Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

BUSINESS **9609/32**

Paper 3 Case Study **February/March 2017**

3 hours

No Additional Materials are required.

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READ THESE INSTRUCTIONS FIRST

An answer booklet is provided inside this question paper. You should follow the instructions on the front cover of the answer booklet. If you need additional answer paper ask the invigilator for a continuation booklet.

Section A
Answer **all** questions.
Section B
Answer **one** question.
You are advised to spend no more than 40 minutes on Section B.
The businesses described in this question paper are entirely fictitious.

The number of marks is given in brackets [ ] at the end of each question or part question.

This document consists of **6** printed pages, **2** blank pages and **1** Insert.

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Saujay Airlines (SA)

SA is a public limited company. Its Head Office is in the capital of a large Asian country, which includes a number of islands. SA is a budget airline and uses a fleet of identical aircraft. Its affordable prices are the Unique Selling Point (USP) for economy class passengers, for whom no food or other extras are included in the ticket price. Economy class tickets are not flexible: they are non-refundable and reservations cannot be changed. A few seats on each flight are provided for business travellers who pay higher prices for larger reclining seats, flexible bookings, 'fast track' check-in, in-flight Internet access and meals.

SA has grown quickly in recent years due to increasing demand for air travel between cities and holiday resorts within its home country. Demand on the popular holiday routes is seasonal, so SA provides extra flights during holidays and festivals.

All bookings are made over the Internet through SA's own website. SA has a good reputation for punctuality and service and has excellent reviews by customers on travel websites.

Economic changes and prospects

The economy in SA's home country has been growing steadily in recent years, but this growth is forecast to slow over the next three years. Unemployment is low and the Government is concerned that inflation may increase if unemployment continues to fall. Current and forecast economic data are shown in Appendix 1. Over the last two years, the currency of SA's home country has been appreciating against the euro and other major currencies. The Government is keen to increase both overseas visitors and businesses to the country. It offers grants and subsidies to encourage companies to provide tourism and other related services.

Expansion of the aircraft fleet

The Board of Directors is now considering whether to expand the airline further, in order to fly to international destinations in neighbouring countries and Europe. This will require the purchase or leasing of two new aircraft. Each new aircraft would cost $40 million to purchase, including the cost of painting in SA's colours. The Finance Director reported that this would need to be fully financed by additional bank borrowing. Alternatively, the leasing cost would be $4.6 million for each aircraft, per year, plus the cost of painting the aircraft with SA's colours. New aircraft will normally be kept in service for 6 years, with a residual value estimated at $12 million for each aircraft. The forecast net cash flow for purchasing and discount factors are shown in Appendix 2.

International routes – capacity utilisation issues

To meet growing demand, SA would like to start flying to major cities in other countries. SA's Operations Director has been looking at the airline's capacity utilisation, in terms of the average number of seats sold in each class on each existing route. The current average levels are 99% in economy and 67% in business class.

The company's Marketing Director has carried out primary research, the results of which suggest that demand for business class travel will be higher on international routes than on the existing domestic flights. He has also obtained some secondary data from one of the large international airlines which suggests capacity utilisation in business class is high – in some cases at maximum capacity. However, it is also clear that SA would face competition from established airlines. At the most recent Board meeting, the Marketing Director emphasised that a detailed marketing plan would be essential for the launch of the new international routes.

The current arrangement on SA aircraft is 12 business class seats and 138 economy seats. The Marketing Director proposes that the new aircraft will have 126 economy seats and 16 business class seats. He believes that business travellers are more interested in convenience and comfort than low ticket prices. Proposed average ticket prices on the new international routes are $150 economy and $400 business class.

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SA's workforce planning

The Human Resources Director plans SA's workforce carefully. Senior pilots and managers are on full-time permanent contracts. However, many employees, including some junior pilots and cabin crew, are on flexible contracts such as part-time and zero hours. However, there is plenty of work available as demand for flights has been growing. There have been some employee complaints, as they feel that their conditions are less secure and rewarding than those offered by other airlines. Although the Human Resources Director sees the benefits to SA of a flexible workforce, he is also aware that in order to recruit and retain experienced junior pilots and cabin crew SA may have to offer full-time permanent contracts to these employees. He has also suggested to the other directors that it would be a good idea to offer loyalty bonuses to all employees.

Options for growth

SA's Board of Directors are considering alternative opportunities for growth. They have identified two possible strategic options, with a view to increasing long term profitability.

Option A: The expansion of SA into the market for international flights, starting with the purchase or lease of additional aircraft as outlined earlier in the case.

Option B: The development of a range of budget hotels, starting by organising a joint venture with a well-known hotel chain in SA's home country, but with further plans to expand to neighbouring countries. The hotels would be promoted and rooms booked through SA's existing website. Initial investment would be $70m, to be financed equally between SA and the joint venture partner.

SA's Managing Director plans to use strategic choice techniques to decide between the growth opportunities and has asked each department within SA to contribute information.

SA's Board of Directors is becoming aware of the increasing level of risk for the company as it grows. The directors have read annual reports from similar companies that identify significant additional costs caused by unforeseen events such as computer problems and very bad weather. The Managing Director has asked the Board to review SA's contingency plans.

Appendix 1: Economic data for SA's home country

	Current year	Average forecast for the next three years
Growth in real Gross Domestic Product (GDP)	6%	4%
Unemployment	8%	6%
Inflation	7%	9%
Interest rates	11%	14%
Currency – change in value against the euro	2% appreciation	1% appreciation

Appendix 2: Forecast net cash flows if two new aircraft are purchased

Year	Net cash flows $m
0	(80)
1	8
2	12
3	15
4	20
5	30
6	54*

*Year 6 net cash flow includes residual value

Yearly discount factors at discount rate of 12%:

Year	1	2	3	4	5	6
Discount Factor	0.89	0.80	0.71	0.64	0.57	0.49

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Appendix 3: Extract from SA's latest published accounts

Statement of financial position as at 31 December 2016	**$m**
Non-current assets:	
Land	115
Buildings	205
Vehicles including aircraft	600
Intangible assets	70
Total non-current assets	990
Net current assets	138
Non-current liabilities	348
Shareholders' equity	780
Income statement for year ending 31 December 2016	
Revenue	850
Profit for the year	56

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[Turn over

Section A

Answer **all** questions in this section.

1 Analyse the likely opportunities and threats to SA of the forecast economic changes given in Appendix 1. [10]

2 **(a)** **(i)** Refer to Appendix 2. Calculate the net present value (NPV) for the purchase of the two new aircraft. [4]

(ii) Refer to Appendix 3. Calculate the new gearing ratio for SA if $80m is borrowed to purchase two new aircraft. [4]

(b) Refer to your results from part **(a)** and other information in the case. Recommend whether SA should purchase or lease the two aircraft. [14]

3 To what extent could a detailed marketing plan lead to a successful launch of SA's proposed new international routes? [16]

4 **(a)** Refer to the information on lines 32–34 and 42–46. Assume the average capacity utilisation will be the same on the proposed international routes as on domestic flights. Calculate SA's forecast average total revenue for one international flight. [6]

(b) Refer to your answer from part **(a)** and other information in the case. Discuss whether SA should offer more seats for business travellers on the proposed new routes. [12]

5 Evaluate the use of flexible employment contracts for SA's future success. [14]

Section B

Answer **one** question in this section.

6 Discuss the importance of contingency planning if SA is to continue to be successful. [20]

7 Evaluate the **techniques** that SA could use to make the strategic choice between the two options for growth. [20]

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