Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

BUSINESS **9609/33**

Paper 3 Case Study **October/November 2016**

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 **5** printed pages, **3** blank pages and **1** Insert.

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Specialist Clothing (SC)

Bo is the Chief Executive Officer of SC, which is a public limited company. She has just left a Board meeting with other directors. They were discussing the two growth strategies which Bo has recently proposed. After several years of falling profits, SC has managed to reverse this trend by cutting production costs and increasing sales over the last 12 months. Bo now thinks that the economic and market environment is right for SC's expansion.

Product range

SC makes a very large range of specialist clothing for work and leisure. Examples of its range – all branded with the SC logo – include:

- Protective work clothing such as heavy duty jackets and trousers for construction workers (work clothing was SC's initial product when the company was set up 35 years ago but the company has now diversified)
- Lightweight leisure clothing for people who enjoy walking and cycling
- Ski clothing such as waterproof trousers and jackets to protect skiers and help keep them warm in very cold weather.

New material – new opportunities?

SC has recently purchased the patent and all manufacturing rights to an innovative new material that can be used for clothing. The material is called 'Weartex'. The inventors of this synthetic material claim that it is very lightweight, completely waterproof and windproof. It is also 'breathable' – this feature helps prevent the user from getting too hot when walking or running. It can be washed easily and dries very quickly. SC's marketing department is very excited about the opportunities Weartex will offer to SC.

'We can design and make a highly original range of clothing that can be worn by leisure customers for use in hot and cold climates' said Jin, the Marketing Director, to his fellow directors. 'We will need to differentiate these innovative products very carefully through our marketing plan. Potential consumers must not confuse these new products with our existing SC products and it must also be made clear that our competitors have no materials quite like Weartex. We should consider an impressive brand name for clothing made from Weartex.' Jin produced some marketing data about SC's existing range of leisure clothing and SC's nearest competitor for the Board to consider. The data is shown in Appendix 1.

Operational changes

Some lean production principles have been incorporated into SC's operations in recent years. The Operations Director has adopted the following approaches:

- Faster development and production of new clothing designs so they reach the market before competitors' similar designs
- Total Quality Management
- Just-in-time management of material and finished clothing inventories.

These changes have caused some problems with employees and their trade union representatives. One union official complained to the Human Resources (HR) manager in SC's largest factory in Asia: 'We always hear about the need for worker flexibility, retraining and increased productivity, but nothing is ever offered in return. I oppose further introduction of lean production approaches until workers can see the benefits too.'

Selecting a new Human Resources manager

The HR manager of SC's largest factory in Asia has found a better paid job at a large clothing manufacturer in the USA. Bo and the Operations Director have a shortlist of two people for this vacant post. Their details are given in Appendix 2.

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Should production be outsourced?

Ski clothing is subject to seasonal fluctuations in demand. SC manufactures all of its own brand ski clothing in its largest factory in Asia, which also makes SC's leisure clothing. Demand for leisure clothing increased significantly last year and Bo is worried that this factory will approach 100% capacity during the months when ski clothing production is at its highest. Bo has asked the Operations Director to investigate the implications of outsourcing the production of all SC ski clothing to a South American manufacturer called PSK. This business has offered to produce identical ski clothing for a cost to SC of $35 per unit. The Operations Director has produced the data shown in Table 1 to help him identify the implications of outsourcing.

Table 1: Data for ski clothing production at SC's largest factory in Asia

Direct material cost per unit	$12
Direct labour cost per unit	$10
Allocated unit fixed cost of production (based on 12 months to October 2016 with output of 500 000 units)	$20
SC profit margin on each item of ski clothing sold (based on costs calculated in October 2016)	50%

Low dividends worry investors

SC has cut dividends to shareholders for each of the last 4 years. Although the Board is planning a small increase in 2016, this will still leave the dividend per share lower than it was in 2011.

SC's share price has fallen since 2010 at a time when average share prices have risen. In 2016 SC's Finance Director tried to boost recorded profits by changing depreciation methods, revaluing intangible assets and by recording revenue from sales before contracts had been signed. These measures were criticised in financial newspapers.

Table 2: Summary of SC accounting data 2016

SC share price on 30 September 2016	$3.30
Total number of shares issued	15m
Total dividends paid	$1.5m
Capital employed	$58m
Non-current liabilities	$15m
Operating profit	$3.5m
Profit after tax	$2.0m

Strategic options

Bo's two strategic options for the future growth of SC are very different. SC currently sells all of its clothing in country X through retailers such as supermarkets. Bo's first option is to cancel most of these contracts and sell almost exclusively online. This would potentially give SC a higher profit margin but there would be costs involved too. The second option is to start selling the SC clothing ranges in country Y for the first time. Bo has provided the directors with information to help in making this decision, including the data shown in Appendix 3.

Appendix 1: Marketing information about leisure clothing

	SC	Main competitor
Marketing objective for 2016	25% market share	38% market share
2016 actual market share (2015)	23% (19%)	40% (39%)
Marketing promotion budget 2016	$5m	$15m
Price level	Low to mid-range	Average 5% higher than SC
Average age of consumer	28	22
Main distribution method	Supermarkets with clothing section	Sports and leisure shops

Appendix 2: Information to help select the new HR manager

	Candidate A	Candidate B
Age	34	52
Existing job	Assistant HR manager – SC factory in Asia	HR manager – medium sized insurance company
Number of previous employers	None	3
Greatest achievement at work	Preventing a strike threat by negotiating with trade unions	Introducing a 'hard' HR strategy at current employer and cutting labour costs by 20%
Career ambition	To become HR manager	To become CEO of a major business
Description of leadership style	'Moving forward through participation'	'Firm yet fair'

Appendix 3: Selected economic and social data for country X and country Y

Country X	Country Y
Total population is rising by 4% per year	Average incomes are rising by 8% per year leading to more foreign holidays
35% of the population is under 24 years old	Building and construction industry is booming due to low interest rates
A Government owned company has a monopoly in Internet service provision	Unemployment is falling
Import quotas on imported electronic goods have been abolished	Import tariffs have recently been increased by the Government
Business property taxes on city centre shops have recently increased	The currency is appreciating against most other currencies

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Section A

Answer **all** questions in this section.

1 Analyse the benefits to SC of lean production. [10]

2 **(a)** Refer to Table 1 and information on lines 48–53. Calculate the likely impact on SC's profits of a decision to outsource production of ski clothing to PSK. [6]

(b) Discuss whether SC should outsource production of ski clothing. Use your result from **2(a)** and other relevant information to justify your answer. [12]

3 Recommend to Bo which candidate should be selected as HR manager for the SC Asian factory. [14]

4 **(a)** Refer to Table 2. Calculate for 2016:

(i) return on capital employed [2]

(ii) price earnings ratio [3]

(iii) dividend yield. [3]

(b) Assess the usefulness of your results from **4(a)** and the data in Table 2 to SC's shareholders. [14]

5 Recommend a suitable marketing plan for the new range of clothing made from Weartex if it was to be launched in your own country. Justify your recommendation. [16]

Section B

Answer **one** question from this section.

6 Evaluate whether the information in Appendix 3 is sufficient to allow SC's directors to choose between the two strategic growth options. [20]

7 Discuss the importance of strategic analysis to SC's directors before considering strategic options for growth. [20]

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