



# **MARKSCHEME**

**May 2008**

**BUSINESS AND MANAGEMENT**

**Higher Level**

**Paper 1**

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**SECTION A**

1. (a) (i) **Define the term *partnership agreement*.**

***[2 marks]***

A partnership agreement is a legal document setting out the formal details of the partnership. It is a document signed by all partners and will contain a range of information. This may include details like roles and responsibilities, the capital share of each partner, the profit sharing arrangement, the process required for the dissolution of the partnership and any other details pertinent to the operation of the partnership.

***[2 marks]***

A clear definition of the term that shows a good understanding of its meaning. For example it includes legal status.

***[1 mark]***

A definition that shows some understanding of the term but may lack in detail or depth.

- (ii) Explain *two* possible reasons why Max and Terry “formalized their agreement with a Deed of Partnership” (lines 10-11). [4 marks]

In most countries, a partnership is a contract between individuals who agree to carry on a business by combining property, knowledge or activities and to share its profit. Partners may have a partnership agreement and/or deed of partnership and in some countries such agreements may be registered and available for public inspection. In many countries, a partnership is also considered to be a legal entity.

Max and Terry may have chosen to formalize the partnership with a deed of partnership because:

- the documents ensure that the partners know what to do in the event of a dispute between them
- the documents give a chance for them to sort out in advance of the setting up of the business what the roles of each partner will be
- formalization with these agreements can allow for the introduction of future partners to expand the skills available
- the formalization process is a chance to address potential issues between partners before the commencement of the business
- the division of profits between them, the procedure in the event of the business being wound down, the investment that each partner will make and so on
- *any other relevant reason.*

**[3 to 4 marks]**

The explanation of the two possible reasons is detailed and balanced. For **[4 marks]** the explanation is related to the case study. The explanation may be lacking detail for one of the reasons at the lower end of the range.

**[1 to 2 marks]**

There is a detailed explanation of one reason or an explanation of two reasons that lacks detail or depth. The explanations may not be related to the case study.

(b) Explain *two* disadvantages of operating *Organix* as a partnership.

[4 marks]

Possible disadvantages of operating *Organix* as a partnership might include:

- the partners are personally liable for business debts and liabilities
- each partner may also be liable for debts incurred, decisions made, and actions taken by the other partner or partners
- disagreements between partners in management plans, operational procedures, and future vision for the business that may cause conflict between partners
- there may be some difficulty in attracting other investors
- it may prove more difficult to persuade banks and other lenders to lend funds – it can be easier as a limited company as this is a more formal structure and less dependent on individual partners
- the partnership may need to be dissolved if either or any of the partners leaves or dies
- *any other relevant disadvantage.*

[3 to 4 marks]

A relevant explanation of two disadvantages. For [4 marks] the explanation is directly related to *Organix*. The relation to the case study may be more limited for [3 marks].

[1 to 2 marks]

An explanation of one disadvantage or a more limited explanation of two disadvantages. The explanation may be unrelated to the case study. For [1 mark] a list of two disadvantages may be provided without explanation.

2. (a) **Evaluate John’s view that further market research is not required before proceeding with the opening of further farm shops (lines 73-76).** **[8 marks]**

It is clear from the case study that John has already carried out considerable secondary research relating to the expansion of the farm shops. He has already sourced data on income levels, population density and traffic patterns to help him to derive appropriate locations. This is arguably important data in terms of the location of the shop to maximize demand, though there may be an argument that he should also look further at other secondary data relating more specifically to the demand for their products. This could include:

- changes in the pattern of demand for organic food and related products
- socio-economic groupings within the catchment area of the proposed shop locations
- possible economic forecasts for the state/regional level – GDP levels, inflation and perhaps exchange rates and other issues that may affect food prices for non-organic products.

Perhaps the main argument relating to the market research though is that he has not so far carried out enough primary research. While it can be argued that organic food is healthier it can also be argued that it is a “lifestyle choice”, so he may like to carry out primary research relating to local attitudes to organic food and related products. Income levels alone are no guarantee of demand. Primary research may also help him to consider peoples’ perceptions of organic food, which may be important information when they consider their pricing strategies. Primary research could be done through questionnaires, surveys or perhaps focus groups in the area and though this is likely to be more expensive, it may also provide more focused information – important in a market such as that for organic food.

***[6 to 8 marks]***

There is a detailed and balanced evaluation of the need for further market research with a clear understanding of the role of market research in the expansion process. The analysis is closely related to the case and business theory and terminology are used appropriately where relevant.

***[3 to 5 marks]***

The analysis considers the role of market research in the process of expansion but may not be balanced and any judgments may not be adequately substantiated. The analysis is generally related to the case, though this may be limited and perhaps tend to be descriptive at the lower end of the range.

***[1 to 2 marks]***

A limited and essentially descriptive answer.

**(b) (i) Define the term *branding*.****[2 marks]**

Branding is an essential part of marketing. A brand is an identifying symbol, words, or mark that distinguishes a product or company from its competitors. The brand will have its own related customer perception as customers associate the brand with certain qualities. Usually brands are registered (trademarked) with a regulatory authority and so cannot be used freely by other parties.

**[2 marks]**

A clear definition of the term that shows a good understanding of its meaning. For example by referring to brand characteristics or brand identity.

**[1 mark]**

A definition that shows some understanding of the term but may lack in detail or depth.

**(ii) Discuss the advantages *and* disadvantages of adopting a single brand for all the different areas of *Organix's* business.****[8 marks]**

There is a keen debate over the way in which branding should be used. Many companies use a single brand for a varied range of products and services and rely on the overall brand to convey the brand/customer perception they want to convey. Other companies will choose to establish individual brands for individual products as they feel that this enables them to use the brand to convey the marketing message they want more effectively.

**Advantages may include:**

In the case of *Organix*, they have chosen to use a single brand for all the different business areas they have set up. The brand name is a catchy one that clearly conveys the focus of the company on organic food and given that all their different areas of business (farm, farm shop and restaurant) are related to this, it could be argued that this is an effective branding strategy. A single brand makes it easy for them to cross-sell *i.e.* use one area of the business to try to sell other areas. This may include marketing of the farm shops to restaurant goers and vice-versa. The single brand may help them to convey a clearer brand perception and identity. It may also help them reduce marketing costs (perhaps even economies of scale as they grow) as they develop their marketing strategies.

**Disadvantages may include:**

The development of holiday accommodation is in *Organix's* expansion plan and this is less related to the core “organic food” business. The single brand may be less effective in this case. Cross-selling runs the risk that any quality issues in one area of the business may also then have an adverse impact on the other areas (*e.g.* as with current potential quality issues with the restaurant).

***[6 to 8 marks]***

There is a detailed and balanced discussion of the extent to which it is appropriate for *Organix* to adopt a single brand. The discussion recognizes related marketing issues and theory. The discussion is related to the case, and business theory and terminology are used effectively and appropriately where relevant.

***[3 to 5 marks]***

There is some discussion of the extent to which it is appropriate for *Organix* to adopt a single brand, though at the lower end of the band the answer may be characterised by a lack of balance. There is some understanding of the theory of branding. The discussion is generally related to the case, though may tend to be relatively incomplete and descriptive at the lower end of the range.

***[1 to 2 marks]***

A limited and essentially descriptive answer.

3. (a) Prepare a PEST analysis for *Organix*. **[8 marks]**

**Political**

- possible dilution of organic standards proposed by government to allow for expansion of organic sector
- lobbying of government by powerful multinational food companies (e.g. supermarkets) to dilute standards
- possible tightening of planning regulations in the local area proposed for farm shop development
- *any other relevant point.*

**Economic**

- fluctuation in global commodity prices lead to uncertainty over income level (caused by supply and demand changes)
- relatively high and stable prices in recent years for organic products
- *any other relevant point.*

**Social**

- growing interest in organic, fresh produce
- increased awareness of health issues relating to organic produce
- changes in social attitudes and aspirations relating to organic produce
- change in demographic profile of local area is causing staff shortages for the lower-skilled staff in the business
- *any other relevant point.*

**Technological**

- technical improvements in fertilisers and lower price of chemicals raising productivity for conventional farming
- growth in use of genetically modified seed and other GM resources is increasing productivity for conventional farming – organic sector struggling to match these productivity improvements. Therefore increase in relative price differences between conventional and organic produce
- *any other relevant point.*

**[6 to 8 marks]**

A relevant PEST analysis covering all four areas. At least two points per section are raised, adequately explained and related to the case study.

**[3 to 5 marks]**

A PEST analysis covering at least two areas. The points raised are generally related to the case study, though some points may not be adequately explained.

**[1 to 2 marks]**

A PEST analysis with some relevant points raised but these may be limited to one area. Or the points are merely listed with no explanation.

- (b) Based on the threats from the PEST analysis prepared in part (a), discuss *two* strategies for *Organix* to minimize the impact of these threats on their business.

[8 marks]

The nature of the answer to this part will depend on the threat chosen from part (a). For example, one threat chosen could be the threat of increased GM usage making conventional farming techniques more productive and therefore relatively cheaper. In this case, *Organix* may choose to alter their marketing strategy. They can refocus their marketing on the health and environmental benefits of organic produce. This will help create a more positive perception in the eyes of consumers and therefore justify the increasing price differential. The extent to which this works will depend on the effectiveness of the marketing strategy and the extent to which this perception ties in with existing views and changes taking place in social attitudes towards organic food. They could also stress the environmental benefits of purchasing local food and use this as an increasing element of their marketing strategy.

The success of the response will depend on the extent to which the candidate develops a balanced discussion of their chosen strategies.

Other possible strategies could include:

	Threats	Strategies
Political	Lobbying by supermarkets	Develop a counter programme against the supermarkets lobbying
Economic	Fluctuating prices	Build up a reserve of food/develop a closer relationship with the distributors
Social	Change in social attitudes	Target new groups as organic food becomes more mainstream
Technological	Improving productivity/GM crops	Develop further research in organic fertilisers/Unproven technology addressed by marketing strategy

***[6 to 8 marks]***

Two appropriate threats are identified and for each one appropriate strategies are selected. The discussion of the strategies is detailed and balanced. For ***[8 marks]*** a judgment is suggested about the appropriateness of each strategy.

***[3 to 5 marks]***

Two threats are selected and there is some discussion of each strategy, though this may be relatively limited at the lower end of the range. For a detailed discussion of just one strategy award a maximum of ***[4 marks]***.

***[1 to 2 marks]***

A limited and essentially descriptive answer. A list of appropriate strategies should receive a maximum of ***[2 marks]***.

4. (a) Define the term *flexible working practices*. [2 marks]

Flexible working practices refers to the ability of the firm to introduce work methods that allow it to vary work levels according to demands and requirements. These practices may include working flexi-time, changing hours of work to suit patterns of demand, temporary contracts (including some core and some temporary workers), teleworking, homeworking, switching staff between departments according to demand and so on.

[2 marks]

A clear definition of the term that shows a good understanding of its meaning.

[1 mark]

A definition that shows some understanding of the term.

- (b) Distinguish between Terry's and Alison's management styles. [6 marks]

Terry's management style is one that could be argued to be quite autocratic, task orientated and controlling in nature. He personally checks the quality of work done each day and believes that staff need close monitoring and control in their working activities. He is often critical of their work. He has a McGregor Theory X perception of his employees and believes they have little loyalty to the business and simply work for the money they receive.

By contrast Alison's style is a much more laissez-faire/democratic approach. She is a great believer in allowing her staff flexibility in their work and wants to supervise them minimally. She feels that this will empower them to work more effectively and develop more loyalty to the organization. She has a McGregor Theory Y perception of her employees and believes that they have motivations other than just money.

*N.B.* Candidates should also be credited appropriately for a discussion of management styles other than McGregor.

[5 to 6 marks]

Different management styles are identified appropriately, are relevant and are adequately explained. There is a detailed comparison between them with a clear contrast.

[3 to 4 marks]

Both management styles are identified though they might not both be appropriate or adequately explained. There is some comparison between them but this may lack detail or depth.

[1 to 2 marks]

A limited answer that may incorporate some information about management styles, but this may be unrelated to the case or simply a series of listed points.

- (c) **To what extent might the motivation of the head chef, Oliver Jayo, differ from the restaurant serving staff? Use appropriate motivation theory in your answer.**

**[8 marks]**

Oliver Jayo, the head chef, is highly paid on a generous contract while the restaurant waiting staff are paid close to the minimum wage. This may have an impact on their motivation if the work of Taylor is considered where people's primary motivation is thought to be the money they receive. In terms of the work of Maslow, it could be argued that the waiting staff may find it difficult to fulfil their basic physiological needs and so may have difficulty in meeting needs further up the hierarchy. For Oliver Jayo, this will not be an issue. However, the waiting staff may have a good sense of teamwork and there may be a good camaraderie amongst them and this may compensate for the low levels of pay. The low level of pay, however, may also be considered a hygiene factor according to the work of Herzberg. If working conditions at the restaurant are good then this may be a motivator, but the presence of hygiene factors may prevent the motivators having any impact.

The high turnover of restaurant waiting staff may well be an indicator of a number of hygiene factors, perhaps pay levels being the primary one. There would also appear to be little prospects for promotion and this may limit motivation.

In the case of Oliver Jayo, he has become more involved with further external campaigns and is now simply training the other chefs to be able to deliver the menus themselves. This may mean that there are significant "motivators" for him as he sees his work being passed on and delivered by others and is given the opportunity to set the tone and nature of the product. However, the part-time nature of his contract and the resultant insecurity may be a factor preventing him rising further up the Maslow Hierarchy of needs. This may be indicated by his increased involvement in external campaigns, which are providing opportunities for self-actualisation, as the restaurant alone may not be providing sufficient motivation for him.

**[6 to 8 marks]**

There is a detailed and balanced analysis of the extent to which motivation will differ between the different staff with detailed application of appropriate motivation theory. The analysis is closely related to the case and business theory and terminology are used appropriately where relevant.

**[3 to 5 marks]**

There is some analysis of the extent to which motivation will differ between the different staff with some application of appropriate motivation theory but the analysis may not be balanced. The analysis is generally related to the case, though this may be limited and perhaps tend to be descriptive at the lower end of the range.

**[1 to 2 marks]**

A limited and essentially descriptive answer.

## SECTION B

5. (a) Using examples from *Organix's* restaurant business, distinguish between fixed, semi-variable and variable costs.

[6 marks]

Fixed costs are costs that do not vary with the level of output. In the case of the restaurant business these could be argued to include chef salaries and many of the property expenses – security and tax for example.

Variable costs, by contrast, are those that do vary with the level of output. In the case of *Organix's* restaurant this may include raw materials (e.g. fresh produce and meat) for the preparation of meals.

A semi-variable cost is one which has fixed and variable elements to it. For example, in the case of *Organix's* restaurant, their fuel bill for electricity or power may be a semi-variable cost. Though there may be a fixed element (perhaps a standing charge or certain minimum level they always use), there may also be a variable element as their power requirements for cookers *etc* may increase in busy periods in the restaurant.

**N.B.** Waiting staff may be either defined as fixed costs, variable costs or semi-variable costs. There should be careful explanation of whatever should be chosen.

**[5 to 6 marks]**

Fixed, variable and semi-variable costs are all adequately explained. There is a detailed comparison between them with a clear contrast. An appropriate example of each from the case study is given, though one or two examples may be missing for [5 marks].

**[3 to 4 marks]**

At least two types of cost are explained though the explanation of one or two may lack detail. There is some comparison between at least two types of cost with some contrast though this may be limited at the lower end of the range. A maximum of [4 marks] should be awarded for a detailed comparison of two types of cost.

**[1 to 2 marks]**

A limited answer that may explain fixed and/or variable costs and/or semi-variable costs, but there may be no examples given from the case or the examples may be unrelated.

(b) Assuming that the restaurant is currently serving 750 meals per month, prepare a break-even chart showing clearly the *annual* break-even level of output, level of profit and the margin of safety. [6 marks]

Students may answer this in a variety of ways:

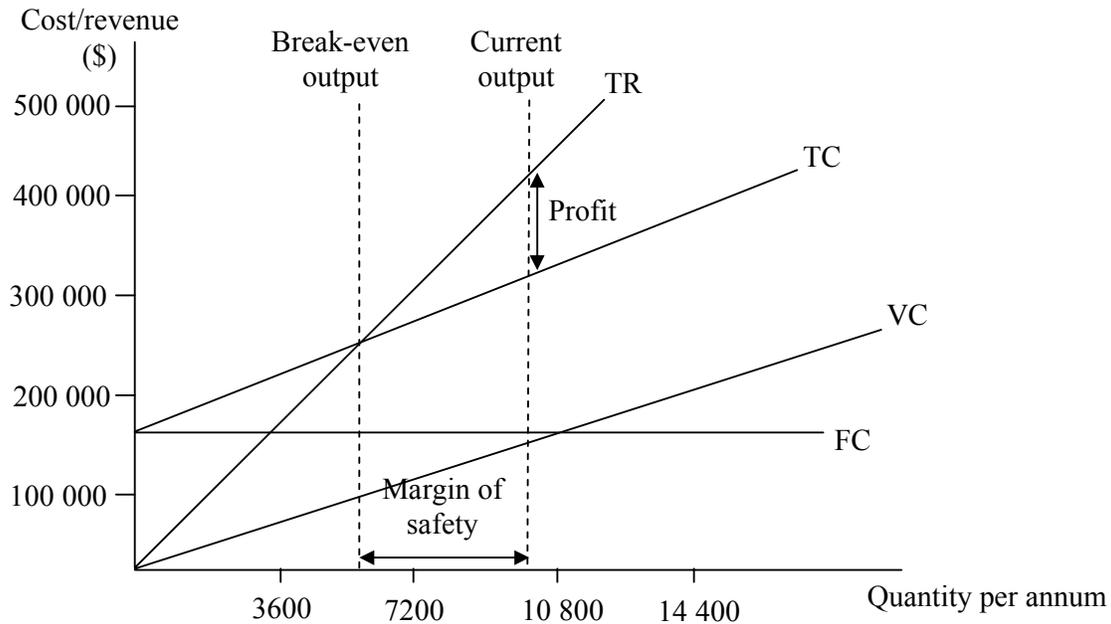
- (a) They use the correct calculations for per annum break even
- (b) They use the correct calculations for monthly break even
- (c) They can put waiting staff wages as VC to find per annum BEQ
- (d) They can put waiting staff wages as VC to find monthly BEQ.

Whilst options (a) or (c) are the preferred ones and will receive the maximum [6 marks] we should accept other answers and allow them up to [4 marks] for Options (b) and (d).

This question will be marked in two parts:

- the construction of the break-even chart [4 marks]
- the calculations [2 marks].

**Construction of break-even chart for answer option (a)**



[4 marks] correct answer based on candidates own assumptions with accurate BEQ, Margin of safety and Profit levels.

[2 to 3 marks] correct approach but with errors of calculation and/or graph plotting.

[1 mark] for a limited attempt at preparing the graph.

**Calculations**

For the calculations, award up to **[2 marks]** based on the student's own calculations. **[2 marks]** for correct calculations. **[1 mark]** if there are errors.

a)

Break-even level of output = Fixed costs / Contribution

$$= \$160\,000 / \$23 = 6956 \text{ meals per annum}$$

Margin of safety therefore =  $9000 - 6956 = 2044$  meals per annum

$$\text{Profit} = \$47\,000 \text{ } (\$23 \times 9000 - \$160\,000)$$

b)

If a student has only made the calculations on a **monthly** basis then they should be the following:

Break-even level of output = Fixed costs / Contribution

$$= \$13\,333 / \$23 = 580 \text{ meals per month}$$

Margin of safety therefore =  $750 - 580 = 170$  meals per month

$$\text{Profit} = \$3,917 \text{ } (\$23 \times 750 - 13\,333)$$

c)

If a student has calculated wages as a variable cost then the figures should be the following:

Break-even level of output = Fixed costs / Contribution

$$= \$115\,000 / \$18 = 6389 \text{ meals per annum}$$

Margin of safety therefore =  $9000 - 6389 = 2611$  meals per annum

$$\text{Profit} = \$47\,000 \text{ } (\$18 \times 9000 - 115\,000)$$

d)

If a student has calculated wages as a variable cost but on a **monthly** basis then the figures should be the following:

Break-even level of output = Fixed costs / Contribution

= \$9583 / \$18 = 532 meals per month

Margin of safety therefore = 750 – 532 = 218 meals per month

Profit = \$3917 (\$18 × 750 – \$9583)

*N.B.* Students will not be penalised for giving waiting staff wages as either fixed, semi-variable or variable costs, providing their calculations are correct.

If the student has produced a completely accurate break-even chart but has no calculations it should be inferred that the calculations are correct and **[6 marks]** can be awarded.

- (c) Discuss *Seagers'* proposal to split the different areas of *Organix's* business into profit centres.

**[8 marks]**

*Organix* has set up a number of different business areas (farm, farm shop and restaurant) with very different business characteristics, but the accounting has up to now been done for the organization as a whole. This may disguise (indeed it probably has done) any possible financial issues developing in the different business areas. The setting up of each department or perhaps business area as a profit centre will enable them to allocate costs and revenues to each of the specific areas. They can then see the degree of profitability of each business area and perhaps the extent to which costs are changing for different departments. This should enable them to tighten the degree of financial control and therefore deal with any emerging problems much faster.

However, the setting up of profit centres will impose a significant financial and administrative burden on what is essentially a small company and this may not prove to be worthwhile given their current size and structure. The isolation of financial data may also lead to them ignoring any positive cross-selling benefits that may arise across the business areas as a whole. The setting up of profit centres may also require some training/retraining of staff and will require a full staff commitment to make it work effectively. This may not be possible given the size of the company.

**[6 to 8 marks]**

There is a detailed and balanced discussion of the value to *Organix* of adopting profit centres. The discussion recognizes related financial issues and theory. The discussion is related to the case, and business theory and terminology are used effectively and appropriately where relevant.

**[3 to 5 marks]**

There is some discussion of the value to *Organix* of adopting profit centres, though at the lower end of the band the answer may be characterised by a lack of balance and may be relatively incomplete and tend to be descriptive rather than discursive. There is some understanding of the theory of profit centres. The discussion is generally related to the case, though may tend to be more general and descriptive at the lower end of the range.

**[1 to 2 marks]**

A limited and essentially descriptive answer.

6. (a) Calculate the Gross Profit Margin, the Net Profit Margin and the Acid Test Ratio for the farm, farm shop and restaurant. **[6 marks]**

Gross Profit Margin = Gross profit / turnover

Net Profit Margin = Net profit / turnover

Acid Test Ratio = Current assets – stock / current liabilities

<b>Ratios</b>	<b>Farm</b>	<b>Farm shop</b>	<b>Restaurant</b>
Gross Profit Margin (%)	70.81	58.59	53.22
Net Profit Margin (%)	16.84	14.06	10.53
Acid Test Ratio (times)	0.80	1.04	0.55

Award **[2 marks]** for correct calculation of all Gross Profit Margin figures and **[1 mark]** where there are errors, but an indication of appropriate method.

Award **[2 marks]** for correct calculation of all Net Profit Margin figures and **[1 mark]** where there are errors, but an indication of appropriate method.

Award **[2 marks]** for correct calculation of all Acid Test Ratio figures and **[1 mark]** where there are errors, but an indication of appropriate method.

- (b) Explain *one* possible reason for the difference in the value of the Gross Profit Margin for the farm and the restaurant. **[4 marks]**

The Gross Profit Margin is calculated by dividing the gross profit by turnover. Gross profit is the turnover less the cost of sales, so the difference must be due to differences in the cost of sales. The restaurant appears to have higher direct costs and therefore a lower gross margin. The direct costs for the farm may be relatively low – perhaps being just things like seed and other relatively minor raw materials. The restaurant may face higher cost of sales. This may be because of the purchase of expensive wines or other special ingredients and/or the salaries of skilled workers such as the chefs or Oliver.

Candidates may offer other possible reasons and should be credited for an appropriate explanation where there is a clear understanding revealed of the gross margin and its determinants.

**[3 to 4 marks]**

The explanation is balanced and related to the calculations done in part (a). For **[4 marks]** the explanation is related to the case study.

**[1 to 2 marks]**

There is a limited explanation, which may not be related to the case study.

(c) (i) Define the term *profit centre*.

[2 marks]

A profit centre is a segment of a business for which costs, revenues, and profits are separately calculated.

[2 marks]

A clear definition of the term that shows a good understanding of its meaning.

[1 mark]

A definition that shows some understanding of the term.

(ii) Using the figures in the table above and those calculated in part (a), and any other relevant information from the case study, evaluate both of the options offered by *Seagers* and suggest which is likely to be the most effective at improving the financial position of *Organix*.

[8 marks]

The options proposed are very different in nature and so this is a fairly open-ended question. However, the first option (tighter credit control), while it may improve cash flow for the firm, will not directly improve profitability. Nevertheless the figures calculated (particularly for the acid test ratio) do indicate that there are liquidity issues in some areas of the business and so this approach may help to isolate the areas where there are liquidity issues and allow for these to be managed better. Overall, however, it is likely to be an approach that has less of an impact than the other options.

Preparation of budgets and variance analysis, will help introduce a degree of financial discipline in all the different areas of the business. This is a planning discipline, which will help the firm to plan ahead better and so could be considered a more pro-active approach to the improvement of the financial position. Though there would be an administrative burden to the implementation of this approach, it would be relatively low and so it can be argued that this option would be an effective one if it helped to inculcate a sense of planning among the staff and therefore greater financial discipline. The use of variance analysis would help *Organix* to see where their forecasts were not accurate and therefore develop strategies to deal with this.

The adoption of profit centres may be one of the most difficult options to implement. The setting up of profit centres will impose a significant financial and administrative burden on what is essentially a small company and this may not prove to be worthwhile given their current size and structure. The isolation of financial data may also lead to them ignoring any positive cross-selling benefits that may arise across the business areas as a whole. The setting up of profit centres may also require some training/retraining of staff and will require a full staff commitment to make it work effectively. This may not be possible given the size of the company. However, as above it will enable them to introduce a degree of financial discipline and is therefore likely to help improve the financial position of the company. Since it would isolate the financial data from the different components of *Organix's* business it may also be helpful in determining where in the business the main issues are arising. It is clear from the profitability ratios calculated that the different areas of the business are performing very differently and the setting up of profit centres may allow for more detailed analysis of this situation over a period of time.

***[6 to 8 marks]***

The evaluation of each option is detailed and balanced. The analysis of each option is well considered and for ***[8 marks]*** a judgment is given about the appropriateness of each option.

***[3 to 5 marks]***

There is some discussion of each option, though this may be relatively limited at the lower end of the range. For a detailed evaluation of just one option award a maximum of ***[4 marks]***.

***[1 to 2 marks]***

A limited and essentially descriptive answer. A list of points should receive a maximum of ***[2 marks]***.

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