



MARKSCHEME

May 2014

BUSINESS AND MANAGEMENT

Higher Level

Paper 2

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

Section A		Section B			Level descriptors
Q1 (e)	Q2 (d)	Q3 (d)	Q4 (d)	Q5 (c)	
Marks 0–6					
0					<ul style="list-style-type: none"> • No knowledge or understanding of relevant issues, concepts and theories. • No use of appropriate terminology.
1–2					<ul style="list-style-type: none"> • Little knowledge and understanding of relevant issues, concepts and theories. • Little use of appropriate terminology. • No reference is made to the information in the stimulus material. The response is mainly theoretical.
3–4					<ul style="list-style-type: none"> • A description or partial analysis/examination with relevant knowledge and/or understanding of relevant issues, concepts and theories. • Some use of appropriate terminology. • Some reference is made to the information in the stimulus material, not just to the name of the organization.
5–6					<ul style="list-style-type: none"> • A balanced analysis/examination with accurate, specific, well-detailed knowledge and understanding of relevant issues, concepts and theories. • An analysis/examination that uses appropriate terminology throughout the response. • Explicit references are made to the information in the stimulus material.

Section B			Level descriptors
Q3 (e)	Q4 (e)	Q5 (d)	
Marks 0–9			
0			<ul style="list-style-type: none"> • No knowledge or understanding of relevant issues, concepts and theories. • No use of appropriate terminology.
1–2			<ul style="list-style-type: none"> • Little knowledge and understanding of relevant issues, concepts and theories. • Little use of appropriate terminology. • No evidence of judgments and/or conclusions. • No reference is made to the information in the stimulus material.
3–4			<ul style="list-style-type: none"> • A description with some knowledge and/or understanding of relevant issues, concepts and theories. • Some use of appropriate terminology. • No evidence of judgments and/or conclusions. • Some reference is made to the information in the stimulus material, not just to the name of the organization. • The response is mainly theoretical.
5–7			<ul style="list-style-type: none"> • A response with relevant knowledge and understanding of relevant issues, concepts and theories. • A response that uses relevant and appropriate terminology. • Evidence of judgments and/or conclusions that are little more than unsubstantiated statements that has balanced analysis and demonstrates understanding. • Explicit references to the information in the stimulus material are made at places in the response.
8–9			<ul style="list-style-type: none"> • A response with accurate, specific, well-detailed knowledge and understanding of relevant issues, concepts and theories. • A response that uses appropriate terminology competently throughout the response. • A response that includes judgments and/or conclusions that is well supported and underpinned by a balanced analysis. • Explicit references to the information in the stimulus material are made throughout the response.

SECTION A

1. (a) Define the following terms:

(i) *debtors*

[2 marks]

Debtors are customers that have received goods or services, but have not yet paid for them. Debtors appear as a current / short-term asset on the balance sheet as it is expected that the accounts will be settled within 30 days, or within whatever is the agreed credit period.

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

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

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

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

(ii) *fixed assets.*

[2 marks]

Fixed assets are long-term assets owned by a business, last more than 1 year, and are used to produce the products, or services the business sells. Fixed assets are usually made up of premises, land and equipment.

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

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

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

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

- (b) Explain *one advantage and one disadvantage* for *AH Ltd* of working at full capacity. *[4 marks]*

It would be expected that if *AH Ltd* is working at full capacity, then unit costs are likely to be at their lowest and the business will be more efficient. Lower costs per unit will result in higher profit. Working at full capacity will also ensure the possibility to generate more total revenue and possibly needed cash to maintain short-term liquidity.

One disadvantage to work to full capacity is likely to be that with no spare capacity, *AH Ltd* will not be able to take advantage of sudden increases in demand. *AH Ltd* may find that its equipment, the climbing gear, which is integral to its operation and success, is worn out and is of a lesser quality, as stated in the stimulus and has to be replaced or attended to a lot quicker and more often to ensure customer safety. This may impact on costs and brand image.

Faulty climbing gear while working at full capacity may result in *AH Ltd* turning away customers - a loss of potential income and much needed profit. Employees may become stressed.

Accept any other relevant advantage / disadvantage with an explanation.

Mark as 2+2.

Award *[1 mark]* for each relevant and correct advantage / disadvantage for *AH Ltd* working at full capacity identified and *[1 mark]* for an appropriate explanation that directly refers to *AH Ltd* up to a maximum of *[2 marks]*.

- (c) (i) Using the information provided from *AH Ltd's* accounts, prepare a balance sheet for *AH Ltd* as at 31 March 2014. [3 marks]

Balance Sheet of *AH Ltd* as at 30 June 2014 (all figures in US\$m)

Fixed assets		
Premises	9	
Equipment	<u>1.5</u>	10.5
Current assets		
Debtors	0.2	
Cash	<u>0.1</u>	0.3
Current liabilities		
Creditors	<u>0.8</u>	<u>0.8</u>
		(0.5)
Total net assets		<u>10</u>
Represented by:		
Loan capital		4
Share capital		4
Retained profit		<u>2</u>
Capital employed		10

N.B. It is expected that the candidates use the IB format.

For [1 mark], there are two or more errors in calculation. However, the candidate must demonstrate some understanding of how to construct a balance sheet.

For [2 marks] there is **one** error in calculation, **or** they are inappropriate or missing one of the classifications.

For [3 marks], the balance sheet is clear and accurately presented with matching calculations of total net assets and capital employed. There is no omission of the heading classifications and any figures.

N.B. Given that only [3 marks] are awarded for this question, do not penalize if **only** the title is missing.

- (ii) Using the reducing balance method of depreciation, calculate the total depreciation charge on the equipment purchased three years ago (*show all your working*). *[3 marks]*

Equipment is valued at US\$1.5m and will need to be depreciated over 3 years at 40% using the reducing balance method

Value (\$)	Year	Amount of depreciation (\$)	Book value (\$)
1.5m	1	$1.5\text{m} \times 0.40 = 600\,000$	$1.5\text{m} - 600\,000 = 900\,000$
0.9m	2	$0.9\text{m} \times 0.40 = 360\,000$	$900\,000 - 360\,000 = 540\,000$
0.54m	3	$0.54\text{m} \times 0.40 = 216\,000$	$540\,000 - 216\,000 = 324\,000$

Total \$1.176m

Award *[1 mark]* for each correct step in calculation per year up to a maximum of *[3 marks]*.

Allow candidate own figure rule (OFR). If the correct final figures are presented for each year without working, award *[1 mark]* for the amount of depreciation.

N.B. Do **not** penalize candidates who do not provide the total sum of the depreciation as they have to arrive at this figure in (c) (iii).

- (iii) Prepare *AH Ltd's* new balance sheet as at 31 March 2014 taking into account the depreciation charge calculated in part (ii). [3 marks]

Amended Balance Sheet of *AH Ltd* as at 30 June 2014 (all figures in US\$m)

Fixed assets			
Premises		9	
Equipment	1.5 – 1.176	0.324	
		Total fixed assets:	9.324
Current assets			
Debtors		0.2	
Cash		<u>0.1</u>	
			0.3
Current liabilities			
Creditors		<u>0.8</u>	
			<u>0.8</u>
			(0.5)
Total net assets			<u>8.824</u>
Represented by:			
Share capital			4
Loan capital			4
Retained profit – accumulated depreciation for equipment			
2 – 1.176			0.824
Capital Employed			8.824

It is assumed that the accumulated depreciation will be subtracted from retained profits as there is no profit and loss account present.

N.B. Given that the candidates have to rewrite the balance sheet as in the previous question, do not give credit for correct format, relevant headings and title. Attention should be paid to the adjustment of the figures.

At the same time do not double penalize for inappropriate format, missing title/heading *etc.*

Award [1 mark] where there is some indication of an adjustment made, but it is not clearly identified. The balance sheet is not correct, but there is some attempt to include a change. Only one side of the balance sheet may have been adjusted.

Award [2 marks] where the adjustment for depreciation is included **and** the adjustment in profitability is noted but they are not correct. The balance sheet does not balance, but there is an attempt to recognize that two items are affected.

Award [3 marks] where both adjustments have been included and incorporated correctly into the new balance sheet. There are no errors.

- (d) **Explain *one* advantage for *AH Ltd* of using a straight line method of depreciation instead of a reducing balance method of depreciation.** [2 marks]

Using a straight line method is simpler and relatively quicker, especially for *AH Ltd* who has not used any method before, due to unawareness of the need and possibly the methods needed to depreciate its assets. The depreciation allowance will be identical for the three years = \$500 000.

Choosing the correct and the most realistic percentage for the reducing balance is crucial. Perhaps, Jose does not have to worry too much about choosing the correct percentage with which to depreciate the assets. Inaccurate choice can lead to highly inaccurate book value and depreciation allowance that affects the recorded profit.

Using the straight line method, the depreciation allowance will be lower for the first and the second years hence, *AH Ltd* is likely to show in the early stages of operation, higher net book value and higher retained profit perhaps to attract funds.

Accept any other relevant advantage with an explanation.

Award [1 mark] for a relevant and correct advantage of *AH Ltd* for using the straight line method of depreciation identified and [1 mark] for how this would benefit *AH Ltd* over using the reducing balance method up to a maximum of [2 marks].

If, however, a candidate explains that one advantage is that the straight line method is easy to calculate without further elaboration, award [1 mark].

- (e) **Examine *two* appropriate sources of finance for *AH Ltd* to fund the replacement of the old equipment.** [6 marks]

The current liquidity situation of *AH Ltd* is worrying with working capital being negative. The business is effectively insolvent and funds from the NGO have been exhausted.

Given this context, sources of finance are going to be limited. However, a quick look at the balance sheet reveals that *AH Ltd's* fixed assets are healthy compared to current assets. *AH Ltd* could sell some of these premises and land / fixed assets and lease them back from the purchaser. The buildings are not essential parts of the operation of *AH Ltd* and this would release much needed funds.

These fixed assets may have to be re-purchased at a higher cost and the business loses a valuable source of collateral against future loans.

Moreover, given the location of the outdoor activity, it might be difficult for *AH Ltd* to find buyers. Also, unless the capital release is successfully used to raise additional revenue, the lease payments, monthly, or every 6 months for example, may put short-term financial strain on *AH Ltd*.

A second source could be a longer term loan guaranteed against the current value of the fixed assets (excluding equipment). However, banks may be wary of lending to *AH Ltd* if the funds are principally going to be used only to pay off debts and replace existing equipment. High interest rate is likely to be charged which can put further financial constraints on the short-term position of *AH Ltd* as short-term liability increases.

AH Ltd can further issue private shares to some friends and family who are interested in the existence and success of the company. Jose can control the number of shares so he does not lose control. However, the funds may not be sufficient if only a small amount of shares are sold, or, Jose may have to give up some control of the business with possible interference in the decision-making process. Perhaps this is an expensive and risky source of fund to finance the equipment.

Given the nature of *AH Ltd's* business, it might be possible for the business to source funds through venture capitalists or social entrepreneurs such as online micro-finance banks. However, the sums involved may be small and venture capitalist may exert unwelcome pressure, to force *AH Ltd* to offer services which are more profit driven in contrast with the objectives of the NGO.

Similarly, although *AH Ltd* is a limited company and hence assumes to be profit focused, its NGO funding suggests more of a social objective. Raising additional investment from private investors may not sit well with its NGO funder.

Accept the option of hire purchase and/or sponsorship from an equipment manufacturer provided the answer is balanced.

A **subsidy** from the government and the use of **retained profit** are not really appropriate source of finance given the nature of an NGO and the liquidity crisis unless the candidate argues these issues in a balanced manner.

*Accept inappropriate sources of finance **only** if a balanced analysis is provided.*

A balanced analysis is one that incorporates one relevant argument for and one relevant argument against each option

For one relevant issue that is one-sided, with no analysis award up to a maximum of **[3 marks]**. For more than one relevant issue that is one-sided, with no analysis award up to a maximum of **[4 marks]**.

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

2. (a) (i) **Define the term *unique selling proposition (USP)*.** [2 marks]

The unique selling proposition (point) is the attribute, or characteristic that makes a business special and differentiates it from the competition in the minds of customers.

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

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

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

N.B. It is expected that candidates comment on the differentiation created by the USP.

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

(ii) **Identify *two* external stakeholders of *HT*.** [2 marks]

External stakeholders might include the following:

- clients – *eg* the trekkers
- suppliers – *eg* the local guides, yak providers and porters
- local entrepreneurs – *eg* lodge owners, food and drink sellers and equipment hirers
- special interest groups – *eg* save the environment groups, political groups
- local community – *eg* local farmers, herders and villagers
- government – *eg* central and regional
- *accept any other relevant external stakeholder.*

Award [1 mark] for each relevant and correct external stakeholder identified, up to a maximum of [2 marks].

- (b) (i) Calculate how many clients (trekkers) *HT* would need to meet its target profit figure of \$400 000 per year (*show all your working*). [3 marks]

The target profit formula is:

$$\text{Target Profit Quantity} = \frac{\text{Fixed Cost} + \text{Target Profit}}{\text{Price} - \text{Variable cost (per unit)}}$$

$$\text{And so: } \frac{800\,000 + 400\,000}{10\,000 - 5\,000} = 240 \text{ trekkers}$$

Accept any other relevant method.

Award [1 mark] for an incorrect answer but with clear working shown.

Award [1 mark] for a correct answer and no working.

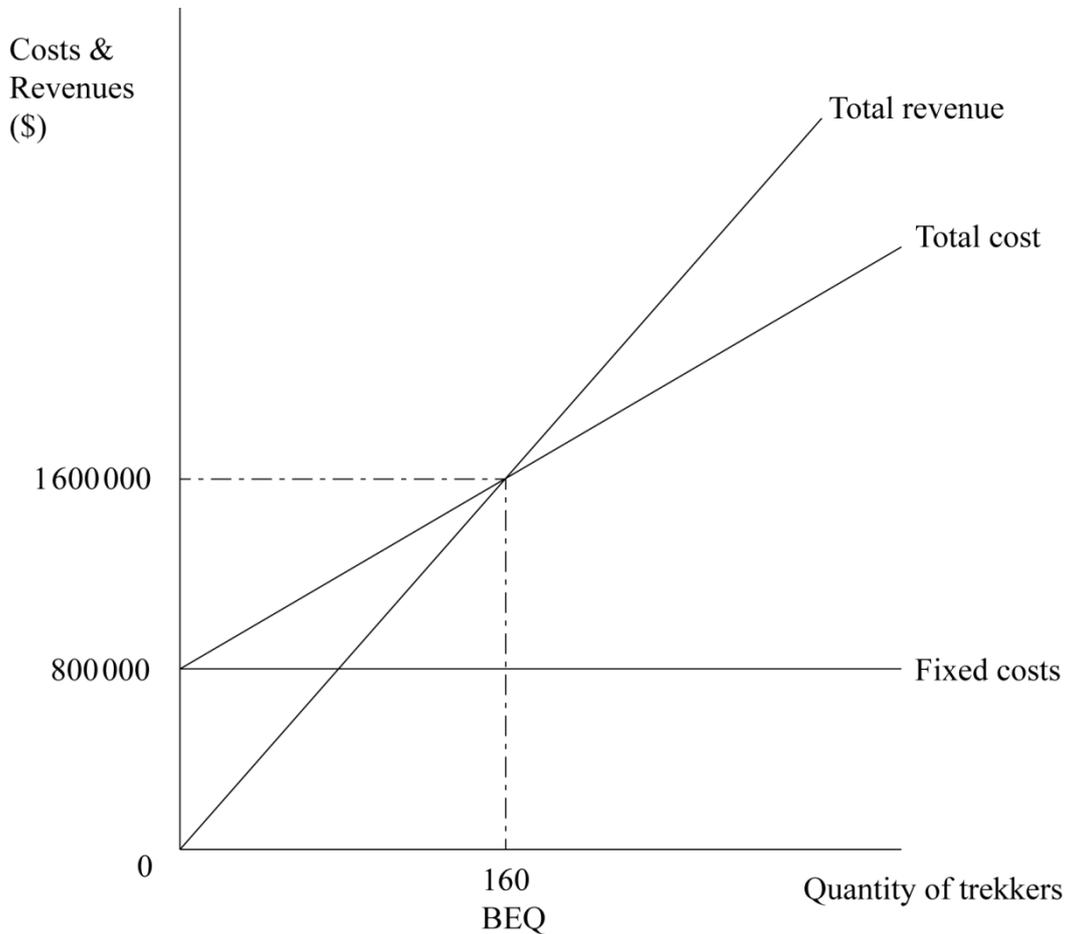
Award [2 marks] for the correct answer but some of the working may be unclear or missing.

Award [3 marks] for the correct answer with clear working. The figures are identified with relevant classifications / headings.

(ii) Using the financial information provided, prepare a fully labelled break-even chart for HT for 2013.

[6 marks]

$$\text{Break even quantity} = \frac{\text{fixed cost}}{\text{Price} - \text{Variable cost (per unit)}} = 160 \text{ trekkers}$$



Do not double penalize candidates.

Award up to a maximum of [6 marks] for any of the following:

- [1 mark] for appropriate labelling of **both** axes.
- [1 mark] for an accurately drawn and labelled fixed costs curve.
- [1 mark] for an accurately drawn and labelled total revenue curve.
- [1 mark] for an accurately drawn and labelled total costs curve.
- [2 mark] for identification of the break-even point with the corresponding level of output and total revenue on the diagram.

$\$10000 \times 160 = \1600000 . Candidates can calculate total costs at the break-even point. The results should be the same.

If the candidate produces a table rather than a chart, award [0 marks].

Award a maximum of [3 marks] if the chart is not neat, not drawn with a straight-edge, or is not to scale, but real figures for calculations are used.

(c) In 2014, the following changes occurred:

- annual fixed costs increased by 20%
- rising fuel costs of flights increased average variable costs by 40% per trekker.

The average price charged per trekker remained the same (\$10 000) as did the number of clients (300).

(i) Taking these changes into account, calculate the new break-even quantity *and* margin of safety for HT in 2014 (show all your working). [4 marks]

The increase in fixed cost (FC) is \$160 000.

The increase in variable cost (VC) is \$2000.

$$\begin{aligned} \text{Break even quantity} &= \frac{\text{Fixed cost}}{\text{Price} - \text{Variable cost (per unit)}} = \frac{960\,000}{10\,000 - 7\,000} \\ &= \mathbf{320 \text{ trekkers}} \end{aligned}$$

Margin of safety = actual (sales) quantity – break-even quantity

$$= 300 - 320 = \mathbf{-20 \text{ trekkers}}$$

Mark as 2 + 2.

Award [1 mark] for the correct answer of the new break-even quantity / margin of safety and [1 mark] for working for each calculation, up to a maximum of [2 marks].

N.B. Do not penalize the candidates that showed clear working of the new break-even quantity without showing how the new FC and VC is arrived at as long as the figures are correct.

If the new VC and/or FC are/is incorrect, without working, do not allow candidate own figure rule (OFR).

- (ii) Explain *one* possible response from *HT* to the change in the break-even quantity *and* margin of safety calculated in part (i). [2 marks]

Possible responses by *HT* include:

- Increase prices – the total revenue curve will increase and *HT* will reduce the break-even point – brand loyalty is very strong so customers are likely to be price inelastic.
- Reduce variable costs, such as shorter itineraries to save on fuel, less food, or lower quality food. The reduction in variable cost will reduce the total cost linear line and *HT* will break even at an earlier point.

Award [1 mark] for the identification of a relevant possible response by *HT* and [1 mark] for the explanation of the response.

N.B. For full marks, candidates must explain why an increase in price will result in an increase in total revenue. An assertion is not sufficient.

N.B. Changing fixed costs is **not** possible; candidates should not be rewarded for choosing this option as trekking permits are set by the government and are outside the control of the trekking business – they are fixed.

- (d) **Examine why changing attitudes to social responsibility might be important for HT.** [6 marks]

Changing attitudes may be important for *HT* because it could lead to the following benefits:

- *HT* may be able to further exploit its USP to reduce the bargaining power of consumers and competition. Furthermore, a brand image that is based on being socially responsible may enable *HT* to increase the price, as socially responsible customers are likely to be more price inelastic. More clients who appreciate *HT's* approach will create more repeat clients and enhance brand loyalty.
- Stronger relationships with the local community which might ensure excellent local guides, better and possibly cheaper supply of food and so on.
- Stronger relationships with regional and central governments which might increase the bargaining power of *HT* for obtaining licences/permits possibly at a reduce cost in the future.
- Help motivate all internal stakeholders especially employees. As *HT* provides a service, employee performance is very important and can further add to *HT's* competitive edge.

Accept any other relevant factor.

However,

- The competitive advantage based on the current USP of being socially responsible may be short lived. Any competitor can do the same.
- Some of the practices used such as sourcing local food, employing only experienced staff with social responsibility practices, employing local guides may actually increase costs and reduce profits.
- Attitudes can change further over time, if *HT* relies on high prices in order to remain socially responsible, the demand may fall. Moreover, the niche, or segment might not be big enough despite the positive changing attitudes toward being socially responsible.
- There could be the possibility of *HT* becoming too popular and this may create issues with capacity utilization, or even create a negative effect on its USP / positioning / branding image to become a mass market operator.

Accept any other relevant factor.

Accept any other relevant issue.

A balanced response is one that covers at least **two** relevant issues for and at least **two** relevant issues against.

For one relevant issue that is one-sided, with no analysis award up to a maximum of [3 marks]. For more than one relevant issue that is one-sided, with no analysis award up to a maximum of [4 marks].

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

SECTION B

3. (a) **Define the term *price skimming*.** **[2 marks]**

Price skimming is a pricing method where a business charges a high price for a highly differentiated, unique and often innovative new good, or service, at the early stage of the product life cycle.

N.B. Do **not** award marks for a response that refers to premium or prestige pricing.

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

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

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

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

- (b) **Identify *two* key features of random sampling.** **[2 marks]**

Key features of random sampling are:

- respondents are equally likely to be chosen by the researcher to participate in a survey hence, there is no bias in the selection of consumers for a market research
- the outcome of the research is likely to be more accurate
- the research is simpler, possibly quicker and cheaper.

Accept any other relevant feature

Award **[1 mark]** for each relevant and correct feature of random sampling identified up to a maximum of **[2 marks]**.

(c) **Explain the importance of people, process and physical evidence for *Turners*. [6 marks]**

For *Turners*, the people element of the marketing mix is critical, given the **intangibility and the unique nature of the service**. As the hotel is perceived as having the highest quality of customer service and the staff / people enabled *Turners* to create a USP. It would appear that until recently, this aspect had allowed *Turners* to differentiate itself away from the competition.

Process involves the ability of *Turners* to successfully allow customers to book and pay for services offered. Currently, the online booking system is slow and unreliable and this will impact on the process element of the mix and impact on customer service, which from the point above is also under threat. The interaction between the customers and the staff can also be explained as process. It is clear from the stimulus that guests judge their experience based on the interaction with the staff, hence this element of the marketing mix is also very important.

Again, given the intangible nature of a service, a high quality hotel with price skimming such as *Turners* will also depend on the physical evidence (surroundings) to reinforce its positioning. Untidy leisure facilities and an overbooked restaurant will hardly help the positioning/perception of the hotel. Importantly, business customers are indicating that the competition is offering improved services for no extra charge. Shane will have to address this issue quickly.

Mark as 2+2+2.

Award [**1 mark**] for the importance of each P described, award an additional [**1 mark**] for the development of the response and application to *Turners* up to a maximum of [**2 marks**] for each P.

(d) **Examine the usefulness for *Turners* of using Handy’s shamrock organization. [6 marks]**

Handy’s shamrock organizational structure could be applied and examined in the following way:

- **Core Staff** – Shane retains a group of experienced managers as well as employees to perform the core important tasks at *Turners*, to ensure that the positioning and traditions of *Turners* remain intact. The core employees will benefit from job security and a career path which is highly motivating. It is hoped that the increase in motivation will result in the much needed improvement in the quality of the service and should enable *Turners* to retain older customers who may have become frustrated with the declining levels of customer service. However, the core employees are likely to be paid a relatively higher wage which might mitigate the original reason for the change in structure.
- **Part-time / peripheral** staff may allow *Turners* to introduce greater flexible working opportunities, allowing *Turners* to offer additional business services 24/7 to compete with the newer hotels in the area. Moreover, the flexible worker with only a short-term contract without many other benefits and rights are definitely cheaper for *Turners*. Shane will be able to cut costs as well as improve the flexibility needed for the cyclical nature of the hotel business.

However, the lack of job security can severely impact on employee motivation. A sense of injustice may arise. The possible lack of motivation may affect the quality of the service provided by those employees, which can cause a further deterioration of the service quality.

Culture clashes may occur between the permanent staff and the temporary ones who might not be able to grasp the USP and the unique way of operating / customer service at *Turners* with negative consequences on the service provided.

- **Contractors / subcontractors** could be employed to fix the Internet booking issues and any other IT issues in order to catch up with the competition. The subcontractors are not part of *Turners* and they are employed to carry out a particular project. Similarly, the training could be subcontracted as well, as suggested by Shane.

As the employees are paid by project, Shane might be able to negotiate a reasonable price and save a lot on costs. Even if a high price is paid for the expertise, it is only temporary as these employees are not on the payroll of *Turners*. Still, these external employees might not be familiar with the culture of *Turners*.

The short-term disruption to *Turners*’ and Shane’s routines in addition to costs of re-organizing and monitoring the new working patterns will be considerable. Profits at *Turners* may fall in the short term due to the introduction of the shamrock. Job descriptions will need to be redrawn and there will be inevitable redundancies of some key established workers. This may impact on the goodwill of the business and could have some de-motivating influences on the remaining staff.

Accept any other relevant argument.

N.B. It is **not** expected that the candidates incorporate all of the above points/issues.

If the candidate incorporates/describes the three elements/“leaves” of the shamrock organization, but, does not attempt to examine and apply any advantages or disadvantages award [**1 mark**].

If the candidate incorporates the three elements/“leaves” of the shamrock organization and attempts to give some generic examination with no linkage to the “leaves”, award up to a maximum of [**2 marks**].

If one part of the shamrock organization is overlooked, award up to [**4 marks**] even if the response is balanced.

For a full explanation of each of the “leaves” with relevant application, but the response is one sided, award up to [**4 marks**].

For [**6 marks**] it is expected that the candidate incorporate the three parts of the shamrock organization and provide any, but at least two arguments for and any, but at least two arguments against.

To achieve the top markband, candidates need to refer to the three elements/“leaves” of the shamrock organization.

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

(e) Evaluate whether *Turners* should outsource its staff training programme. [9 marks]

Outsourcing *Turners'* training programme, which is currently on-the-job, will allow Shane Peterson to focus on the key competitive issues, such as marketing/strategic planning and the state of its IT provision facing the hotel. Currently, *Turners* is facing increased competition and other changes in the external environment that are negatively affecting the established hotel.

The issues against outsourcing the training programme revolve around finding a suitable agency to run the programme that will be able to meet the high standards demanded by Shane. Shane should be able to find a reputable company that provide an excellent training programme.

Business customers who have complained about the level of customer service may be reassured that by outsourcing the training of future employees Shane is serious about providing the latest and possibly most effective level of customer service. By communicating with its stakeholders that the training programme will better the level of customer service will protect *Turners'* current positioning.

The above can be seen as a very significant argument in favour of this option.

Moreover, the training provider that *Turners* outsources to is likely to experience economies of scale and hence be cheaper than in-house training. It is said in the stimulus that *Turners* will see a 9 % cut in training costs while improving quality. It is evident that the current on-the-job training method is no longer effective.

The employee might be exposed to new and even higher standards of customer service by an outsider to improve on their current deficiencies and further enhance future USP.

However,

Would *Turners* wish to risk handing over customer service to a third party. How will the quality be monitored? With the number of complaints rising about overbooking and the business services, outsourcing the training function may add to employee anxiety. What other services will be outsourced in future?

Moreover, some employees who were trusted with the training may feel demoted, or feel that the job enlargement has been taken away from them, with some consequences on their motivation that can further deteriorate the quality of customer service at the hotel. Perhaps this argument is of less significance as there are clear deficiencies with the current training.

Conclusions/judgment

It appears as if the arguments for the option of outsourcing are of more significance than the arguments against, given the current problem that the hotel is facing. Shane needs to take action now, in the short run, to turn the fortunes of the hotel around. By reducing costs and improving customer service, some of the issues will be addressed, but there is a significant risk of uncertainty and further de-motivation given the number of changes Shane is proposing. Clear communication around the intentions of the move to outsourcing will be needed.

Despite possible resentment from some employees in the short run, in the long run the quality of the service will increase and other opportunities can be given to employees to further develop their skills and interest.

Moreover, the outsourcing of the training programme fits very well with the structural strategic changes proposed. Shane should outsource.

Accept a different recommendation / evaluation as long it is applicable and substantiated.

N.B. accept the use of the term subcontracting in the candidate's response.

Given the command term, a judgment is expected.

A balanced response is one that covers at least **two** relevant issues for and at least **two** relevant issues against.

For one relevant issue that is one-sided, award up to a maximum of **[3 marks]**.
For more than one relevant issue that is one-sided, award up to a maximum of **[4 marks]**.

Award a maximum of **[5 marks]** if the answer is of a standard that shows balanced analysis and understanding throughout the response with reference to the stimulus material but there is no judgment/conclusion.

Candidates cannot reach the **[5–7]** markband if they give judgment/conclusions that are not based on analysis/explanation already given in their answer.

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

4. (a) **Define the term *public limited company*.** [2 marks]

A public limited company (plc) is an incorporated organization in the private sector, which is allowed to be quoted / listed on the stock exchange. A plc has a widespread of owners all with limited liability.

N.B. It is expected that the candidate mentions more than just sells shares in the stock exchange, see some suggestions above.

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

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

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

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

(b) **Describe the method of growth used by the proposed merger.** [2 marks]

The method of growth suggested in the stimulus is external / inorganic growth. Such growth comes from outside the business by **acquiring** a stake in, **or merging** with another firm. (In the stimulus *Walgreens* has made an offer to acquire a 45% stake in *Alliance Boots*).

It is not expected that the candidates cover the benefits or otherwise of such a method.

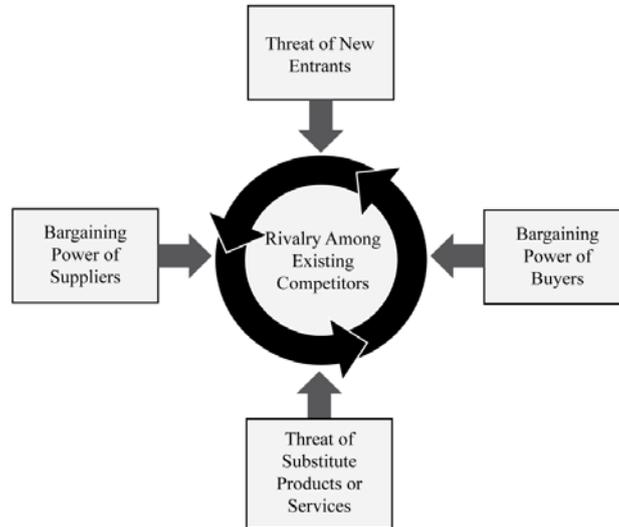
N.B. If a candidate describes, but does not use the term “external growth” or “inorganic”, award [1 mark] for a different description, for example of horizontal growth / integration.

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

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

- (c) Explain the changes to *two* of Porter’s five forces resulting from the proposed merger. [6 marks]

The Five Forces That Shape Industry Competition



[source: “The Five Competitive Forces that Shape Strategy” by Michael E. Porter, Harvard Business review, January 2008]

It is not expected that the candidate draws the model to answer this question, but a short explanation of the essence of the model is expected. Candidates can choose **any** two of the five forces, provided they explain the changes in relevant and applicable ways.

The creation of the world-leading pharmaceutical chain of more than 11 000 stores could potentially reduce the bargaining power of the buyer, especially in the UK and perhaps in the US. The reason why is the newly formed organization’s ability to determine / affect price in the market to a large extent.

The combined resources and specific knowledge in R&D, distribution and retailing might erect barriers to entry to other pharmacies / drug store companies hence the ease of entry will become lower. The threat of new entry which is relatively low anyway due to significant start-up costs in this industry will be further reduced.

If *Alliance Boots*’ own brand products are introduced to the US market and are well respected by the customers, one may argue that the availability of substitutes in the eyes of *Walgreens*’ customers may reduce by the creation of the USP and differentiation.

The bargaining power of various suppliers may be reduced. The newly formed company is likely to purchase a large amount of ingredients and be able to negotiate a very good price. The ability to distribute medicine in 11000 stores may allow irresistible opportunities for the suppliers of ingredients. Hence lower prices for the new company.

The integration of the two large organizations will reduce the competitive intensity in the market.

Accept any other relevant explanation with application.

N.B. Do not penalize candidates that use other terms apart from merger, such as acquisition of 45 % of the company.

Accept different arguments / explanation regarding the competitive nature of the industry. For example, competitors may be able to maintain the bargaining power of suppliers, buyers, threat of substitutes. One may argue that the ability of each company to put its own products in each other stores may actually increase the availability of substitutes for consumers.

Mark as 3 + 3.

Award [**1 mark**] for identifying each appropriate change to the relevant force, [**1 mark**] for an appropriate explanation and [**1 mark**] for a further development of this explanation with reference to the organization. Award a maximum of [**3 marks**].

Award up to a maximum of [**2 marks**] for each change to the force explained if no relevant reference is made to the stimulus material.

(d) Examine the claim that the merger would result in “increased internal economies of scale”.

[6 marks]

On one hand, one can argue that the merger will indeed result in increased internal economies of scale and the average cost per unit of the combined organization will fall as scale of production increases. A joint marketing/advertising strategy can lead to marketing economies of scale. A jointly implemented promotion strategy can significantly reduce costs per unit given the global reach / larger number of customers; as well as purchasing economies of scale created due to very strong bargaining power of the combined large organization. Together they will be able to secure cheaper prices from the suppliers of the medicines, or any other product sold in both chains. Moreover, financial economies of scale can be created as the bigger organization should be able to secure, if needed, more loans in more favourable terms for the planned expansion strategies into China and other countries.

Accept any other type of economies of scale provided each type is relevant and applied to the newly formed organization and the specific industry.

However, diseconomies of scale can be created due to the large size of the new organization. Managerial diseconomies in particular due to break of communication and coordination between the various administration offices, distribution centres *etc*, located in at least two continents and stores in different countries, the issue of control which are raised by the opponents.

Motivation of employees may also be reduced due to the fact that they will be working for a large organization with less direct relationship between management and employees and with other employees. Inefficiency will contribute to higher average costs

Some cultural clashes between the American and the British way of running a business can be created between the managers as well as between the employees which could cause miscommunication, inefficiency and possibly diseconomies of scale.

Accept any other relevant and applied argument.

To achieve the top markband candidates must give a balanced analysis of **two** relevant internal economies of scale and **two** relevant internal diseconomies of scale.

It is expected that the candidates explain, not just assert, how unit costs are reduced for their chosen types of economies and diseconomies of scale.

A specific classification for **internal economies of scale** is expected. For diseconomies of scale, accept relevant issues and examples – specific categorization might not be given

For one relevant issue that is one-sided, award up to a maximum of **[3 marks]**. For more than one relevant issue that is one-sided, award up to a maximum of **[4 marks]**.

For one relevant internal economy of scale and one relevant internal diseconomy of scale award **up to** a maximum of **[4 marks]**.

For a relevant generic/theoretical response with no application at all, award up to **[4 marks]**.

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

- (e) **Discuss whether the proposed merger of *Walgreens* with *Alliance Boots* will result in the positive outcomes stated (apart from economies of scale).** [9 marks]

It is expected that the candidates will use the information provided to base their applicable response, but then go beyond just the information provided. Candidates should not just reproduce some points mentioned in their previous answer as there may be a slight overlap, but this should be minimal. It is also expected that the candidate looks at the two companies for their discussion/evaluation.

Possible arguments in favour:

For *Walgreens*:

A synergy can be created between the two organizations. There are examples provided for the candidates to use. *Walgreens* can benefit from product development due to the R&D as well as the introduction of *Alliance Boots*, a reputable brand in the UK, into the US. One can also judge the move as possible related diversification. *Alliance Boots* can also provide enhanced manufacturing capability and improved customer service, for example, the 3 extra Ps – people, process and physical evidence which are relevant for retailers.

Alliance Boots has considerably higher number of ready-made outlets for *Walgreens* to use. This is a quick and relatively cheaper option to expand globally. *Walgreens* can benefit from quick entry to Europe and beyond – market development strategy.

For *Alliance Boots*:

It is a friendly merger. There should not be much if any resistance to change / to the merger / acquisition as the decision had to be approved by all of the private shareholders anyway.

Alliance Boots can benefit from immediate market development strategy to the US market which can enhance future profit. The shareholders of *Alliance Boots* clearly sees many benefits, especially less reliance on the stagnated European markets and possible future marketing expansion into other continents with the finance provided by *Walgreens*.

However, regarding *Walgreens*:

Will *Walgreens* be able to purchase part of *Alliance Boots* given the 10% fall in its sales? Analysts believe that the friendly merger is not the right strategy for the organization. They suggest that *Walgreens* need to pursue a different strategic move.

With a 45 % stake, *Walgreens* may not be able to push through any changes not acceptable to *Alliance Boots*.

Why are the shareholders not satisfied? Being a plc, *Walgreens'* CEO and its executives must pay attention to the investors' opinion. Dissatisfaction may lead to further sale of shares and a further fall in market value. The new group may be subject to takeover by a different company, pharmaceutical or retailer. Cultural clashes or rather misunderstandings between the management and possibly staff in the UK and the US. Stakeholders are strong, significant and powerful and the management need to listen to their opinion about this strategic move.

Regarding *Alliance Boots*:

The organization may lose its brand image / positioning as a reputable British drug store. A fall in the share price and possibly a further decline in *Walgreens* revenue may result in *Alliance Boots* not being able to pursue its **market development** strategy into China and South America. Diseconomies of scale can occur but it is not expected that the candidate will elaborate on this issue given the previous question.

Conclusions / evaluation

Candidates can provide any judgment provided it is well supported and hence substantiated. It is crucial however, that candidates provide substantiated judgment not just some repetition of previous arguments.

A candidate may judge that one organization is likely to benefit overall and another candidate may judge otherwise not. The exact nature of judgment is not really important. What is important is the strengths of the arguments and the candidates' ability to incorporate relevant issues, their significance, from which stakeholders' point of view and so on. Provided the above is done, credit any judgment.

N.B. It is **not** expected that the candidates incorporate all of the above points/issues.

A balanced response is one that covers at least **two** relevant issues for and at least **two** relevant issues against.

For one relevant issue that is one-sided, award up to a maximum of **[3 marks]**. For more than one relevant issue that is one-sided, award up to a maximum of **[4 marks]**.

Award a maximum of **[5 marks]** if the answer is of a standard that shows balanced analysis and understanding throughout the response with reference to the stimulus material **but** there is no judgment/conclusion.

Candidates cannot reach the **[5–7]** markband if they give judgment/conclusions that are not based on analysis/explanation already given in their answer.

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

5. (a) Define the following terms:

(i) *family branding*

[2 marks]

Family branding can be formed as part of a marketing strategy that involves selling several related products under one brand name. (Family branding is also known as umbrella branding).

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

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

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

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

(ii) *contribution to fixed costs.*

[2 marks]

Contribution to fixed costs refers to the difference between the sales price of one unit of production and the variable costs needed to make that unit of production. The difference between the two is “how much” each sale (per unit) contributes to the payment of fixed costs.

If a candidate writes the formula for calculating contribution, but does not define the term, award [1 mark].

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

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

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

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

- (b) **With reference to *MTC*, explain the difference between objectives, strategies and tactics.** **[6 marks]**

An objective is where the business wants to be in the future, its goals. Objectives can be strategic – long term, tactical – medium term and operational – short term and are often SMART. The objective for *MTC* is to increase revenue.

A strategy is how the organization *MTC* is going to get there. A strategy is a broad plan of action used by an organization as to how to achieve its aims and strategic objectives. It usually involves long-term, overall corporate decisions.

Accept any strategy mentioned in the stimulus.

Tactics are concerned with **smaller-scale and/or short-term** decisions, or actions, aimed at reaching more limited and measurable goals. Tactics are set to facilitate strategies.

Accept any tactic mentioned in the stimulus.

Given the nature of the question, please do not penalize information directly quoted from the stimulus material.

Accept any other relevant explanation.

Mark as 2+2+2.

Award **[1 mark]** for identifying/defining each element and **[1 mark]** for an appropriate explanation with reference to *MTC*. Award a maximum of **[2 marks]**.

- (c) **With reference to *MTC*, examine the dynamic nature of organizations and the relative importance of driving and restraining forces.** [6 marks]

MTC, like any other organization that is facing new challenges, both internally and externally, suggests the needs for change. Indeed the Managing Director, Seb and the Marketing Director Tina, identified the need to change and to respond to the challenges in the external environment. One can therefore say, given the stimulus, that *MTC* is operating in a very dynamic environment.

Factors for change (driving forces):

- Increasing competition: if nothing is done, it represents a threat to the business.
- Falling contribution from restaurant may have impact on profits.
- Overworked / stressed workforce may reduce quality of service and hence the number of members.

Factors causing resistance to change (restraining forces):

- The objection of Alex as well as the employees who are already overworked. Stressed employees will be unmotivated with further deterioration in service quality.
- Membership is already at saturation point – *MTC*'s management should be worried about the negative impact on the atmosphere of the club. Current members might leave if more members are to join as the atmosphere of the club and the exclusivity of the service might be eroded.

Accept any other driving force for change and restraining forces causing resistance to change with relevant explanation and application.

It is expected that the candidates go beyond the regeneration of the stimulus material and fully explain each driving and restraining forces.

Candidates are not expected to draw the Lewin model.

For one relevant force (either driving or restraining) explained, award up to a maximum of [3 marks]. For more than one relevant force with no examination (either driving or restraining), award up to a maximum of [4 marks].

For full marks, a minimum of **two** well-explained relevant driving forces and **two** well-explained relevant restraining forces are expected.

N.B. This question asks for examination, hence evaluation / substantiation is not required as perhaps the wording of the question might imply when asking for the relative importance. Award a maximum of [5 marks] if there is no reference at all to the importance of the forces.

If only the Lewin model is presented as a list with some arrows and possibly figures without explanation, award a maximum of [2 marks].

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

- (d) **Discuss the likely success of Seb’s five-year plan to achieve an increase in revenue for *MTC*.** [9 marks]

Arguments suggesting that Seb’s five-year plan might be successful:

- Five years is quite a long time to make changes. The employees, managers and possibly members will have time to adjust. The plan could be adapted throughout the years if needed. Tina’s tactics look achievable over a long time period.
- Some of the changes are relatively easy to make, *eg* opening the restaurant to the general public, opening a shop. These changes are unlikely to affect *MTC*’s culture and corporate image.
- Seb seems to be a person with drive. He has Tina on his side. Management unity to start with, is likely to result in a smoother implementation of any strategic plans. Moreover, collaboration and consultation between the two managers is likely to result in: a better understanding of the situation, better and possibly more varied strategies and better implementation.
- With a clear plan, *MTC* might be able to raise funds more easily from investors or financial institutions.

Arguments against:

- The competitor, *Best Sport*, being a MNC with probably better and more funds, can easily react to the strategies and tactics used by *MTC*, especially in terms of promotion and price reduction. A price war with a MNC could destroy *MTC*.
- Employees and the HR Manager are worried about stress level and low wages. A lack of motivation can seriously affect the performance of the employees who are vitally important in this kind of business / service.
- How successful will the tactics be? For example would decreasing membership fees increase revenues? Depends on elasticity.
- How effective is social networking and advertising?
- Has *MTC*’s management, researched if there is a market for over 60s and young people? The market might not be sufficient.
- The idea of family branding might not be viable. How effective is the branding? Could the brand image be negatively affected if any of the new ventures are a failure.
- Given the fall in contribution and higher break-even point before profit is made, will *MTC* have sufficient funds? Borrowing might result in further financial difficulties.
- Alex’s resistance to change might impact on the implementation of the strategies. He is the HR Manager and people/employees hold key roles in running a tennis club.

Accept any other relevant argument with an appropriate discussion.

Conclusions/ judgment:

It appears that the strategies and tactics suggested, despite some acceptable objection on behalf of the HR Manager, seem achievable and realistic. They are not extremely drastic, hence likely to be overall successful especially if implemented incrementally over the designated 5 years. Tactics especially are easy to change and the overall objectives of *MTC* do not seem to be objected by any. The HR Manager is worried about the employees being overworked, overstressed and underpaid. These issues can be resolved rather easily with negotiation, recruitment, flexible working *etc.* Hence the 5 year plan is likely to be a success albeit perhaps not brave and risky enough.

Accept any other relevant and substantiated conclusion.

Candidates are not expected to include in their response all of the issues above.

A balanced response is one that covers at least **two** relevant issues for and at least **two** relevant issues against.

For one relevant issue that is one-sided, award up to a maximum of **[3 marks]**.
For more than one relevant issue that is one-sided, award up to a maximum of **[4 marks]**.

Award a maximum of **[5 marks]** if the answer is of a standard that shows balanced analysis and understanding throughout the response with reference to the stimulus material but there is no judgment/conclusion.

Candidates cannot reach the **[5–7]** markband if they give judgment/conclusions that are not based on analysis/explanation already given in their answer.

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