Cambridge International A Level

Cambridge International Examinations
General Certificate of Education Advanced Level

BUSINESS STUDIES **9707/32**

Paper 3 **October/November 2014**

3 hours

Additional Materials: Answer Booklet/Paper

7891531670

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, graphs or rough working.
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 **6** printed pages and **2** blank pages.

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Timtang Corporation (TC)

In the fiercely competitive world of consumer electronics, TC has experienced rapid sales and profits growth in recent years. This success has been built upon substantial research and development (R & D) spending. This has allowed the business to develop a range of advanced cell (mobile) phones and 'tablet' computers that are market leaders. The strategy of product differentiation has helped establish the TC brand as one of the most valuable in the global consumer electronics market. TC's directors understand that the market leadership the corporation has achieved could change in future because competitive rivalry is growing.

Buyer power is increasing

Even a brand as well known as TC is subject to pressure from buyers of its products. Most TC cell phones and tablet computers are sold to multinational retailers or cell phone service operating companies. The bargaining power of these groups has increased due to integration and concentration of buying power in fewer companies. This distribution strategy also means that TC does not have direct contact with final consumers of its products, making the establishment of long term customer relations with them more difficult.

Financial efficiency

Over the 3 years up to 2013, TC managed its working capital efficiently. Both the inventory turnover and days' sales in trade receivables improved. However, in 2014 TC was left with large inventories of unsold 3G 'old generation' cell phones. A combination of increased competition and poor communication between the R & D department and the production scheduling team resulted in excess output of the old generation phones. The R & D team had developed and prepared for sale the new generation 4G cell phones much quicker than expected, but production of the 3G models was not cut in response to this. In addition, large retail corporations were taking longer to pay debts to manufacturers such as TC. Table 1 shows some selected accounting data for TC.

Table 1: Summary accounting data for TC (as at 31 October)

	2014	2013
Revenue	$1 695m	$1 580m
Cost of goods sold	$650m	$580m
Net profit margin	17%	15%
Current assets	$265m	$210m
of which: Inventories	$50m	$29m
Trade receivables	$205m	$160m
Dividend yield ratio	6%	8%
Current liabilities	$198m	$212m

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Production rationalisation

TC used to own and control all of the factories making its products. This was in contrast to other manufacturers of consumer electronics which usually outsourced production. TC has now started to outsource production of its latest products, which has reduced variable costs of production by 20%. TC's Board of Directors is now planning further outsourcing. The directors are keen for this process to be extended because as well as lower costs there are likely to be other benefits. However, some directors are worried about the impact of continued outsourcing on TC's own employees and the corporation's ethical reputation.

Turnover of managers at record high

Currently, TC employs a total of 25 000 people of whom 3500 are classified as 'management staff'. This term covers all managers below Board of Directors level. The turnover of managers is high – above the industry benchmark percentage. TC managers are often 'headhunted' and attracted away from TC by other companies in the sector with more appealing employee incentives and career pathways. An organisational restructuring took place within TC last year. This led to many management resignations as a matrix organisation was imposed on the corporation by the Board. This resulted in large numbers of people with hierarchical line functions being reallocated to project teams in which leadership was shared, although still retaining their former salary. The Timtang family still have 2 directors on the Board but the family shareholding is now down to 5% of total issued shares. The company has policies of only recruiting senior managers externally to Board level and limiting share ownership schemes to the Board.

Accept new offer?

The Purchasing Director of the Hanshai Retail Store (HRS) has been in contact with TC's marketing department. HRS is offering to buy all of the old generation 3G cell phones held in inventory by TC at a price of $10 each. This is less than cost. HRS has asked that the front covers of the phones are changed to show the HRS name and logo rather than those of TC. Key information about this offer is shown in Table 2.

Table 2: Financial data for old generation cell phones

Size of inventory of 3G model	3m units
Cost of changing name and logo per unit	$1
Original cost of making each unit	$15
Net realisable value of each cell phone on TC's 2014 accounts	$7

Strategic options: own shops or defence electronics?

Shareholder pressure on TC's directors for further increases in dividends and share price has encouraged the Board to do a strategic analysis (see Appendix 1 and Appendix 2). As a result of this analysis the Board is considering the following 2 strategic options for further growth. These would involve different degrees of risk as well as different management skills.

Strategic Option 1: Open own retail outlets *65*

Key points:

- Open shops selling only TC products in major cities.
- Offer full range of TC products.
- Objective would be to establish and build direct customer relationships.
- Before and after sales service. *70*
- Customer support and product upgrades available.

Strategic Option 2: Diversify into defence electronics

Key points:

- Use competencies in communication technology and tracking technology to develop cell phones and other equipment for defence forces. *75*
- Establish defence equipment marketing team.
- Develop close links with Government departments responsible for defence purchases.

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Appendix 1: SWOT analysis for TC

Strengths	Weaknesses
Brand name Strong R & D experience Market leader High liquidity	Management turnover is high Business growth might worsen internal communication High inventory levels
Opportunities	**Threats**
New product developments, e.g. more advanced hand-held computers New market developments Other channels of distribution possible	Competition is growing Increased buyer power Technological change

Appendix 2: PEST analysis for TC

Political	Economic
Government's outline plans to reduce defence spending Government controls sales of 4G phone operating licences	Changes in consumer disposable incomes could affect sales Emerging markets growing rapidly
Social	**Technological**
Growth of social networking sites More leisure time	Advances in technology are rapid Competitors are spending on R & D too

Appendix 3: Strategic choice between Option 1 and Option 2

	Option 1	Option 2
Decision tree summary	Chance of failure: 20% Expected monetary value: $30m per year	Chance of failure: 40% Expected monetary value: $50m per year
Force field analysis	Forces for change: 10 Forces against change: 9 Main force for change: Better able to establish customer relationships	Forces for change: 9 Forces against change:11 Main force for change: Growing global demand for defence equipment
Ansoff matrix	Market penetration through offering retail services to existing customers with existing products	Diversification
Investment appraisal	Capital cost: $200m Forecasted payback: 4 years	Capital cost: $150m Forecasted payback: 3 years

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[Turn over

Section A

Answer **all** questions in this section.

1 Analyse the likely impact on TC of increased outsourcing of production. [10]

2 **(a)** Refer to Table 1. Calculate for 2014:

(i) inventory turnover ratio [3]

(ii) days' sales in trade receivables. [3]

(b) Refer to Table 1 and your answers to **2(a)**. Assess the usefulness of accounting ratio results to any **two** of TC's stakeholder groups. [14]

3 Evaluate how TC could develop its long term relationships with customers if it opens its own retail outlets (Strategic Option 1). [16]

4 **(a)** Refer to Table 2 and line 55 [where price is stated]. Calculate the effect on TC's profits if the HRS offer for the cell phone inventory is accepted. [6]

(b) Using your results to **4(a)** and other information, assess whether the HRS offer should be accepted. [12]

5 Discuss whether TC's Board of Directors should be concerned about the high turnover of management staff. [16]

Section B

Answer **one** question from this section.

6 Evaluate the usefulness of the information in Appendix 1 and Appendix 2 to TC's strategic analysis. [20]

7 Refer to Appendix 3 and other information in the case. Recommend to TC's Board of Directors which of the 2 strategic options for further growth should be chosen. Justify your recommendation. [20]

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