

MARKSCHEME

May 2007

BUSINESS AND MANAGEMENT

Higher Level

Paper 2

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1. (a) (i) **Identify *two* ways the size of a firm can be measured.** [2 marks]

The size of a firm can be measured by the number of employees, total assets, sales revenue or market capitalization profit.

Award [1 mark] for each form of measuring the size of a firm up to a total of [2 marks].

- (ii) **Explain why *Petroquímica Argentina SA* needs to grow.** [4 marks]

The firm is competing in a globalized market with large multinationals. If it wants to survive it must have a growth rhythm that keeps pace with its competitors. It must bring its prices to a level that is similar to them or else it will lose business to them. The field in which *Petroquímica Argentina SA* operates requires a large amount of research and development, since scientific and technological advance keep pushing for new innovations. Large multinationals have huge funds to invest in R&D. Innovation and quality control in the field is a necessity, but also costly and sophisticated. Firms operating in globalized markets have to keep up with the growth and quality of the larger leading firms, or divert their products to smaller, niche markets. *Petroquímica Argentina SA* may also need to grow in order to defend itself against a potential takeover bid by a larger organization.

[3 to 4 marks]

A detailed explanation of why the firm needs to grow in order to compete in a globalized market. Reference is made to the case for *[4 marks]*.

[1 to 2 marks]

An explanation of the need to grow in general terms.

(b) Examine the advantages and disadvantages of *Petroquímica Argentina SA* raising finance by floating shares on the Stock Exchange.

[6 marks]

The possible advantages to *Petroquímica Argentina SA* of floating shares in the Stock Exchange may include:

- a large amount of capital can be raised. *Petroquímica Argentina SA* needs this large amount of capital
- limited loss of control as if only 15% of the shares (a minority percentage of shares) is sold, then there is no risk of takeover
- *Petroquímica Argentina SA* will not have to pay the high interest on loans – the other source of finance. Interest charges would push costs up in such a manner that they might not allow *Petroquímica Argentina SA* to be competitive
- gearing is kept low by floating shares, which is good for the above mentioned reasons
- if the money were to be borrowed, creditors would have the right to sue the firm if it defaulted on its loan repayments
- there is an option not to pay dividends if sufficient profit is not made. Interest and the borrowed capital have to be paid to the lender. Shareholders cannot sue if dividends are not paid
- *accept any other relevant advantage.*

The disadvantages may include:

- as stated in the case the process involved in going public is long, complex and costly. Documents have to be prepared and presented; professionals will have to be paid for their involvement
- there is a certain loss of privacy since financial documents will be available to the public, including the competitors when the firm becomes public company
- ownership and control will be diluted (although the shares sold still represent a minority holding)
- if profits do not grow in a more than proportionate manner to the additional shares, then the dividends per share will go down. If shareholders are not satisfied with the dividends given, they might sell their shares and the value of the company will fall
- *accept any other relevant disadvantage.*

[5 to 6 marks]

The answer is balanced with a detailed examination of both advantages and disadvantages of floating shares in the stock exchange to finance growth. Reference is made to the case for ***[6 marks]***.

[3 to 4 marks]

A balanced examination of very few issues. The answer may lack balance but has some examination of advantages and/or disadvantages. Award a maximum of ***[3 marks]*** for a detailed examination of just advantages or just disadvantages.

[1 to 2 marks]

Identification of advantages and/or disadvantages but this may be lacking examination or explanation.

- (c) **Two years after floating 15 % of their shares *Petroquímica Argentina SA* is considering financing further growth by issuing more shares to the public. At the same time *Basf* has put up a takeover bid to purchase 100 % of the company.**

Evaluate both options and make a recommendation to the shareholders.

[8 marks]

Basf's takeover bid will push up the price of the shares that are held publicly and privately. Many shareholders might be tempted to sell. It is only natural that the existing shareholders must hold the shares with different degrees of commitment to the firm, and for different reasons. Some must definitely feel sense of ownership of the firm, such as the founding members, but others might only want dividends and the possibility of making a capital gain.

Different shareholders will react in a different manner according to these interests. For the shareholders who want capital gain, the offer made by *Basf* is an opportunity to do this in the short run. With the capital gained, they can make new investments. For the shareholders who mostly wanted dividends the offer of a MNC may also be attractive - depending on the dividend payment history of *Petroquímica Argentina SA*. The founding members will probably be much attached to the firm and not want to sell.

Majority shareholders can see this as an opportunity to gain lots of money and start a new firm in another field. Many smaller entrepreneurs go through the sale of their companies to bigger companies who would rather absorb competition than face it. So accepting *Basf's* takeover bid might be an opportunity to start afresh somewhere else.

If the offer is not accepted and the firm keeps growing by issuing more shares on the Stock Exchange the risk of a takeover and diluted control might occur in the future. The firm will still have to face the competition of large multinationals and maintain the industry's growth rate. Since control will inevitably be diluted, sooner or later it might be an attractive offer to be taken over by a large multinational now.

Yet *Petroquímica Argentina SA* might take pride in fighting off the takeover from *Basf*, and different finance might arise in the future. Macroeconomic indicators of economic growth in the country and the region will have an impact on the decision. If the further issues of shares can help the firm produce quality at low cost and low prices, it might become the leader in the Latin American market and fend off the competition of the multinationals.

Growth without accepting *Basf's* takeover bid will be a challenge both in terms of keeping the competition in check and the shareholders happy with a reasonable dividend and/or growth rate.

The recommendation can be either to sell or not to sell. It depends on the position taken by the candidate. Accept both options - selling to *Basf* or retaining ownership and growing by floating more shares- as long as the answer is well supported.

Accept any other relevant issue raised.

[7 to 8 marks]

Both options are evaluated in detail and the answer is well balanced with. For ***[8 marks]*** a supported recommendation is made.

[5 to 6 marks]

Both options are examined in some detail with some analysis of both alternatives, though this may lack detail at the bottom end of the range.

[3 to 4 marks]

Some examination of both options or a detailed examination of one option, though the answer may lack balance.

[1 to 2 marks]

A limited and essentially descriptive answer.

2. (a) Explain *one* advantage and *one* disadvantage to British firms of offshoring.

[4 marks]

Advantages for British firms:

- the British firms can concentrate on and develop their core activities
- the British firms contract the call centres. Therefore all responsibility for employment and dismissal falls on a different firm, legally detached from the British firms
- the lower employee costs should be reflected in lower prices for consumers and can generate greater sales, or simply higher profits for the owners
- labour laws could be a lot more flexible abroad than in Great Britain, and therefore employment and dismissal is simpler
- if the British firms are not satisfied with the performance of the sub-contractors the contract can be terminated and the contractor can be easily replaced
- if the offshore workers are properly trained and motivated, customers should get a better service than if their calls were to be answered by less willing labour at home
- *accept any other relevant point.*

Disadvantages for British firms:

- other costs might increase, since some of the workers in managerial positions will need to travel overseas from time to time to check on / appraise the call centre operations
- the firm might not have the same degree of control over workers as if they were home based
- it might be difficult to ensure consistent good quality of service
- quality control has to be done over the telephone or internet, which is not the same as doing it face to face
- negative publicity at home
- the loss of goodwill
- possible negative effects on other stakeholders and suppliers
- *accept any other relevant point.*

[3 to 4 marks]

One relevant advantage and one relevant disadvantage are clearly explained. Award [3 marks] for either an advantage or disadvantage that is clearly explained with the other only briefly described.

[1 to 2 marks]

Either one advantage or one disadvantage is explained, or both the advantage and disadvantage are listed but not explained.

(b) (i) Describe *two* objectives of a trade union. **[2 marks]**

- Unions have the objective of protecting rights of workers in terms of pay and in terms of better working conditions. They do this by negotiating with management as a group. Workers who group together (“unionize”) have greater power than if each tries to bargain for his rights individually.
- Acting as a channel of communication between the employees and the employers.
- Providing assistance to individual members with grievances and disciplinary matter.
- *Any other relevant function.*

[2 marks]

A description of two appropriate objectives of a trade union.

[1 mark]

A description of one appropriate objective or a list is provided for two objectives.

(ii) Examine how a call centre trade union could affect the employees. **[6 marks]**

Unions could bargain with employers in order to obtain the following benefits:

- workers could be given more achievable targets, lowering quotas on calls and mails
- working hours could be limited given the stress and monotony of the job
- more breaks could be introduced
- better pay
- the union might come up with social entertainment or activities that might improve the well being of the employees.

The trade union could also affect the employees in a negative way. The action could limit the desire of firms to use India as a call centre base, and might take the business elsewhere. By forcing demands on the companies, the workers might find that the jobs are no longer available. Fewer employment opportunities will be available for local people.

Industrial action of a different type might be called for and some people might not like to participate, since their jobs might be at stake if they do. Membership cost money. Moreover, tension between the employees can rise.

[5 to 6 marks]

A detailed and balanced examination of the potential impact of a trade union with consideration of both positive and negative effects. There is appropriate reference to the context of a call centre.

[3 to 4 marks]

Some examination of the potential impact of a trade union though this may lack detail, depth or balance, particularly at the lower end of the range. The answer may lack reference to the context of the call centre for *[3 marks]*.

[1 to 2 marks]

A limited and essentially descriptive answer.

- (c) **Using appropriate motivational theories analyse the methods used by call centres to get the best performance from their employees.**

[8 marks]

Maslow's contribution was the theory about human behaviour and satisfaction of needs. He believed that needs are satisfied in a certain way, with lower order needs being satisfied first – physiological, security and love and belonging needs. Once they are satisfied these needs do not longer motivate the employees and the employees will be looking at ways of satisfying their higher level of needs – like self esteem and self actualisation. However, if the lower level of needs are not satisfied, the employees will not be able to move up towards the fulfilment of the higher levels of needs

Herzberg sustained that in an employment situation, management can offer an environment that just supplies what the worker needs to perform efficiently, without which discomfort will set in. These are called the hygiene factors. Workers are not motivated by them. These factors provide dissatisfaction. To motivate workers the 'motivators' should be provided. These motivators correspond to Maslow's higher level of needs and to the nature of the job itself.

It can be argued that the lower levels of needs are satisfied and the hygiene factors are provided given the information of good salaries, cafes – (a place to relax and socialise), popcorn machines etc. Moreover, if we accept the view that the organisation provides career opportunities, one can argue that the higher level of needs – self esteem – are fulfilled (a chance for development and promotion) and some motivators' are provided. At the call centres workers are led to believe that management is taking care of them by giving them a variety of things such as coffee and popcorn and investing in the work environment. Some workers might be satisfied with this attention and respond positively to the stimulus.

However, information is also provided about 'Burning out', exploitation, work monotony, quotas, lack of job security and so on. One can therefore argue that even the lower of level of needs and the hygiene factors are not provided. If people like Vinita have to sacrifice their career to stay in the job, then it is doubtful that she will reach self actualization.

In terms of Herzberg, call centres have paid a lot of attention to the hygiene factors, but not to the motivational ones. A possible reason for this is that there is no real interest in having highly committed participative, workers who take pride in sharing in the decision-making process.

Theory X/Y

McGregor introduced the theory of management based on the management perceptions of employees. Workers can be perceived and lazy, dislike work, need to be told what to do and who are generally not committed to their jobs. Those workers are motivated by financial rewards. These are referred to as Theory X workers, a term coined by McGregor, when he referred to Taylor's scientific management. McGregor also sustained that workers can be perceived as theory Y - workers who identify with the organisations' objectives, like to get involved and want to participate in relevant decision-making. These employees are not motivated by money. but more by the nature of the job itself. It seems that the call centers are using a variety of Theory X ideas, keeping workers happy with things such as pay and working environment. The firms do not need workers to think creatively. They actually want them to obediently follow rules. Targets are set high, so that workers will push themselves to achieve these higher targets. Again, given the quotas and the constant monitoring /control, one can argue that the call centre management perception of the employees is of Type X. These practices will not motivate the Y type employees.

Mayo

This theorist discovered through a variety of experiments, that workers productivity increased when they were considered by management and their ideas were listened to. They felt part of a team, and regardless of whether the working condition improved or deteriorated, they responded with higher productivity to a stimulus, regardless of its quality, which to them was interpreted as "management cares".

The motivation techniques applied by management may or may not be seen as motivator. It seems that workers are nevertheless accepting the jobs. The possible involvement of the trade union might indicate that the level of dissatisfaction is increasing.

[7 to 8 marks]

A clear and well balanced examination of methods used to improve the performance of the workers with appropriate reference to and application of the work of more than one theorist. Appropriate reference is made to the case study.

[5 to 6 marks]

A clear examination of methods used to improve the performance of the workers with some reference to and application of the work of at least one theorist. The analysis may not be well balanced. Some reference is made to the case study though this may be limited at the lower end of the range.

[3 to 4 marks]

The answer describes some methods used by call centres to improve performance though it may lack depth and is mostly descriptive. A reference may not be made to the case study.

[1 to 2 marks]

A limited and essentially descriptive answer.

3. (a) **Examine the advantages *and* disadvantages of firms like the bank *HSBC* operating as a single brand around the world.**

[6 marks]

Possible advantages:

- *HSBC* can obtain marketing economies of scale by using the same range of advertisements to target more customers with their message. They would be able to spend more money on the production of the advertisements to produce a higher quality result. Mass purchase of advertising media may result in higher discounts
- brand recognition will be higher and over several years, individual countries and domestic customers may come to perceive *HSBC* as a local brand. Any advertisement for *HSBC* worldwide will be recognised by travellers and the messages reinforced
- being a global brand will reinforce the concept of *HSBC* as a global and international bank, which may add to its image
- increased brand recognition will lead to higher brand values
- companies will be more prepared to bank with *HSBC* because of its global presence
- global branding will allow the goodwill built up with customers to be transferred to other countries.
- *accept any other relevant point examined.*

Possible disadvantages:

- global brands may find it more difficult to reflect local variations in taste and attitude
- local customers may not become as brand loyal as they do not perceive the brand as local. It may be seen as a distant brand representing the interests of other countries
- language and cultural differences may mean that the brand name is not completely appropriate in different regions of the world or that it needs translation. The name may be associated with the politics of the developed world
- *accept any other relevant point examined.*

There is unlikely to be a situation where it is possible to claim that global branding is an advantage or disadvantage for every company. It is likely that firms will need to balance the advantages and disadvantages for their particular business in different markets following extensive research of customers and an analysis of the present market position of the business.

[5 to 6 marks]

A balanced range of advantages and disadvantages of operating as a single brand appropriate to the position of *HSBC* are examined in detail. Relevant business and marketing issues are developed.

[3 to 4 marks]

A range of advantages and disadvantages, which may be unbalanced, of operating as a single brand appropriate to the position of *HSBC* are considered. This may tend to be descriptive at the lower end of the range. There is a reasonable, but increasingly brief coverage for **[3 marks]** with no reference to the HSBC bank.

[1 to 2 marks]

A limited and essentially descriptive answer.

- (b) Evaluate possible primary *and* secondary market research that companies, like *Coca-Cola* and *McDonalds*, can conduct to ensure new promotional approaches are effective in targeting existing and potential customers.

[8 marks]

Market research can be classified as primary or secondary, qualitative or quantitative.

Quantitative data – concentrates on numbers representing factual information. It is possible to present this in the form of diagrams, graphs and charts.

Qualitative data – in-depth research, which may concentrate on opinions and motivation behind consumer behaviour. It may be difficult to present this information in a simple and digestible form.

Primary research – this is the first hand collection of data. There are three basic techniques of field research to collect primary research:

- surveys/questionnaires *e.g.* face to face interviews
- observation *e.g.* focus groups
- experimentation.

Primary research might be through the use of focus groups or questionnaires sent to existing and potential customers. Appropriate techniques should be selected to ensure that the sample is representative and statistically significant. This is likely to provide more qualitative data.

For *Coca-Cola* and *McDonalds* this data could be conducted in restaurants, shopping malls and any major outlet for their products. It is likely that the surveys will examine satisfaction ratings, the effectiveness of its promotion mix and customer loyalty over a period of time. Reactions to new product varieties and the supporting promotion messages and techniques need to be collected, as well as views on areas of the market which provide further marketing opportunities *e.g.* in recent times *Coca-Cola* has extended its range into juices and waters.

The advantages of primary research are that they can be at the individual consumer level and up-to-date. This needs to be balanced with the likely high costs. However, new technologies allow quicker, and possibly cheaper, on-line surveys to be conducted and interactive television will allow easier and quicker access to customer opinions and reactions. It helps these companies to reduce their advertising spend on more traditional, mass marketing mediums and focus on more effective and targeted approaches.

Secondary research – this is the collection of second hand data, collected by somebody else normally for another purpose. This data may be manipulated and analysed to suit the new purpose. This desk research may come from internal or external sources, and include some of the following:

- Internal – sales and financial records, customer records, internal reports in order to analyse the needs, satisfaction, buying habits of its existing customers. The promotional mix can be adapted to the changing needs and according to the level of satisfaction of its current customers.
- External – media reports, company reports, government statistics, retail and market data, social trends statistic in order to identify potentially new customers, their needs, habits, again in order to design an effective promotion mix.

This data is relatively cheap to gather, but may lack relevance and/or may be dated. *Coca-Cola* and *McDonalds* will be interested in product reviews and media reaction to marketing approaches. Sales figures especially linked to advertising campaigns will be of particular interest.

Social trends will be a major concern, especially with an increased awareness of diet and health. This will allow targeting to be more accurate and to maintain a suitable product range.

A range of market research may be suggested and applied. *Secondary data* from government sources on social trends and economic patterns would be helpful. Analysis may be necessary to identify the best marketing opportunities outside the traditional promotional routes. Much of this will be quantitative data. It may be used to identify likely target groups and the supporting promotion mix. Various lists of potential customers can be purchased from retail audit groups. These may be customers with life styles and interests that may differ from the core customer base.

It is appropriate to use a range of primary and secondary sources and techniques. Clearly, a combination of such data, and research, is likely. Retail audits and market reports are likely to be useful as is data on social attitudes and trends linked to economic data.

[7 to 8 marks]

A detailed evaluation of market research techniques. The techniques selected are considered with reference to the needs of companies like *Coca-Cola* and *McDonalds* to ensure new promotional approach and may use examples from the stimulus material.

[3 to 6 marks]

Some assessment of market research techniques. There is some evaluation at the top end of the band using the case study, but the answer becomes more generalised and descriptive towards the bottom.

[1 to 2 marks]

A limited and essentially descriptive answer.

- (c) Using examples, explain the impact of new technologies and advertising media on the marketing objectives and promotional strategies of large corporations.

[6 marks]

It says in the articles that Professor Leavitt argued technology had created a world in which consumer tastes were converging and that successful businesses should market globally standardized products. The result is that firms will be looking at existing product ranges and considering whether a global approach to marketing is possible, if it is not already in place. This will entail the changing of brand names and supporting advertising to inform customers of this change and emphasising the new brand values. Examples are *Cif* cleaners, *Magnum* ice creams and *Starburst* sweets. The purpose will be to take advantage of economies of scale in promotion and distribution.

The marketing objectives will be to produce a standardised offering whilst being aware of, and sensitive to, cultural and national issues. Firms may also implement the marketing approach of “think global, act local”.

The article also identifies that the traditional approach of building brands through the mass media is over, with hundreds of cable channels and specialist magazines aimed at smaller groups replacing mass-market publications. This will quite clearly have implications for the spending of promotion budgets. Firms will be seeking to be more cost effective by segmenting their product ranges more carefully and targeting their products to smaller, and potentially niche markets. Interactive satellite channels should allow firms to have a more personal relationship with customers, and to gain greater knowledge of customer behaviour in terms of their use of entertainment and their purchasing habits. They will have to be more creative in their approaches, especially when technologies like *Sky+* allow adverts to be avoided. The use of more internet based marketing strategies is likely to become a major objective of many firms.

In addition, promotion has shifted to online advertising and into video games, films and song lyrics, often aimed at children. Greater spending on sponsorship and merchandising is likely to result and there will be crossovers between promotional approaches. Firms will have to consider the marketing ethics of their promotional strategies.

[5 to 6 marks]

A thorough explanation of the impact of new technologies and advertising media on the marketing objectives and promotion strategies of large corporations. Relevant examples are provided from the article.

[3 to 4 marks]

An explanation of some impacts of new technologies and advertising media on the marketing objectives and promotion strategies of large corporations. The explanation may be brief and relatively narrow for [3 marks].

[1 to 2 marks]

A generalized and limited response.

4. (a) Describe *one* disadvantage to *Zesty* of being a partnership. [2 marks]

A partnership is a legal form of business organisation where two or more people trade together under the partnership act. The terms of the partnership are outlined in a partnership agreement. Partnerships are usually found in professional services (doctors, solicitors, dentists and accountants) and in family-run businesses.

The main disadvantage of a partnership is that the individual partners tend to have unlimited liability. This means the individual partners are responsible for any debts incurred by the business and they can be sued for decisions made by the business.

Another disadvantage of a partnership, when compared, for example, with a private limited company, is access to capital. More capital can be raised in a private limited company as there is no limit on the number of shareholders. Access to capital is limited by the number of partners.

Another disadvantage of a partnership is that the business may end when a partner dies whereas with a private limited company, the business continues as the shares will be transferred to another owner. Also, conflicts can occur between the partners.

Award [2 marks] for a relevant disadvantage, identified [1 mark] and described [1 mark].

(b) Distinguish between strategic objectives *and* operational objectives. [4 marks]

Strategic objectives concern the overall objectives and plans of the organization. Examples of strategic objectives that *Zesty* may consider might be to access more finance for capital expansion and to move into different areas of production, such as frozen concentrated orange juice. Such decisions are long-term in nature, looking at the future of the organization, and are usually made by the senior management or directors of the business.

Operational objectives are often routine plans about the day-to-day operation of the business. Examples of operational objectives that *Zesty* may consider might be to increase the number of temporary staff (fruit pickers) in response to better growing conditions and to reduce the debtor day's ratio. As opposed to strategic objectives, operational objectives are short-term or medium-term in nature and are usually made by middle management.

N.B. The question did not ask for an example, therefore, do not penalize candidates for not referring to one.

[3 to 4 marks]

A clear understanding of strategic objectives and operational objectives is shown. Most importantly to achieve **[4 marks]** there is a clear explanation of the difference between the two terms.

[1 to 2 marks]

There is some description of the nature of strategic objectives and operational objectives but the difference between them may not be clearly explained. **[1 mark]** is awarded where the nature of strategic objectives or operational objectives is described but not both.

- (c) **Examine Zesty’s decision to use a product-orientated approach rather than a market-orientated approach to increase its sales revenue.**

[6 marks]

A market-oriented approach has at its heart the consumer and his or her needs. A marketing campaign/strategy is devised to satisfy the customer to the mutual advantage of the buyer and seller. Market research will determine the customer needs and the firm will produce what it can sell. The consumer determines what will be produced and how much will be produced. A product-oriented approach has at its heart the product itself, not the consumer. Such a marketing strategy would acknowledge the intrinsic worth of the product and know that consumers will buy the product if the price and/or quality are right. The aim is to sell what has been produced.

The Zesty marketing team may consider that consumers have an intrinsic belief in the value of fresh fruit, particularly oranges and this may lead to a product-orientated approach. For example, consumers already know they provide vitamins and are part of a healthy diet. There is no need to convince consumers that they need the product. This may be added by the promotional campaign by The Florida Citrus Growers Association. So the emphasis is on selling what is produced. Advertising is likely to concentrate on the quality of the product compared to other orange drinks. Perhaps they can use the threat of new quality standards in the US to their advantage. Advertising could also emphasize a “support America” campaign in order to eat into Brazil’s market share. Zesty’s marketing team could also emphasize the “value for money” of the product by pricing it competitively.

However, given the competitive nature of the market and the type of the product (orange juice) and as stated in the case, the current product – concentrated orange juice – is very popular; perhaps Zesty should have carried out a market research re possible sizes of the bottles, added natural ingredients and so on. This market research might have reduced the chance of failure and ensured success. After all it is very easy to imitate a product that offers fresh orange juice. Zesty’s unique selling point may not last too long.

[5 to 6 marks]

A detailed and balanced examination of *Zesty's* decision to adopt a product-oriented approach to increase its sales revenue.

[3 to 4 marks]

Some examination of *Zesty's* decision to adopt a product-orientated approach, though this may lack detail at the lower end of the range. If *Zesty* is not mentioned, award no more than ***[3 marks]***.

[1 to 2 marks]

Some superficial understanding of market orientation and/or product orientation is shown.

(d) To what extent is

(i) a 50 % a smaller crop in Brazil an opportunity for Zesty?

and

(ii) an appreciation in the value of the US dollar a threat to Zesty?

[8 marks]

A 50 percent cut in the Brazilian crop is a *significant* opportunity for Florida's orange producers and Zesty in particular. Brazil is the world's largest producer of oranges. Such a significant drop in its production opens up the possibility of new markets and increased sales for U.S producers. With an expected 29 per cent increase in the Florida crop next year, Zesty is well placed to establish a foothold in these new markets. This is particularly the case in Cuba, where the US government is in negotiations with the Cuban authorities to establish a free trade agreement. The down side or possible threat of Brazil's cut in production is the impact it will have on the world price of oranges. Being a competitive market, a cut in supply will lead to an increase in price. Given the predicted labour shortage, Zesty might not be able to satisfy the increased demand. However, Zesty grows its oranges in Florida and is not likely to be severely affected by the possible increase in price and the danger of losing customers. The impact on Zesty's sales and revenue, in the event of price increase will depend on the price elasticity of demand of oranges.

An appreciation in the value of the US currency is certainly a significant threat to Zesty, especially because it exports its oranges to Japan and Canada. If the US dollar has appreciated relative to the Canadian dollar and the Japanese yen, then the price of exports, in this case oranges, increases. Zesty will find it more difficult to sell its product and is in danger of losing its market to cheaper orange producers in other countries. It will, therefore, have to explore ways of reducing costs- a possible benefit. Other benefit or opportunity of the appreciation of the currency is that any imported components Zesty might use, for example imported fertilizer or capital machinery, are now cheaper. This might help lower costs of production. It is unlikely that Zesty imports the above and therefore the appreciation of the US dollar can be judged as a *significant* threat.

[6 to 8 marks]

Both factors are clearly and accurately analysed and evaluated in a balanced manner. At the top end of the band, the candidate makes a well-supported appraisal of the impact on *Zesty*.

[3 to 5 marks]

Both factors are analysed but the answer may lack some balance, examination, accuracy and clarity. A maximum of **[4 marks]** should be awarded where just one factor is analysed in depth.

[1 to 2 marks]

A limited and essentially descriptive answer.

5. (a) (i) Define the term *takeover*.

[2 marks]

A takeover is when one firm acquires full management control of another firm by purchasing at least 51 %, of the share capital of another firm. This is also called an acquisition and is a form of integration. The acquiring firm will often replace the managers of the firm acquired with its managers. It is common for the acquiring company to be the larger of the two businesses making financing of the deal easier. However, it is possible for the acquiring firm to be smaller – this is known as a “reverse takeover”. A takeover may be “hostile” and opposed, or “friendly”, where the management of the firm being acquired recommends the deal to their shareholders.

[2 marks] for an accurate, detailed definition and **[1 mark]** for a definition lacking in detail.

- (ii) Explain *two* potential advantages and *one* potential disadvantage of a business, such as *Kmart*, growing through takeover or merger.

[6 marks]

Advantages

- *Instantaneous growth* – natural, organic growth is slow and there may be a limit to the expansion of a particular brand or family of brands. Integration allows a business to grow overnight and to obtain a presence in a market where entry would otherwise be difficult
- *Economies of scale* – significant savings may be made in marketing, production and research. The integrated organizations are able to spread costs, such as fixed costs across the business more efficiently. This cutting of costs may allow the business to make higher profits and/or gain market share. Finance may be more available to the larger, combined organization, and the rate of interest may be lower. Other areas of business may be carried out more cost-effectively such as marketing and purchasing where bulk-buying discounts may be obtained. New product development may now be shared. Saving of \$500 millions will be made through economies of scale. Increase in market power will give the newly formed organisation the power to influence the prices in the market.
- *Supply and distribution chains* – combined organisations may allow access to new markets. Combined retail networks, such as *Sears* and *Kmart* not only provide more selling space but may provide access to new customers with different purchasing characteristics and in new geographical areas. Similarly, the supply chain may be more efficient with both firms taking advantage of additional supplier opportunities or controlling the distribution chain, cutting out middlemen and their profit margins. This could be through warehousing or transport fleets
- *Synergies* – two businesses combined may be more able to dominate a market and follow the logic of $1+1=3$, the sum of the parts is greater than the two individual parts operating separately. The acquisition of brands, the rationalization of assets such as technology may allow the business to rapidly gain market share
- *Predatory instincts* – integration may allow one organization to acquire a brand that they have coveted for a long period. It may also be a way of ridding itself of competition or acquiring patents and copyrights. The acquiring firm may simply be looking to “asset strip” the acquired business
- *Survival* – a merger may be the only way that a firm may survive cash flow or financial difficulties.

Disadvantages

- *Conflicting corporate cultures* – many mergers and takeovers have been disastrous, such as *AOL* and *Time-Warner*. It soon became clear that the management styles and organisational structures of the merging businesses were not compatible. Internal conflict affected the performance of the combined businesses
- *Diseconomies of scale* – as businesses grow, they may lose control of their core activities and costs
- *Moving away from core competence* – an integrated business may lose focus on its core activities and become spread across operations where it has less knowledge and experience. One part of the business may actually compete with the other
- *Corporate Image* – customers may become confused by the new business and its identity. An acquiring firm, for example, may find that its core customer is put off by the image of the new integrated business components. *Sears* and *Kmart* serve different market segments and geographical locations. The old customers of each group may feel no loyalty to the other part of the business.

[5 to 6 marks]

A clear and detailed explanation of two advantages and one disadvantage. There is some reference to the stimulus material.

[3 to 4 marks]

An explanation of the advantages and the disadvantage, which may lack detail, depth and balance at the lower end of the range.

[1 to 2 marks]

A limited response tending to listing and/or lacking detail.

- (b) **Examine the potential problems of integrating the corporate cultures of two large firms such as *Kmart* and *Sears*.**

[5 marks]

Culture in organizations is often described as the set of values, beliefs and attitudes of both employees and management that helps influence decision-making within them. Each organization has a unique culture, which defines how the organization works. Culture is not static. It can change as personnel do or as the aims and objectives of the firm evolve or the competitive forces in the market alter. Clearly the style adopted by the management will be highly influential on the culture of an organization. Corporate culture is consistently reinforced within an organization.

The culture is therefore the result of many factors including:

- management style
- tradition
- the mission statement
- the nature of the workforce
- external pressures including legal and social change
- risk tolerance.

Merging two organizations may be problematic if the businesses have significantly different cultures. Employees may have different values regarding key areas such as customer service, quality, investment and training. Employees may find that behaviour, which was praised and rewarded in the past, is now criticised. This may be related to whether the new management are risk taking or risk averse. This can lead to a lack of common purpose. In the case of *Kmart* and *Sears* it is clear that the senior management is predominantly from *Kmart*, which may be resented by *Sear's* staff.

Kmart has a different history and customer focus from *Sears*. *Kmart* has always focused on out of town stores with a traditional customer base. *Sears* has located more in shopping malls and has targeted younger and more adventurous customer. These factors are likely to lead to different corporate cultures and therefore problems with integration of the companies.

[4 to 5 marks]

A clear understanding of corporate culture with a detailed examination of the potential problems associated with integrating two corporate cultures, with relevant illustrations. For **[5 marks]** including reference to *Kmart* and *Sears* and to the case study.

[2 to 3 marks]

Some examination of the potential problems associated with integrating two corporate cultures.

[1 mark]

A limited and generalized response.

- (c) **To what extent can the enlarged group, *Sears Holdings*, use information and communication technologies to improve operations and profit margins?**

[7 marks]

As stated in the extract, savings are expected from improved distribution and shared information and communication technologies (ICT). Retailers use technologies as part of their EPOS and EFTPOS systems and can track ordered stocks and stock levels within their stores ensuring a close match of supply and demand. Scanning technology can produce sales data and automatically reorder stocks and EFTPOS systems can be used to transfer funds and to build up customer profiles. The combination of the two systems, plus the huge size of the overall business can produce administrative and technical economies of scale and higher profit margins. The firm can afford the most sophisticated and powerful hardware and software as well as affording the specialists to operate these.

Sears Holdings can use computer systems for many aspects of their operations including payroll, sales analysis, budgeting, financial statements and personnel records. Large organizations are complex and employ ICT to control and monitor operations and ensure costs are minimised, recorded and tracked.

In addition, communication systems will be enhanced by the use of technologies such as e-mail, the worldwide web and video-conferencing. ICT may also be used for security systems to minimize theft. These systems will allow for the quicker transfer of information, improved coordination, better time management, clearer communication of objectives and reduced expenses. Database information may be used for targeting customers with additional products and services. All of which will provide significant advantages for larger retailers.

However, the companies have different systems and applications. Combining them to efficiently support a 3500-store chain is a massive undertaking. It may be that the attempt will lead to increasing costs. There are many recent examples of inefficient and costly ICT systems, which have cost firms significant funds rather than saving money. It can be assumed that given the size and the market power of these organizations, despite the short run extra costs of investment, an efficient system will be installed.

In addition, an efficient ICT system cannot overcome other deficiencies such as poor person-management, flawed buying decisions, poor stock maintenance, poor image and inadequate marketing. As firms grow large, there are also possible diseconomies of scale.

However, it is very likely that large retailers will benefit from sophisticated information and communication technology (ICT) to a very large extent to improve operations and profit margins.

[6 to 7 marks]

The discussion provides a balanced assessment of the extent to which the enlarged group, *Sears Holdings*, can use information and communication technologies to improve operations and profit margins. There is a broad coverage of ideas and technologies and for **[7 marks]** some judgment(s) about the benefits or otherwise of ICT.

[3 to 5 marks]

The discussion provides some assessment of the extent to which the enlarged group, *Sears Holdings*, can use information and communication technologies to improve operations and profit margins though this may tend to be descriptive at the lower end of the band. If only the positive aspect is referred to, allocate no more than **[4 marks]**.

[1 to 2 marks]

A generalized and limited response.

6. (a) **With reference to *Paolo's Pasta*, distinguish between fixed costs and variable costs.**

[3 marks]

Fixed costs are incurred by a business irrespective of output. They occur even if nothing is produced and remain the same as the production rises or falls. The fixed costs incurred by *Paolo's Pasta* are leasing, mortgage payments and Paolo's salary. Variable costs are dependent on the amount produced. The higher the output levels, the higher the variable costs. If nothing is produced no variable costs will be incurred. The variable costs incurred by *Paolo's Pasta* are raw materials, wages and electricity/water/gas.

[3 marks]

An appropriate definition of both fixed costs and variable costs, a clear distinction between the two and relevant examples from *Paolo's Pasta*.

[2 marks]

An appropriate definition of both fixed costs and variable costs. There may be no examples provided, or one or more examples are incorrect. Less than accurate definition but the examples from the case are correct and relevant.

OR

Less than accurate definition but the examples are relevant.

[1 marks]

An appropriate definition of fixed costs and/or or variable costs (but perhaps not both). There may be no examples provided or they may be incorrect or inappropriate. No definitions are given but the examples are appropriate.

- (b) Construct a break-even graph showing the break-even level of output, the margin of safety and the amount of profit at current output level. (Show any relevant workings)

[5 marks]

Contribution

Variable costs $\$1.25 + \$1.60 + \$0.15 = \3.00 per kg of pasta
 Selling price $\$7$ per kg of pasta
 Contribution $\$7 - \$3 = \$4$ per kg of pasta

Break-even level of output

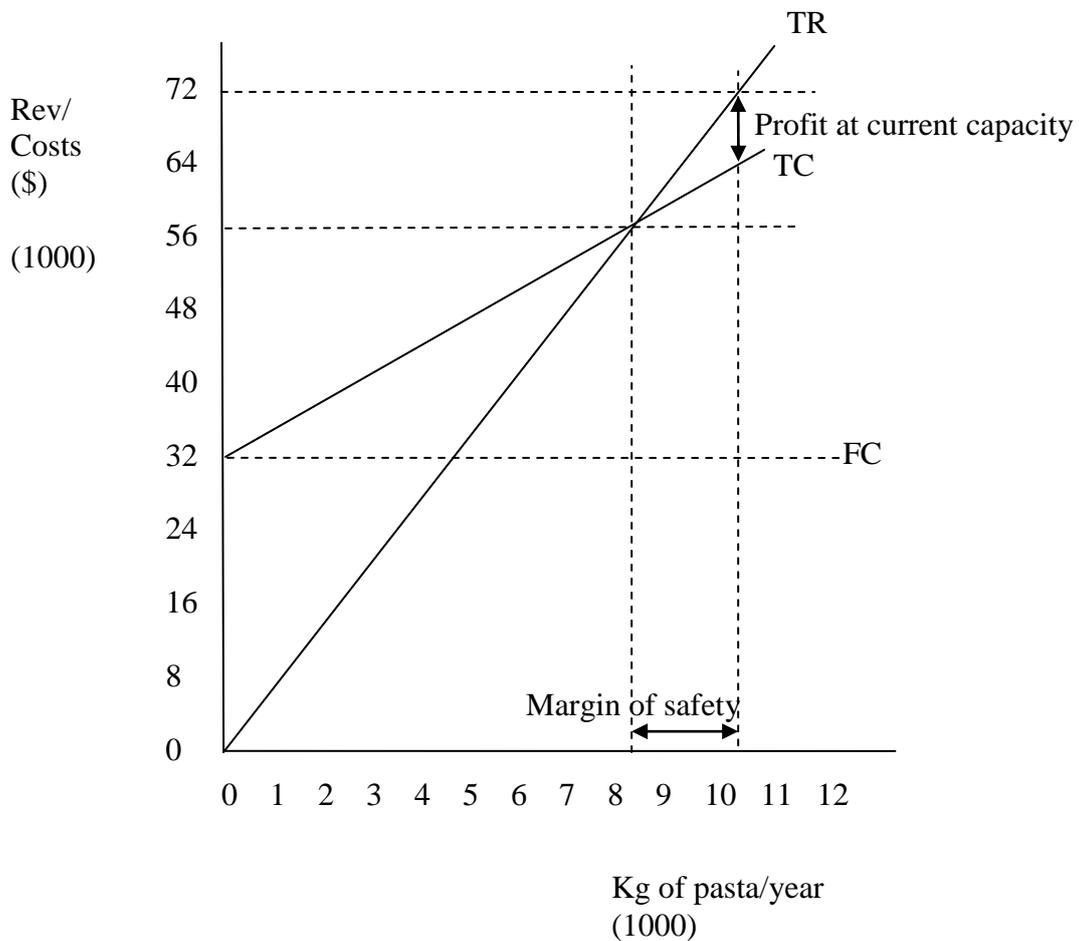
Fixed costs $(\$500 \times 52) + (\$500 \times 12 = \$6000) = \$32\,000$
 Contribution $\$4$ per kg of pasta
 Break-even quality $\$32\,000 / 4 = 8000$ kg of pasta per year

Margin of safety

Current output level – break-even level
 $10\,000 \text{ kg} - 8000 \text{ kg} = 2000 \text{ kg}$

Profit at current capacity

Margin of safety \times contribution: $2000 \text{ kg} \times \$4 = \8000



[5 marks]

The diagram is correct, properly labeled, drawn to a reasonable scale, and all the required factors (BEP, MOS, profit) are correctly calculated and identified. Relevant workings are shown.

[3 to 4 marks]

The diagram is essentially correct but there may be a small number of minor errors – not all factors are identified on the chart and/or correctly calculated. Relevant workings are shown.

Or

The diagram is correct, properly labeled, drawn to a reasonable scale, and all the required factors are correctly identified and calculated. Relevant working is not shown for ***[4 marks]***.

[1 to 2 marks]

There is a diagram, and recognition of costs and revenues, a break-even point is attempted but might be wrongly identified. Correct calculations but no chart is shown.

- (c) **Paolo is considering changing the price of his pasta. Describe two possible pricing strategies and advise Paolo on the most appropriate to adopt.** [6 marks]

Cost-based pricing involves the addition of a profit element to the costs of production. This form of pricing guarantees a profit since the fixed and the variable costs are all covered, and the price is always set above the costs to allow for a net margin. Its drawback is that it ignores the impact of competition and consumers. If competitors are selling at lower prices then the firm might see its sales decreasing rapidly.

Competition-based pricing is where the price charged by competitors, not the cost of producing the good, is the main factor influencing pricing decisions. The pricing policy is most often used in markets with a lot of producers. Generally businesses are reluctant to lower prices for fear of setting a "price war" and they are reluctant to raise prices for fear of lower sales revenue as consumers switch to the relatively cheaper competitors.

Consumer-orientated pricing is where the business analyses the market conditions when setting the price. It considers the demand for the product and the price elasticity of demand of the product along with market potential.

Accept other relevant description and evaluation of any other pricing strategy.

Paolo's does not currently take into account its competitor's prices. Paolo positioned his product as high quality high price. His prices are currently relatively high (premium pricing / customer-value pricing) and his business seems to do well with this approach. However, the market is becoming more competitive and Paolo is worried about future fall in sales. This might be because competitors are getting more efficient, selling good quality at lower prices or other variables might be interfering (if income is dropping then people might be swapping to inferior products). The customers' perception of his products might be changing. He, therefore, needs to undertake market research to fully understand the nature of his target market. He needs to know what type of price and income elasticity his product has, the customers' perceptions and his product positioning, he needs to be aware of the sphere of influence of his competitors and only then act accordingly.

Customer orientated pricing or Competition based pricing might be appropriate strategies. However, Paolo might have to sacrifice some of his profit if prices are lowered. A reduction in price might also chance the image of the product. Paolo might want to stick to his premium pricing to differentiate himself from the competitors. This strategy will be appropriate if the quality of his products is indeed superior. He does have 2000 kg a year of spare capacity and this has to be investigated. He might be losing market at \$7 and a reduction could put him closer to the competitors and increase the output.

Please do not accept any strategy as appropriate without an evaluation or some analysis of its suitability or otherwise to Paolo - not just a general pros and cons of a strategy.

[5 to 6 marks]

Two possible pricing strategies are identified, described in sufficient detail with a balanced evaluation and appropriate application to the case. For ***[6 marks]*** a reasoned judgment is made as the most appropriate pricing strategy in the circumstances.

[3 to 4 marks]

Two possible pricing strategies are identified and described with some consideration of their relevance and appropriateness. A maximum of ***[3 marks]*** should be awarded for a detailed discussion of one pricing strategy. At the lower end of the range the answer may lack detail and balance.

[1 to 2 marks]

A limited and essentially descriptive answer.

(d) Evaluate whether Paolo should accept the offer from the hotel chain.

[6 marks]

Currently *Paolo's Pasta* has 2000 kg a year of spare capacity. It makes 10 000 kg a year which are sold at the same price of \$7 per kg, leaving an annual profit of \$8000. He could therefore add a considerable amount to his profit if he were to be able to sell the 2000 kg, which he can make but not sell. If he could sell them at \$7 per kg he would make an extra profit of \$6000 a year.

Yet the hotel chain is offering to purchase 4000 kg per year. Therefore Paolo would need to produce annually 8000 kg sold at \$7 to break-even, and he is left with 4000 kg to sell to the hotel chain at \$4.50. Contribution from each one of these kilograms is \$1.50. This will give him a profit of \$6000 per year.

Clearly if he sells to the hotel, his profit drops by \$2000. On these grounds Paolo might decide not to accept the offer. If a competitor offers the same premium quality product at the lower prices, the image of *Paolo's Pasta* may be eroded and sales will fall. If he is to build extra capacity, extra capital has to be raised and invested. It might be very risky given the prediction of increased competition. Extra work might increase staff stress level and some motivation issues can emerge.

On the other hand, sales are dropping. Paolo knows that the pasta market is highly competitive since entry is relatively easy. There are no great barriers since the capital needed is not a large amount. So accepting the offer might be convenient in terms of securing a steady income throughout. He might be able to decrease costs in the future, supply pasta to other hotel chains and end up growing into a larger manufacturer.

Yet Paolo might not like this dependent relationship at all and he might want to keep his independence. He might be able to adjust his pricing policy, maybe discriminate better, and increase his output to get the same or more profit.

Accept any other relevant argument for or against the offer. Based on the financial and non financial data, in the short run the offer is not attractive. Perhaps the offer will pay off in the longer term when adjustment to the production facilities has been made as well as the changes in the market occurred.

Accept any substantiated recommendation.

[5 to 6 marks]

Both advantages and disadvantages of accepting the offer are evaluated in a balanced manner. A variety of issues- both financial and non financial are considered, including calculation of future profits and the drop in sales.

[3 to 4 marks]

Both advantages and disadvantages of accepting the offer are analysed but the answer may lack balance. Some financial and non financial issues are considered, but calculation of future profits and the drop in sales are not presented or are not entirely accurate

[1 to 2 marks]

A limited and essentially descriptive answer that may simply identify or list advantages and/or disadvantages.
