BUSINESS AND MANAGEMENT
HIGHER LEVEL
PAPER 2

Wednesday 17 May 2006 (morning)

2 hours 30 minutes

INSTRUCTIONS TO CANDIDATES

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

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1. The Third Age of Globalization

Many multinational companies (MNCs) are shifting operations and control of key business functions away from their head office. One example is *IBM*, which recently opened an office in Singapore to control operations in the region. *IBM* has said it will accelerate the transfer of its management outside the USA.

At first when MNCs went global, they sold abroad, manufactured at home and controlled their organization from home. This resulted in significant advantages of economies of scale. In the second phase, driven by a desire to cut costs, both sales and manufacturing were decentralised around the globe, but control remained firmly in the hands of the parent companies' head offices, located mostly in America, Japan or Western Europe. By 2001, 39 % of the 500 largest companies in Latin America were owned by foreign MNCs.

Now MNCs are shifting control overseas and becoming truly global. Evidence of this is seen in the following developments:

- a growing number of regional headquarters in developing countries
- more outsourcing of key business functions; particularly ICT networks
- more integration of senior managers of different nationalities
- a flattening of company hierarchies and changing management styles
- increasing joint ventures and mergers particularly in the field of research and development. General Motors, for instance, recently began fitting engines developed in Brazil.

[Source: adapted from *The Economist: The World in 2004*]

(a) Using examples, explain what is meant by economies of scale. *[4 marks]*

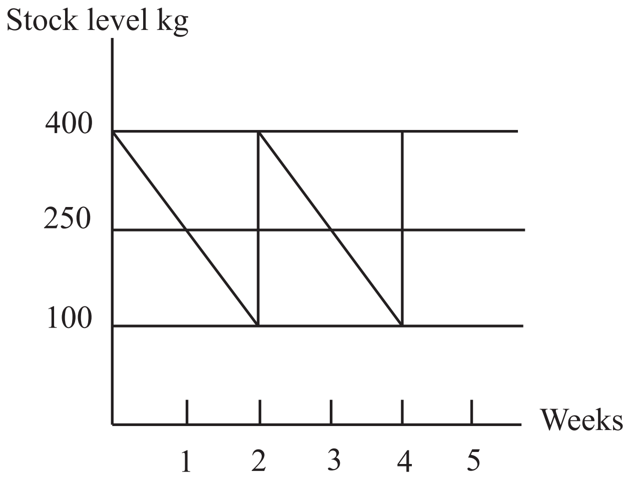
(b) Analyse the driving and restraining forces on MNCs that are considering globalizing their sales, manufacturing and operations. *[6 marks]*

(c) Discuss how leadership and motivation in MNCs will be affected as they become increasingly global. *[10 marks]*

2. Coffee-Cool

Fernando and Marco are partners who own a coffee bar *Coffee-Cool* in a central city location.

Marco is in charge of purchasing the coffee beans. He orders the coffee from a wholesaler located outside the city. Fernando prepares, and serves the coffee. *Coffee-Cool* makes a low level of profit but the market is growing and the partners are considering expanding the premises into its stock room. Marco, wants to operate a Just-in-time (JIT) system whereby the stock arrives an hour before opening time. Fernando prefers to keep the same stock management system. *Coffee-Cool's* stock control system is presented in the following graph:



After a meeting with a bank manager regarding a possible loan for the renovation of the stock room, Marco produced forecasted sales revenue and costs for July to December 2006 (assuming JIT will be used from November 2006):

Revenue	$4000 per month
Costs of buying and holding stock	$700 per month from July until October $400 per month onwards when JIT is used
Costs of ordering stock	$100 per month from July until October $200 per month onwards when JIT is used
Own drawings	$1200 per person per month
Opening balance for July	$400
Promotion	$200 per month
Electricity	$800 per year to be paid in equal instalments every January and July
Rates	$600 to be paid in January every year
Finance charge (interest paid)	$100 per month for three years
Repayment of loan	$2500 per payment to be paid in September and February for two years

If the stock room is not to be used for expansion, a nearby building is available for rent and will cost *Coffee-Cool* $1000 a month.

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(Question 2 continued)

(a) Identify the following for *Coffee-Cool*

(i) lead time
(ii) buffer stock
(iii) reorder quantity. *[3 marks]*

(b) (i) Construct a cash flow forecast for *Coffee-Cool* for each month from July 2006 to December 2006 assuming a loan is taken for renovation. *[6 marks]*

(ii) Comment on *Coffee-Cool's* liquidity position. *[4 marks]*

(c) Evaluate Marco's proposal to change to a Just-in-time (JIT) stock management system. *[7 marks]*

3. The Future Is Asia

Much of the growth of world trade in recent years has taken place in Asia; particular in China and India. In 2004, Europe remained the slowest growing of the world's major regions.

The EU countries face such a severe aging problem that the working populations of Germany, Italy and Spain are projected to fall by a third over the next 30 years. This is having a significant impact on workforce planning, recruitment and training. Firms are hiring older staff and introducing more flexible work practices. Part time opportunities have increased, particularly for women.

The situation in Japan is similar. In 2004, one-fifth of its population was 65 or over. However, Japanese companies thrive and are world leaders in catering for the "grey" market*. Tokyo is a pensioner's paradise. Shops are full of gadgets for the elderly, such as electronic goods with extra large buttons. The market for pensioner friendly goods is estimated to be worth more than $18 billion.

In Asian economies, the working population is growing steadily and there are massive increases in production efficiency. These economies are expected to be larger than Europe's within 20 years, with trend growth in China at 10 %, and in India, at 7 %. A vast new middle-class in these countries with significant purchasing power is attracting major producers of consumer goods and services.

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* The "grey" market refers to those consumers of retirement age.

[Source: adapted from *The Economist: The World in 2004* and *Sunday Times* 29 August 2004]

(a) Describe **four** consequences for global businesses arising from different rates of regional economic growth in the world. *[4 marks]*

(b) Examine the reasons for firms moving towards more flexible working patterns and the likely consequences for workforce planning, recruitment and training. *[8 marks]*

(c) To what extent will firms have to adapt their marketing strategies in response to changes in population structures worldwide? *[8 marks]*

4. Subway

In 2003, the *Subway* sandwich chain overtook *McDonald's* burgers to become the biggest fast-food firm in America. Fred DeLuca, opened the first *Subway* outlet in 1965, when he was 17 years old using a $1000 loan from a family friend. The business was an immediate success and he set a target of 32 new branches in the first 10 years; but only managed 16. He turned to franchising, because it had worked for *McDonald's* and *KFC*. In 2004 there were 17 383 *Subway* outlets in the USA and 21 000 worldwide.

On average 2500 new franchises open each year. *Subway* is now expanding into Europe with hundreds of new stores planned. Annual sales have doubled in the past three years to $9 billion. Franchisees pay *Subway* an initial $10 000 membership fee and typically invest $200 000 of their own capital in a store. *Subway* receives 8 % of an outlet's turnover and franchisees also pay 3.5 % of turnover into a regional marketing fund. Assistance is also provided to improve recruitment and training.

DeLuca knows it will not be easy to grow in Europe having closed unsuccessful stores in the past. However, recent changes in popular taste has convinced him the time is right with "fast food reinventing itself as healthy food". Marketing is aggressive. New *Subway* stores are opening in the busiest areas only; often close to *McDonald's* and, in some cases, remaining open 24 hours a day.

[Source: adapted from *The Times* 19 August 2004]

(a) Examine reasons why new firms, especially those set up by younger people, find it difficult to raise start-up capital. *[3 marks]*

(b) (i) Explain the advantages **and** disadvantages for *Subway* of using franchising as its main method of expansion. *[5 marks]*

(ii) Examine the potential operational problems that *Subway* may face as a result of its planned rapid expansion. *[4 marks]*

(c) Evaluate possible market research available to *Subway* when expanding its operations in Europe. *[8 marks]*

5. Alitalia

The Italian airline, *Alitalia* is losing \$60 000 an hour. An agreement with trade unions should allow the airline to access \$400 million of European and government loans. After a year-long struggle between the *Alitalia* management and the trade unions over a series of cost-cutting measures, several senior managers departed. The trade unions said they will continue to protect members' interests. Employee opposition to change reflects the culture found in many Italian firms.

However, faced with financial disaster, even the trade union admits that *Alitalia* needs reform. Like other airlines, *Alitalia* was hit hard by the impact of the 9/11 terrorist attack and by the growth of low cost airlines. Domestic travellers fell by 11 % and increasing fuel costs has added to its problems.

Alitalia, facing a cash flow crisis, negotiated with trade unions to cut one quarter of its workforce and to sell loss-making service operations such as maintenance and bookings. However, critics argue *Alitalia* has not addressed problems as effectively as other airlines, which restructured and reduced their workforces earlier. It failed to update its fleet with more economical and faster planes. The Italian government, with more than 50 % ownership of the airline deliberately slowed management reform.

[Source: adapted from *The Economist* 11-17 September 2004 and *The Guardian* 7 September 2004]

(a) Using a PEST framework, identify the external factors that led to crisis at *Alitalia*. *[4 marks]*

(b) Discuss the methods that unions at *Alitalia* can employ to protect their members' interests. *[7 marks]*

(c) Evaluate strategies for dealing with the financial crisis and cash flow problems at *Alitalia*. *[9 marks]*

6. Jetstream Hot Tubs

Jetstream Hot Tubs sells three models of hot tubs designed for use in gardens.

Product	Price	Description
Jetstream Premier 12	$8500	Premium price assembled by hand in Sweden only for *Jetstream Hot Tubs* and made to customer specifications.
Jetstream 6	$4600	Supplied by a large company, Bubbleflow, produced in batches for several hot tub suppliers. Additional optional specifications available. "Own branded" with the name of *Jetstream Hot Tubs*.
Jetstream 8	$5200	

Jetstream Hot Tubs is considering importing the Jetstream 8 and Jetstream 6 from a Japanese manufacturer that uses cell production techniques to mass produce hot tubs. The quality is very high. Bubbleflow, however, has informed *Jetstream* that it, too, is upgrading its manufacturing processes to incorporate mass and cell production and are prepared to renegotiate their terms.

Jetstream Hot Tubs had eight Premier 12 hot tubs in stock at the beginning of July 2005, that cost $6200 each to purchase. The following are stock purchases and sales for the last six months of 2005:

<u>Premier 12 stock purchases and sales</u>:

Month (2005)	Purchases (units)	Cost per unit ($)*	Sales/issues (units)
July	20	6300	25
August	35	6150	32
September	28	6400	30
October	20	6300	18
November	52	6200	50
December	54	6500	56

* The cost per unit changes due to currency fluctuations.

(a) Describe two advantages **and** two disadvantages of using job production as a method of producing the *Jetstream Hot Tubs* Premier 12. *[4 marks]*

(b) Using both LIFO and FIFO methods of stock valuation for the Premier 12, calculate the following for the first six months of operation:

(i) the value of the closing stock *[7 marks]*
(ii) the half-year gross profit. *[3 marks]*

(c) Evaluate the marketing, human resource and finance implications for Bubbleflow if it introduces mass and cell production. *[6 marks]*