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BUSINESS AND MANAGEMENT
HIGHER LEVEL
PAPER 2

Friday 18 November 2011 (morning)

2 hours 15 minutes

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- Section A: answer one question.
- Section B: answer two questions.

SECTION A

*Answer **one** question from this section.*

1. Revive Livre (RL)

Revive Livre (*RL*), a bookshop located in central London, has one of the largest collections of second-hand books in Europe. *RL* operates as a partnership of two brothers, James and Nick Cusack. The bookshop is known for its untidy store layout and lack of space. These features have given the bookshop its memorable promotional catchphrase, "Hard to find but worth the time", which has generated substantial brand value through word-of-mouth promotion. *RL* claims that it can find and order any second-hand book.

Changes in reading habits and technology have impacted on *RL*. The availability of second-hand books from online competitors such as *Amazon* has become a real concern. Despite the popularity of *RL*, there has been new negative feedback on customer service and the size of the bookshop. Customers have complained that it is too time-consuming to find a specific book. A liquidity problem has also emerged. *RL* is holding too much working capital in unsold second-hand books.

James has identified three options of physical expansion for *RL*. He argues that all options would provide a better service to customers and help with the liquidity problem if they proved successful.

The estimated cost and financial return for each option is given below (for all options the probability of being successful is 0.6 and the probability of not being successful is 0.4):

Option	Cost (UK£)	Financial return if successful (UK£)	Financial return if not successful (UK£)
1. Purchase additional storage space nearby	200 000	400 000	150 000
2. Purchase the building next door to expand the current bookshop: (a) without a café	900 000	2 000 000	400 000
(b) with a café	Extra 200 000	2 500 000	–100 000
3. Move the bookshop to a large shopping centre outside of central London	1 600 000	2 500 000	1 000 000

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(Question 1 continued)

Nick has a completely different strategic vision for *RL*, which he believes is a less risky and cheaper solution to the store's liquidity and customer service problems. He argues to keep the original central London bookshop and set up an e-commerce facility. The web site will also attract new customers and Nick believes many second-hand books in the shop may finally be sold.

(a) Define the following terms:

(i) *partnership* *[2 marks]*

(ii) *working capital.* *[2 marks]*

(b) Explain **two** disadvantages for *RL* of having too much working capital in unsold second-hand books. *[4 marks]*

(c) (i) Construct a fully labelled decision tree for James' "three options of physical expansion for *RL*". Calculate the predicted outcome for each option and identify the most profitable option *(show all your working)*. *[7 marks]*

(ii) Explain **one** advantage and **one** disadvantage for *RL* of using a decision tree as a decision-making tool. *[4 marks]*

(d) Contrast James' strategy of physical expansion with Nick's e-commerce strategy. *[6 marks]*

2. Fabia

Fabia is a premium dress manufacturer in Australia. *Fabia* produces dresses for the Australian market and exports to a few Asian markets. The main target segment is women with high incomes who prefer high quality, luxurious dresses, for which they are willing to pay premium prices. However, these customers are income elastic. Total quality management (TQM) is used in the production of the dresses. *Fabia's* unique selling point (USP) is based on high quality and unique design, as well as its ethical business behaviour.

The global economic recession in 2009–2010 resulted in a severe fall in demand for *Fabia* dresses and consequently profit. Despite some optimism about economic recovery, *Fabia's* financial manager is considering outsourcing production to the Vietnamese manufacturing company *Patella* to reduce costs. *Patella* is a reliable mass-market* company that takes advantage of the lack of regulations in Vietnam with regard to employment and the environment. *Patella* also has access to cheap raw materials. *Fabia* would retain the design and marketing departments in Australia. The dresses would continue to be sold under the *Fabia* brand.

Table 1: selected current data for *Fabia* in 2010

Number of units sold	200 000 units per annum
Full capacity	400 000 units per annum
Fixed costs	US$7 million
Variable cost per dress	US$80
Price per dress	US$150

If *Fabia* outsources the production of the dresses to *Patella*, the closure of the manufacturing facility in Australia will save US$5 million on fixed costs, but 65 % of the workforce will face redundancy.

Patella could produce up to 2 million dresses per year, charging *Fabia* US$85 per dress, including transport.

Table 2: selected financial data for *Fabia* in December 2010 (all figures in US$)

Closing balance for November 2010: 1 500 000	Fixed assets: 9 000 000
Payment for raw materials: 1 600 000	Cash sales revenue: 2 000 000
Capital and reserve: 15 000 000	Depreciation allowance: 7000
Electricity payments: 20 000	Short-term borrowing: 3 000 000
Salaries and marketing: 175 000	Interest payment: 11 000

* mass-market: wide ranging demand from undifferentiated consumer segments

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(Question 2 continued)

(a) Define the following terms:

(i) *total quality management (TQM)* *[2 marks]*

(ii) *redundancy.* *[2 marks]*

(b) (i) Explain why "the global economic recession in 2009–2010 resulted in a severe fall in demand for *Fabia* dresses" and what the likely consequences of the economic recovery are for *Fabia*. *[5 marks]*

(ii) Using Table 1 and any other relevant information, calculate whether outsourcing the production of dresses to *Patella* would be profitable for *Fabia* at 200 000 dresses per annum *(show all your working)*. *[6 marks]*

(iii) Using data from Table 2, prepare a cash-flow forecast for December 2010 for *Fabia (show all your working)*. *[4 marks]*

(c) Analyse the proposal to outsource the production of dresses to *Patella*. *[6 marks]*

SECTION B

*Answer **two** questions from this section.*

3. Nesbit

For years, *Nesbit* has produced chocolate bars targeting the youth market segment and has been the market leader. The market became saturated due to the entry of many competitors. *Nesbit's* founder, Shira Nesbit, was concerned about falling market share, especially because many competitor products were perceived to be similar to *Nesbit's*. As a result Shira decided to hire an agency to prepare a market audit and to conduct market research. The results confirmed Shira's concerns.

The audit identified a new gap in the market: a chocolate bar for health conscious consumers. Shira thought that it was a good opportunity for *Nesbit* to exploit. She estimated that a chocolate bar for health conscious consumers could be produced in small batches using imported cocoa beans from Venezuela. Shira knew that these beans had significant health benefits and that the new bar could change customer perceptions of *Nesbit*. It could also be priced considerably above other chocolate bars. *Nesbit* began the product development of the new healthy chocolate bar, "Veneziano".

The introduction of Veneziano gave Shira the opportunity to introduce total quality management (TQM) across the company. Previously chocolate bars were produced using flow production and only three workers were employed to check quality. With the adoption of the system of TQM, Shira expected that the quality of all *Nesbit* products could improve with zero defects and reduced waste. However issues remain. *Nesbit* workers have traditionally resisted changes in the production process and Shira is worried about the impact on worker motivation. Shira is considering change management practices.

Early sales of Veneziano have been impressive. Shira believes that the strategy of introducing a new healthy chocolate bar would differentiate *Nesbit* from its competitors and change customer perceptions away from a youth chocolate company towards a more adult one. However, the move might be unpopular with *Nesbit's* other stakeholders and would require further extensive promotion to change perceptions of its brands and company. Some competitors are also experimenting with health conscious products similar to Veneziano.

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(Question 3 continued)

(a) Define the following terms:

(i) *market segment* *[2 marks]*

(ii) *flow production.* *[2 marks]*

(b) Explain what Shira could do in order to overcome the workers' resistance to change. *[6 marks]*

(c) Analyse the usefulness of Shira hiring an agency "to prepare a market audit and to conduct market research". *[6 marks]*

(d) Discuss whether the launch of Veneziano could change customer perceptions of *Nesbit*. *[9 marks]*

4. GSK

As the chief executive officer (CEO) of *GlaxoSmithKline* (*GSK*), a large pharmaceutical company, Andrew Witty is perceived as profiting from the misfortune of others. *GSK* has profited significantly from the H1N1 flu[1] pandemic. In 2009, *GSK* had received orders for 195 million flu vaccines and sales revenue from the vaccine in 2010 was US$1.3 billion. Andrew said, "If a pharmaceutical company cannot make a profit during a pandemic, when can it?". *GSK* had spent 18 years and US$3 billion on researching and developing new flu vaccines.

Although a public limited company, *GSK's* aim is to balance the need to make a profit with the ethical side of health care. On the ethical side, *GSK* plans to use a price discrimination strategy of charging in sub-Saharan Africa, only a quarter of the price charged in British and American markets. *GSK* also plans to collaborate with rival companies to research some tropical diseases prevailing in developing countries.

To boost profitability, Andrew has strategies to become less dependent on a few highly successful drugs. He plans to:

- extend *GSK's* product range, particularly in cosmetic products, through acquisitions of companies such as *Stiefel Laboratories, Inc.*, an American manufacturer of skincare products
- enter emerging, fast-growing economies by acquiring *Dr. Reddy's*, an Indian generic drugs[2] company
- collaborate with other pharmaceutical companies, such as via a joint venture to develop a treatment for AIDS.

Andrew will also cut costs by US$1.7 billion by 2011, which will result from 10 000 redundancies.

[Source: adapted from Tom Bawden, "Yes, we will make profits from the flu pandemic. No, I won't apologise", *The Times*, 25 July 2009]

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[1] H1N1 flu: an acute and highly contagious respiratory disease of swine, which can pass from pigs to humans
[2] generic drugs: as opposed to branded drugs, generic drugs are produced and sold without patent protection

(a) Describe **two** characteristics of a public limited company. *[4 marks]*

(b) Using the concept of price elasticity of demand, explain *GSK's* pricing strategy for its flu vaccine. *[6 marks]*

(c) Using the Ansoff matrix, examine **one** of the strategic options planned by Andrew. *[6 marks]*

(d) Discuss *GSK's* aim to "balance the need to make a profit with the ethical side of health care". *[9 marks]*

5. Eat Well

Eat Well is a small family-run, local restaurant that prides itself on excellent service and local dishes made from fresh ingredients. Kaa Lee, the chef, is in charge of ordering the ingredients and devising the menu. Currently, he uses a daily just-in-time (JIT) stock control method, ordering from local farmers.

Kaa is concerned about:

- a fall in demand caused partly by a new organic restaurant that opened recently in the area
- frequent delays in deliveries of ingredients from local farmers
- some cash-flow problems resulting from credit given to loyal customers and from purchasing ingredients daily
- customers becoming more demanding, for instance desiring more varied menus with fewer local dishes
- the government becoming stricter with health and safety regulations in the food service industry
- a recent increase in the level of tax (as this has increased the current liabilities of *Eat Well*)
- changing trends in eating out habits.

Kaa wants to carry out market research to determine how to attract more customers and how to compete more effectively.

He is also considering a move to a more traditional just-in-case (JIC) stock control method, and ordering from one single wholesaler located in the regional capital. Kaa is unsure of which method of stock valuation to use: last-in-first-out (LIFO) or first-in-first-out (FIFO).

(a) Define the following terms:

(i) *current liabilities* *[2 marks]*

(ii) *wholesaler.* *[2 marks]*

(b) Explain the effects on *Eat Well's* profit and loss account resulting from using LIFO and FIFO stock valuation *(figures are not required)*. *[6 marks]*

(c) Analyse Kaa's decision to change *Eat Well's* stock control method to just-in-case (JIC). *[6 marks]*

(d) Discuss the usefulness of market research for Kaa in order to "determine how to attract more customers and how to compete more effectively". *[9 marks]*