



MARKSCHEME

November 2010

BUSINESS AND MANAGEMENT

Standard Level

Paper 2

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The markbands on pages 3–4 should be used where indicated in the markscheme.

Section A		Section B			Level descriptors
		(c) questions			
Q1 (c)	Q2 (d)	Q3 (c)	Q4 (c)	Q5 (c)	
Marks 0–5					
0					
1–2					<ul style="list-style-type: none"> • Little knowledge and understanding of relevant issues, concepts and theories. • Little use of appropriate terminology. • No reference is made to the information in the stimulus material. The response is mainly theoretical.
3–4					<ul style="list-style-type: none"> • A description or partial analysis/examination with relevant knowledge and/or understanding of relevant issues, concepts and theories. • Some use of appropriate terminology. • Some reference is made to the information in the stimulus material, not just to the name of the organization.
5					<ul style="list-style-type: none"> • A balanced analysis/examination with accurate, specific well-detailed knowledge and understanding of relevant issues, concepts and theories. • An analysis/examination that uses appropriate terminology throughout the response. • Explicit references are made to the information in the stimulus material.

Section B			Level descriptors
(d) questions			
Q3 (d)	Q4 (d)	Q5 (d)	
Marks 0–7			
0			<ul style="list-style-type: none"> • No knowledge or understanding of relevant issues, concepts and theories. • No use of appropriate terminology.
1–2			<ul style="list-style-type: none"> • Little knowledge and understanding of relevant issues, concepts and theories. • Little use of appropriate terminology. • No evidence of judgments and/or conclusions. • No reference is made to the information in the stimulus material.
3–4			<ul style="list-style-type: none"> • A description with some knowledge and/or understanding of relevant issues and concepts. • Some use of appropriate terminology. • No evidence of judgments and/or conclusions. • Some reference is made to the information in the stimulus material, not just to the name of the organization. • The response is mainly theoretical.
5–6			<ul style="list-style-type: none"> • A response with relevant knowledge and understanding of relevant issues, concepts and theories. • A response that uses relevant and appropriate terminology. • Evidence of judgments and/or conclusions that are little more than unsubstantiated statements that has balanced analysis and demonstrates understanding. • Explicit references to the information in the stimulus material are made at places in the response.
7			<ul style="list-style-type: none"> • A response with accurate, specific well-detailed knowledge and understanding of relevant issues, concepts and theories. • A response that uses appropriate terminology competently throughout the response. • A response that includes judgments and/or conclusions that is well supported and underpinned by a balanced analysis. • Explicit references to the information in the stimulus material are made throughout the response.

SECTION A

1. (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]**

Advantages of changing legal status from a sole trader include:

- investors such as Alejandra and her father have limited liability, which is to say that their liability is limited to their investment in the company
- as a private limited company has a legal existence separate from the owners, it increases the likelihood of a successful continuity in the event of the death of one of the principals/principal shareholders
- ownership of the company can be more easily transferred (note that Alejandra purchases additional shares every year)
- shares can provide an additional source of compensation, which may be appropriate in the case of *LCS*
- with a private limited company, there is a convenient legal structure (selling shares) to raise additional equity capital
- banks, trade creditors and other external sources of finance are generally more likely to lend money/provide finance to private limited companies.

Accept any other relevant advantage outlined.

Award **[1 mark]** for each relevant advantage identified of changing legal status to a private limited company up to **[2 marks]**. For each advantage identified (up to two), award an additional **[1 mark]** if the advantage is briefly explained or summarized, is appropriate to the circumstances of *LCS*, and the candidate has made explicit reference to the stimulus material up to **[2 marks]**. Award a maximum of **[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]*

	January	February	March	April	May	June
Cash sales						
Credit sales received		10 000	10 200	10 404	10 612	10 824
Capital introduced	60 000					
Total receipts	60 000	10 000	10 200	10 404	10 612	10 824
Payments						
Purchase equipment	60 000					
Meat purchases	3000	3060	3121	3184	3247	3312
Wages	3000	3000	3000	3000	3000	3000
Monthly charges*	3150	3150	3150	3150	3150	3150
Electricity	400		400		400	
Total payments	69 550	9210	9671	9334	9797	9462
Net cash flow	-9550	790	529	1070	815	1362
Opening balance	0	-9550	-8760	-8231	-7161	-6346
Closing balance	-9550	-8760	-8231	-7161	-6346	-4984

* Monthly charges: telephone, rent, debt repayment, insurance and miscellaneous.

[1 mark]

The candidate conveys some understanding of what a cash-flow forecast is, but otherwise the forecast is largely inaccurate, incomplete, or illegible.

[2 to 3 marks]

A cash-flow forecast is drawn, but either it is not in a generally accepted format or it is untidy, and the forecast contains two or more errors.

[4 to 5 marks]

The cash-flow forecast is drawn essentially correctly and neatly in a generally accepted format. Award *[5 marks]* if there is one error, *[4 marks]* if there are two errors. If the candidate produces an accurate cash-flow forecast (that is, the final closing balance is correct and the means by which the candidate arrived at that figure is clear and logical) but does not use a generally accepted format, award *[5 marks]*.

[6 marks]

The cash-flow forecast is drawn accurately and neatly in a generally accepted format, and is error free. Candidates may round figures, as is done here, but are not required to.

Do not penalize a response more than once for errors that are carried forward.

- (ii) **Comment on the impact that the *new* wholesale facility will have on the current cash position and cash flow of *LCS*.** **[5 marks]**

The impact of the new location on *LCS* appears positive in the long run, assuming that her forecasted sales materialize rather quickly. After expenses, the company has positive cash flow on a monthly basis and by the end of six months is averaging over US\$1000 a month. In the short run, the cash position of *LCS* will be much lower, as in the first month of the new location there will be a net cash outflow of US\$9550, reducing the company's total cash to less than US\$5000. This may be less of a reserve than the company is accustomed to or is comfortable with. Moreover, these are forecasts. The actual net cash flow could be lower. Until the new location is fully established and the debt is paid off, *LCS* may struggle both to pay off the debt and pay US\$12000 a year in dividends. For Alejandra personally, suspension of the dividends might not be a problem; she has her salary. For her father, however, this might be a concern.

[1 to 3 marks]

The answer is basic and does not question the accuracy or reliability of cash-flow projections or if the candidate fails to recognize that the trend of the cash-flow forecast is negative. For **[3 marks]** there is recognition that the cash flow is positive but reduces the company's total cash.

[4 to 5 marks]

The candidate recognizes that the cash-flow projections, and extrapolations therefrom for the months following, suggest that the new facility will have a net cash flow that reduces the company's total cash and that they need to take into consideration the loan repayments, which may have to be paid by the established *LCS* location until the new facility becomes more established.

- (c) **Examine *two* financial rewards *LCS* could use to “encourage effective leadership and strong performance by the senior butcher”.** [5 marks]

Financial rewards available to *LCS* to encourage effective leadership and strong performance could include:

- commissions based upon sales volume
- salary increases based upon sustained sales volume and low employee turnover (performance-related pay)
- shares in the company (some type of share-ownership scheme)
- some form of profit-related pay.

The purpose of rewards such as these are to give the senior butcher some sort of figurative or literal ownership in the company – that is, to elevate the interest in the senior butcher to a level higher than merely someone collecting a salary. Rewards based upon sales volume alone expands volume, but *LCS* runs the risk that the senior butcher will not focus on other aspects of the business. If the reward is based upon sales volume and low employee turnover, the senior butcher then has to consider more aspects of the business than sales. However, sometimes there is employee turnover that is beyond the control of the manager and this may be a disincentive to the senior butcher that his salary increases are linked to external factors. Share of the company would give the senior butcher literal ownership of the company, but Alejandra would lose some ownership in the company. Profit-sharing has many advantages, in that it gives the senior butcher an interest in the company’s success and is tied to profits (which in theory include all the costs of a business, including human resource practices that influence turnover). Alejandra would also not have to give up ownership in the company. However, profit-sharing is usually governed by a contract and, if profits soared, *LCS* might have to pay more in profit-sharing than it would prefer.

Each of the above rewards has advantages and disadvantages. Alejandra should select the one that has the best fit with the overall aims of the business.

Accept any other relevant examination.

If the response is a one-sided relevant approach with no examination, award a maximum of [3 marks]. If only one financial reward is examined, award a maximum of [3 marks].

Marks should be allocated according to the markbands on page 3.

2. (a) **With reference to *ThaiModa* and *Sleek Textiles*, outline two differences between a strategic alliance and a joint venture.** [4 marks]

Differences between a strategic alliance and a joint venture include:

- Whereas strategic alliances usually have legal standing (that is, there is some documented understanding of the relationship between strategic partners: “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”), a joint venture will have a legal existence separate from the organizations or persons forming the venture. In other words, the joint venture will legally constitute a new organization and will not be merely a documented understanding.
- Strategic alliances are typically formed when two or more companies can achieve synergies without fundamentally changing their individual long-term strategies. In the case of *ThaiModa* and *Sleek Textiles*, their strategic alliance allows each company to grow without changing the strategy of either company. Joint ventures are typically created when companies want some aspect of their company to go in a new direction (in this case, antibacterial fabrics) and realize that they can benefit by sharing expertise and resources with another company or companies.
- Although strategic alliances may be long-term, because they typically do not have legal existence apart from the companies involved (as noted above, they typically have a legal understanding between companies), they are generally easier to enter and easier to exit. If *ThaiModa* found that it was getting no benefit from its strategic alliance with *Sleek Textiles*, it would get out of the relationship easily. Joint ventures, on the other hand, involve the creation of a new legal entity (the joint venture) and are typically more difficult to terminate, as the new legal entity will have legal obligations, such as debt and leased space, that require complicated negotiations for resolution.

Accept any other relevant difference outlined.

Award [1 mark] for each difference between a strategic alliance and a joint venture that the candidate identifies, up to [2 marks]. For each difference identified, award an additional [1 mark] if the difference is briefly explained or summarized, is appropriate to the circumstances of the stimulus material, and the candidate has made explicit reference to the stimulus, up to [2 marks]. Award a maximum of [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]

X = 249, Y = 2458, Z = 1503

ThaiModa balance sheet as at 31 May 2009 (in millions of Thai baht)

Fixed assets		1555
Current assets		
Stock	781	
Debtors	479	
Cash	243	
Total current assets		1503
Current liabilities		
Creditors	249	
Short-term borrowing	351	
Total current liabilities		600
Net assets		2458
Share capital		1150
Retained profit		1308
Capital employed		2458

Award [1 mark] each for the calculation of (X) creditors, (Y) net assets, and (Z) total current assets. Maximum award for calculations: [3 marks].

In terms of layout, award [4 marks] for a fully accurate and fully labelled balance sheet that conforms to the layout in the guide. If the balance sheet balances but the order of the assets or liabilities is slightly inaccurate (according to the generally accepted method the candidate has chosen), award [3 marks]. If the balance sheet balances but the order of the assets or liabilities is significantly inaccurate, such as placing share capital and retained profit as a liability, award [2 marks]. Award [1 mark] if the candidate conveys some understanding of a balance sheet and some sense that assets equal liabilities + owners' equity.

Candidates do not have to list total current assets or total current liabilities as separate lines.

- (c) (i) **Calculate the acid test (quick) ratio of *ThaiModa*.** [1 mark]

$$\frac{\text{Current assets} - \text{stock}}{\text{Current liabilities}} = \frac{1503 - 781}{600} = 1.2$$

Award [1 mark] for the correct calculation. Apply Own Figure Rule (OFR).

- (ii) **Calculate the current ratio of *ThaiModa*.** [1 mark]

$$\frac{\text{Current assets}}{\text{Current liabilities}} = \frac{1503}{600} = 2.5$$

Award [1 mark] for the correct calculation. Apply Own Figure Rule (OFR).

- (iii) **Using these ratios, briefly comment on the liquidity position of *ThaiModa*.** [2 marks]

A manufacturing company should typically have a current ratio between 1.5 and 2 and an acid test ratio greater than 1. *ThaiModa* certainly has an acceptable level of liquidity despite its significant investment in inventory.

Award [1 mark] if the candidate notes that the liquidity is strong but provides no basis for that assertion or makes no other relevant or meaningful commentary.

Award [2 marks] if the candidate assesses the liquidity position favourably and provides some basis for that judgment or notes that *ThaiModa* has a strong liquidity position despite its significant investment in inventory or makes some other relevant and meaningful commentary on the liquidity.

- (d) **Examine *one* possible advantage and *one* possible disadvantage for *ThaiModa* of the joint venture with *Sleek Textiles*.** [5 marks]

In forming a joint venture, *ThaiModa* will benefit from *Sleek Textiles*' expertise in the textile industry, including a human resource pool that has knowledge of the textile industry, production facilities (or, if a new production facility has to be built, established contacts with companies that supply textile manufacturers), expertise in the actual production of cloth (once the new fabric is developed), and insight/infrastructure for marketing the new textiles. *ThaiModa* will enjoy the advantages of growth without having to lose its identity, both *ThaiModa* and *Sleek Textiles* can specialize in their respective areas of business while avoiding the high legal and administrative costs of a takeover.

However, some joint ventures do not achieve the desired results. Sometimes in joint ventures, compromises are made that are not ideal for either company individually or for the joint venture (which, had a takeover occurred, the purchasing company would and could act more decisively in terms of achieving its objectives). As with any partnership, disagreements can occur. *ThaiModa* or *Sleek Textiles* might regret the partnership were either one to conclude, after the fact, that it could have been as or more profitable without the joint venture.

Accept any other relevant possible advantage and disadvantage examined.

If the response is a one-sided relevant approach with no examination, award a maximum of [3 marks]. If only one possible advantage **or** disadvantage is examined, award a maximum of [3 marks].

Marks should be allocated according to the markbands on page 3.

SECTION B

3. (a) **Describe *one* marketing advantage for *Cyprus Tours* of owning its own cars. [2 marks]**

Examples of marketing advantages for *Cyprus Tours* of owning its own cars include:

- price: *Cyprus Tours* will have greater control over the price of transport and can adjust price according to its strategic needs
- promotion: *Cyprus Tours* could have the company's name, logo, and contact information on the vehicles, thus providing a form of promotion
- product: owning the vehicles itself and providing its own drivers, *Cyprus Tours* has greater control over the quality of the vehicles and the service
- people: the drivers of the vehicles, as employees of *Cyprus Tours*, can be proactive and positive representatives of the company and can cross-sell products and services.

Accept any other relevant marketing advantage.

Award [**1 mark**] for an appropriate and correct marketing advantage identified and [**2 marks**] for a correct description that includes specific reference to the stimulus material. If there is no reference to the stimulus material, award no more than [**1 mark**].

(b) Calculate, *showing all your working*:

(i) the payback period *and* the average rate of return (ARR) for the petrol-only cars. *[3 marks]*

Payback period

$$= \frac{\text{Capital outlay (cost)}}{\text{Net return (profit) per annum}} = \frac{\text{€400 000}}{\text{€85 000}} = 4.7059 \text{ years}$$

$$0.7059 \times 12 \text{ months} = 8.47 \text{ months} \approx 9 \text{ months}$$

Payback period is 4 years and 9 months (accept 4 years and 8.47 months)

Average rate of return

$$= \frac{\text{Net return (profit) per annum}}{\text{Capital outlay (cost)}} \times 100$$

Net return (profit) per annum: €85 000

Capital outlay (cost): €400 000

$$\frac{\text{€85 000}}{\text{€400 000}} = 0.2125$$

$$0.2125 \times 100 = 21.25$$

Average rate of return on petrol-only cars = 21.25 %

Award *[1 mark]* for each correct answer for a maximum of *[2 marks]* and award *[1 mark]* for correct workings of both the payback period and the average rate of return. Award a maximum of *[3 marks]*. If correct calculations for **both** are not shown, award a maximum of *[2 marks]*.

- (ii) the payback period *and* the average rate of return (ARR) for the hybrid cars. *[3 marks]*

Payback period

$$\frac{€500\,000}{€85\,000} = 5.88235 \text{ years}$$

$$0.88235 \times 12 \text{ months} = 10.59 \text{ months} \approx 11 \text{ months}$$

Payback period is 5 years and 11 months (accept 5 years and 10.59 months)

Average rate of return

Net return (profit) per annum: €85 000

Capital outlay (cost): €500 000 (~~€400 000~~ × 1.25)

$$\frac{€85\,000}{€500\,000} = 0.17$$

$$0.17 \times 100 = 17$$

Average rate of return on hybrid cars = 17 %

Award *[1 mark]* for each correct answer for a maximum of *[2 marks]* and award *[1 mark]* for correct workings of both the payback period and the average rate of return. Award a maximum of *[3 marks]*. If correct calculations for **both** are not shown, award a maximum of *[2 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]

For *Cyprus Tours*, as for any company, the payback method is simple to use and it lets the company know how quickly the investment will be repaid. This is especially helpful when technologies are changing rapidly and the investment is subject to technological obsolescence. Also, although the payback method does not refer specifically to paying back external sources of funds, almost certainly *Cyprus Tours* will have to borrow money to purchase the vehicles and, in some sense, the payback method will correspond to debt repayment. For small companies like *Cyprus Tours*, without a broad range of revenue streams, this can give some peace of mind – knowing when the investment/debt will be repaid. A drawback to the payback method is that it does not take into account cash earned after the payback nor the profitability of the investment considered.

The average rate of return (ARR), on the other hand, will clearly show *Cyprus Tours* the profitability of the investment. That way, *Cyprus Tours* can compare the investment of funds in the vehicles to other possible investments. ARR does not take into account the time value of money.

Accept any other relevant analysis.

If the response is a one-sided relevant approach with no analysis, award a maximum of [3 marks]. If the usefulness of only **one** investment appraisal is analysed, award a maximum of [3 marks].

Marks should be allocated according to the markbands on page 3.

(d) **Discuss whether *Cyprus Tours* should purchase the hybrid cars.** **[7 marks]**

Cyprus Tours' decision whether to purchase hybrid cars depends on the company's commitment to social responsibility and their estimation of the validity of their forecasts.

From the point of view of social responsibility, unquestionably the company should purchase the hybrids, which are better for the environment and reduce *Cyprus Tour's* dependence on imported oil. Furthermore, the people of Cyprus want to preserve the environment of their small island not only for its own sake, but also for tourism, which is one of the most important industries in Cyprus. *Cyprus Tours* might be in a position to use hybrids for marketing purposes, as many consumers at least claim to be committed to "going green".

On the other hand, saving €100000 over six years is a significant saving for a small business. Moreover, were the forecasts too optimistic and the profits from the vehicles lower, the burden of the additional cost of the hybrids could pose a real problem for the company. The company would, nevertheless, have to consider the potential damage in the marketplace it would suffer from using petrol-only cars. If the pressure groups focused on specific companies, and *Cyprus Tours* were one of them, the negative publicity could hurt the company. Also, purchasing the hybrid cars would result in redundancies and reduced bonuses in order to fund the initial investment, which may subsequently reduce employee motivation and morale.

One alternative would be to purchase five petrol-only cars and five hybrids. This way, the company could achieve some savings from the less expensive petrol-only cars, while also demonstrating, to some degree, its social responsibility.

Accept any other relevant discussion.

If the response is a one-sided relevant approach with no discussion, award a maximum of **[4 marks]**.

Marks should be allocated according to the markbands on page 4.

4. (a) **Define the term *job production*.** [2 marks]

Job production refers to the process of production whereby each order (job) is manufactured when the order comes in and according to the individual specifications of the order (thus each order is a one-off). Job production typically involves products that are expensive and are designed according to the particular needs and wants of a specific buyer.

Candidates are **not** expected to word their definition **exactly** as above.

Award [1 mark] for a basic definition that conveys partial knowledge and understanding.

Award [2 marks] for a full, clear definition that conveys knowledge and understanding similar to the answer above.

For **only** a relevant: example **or** application to the stimulus award [1 mark].

(b) (i) **With reference to *MKD*, distinguish between fixed costs and variable costs.** [4 marks]

Fixed costs are costs that do not vary with output; variable costs do. Compared to traditional house construction companies, *MKD* has higher fixed costs and lower variable costs. The higher fixed costs stem from the fact that the company maintains a factory, which has fixed costs such as rent, which do not change regardless of output. By using a factory, however, the company is able to build modules/the houses more efficiently, thus lowering the variable costs of the company (expenses such as petrol, wages, materials (due to less waste), *etc.*).

Accept any other relevant answer.

If the candidate demonstrates some understanding between fixed and variable costs, but their understanding is vague or imprecise and they make no reference to the stimulus material, award [1 mark].

For [2 marks] or more the candidate must convey the idea, however worded, that variable costs change **with output** while fixed costs do not.

For [2 to 3 marks], the candidate demonstrates understanding, but the application to the stimulus material may be limited, the response may lack balance, or there may be some lack of clarity.

For [4 marks], the candidate clearly distinguishes between fixed and variable costs (and includes the idea of output) and explains the distinction clearly in terms of the specifics of *MKD*.

- (ii) Explain *one* reason why it is important for *MKD* to strengthen its brand. [2 marks]

One reason could include:

- With the competition in the market, *MKD* needs to raise awareness of the brand for a competitive edge, especially during the severe downturn in the market.

Other reasons could include that branding:

- creates product awareness
- can relay a product's performance
- helps to ensure customers will remember a company and can create brand loyalty
- makes marketing so much easier
- promotes sales.

Accept any other relevant explanation.

Award [1 mark] for a relevant and appropriate reason identified, and [1 mark] for a relevant and appropriate explanation of the reason, up to [2 marks].

- (c) With reference to *MKD*, analyse the role of a mission statement and a vision statement. [5 marks]

A mission statement conveys the fundamental purpose of the organization. It defines critical processes and allows the company and customers to know the meaningful and measurable criteria of the company, thus allowing some understanding of the desired level of performance. A vision statement is loftier, more abstract. It outlines what the organization wants to be, or how it wants the world in which it operates to be. It concentrates on the future. It is a source of inspiration.

Both mission and vision statements provide clear decision-making criteria. Because *MKD's* mission and vision powerfully outline socially responsible objectives, the mission and vision statements are crucially important tools providing guidance, primarily to Michelle and her employees but also to all stakeholders. The company's commitment to green construction and green processes is constantly being challenged by merely the fact that non-green options are available everywhere and at lower cost. Pressure is further added because some of the clients/potential clients are pressuring the company to make compromises. The company can constantly turn to their mission and vision statements to help make decisions, assuming everyone in the company buys into them.

Accept any other relevant analysis.

If the response is a one-sided relevant approach with no analysis, award a maximum of **[3 marks]**. If the role of only a mission **or** a vision statement is analysed, award a maximum of **[3 marks]**.

Marks should be allocated according to the markbands on page 3.

- (d) Discuss whether Michelle should start using “non-environmentally friendly materials to keep prices down”.** **[7 marks]**

Although for some companies the question of whether to “go green” is open, for a company such as *MKD*, it is less so. To be sure, making some compromises on materials would not entirely vitiate the company’s commitment to “Making green architecture affordable to everyone”. Also, some might argue that making “semi-green” architecture affordable is still laudable. Nonetheless, once compromises were made, the company’s commitment to being green would be weakened and could lead to further erosion of its vision and mission statement. Moreover, the company would open itself to charges of hypocrisy by any competitors who were not making such compromises. To be consistent with both the vision statement and the mission statement of the company, *MKD* must continue to strive to live by its principles. The downturn in the United States (USA) housing market has probably put real pressure on Michelle, and perhaps the only justification for making compromises on materials used would be if the very existence of the company were at stake.

Accept any other relevant discussion.

If the response is a one-sided relevant approach with no discussion, award a maximum of **[4 marks]**.

Marks should be allocated according to the markbands on page 4.

5. (a) **Outline the importance of innovation for *Café Paradise*.** [2 marks]

Innovation is the commercial use of new inventions or processes. For *Café Paradise*, innovation has been important on two occasions in the business, the first when Imran transformed his business into an Internet café and now, at the current stage, when he is determining the next phase of the business. In both instances, new technologies, first the Internet and second Wi-Fi, have played a major role in his decision to innovate and, in both instances, the decisions regarding innovation had and will have an important impact on the success of the business.

Award [1 mark] for a general statement about innovation in business that demonstrates some understanding of the concept. Award [2 marks] for a brief explanation or summary of the importance of innovation for *Café Paradise*.

(b) **Explain the effect of *one* political, *one* economic and *one* social factor on *Café Paradise*.** [6 marks]

Political factors referred to in the stimulus material include the Moroccan government's commitment to making computer use easier by having Wi-Fi available in major cities and a provincial governor issuing warnings about a certain pressure group, a sign that governmental action could be a factor restricting access to certain web sites. The first will increase personal and laptop computer use, thereby decreasing demand for Internet cafés. If the government restricts web site access, that could further reduce demand for Internet cafés.

An economic factor referred to in the stimulus material is the downturn in the economy. A weaker economy could mean that consumers have less money for discretionary uses, like going out to a café. On the other hand, with less money for discretionary spending, consumers may delay the purchase of a major item, like a computer, and continue to use Internet cafés.

Social factors referred to in the stimulus material include increased usage of personal computers by Moroccans, who are increasingly knowledgeable about computers (innovation), and potentially growing concern about access to certain web sites. As even more Moroccans use computers on a regular basis, they will tend toward owning their own, reducing the need for "traditional" Internet cafés. However, there could be some backlash against computer use by the more socially conservative members of society.

Accept any other relevant explanation.

Mark as 2+2+2.

Award [1 mark] for identification of a political factor, [1 mark] for an economic factor, and [1 mark] for a social factor. Award an additional mark for each factor identified when the candidate explains its effect on *Café Paradise*. Do not award marks for the identification of a second political, economic, or social factor.

- (c) **Analyse the relationship between investment, profit and cash flow at *Café Paradise*.** [5 marks]

There is a clear relationship between investment, profit, and cash flow at *Café Paradise*. Imran’s decision to transform his café into an Internet café, a decision that required investment in computers and presumably some modification to the set-up of the café, led to several years of high profits. Now, as circumstances have changed and profits have diminished, he must consider his next investment option, whether to buy new computers or to transform his café into a next-generation café. Whichever way the business goes, it will be Imran’s intention to see an increase in profits. Regardless of which path he chooses, in the short term he will probably experience some cash flow challenges. Revenues will rise, but in terms of cash position or cash flow, it will take several years to recoup the investment.

Accept any other relevant analysis.

Marks should be allocated according to the markbands on page 3.

- (d) **Evaluate Akila’s recommendation for the future direction of *Café Paradise*.** [7 marks]

There are many strengths to Akila’s recommendation. The “boom years” for Internet cafés are clearly over in the major cities of Morocco, as many individuals now possess their own computers. Even if the business could earn enough profit to pay for the computers, the profitability from “traditional” Internet cafés is not what it formerly was and will probably never be again. Akila’s suggestion requires a significantly lower capital investment and the business will have substantially reduced operating expenses (laying-off the two remaining part-time employees).

On the other hand, with their established customer base accustomed to an Internet café, they may find that if they no longer offer computer access, they may lose many customers. Also, with the economy in recession, it is possible that the sale of personal computers will slow and there will continue to be demand for Internet cafés. With the Internet café “industry” in decline, possibly other Internet cafés are closing, reducing competition, which might give further life to *Café Paradise*’s current business model.

The Kwashanes should conduct a thorough marketing analysis to determine which action to take.

Accept any other relevant evaluation.

If the response is a one-sided relevant approach with no evaluation, award a maximum of [4 marks].

Marks should be allocated according to the markbands on page 4.
