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**BUSINESS AND MANAGEMENT  
STANDARD LEVEL  
PAPER 2**

Friday 19 November 2010 (morning)

1 hour 45 minutes

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**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. La Carnicería Sanitaria (LCS)**

Alejandra Morales manages a meat wholesale\* business in the southern side of Panama City, Panama. The business was set up by her father. When he retired, he changed the legal status from a sole trader to a private limited company. Every year Alejandra uses her personal savings to purchase an additional 5% of her father’s shares. The firm is profitable, has an average monthly positive cash flow of US\$1200 (after paying Alejandra’s monthly salary), no debts, and presently has a US\$14 000 cash balance. The present policy of the firm is to pay dividends of US\$12 000 each year.

Alejandra wants to open a new wholesale facility in the northern side of the city in January 2011. According to her business plan she would need to rent a building and purchase new equipment.

- To finance the new equipment, she will obtain a US\$60 000 bank loan which must be repaid in five years.
- Alejandra forecasts sales of US\$10 000 in January 2011 and she expects sales to grow by 2% per month for the following six months.
- Sales will be on credit with customers required to pay in 30 days.

Forecasted cash outflows of *La Carnicería Sanitaria (LCS)* at the new wholesale facility for the first six months (January to June 2011) will include:

	US\$
Monthly purchase from meat suppliers	the purchase price (paid in cash) is equivalent to 30% of forecasted sales
Monthly wage of:	
• Senior butcher	1200
• Junior butcher	1000
• Van driver	800
<b>Total monthly wages</b>	<b>3000</b>
Monthly charges:	
• Telephone	150
• Rent	1200
• Debt repayment (principal and interest)	1200
• Insurance	200
• Miscellaneous	400
<b>Total monthly charges</b>	<b>3150</b>
Electricity expenses to be paid every two months (starting in January 2011)	400

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\* wholesale: the sale of goods in large quantities for resale by a retailer

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*(Question 1 continued)*

When Alejandra makes the proposal to open the new wholesale facility, her father still has 60% ownership of *LCS*. He is concerned that Alejandra is too optimistic with her sales forecasts.

To encourage effective leadership and strong performance by the senior butcher at the new wholesale facility, Alejandra is considering a range of financial rewards.

- (a) Outline **two** advantages for Alejandra’s father of changing the legal status of *LCS* from a sole trader to a private limited company. *[4 marks]*
  
- (b) (i) Prepare a monthly cash-flow forecast for the first six months of operation of the **new** wholesale facility of *LCS*. *[6 marks]*
  
- (ii) Comment on the impact that the **new** wholesale facility will have on the current cash position and cash flow of *LCS*. *[5 marks]*
  
- (c) Examine **two** financial rewards *LCS* could use to “encourage effective leadership and strong performance by the senior butcher”. *[5 marks]*

## 2. ThaiModa

*ThaiModa* is a Thailand-based manufacturing company that produces:

- office furniture
- residential furniture
- furniture specifically designed for elderly people selling under the brand name of “*ThaiModa* Health and Care” (“TMHC”).

Selected items from *ThaiModa*'s profit and loss account for the year ended 31 May 2009 (in millions of Thai baht)

Sales revenue	2628
Cost of goods sold	1537
Gross profit	1091
Expenses	695
Net profit before interest and tax	396
Interest	6
Tax	87
Net profit after interest and tax	303

Selected items from *ThaiModa*'s balance sheet as at 31 May 2009 (in millions of Thai baht)

Capital employed	2458
Cash	243
Creditors	X
Debtors	479
Fixed assets	1555
Net assets	Y
Retained profit	1308
Share capital	1150
Short-term borrowing	351
Stock	781
Total current liabilities	600
Total current assets	Z

*ThaiModa* has 4 production sites and 10 distribution centres in Thailand. Its products are sold in both domestic and overseas markets. *ThaiModa* also sells furniture imported from Italy under the brand name “Casaperfetta”.

In 2002 *ThaiModa* established a strategic alliance with *Sleek Textiles*, a manufacturer of luxury fabrics. Both companies agreed to sell each other's products in their showrooms and share their design resources in Thailand. *ThaiModa* also uses *Sleek Textiles*' extensive international sales network, primarily in Austria, Australia, Germany and Malaysia.

*(This question continues on the following page)*

*(Question 2 continued)*

In addition to the existing strategic alliance, *ThaiModa* is now considering a joint venture with *Sleek Textiles* focusing on the development of new antibacterial fabrics. “TMHC” is particularly interested in using these new antibacterial fabrics in their furniture for elderly people.

In 2010, *ThaiModa* reported a revenue of 30 million Thai baht from “TMHC”. Future sales revenue is forecasted to grow rapidly. Sales are mainly to hospitals and hospices. In an aging society, there is potential for growth in the market for furniture for elderly people.

- (a) With reference to *ThaiModa* and *Sleek Textiles*, outline **two** differences between a strategic alliance and a joint venture. *[4 marks]*
  
- (b) Calculate the missing figures X, Y, Z **and** with those figures and from the financial information provided, construct a complete balance sheet for *ThaiModa* for 2009. *[7 marks]*
  
- (c) (i) Calculate the acid test (quick) ratio of *ThaiModa*. *[1 mark]*  
  
(ii) Calculate the current ratio of *ThaiModa*. *[1 mark]*  
  
(iii) Using these ratios, briefly comment on the liquidity position of *ThaiModa*. *[2 marks]*
  
- (d) Examine **one** possible advantage and **one** possible disadvantage for *ThaiModa* of the joint venture with *Sleek Textiles*. *[5 marks]*

**SECTION B**

Answer *two* questions from this section.

**3. Cyprus Tours**

*Cyprus Tours*, owned and operated by Nikolas Georgiadis, is a travel agency. It arranges sightseeing tours for groups of tourists, as well as accommodation and restaurant bookings. Tourism is one of the most important industries in Cyprus. Presently, *Cyprus Tours* hires cars from local taxi companies to transport groups of tourists on the island of Cyprus. The hiring of the cars is a major expense for *Cyprus Tours*.

Nikolas is considering purchasing 10 cars so that *Cyprus Tours* can transport customers itself. The cost of the 10 cars that run on petrol (gasoline) only is €400 000, and the firm forecasts that the net profit will increase by €85 000 per annum from the investment. The vehicles will have a useful life of 6 years.

Pressure groups in Cyprus have demanded that all new vehicles be hybrid\* in order to reduce pollution. At low speed, hybrid cars pollute less. Taxi companies, however, object to the demand from the pressure groups. A hybrid car costs 25% more than a petrol-only car to purchase, and the cost difference cannot be passed on to consumers.

If Nikolas acts immediately, *Cyprus Tours* can purchase the petrol-only cars before any changes in the law. However, his son Dimitri, a university student, objects to purchasing petrol-only cars. He argues that businesses have a social responsibility to protect the environment, which also ensures the long-term viability of tourism in Cyprus. Nikolas fears that purchasing hybrid cars would put a financial burden on the company. *Cyprus Tours* would have to cut expenses by making several booking agents and administrative staff redundant. *Cyprus Tours* would also have to reduce year-end bonuses.

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\* hybrid: hybrid vehicles combine the use of electric and petrol power

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*(Question 3 continued)*

- (a) Describe **one** marketing advantage for *Cyprus Tours* of owning its own cars. [2 marks]
- (b) Calculate, *showing all your working*:
- (i) the payback period **and** the average rate of return (ARR) for the petrol-only cars. [3 marks]
- (ii) the payback period **and** the average rate of return (ARR) for the hybrid cars. [3 marks]
- (c) Analyse the usefulness for *Cyprus Tours* of using the payback period **and** the average rate of return (ARR) methods for investment appraisal. [5 marks]
- (d) Discuss whether *Cyprus Tours* should purchase the hybrid cars. [7 marks]

#### 4. Michelle Kaufmann Designs (MKD)

*Michelle Kaufmann Designs (MKD)* in San Francisco, USA, is a leader in designing and manufacturing modular\* houses that are both beautiful and environmentally friendly. Customers choose one of six basic *MKD* models and then further customize the number of bedrooms, bathrooms, and the final details. Customers can also decide whether to have solar panels.



[Source: <http://www.mkd-arc.com/homes/mksolaire/>, 18 February 2009]

The modules are built in four to six weeks using job production methods in the firm’s factory. To be more environmentally friendly, the factory is located near suppliers of the building materials. Michelle Kaufmann, owner and founder of *MKD*, insists that all suppliers operate in an environmentally friendly manner. Lorries deliver the modules to the location where the house will be built. It then takes another six weeks for the work to be completed.

The main benefits of buying a *MKD* house compared to an identical traditionally built house are:

- it takes a third less time to construct
- it is of better quality
- it requires less petrol (gasoline) to transport labour and materials to and from a construction site.

These benefits fit *MKD*’s vision statement: “Making green architecture affordable to everyone”.

The firm’s mission statement includes the firm’s five eco-principles: smart design, eco-materials, energy efficiency, water conservation and healthy environment. Michelle hopes to build a brand around environmental friendliness and elegant design. She is strengthening her brand by also selling books, T-shirts, bags and furniture, all bearing the *MKD* logo.

*MKD* faces several challenges:

- Americans have negative perceptions of modular houses
- environmentally friendly houses are more expensive than other houses
- there is a severe economic downturn and the demand for new houses is falling rapidly
- price sensitive customers are requesting the use of non-environmentally friendly materials to keep prices down
- it has numerous competitors in the market for environmentally friendly houses.

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\* modular: designed with standardized units or dimensions

*(This question continues on the following page)*



*(Question 4 continued)*

Although Michelle differentiates her business by being the only one in San Francisco offering modular houses, she has higher fixed costs to maintain the factory.

[Source: adapted from <http://www.prweb.com/releases/prefabgreen/mkd-arc/prweb2102184.htm>, 18 February 2009]

- (a) Define the term *job production*. *[2 marks]*
  
- (b) (i) With reference to *MKD*, distinguish between fixed costs and variable costs. *[4 marks]*
  
- (ii) Explain **one** reason why it is important for *MKD* to strengthen its brand. *[2 marks]*
  
- (c) With reference to *MKD*, analyse the role of a mission statement and a vision statement. *[5 marks]*
  
- (d) Discuss whether Michelle should start using “non-environmentally friendly materials to keep prices down”. *[7 marks]*

## 5. Café Paradise

In 2002, four years after the first Internet café opened in Morocco, Imran Kwashane transformed his traditional café, *Café Paradise*, located in a suburb of Rabat into an Internet café. Revenue and profits grew rapidly. Within a year he had hired three part-time employees to help customers use the café's computers.

Many entrepreneurs were opening Internet cafés in Morocco. Soon there were 2500 Internet cafés. Facing strong competition, in 2005, Imran lowered his price of Internet access from six to four dirhams per hour. Revenue fell, and, despite cutting costs by making one employee redundant, profits were lower than before. Moreover, in late 2008, following a decade of economic growth, Morocco's economy went into recession.

When *Café Paradise* first opened, there were no government restrictions on Internet cafés in Morocco. The national government was actually encouraging computer use by upgrading the country's information communication technology (ICT) infrastructure and providing free wireless access (Wi-Fi) services in major cities like Rabat. As a result, sales of computers, especially laptops, increased by 10% per year between 2000 and 2007. However, a provincial government official has recently instructed local Internet cafés not to serve customers belonging to a banned pressure group. Many Moroccans also believe that there should be more control over access to inappropriate web sites.

Internet café customers, increasingly knowledgeable about innovations in information technologies, have begun to demand newer, faster computers. As *Café Paradise's* computers are seven years old, Imran is considering purchasing 15 new computers at a cost of 150 000 dirhams. His wife Akila, however, thinks that the first generation Internet café sector will soon not be financially viable. Rather than buying new computers, she recommends modernizing the décor\* (at a cost of 60 000 dirhams), laying-off the two remaining part-time employees, and providing extra services such as scanning and printing photos for customers with laptops or memory sticks.

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\* décor: a decorative style or scheme, as of a room

[Source: adapted from <http://www.openarab.net/en/node/364> and [http://outreach.lib.uic.edu/www/issues/issue9\\_1/ibahrine/](http://outreach.lib.uic.edu/www/issues/issue9_1/ibahrine/), 9 February 2009]

- (a) Outline the importance of innovation for *Café Paradise*. [2 marks]
- (b) Explain the effect of **one** political, **one** economic and **one** social factor on *Café Paradise*. [6 marks]
- (c) Analyse the relationship between investment, profit and cash flow at *Café Paradise*. [5 marks]
- (d) Evaluate Akila's recommendation for the future direction of *Café Paradise*. [7 marks]