

Football club B

ARR =

\$108m – \$70m = \$38m

$$\frac{\$38\text{m}}{5} = \$7.6\text{m per annum}$$

$$\frac{\$7.6\text{m}}{\$70\text{m}} \times 100 = 10.86\ \%\text{ on investment}$$

[3 marks]
The calculations are accurate and there is clear, full working.

[2 marks]
There are up to two errors, but full working is shown.

[1 mark]
The answers are accurate, but the working is missing or unclear, or the answer is inaccurate, but there is some understanding of method.

Answer summary:

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
Total return	290	108
Cost of takeover in Year 0	–200	–70
Net return	90	38
payback	–200 –30 –2 +76 +96 = –60 60/150 × 12 = 4 years 4.8 months (146 days)	–70 +15 +18 +21= –16 16/24 × 12 = 3 years 8 months (243 days)
ARR	90/5 = \$18 m 18/200 × 100 = 9 %	38/5 = \$7.6 m 7.6/70 × 100 = 10.86 %

(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]

DCF and Net Present Value

Football Club A

–30	×	.9434	= –28.3
–2	×	.89	= –1.78
76	×	.8396	= 63.81
96	×	.7921	= 76.04
150	×	.7473	= 112.1
290			221.87 less investment of $200m = $21.87m NPV

Football Club B

15	×	.9434	= 14.15
18	×	.89	= 16.02
21	×	.8396	= 17.63
24	×	.7921	= 19.01
30	×	.7473	= 22.42
108			= 89.23 less investment of $70m $19.23m NPV

[4 marks]
The calculations are accurate and there is clear, full working.

[2 to 3 marks]
There are up to two errors, but full or partial working is shown.

[1 mark]
The answers are accurate, but the working is missing or unclear, or the answer is inaccurate, but there is some understanding of method.

(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]***

The financial issues are not clear-cut. The investment in Club A provides the highest Net Present Value, but the investment in Club B provides the quickest payback and the highest ARR.

Lev Yashin wishes to select the lowest risk investment, which is the one that usually paybacks more quickly, which is the investment in Club B. However, the payback periods are relatively close so it would be worth examining the other two measures. Club B's returns are more consistently more in the early years. Its ARR is higher and at 10.86 % appears good, although it would need to be compared to other potential market investments. Its initial investment at $70m is also considerably lower than the $200m required to acquire Club A. In the early years, the investment in Club A will lose money. As risks increase over time, it may not be wise to risk such an investment.

Alexi is more willing to take a risk. Club A offers by far the largest future returns, although its net present value is not substantially greater than the investment in Club B.

There are other issues, which may persuade the pair to invest in either or neither of the investments. It is clear that football is not predictable and that the financial estimates for net returns are based on performance. Even the top clubs can have lean spells, which may reduce their attractiveness to investors. Many clubs make losses. Club A already has substantial debt, but the interest of future sponsors would have to be evaluated.

Club B's ground offers the opportunity for other commercial ventures and these would also have to be evaluated on financial grounds. This may be the difference between the two investments, as the two partners appear to be interested in a commercial return rather than the acquisition of a football club. However, if either partner has a genuine interest in the game then the opportunities for publicity, power and personal satisfaction may be offered by the bigger club, Club A.

There is no right answer to the decision, but it is clear that further information may be required and the objectives of such an acquisition made clear. Ultimately, the risks may be too high to suggest that an investment is wise.

N.B. *Comments based on candidate's own figures should be rewarded. Do not double penalize.*

[7 to 8 marks]
The advice on investments is supported by both numerate and qualitative judgments, using the evidence presented in the question. The closeness of the investment appraisal results is recognized as well as the high levels of risk involved in both investments. The need for further research may be stated.

[3 to 6 marks]
The advice on investments is supported by some evidence. The discussion may lack some balance and depth, particularly at the lower end of the band.

[1 to 2 marks]
The answer is limited and generalized, and does not use the range of information available.

6. (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]***

Political – legal environment
Advantages
- possible government grants and support from governments in the countries where companies they are moving their operations
- laws in other countries may not be as strict or as restricting, leading to higher returns.

Disadvantages
- political opposition from domestic governments may lead to restrictions on operations and may affect attitudes to expansion plans or other operational activities. This may take the form of tariffs or barriers to trade
- political instability in the new host country may lead to operational difficulties.

Economic environment
Advantages
- large savings made by firms may be passed on to consumers in lower prices
- increased employment opportunities in the lower cost countries
- new market opportunities as the local economy develops
- tax rates may be lower overseas.

Disadvantages
- loss of employment in the West – increasing unemployment among middle management may affect the popularity of the firms deciding to offshore
- exchange rate fluctuations may affect profits
- the economies of the offshore countries may be less stable affecting the quality and availability of resources.

Social – cultural environment
Advantages
- social norms may encourage a better work ethic
- demographic trends may provide a large pool of appropriate employees
- improving education provides cheap skilled labour.

Disadvantages
- local communities may oppose the relocation as it affects local businesses
- political opposition from pressure groups
- opposition from domestic pressure groups and local communities badly affected by the changes may cause the reputation of the firm to fall
- reduced goodwill may affect sales and profits
- different social values and cultures may adversely affect the operations of the firm.

Technological environment
Advantages
- lower wage rates may result in cheaper ICT and communications systems and maintenance
- training and recruitment of staff may be easier and wage rates lower for technology graduates.

Disadvantages
- communications systems and ICT capabilities may be worse in LEDCs and even NICs
- spare parts, maintenance and availability of systems may be poor.

[6 to 8 marks]
A PEST framework is used with at least one entry in each category. Advantages and disadvantages are analysed with the use of relevant and informed examples.

[3 to 5 marks]
At the upper end of the band there is a reasonable analysis although it may tend to description at times. The entries may not be comprehensive and although advantages and disadvantages are considered, the analysis may be imbalanced. At the lower end of the band, the answer may not be in a PEST framework.

[1 to 2 marks]
The answer lacks detail, balance and structure. There must be at least two relevant elements of PEST identified. Analysis may be limited or missing.

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

The stakeholders who may be affected by any outsourcing consist of

- suppliers
- employees
- shareholders
- customers
- creditors
- competitors
- government
- local community.

Outsourcing/offshoring, may have different consequences for each of these groups.

Suppliers: US suppliers may find that the companies change their suppliers to those resident in the countries where they relocate some of their business. They will obviously be affected financially and may well close, especially if they have sole supplier agreements.

Employees: US employees may well lose their jobs or find that wages in the industry fall as a result of lower demand and competitive pressures. They will oppose the move.

Shareholders: The reduction in costs caused by the offshoring should mean that profits are higher. This will lead to higher dividends and satisfaction among shareholders and potential investors.

Customers: If the cost savings are passed onto consumers, this may provide cheaper goods and services. However, quality controls may not be as good as legal protections may be less onerous overseas. In the service sector, the expertise or knowledge of those employed may be less reducing the level of quality provided. New customers overseas have increased choice.

Creditors: The effect on creditors may be little. The positive effect may be that higher profits or lower losses may lead to less business failure and bad debts. However, exchange rate issues may complicate payments.

Competitors: Those competitors retaining a domestic base may find that they become less competitive and that their businesses are less successful. This will affect employees. There is little evidence to suggest that customers may prefer products and services sourced locally, although it may be the case.

Government: The government wishes to retain popularity. Loss of employment and pressure group activities may be harmful. However, employment substitution may take place with new industries and services being created. Higher corporate profits may lead to a wealthier society.

Shareholders may wish to move functions overseas. Senior managers may concur if it increases returns and possibly their bonuses. However, middle managers and those affected by the move may oppose the plans. Similarly local government may campaign against the offshoring trends and managers may find themselves under pressure from the communities in which they operate. Pressure groups may be established. Potential conflicts may result in terms of industrial action by staff, legislation from governments restricting business behaviour *e.g.* tariffs and employee protection measures.

The level of conflict will depend on how the change is handled and what each individual group believes it is losing or gaining.

[5 to 6 marks]
The answer assesses the effects of offshoring on four appropriate stakeholder groups in a balanced way using relevant examples and illustrations from the case.

[3 to 4 marks]
There is some an attempt to identify at least three relevant stakeholder groups and to assess the effects of offshoring on these. However, the detail and illustration may be more limited and/or fewer accurate stakeholder groups are identified.

[1 to 2 marks]
The answer is less accurate. There must be at least one relevant group identified. The discussion may be limited.

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

The key elements of the management of the process are
- careful planning and communication
- a clear explanation to stakeholders on the need for, and purpose of, change
- show the benefits of change – create a shared vision
- reduce fear - if possible. Be realistic
- involve the workforce, managers and stakeholders in the change as far as possible
- train staff to accept and even embrace change – this will increase commitment
- recruit external staff, especially those experienced in the management of change
- time manage and plan change
- clear market research.

Negotiate carefully with those affected by change and try to make sure that changes appear to be fairly applied. Involve employee associations, especially if the law requires it
- where required force change through by targeting resistance
- strong leadership is essential.

It is essential that the staff members are not surprised by change. The reasons for change must be clear and well communicated. It is inevitable that change may affect some staff adversely and that there may be resistance leading to conflict. Redundancy is inevitable and promising that it will not happen could be counterproductive. However, if change is planned and the benefits explained then resistance may be minimized. If the culture of the organization is one that embraces change then it will be easier to implement. Careful recruitment and training will create a more flexible environment.

[5 to 6 marks]
There is a detailed discussion of the main elements of change management, which includes communication and planning. There is an analysis of potential conflict and how this may be reduced.

[3 to 4 marks]
There is discussion of some elements of change management, which includes communication and/or planning. There is reference to potential conflict and how this may be reduced.

[1 to 2 marks]
The answer is limited and generalized.