



MARKSCHEME

November 2008

BUSINESS AND MANAGEMENT

Standard Level

Paper 1

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1. (a) (i) **Define the term *gearing*.** [2 marks]

Gearing, known as leverage in the United States, refers to the relationship between debt capital and equity capital of an organization and is typically expressed as a ratio or as a percentage. Though several ways to calculate the ratio are used, depending on the circumstances, each tries to examine what percentage of total capitalization is composed of debt and what percentage is composed of equity capital.

[2 marks]

Gearing is accurately defined.

[1 mark]

A vague definition of gearing is provided, though the response indicates some understanding.

(ii) **Explain *two* reasons why *Organix* produces accounts.** [4 marks]

The main reasons accounts are produced include:

- to record assets, liabilities and transactions
- to allow management to analyse and evaluate the performance of the organization
- to control the flow of funds in and out of the firm
- to allow internal stakeholders to understand the performance of the firm, which can influence decisions (for example, by the firm's owners or shareholders or labour)
- to allow external sources of funds (banks, lending institutions, suppliers, equity markets) to understand the credit-worthiness or viability of the firm.

Award [1 mark] for each reason identified plus [1 mark] for the development/explanation.

- (b) **Discuss financial *and* non-financial implications for *Organix* of borrowing \$500 000 to finance the restaurant and the farm shop. Your answer should consider the implications for the balance sheet, profit and loss account and gearing.** *[10 marks]*

Financial and other implications for *Organix* of borrowing \$500 000 include:

- increased gearing and higher debt service
- higher fixed costs for the operation of the business (of the restaurant and the farm shop)
- greater complexity in maintaining accounts
- need for improved security procedures for cash/currency used in the business, which now has several locations
- increased complexity of operations
- risk associated with entry into a business activity new to *Organix* (the restaurant)
- increased complexity in maintaining accounts and records
- increased organizational stress, with the potential to exacerbate existing tensions within the business (for example, between Terry and Max, who have different leadership styles)
- greater challenges with respect to hiring or developing mid-level managers (to run the farm shops or to coordinate various aspects of the business).

Overall, at this stage, *Organix* can expect to face a number of challenges associated with the growth and the \$500 000 loan. The loan will immediately increase debt service, which is anticipated to be met from the operation of the restaurant and new farm shop. The expansion of *Organix*'s operation to include an extra farm shop and restaurant will increase the complexity of the organization, creating a number of stresses (noted above). While some synergy can be expected (organic produce being used in the farm shops and restaurant), the increase in the size of the business is small enough that it is unlikely to produce significant economies of scale and, possibly, will produce diseconomies of scale. The decision to borrow \$500 000 and proceed with the expansion constitutes implementation of a strategic-level decision and, at this stage, constitutes a significant risk for the firm.

[9 to 10 marks]

Candidate discusses both financial and other implications of *Organix* borrowing \$500 000 in detail, including higher gearing and debt service, profit and loss account, and the balance sheet. Non-financial implications may include the impact of change on the organization, the stresses that will be placed on human resources and the management of personnel, and other relevant implications that the candidate may identify. At the higher end, the candidate will recognize some potential benefits stemming from the expansion of the business (made possible because of the loan), though overall the candidate will recognize that at this stage *Organix* will probably face more risks and challenges than immediate benefits of synergy or economies of scale.

[6 to 8 marks]

Candidate discusses both financial and non-financial implications of *Organix* borrowing \$500 000, including higher gearing and debt service, profit and loss account, and the balance sheet. Candidate either does not address the potential benefits stemming from the loan (and expanded business) or accepts those benefits uncritically, without serious consideration to the many risks involved in the expansion.

[3 to 5 marks]

Candidate discusses some financial and non-financial implications of *Organix* borrowing \$500 000, though the answer is limited in detail, specifics, or balance (*e.g.* the candidate addresses financial implications but none of the other organizational implications).

[1 to 2 marks]

Candidate provides a limited and descriptive answer.

2. (a) Define the term *social responsibility* (line 72). [2 marks]

Socially responsible firms are those that understand that the activities of their business have a direct and indirect impact on society and act responsibly and ethically toward all stakeholders, not just those most directly affected by the organization's decisions. The actions of socially responsible firms extend well beyond concern to increase shareholder value; they typically extend as well to employees, customers, suppliers (*e.g.* a socially responsible firm will not acquire supplies or raw materials from a firm that itself does not have ethical or environmental policies), the community, and other stakeholders.

[2 marks]

Social responsibility is accurately defined.

[1 mark]

A vague definition of social responsibility is provided, though the response indicates some understanding.

(b) Describe *two* objectives of socially responsible organizations like *Organix*. [4 marks]

Objectives of socially responsible firms like *Organix* include:

- fair labour practices, including:
 - non-employment of children
 - non-discriminatory hiring and promotion practices
 - fair and livable wages, adequate benefits
 - a fair and transparent approach to dealing with employees
 - allowing labour to bargain collectively
- environmentally sustainable practices, including:
 - reducing energy consumption
 - using only organic and/or biodegradable supplies/products
 - when appropriate, recycling
 - not polluting the environment
 - minimizing noise and other forms of social pollution
- operation of the business in a transparent fashion (not having hidden costs to customers)
- ethical marketing, including:
 - honesty in advertising
 - avoidance of deceptive strategies, such as “bait-and-switch”
 - development of socially responsible products
- *any other valid response.*

Award [1 mark] for each socially responsible objective the candidate identifies, up to a maximum of [2 marks]. Award an additional [1 mark] for development of why the identified objective is socially responsible, up to a maximum of [2 marks].

- (c) **Examine *one* advantage and *one* disadvantage to *Organix* of making a full commitment to operating as a socially responsible organization.** [8 marks]

Traditional for-profit organizations focus primarily on maximizing shareholder value through short to intermediate-term objectives that permit survival, profit maximization, growth, sales revenue maximization, and enhancement of image. Increasingly firms are finding that adoption of socially responsible practices can enhance image, making the firm attractive to many potential employees, customers, or investors. In the long run, therefore, acting in a socially responsible fashion can often help firms reach traditional objectives (growth, profit maximization, *etc.*), even though doing so sometimes means higher costs or lower returns in the short term. Firms making a **full** commitment to socially responsible practices do so not merely for the benefits that come with image enhancement. These firms consider their full range of stakeholders, not just shareholders, employees, or customers, and make a commitment to particular ethical ideals, even if it means “permanently” higher costs and lower returns (many firms, however, are increasingly finding that in the long run operating in a socially responsibility fashion “pays off” literally).

Advantages of operating in a socially responsible fashion include:

- many human resources advantages, including:
 - easier recruitment and retention of qualified employees
 - higher employee satisfaction and motivation
 - fewer employee distractions (such as worrying about affordable day care, health insurance, *etc.*), thus improving productivity
 - easier labour negotiations
 - a vision and focus to the employees of the firm
 - maintenance of a high internal ethical ideal (reducing, for example, employee theft)
- enhanced image in the market place, attracting customers and investors
- enhanced brand identity
- reduced litigation threats and costs
- improved relations with all stakeholders.

Disadvantages to operating in a socially responsible fashion include:

- increased costs (wages, benefits, environmentally friendly practices, *etc.*)
- training costs
- possible reduction of firms with which to do business (if the socially responsible plan, for example, includes purchasing only from firms that are socially responsible)
- costs of renovation of facilities or costs of restructuring of practices.

For *Organix*, a full commitment to socially responsible practices would require adoption of policies and practices that go beyond merely being a producer of organic food. It would require, further, a full analysis of all aspects of the business to ensure that in all areas of operations the most advanced environmentally friendly approaches were being followed, which could involve considerable costs in terms of replacing equipment and restructuring the operation of the farm. In addition, all human resources policies and practices would require evaluation and many would require costly changes. Such changes would require considerable concessions on the part of Terry, whose style is generally inconsistent with socially responsible human resources practices. The firm could anticipate both one-off costs for restructuring the business as well as an increase in certain fixed and variable costs.

There are, however, many potential benefits to *Organix* of such a move. Full social responsibility would dovetail with the *Organix* brand, thus allowing the firm to leverage off its existing image in the marketplace. Improved pay, benefits, and conditions would probably lead to enhanced employee loyalty, as well as to employees working harder to promote the firm, both when on and off the job. In the long run, many socially responsible firms enjoy economies once the upfront costs have been absorbed (making the barn energy efficient through improved insulation and solar panels, for example, would increase short-term costs but lower energy costs in the long run).

[7 to 8 marks]

Examining in detail one advantage and one disadvantage of *Organix* operating as a socially responsible firm, the candidate recognizes that a genuine, full commitment would mean adopting socially responsible practices not solely for the enhancement of image but because of belief in the ethical ideals behind the practices. For *Organix*, this would mean a willingness to absorb the various costs and overcome the impediments that come with this ethical ideal, even if the payoff is not certain or future profits are diminished.

[5 to 6 marks]

The candidate examines in detail one advantage and one disadvantage of *Organix* operating as a socially responsible firm, focusing largely on the value of image enhancement as the chief motive for adopting socially responsible practices.

OR

The candidate conveys an understanding that a full commitment means more than image enhancement, but the response lacks sufficient detail and balance.

[3 to 4 marks]

The candidate examines one advantage and one disadvantage of *Organix* operating as a socially responsible firm, though the response lacks balance or depth. The candidate's response indicates an understanding of social responsibility solely as a means to enhance image, not as a genuine commitment to ethical ideals.

[1 to 2 marks]

The candidate provides a limited, descriptive answer.

3. (a) (i) **Define the term *stakeholder*.** [2 marks]

Various groups of people who have an interest in an organization or business activity are stakeholders.

[2 marks]

Stakeholder is accurately defined.

[1 mark]

An imprecise definition of stakeholder is provided, though the response indicates some understanding. If the candidate provides correct examples, but not a definition, award [1 mark].

(ii) **Identify *two* internal and *two* external stakeholder groups of *Organix*.** [4 marks]

Internal stakeholders include:

- owner/shareholders
- directors (who typically are owners, or substantial shareholders, but not necessarily so)
- managers
- employees.

External stakeholders include:

- customers
- government
- suppliers
- lenders
- community
- pressure groups
- *any other appropriate stakeholder.*

Award [1 mark] for correct identification of two of the above internal stakeholders up to [2 marks]. Award [1 mark] for correct identification of two of the above external stakeholders up to [2 marks].

- (b) Explain the implications for two of *Organix*'s stakeholder groups if the government reduces "organic standards to make it easier for farms to convert to organic status" (lines 149-150). [8 marks]

The owners/shareholders of *Organix* would be affected, is the government were to make it easier for farms to convert to organic status. *Organix* could expect to see considerably increased competition as farms converted to organic status, thereby putting downward pressure on the prices *Organix* could charge. Terry and Max's investment of time and money achieving the formerly high organic status would lose considerable value, while future profits and returns on investment would be lowered. *Organix*'s brand identity would probably suffer as well, as *Organix* would no longer be one of a small group of organic producers. On the other hand, a larger range of grocery stores and chains, including those selling to price-sensitive customers, would presumably be interested in selling *Organix* products. As a lesser investment would be required to produce organic food and as there would be, probably, a larger market for their goods, *Organix* could probably bring more acreage under till. Overall, *Organix* could expect to shift from a small niche firm to a large firm competing in a thinner margin, more price sensitive market.

Other internal stakeholders would be affected as well. If the transition to a large firm competing in a thinner-margin, more price sensitive market did not go well, employees, whether managerial or ordinary staff, could, at the least, anticipate lower pay raises and no additional benefits. If increased competition were intense enough, they could face lay-offs, lower wages, and reduced benefits. Overall, added stress would be placed upon the business, whose niche position was eroded by government action.

External stakeholders would be affected as well. Customers may not be pleased with the government's actions, but would probably find the lower prices at the markets attractive. On the other hand, for those customers fully committed to organic food (such as *Organix* had produced), many might find the increased number of producers distracting, making it harder for them as customers to determine which farms still produced according to the formerly high standards. *Organix*'s lenders would also be affected. As margins and profits at *Organix* felt the downward pressure of increased competition, *Organix* would probably find it harder to service its debt, while the value of the farm, as collateral, probably would decrease as the investment in the former organic standards would now be considerably reduced. Were *Organix* to try to continue to operate as before, its suppliers would probably feel some impact, as the firm were less profitable. If, however, *Organix* acceded to the new, lower standards for the label organic, it would probably abandon its traditional suppliers for less costly ones.

Both the government and pressure groups would presumably have mixed reactions. The government would now be able to hold organic farms to lower standards, thereby reducing the intensity of inspections, but the number of farms would increase considerably, thereby increasing the scale of the regulatory and oversight work. Pressure groups would probably be pleased that a large number of farms would convert to being organic, though they would probably be dissatisfied with the erosion of standards.

Mark the question as follows:

- (i) Identify each stakeholder (up to two), label the first stakeholder S1 and the second S2.
- (ii) For each stakeholder group identified above, award up to **[4 marks]**.
- (iii) For any additional stakeholders identified within the answer that do not add value circle them.
- (iv) At the end of the second response, write END to signify that you have not marked beyond this point.

For each stakeholder group, award marks as follows:

[4 marks]

Candidate explains in detail implications for the stakeholder group, considering, where appropriate, both the opportunity and threats presented by the change in government policy.

[2 to 3 marks]

Candidate identifies a stakeholder group affected by the change in government policies, but the explains lacks specificity, thoroughness, and/or balance.

[1 mark]

Candidate identifies a stakeholder group affected by the change in government policy.

4. (a) Compare and contrast the leadership styles of Terry and Max.

[6 marks]

Terry’s leadership style is generally autocratic, and he has Taylorist/Theory X assumptions about employee motivation and appropriate treatment of employees. Max’s style is more difficult to fit neatly in the categories used by textbooks, as at times he is entrepreneurial, at other times democratic. Overall, he shows a commitment to positive relations with employees and to employee empowerment.

[5 to 6 marks]

Candidate correctly compares and contrasts the leadership styles of Terry and Max and uses appropriate business language and specific references to the case to describe them.

[3 to 4 marks]

Candidate describes the leadership styles of Terry and Max, though the response may be lacking in appropriate business language and specifics from the case study. Candidate does not have to use the terms such as “autocratic” to describe Terry, but needs to show a clear understanding of his style and must clearly differentiate it from Max’s. At the lower end, candidate provides a satisfactory description of the leadership style of only Terry or only Max.

[1 to 2 marks]

Candidate provides a general and limited response.

- (b) **Advise Terry and Max of an appropriate organizational structure for the farm in the future. Your answer should consider differing leadership styles, the changing external environment and *Organix's* expansion plans.** [10 marks]

The point award is to be determined based upon the strength of the argument that the candidate makes and their use of specific evidence drawn from the case study and business concepts and theory, as well as their consideration of (1) differing leadership styles, (2) the changing external environment, and (3) *Organix's* expansion plans.

[9 to 10 marks]

Candidate provides clear advice for the organizational structure of the firm. In formulating the response, the candidate has considered fully the implications of (1) the differing leadership styles, (2) the changing external environment, and (3) *Organix's* expansion plans. In the context of the evidence presented and using appropriate business language and concepts, the candidate makes a strong case for a particular organizational structure, highlighting both its strengths and limitations.

[6 to 8 marks]

Candidate provides clear advice for the organizational structure of the firm. Though the candidate has identified (1) the differing leadership styles, (2) the changing external environment, and (3) *Organix's* expansion plans, consideration of all three may not be complete. Based upon the evidence presented and the business language and concepts used, the recommended organizational structure is plausible, though, in the absence of full treatment of each of the three factors above, the candidate's case is not fully convincing. Some weaknesses may be evident in the use of language of business or business concepts.

[3 to 5 marks]

Candidate provides advice for the organizational structure for the firm. Of the three sets of circumstances prescribed by the question (the differing leadership styles, the changing external environment, and *Organix's* expansion plans), a maximum of [4 marks] is to be awarded if the candidate fails to treat at least one and a maximum of [3 marks] is to be awarded if the candidate fails to treat at least two. Because of lack of treatment of these circumstances, or because of lack of specifics drawn from the case or from appropriate business language and concepts, the candidate's advice can not genuinely be evaluated. Nonetheless, the advice should at least be realistic with respect to the broad outline of the case and question (for example, a recommendation that *Organix* "go public" would not be a realistic recommendation).

[1 to 2 marks]

Either the candidate gives no advice, or the answer is general and limited with respect to the circumstances prescribed by the prompt and business language and concepts.
