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

N05/3/BUSMT/HP2/ENG/TZ0/XX

88055012

BUSINESS AND MANAGEMENT
HIGHER LEVEL
PAPER 2

Wednesday 16 November 2005 (morning)

2 hours 30 minutes

INSTRUCTIONS TO CANDIDATES

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

1. Comfort

Comfort is a private limited company that sells garden furniture. The company owns ten stores nationwide. Four members of the Rodriguez family own all the shares. *Comfort* has a very good reputation for quality and service and is highly profitable.

Comfort's objective is to grow and increase its national market share by 10 % in the coming two years. The market for garden furniture is growing but competition is intensifying. The task of Dan Rodriguez (the Finance Director) is to decide which growth path the company should take.

Two growth options are currently being considered:

- set up a franchising operation that would allow 10 new stores to be opened each year for the next five years
- "go public." This would mean a float of 49 % of the company on the stock market. This should raise £10 million to fund five new stores a year for the next five years.

Despite being profitable *Comfort* lacks sufficient internal capital to finance the desired growth.

(a) Define *a private limited company*. *[2 marks]*

(b) Explain the importance of setting objectives in managing an organization like *Comfort*. *[4 marks]*

(c) Evaluate the **two** growth options being considered by *Comfort* and recommend which of them is most suitable for the company. *[10 marks]*

(d) Examine **one** other possible method of growth available to *Comfort*. *[4 marks]*

2. Stay in Touch

Stay in Touch is a well-known national company with a good reputation. It manufactures and markets mobile phones.

To be more competitive in both international and domestic markets the management of *Stay in Touch* is considering the possibility of contracting out the production of the mobile phones. They are in discussions with Speedy which is a specialized manufacturing company, located in a developing country. Speedy manufactures similar types of mobile phones for various companies around the world and is looking for more business as it currently operates below full capacity. The contracting out option will enable *Stay in Touch* to concentrate on both research and development and the marketing of their machines. *Stay in Touch's* target profit is $15 million.

Stay in Touch currently produces 1 million units per year. Variable costs are $10 per unit with total fixed costs of $5 million.

Each mobile phone is sold for $25 per unit.

In the event of contracting out, *Stay in Touch* will save $5 million fixed costs as a result of closing down production. Speedy will charge *Stay in Touch* $13 for each phone.

Speedy's current production level is 10 million unit per year, two million less than their full capacity. Their variable costs of production are $12 per unit with fixed costs of $60 million. They sell the phones to other companies at $20 per unit.

Please note: *Clearly show all your working when calculations are required.*

(a) (i) Calculate the break-even level of output for *Stay in Touch*. *[2 marks]*

(ii) Calculate the number of phones that *Stay in Touch* will have to sell to achieve their target level of profit of $15 million. *[2 marks]*

(b) Using appropriate calculations, evaluate whether *Stay in Touch* should contract out production to Speedy. *[8 marks]*

(c) Using appropriate calculations, evaluate whether Speedy should accept the order from *Stay in Touch*. *[8 marks]*

3. Fast Eater

Fast Eater, a fast food restaurant company went public in 1975 and until 2000 had always made a profit. From 2000, sales in Europe (the company's biggest market) started to decline. The following table gives information on *Fast Eater's* current portfolio:

Date of launch	**Product**	**Market information**	**Other information**
1975	burger rolls	high market share but beginning to fall, very low sales growth	very profitable, core product but profitability is beginning to fall
1975	fried potatoes	high market share but beginning to fall, very low sales growth	very profitable, core product but profitability is falling rapidly
1995	toasted bacon sandwich	high market share, low market growth	very successful product
2002	chicken roll	falling sales, low market share in a low growth market	not a commercial success
2002	cheese and tomato pizza	falling sales, low market share in a low growth market	not a commercial success

During the 1990s, *Fast Eater* opened stores worldwide at the rate of 250 a year. However, by 2004 *Fast Eater* was closing restaurants and concentrating on attracting more customers into existing outlets. Industry analysts suggest that the trend towards healthier food is affecting the popularity of the chain and so *Fast Eater* is proposing the introduction of a new product to cater for the market. Newly established health-food stores are becoming major competitors. *Fast Eater* is caught in a marketing war with aggressive rivals. In addition, economic downturn in its major markets is affecting demand.

(a) Explain what is meant by the "company went public in 1975". *[2 marks]*

(b) (i) Use the Ansoff Matrix to identify and explain *Fast Eater's* past and current growth strategies. *[4 marks]*

(ii) Use the Boston Consulting Group Matrix to analyse *Fast Eater's* product portfolio. *[6 marks]*

(c) Suggest a new product for *Fast Eater* and devise a marketing mix (7Ps) to support your chosen product. *[8 marks]*

4. Global Airline Consolidations

The airline industry is facing difficult trading conditions. Individual airlines are considering a number of strategies to respond to these conditions. For example, *Air France* is in advanced negotiations with *KLM Royal Dutch Airlines* with a view to "closer co-operation". *Air France's* proposed strategic alliance with *KLM* reveals a new industry pattern.

Most countries ban mergers between their own airline and a foreign national airline. Therefore, a more likely outcome is a looser tie-up. *KLM* may join the global *Sky Team Alliance* of airlines based around *Air France* and America's *Delta Air Lines*.

KLM can no longer survive on its own. It has no choice other than to join a big alliance as it is weak, in debt and has been hurt by the recent economic slump (downturn).

Under the *Sky Team Alliance*, both *KLM* and *Air France* would combine flights and coordinate schedules and prices – as far is allowed by the European Union regulatory body on competition.

[Source: adapted from *Airlines Global Pattern*, *The Economist*, 20 September 2003]

(a) Explain the difference between a merger and a strategic alliance. *[4 marks]*

(b) (i) Define *economies of scale*. *[2 marks]*

(ii) Examine **two** types of economies of scale that *KLM* may benefit from after forming an alliance. *[4 marks]*

(c) Analyse **three** possible problems that *KLM* might experience after joining the *Sky Team Alliance*. *[6 marks]*

(d) Explain why the European Union regulatory body on competition may be concerned by the reduction in competition as a result of the *Sky Team Alliance*. *[4 marks]*

5. CU Ltd

CU Ltd started up in business seven years ago producing web cameras for computers. It has developed a reputation amongst its customers for high quality and reliability. At first the company grew rapidly. As a result of an initial injection of venture capital *CU Ltd* was valued at $75 million at the height of the technology boom. Unlike many other firms, it survived the technology crash at the start of the century. However, despite slow but consistent sales growth it has faced significant financial problems since. In recent months *CU Ltd* has even had to negotiate with staff to delay salary payments by up to two weeks to help with cash flow. The financial director has been looking at a range of solutions and is suggesting the flotation of the company on the Stock Exchange to inject new capital.

The profit and loss account and balance sheet for 2003 and 2004 are given below:

Balance sheet as at 31 December

$000		**2003**		**2004**
Fixed assets		1500		1400
Current assets				
Stock	910		1220	
Debtors	550		650	
Cash	10		5	
Total current assets		1470		1875
Current liabilities				
Creditors	300		250	
Overdraft	350		475	
Total current liabilities		650		725
Net assets		2320		2550
Share capital		250		250
Profit and loss account		320		350
Loan capital		1750		1950
Capital employed		2320		2550

(This question continues on the following page)

(Question 5 continued)

Profit and loss account for the year ended 31 December

$000	**2003**	**2004**
Turnover	5750	6100
Cost of goods sold	4175	4750
Gross profit	1575	1350
Marketing and admin expenses	1250	1300
Net profit before interest and tax	325	50
Interest	175	225
Taxation	100	10
Profit after interest and tax	50	(185)
Dividends	20	0
Retained profits	30	(185)

(a) Calculate the level of working capital for 2003 and 2004. *[2 marks]*

(b) Assess the likely impact on *CU Ltd* of increasing worldwide Internet access. *[4 marks]*

(c) Examine the value of these accounts to the board of directors of *CU Ltd*. *[4 marks]*

(d) Using appropriate liquidity, efficiency and profitability ratios analyse the financial position of *CU Ltd* from the perspective of a potential investor. *[10 marks]*

6. Banking on co-operation

The *Co-operative Bank* is recognized as a leader in corporate social responsibility. It has won a string of international awards for sustainable development and social and environmental reporting. Last year it lost nearly £4.4 million worth of business from companies it turned down on ethical and environmental grounds. The bank has given details of 41 companies with which it declined to do business in its annual partnership report. Human rights abuses, support of animal testing, arms trading and sweatshop labour were significant reasons for refusing business. Simon Williams, Director of Corporate Affairs, said "While our ethical stance clearly leads to lost business, the customer value analysis shows that it has a very positive impact on our overall profits". The bank's ethical policy was responsible for £30 million, or 24 % of pre-tax profits last year according to their report. The report lists 56 financial, social and ecological "improvement targets" that the bank either met or made progress towards and eight that it failed to meet. Successes include the first *Co-operative* bank office using electricity only from renewable sources. The bank has set 77 new improvement targets for next year.

Co-operative Bank Ecological Mission Statement:

"We, the *Co-operative Bank*, will continue to develop our business taking into account the impact our activities have on the environment and society at large."

[Source: adapted from *Social responsibility costs Co-operative £4 million, Financial Times* 6 May 2003]

(a) Explain what is meant by a co-operative. *[2 marks]*

(b) Assess possible conflicts that may arise between any **two** of the stakeholders of the *Co-operative Bank*. *[4 marks]*

(c) Explain how the *Co-operative Bank* may use its Ecological Mission Statement to create competitive advantage. *[6 marks]*

(d) Analyse the problems the *Co-operative Bank* may face in meeting the "77 new improvement targets" they have set for next year. *[8 marks]*