Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

BUSINESS STUDIES **9707/32**

Paper 3 **May/June 2015**

CASE STUDY

3 hours

Additional Materials: Answer Booklet/Paper

9896152600

READ THESE INSTRUCTIONS FIRST

If you have been given an Answer Booklet, follow the instructions on the front cover of the Booklet.
Write your Centre number, candidate number and name on all the work you hand in.
Write in dark blue or black pen.
You may use an HB pencil for any diagrams or graphs.
Do not use staples, paper clips, glue or correction fluid.
DO **NOT** WRITE IN ANY BARCODES.

Section A
Answer **all** questions.
Section B
Answer **one** question.
You are advised to spend 40 minutes on Section B.
The businesses described in this question paper are entirely fictitious.

At the end of the examination, fasten all your work securely together.
The number of marks is given in brackets [ ] at the end of each question or part question.

This document consists of **5** printed pages and **3** blank pages.

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Mbella Farms (MF)

Robert Mbella is the Chief Executive of Mbella Farms (MF). Members of his family have senior management positions within this private limited company. MF is one of the largest maize (corn) producers in the country. The company owns 30 farms across the country and each farm is operated by an MF appointed farm manager. The company does more than just grow maize. It has developed a range of maize related products that it sells under the Mbella Farms brand name through its own farm shops and leading retailers. These products include starch, flour, syrup and popcorn. The flour is the best selling product. It is all produced and packaged within MF's own factory. Production of other MF branded goods is outsourced to small food processing businesses. MF has a good reputation with retailers for prompt deliveries and with consumers for good value products. Robert is proud of his mission statement which states that MF 'will always consider the interests of stakeholders as more important than profit'.

New factory or further outsourcing?

MF's flour milling factory is 25 years old. It was designed and built before the principles of lean production were widely recognised. Access for regular deliveries from farms and other suppliers is poor, traditional flow production lines prevent team-working and there is a large section allocated to quality control inspectors. Total output in 2014 was 30 000 tonnes but factory managers believe that full capacity working using 24 hour per day operations could achieve 36 000 tonnes.

The Operations Director, Amanda Mbella, wants the company to replace the factory by building a new one in an industrial area with good transport links. This will increase potential capacity and she believes it could eventually improve competitiveness as a result of lower unit costs. Amanda has calculated the operating costs of the existing factory and has compared them with forecasts for a new factory (Table 1). Several other directors doubt whether MF could raise the finance needed to pay for a new factory. They are trying to convince Robert that outsourcing flour production would be a better decision.

Table 1: Operating costs of existing factory and forecasts for new factory

	2014 ($000)	2016 ($000) (Forecasts for new factory)
Total annual labour costs (based on 30 000 tonne output)	600	450
Other annual direct costs (based on 30 000 tonne output)	1200	1200
Annual depreciation of equipment	60	280
Other annual indirect costs	330	290

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Increasing the product portfolio – 'Maize Crunchies'

MF's small team of food researchers has developed a new type of breakfast cereal based on maize. It tastes equally good whether eaten with milk or fruit juice and different varieties can be flavoured with nuts and dried fruits. By adding a lot of sugar the product stays crisp even when stored for long periods. Researchers believe it tastes best when made from maize grown using organic and sustainable methods. Eshe Mbella, the Marketing Director, wants to expand MF's product portfolio. She told Robert that: 'Some of our products are in slow growing markets and MF's popcorn has a very low market share. We need to launch new products into fast growing markets and the breakfast cereals market is one of these. I will prepare a marketing plan and present this to the Board for approval. Despite the high costs of launching a new product and fierce competition from multinational breakfast cereal companies, the plan should ensure that 'Maize Crunchies' becomes a profitable product for us.'

Option to buy additional farms

Africa Brand Cereals (ABC) is the largest supplier of maize products in the region. It owns 50 farms spread across four countries and operates four maize processing factories. Profitability has declined in recent years despite ABC growing only genetically modified (GM) maize crops and using only GM maize in its processed products. GM crops are resistant to certain insects and to powerful weedkillers called herbicides, leading to higher output. Some consumer pressure groups believe that there could be long term health risks from GM crops.

ABC has been badly managed since it was purchased by a venture capital business. Managers have received huge salary increases not linked to performance. There has been no investment in farm equipment or in factory infrastructure. Some farms do not even have a reliable electricity supply. The venture capital business has sold many of ABC's assets and now plans to sell ABC's ten largest farms. Robert enquired about the price of buying these and was told that if a cash sale could be arranged within three months then the price would be $10m. MF's Finance Director is keen to purchase these farms and he told last week's Board meeting that: 'The deal is a good one if you take a long term view. You all have a copy of MF's latest summary of accounting data (Appendix 1). My estimate is that if we buy these ABC farms, and assuming no other changes, then in 2016 total MF revenue will increase by 30% and profit (before tax) will rise by 20%. From 2017, we should be able to make changes within ABC's farm operations that increase both efficiency and MF's overall profit margins.'

Farm managers

The 30 farm managers have all worked for MF for at least five years. Some have worked their way through the business to reach managerial level but a few have been recruited externally. Robert trusts his farm managers to take most of the key decisions about their farm themselves apart from the use of non-GM seeds which Robert insists on. Managers decide the best time to plant maize seeds, which fertilisers to use and how many employees to recruit and their conditions of employment. Farm managers receive bonuses based on keeping costs low, increasing output levels and high quality. Robert's faith in delegation seems to be well rewarded. Output levels from most farms increase each year and very few managers leave MF. However, Robert has just read a newspaper article which claims that some MF farm workers are not paid the minimum wage and that accidents on two MF farms have not been reported to the Government's Health and Safety Office. He wonders why he was not told of these problems by the farms' managers.

Expansion into country X

In country X a newly formed Government has started to reduce trade barriers with other African countries. It is encouraging investment from foreign businesses, especially joint ventures, and MF's directors consider that entering the market for maize products in country X could be profitable. Subsidies and investment grants are currently available from the Government and MF wants to act quickly to take advantage of these. The Finance Director has researched information about the external environment in country X and has forecast the financial impact on MF of entering the market in country X (Appendix 2 and Appendix 3).

Appendix 1: MF summary of accounting data for year ending 31 December 2014

Revenue ($m)	35
Gross profit ($m)	20
Profit (before tax) ($m)	8
Tax + dividends ($m)	6
Retained profit ($m)	2
Net profit margin	22.9%

Appendix 2: External environment information – country X (2014)

Growth in Gross Domestic Product	7%
Rate of inflation	10%
Exchange rate depreciation since 2010 (against $)	25%
Average import tariff	20%
Proportion of population under 25 years old	35%
Number of changes of Government in last 3 years	4

Appendix 3: Financial forecasts for MF's entry to country X market

Decision tree: annual expected monetary value of this decision based on 80% chance of success	$2m
Payback period of initial investment	3 years
Government grants and subsidies as proportion of initial investment	35%

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Section A

Answer **all** questions in this section.

1 Analyse the benefits and limitations to MF of the level of delegation given to farm managers. [10]

2 Using data on lines 16–18 and Table 1, calculate:

(a) (i) capacity utilisation in 2014 [2]

(ii) the difference, at an output of 30 000 tonnes of flour, between the average cost per tonne in 2014 and the forecasted average cost per tonne in 2016. [4]

(b) Using your results to **2(a)** and other information, recommend whether MF should build the new factory. Justify your answer. [12]

3 To what extent will a marketing plan ensure that the new 'Maize Crunchies' product is profitable? [14]

4 (a) (i) Assume ABC's farms are purchased. Using Appendix 1, the assumptions on lines 54–55 and other information calculate the net profit margin of MF in 2016. [6]

(ii) Briefly assess **one** way in which MF's net profit margin could be increased. [4]

(b) Discuss the problems that MF might experience if it buys the ten ABC farms. [14]

5 Discuss whether MF should 'always consider the interests of stakeholders as more important than profit' (line 11). [14]

Section B

Answer **one** question in this section.

6 Evaluate the importance of the data in Appendix 2 and Appendix 3 to MF's directors when making the strategic choice whether to enter the market in country X. [20]

7 Discuss how the strategy of entering the market in country X could be effectively implemented by MF's directors. [20]

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