Cambridge International A Level

**Cambridge International Examinations**
Cambridge International Advanced Level

**BUSINESS** **9609/33**

Paper 3 Case Study **May/June 2016**

MARK SCHEME

Maximum Mark: 100

**Published**

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**1 Analyse the benefits to XM of using a 'soft' approach to human resource management.**

**[10]**

| Level | Knowledge<br>3 marks | Application<br>3 marks | Analysis<br>4 marks |
|---|---|---|---|
| 2 | 3 marks<br>Knowledge shown of soft HRM and two benefits identified | 3 marks<br>Issues well applied to XM | 3–4 marks<br>Good use of reasoned argument or theory to consider benefits of soft HRM |
| 1 | 1–2 marks<br>Knowledge shown of soft HRM and/or benefit(s) | 1–2 marks<br>Some attempt to apply concept to XM | 1–2 marks<br>Some use of reasoned argument or theory to consider benefits of soft HRM |
| 0 | No creditable content | | |

Examiner notes:
- No marks for disadvantages
- Benefits to XM not to employees

Definition of soft HRM – an approach to human resource management that involves employees in decision making and allows employees greater control over their working lives.
Benefits may include:

- As XM competes in a high technology market it may be important to encourage employees to contribute ideas to the business to ensure that the business is more dynamic. Cell phones are a competitive market and as such XM must remain competitive.
- Employees in R&D may respond to having more autonomy in a positive way and be more motivated as a consequence of this approach.
- This is a fast changing market and the XM need to be able to adapt to change quickly. A soft approach may encourage a more flexible and adaptable workforce.
- Employees involved in product development will be highly skilled and are less likely to respond well to authoritarian approaches.
- Reference may be made to theorists such as Maslow and Herzberg as providing support for democratic management.
- High investment in training and development of employees will increase their productiveness and effectiveness.
- The approach may reduce the costs of labour turnover and encourage lower rates of absenteeism. This will reduce costs of XM – this is important as the business competes on price.
- Use of a share option scheme encourages motivation and gives employees a stake in the business.
- XM aims to be an innovative brand. Employees are essential to achieving this goal.

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**2 Discuss the importance of research and development (R&D) to XM's future success in the smartphone market. [14]**

| Level | Knowledge<br>3 marks | Application<br>3 marks | Analysis<br>4 marks | Evaluation<br>4 marks |
|---|---|---|---|---|
| 2 | 3 marks<br>Knowledge shown of R&D and benefits / drawbacks | 3 marks<br>Points well applied | 3–4 marks<br>Good use of reasoned argument or theory to explain the role of R&D in XM's success | 3–4 marks<br>Good judgement shown in answer and conclusion |
| 1 | 1–2 marks<br>Knowledge shown of R&D and/or benefits | 1–2 marks<br>Some attempt to apply | 1–2 marks<br>Some use of reasoned argument or theory to explain the role of R&D in XM's success | 1–2 marks<br>Some judgement shown in answer and/or conclusion |
| 0 | No creditable content. | | | |

Definition of R&D – refers to scientific research and technological development.
Candidates may develop some of the following arguments:

- Smartphones are constantly being developed with the addition of new features and faster processing power. Technical performance of phones improves rapidly.
- In such a dynamic market phones quickly become outdated leading to falling demand, prices and revenues. Therefore it is important for XM to develop new models constantly to remain competitive.
- XM aims to be an innovative firm rather than a copycat firm. R & D is essential to innovation.
- Successful R&D gives XM a competitive advantage and will allow them to gain control over price. Demand will be less price elastic as a result.
- Innovation will strengthen the XM brand image and boost sales.

However,

- R&D adds considerably to costs and is not guaranteed to be successful as other firms may gain first mover advantage through their own research. In such a market an alternative approach is to allow other firms to develop new technologies and then to copy that technology. This would enable XM to reduce costs and therefore prices to gain market share.
- XM may struggle to compete as much larger firms may have greater access to finance for R&D. To be competitive XM may need to spend more on R&D as a proportion of sales than their competitors.
- As a growing firm XM faces many demands on its finances.

<u>Evaluation:</u>

- How important is it for XM to have cutting edge products to continue to grow?
- Other factors will also be critical. R&D is important but XM must anticipate and respond to market changes.

Note: If R&D is defined as market research then a candidate is not answering the question. They must either define R&D accurately or imply through their arguments presented that it is actually scientific research and technological development that is being discussed.

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**3 (a) Refer to Appendix A. Calculate for 2015:**

**(i) dividend yield** **[3]**

Dividend per share = \$25m/100m = \$0.25 (1 mark)

Dividend yield = $\frac{\text{dividend per share}}{\text{current share price}} \times 100$ (1 mark)

= $\frac{0.25 \times 100}{15} = 1.67\%$ (3 marks)

Accept 1.6 or 1.7 for 3 marks

Own Figure Rule (OFR) applies

**(ii) price earnings ratio.** **[5]**

PE Ratio = $\frac{\text{current share price}}{\text{Earnings per share}}$ (1 mark)

Earnings per share = $\frac{\text{Profit after tax}}{\text{Total number of shares}}$ (1 mark)

EPS = 220m/100m = 2.2 (2 marks)

Price earnings ratio = 15/2.2 = 6.82 (5 marks)

Accept 6.8 or 7

OFR applies

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**(b) Refer to your answers from (a) and other relevant information. To what extent should the shareholders of XM be pleased with the company's financial performance in 2015? [16]**

| Level | Knowledge 3 marks | Application 3 marks | Analysis 5 marks | Evaluation 5 marks |
|---|---|---|---|---|
| 2 | 3 marks Good knowledge shown of financial performance | 3 marks Points well applied | 4–5 marks Good use of reasoned argument or theory to explain shareholder view of XM's financial performance | 4–5 marks Good judgement shown in answer and conclusion |
| 1 | 1–2 marks Knowledge shown of financial performance e.g. different measures | 1–2 mark Some attempt to apply | 1–3 marks Some use of reasoned argument or theory to explain shareholder view of financial performance | 1–3 marks Some judgement shown in answer and/or conclusion |
| 0 | No creditable content. | | | |

A range of financial ratios can be used to analyse the success of XM from the perspective of shareholders.

Shareholders are the owners of the business and shareholder value is represented by the increase in the value of shares and by the dividend received.

Answers may include:

- The business is profitable and post-tax profits have increased by $70m between 2015 and 2016. Shareholders are interested in profit as it will affect share price and the ability of the firm to increase dividends paid.
- Operating PM has increased from 11.13% to 12.2%.
- [Operating PM = operating profit / revenue × 100]
- ROCE has increased from 4.2% to 5.3%.
- Dividends have risen to $25m but there has been a fall in the dividend yield to 1.7%. Shareholders may be disappointed that the firm is not returning more dividends to them.
- The PE Ratio has increased slightly to 6.8. This suggests that the market is confident about the future ability of XM to generate profits. The higher the PE ratio the more confident are investors.
- There has been a substantial increase in the share price of 50%. This is good for shareholders who will make a capital gain if they sell their shares.
- XM has suffered from cash flow shortages in the past and there is some evidence of limited working capital in the business currently. The quick ratio has deteriorated to 0.82 and this means that for every $1 of short term debt the business only has $0.82 of liquid assets. Does this suggest that the business faces potential liquidity problems – particularly as they have ambitious plans for expanding internationally and launching new products?

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Evaluation:

- This is a relatively new business that has entered a difficult market. Sales growth has been substantial and revenues grew by 1/3 over the last year. This is an excellent performance considering how competitive the market is.
- Xiang and other shareholding directors may not be interested in short term dividend payments. The low dividend yield is not a problem and they may be more focused on the growth of the business and its market share.

**4 Refer to Appendix B and other information. Discuss the changes that XM might need to make to its current marketing strategy when entering the market in country Z. [16]**

| Level | Knowledge<br>3 marks | Application<br>3 marks | Analysis<br>5 marks | Evaluation<br>5 marks |
|---|---|---|---|---|
| 2 | 3 marks<br>Good knowledge shown of marketing strategy | 3 marks<br>Points well applied | 4–5 marks<br>Good use of reasoned argument or theory to explain changes to the marketing strategy | 4–5 marks<br>Good judgement shown in answer and conclusion |
| 1 | 1–2 marks<br>Knowledge shown of marketing strategy | 1–2 marks<br>Some attempt to apply | 1–3 marks<br>Some use of reasoned argument or theory to explain the changes to the marketing strategy | 1–3 marks<br>Some judgement shown in answer and/or conclusion |
| 0 | No creditable content | | | |

Definition: Marketing strategy – the plan of how the marketing objectives are going to be achieved

Answers could include:

Identification of the existing marketing strategy: low prices; sold direct to customers; well specified product; low marketing costs with little advertising and use of social media to promote products.

Pricing: A number of factors point to the importance of a low pricing strategy.

As median household income is 20% lower in country Z this would suggest that a low price strategy may be required as used in Country Y.

The market is dominated by the leading brand. Strong brand loyalty may exist and therefore XM will need to offer low prices to attract customers.

With ambitious target sales of 2m units in 2017 penetration pricing might be appropriate. This represents no change in the current pricing approach.

Promotion: Success in country Y has been achieved with a low marketing budget. How feasible is this approach in country Z?

Internet access is significantly lower and thus use of social media may be less widespread.

There is a higher proportion of the population aged 20-34. This age group may be early adopters of new technologies so the market may change rapidly in the future. This could favour their existing strategy.

Will it be necessary to use other forms of promotion such as advertising in magazines or on television? This will have a much greater cost to XM.

Product: Smartphone ownership is much lower in country Z. Should XM release simpler phones for this market or will the low prices that XM charge enable the company to offer smartphones at prices competitive with more basic models?

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Place: XM has sold mainly online. However, due to low internet access is this the best strategy in country Z? Use of retailers is the dominant method of selling in country Z. It may be necessary for XM to use different channels of distribution to enter the market.

Evaluation:

- Changes may depend on the response from the established brand: aggressive marketing tactics or promotions by them could harm the impact of XM's entry at low price.
- How much budget will be available? It is likely that promotion will need to be more traditional given less internet access and media such as print or TV will be costly. Plus choice of media to reach 20–34 year olds will affect this.
- What margin will retailers/distributors ask? This could affect XM's ability to offer low prices or impact on their own margins – especially since the cost of distribution will already have added to cost of sales.
- Country Z has growing GDP and strengthening currency – the inevitable rise in demand for new technology is a strong motivation to enter the market no matter what.
- Overall – balance of changes to price and promotion will be most significant.

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**5 Discuss the extent to which external factors, such as those shown in Appendix C, could influence the future success of XM. [16]**

| Level | Knowledge<br>3 marks | Application<br>3 marks | Analysis<br>5 marks | Evaluation<br>5 marks |
|---|---|---|---|---|
| 2 | 3 marks<br>Good knowledge shown of external factors | 3 marks<br>Points made are well applied | 4–5 marks<br>Good use of reasoned argument or theory to explain influence of external factors | 4–5 marks<br>Good judgement shown in answer and conclusion |
| 1 | 1–2 marks<br>Knowledge shown of external factors | 1–2 marks<br>Some attempt to apply | 1–3 marks<br>Some use of reasoned argument or theory to explain influence of external factors | 1–3 marks<br>Some judgement shown in answer and/or conclusion |
| 0 | No creditable content | | | |

Definition: External factors – influences beyond the firm's control, including economic factors.

Using data from Appendix C answers could include:

- GDP growth leads to rising incomes therefore demand for mobile phones; GDP per capita is forecast to rise as economic growth is greater than the population growth. Impact depends on income elasticity of demand. In both country Y and country Z there is also significant room for the market to grow as smartphone ownership is 40% and 20% respectively and sales are expected to grow by 5% and 11.11% respectively – this could be partly due to growth in GDP.
- Inflation will have an important impact on costs and therefore pricing. Is inflation stable in country Y and country Z? Volatile inflation can disrupt markets and impact demand.
- The exchange rate will be important as XM will start exporting phones in 2017. Depreciation in country Y and appreciation in country Z will improve price competitiveness of XM. However, may lead to increasing manufacturing costs in country Y if components are imported.
- The increasing interest rates may dampen demand for goods and services and affect the mobile phone market adversely.

Other factors will also be important:

- Demographic changes such as the number of 20–34 year olds
- Technological change: this is a dynamic market and XM will need to keep pace with these changes. R&D will therefore be significant internal factor
- Risk of leading brands launching better and/or cheaper mobile phones.

However other factors will affect success apart from external ones:

- Skill of management
- Success of future R&D projects
- Motivation of workforce
- Leadership of management team.

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Evaluation:

- Exchange rate and GDP growth will be most significant in providing the competitive opportunity for their entry with low prices.
- Quick response from established brand with new developments or aggressive pricing strategy could erode those advantages.
- Success of distribution and supply chain efficiency will be important in good customer service and creating brand loyalty.

So external influences will be very important but are they are only one aspect of factors that will determine success of this business?

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**Questions 6 and 7 use this marking grid:**

| Level | Knowledge<br>3 marks | Application<br>3 marks | Analysis<br>4 marks | Evaluation<br>10 marks |
|---|---|---|---|---|
| 3 | | | | 7–10 marks<br>Good judgement shown throughout with well supported conclusion/ recommendation, focused on the business in the case |
| 2 | 3 marks<br>Good understanding shown | 3 marks<br>Good application to the case | 3–4 marks<br>Good use of reasoned argument or use of theory to explain points made | 4–6 marks<br>Some judgement shown in the main body of the answer and an attempt to support conclusion/ recommendation, focused on the business in the case<br>OR<br>effective and well supported conclusion/ recommendation, focused on the business in the case |
| 1 | 1–2 marks<br>Some understanding shown | 1–2 marks<br>Some application to the case | 1–2 marks<br>Limited use of reasoned argument or use of theory to support points made | 1–3 marks<br>Limited attempt to show judgement either within the answer<br>OR<br>a weakly supported conclusion/ recommendation with some focus on the business in the case |
| 0 | No creditable content | | | |

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**6 Refer to the strategic choice data in Appendix D and other information. Recommend to the Board of Directors of XM which one of the two options for future growth should be chosen. [20]**

Answers could include:

Reference to Ansoff's Matrix. Both options could be defined as diversification in Ansoff's matrix. Therefore, both options are potentially more risky than other possible alternatives for growth.

Decision tree analysis:

Option 2 has a lower chance of failure than Option 1 and has the higher expected monetary value. This favours Option 2.

But who conducted the DTA and over what time period are the estimates? There is significant room for error with this technique.

What is the financial outcome of failure in both cases?

The force field analysis also favours Option 2.

This highlights the potential benefit of using a core competence of XM – i.e. its design capability and knowledge of relevant technologies.

XM has no experience of manufacturing. Is the existing board of directors capable of turning a manufacturing business to profit?

However, a takeover of the smart TV manufacturer would provide an opportunity for producing XM smartphones. This could be a significant advantage as their current supplier has capacity shortages and recent quality has worsened. With continued expansion XM has to consider its supply chain and may need to find other suppliers very soon.

Development of a tablet will delay cash inflows for one year. XM's liquidity appears weak and thus they would need to ensure sufficient financing was in place for this development.

Investment appraisal:

The capital cost of Option 1 is less than half of developing a tablet. Financing Option 2 may be beyond XM especially as they are also expanding internationally in 2017. XM must be careful to ensure it has sufficient liquidity to achieve its objectives.

NPV is higher for Option 2 but is a lower rate of return.

Other data on investment appraisal would be useful e.g. ARR and payback.

How easy will it be for XM to turn round the Smart TV business? It has made losses for 3 years. However, the purchase price may reflect the problems faced. This could offer good value for money.

The tablet market is competitive.

The tablets may be a better fit with current products and will be able to utilise the apps that XM is already developing.

<u>Evaluation:</u>

- XM is innovative and its experience in the smartphone market may suggest that it can repeat that success in the tablet market which has considerable similarities and technology.
- Could XM asset strip Smart TV to finance Option 2 anyway?
- Major factor here will be finance – what is the likelihood and availability of finance for Option 2? Option 1 utilises less capital and can also integrate their current workforce skills and apps.
- How far ahead is it realistic to forecast in this kind of market? Will Smart TVs be replaced by wall mounted tablets?

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**7 XM operates in a dynamic market. Evaluate the importance of corporate planning for XM's future profitability. [20]**

Definition:
A corporate plan is a detailed report on a company's future long-term aims/objectives and the strategies it will follow to achieve them.

Answers could include:

- A corporate plan:
  - Gives direction to the business. The plan provides XM directors with a clear focus for what the company should be trying to achieve in the medium term.
  - Helps motivate staff. It provides a sense of purpose.
  - Enables planning at different levels of the business and ensures all staff are working towards the same goals.
  - Acts as a means for control and review. Actual outcomes can be compared with the objectives set and the performance of XM can be assessed.
  - Helps ensure that resources are used effectively and that all departments are working together.
- Definition of profitability.
- Comment on meaning of dynamic market applied to XM e.g. rapid technological change.
- The planning process itself is useful. It encourages directors and managers to consider the current situation of the firm and to set objectives accordingly.
- How dynamic markets may undermine plans.
- As there is a dynamic business environment therefore there is a need to adjust plans accordingly. Relevant changes could occur include: smartphone industry is innovative and changes rapidly, therefore corporate plans will need to be updated frequently.
- Potential link between profitability and having clear corporate plans.
- Planning of finance (sources and time-scales) will impact on expenses which can affect profitability.

<u>Evaluation:</u>

- Needs to be flexible and adaptable to meet new situations.
- Reliability of information – how much is spent on market research/data gathering and how relevant is it? Interpretation of information used in planning can be influenced by skills and training of leadership.
- Profitability is about margins: corporate planning may be too much of an overview and the impact on profitability may depend on how well the plan is communicated to managers lower down the hierarchy who will be implementing the plan to produce the profitability.
- May also be impacted by the authority/power the managers possess to adjust the plan in response to changes without needing to wait for decisions from the top.
- Planning is time-consuming and can be expensive.
- Monitoring and review essential to ensure costs are not increasing in this rapidly changing market.

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