UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education Advanced Level

BUSINESS STUDIES **9707/31**

Paper 3 **October/November 2011**

CASE STUDY

3 hours

Additional Materials: Answer Booklet/Paper

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 a soft pencil for any diagrams, graphs or rough working.
Do not use staples, paper clips, highlighters, glue or correction fluid.

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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Lucky Printing Corporation (LPC)

The current situation

LPC is a public limited company. It is a book publishing business. LPC made a net profit in the year ending 31 October 2011 of $1.2m. The company undertakes the following activities.

- Appoints authors to write books or considers publishing books sent in by authors.
- 'Typesets' each book – this means using a computer to set out the author's work exactly as it will appear in the book.
- Prints copies of each book. Sometimes it prints thousands of copies for popular books. For less popular books, just a few hundred are printed.
- Transports and distributes books to retailers and wholesalers around the world, including to some shops that it owns.

LPC is, therefore, a vertically integrated business. This is both a strength and a weakness. It enables the business to keep complete control of the publishing process with timings, quality and costs all under LPC management. However it means that LPC does not specialise in any one aspect of publishing. Its costs are high compared to specialist external firms, some of which are located abroad, and the size of the business makes communication difficult.

Abbas Khan success story

Over 30% of LPC's revenue in 2010 was earned by book sales of just one author, Abbas Khan. He has become one of the most famous authors of children's books in the world since the adventures of his creation, Hario Petra, were made into a blockbuster film. The success of Khan's books has been a mixed blessing for LPC. The increased revenue and profits from the books have been very positive for the company. However the business is now very dependent on the work of this one author of children's books. This market segment of children's books may not grow in the future. Also, the additional pressure on the printing capacity of the business is a problem. LPC is just managing to meet demand for Khan's books, but the full capacity working in the printing department is a worry for the Operations Director, Safia.

Outsource printing?

Safia has recently been to a trade fair for printing machines where she met the Sales Director of AAP, a printing company, based in a large emerging economy. He offered to do all of LPC's book printing 'at a cost level that will surprise you'. Safia told him the annual capacity of the book printing department at LPC. Shortly after they met, AAP's Sales Director e-mailed the following offer to do all of LPC's book printing: 'For undertaking all book printing for LPC based on the 2010/2011 output level – total cost $4 300 000'.

Safia reported the AAP offer to the Board of Directors and reactions were mixed. 'If we outsource printing completely and close this division we will have to make 300 staff redundant' said the Human Resources Director. The Marketing Director responded: 'By closing the printing division we could expand book publishing by developing new technological innovations such as e-books available on the Internet. I think we should specialise in this and get out of old-fashioned paper based printing'. Other directors were worried about the lack of detail in AAP's offer, the reliability of AAP in meeting delivery dates and the quality of printing.

Details of the costs of LPC's printing division have been prepared by the Finance Director. These are given in Table 1.

Table 1: LPC printing division costs based on output in year ending 31 October 2011

	LPC printing division costs $000
Direct material costs (paper, ink etc)	3000
Direct labour costs	1250
Management salaries	750
Allocated share of the administration and selling overheads of LPC	1450

How to increase sales of textbooks

LPC publishes 100 textbook titles for different IGCSE and A level subjects. Sales of these books have fallen over the last two years despite growing numbers of students taking these qualifications. Other publishers have increased their shares of the textbook market. The LPC Marketing Director has produced the marketing data in Table 2. *50*

Table 2: Marketing data for textbooks

	LPC textbooks	Competitors' textbooks
Average time span since new edition	5 years	2 years
Average cost of producing each new edition	$18 000	$20 000
Likely increase in first year's sales after new edition	5000 copies	7000 copies
Change in 2010 sales after a 10% price reduction	Sales rose by 30 000 copies to 630 000	Sales rose by 200 000 copies to 1 000 000
Average textbook price after 10% price reduction	$4.50	$5.40
Average credit period offered to bookshops	1.5 months	2 months
Promotion elasticity of demand	0.2	0.4
Promotion spending in 2010	$20 000	$30 000

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[Turn over

Accounting and finance changes proposed

Even though LPC's profits have increased in recent years, largely due to the success of Abbas Khan's books, the company accountant has suggested to the directors some changes which will affect LPC's accounts. 'The changes I propose will have the effect on the published accounts of increasing the balance sheet value and making it seem as if the company is both more profitable and more liquid.' The accountant proposed the following changes.

- Increase the expected life of all major assets held by the business when calculating straight line depreciation.
- Sell off some fixed assets for cash and lease them back so that the company can still use them.
- Increase the value of intangible fixed assets by including a value for the copyright to Abbas Khan's books.

It is good news for some

The latest economic forecasts indicate that recent economic growth in the country is about to end – see Appendix A. Despite these forecasts, the Chief Executive Officer proposed to the Board of Directors an increase of 20% in directors' salaries and a 10% increase in dividends. He said: 'We must reward, motivate and retain our senior managers. Shareholders deserve an increased return from their investment. It is right to increase these payments this year as, judging by the economic data, profits may fall over the next 2–3 years. Also, looking to the future, the data suggests that we should try to protect sales and profits by looking at new export markets and e-book editions of our top selling books.'

Appendix A: Economic forecasts for the country where LPC operates

	2012	2013
Annual increase in real GDP	1.5%	–2%
Annual inflation	4%	6%
Average exchange rate index of country's currency against other currencies	100	90
% of population aged 5-15 years	16%	17%
% of population aged 16-18 years	4%	3%
Unemployment as % of working population	5%	7%

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Section A

Answer **all** questions in this section.

1 Analyse the advantages and disadvantages for LPC of being heavily dependent on the sales of books written by Abbas Khan. [10]

2 **(a)** Assume the book printing department was closed and the offer from AAP had been accepted. Calculate LPC's profits for the 12 months to 31 October 2011. Clearly state any assumptions you make. [10]

(b) Using your answer to **(a)** and other relevant information, recommend whether the company should outsource all book printing to AAP. Justify your answer. [16]

3 Discuss the likely benefits and drawbacks to LPC of the accounting and finance changes suggested by the company accountant (lines 61–66). [12]

4 Recommend and justify a suitable marketing strategy for increasing LPC textbook sales over the next 12 months. Your answer should include relevant analysis of the data in Table 2. [16]

5 Consider the economic data in Appendix A and the fact that 300 redundancies are possible. LPC plans to increase salaries to directors and dividends to shareholders this year. Is it right to increase directors' salaries and shareholder dividends at this time? Justify your answer. [16]

Section B

Answer **one** question in this section.

6 Evaluate the most important factors likely to affect LPC's future success by undertaking a SWOT analysis of the business. [20]

7 Evaluate the strategic choices which LPC could make to improve its competitive advantage in an increasingly competitive world. [20]

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