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BUSINESS AND MANAGEMENT
HIGHER LEVEL
PAPER 2

Friday 9 November 2012 (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.
- A calculator is required for this examination paper.
- Clean copies of the ***Business and Management*** *formulae sheet and discount tables* are required for this examination paper.
- The maximum mark for this examination paper is *[75 marks]*.

SECTION A

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

1. Easy E Booking (EEB)

Easy E Booking (*EEB*) is a small, well-known, reputable and financially stable online hotel reservation service. *EEB* employees are highly motivated and take great pride in their work. *EEB* has received recognition for their high quality customer service. Due to an increase in global demand, greater competition and changes in technology, the finance director, Maia, has decided to upgrade *EEB's* computers and/or software.

Maia has two options:
Option A: purchase only a new software called "Book-Fast" from a local software designer.
Option B: purchase new computers with installed software called "Global Reach" from a manufacturer abroad.

	Option A	**Option B**
Cost	$20 000	$40 000
Technical support	24 hours onsite at *EEB*	24 hours online
Further payments payable:		
Employees	No change	At the end of their contract 15 % of employees to be made redundant, cost: $15 000 in year 2
Training cost	On-the-job: free	Intensive: $12 000 in year 1
Maintenance cost	Free	$1000 per year
Insurance cost	$500 per year	$1000 per year

The estimated return/total revenue in $ per year is shown below:

	Option A	**Option B**
Year 1	10 000	14 000
Year 2	12 000	16 800
Year 3	17 000	23 800
Year 4	20 000	28 000

The average rate of return (ARR) of Option A is 46.25 %.

Maia is considering using a straight line method of depreciation.

EEB employees favour Option A, even though some of their competitors using "Book-Fast" have reported problems with the software, including security issues. However, Maia has chosen Option B, which will provide more up-to-date, sophisticated and secure reservation system software. It will also give *EEB* a competitive advantage and an ability to handle a large global volume of hotel reservations.

(This question continues on the following page)

(Question 1 continued)

(a) Describe **one** strength and **one** weakness of *EEB* using a straight line method of depreciation. *[4 marks]*

(b) Calculate the payback period for Option A *(show all your working)*. *[2 marks]*

(c) Calculate the average rate of return (ARR) for Option B *(show all your working)*. *[4 marks]*

(d) For **both** Option A **and** Option B, calculate the net present value (NPV) using a discount rate of 4 % *(show all your working)*. *[5 marks]*

(e) Explain **one** advantage and **one** disadvantage for *EEB* of using the NPV method of investment appraisal. *[4 marks]*

(f) Examine Maia's choice of Option B. *[6 marks]*

2. BP and the Gulf of Mexico

In May 2010, the oil company *BP* suffered a major disaster while drilling for oil off the coast of Louisiana, United States (US) in the Gulf of Mexico. The drilling platform exploded and was destroyed, killing 11 workers. Millions of tonnes of oil spilled out into the sea. This was the worst industrial accident *BP* had ever faced. Subsequently the price of *BP* shares fell by 30 %.

It took *BP* three months to stop the leak in the oil well. The oil spill had a major negative impact on fish, birds and the whole ecosystem. Regional fishermen, seafood restaurants and the tourist industry were the first to suffer from the impact of the pollution and demanded compensation.

This was a public relations (PR) crisis for *BP*. The US media attacked the company on a daily basis. Environmental pressure groups called for a ban on deep water oil drilling and even the US president got involved, announcing on television that *BP* would be "made to pay heavily". The perception was that *BP's* crisis management was slow, uncaring and inefficient. For example, Tony Hayward, the Chief Executive Officer (CEO) of *BP* was reported to have said that the oil spill "was tiny" and on another occasion he complained of stress and said he "would like his life back". However, to solve the problem in deep water was a very technical exercise, which had never been attempted before. As a result of this PR crisis, *BP* decided not to give dividends to its shareholders in 2010.

BP has identified the following as causes of the decline in financial performance:
- the loss of the oil drilling platform
- the cost of stopping the leak 250 metres below the sea
- the cost of the clean-up operations
- the fall in share price
- the loss of brand image and goodwill
- compensation paid to regional businesses
- compensation paid to the families of the workers killed.

Selected items from *BP's* balance sheet as at 31 December 2009 (US$ millions) (before the disaster).

Cash	5000
Creditors	30 000
Debtors	35 000
Depreciation	40 000
Fixed assets	250 000
Loan capital	X
Retained profit	72 000
Share capital	100 000
Short-term borrowing	29 000
Stock	25 000

(This question continues on the following page)

(Question 2 continued)

(a) Outline the importance of the balance sheet to **two** stakeholder groups of *BP*. *[4 marks]*

(b) (i) Using the information in the selected items from *BP's* balance sheet, calculate the loan capital (figure X) and construct a balance sheet for *BP* as at 31 December 2009. *[5 marks]*

(ii) Explain how **two** of the financial consequences of the disaster will appear on *BP's* balance sheet as at 31 December **2010**. *[4 marks]*

(c) Explain **three** possible ways in which *BP's* marketing department could have better managed the public relations (PR) crisis, to limit the damage to *BP's* reputation. *[6 marks]*

(d) The table below shows selected ratios for *BP* for 2008 to 2010:

Ratio	**2008**	**2009**	**2010**
Liquidity:			
Acid test (quick) ratio	0.7	0.8	0.4
Gearing (%)	19	20	35
Shareholder:			
Dividend yield (%)	5	5	0
Profitability:			
Net profit margin (%)	11.4	12.3	4.5

Using relevant information and the ratios above, analyse the likely impacts of the disaster on *BP's* future financial performance. *[6 marks]*

SECTION B

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

3. Toyota

Toyota is one of the biggest car manufacturers in the world. For decades it was known for production efficiency and car quality. Its Kaizen approach to manufacturing transformed car-making worldwide resulting in years of growth in sales and profits. With rapid global growth, *Toyota* began outsourcing production activities of some car parts to overseas manufacturers, with whom it had not worked before, resulting in a loss of quality control. In addition to this, it ignored employees' concerns about car safety and quality and was also slow in responding to customers' complaints.

In 2009, *Toyota* recalled 11 million cars worldwide due to various defects in car parts. The financial loss to *Toyota* from the recall and lost sales was US$2 billion. The total market value of *Toyota's* shares fell by US$20 billion.

Following the recall, company President Akio Toyoda said that in expanding too rapidly *Toyota*:
- Lost sight of its long-established customer focus.
- No longer stopped to study every defect, or problem to determine the causes.
- Forgot its core values of safety first, quality second and volume third. Its main strategic objectives became "world biggest" and profit.

He added that the situation is urgent and to recover its reputation and core values:
- New quality control standards will be put in place.
- New procedures will pay closer attention to customers' feedback.
- A team will be set up to investigate every defect reported within 24 hours.
- Change will be implemented more rapidly than normal.

Other famous car brands have also experienced product recalls. Regarding *Toyota*, analysts commented that Akio Toyoda understands the problems and has personal interest in *Toyota*, his name is on every car. Financially, *Toyota* created a US$1.4 billion provision for the recall and it has US$23 billion in reserve. In America, *Toyota's* sales were up 6% in 2010 over the previous year.

(a) Describe **two** practices of a Kaizen approach to manufacturing. *[4 marks]*

(b) Explain **two** methods of research that *Toyota's* marketing department could use to improve its relationship with customers. *[6 marks]*

(c) Examine *Toyota's* decision to outsource "production activities of some car parts to overseas manufacturers". *[6 marks]*

(d) To what extent will *Toyota* be able to recover its reputation, core values and brand image? *[9 marks]*

4. "Think locally, grow globally"

To avoid negatively affecting sales, *McDonald's®* senior managers in the United States (US) headquarters realized that they should not apply identical American standards worldwide. *McDonald's®* must now think locally to grow globally.

British-born Steve Easterbrook, head of *McDonald's®* in the United Kingdom (UK), understood the need for strategic change and prepared tactics with two objectives:

- to attract new and different customers
- to enhance the good value of products to appeal to customers during economic recession.

One of the first tactics in the UK was the introduction of "Little Tasters®", which offered new products, in small portions, at low prices. Steve understood that young mothers, when taking their children to *McDonald's®*, would not buy meals for themselves because they felt the portions were too large. Other tactical changes, in response to customer demand, included the introduction of more chicken-based products for health-conscious customers. Moreover, an improved breakfast menu and better quality coffee attracted more price-conscious people on their way to work.

These adaptations to local conditions proved successful in the UK and beyond. *McDonald's®* UK had 13 million more customers in 2010 compared to 2009, resulting in an increase in market share (during the economic recession). In other host countries *McDonald's®* also successfully implemented its "think locally, grow globally" strategy. For example, it successfully launched products made from local produce and suited to local tastes such as the "Maharaja Mac™" in India, the "McLobster®" in Canada and the "Ebi Filet-O" (a shrimp burger) in Japan.

At the same time *McDonald's®* launched a "global uniform initiative" to redecorate its restaurants with uniform appearance. *McDonald's®* still tries to maintain the global recognition and the quality of its global brand. Local construction material and local labour are used, as well as different colours, comfortable armchairs and free Internet access. Other multinational food and drink companies, such as *KFC®* and *Starbucks®*, are also using a similar strategy to the "think locally, grow globally" strategy used by *McDonald's®*.

[Source: Adapted from: Ian King, 'Who is loving it this time?' *The Times*, 9 February 2010.]

(a) Describe **two** possible factors that have contributed to the growth of globalization. *[4 marks]*

(b) Draw the Ansoff matrix and use it to explain **two** of the growth strategies used by *McDonald's®*. *[6 marks]*

(c) Analyse the possible impacts of multinational companies like *McDonald's®* on the host countries. *[6 marks]*

(d) Discuss the effectiveness of the "think locally, grow globally" strategy used by *McDonald's®*. *[9 marks]*

5. Rox and Inclusive Music (IM)

Rox was a music band managed by Michel Mbappe. The band enjoyed considerable commercial success thanks to Michel's autocratic leadership style. He personally made all decisions. Rox had given generously to local schools and other non-profit organizations. The band received many awards for their acts of corporate social responsibility. Their last CD "Action Not Words" had brought them considerable fame.

In June 2010, Michel was asked to help finance the start-up of a new non-profit music school called "Inclusive Music" (*IM*). *IM's* aim was to support young musicians from low income families. At first, Michel was very enthusiastic and prepared a business plan. Unfortunately, he realized that Rox could not afford to finance *IM* fully. External sources of finance other than contributions from Rox would be needed for *IM* to grow. Until then *IM* would only have a limited budget for marketing and market research.

In June 2011, *IM* opened with the mission statement "Action not words". To support its mission, it offered free lessons and allowed students to borrow musical instruments. Michel asked a popular former singer, Louis Marsaud, to be the school's director. Louis adopted a laissez-faire leadership style, hoping it would allow creativity among students. Initial student attendance was lower than expected and quickly worsened. Within three months, many instruments had gone missing and many students were no longer attending music lessons.

IM's finances were deteriorating, and Louis could not attract external sources of finance. Michel took action and organized a concert by Rox to promote *IM*. He also examined *IM's* accounts and discovered a significant liquidity problem. Without consulting anyone, he dismissed Louis. In the music media, Michel received much criticism for dismissing Louis. Journalists argued that the two main problems were, *IM's* vague mission statement and poor marketing. However, Michel aimed to ensure that *IM* became sustainable in the long term.

(a) Define the term *corporate social responsibility*. *[2 marks]*

(b) Identify **two** possible causes of a liquidity problem. *[2 marks]*

(c) Explain how the following may have contributed to *IM's* financial problems:

(i) its mission statement. *[3 marks]*

(ii) its limited marketing budget. *[3 marks]*

(d) Analyse the appropriateness of Michel's autocratic leadership style, for the running of an organization such as *IM*. *[6 marks]*

(e) Discuss **two** possible medium- to long-term external sources of finance that *IM* could use to help solve its financial problems. *[9 marks]*