UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education Advanced Level

BUSINESS STUDIES **9707/33**

Paper 3 **October/November 2013**

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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Pop Cool (PC)

PC is a public limited company. Its Head Office is in Europe and it operates with centralised decision making. The company owns the Pop Cool brand name, logo and the distinctive bottle shape that is still used in some markets. PC operates its own bottling and canning factories in some countries. However, it also has joint venture agreements with packaging businesses in other countries. Much of the fruit and sugar used in producing the drinks is imported from African and Asian countries. 75% of PC's sales and 90% of its net profits are earned in the USA and Europe. The directors of PC are keen to develop other markets and other products so that the company becomes less dependent on a few key markets and products.

Economic changes

The economies of the USA and Europe have experienced very slow economic growth since 2008 – and some have even been hit by recession. Interest rates are very low as the monetary policy of these countries is aiming to boost demand. However, this has contributed to exchange rate depreciations of the US Dollar and the European Euro. Consumer spending has fallen due to declining real incomes. There are ageing populations in most of the countries where PC sells its products. A loss of competitiveness in many industrial sectors has resulted in rising unemployment.

Balance sheet valuations

Since 2008 PC's share price has fallen. This has been the trend for many public limited companies. PC's Finance Director has been considering three changes that will affect PC's accounts. He could make all three changes or just one or two of them.

- When calculating depreciation of new production equipment bought last year for $25m, use an estimated life of 8 years not 5 years. The equipment would still have an estimated residual value of $3m.
- Sell $10m of property assets and lease them back at an annual leasing cost of $1.5m.
- Revalue the company's intangible assets by 50%.

He used an extract of PC's most recent accounts to calculate what the impact of these changes might be on profit and gearing (see Appendix 1).

Entering new markets – Africa and Asia

Paul, PC's Chief Executive Officer (CEO), has been discussing with the Marketing Director, Suzy, alternative marketing strategies the company could use to enter the rapidly expanding markets of Asia and Africa. They have different views.

Paul stated that: 'I think we should take over an existing soft drinks manufacturer in, for example, India or China. We would then have all of the production facilities and distribution channels through large supermarkets that we will need. The existing brand names could then be replaced with the Pop Cool brand which we would advertise very heavily for a short period. Consumers will be attracted to this because it is so popular elsewhere in the world.' Suzy replied: 'There could be local opposition to this globalised approach – although the marketing economies of scale will be substantial. I think we should develop a range of soft drinks to suit local tastes with brand names that reflect local language and culture. We could distribute these new drinks through small retail stores and street markets. This way we will slowly but steadily build up consumer awareness and loyalty.'

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Workforce planning in country X

Country X is one of PC's biggest markets. The company fully owns all of the production facilities in this country and it has a large sales and marketing team too. PC employs 468 people in country X and labour costs are the company's biggest expense in this country. The Human Resources department is under pressure from PC's Head Office to reduce labour costs in country X by 15%. The Human Resources manager in country X, Bill, thinks that cutting labour costs might be risky. He told other senior managers: 'We must maintain consistent and adequate production levels so that consumers can always buy the quantity they want. Production workers are sometimes reluctant to learn new skills and they are resistant to job flexibility. Should we cut back on sales and marketing staff? Perhaps we should employ more production workers on flexible contracts. Another option is to introduce even more automation at our main packaging plant.' The other managers agreed with him that meeting this new company objective of reducing labour costs was going to need careful workforce planning.

Special order in country X

PC's marketing team in country X has just received an enquiry from the country's largest supermarket group – Superfood. The supermarket is asking PC to produce one large batch of soft drinks as a trial product to be sold under Superfood's own brand name. The drinks would be similar to an existing Pop Cool product. PC's Marketing manager in country X is not prepared to take this decision without the approval of Head Office. He consulted with the Operations manager in country X. They compiled data to present to PC's senior management team in country X before asking Head Office for a final decision (see Appendix 2).

Future options for PC's growth

PC's Board of Directors has been criticised by the newspapers and by major shareholders for the company's slow rate of growth in sales and profits since 2008. Apart from expansion into markets in Asia and Africa, the directors are investigating two other strategic options for growth and increasing long term profitability.

Option A: Develop new flavours and distinctive names for a wider range of PC products. These could include: Pop Cool Energy aimed at the sports people market segment and Pop Cool Vital aimed at young people wanting to buy healthy drinks. The Marketing Director believes that much clearer market segmentation is the best strategy for achieving market penetration and higher profits. He said at a recent Board meeting: 'This is a low risk strategy that could be implemented within two years'.

Option B: Extend the Pop Cool brand name and image by organising a joint venture with a clothing designer. The plan would be to launch a range of modern clothes aimed at young consumers. With careful and extensive promotion, the CEO thinks that these consumers would quickly link the clothing range with Pop Cool's positive image. He believes that the best way to expand profitably in the longer term is for PC to diversify into markets and products that could lead to higher profit margins than those achieved with soft drinks.

Appendix 1: Extract from Pop Cool's latest published accounts (before any changes proposed by Finance Director)

Balance sheet extract as at 31 October 2013	$m
Non-current assets:	
Land	78
Buildings	112
Production equipment	78
Vehicles	10
Intangible assets	80
Total non-current assets	358
Net current assets	86
Non-current liabilities	156
Shareholders' equity	288
Income statement extract for year ending 31 October 2013	
Revenue	750
Profit after depreciation and interest	87

Appendix 2: Superfood's special order – data produced by Marketing manager and Operations manager

PC's annual production capacity in country X	50m cans
PC's actual production level (2012) in country X	45m cans
Superfood order	4m cans
Unit material cost per can of drink	$0.10
Unit direct labour cost per can of drink	$0.15
Cost of new design of can for Superfood and product testing	$0.5m
Transport costs for Superfood order	$0.1m
PC factory overhead cost per can of drink (2012)	$0.25
Price per can offered by Superfood to PC	$0.50

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Section A

Answer **all** questions in this section.

1 Analyse the likely impact on PC's profitability of the economic changes referred to in lines 10–17. [10]

2 **(a)** Refer to lines 18–30 and Appendix 1. Calculate:

(i) change in the annual depreciation of the new production equipment [4]

(ii) gearing ratio after the revaluation of PC's intangible assets by the Finance Director (assume he makes no other changes). [4]

(b) Assess the usefulness of ratio analysis of PC's published accounts to its stakeholders. [12]

3 Recommend to PC's Board of Directors which one of the two strategies should be adopted for entering new markets in Asia and Africa (lines 31–45). [16]

4 **(a)** Refer to the data in Appendix 2. Calculate the impact on PC's profits of accepting the special order from the Superfood supermarket group. [6]

(b) Using your result from **4(a)** and other information, advise PC on whether to accept this special order. [12]

5 Evaluate the factors that the Human Resources manager should consider before completing the workforce plan for PC's operations in country X. [16]

Section B

Answer **one** question from this section.

6 PC has the objective of increasing long term profits. Evaluate the strategic factors that the directors should consider when making the choice between option A and option B. [20]

7 Several strategic changes are likely to occur within PC. Evaluate how senior managers could implement these changes most effectively. [20]

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