CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Level

MARK SCHEME for the May/June 2014 series

9707 BUSINESS STUDIES

9707/32 Paper 3 (Case Study), maximum raw mark 100

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1 Analyse how the Government's policies to cut the rate of inflation are likely to affect GC. [10]

	Knowledge 3 marks	Application 3 marks	Analysis 4 marks
Level 2	3 marks Good knowledge shown of economic policies/statements about impacts	3 marks Points well applied	4–3 marks Good use of reasoned argument or theory to explain impact of at least two economic policies or one policy and lower inflation
Level 1	2–1 marks Knowledge shown of economic policies / inflation or statements of up to 2 impacts	2–1 marks Some attempt to apply points or one point well applied	2–1 marks Some use of reasoned argument or theory to explain impact of one economic policy / lower inflation

Answers could include:

- Definition of inflation – fall in purchasing power of money
- Higher interest rates – monetary policy to increase cost of borrowed money and increase returns to savers
- Raised direct taxes – fiscal policy to increase revenue from income and corporation taxes
- Reduced government spending – fiscal policy to reduce aggregate demand.

Application and analysis:

- Higher interest rates could reduce the demand for housing and apartments – many buyers will purchase on credit/with mortgages – GC may have trouble selling existing stock and may have to reduce prices or offer better credit terms (and accept the cost of doing this).
- Higher direct taxes – reduce disposable incomes and especially from higher paid – may reduce demand for higher priced houses and apartments – may affect decision on Pheonix site.
- Reduce government spending – may reduce government demand for office space and this may impact on GC's stock of unsold office space or the decision on the Phoenix site.
- Appreciating currency exchange rate (likely to be a result of higher interest rates) – makes imported building materials cheaper and helps GC to cut costs/price inflation of new housing. GC imports up to 40% of its bricks.
- As GC has low levels of liquidity, they may need to borrow money for the ecohouse Research & Development and for developing the Phoenix site. Therefore, the higher cost of borrowing will reduce the returns possible from these investments and/or influence the choice of finance.
- Impact of higher interest rates on the demand for shares.
- The increase in direct taxes e.g. corporation tax will impact GC as it is a plc.

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2 (a) Using the data in Table 1, calculate:

(i) Payback period: **[2]**

3 years, 2.4 months – 2 marks
3.2 years – 2 marks
3 years, 73 days – 2 marks

Some attempt e.g., just over 3 years – 1 mark

Year	Net cash flow ($m)	Cumulative cash flow ($m)
0	(15)	(15)
1	2	(13)
2	4	(9)
3	7	(2)
4	10	8
5	10	18

Working:

Pay back in 4th year: 2/10 x 12 = 2.4
Payback 3 years 2.4 months

(ii) net present value (NPV) at a discount rate of 12%. **[4]**

Year	Net cash flows	Disc factor	Discounted cash flow $m	Marks
0	($15m)			
1	$2m	.89	1.78	1 mark for some attempt to use discount factors 2 marks for arithmetic error and failure to subtract capital cost 3 marks for $22.05m 4 marks for correct answer
2	$4m	.80	3.20	
3	$7m	.71	4.97	
4	$10m	.64	6.40	
5	$10m	.57	5.70	
		NPV	**7.05**	

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(b) Using your results from **2(a)** and other information, discuss whether further research and development expenditure is advisable for GC. [14]

	Knowledge 2 marks	Application 2 marks	Analysis 5 marks	Evaluation 5 marks
Level 2	2 marks Good knowledge shown of research and development and/or investment appraisal and/or results	2 marks Good application to case	5–3 marks Good use of reasoned argument or theory to explain investment appraisal results and other issue(s)	5–3 marks Good judgement shown in answer and conclusion
Level 1	1 mark Some knowledge of research and development and/or investment appraisal and/or results	1 mark Some application to case	2–1 marks Some use of reasoned argument or theory to either investment appraisal results or other issues(s)	2 – 1 marks Some judgement shown in answer and/or conclusion

Answers could include:

- NPV positive for further research spending – profit from investment at today's money values.
- Payback (time taken to repay further research investment) quite long given that this is after previous research expenditure. Candidates may interpret 3 years as being quite short and suggest that GC may be confident about returns over such a time scale.
- These cash flows are estimated and are not guaranteed and competitors' research may lead to even more effective ecohouses.
- How much has already been spent? Joint ventures started in 2012.
- Can the $15m be afforded – as well as development of the Phoenix project? Refer to liquidity and gearing shown in Appendix 2.
- How unique is the ecohouse going to be and will it carry a price premium?
- Is a period of economic "deflationary" policies the right time to focus on this kind of project?
- Calculation of ARR = L1 K & P.

ARR = 3.6/15 x 100 = 24% OR ARR = 3.6/3 x 100 = 120%

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3 Evaluate the sources of finance GC could consider for the development of the Phoenix site. [14]

	Knowledge 2 marks	Application 2 marks	Analysis 5 marks	Evaluation 5 marks
Level 2	2 marks Good knowledge shown of sources of finance/ accounting data	2 marks Good application to case	5–3 marks Good use of reasoned argument or theory to explain advantages/ disadvantages of at least 2 different sources of finance	5–3 marks Good judgement shown in answer and conclusion
Level 1	1 mark Some knowledge of sources of finance/accounting data	1 mark Some application to case	2–1 marks Some use of reasoned argument or theory to explain advantages/ disadvantages of 1 source of finance	2–1 marks Some judgement shown in answer and/or conclusion

Answers could include:

- Knowledge of gearing ratio; rights issues, impact of further long term loans etc.
- Increased working capital needed e.g. work in progress is likely to increase substantially – could this be financed from trade credit? Would this reduce the likelihood of discounts from suppliers?
- Increased capital expenditure – could this be financed by a rights issue? Does the management want to risk some loss of control? Will GC's share price continue to fall, making a rights issue inadvisable?
- How much will the gearing ratio increase to? (110/240 x 100 = 45.83% or 46%)
- Is this wise at a time when interest rates are rising?
- Sale of the brickworks? How much would this raise? Is now a good time to sell assets such as this?
- Is leasing a possibility?

Evaluation:

- Balancing of advantages and disadvantages of different finance options.
- Other data that would be useful e.g. are existing loans at fixed interest rates.
- Overall judgement on most suitable sources in this case.

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4 (a) Using Appendix 1, calculate the expected monetary values for the 3 options for the Phoenix site. **[6]**

Options	Additional capital cost	Chances of successful outcome	Economic payoffs	Expected values	Marks
1: Develop for offices	$15m	0.8	Success: $30m Failure: $10m	[.8 x 30 + .2 x 10] - 15 = $11m	2
2: Develop for housing	$20m	0.7	Success: $40m Failure: $18m	[.7 x 40 + .3 x 18] -20 = $13.4m	2
3: Sell site after three years	Nil	0.5	Success: $10m Failure: $5m	[.5 x 10 + .5 x 5] - 0 = $7.5m	2

Some attempt to multiply economic payoffs by relevant probability – 1mark

(b) Using your results to **4(a)** and other information, recommend to GC which of the 3 options for the Phoenix site should be chosen. Justify your answer. **[14]**

	Knowledge 2 marks	Application 2 marks	Analysis 5 marks	Evaluation 5 marks
Level 2	2 marks Good knowledge shown of results and / or other information	2 marks Good application to case	5–3 marks Good use of reasoned argument or theory to explain advantages/ disadvantages of options	5–3 marks Good judgement shown in answer and conclusion
Level 1	1 mark Some knowledge of results and / or other information	1 mark Some application to case	2–1 marks Some use of reasoned argument or theory to explain advantages/ disadvantages of options	2–1 marks Some judgement shown in answer and/or conclusion

Answers could include:

- Expected values = economic payoffs x probability = the average economic result from making this decision.
- Housing looks most profitable.
- Offices next, followed by selling the site after 3 years.
- But how reliable are the estimates?
- Has GC undertaken a project similar to this before?
- How will the economic policy changes affect these estimates? – Demand for housing might fall – especially prestigious apartments. How will this affect the profitability of this option?

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- Demand for government offices might fall.
- Demand for social housing might increase – but how profitable is this?

Evaluation:

- Other data might be useful including forecasts for future economic policy changes.
- Results from similar developments.
- Selling the site might involve less risk as no further expenditure is required – and raising finance could become an issue for GC.

5 Discuss whether GC should be more accountable to its stakeholders by reporting on its CSR activities in its annual report. [16]

	Knowledge 3 marks	Application 3 marks	Analysis 5 marks	Evaluation 5 marks
Level 2	3 marks Good knowledge shown of CSR/ reporting CSR activities	3 marks Good application to case	5 – 3 marks Good use of reasoned argument or theory to explain benefits and limitations of CSR reporting	5 – 3 marks Good judgement shown in answer and conclusion
Level 1	2 – 1 marks Some knowledge of CSR/reporting CSR activities/ stakeholders	2 – 1 marks Some application to case	2 – 1 marks Some use of reasoned argument or theory to explain benefits or limitations of CSR reporting	2 – 1 marks Some judgement shown in answer and/or conclusion

Answers could include:

- CSR – showing responsibility in business decision making for stakeholders other than just shareholders.
- CSR reporting – a report on the social/wider impact of the activities of a business – other than just financial performance
- Stakeholders – groups interested in the wider performance of the business such as employees, local community.

Yes they should:

- They do not at present and they miss the opportunity – as some other firms in the country have – to portray the positive aspects of their operations e.g. social housing project (possibly) and research into ecohouse – both of these are of interest to potential customers.
- If the CSR report is largely positive then this could give and boost to the image of this construction company – it might attract some potential customers and favourable media reports. This could help to secure workers jobs.
- Stakeholders would be able to take more effective decisions about GC if they were provided with a more complete picture of its wider social impact.

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No they should not:

- There are some negative social impacts of GC's activities – accidents record; potential job losses; may leave Phoenix site empty for 3 years; some risk of asbestos pollution – are they going to check on this and take some action?
- Might lead to negative reaction from pressure groups and employees if the complete/true picture of GC's activities is published.

Evaluation:

- Is this just "greenwash" or will the CSR report be verified by outside body?
- Will "hiding" the truth lead to negative publicity?
- Will the company be rewarded by positive stakeholder reaction as a result of an honest CSR report?
- Is it better to produce such CSR reports before they become a legal requirement?

Section B

6 Discuss how the strategic decision to close the brick factory should be implemented. [20]

	Knowledge 3 marks	Application 3 marks	Analysis 4 marks	Evaluation 10 marks
Level 3				10–7 marks Good judgement shown in answer and conclusion
Level 2	3 marks Good knowledge of issues shown	3 marks Issues well applied to case	4–3 marks Good use of reasoned argument or theory to explain answer	6–4 marks Good judgement shown in answer or conclusion
Level 1	2–1 marks Some knowledge of issues shown	2–1 marks Some attempt to apply issue	2–1 marks Some use of reasoned argument or theory to explain answer	3–1 marks Some judgement shown in answer and/or conclusion

- Rationalisation – downsizing the organisation/making it more efficient.
- The way this decision is managed could impact on public image of GC (included in potential social audit?)
- Could also impact on workers on building sites – is this how workers are treated when things get tough?
- Already likely to be some fear over job security as a result of the economic policy changes.
- Make a quick decision to close; do not involve the workers (takes time and may give them opportunity to object); pay minimum redundancy.
- This is the "hard" and low cost method.
- Involve the workforce; discuss how the decision might be implemented; discuss the possibility of a takeover.
- This is the "softer" approach and might create better industrial relations with the rest of the workers.
- GC could blame government policies when discussing with workers.

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- Importance of keeping workers on side if GC wish to sell factory as a going concern.
- Would an authoritarian approach be beneficial so that a quick sale can be made to limit impact of a fall in land prices resulting from government policies.
- Issue of finding supplier of bricks before closing the factory.

Evaluation:

- Additional information would have been useful; profit/loss of the factory; chances of selling it; value of the site.
- Risk of union action – involvement of other workers?
- How will the closure be perceived by other stakeholders?

7 Evaluate the extent to which more effective long term planning might influence GC's future success. [20]

	Knowledge 3 marks	Application 3 marks	Analysis 4 marks	Evaluation 10 marks
Level 3				10–7 marks Good judgement shown in answer and conclusion
Level 2	3 marks Good knowledge of issues shown	3 marks Issues well applied to case	4–3 marks Good use of reasoned argument or theory to explain answer	6–4 marks Good judgement shown in answer or conclusion
Level 1	2–1 marks Some knowledge of issues shown	2–1 marks Some attempt to apply issue	2–1 marks Some use of reasoned argument or theory to explain answer	3–1 marks Some judgement shown in answer and/or conclusion

Corporate planning – systematic approach to setting corporate objectives, making strategic decisions and checking progress towards objectives (can include contingency planning too).

- Some evidence of corporate planning in this case – long term aim to be more sustainable, strategy of joint ventures to develop materials. Progress check has concluded that more investment is needed.
- This could be a good example of successful corporate planning.
- Use of decision tress technique when deciding on how to go forward with the Phoenix project
- No other clear examples given – but expansion seems to have been an objective (before economic changes).
- Evidence that flexible planning/objective setting was not undertaken – seemed to have been caught by surprise by the economic changes – purchase of Phoenix site at high price may be evidence that the plan was not adjusted in time.
- This could lead to losses – especially if the chances of success of this project are rated too high.
- Apparent lack of contingency planning with the serious accident and the aftermath of this.
- Creates a very bad image for the business – might even lead to legal charges against the business.

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Evaluation:

- GC has been successful in the past – but was this just due to a rising property market?
- Is the Board of GC planning for the new economic environment? Proposed closure of the brick works could be an example of this.
- Other factors will affect future success too – success of the eco-house; competitors R and D spend; further changes in economic policy.

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