UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education Advanced Level

BUSINESS STUDIES **9707/31**

Paper 3 **October/November 2012**

CASE STUDY

3 hours

Additional Materials: Answer Booklet/Paper

2721396570

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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Shoe Style International (SSI)

SSI is a public limited company that makes a wide range of shoes for some of the biggest retailers in the country. For the first time, last year shoes were also sold abroad. SSI shoes are cheap copies of the most popular styles from the best known international fashion designers. Retailers say that SSI shoes are very popular with consumers. This is because they look like 'the real thing' but are much cheaper. Quality is not to the highest technical standards – the shoes tend to last about six months on average but most customers seem happy with this.

Strategic analysis

The directors of SSI are worried that sales growth has slowed in recent years. They are considering entering new market segments. SSI's Marketing Director, Paul DeVille, has analysed the market for high quality, high priced shoes. A SWOT analysis was done to establish the current position of the business. Competitive rivalry was analysed using Porter's Five Forces model. Boston Matrix analysis was used to assess the current market position of existing ranges. Sales forecasts for each market segment were obtained from market research consultants. The results from this strategic analysis convinced Paul that SSI should develop new shoe styles for the high income market segment. These shoes will be designed and developed by a new team of designers within SSI and will <u>not</u> be copies of shoes from fashion designers. The Marketing Director has thought of a name for this range of shoes – 'Marco'.

A new approach to selling shoes

Marco shoes will be sold through the same retailers that SSI currently use. However, the idea is to make every pair of Marco shoes to each customer's personal taste and foot size, so the shops will only display a few designs. Customers will have their feet measured by a computer-controlled machine that can take very accurate measurements in a few seconds. These measurements will then be sent to a new SSI factory where each pair of shoes will be handmade by skilled workers and delivered to the retail shop within a week. Paul DeVille told the other directors: 'This is a unique way of selling shoes. Customer recommendation will be our main form of promotion. To make a success of this strategy all we have to do is to get the product right.'

Locating the new factory

Currently, all SSI shoes are made in three factories located in countries where wages are low. Labour cost per shoe is very low, but materials such as leather have to be imported so exchange rate changes affect the cost of supplies. The directors believe that a new factory is needed to make Marco shoes. This is because the existing factories are operating close to full capacity and workers only have experience of producing the cheap shoe ranges. There are two locations being considered for the new factory. Location A is in one of the countries where SSI currently has a factory. Location B is in a high income country which is part of a large free trade area. It has rising unemployment and the Government offers capital construction grants for new business projects. The skill level of the country's workforce is high. Further data about these two locations is given in Appendix A.

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Human resource strategy

The manufacturing process used for the current shoe ranges is semi-automated with some stages of production still needing human input. The human resource strategy is focused on recruiting and employing labour with the aim of minimising the costs of the business. Selection and recruitment is based on a short interview with a supervisor. Training is limited to explaining how to operate the machines that each worker will be responsible for. Teamwork is not encouraged. The same wage rate is paid to all workers no matter how long they have worked for SSI. There is a small annual bonus for no absences over the previous 12 months. Very few workers qualify for this bonus.

Should dividends be reduced?

There are likely to be many unhappy shareholders at the next Annual General Meeting! The Chief Executive Officer (CEO) is proposing to reduce dividends for the financial year ending 31 October 2012. 'We need to retain most of the profits in the company to help keep an acceptable gearing ratio and to finance our ambitious expansion programme' he told the Board of Directors. 'We need to utilize our profits for the long-term rather than pay high dividends in the short-term. If shareholders agree with my proposal then the company can look forward to higher profits in the future from our expansion programme. This should lead to increasing shareholder returns in the long-term'. Appendix B shows an extract of SSI accounts that will be presented to the Annual General Meeting.

Cultural changes at SSI

Jacques Blanc has been CEO of SSI for just 2 months. Before joining SSI he was the CEO of an international business that manufactures and retails clothes. When he was appointed to SSI he told the other directors that he believed all businesses have a responsibility to society that extends beyond making profits for owners. After he was appointed CEO, he had a film made of himself explaining his views and sent copies of it to all SSI factories and offices. In the film he said: 'I took over control of SSI to change it. The company will adopt a new mission statement and ethical code of practice. SSI will sponsor environmental charities. We need to trust our workers more. SSI must be seen to do the right thing at all times. I have sold the company's executive aircraft and I will claim minimum expenses while I am away on SSI business. I expect all directors and managers to follow my example. SSI will stop using dangerous colour dyes on the leather and plastics that we buy. Health and safety rules in factories will be strictly observed.'

Some senior managers laughed and joked when they saw the film. Their view was that the business should be a 'profit machine' and nothing else. A manager in one of the regional sales offices, many kilometres away from SSI Head Office, watched the film. This did not stop him inviting a retail shop manager to dinner and offering a bribe to encourage her to stop selling a competitor's shoes. He said to the shop manager: 'Our new boss thinks that acting in a socially responsible manner can actually increase profits – we know differently, don't we?'

Jacques heard rumours about negative reactions to his new culture for SSI. He realized that changing the culture of the company was not going to be that easy.

Appendix A: Location data

	Location A	Location B
Capital cost of construction	$15m	$10m
Forecast annual net cash flows from the investment	$4.4m	$4.2m
Annual fixed costs	$2.5m	$3m
Contribution from each pair of shoes made in this location	$3.5	$2.8
Unemployment rate in the country	21%	12%
Number of other shoe makers within 100 kilometres	8	1
Number of suppliers within 100 kilometres	4	6
Trade union membership as % of national workforce	7	23
Minimum wage law in the country	No	Yes
Forecast annual break-even output (millions of pairs of shoes)	0.71	See question 2(a)
Forecast payback period for the investment	See question 2(a)	2 years 5 months

Appendix B: Summary accounting data for SSI

	Year ending 31 October 2012	Year ending 31 October 2011
Total dividends	$40m (proposed by CEO)	$60m
Total profit (after tax)	$85m	$90m
Total number of issued shares	200m	200m
Dividend per share	$0.20	$0.30
Earnings per share	$0.425	$0.45
Share price	$5	$6
Price/earnings ratio	See question 4(a)	13.3
Dividend yield	See question 4(a)	5%

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Section A

Answer **all** questions in this section.

1 Analyse the possible disadvantages for SSI of the company's human resource strategy within its existing factories. [10]

2 **(a)** Refer to Appendix A. Calculate the:

(i) break-even level of output of Location B [3]

(ii) payback period for Location A. [3]

(b) Recommend which location SSI should choose for the new factory. Justify your recommendation using your results from **(a)** and other information. [14]

3 Discuss the importance to the success of Marco shoes of an integrated and coordinated marketing mix. [14]

4 **(a)** Refer to Appendix B. Calculate for 2012 the:

(i) price/earnings ratio [3]

(ii) dividend yield. [3]

(b) Recommend to the directors of SSI whether to reduce the 2012 dividend payment to shareholders, as proposed by the CEO. Justify your recommendation using your results from **(a)** and other information. [14]

5 Evaluate strategies that SSI could adopt (other than introducing the Marco range of shoes) to achieve increases in sales and profits. Use Ansoff's Matrix in your answer. [16]

Section B

Answer **one** question from this section.

6 Refer to the strategic analysis undertaken by the Marketing Director (lines 8–20). Evaluate the importance of this strategic analysis to the successful introduction of the Marco range of shoes. [20]

7 Discuss the factors that will determine whether the CEO is successful in changing the corporate culture of SSI. [20]

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