Cambridge International A Level

Cambridge International Examinations
Cambridge International Advanced Level

BUSINESS STUDIES **9707/33**

Paper 3 **October/November 2014**

CASE STUDY

3 hours

Additional Materials: Answer Booklet/Paper

2652715763

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 or graphs.
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.

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Senbo Construction (SC)

SC is the third largest construction company in country X. It is a public limited company. It builds houses, factories and shops in country X. The directors of SC focus the company's strategies on long term objectives of a return on capital employed of 15% and increased annual shareholder returns. The directors are constantly seeking new sites for large scale developments such as housing estates and industrial parks. The purchase of new sites is usually financed from retained profits and long term loans.

The demand for homes and business premises has increased in recent years in country X as the economy has grown. However, the rate of inflation in country X has risen above target and rapid economic growth has led to record low levels of unemployment. The Government is worried about rising prices and plans to increase direct taxes on incomes and company profits to reduce total demand in the economy.

Building customer relationships

SC has a home maintenance division – Senbo Home Maintenance (SHM). House owners can pay an annual fee to SHM and benefit from an emergency call out service if any problems occur such as water and gas pipe leaks or blocked drains. SHM is very profitable as it charges high fees. The Marketing manager of SHM is pleased that the division achieved its market share objective of 15% last year. However she is worried about the low levels of consumer loyalty. Many consumers do not renew their subscriptions. This means that SHM needs to promote itself using extensive media advertising and offer 'special introductory deals' in order to attract new customers. The Marketing manager wonders if it would be more cost effective for SHM to devote more of its resources to trying to retain a higher proportion of its existing customers and build long term relationships with them.

New equipment

SC's Finance Director is attempting to reduce the annual fixed costs of the business. He has negotiated a substantial discount from a manufacturer of construction equipment for the purchase of 15 large cranes and 10 earth moving trucks. These would replace equipment that is currently leased on a 4-year agreement which is due to end soon. The finance of $25 m would have to be borrowed, but the Finance Director believes that this will prove to be cheaper in the long term than taking out a new 4-year leasing agreement. The Finance Director has estimated the net cash flows of these two options and has almost completed an investment appraisal of them (see Appendix 1).

Selecting a new Human Resources Director

Jim Chan has just retired as SC's Human Resources Director. During his 15 years at the company there had been many changes in the company's HR strategy, partly because of new labour laws. These changes included giving the employees written employment contracts, extending the holiday scheme to all employees and not discriminating in favour of men. Industrial relations at SC are excellent, trade union membership is high and pay levels are competitive. However, SC's Board of Directors realise that tougher macroeconomic conditions in future might require a change of HR strategy to keep SC competitive. The Board's Recruitment and Selection Committee advertised the HR Director vacancy nationwide and this attracted many applicants. These have been reduced to 2 candidates and a final decision will be made soon based on replies on the application form and a rigorous selection process. Some of the candidates' answers to application form questions are shown in Table 1.

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Table 1: Summary of candidates' answers to questions on application form for post of HR Director

Questions	Candidate C's answers	Candidate D's answers
Education qualifications	University degree in Human Resource Management.	Two university degrees: Business Management; Accounting and Finance.
Previous experience	15 years with current employer – major retailer. First post – HR assistant. Current post – senior HR manager.	Varied experience in several posts. 3 years with current employer – small construction business. Current post – HR Director.
What is your main strategic focus in Human Resources?	To develop employees and offer them challenging roles so they can all contribute fully to the success of the business.	To manage employee costs effectively so that the financial targets of the business can be achieved.
Current salary	$35 000	$29 000
Foreign country experience	None.	Yes – several years ago I worked in country Y with a multinational mining company.

Alternative growth strategies

SC's directors are planning to expand the business further. They are considering 2 strategic options. One is based in country X, where SC currently operates, and the other in country Y.

Option A: Use a vacant site owned by SC in country X to build a hotel and country club. This would be owned and operated by a new SC division. The key features of this strategy are:

- first attempt at managing a development after construction, SC have always sold sites they have developed
- according to a preliminary critical path analysis, conducted by SC's Operations Director, it could be completed within 1 year; this is likely to be 9 months quicker than Option B.

Option B: Purchase a vacant site in country Y and develop a luxury housing estate by forming a joint venture with a building firm in that country. The key features of this strategy are:

- first time SC will have operated in another country
- first time SC will have formed a joint venture
- country Y has high average incomes, its economy is expanding rapidly and interest rates are low.

Flood disaster

At the end of 2013, SC purchased a privately owned construction business called SureBuild. This company's reputation was not as good as SC's but it owned many sites with potential for development. SureBuild has been accused by pressure groups of using contaminated and polluted former factory sites for building houses. If true, this would have put the new house owners' health at risk. SureBuild has always rejected this criticism. Although SC owns SureBuild, the integration of the business and its employees into the SC organisation is not yet complete.

Last month, heavy and prolonged rains in the northern region of the country caused widespread flooding. Some of the buildings in Exodus, a large new shopping and residential complex constructed by SureBuild in 2012, were destroyed and swept away by these floods. Many people lost their homes. The newspapers in country X have started to investigate the construction methods that SureBuild had used for this development. A retired building inspector claimed that: 'The foundations were not deep enough and the underground lake had not been drained correctly'.

SC's senior management were not prepared for the floods and the disaster that resulted. Initially, a spokesman for the company suggested that the Government's failure to build flood defences was the major problem and that SC could not be held responsible for SureBuild's developments when it was a separate company. However, yesterday SC's Board of Directors changed the company's approach completely by issuing the following press release: 'SC accepts full responsibility for any damage or loss that might have resulted from faulty construction of the Exodus site even though this was built by SureBuild when it was not part of our group of companies'.

Appendix 1: Investment appraisal data for the two options for new equipment

	Equipment leasing option	Notes	Equipment purchase option	Notes
Net cash flow (NCF)Year 0	($2m)	No capital costs of purchase but legal charges incurred	($25m)	Capital cost of machinery
NCF Year 1	$6m	Cash inflows from use of machinery minus leasing charges	$14m	Cash inflows from use of machinery minus maintenance costs
NCF Year 2	$6m		$14m	
NCF Year 3	$6m		$14m	
NCF Year 4	$6m		$20m	Includes expected residual value from sale of equipment
Net present value @ 10% discount	$17.02m		See **Question 2(a)**	

10% discount factors: Year 1 = 0.91; Year 2 = 0.83; Year 3 = 0.75; Year 4 = 0.68.

Appendix 2: Summary accounting data for SC – 2014

Profit after tax (year ending 31 October 2014)	$36m
Retained profit (year ending 31 October 2014)	$22m
Non-current liabilities (as at 31 October 2014)	$44m
Capital employed (as at 31 October 2014)	$88m

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Appendix 3: Option A – New hotel and country club development, activities for this project.

Activity	Description	Preceding activity	Expected duration (weeks)
A	Clear site	–	10
B	Build hotel	A	23
C	Decorate and furnish hotel	B	16
D	Install kitchen equipment	B	8
E	Landscape gardens	B	12
F	Recruit and select hotel staff	B	4
G	Train hotel staff	F	3
H	Test hotel information technology systems	C, D, G	2

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[Turn over

Section A

Answer **all** questions in this section.

1 Analyse the likely impact on SC of an increase in direct taxes in country X. [10]

2 **(a)** Using Appendix 1, calculate the net present value of the equipment purchase option. [3]

(b) Investment in purchasing equipment will require SC to borrow $25m. Using the information in Appendix 2, calculate the new gearing ratio after borrowing this amount. [3]

(c) Using your results from **(a)** and **(b)** and any other relevant information, advise SC's Finance Director whether to lease the equipment or purchase it. [12]

3 Evaluate ways in which SC could increase customer loyalty for SHM. [14]

4 **(a)** **(i)** Using the information in Appendix 3, draw a network (CPA) diagram for the new hotel development. [8]

(ii) Identify the critical path activities. [1]

(iii) State the length of the critical path. [1]

(b) Assess the usefulness of critical path analysis to the success of option A. [12]

5 Using data in Table 1 and any other relevant information, recommend to SC's Recruitment and Selection Committee which one of the two candidates for HR Director should be appointed. Justify your recommendation. [16]

Section B

Answer **one** question in this section.

6 Discuss appropriate strategic choice techniques that SC's directors could use to help them decide between option A and option B. [20]

7 Assess the importance of contingency planning to SC's future success. [20]

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