Diploma Programme
Programme du diplôme
Programa del Diploma

# Business management
# Standard level
# Paper 2

Monday 3 May 2021 (morning)

1 hour 15 minutes

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**Instructions to candidates**

- Do not open this examination paper until instructed to do so.
- A clean copy of the **business management formulae sheet** is required for this examination paper.
- Section A: answer one question.
- Section B: answer one question.
- A calculator is required for this examination paper.
- The maximum mark for this examination paper is **[30 marks]**.


2221 – 5014

## Section A

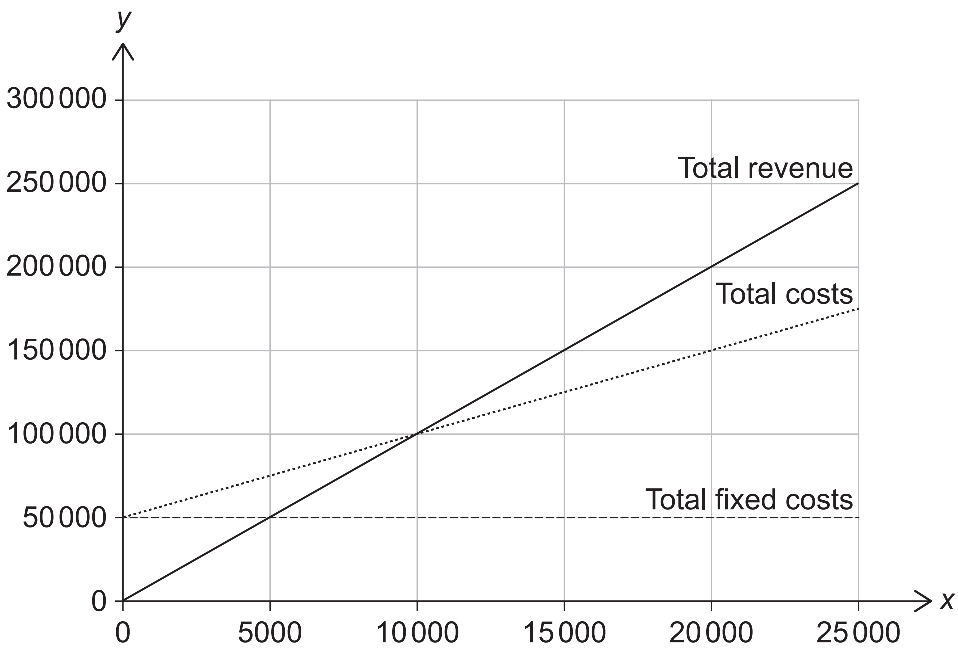
Answer **one** question from this section.

**1. Hafs**

*Hafs* is a new cooperative. It plans to manufacture wastepaper bins for the household market.

*Hafs* has forecast its sales in 2021 as 25 000 units. Its forecasted break-even chart is shown in **Figure 1**.

**Figure 1: Forecasted break-even chart for *Hafs* for 2021**




(a) State **two** features of a cooperative. [2]

(b) Using **Figure 1**:

(i) explain what the *y* axis shows; [2]

(ii) calculate forecasted profit if sales are 25 000 units in 2021 (*show all your working*); [2]

(iii) calculate the total contribution in 2021 if *Hafs* only sells 20 000 units (*show all your working*). [2]

(c) Explain whether an increase in total fixed costs has an impact on unit contribution. [2]

**2. The Pie Store (TPS)**

*The Pie Store* (*TPS*) bakes pies and sells them in its three retail stores. When developing its brand, *TPS* used the mathematical symbol pi ($\pi$). In 2020, each store made a profit.

**Table 1: Financial information for *TPS*' three retail stores for 2020 (all figures in $)**

| | **Store 1** | **Store 2** | **Store 3** |
|---|---|---|---|
| Sales | 180 000 | 223 000 | 170 000 |
| Cost of goods sold | 90 000 | 120 000 | 85 000 |
| Gross profit | 90 000 | 103 000 | 85 000 |
| Expenses | 66 000 | 76 000 | 67 000 |
| Net profit before interest and tax | **X** | **Y** | **Z** |

At the end of 2020, the balance sheet for *TPS* (the three stores combined) showed $200 000 in assets and $120 000 in liabilities. $50 000 of the liabilities was long-term debt.

(a) Describe **one** step in the development of a brand. [2]

(b) Calculate:

(i) which store made the highest net profit before interest and tax (*no working required*); [1]

(ii) which store had the highest profitability (*show all your working*). [2]

(c) Calculate:

(i) *TPS*' equity; [1]

(ii) *TPS*' return on capital employed (ROCE) (*show all your working*). [2]

(d) Explain **one** effect that the $50 000 long-term debt may have on *TPS*' profit and loss account. [2]

## Section B

Answer **one** question from this section.

**3. Buzza**

Jo and Demi Straus established *Buzza*, a partnership, in 1999. *Buzza* manufactures women's fashion accessories, such as handbags and scarves. Jo, a gifted designer, directs the design team. Demi, a business graduate, organized the business by function. She manages most of those functions.

In 2012, they converted *Buzza* to a private limited company to help obtain finance for the business's expansion. Jo and Demi retained 60 % ownership between them.

Because of the brand's reputation, *Buzza* can recruit creative graduates from design universities. Graduates receive 12-month contracts, which are renewed only if *Buzza* accepts their designs. *Buzza* tells graduates that, generally, only half of all contracts are renewed. The average age in the design team is 26. Labour turnover in the design team is much higher than in similar exclusive brands.

Wealthy consumers interested in the latest fashions find *Buzza* a highly desirable and exclusive brand. Only approved retail outlets sell *Buzza* products. New collections are produced four times a year. At the end of each season, retailers return unsold products to *Buzza*. Last year, these unsold products were valued at $15 million. At present, *Buzza* sends returned products to an incinerator plant to be destroyed. A recent television documentary revealed that *Buzza* incinerates perfectly good products, which led to damaging social media comments.

In response to the negative publicity, Jo and Demi are considering two options:

**Option 1**: Sell surplus products at greatly reduced prices on its website.

**Option 2**: Break down returned products to recover raw materials for re-use in future products. This process of breaking down returned products will be time consuming and costly.

(a) State **three** of *Buzza*'s main business functions. [2]

(b) Explain **one** advantage **and one** disadvantage to *Buzza* of operating as a partnership. [4]

(c) Explain **one** advantage **and one** disadvantage of the high labour turnover of designers at *Buzza*. [4]

(d) Discuss the two options that Jo and Demi are considering. [10]

**4. ReVolve Ltd (RV)**

*ReVolve Ltd* (*RV*) manufactures and sells high-quality, high-priced bicycles to high-income earners. Operating in a niche market, its advertising slogan and unique selling point/proposition (USP) is "hand made to order, in the USA, delivered within seven days". Brand loyalty is strong, but brand recognition outside of its customer base is weak. 98 % of its sales are to customers living within 50 miles of the business.

Prior to 2017, *RV* received an increasing number of customer complaints that phone lines were often engaged and calls not returned. As such, it adopted e-commerce. Its website now allows customers to:

- customize their choice of bicycle
- place orders
- pay for purchases
- have their questions answered.

*RV* employs 20 highly paid, skilled employees using job production. To retain these workers, *RV* has raised their wages significantly since 2016.

Increasing competition from imports of hand-made high-quality bikes has forced down prices in this niche market. *RV* has been making increasingly larger losses since 2017. In 2020, its sales fell by 15 %. Inflation is forecasted at between 2 % and 3 % for the next three years. As such, *RV*'s directors are considering two options to enable it to lower the prices of its bicycles.

**Option 1**: Offshore production to China, where production costs are significantly lower. The bicycles would be manufactured using batch production. *RV* would focus only on the design and marketing of its bicycles.

**Option 2**: Invest in new job production techniques that enable parts to be glued rather than welded, which only requires unskilled labour. Investment would cost \$3 500 000 and the forecasted annual net cash flow is \$600 000.

(a) Define the term *niche market*. [2]

(b) Explain **two** benefits to *RV* of the decision to adopt e-commerce. [4]

(c) (i) Calculate the payback period if *RV* chooses **Option 2** (*show all your working*). [2]

(ii) Explain **one** disadvantage to *RV* of using the payback period method of investment appraisal. [2]

(d) Recommend whether *RV*'s directors should choose **Option 1** or **Option 2**. [10]

**5. KapTan**

*KapTan* (*KT*), which manufactures rechargeable batteries for cordless consumer products like vacuum cleaners, began five years ago as a business with a product orientation. It sells business to business (B2B). Multinational companies dominate the rechargeable battery industry, and *KT* suffered from cash-flow problems in its first year of trading. Its profits are small and, in the last two years, have fallen.

*KT* has now developed an innovative battery that is small and lightweight. This battery is an emergency power source allowing electric cars to reach a charging station. However, the battery can only be used ten times before it runs out. *KT* has insufficient finance to create a battery that can be recharged an unlimited number of times.

Through market research, *KT* has discovered that:

- no other emergency batteries for electric cars exist
- owners of electric cars fear running out of power
- *KT*'s new battery could be obsolete in five years.

*KT* has the capacity to produce 90 000 of these new batteries each year. The average cost is $200 per unit. *KT* has insufficient funds to invest in additional capacity.

*KT* is considering two options:

**Option 1:** Market and sell directly to existing car owners through business to consumer (B2C) at a retail price of $400. *KT* will need to borrow significant capital to finance this option.

**Option 2:** Accept an offer of a five-year strategic alliance with a manufacturer of electric cars. *KT* would provide its product exclusively at $250 per unit. Sales are guaranteed.

**Table 2: *KT*'s forecasted and guaranteed worldwide unit sales (in 000s) for the two options**

| Year | Option 1 forecasted sales | Option 2 guaranteed sales |
|---|---|---|
| 1 | 50 | 40 |
| 2 | 60 | 50 |
| 3 | 100 | 85 |
| 4 | 110 | 80 |
| 5 | 90 | 60 |
| Total sales | 410 | 315 |

(a) Define the term *product orientation*. [2]

(b) With reference to **Option 1**, for *KT*, explain the relationship between the product life cycle, investment, profit and cash flow. [4]

(c) With reference to *KT*, explain **two** problems that a new business may face. [4]

(d) Recommend whether *KT* should choose **Option 1** or **Option 2**. [10]

**References:**

**4.** [Bicycle] Hall, E., (2006). My new bicycle [online]. Available at https://www.flickr.com/photos/mulegirl/99132433 (CC BY-SA 2.0) https://creativecommons.org/licenses/by-sa/2.0/ [Accessed 29 August 2019].