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**BUSINESS AND MANAGEMENT
STANDARD LEVEL
PAPER 2**

Thursday 22 May 2014 (morning)

1 hour 45 minutes

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- Section A: answer one question.
- Section B: answer two questions.
- A calculator is required for this examination paper.
- A clean copy of the ***Business and Management formulae sheet*** is required for this examination paper.
- The maximum mark for this examination paper is [60 marks].

SECTION A

Answer **one** question from this section.

1. LuxEclairage (LE)

LuxEclairage (LE) was founded by Maurice Dahman, an Electrical Engineer from Algeria. He has a degree in electrical engineering and is fluent in French. In 2007, after 12 years working for a large lighting business in Luxembourg, Maurice established *LE*. His business produces energy-efficient parts for various indoor and outdoor lighting.

LE has a unique selling point (USP): the lowest price in the market. Although most sales are in Europe, all production is in Algeria, where costs are much lower. As a result, growth in sales revenue has been rapid and significant, and *LE* has gained market share each year.

Selected financial information for *LE* (all figures in €m):

	2009	2013
Sales revenue	28	93
Cost of goods sold	11.5	X
Gross profit	Y	58
Net profit before interest and tax	2.8	8.1
Creditors	1.8	10.2
Stock	0.94	4.32
Debtors	0.94	3.56
Total current assets	5.74	15.52
Total current liabilities	1.94	11.0

With the rapid growth in sales revenue since it was first established, *LE* has experienced some diseconomies of scale, especially in the administration of the business. Production occurs in 12 small factories located around the city of Algiers, rather than in one large factory. Coordination between factories and the administrative offices is, therefore, complicated, and the internet is sometimes unavailable. Whereas French is the language used by managers and customers of *LE*, the workers generally speak only basic French and prefer to speak Arabic. In addition, patterns of non-verbal communication differ widely between Europe and Algeria.

(This question continues on the following page)

(Question 1 continued)

- (a) Define the term *market share*. [2 marks]
- (b) Describe **one** diseconomy of scale for *LE*. [2 marks]
- (c) Calculate for *LE*:
- (i) the gross profit for 2009 (figure Y). [1 mark]
 - (ii) the gross profit margin for 2013. [1 mark]
 - (iii) the stock turnover for 2009 **and** 2013. [2 marks]
 - (iv) the current ratio for 2009 **and** 2013. [2 marks]
 - (v) the acid test (quick) ratio for 2009 **and** 2013. [2 marks]
- (d) Comment on the decline in liquidity at *LE*. [3 marks]
- (e) Analyse communication at *LE*. [5 marks]

2. Klar

Klar is a factory that bottles mineral water for use in large water dispensers. The factory is located on a hill next to a spring from where water flows naturally. *Klar* uses a flow production method with a production capacity of 35 million litres per year. *Klar* has a 60% share of the national market and also exports bottled mineral water to several countries.

A multinational company called *Kaiser* is interested in acquiring *Klar*. “If the acquisition takes place, we will expand *Klar*’s production to gain economies of scale; we will also add a new range of flavoured drinks that will be produced in batches and sold in 1.5 litre bottles. Our maximum production capacity of flavoured drinks will be 3 million bottles a year,” says Roman Hitschfeld, *Kaiser*’s Production Manager.

The forecast costs for producing *Klar*’s new flavoured drinks are as follows:

- variable cost per bottle: \$0.4
- estimated sales price per bottle: \$1.6
- fixed costs: \$240 000.

Klar is facing fierce competition from other companies that use plastic bottles and offer lower prices to consumers. Although the cost of glass bottles is higher than plastic ones, up until now *Klar* has only used re-useable glass bottles to support its ethical objectives of being environmentally-friendly. Now, *Klar* is considering switching from re-useable glass bottles to non re-useable plastic ones. The environmental pressure group *Plastic No More!* is campaigning against the use of plastic. A spokesperson from *Plastic No More!* said: “there is a growing trend among consumers to purchase products that will not damage the environment, but we are still a minority”.

- (a) (i) Define the term *pressure group*. [2 marks]
- (ii) Describe the production method known as batch production. [2 marks]
- (b) Calculate for *Klar*’s new flavoured drinks (*show all your working*):
- (i) the break-even level of output. [2 marks]
- (ii) the margin of safety if it operates at full capacity. [2 marks]
- (iii) the profit or loss if it operates at full capacity. [2 marks]
- (c) Construct a fully labelled break-even chart for *Klar*’s new flavoured drinks. [5 marks]
- (d) Analyse **one** advantage **and one** disadvantage for *Klar* of having ethical objectives. [5 marks]

SECTION B

Answer **two** questions from this section.

3. Khumalo Pottery (KP)

Lungile Khumalo owns a small company called *Khumalo Pottery (KP)* in Johannesburg, South Africa. *KP* manufactures plates and bowls that are sold to small shops. *KP* has a unique selling point (USP) based upon traditional African designs and patterns decorating the pottery. *KP* does not pay its workers high wages and has never made anyone redundant, even during difficult economic times. Lungile always repeated to his workers that beauty was more important than quantity. Workers at *KP* could take time to produce beautiful pottery. They also developed great pride in the company and in their work.

Across the Atlantic, in the United States (US), pottery with African designs was becoming increasingly popular. As a result, several large American pottery manufacturers, operating on a very large scale, began to mass produce pottery with African-looking patterns. Thanks to their economies of scale, these American manufacturers sold their products at a very low price.

In 2013, one large American company opened a highly automated factory in Johannesburg. The aim was to produce and sell African-looking pottery to large retailers across sub-Saharan Africa. If successful, the American company would employ up to 150 South Africans. These jobs would not require much creativity: the pottery would not be hand-made, but the company would offer good wages with fringe payments (benefits).

The American company used penetration pricing in South Africa, and large retailers eagerly stocked their shelves with the pottery. *KP*'s sales started to decline almost immediately, as the small shops selling *KP*'s pottery were losing customers to the large retailers with lower prices.

- (a) Identify **one** advantage **and one** disadvantage of mass production for the American company. [2 marks]
- (b) Explain **one** difficulty that the American company may face when entering the South African market. [2 marks]
- (c) Explain **two** possible purposes of penetration pricing. [4 marks]
- (d) Examine the roles of intrinsic motivation and extrinsic motivation of the workers at *KP* **and** at the factory opened by the American company. [5 marks]
- (e) Evaluate the impact on South Africa of the American company opening a factory in Johannesburg. [7 marks]

4. Magda’s flower business

Magda Fiori has always loved flowers. When 18 years old, she left school and worked as an assistant florist. Then, three years later, she set up her own flower business. She is a sole trader; this type of organization is common for florists. She employs two part-time assistants: one who delivers flowers to customers in the morning, and one who helps her in the shop at busy times, in the late afternoon. Both assistants work four hours a day, six days a week.

After a difficult start, Magda’s business has been very successful for the last two years. Her customers are loyal, even if they cannot always find the flowers they want. Customers like her creativity, her sense of humour and the good advice that she gives.

Magda would now like to expand her business. She could join an international franchise such as *Interflora*. She likes the idea, but she knows that her stock control methods would have to change radically. She would need to adopt a “just-in-case” method of stock control, which *Interflora* would require to ensure that customers always find the flowers they want. Magda also fears that she cannot afford the necessary investment for storage and marketing. She wonders whether a bank will loan her money. Magda’s small business has only one source of revenue.

Magda has also considered three methods of external growth:

- a joint venture with a local wedding organizer
- a strategic alliance with a garden centre
- a merger with another florist.

- (a) Identify **two** variable costs for Magda’s flower business. [2 marks]
- (b) Explain the meaning of the sentence: “Magda’s small business has only one source of revenue”. [2 marks]
- (c) Using Magda’s flower business, distinguish between “just-in-case” and “just-in-time” methods of stock control. [4 marks]
- (d) Analyse the advantages **and** disadvantages for Magda of joining an international franchise such as *Interflora*. [5 marks]
- (e) Recommend to Magda **one** of the three methods of external growth that she has considered. [7 marks]

5. Setting up new businesses in Albania

Gent Spahiu has worked as a teacher for 25 years in Kotë, a small town in Albania. His son Agon has just moved to Tirana, the Albanian capital, to set up a small business importing electrical appliances from Germany. Albania is one of Europe’s poorest countries and its economic and political environment is difficult to conduct business in. Agon is aware of the economic and political challenges. Most of the population work in agriculture. Towns suffer from poor infrastructure. In the countryside, access to electricity can sometimes be unreliable. In 2009, Albania applied to become a member of the European Union (EU). Agon thinks that his business could benefit if Albania joins this regional trading bloc.

As Agon now lives away from home, Gent wants to use the free time that he now has in the evening. He wants to give local people the skills and knowledge necessary in a modern society. He imagines an evening school for adults, with classes in subjects such as English, basic computer skills and business. To pay for the overheads and teachers’ wages, Gent is thinking about the following sources of finance for the evening school:

	% of total funding required by Gent
Fees paid by students	10 %
Bank loan (at a very low interest rate)	10 %
Funding from international non-governmental organizations (NGOs)	40 %
Funding from local authorities	40 %

Gent has work colleagues who have agreed to teach for very low wages; their main motivation is non-financial. Gent’s evening school will follow business principles, especially for quality management, but his aim is not primarily to make a profit, it is rather to make improvements to society.

- (a) Describe **one** form of non-financial reward that Gent could use to motivate the teachers in the evening school. *[2 marks]*
- (b) Explain **one** benefit for Agon’s business if Albania joins a regional trading bloc such as the European Union (EU). *[2 marks]*
- (c) With reference to Gent’s evening school, contrast **two** reasons for setting up a business. *[4 marks]*
- (d) Analyse the main problems that a business start-up may face in a less economically developed country such as Albania. *[5 marks]*
- (e) Discuss Gent’s proposed sources of finance for the evening school. *[7 marks]*