CAMBRIDGE INTERNATIONAL EXAMINATIONS

Cambridge International Advanced Level

MARK SCHEME for the October/November 2015 series

9707 BUSINESS STUDIES

9707/32 Paper 3 (Case Study), maximum raw mark 100

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1 Analyse the potential benefits and limitations of GO's high gearing ratio. [10]

	Knowledge 3 marks	**Application 3 marks**	**Analysis 4 marks**
Level 2	3 marks Knowledge of gearing and benefits/limitations of high gearing	3 marks More than one benefit/limitation explained in context	4–3 marks Good use of theory and/or reasoned argument to explain benefits and limitations
Level 1	2–1 marks Some knowledge of gearing or benefits/limitations of high gearing	2–1 marks Some application to case	2–1 marks Some use of theory and/or reasoned argument to explain benefits or limitations

Level 1 Analysis if only benefits or limitations

Answers could include:

- Gearing is proportion of total capital financed from loans – formula accepted too
- GO's non-current assets are greater than equity
- Gearing has increased (by 5% points)
- High gearing – as in this case, over 50% – can be risky especially if profits start to fall – as in this case
- High gearing can lead to high interest costs – especially, as in the case, the Government is pursuing an anti-inflation policy which **could** increase interest rates
- Financing growth through high gearing seems to have occurred in this case – this can benefit shareholders – who include directors in this case – by increasing returns to shareholders at a faster rate than profits growth. This has not led to much higher dividends yet

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2 (a) Refer to Table 2. Calculate for System 2:

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

BE = fixed costs/contribution per unit 1 mark (If no relevant calculation)

Working	Mark for working	Answer	Mark	Justification
2 m/800	2	2500	3	Correct
1 m/800	1	1250	2	Not all fixed costs
5 m/800	1	6250	2	Added capital cost to fixed costs
4 m/800	0	5000	1	Included capital cost and ignored one of fixed costs
3 m/800	0	3750	0	Only included capital cost. Fundamental misunderstanding of concept

(ii) the safety margin based on the 2014 output level [2]

Safety margin = current output – BE output (1 mark)
4000 – 2500 = 1500 units (2 marks)

Own Figure Rule applies based on answer to **(i)**

(iii) annual profit based on maximum system capacity. [3]

Profit = TR –TC OR Contribution per unit × output in excess of BE (1 mark)
2500 × \$800 (2 marks)
\$2m (3 marks)

Own Figure Rule applies based on answer to **(i)**
i.e. (5000 – Calculated BE) × 800

B/E	OFR Profit
1250	\$3m
6250	(\$1m)
5000	\$0
3750	\$1m

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(b) Using your results to (a) and any other relevant information, recommend to GO's directors which production system to purchase. [14]

	Knowledge 2 marks	**Application 2 marks**	**Analysis 5 marks**	**Evaluation 5 marks**
Level 2	2 marks At least two relevant points made	2 marks Application of two or more points to case/use of results	5–4 marks Good use of theory to answer question	5–4 marks Good judgement shown
Level 1	1 mark One relevant point made	1 mark Some application to case/use of one result	3–1 marks Some use of theory to answer question	3–1 marks Some judgement shown

Level 1 Analysis and Evaluation if only one out of results to **(a)** and other relevant information

Answers could include:

- Analysis of BE results: Lower BE for cheaper option – good
- Higher safety margin too – good
- BUT lower profit at max capacity so much depends on whether output will increase in future – System 2 actually gives higher profits at 4000 output
- The higher profit from System 1 (at max capacity) would help to pay back the higher capital cost

Other factors:

- Can finance be raised for System 1? Impact on already high gearing if this is borrowed?
- Training costs for System 1? Can suitably qualified workers be recruited?
- Loss of employment with System 1 – how important is CSR to GO? Is there a risk of industrial action?
- Greater flexibility of System 1 could be crucial if they enter the consumer market
- System 2 requires 50 production workers but System 1 only requires 16. Link could be made to current number of production workers (105) and level of redundancies
- System 2 is less flexible. Link could be made to entry into consumer oven market

Evaluation:

- Most important factor in this case?
- Accuracy of quantitative estimates – can these be relied on?
- How long will each system take to introduce?
- Has there been sufficient technical research into the systems?
- Final recommendation needs to be supported by appropriate analysis

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3 Discuss the factors that may determine the success of GO's entry into the consumer oven market. [16]

	Knowledge 3 marks	**Application 3 marks**	**Analysis 5 marks**	**Evaluation 5 marks**
Level 2	3 marks At least two relevant points made	3 marks Application of two or more points to case/use of results	5–4 marks Good use of theory to answer question	5–4 marks Good judgement shown
Level 1	2–1 marks One relevant point made	2–1 marks Some application to case/use of one result	3–1 marks Some use of theory to answer question	3–1 marks Some judgement shown

Answers could include:
Success in consumer markets will depend on…

- Differences between consumer and industrial markets – consumer market more widely dispersed, consumer choices may be based on different factors, direct selling unlikely etc.
- Effective market research e.g. size of market, market segments, major competitors, "what consumers are expecting" in this market
- Product – can existing small GO ovens be adapted for consumers? Will they accept a "former industrial oven"?
- Price – cost plus unlikely to be successful if there is much competition – need to use penetration to get established – or skimming if they want to present a very high image for the product?
- Promotion budget – may need to equal that of competitors in this market
- Promotion methods – very different e.g. adverts and point of sale displays to attract consumers
- Distribution – through retailers? Need to establish good links with major retailers and to have supportive brochures written for consumers
- Adopting System 1 might help
- Macroeconomic events could influence success

Evaluation:

- Completely new marketing plan needed – most important factor could be identified and explained
- Essential to have fully integrated and supportive marketing mix aimed at consumer market
- Competitive rivalry will be an important factor – no information on this
- How will "success" be judged?
- Original objective needs to be realistic (market share?) and used as a form of assessment of this market development strategy

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4 (a) Refer to Appendix 1.

(i) Calculate the values v and w. [4]

(ii) Calculate the values x and y. [2]

(iii) Identify whether the variances you have calculated for x and y are adverse or favourable. [2]

Question	Letter	Answer	Mark
(i)	v	1 051 000	2
	w	886 000	2
(ii)	x	20 000	1
	y	2 000	1
(iii)	x	Adverse	1
	y	Favourable	1

	Budget	Actual	Variance A = Adverse F = Favourable
Sales (units)	400	350	50 A
Average price per unit	$3 000	$3 000	–
Revenue	$1 200 000	$1 050 000	$150 000 A
Sales employees basic salaries	$65 000	$68 000	$3 000 A
Sales employees commission payments	$30 000	$24 000	$6 000 F
Local advertising costs	$40 000	$60 000	*$20 000 A (1 + 1)*
Other regional marketing costs	$14 000	$12 000	*$2 000 F (1 + 1)*
Contribution to Head Office and Factory costs	*$1 051 000 (2) Allow 1 mark for an attempt*	*$886 000 (2) Allow 1 mark for an attempt*	

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(b) Assess the usefulness of the budgetary system used by GO. [10]

	Knowledge 2 marks	**Application 2 marks**	**Analysis 2 marks**	**Evaluation 4 marks**
Level 2	2 marks At least two relevant points made	2 marks Application of two or more points to case/use of results	2 marks Good use of theory to answer question	4–3 marks Good judgement shown
Level 1	1 mark One relevant point made	1 mark Some application to case/use of one result	1 mark Some use of theory to answer question	2–1 marks Some judgement shown

Answers could include:

- Budgetary system: method of allocating and reviewing financial plans for parts of the business
- Current system allows each region's demands to be decided on centrally so coordination and fairness are possible
- Long term planning aided by annual budgets
- Budgets allow for long term planning of resources and allow reviews to be held – as with calculation of variances above

Evaluation:

- Not very useful/effective because too rigid – no scope for flexible budgets?
- No regional input – these are "handed down from central office" so this demotivates managers and means that budgets might not reflect regional conditions
- No monthly budgets? Review only seemed to be held at end of year

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5 Assume GO enters the consumer oven market and adopts Growth Strategy 1 (see Appendix 2). Discuss appropriate changes to GO's organisational structure. [14]

	Knowledge 2 marks	**Application 2 marks**	**Analysis 5 marks**	**Evaluation 5 marks**
Level 2	2 marks At least two relevant points made	2 marks Application of two or more points to case/use of results	5–4 marks Good use of theory to answer question	5–4 marks Good judgement shown
Level 1	1 mark One relevant point made	1 mark Some application to case/use of one result	3–1 marks Some use of theory to answer question	3–1 marks Some judgement shown

Answers could include:

- Organisational structure: shows lines of authority/communication between different sections/departments/levels of hierarchy of an organisation
- Current structure is "rigid, inflexible, hierarchical and centralised"
- Candidates may try to draw existing structure or a replacement for it – showing how a new consumer oven division and country Y's operations would be included – allow up to 4 marks (Knowledge/Application) for organisational chart
- Analysis marks awarded for advantages/disadvantages of existing and/or proposed structure
- Keep current structure but delayer – reduces costs of middle management and increases spans of control – but will this be suitable for new divisions abroad?
- Switch to divisional structure based on countries or consumer/industry products – or both. May allow some independence/decentralisation for the new sections of the business and this could be important as they will need to take different decisions from the "original" parts of GO. Is existing management prepared to give up some control? Which decisions will remain centralised?
- Matrix structure – combining, for example, departments with horizontal project teams, e.g. consumer products, industrial products, export division etc. This might lead to confusion with too many changes occurring within the business. Existing management might resist this – could end up having "two bosses" and divided loyalties.
- Other structures possible

Evaluation:

- Advantages and disadvantages of each suggestion balanced against each other
- Most important factors identified in this case
- Overall recommendation for including consumer oven division and country Y's operations and for improving current structure with supported argument

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6 Discuss the importance to GO of undertaking strategic analysis before making a decision about future growth strategies. [20]

	Knowledge 3 marks	**Application 3 marks**	**Analysis 4 marks**	**Evaluation 10 marks**
Level 3				10–7 marks Good judgement shown in text and conclusions
Level 2	3 marks Good understanding shown.	3 marks Good application to case	4–3 marks Good use of theory to explain points made	6–4 marks Some judgement shown in text and/or conclusions
Level 1	2–1 marks Some understanding shown	2–1 marks Some application to case	2–1 marks Limited use made of theory	3–1 marks Limited judgement shown

Answers could include:

- Strategic analysis – analysis of the business and the business environment in which it operates
- SWOT; PEST; Ansoff; Porter; market research and any other appropriate tools might be suggested
- Some analysis seems to have been undertaken by the consultant – some recognition of strengths and weaknesses.
- These are major strategic changes for GO so very important to undertake further and up-to-date analysis
- SWOT – how significant is finance as a weakness? Will existing organisational structure prevent effective expansion overseas or into other product markets?
- PEST – how has economic environment changed since 2012? Is anti-inflation policy likely to continue and what impact will this have on interest rates?
- Ansoff – degree of risk associated with these two growth strategies?
- Market research – essential for both strategies but especially with exporting and the different market conditions/competitive rivalry that might exist there

Evaluation:

- How important is strategic analysis in this case?
- Are the two strategies very different from those already undertaken by GO?
- Is the environment in which the business operates continuously changing – in which case strategic analysis will need frequent updating
- Which aspects of strategic analysis are of greatest importance in this case?
- What could be consequences for GO of not undertaking it?

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7 Evaluate the importance of strategic management to the future success of GO. [20]

	Knowledge 3 marks	**Application 3 marks**	**Analysis 4 marks**	**Evaluation 10 marks**
Level 3				10–7 marks Good judgement shown in text and conclusions.
Level 2	3 marks Good understanding shown.	3 marks Good application to case	4–3 marks Good use of theory to explain points made	6–4 marks Some judgement shown in text and/or conclusions
Level 1	2–1 marks Some understanding shown	2–1 marks Some application to case	2–1 marks Limited use made of theory	3–1 marks Limited judgement shown

Answers could include:

- Strategic management – planning for the future with long term objectives and development of future strategies
- GO needs to take some measures to deal with declining sales and profit – these measures will require:
  - Strategic analysis – where are we now? e.g. SWOT and PEST. This could help to identify the risks associated with the two proposed strategies – market development and product development
  - Strategic choice – deciding between different options e.g. Strategy 1 and Strategy 2. This will require the use of specific strategic choice techniques such as decision trees.
  - Strategic implementation – putting the chosen strategy into effect and monitoring performance against the long term plan

Evaluation:

- Important for long term success but short term/tactical decisions might also be needed if sales and profit continue to fall e.g. adjustments to existing marketing mix
- Strategic management will only be effective if undertaken by effective managers. Is GO's management capable of clear objective setting and long term planning?
- Strategic management should allow for flexibility in planning e.g. changes in consumer incomes will affect the success of the GO consumer market initiative and plans might need to be changed to allow for these

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