CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Level

MARK SCHEME for the May/June 2014 series

9707 BUSINESS STUDIES

9707/33 Paper 3 (Case Study), maximum raw mark 100

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1 Analyse the advantages to PA of market segmentation. [10]

	Knowledge 3 marks	Application 3 marks	Analysis 4 marks
Level 2	3 marks Good knowledge shown of market segmentation e.g. definition and two or more benefits identified	3 marks Issues well applied to Platypus	4–3 marks Good use of reasoned argument or theory to consider benefits of segmentation
Level 1	2–1 marks Knowledge shown of market segmentation e.g. definition and benefit identified	2–1 marks Some attempt to apply segmentation to Platypus	2–1 marks Some use of reasoned argument or theory to benefits of segmentation

Definition of market segmentation: identifying different segments (consumer groups) within a market and targeting different products or services to them. Segmentation can be according to age, gender, income, religious belief, ethnicity etc.

Platypus aims its accessories at a distinct segment of the phone/MP3 player market i.e. young fashion conscious individuals

Potential benefits:

- A customer focused strategy.
- Allows Platypus to tailor its marketing mix to meet the needs of the target segment and ensures that there is a consistent brand message.
- More effective use of marketing expenditure, for example, advertising in appropriate fashion magazines. Promotion through music festivals and placement of products with suitable celebrities. This avoids wasting money on trying to sell products to the whole market.
- Marketing expenditure is 9% of sales i.e. $216 000 in 2012 and projected to be $270 000 in 2014. This significant expenditure should be used wisely.
- Improve the distribution through careful targeting of high street chains appealing to the target market.
- Create a clear brand identity to appeal to customers and fulfils the corporate objective of developing products that are fun, colourful and creative.
- Ensure that the products appeal to target segment through the use of rising fashion designers thus increasing sales and profit.

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2 Discuss the factors that are likely to influence the decision of whether to introduce JIT inventory control at PA's distribution centres. [14]

	Knowledge 3 marks	Application 3 marks	Analysis 4 marks	Evaluation 4 marks
Level 2	3 marks Good knowledge shown of JIT and factors	3 marks Points well applied	4–3 marks Good use of reasoned argument or theory to explain the influences on JIT	4–3 marks Good judgement shown in answer and conclusion
Level 1	2–1 mark Knowledge shown of JIT and / or factors influencing success	2–1 mark Some attempt to apply	2–1 marks Some use of reasoned argument or theory to explain the factors on JIT	2–1 marks Some judgement shown in answer and/or conclusion

Definition of JIT inventory control: Aims to avoid holding the inventory by requiring supplies to arrive just as they are needed. Balancing the goals of avoiding stock-outs whilst minimising inventory costs is at the heart of just-in-time.

Answers could include:

- As a technique JIT has been applied more frequently to manufacturing
- Relationship with suppliers must be good. Suppliers must be prepared and able to supply new supplies at very short notice. A short lead time is therefore preferable. Appendix D shows that the lead time for some manufacturers of the plastic cases is up to 20 days. The longer the period, the more difficult for Platypus to respond to demand from customers. Is it possible for Platypus to form a closer relationship with suppliers who are able to offer a shorter lead time?
- How reliable are suppliers? Unreliable suppliers will make JIT unworkable, as late deliveries will leave Platypus with insufficient inventory.
- Can Platypus accurately predict demand? This may be difficult, as they are constantly bringing out new designs. There will be uncertainty as to the level of demand for each new design.
- Can manufacturers vary the supply to meet seasonal variations in demand? If not then Platypus may have to inventory up in advance of periods of peak demand.
- Should PA reduce the number of suppliers so that they can establish a closer working relationship with a small number of core suppliers?
- Do suppliers have a no-strike deal with major unions to avoid disruptions?
- Platypus is planning to invest in ERP software. This may be essential to manage supplies and track orders efficiently. Introducing new technology will require that staff are trained, and liaison with manufacturers will be required to integrate the software with their systems.
- Potential industrial relations problems could limit employee's willingness to cooperate.

Evaluation:

- Effectiveness of new ERP software may be crucial, but an ability to predict demand and work with suppliers is paramount to success.
- JIT will require frequent small orders. As products are sourced from Country Y and Z, transport costs for small deliveries may make the introduction of JIT uneconomic, as will the cost of expensive IT systems.

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3 Using Appendices A and B, calculate for the proposed investment in Eastern Airports:

(a) (i) Average Rate of Return (ARR). [4]

Cash inflow $965 000
Cash outflow $600 000
Net cash flow $0.365m
Net annual profit $73 000
ARR = 12.17%

ARR % = Annual profit/initial capital cost × 100
OR = Annual profit/average capital cost × 100 in which case the result will be 24.3%
[73000/300000 × 100] Allow partial marks as below if working is shown

= 73 000/600 000 × 100 = 12.17%

Result	Explanation	Marks
12.17%		4
12% or 12.2%	Answer correctly rounded	4
365/600 × 100 = 60.8% 193/600 × 100 = 32.2%	Does not calculate annual profit Does not subtract capital cost	3
2 errors		2
Formula only		1

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(ii) Net Present Value (NPV). **[4]**

Year	NCF (000s)	DCF (000s)
0	–600	–600
1	95	88.35
2	160	137.6
3	200	158
4	240	177.6
5	270	183.6
NPV		145.15

Result (000s)	Explanation	Mark
145.15	Correct	4
145 to 146 acceptable	Margin of error accepted due to rounding of results	4
745.2	All correct DCFs but capital cost not subtracted Correct process but 1 omission	3
5 correct DCFs and no subtraction of capital cost	1 error and 1 omission	2
Two arithmetical errors		2
Some use of technique	E.g. any multiplication of cash flows by discount factors	1

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(b) Using your answers to part (a) and any other relevant information, recommend whether PA should invest in Eastern Airports. [16]

	Knowledge 3 marks	Application 3 marks	Analysis 5 marks	Evaluation 5 marks
Level 2	3 marks Good understanding shown of results/ other factors	3 marks Points well applied	5–3 marks Good use of reasoned argument or theory to explain the advantages/disadvantages of this decision	5–3 marks Good judgement shown in answer and conclusion
Level 1	2–1 mark Some understanding shown of results/other factors	2–1 mark Some attempt to apply	2–1 marks Some use of reasoned argument or theory to explain the advantages/disadvantages of this decision	2–1 marks Some judgement shown in answer and/or conclusion

Answers could include:

- Analysis of results (accept OFR analysis).
- ARR of 12.17% is above the target stated by Dave – but depends on cost of capital.
- NPV of $145 150 is positive and therefore provides support for the investment.
- Quantitative data strongly in support of decision to invest in Eastern Airways – but should consider other uses of capital.

Other factors:

- Presence in airports could introduce the brand to an international market and Dave believes that the investment will move the brand forwards.
- Issues surrounding the recruitment of staff. Is this significant? The shops will only be small, so relatively few staff will be required. Will current labour dispute deter applicants for jobs?
- Platypus does not have experience of managing retail units having only sold online and through high street chains.
- Question over managing inventory to meet airport expectations.
- Does the business have the funds to finance the investment or will debt finance be required. If so how will this affect gearing? Note in 2014 the business is set to make net profit of $330,000 but this is before tax and payment of any dividend so extra funds could well be needed.
- The leasing cost is significant for the shops – if sales do not meet expectations will Platypus be locked into the airports for the full five years?
- Airport traffic may be particularly sensitive to changes in the domestic and world economy. Economic forecast for Country Y is not good with declining GDP growth.
- Passenger numbers may be affected by the proposed imposition of a tax on flights. Was this factored into the forecasts in Appendix A.

Evaluation:

- Final, justified, conclusion is needed for level E2.
- How reliable are the forecasts?
- Have management influenced the data in any way to achieve a particular decision?
- Is the discount rate appropriate? Interest rates are forecast to rise to 11% in 2015.

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4 Discuss whether PA should consider increasing its pay offer to employees. [16]

	Knowledge 3 marks	Application 3 marks	Analysis 5 marks	Evaluation 5 marks
Level 2	3 marks Good knowledge shown of issues involved	3 marks Issues recognised well applied	5–3 marks Good use of reasoned argument or theory to explain the issues involved	5–3 marks Good judgement shown in answer and conclusion by considering both sides
Level 1	2–1 mark Knowledge shown of the issues involved	2–1 mark Some attempt to apply issues to	2–1 marks Some use of reasoned argument or theory to explain the issues involved	2–1 marks Some judgement shown in answer and/or conclusion

Answers could include:

- Current pay offer is well below current inflation rate in Country A. Employees facing an approximate 2.5% cut in real pay in 2014. The pay offer is worth just $75 per employee per year.
- Employees are already earning 6% less than other workers in similar jobs.
- As Platypus is profitable should the business reward its staff?
- Will they be able to redeploy workers to other distribution centres if there is a work to rule? If not how will this affect retail customers?
- How much impact would a work to rule and a strike affect operations?
- How much will a more generous pay offer cost? Assuming that 4% is paid then total cost would be $200 per employee per year or $8000 in total. Net profit in 2014 projected to be $330 000.
- The union only represents 60% of the workforce i.e. 24 out of the 40 employees.
- Staff are unskilled and unemployment is set to rise in 2015. Recruiting staff may be relatively easy if there is an increase in labour turnover.
- Would a strike damage the reputation of Platypus? Would the public be sympathetic to workers given the drop in real wages or would they sympathise with the business given the prospective increase in indirect taxation and the low forecast economic growth?

Evaluation:

- Which of these considerations is most important?

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5 Refer to the data in Appendix B. Evaluate how the forecast changes in Country A's macroeconomic performance might influence PA's future profitability. [16]

	Knowledge 3 marks	Application 3 marks	Analysis 5 marks	Evaluation 5 marks
Level 2	3 marks Good knowledge shown of issues involved	3 marks Issues recognised well applied	5–3 marks Good use of reasoned argument or theory to explain the issues involved	5–3 marks Good judgement shown in answer and conclusion
Level 1	2–1 marks Knowledge shown of the issues involved	2–1 marks Some attempt to apply issues to Platypus	2–1 marks Some use of reasoned argument or theory to explain the issues involved	2–1 marks Some judgement shown in answer and/or conclusion

Answers could include:

- The short term outlook for the economy appears to be worsening for Country A and this is likely to have a negative impact on Platypus both in terms of sales growth and profitability.
- The fall in GDP growth will be associated with weaker sales growth in many markets. Thus sales of Platypus products may also show less growth. This could put increased pressure on profit margins as Platypus may need to consider more competitive pricing.
- The forecast increase in the inflation rate in 2015 will lead to higher cost pressures. For example, workers will press for higher wages and rents may increase for premises. This could also have a negative impact on profitability.
- The predicted increase in indirect taxation will mean a likely increase in the price charged for Platypus products. Retailers purchasing from Platypus may seek to reduce the price they pay for supplies. The overall impact on sales will depend critically on PED. As Platypus aims its products at young fashion conscious individuals does this mean that they will be less sensitive to price increases than the customers of more downmarket products? If so, then the burden of the VAT increase will fall more on the consumer rather than the producer.
- The depreciation of the exchange rate between 2014 and 2016 poses a threat to Platypus. This will cause an increase in the cost of purchasing stock from manufacturers in Country Y and Z.
- The increase in interest rates will impact on the borrowing costs of Platypus. If their debt finance is on variable rate terms then interest charges will increase.

Final evaluation:

- How reliable are the forecasts?
- How dependent is the business on loan capital?
- How price elastic is demand – can Platypus pass on the increased cost of imported stock and the increase in indirect taxes.
- Does the poor economic outlook jeopardise the proposed investment in Eastern Airways?

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Question 6 & 7

	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

6 Evaluate the importance of planning in PA's business strategy. [20]

Candidates could discuss a range of issues relating to the role of planning with regard to strategic implementation. Reference could be made to business plans and corporate planning as well as the role of contingency planning.

There are many references to planning in the case material including:
- Detailed business plan use by Haile to set up the business
- Clear vision the business had at the start
- Planning for new opportunities such as Eastern Airports.

There is also the failure to have a contingency plan for the fire in the distribution centre.

Business Plan: A written document that describes a business, its objectives and its strategies, the market it is in and its financial forecasts.

Corporate Plan: This is a methodical plan containing details of the organisations central objectives and the strategies to be followed to achieve them.
- Clear focus to senior managers
- Control and review process
- Planning process useful forcing consideration of strengths and weaknesses
- Of interest to potential investors and staff.

BUT
- Business environment is dynamic. There can be unexpected internal and external changes.

Contingency planning: Definition: preparing an organisation's resources for unlikely events. This may also be referred to as crisis management and business continuity planning.

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Benefits:
- Reassures customers and staff that their interests are being considered.
- Reduces potential impact on customers in the event of a major disaster.
- With fore-planning the public relations response is much more likely to be quick and appropriate so that senior managers can manage the media attention and communicate effectively what the company intends to do, by when and how, from disasters both in terms of costs and bad PR and loss of customer loyalty.
- Recognising major risks, such as fire, may actually reduce the risk of the disaster happening.

Limitations: Disasters still occur – refer to case.
- Can be expensive and time consuming especially for small businesses. There is the planning process and also the need to train staff for each possible eventuality.
- Avoiding disasters is better than planning what to do if they happen.
- Plans need to be updated frequently as the business develops.

Application:
- Management unprepared for dealing with the consequences of the fire. This may prove costly to Platypus due to the extended disruption to distribution.
- May lose contracts from fashion outlets if management has failed to communicate effectively with customers.
- Online customers may be lost if orders cannot be met on time. This is particularly significant as many customers repeat purchase within the year.
- With appropriate contingency planning in place Platypus might have been prepared for transferring employees from one centre to another. Appropriate employment contracts could have been in place with better planning.

Final evaluation:
- Cost of CP needs to be balanced against the potential costs of not doing it. Which potential disasters should be planned for?
- How much time is spent on preparing and testing contingency plans?

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7 Evaluate how strategic analysis might aid PA's management when taking strategic decisions. [20]

Definition of strategic analysis: This is the first step in the strategic management process and involves research into the business environment within which the organisation operates, and into the organisation itself. Strategic analysis helps to shape future strategies.

Answers could include:

- SWOT – this will help match the firm's resources and strengths to the competitive environment within which it operates thus helping to select strategies. Does Platypus have the necessary strengths to proceed with the Eastern Airways investment.
- PEST – the strategic analysis of a firm's macro-environment. This helps determine the likely chances of a business strategy being successful. Considering the economic environment will be important in deciding whether to proceed with the Eastern Airways investment. Will changes in government policy with regard to taxation lessen the chances of success? For Platypus social changes may be an important influence as these will influence fashion. Platypus will also have to respond to technological developments in computing and mobile telephony.
- Boston Matrix may be useful in reviewing the product portfolio offered by Platypus and help make decisions about divestment.
- Porter's 5 Forces analysis; could this be used to help Platypus establish competitive advantage over rivals? For example by analysing current markets it may help identify different segments of the market that are less competitive.
- What are the core competencies of Platypus? Does Platypus have a core competence in design that could be further developed to produce a larger number of end products.

There should be discussion of more than one form of strategic analysis for award of full marks.

Evaluation:

- Subjective nature of any analysis is a significant problem with strategic analysis. Managers can therefore influence the content of the analysis to provide support for predetermined course of action.
- These approaches provide a snapshot of the business and will need to be constantly updated.

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