UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education Advanced Level

BUSINESS STUDIES **9707/31**

Paper 3 **October/November 2013**

CASE STUDY

3 hours

Additional Materials: Answer Booklet/Paper

6618595148

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.

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LeBlanc Kitchen Equipment (LKE)

Serge LeBlanc was only 21 years old when he became manager and sole owner of the family business, LKE, after his father died three years ago. The business makes metal saucepans, pots and dishes for use in home and restaurant cooking. Most products are made of iron but a small section of LKE's factory has been equipped to produce the latest stainless steel products. The demand for these new products is increasing from high income consumers. LKE distributes its products through wholesalers but also sells directly online through its website. LKE prices are competitive with other similar products sold in country X – the only country that LKE currently operates in.

Serge did not study business subjects at university. However, once he became manager of LKE he gained a reputation for taking good business decisions.

Forecasts for 2014

Serge understands the need for forecasting future business performance. He has already prepared some budgets for 2014 and he is about to prepare a forecast income statement. He will use the income statement for the year ending 30 September 2013 as his starting point (see Appendix 1). Serge forecasts the following changes over the next 12 months.

- Revenue will increase. Sales are expected to rise from 350 000 units at an average price of $15 to 370 000 units at an average price of $16.
- Average cost of sales will increase from $4 per unit to $5 per unit due to higher metal costs.
- Factory overhead costs will increase by 10%.
- Administration and marketing costs will not increase. Serge intends to make savings on the promotion budget to cancel out the impact of higher salaries.
- Annual interest costs on the company's long term loans of $1m are likely to rise from 16.5% to 18%.
- All other costs including depreciation will remain as in 2013 but the Government is expected to reduce corporation (profit) tax from 50% to 40%.

Serge thinks the business should be even more profitable. At the next meeting of senior managers he is going to ask for managers' views on how to increase profits.

Industrial disputes seem likely

Serge leaves most human resource decisions to the Human Resources manager, Sheila. All of the employees have a written contract of employment. Many have temporary and part-time contracts. However, a few key employees (including supervisors, accountants and specialist machine operators) have full-time permanent contracts and are given non-financial benefits. Sheila has decided to replace the current hourly wage plus bonus for good attendance with a simple piece rate system for all factory production employees. Holidays are to be reduced by one week.

When these changes were communicated to workers in the weekly LKE newsletter there was much opposition. Nearly half the employees belong to trade unions and the union representatives asked for meetings with Sheila but this request was refused. Serge explained his response to this union request to LKE's managers: 'LKE does not negotiate with union leaders. LKE managers know what is best for the business which means, in the long term, we know what is best for our workers too. I think we can gain agreement for these changes. After all, our factory is in an area of high unemployment.' Since Sheila's decision, more LKE employees have joined trade unions and one of the unions is planning to call its members out on strike.

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Operational efficiency and new technology

LKE's Operations manager is studying some of the latest data on the efficiency of the business (see Appendix 2). She wants to introduce some of the latest technology production equipment as she thinks this will improve operational efficiency. This technology will increase annual capacity by 25% but annual factory overheads will increase (from 2013 levels) by only 20% to $1.92m. Contribution per unit should increase by $1 to $12 due to lower direct costs. The new machinery should also cut down on the noise and carbon pollution caused by the production process.

Globalisation – threat or opportunity?

Country X has recently joined a large international free trade area. The Employers Association of country X has warned its members that this will increase the impact of globalisation. Serge thinks that competition from imported kitchen equipment will increase but that LKE also has the opportunity to export for the first time. He has obtained a research report which compares the kitchen equipment markets in country X and country Y (see Appendix 3). Serge has been advised to use an agent or distributor if LKE starts to export to country Y. He could also consider a joint marketing venture with a large retailing business in that country. However, Serge is keen to retain full control over the marketing of LKE products. He believes that if his marketing department translates existing LKE advertising and promotional material into the language most widely used in country Y then his business could enter this market successfully.

Family business to be taken over?

LKE has three competitors in country X and LKE has the smallest market share. The economies of scale experienced by the other companies give them a competitive cost advantage. However, the LKE brand name is well recognised and the quality of its products is a differentiating factor. The other firms are constantly improving designs and materials, but LKE has a limited budget for research and development. So when one of the directors of the largest competitor, CPS, approached Serge and offered to buy 51% of LKE it gave him much to think about. The CPS director suggested that Serge could remain in day-to-day control of the LKE business but that the following changes would have to be made.

- Sell the existing factory site, near the city centre, which is worth $5m.
- Relocate to a region with much lower land prices. The director estimated that around 60% of LKE employees would move to the new site.
- Adopt lean production techniques.
- Expand the research and development team and aim to develop new materials for the LKE range of products.
- Replace most LKE senior managers with CPS managers.

Serge has always wanted to be very rich – but should he sell off most of the family business for his own gain?

Appendix 1: LKE income statement for year ending 30 September 2013

	$000
Revenue	5250
Gross profit	3850
Overheads:	
Factory	(1600)
Administration and marketing	(1625)
Depreciation	(320)
Net profit (before tax and interest)	305
Interest	(165)
Pre-tax profits	140
Tax	(70)
Profit after tax	70

Appendix 2: Operation management data for LKE for year ending 30 September 2013

Annual production capacity	440 000
Actual output	360 000
Direct labour cost per unit	$1
Direct material cost per unit	$3
Total annual factory overheads	$1.6m
Current break-even level of output (based on factory overhead costs)	145 454 units
Factory production employees (full-time equivalent)	220
Annual pollution level (tonnes of carbon dioxide)	650

Appendix 3: Comparing kitchen equipment market: country X and country Y

	Country X	Country Y
Average family size	4	7
Number of retailers of kitchen equipment	56	234
Most popular material for cooking equipment	Iron	Stainless steel
Number of high income consumers	1.2m	5.5m
Joint marketing ventures between kitchen equipment manufacturers and retailers	1	5
Number of manufacturers of kitchen equipment	4	7

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Section A

Answer **all** questions.

1 Analyse the impact on LKE of any **two** of its current weaknesses. [10]

2 **(a)** Refer to Appendix 1 and information on lines (18–30). Construct a forecasted income statement for LKE for the year ending 30 September 2014. [8]

(b) Assess how LKE could increase profit in 2014. [12]

3 Discuss how LKE could effectively solve the dispute with the workforce. [16]

4 **(a)** Refer to Appendix 2. Calculate:

(i) capacity utilisation [3]

(ii) labour productivity. [3]

(b) Using data in Appendix 2 and other information, assess the likely impact on LKE's operational efficiency of increased use of technology. [12]

5 Recommend to LKE an appropriate strategy for marketing its products in country Y. Justify your recommendation. [16]

Section B

Answer **one** question from this section.

6 Evaluate the importance to LKE of strategic analysis before deciding on market development in country Y. [20]

7 Evaluate how Serge could effectively manage the changes that would result from a takeover by CPS. [20]

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