Cambridge International A Level

Cambridge International Examinations
Cambridge International Advanced Level

BUSINESS STUDIES **9707/32**

Paper 3 **May/June 2014**

CASE STUDY

3 hours

8721366854

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 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.
The businesses described in this question paper are entirely fictitious.
You are advised to spend 40 minutes on Section B.

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.

DC (RCL (JDA)) 82882/5

CAMBRIDGE International Examinations

GLOBAL CONSTRUCTION (GC)

GC is a public limited company that builds houses, apartments and offices. It has recorded high profits in recent years, benefiting from a national property price boom. Last year, there was a 20% average increase in house and apartment prices and this contributed to record high inflation in the whole economy. Two months ago, the Government took action to cut the rate of inflation – interest rates were increased to 8%, direct tax rates raised and plans announced to cut Government spending. One impact of these changes has been an appreciation of the country's currency exchange rate.

Eco-house research

In recent years, one of GC's strategies has been focused on achieving its long term aim to become more socially responsible in its construction methods. In 2012, the company formed joint ventures with several suppliers of building materials to develop environmentally friendly building products. These products would be made of recycled and sustainable materials and will be used to construct a unique type of 'eco-house'. Once constructed, the combination of high insulation standards and renewable energy sources should mean that this design of house will generate its own electricity. The eco-house project is nearing completion, but further research funds must be invested before returns can be expected. Table 1 contains forecasted net cash flows if GC's Board of Directors approve this further investment.

Table 1: Forecasted net cash flows if further research investment is undertaken

Year	Net cash flows	Notes
0	($15 m)	The additional research finance required
1	$2 m	Years 1–5: Cash inflows from sale of 'eco-houses' and possible sale of design patents
2	$4 m	
3	$7 m	
4	$10 m	
5	$10 m	

Discount factors at a discount rate of 12%

Year 1 = 0.89	Year 2 = 0.80	Year 3 = 0.71	Year 4 = 0.64	Year 5 = 0.57

Further returns might occur after 5 years, but this depends on the success of similar research being undertaken by GC's competitors.

Developing the Phoenix site

GC recently purchased, before the Government took its anti-inflationary macroeconomic decisions, a large building site near the city centre. GC believes the value of the site has fallen in recent weeks. There used to be a large factory on the site making asbestos but, as the city expanded, the local government objected to the pollution it caused. When GC purchased the site it was assured that the site was no longer polluted. However, a newspaper report has suggested that a similar location in the north of the country still contains dangerous traces of asbestos.

GC's Board of Directors must decide between three options for the site. The chances of success and the expected economic payoffs from these are shown in Appendix 1.

Finance options

Before the recent economic changes, GC planned to reorganise the finances of the company and prepare for the costs of developing the Phoenix site. The Finance Director was preparing to have a rights issue of shares and increase long term borrowing. She had not planned for the Government's recently introduced anti-inflationary policies and these may change her mind about the best sources of finance. If the Phoenix site is developed, working capital needs will increase by a maximum of $15 m and additional equipment of $40 m will be required. A summary of GC's most recent accounts is shown in Appendix 2.

Bad weather stops construction

The construction industry was badly affected by last month's storms. Work on most construction sites was halted for several days. Unfortunately, one of GC's site managers had ignored the weather warning and high cranes were still being operated when the storms struck. Three workers were seriously injured when a crane collapsed. The site manager had initially claimed that the workers had been told to dismantle the crane. He thought that by covering up the true cause of the accident, his position and the company's reputation would not be damaged. At a company inquiry last week, the site manager suggested that: 'If we had not been so far behind on this project I could have been more focused on health and safety. Once the accident occurred, I did not know what actions to take.'

Managing strategic change – rationalisation

GC owns and operates a factory that makes bricks. This provides 60% of the bricks used by GC and supplies some other construction companies. Most of the other bricks and building materials used by GC have to be imported, which reduces GC's costs when the currency appreciates. Labour productivity in the brick factory is low and is falling due to poor industrial relations and old equipment. A decision has been taken to close the factory. It could either be sold to another brick company or the site could be used for building houses. The brick factory employees would be greatly affected by both options. The Operations Director wants to close the factory as soon as possible and give the workers minimum redundancy payments. The Operations Director said: 'We could even sell the site to help finance the Phoenix development. The workers do not deserve to keep their jobs as productivity was so low anyway.'

The Human Resources Director advised caution in the implementation of this strategic decision: 'This would create substantial local unemployment. We would not be able to offer the workers employment elsewhere in the business. Discussions with trade union leaders should be undertaken to reach agreement with them over worker retraining or even how to increase productivity to make the factory more attractive to a potential buyer.'

Accountability to stakeholders

GC does not currently report its corporate social responsibility (CSR) activities in its Annual Report. The Chief Executive, Ben, is keen to start including this information in the report in order to show the impact that the business has on society. Some other companies in the country already do this. It is claimed that this helps them deal with pressure groups and obtain Government contracts.

Ben told other directors that: 'We could publish our eco-house research and our plans to build housing for low income groups.' The Finance Director was against the idea: 'Would we also publish our health and safety record and mention worries over pollution on the Phoenix site? We should only report on CSR if it becomes required by law.' Ben replied: 'As there are few controls over CSR reporting we would only report what we want to say. This would be a chance to promote ourselves at a difficult time when the construction industry is starting to face adverse external pressures.'

[Turn over

Appendix 1: The 3 options for the Phoenix site

Option	Explanation	Additional capital cost	Chance of successful outcome	Economic payoffs
1: Develop for offices	**Office accommodation:** Including offices for Government departments. This is the least risky option as prices for office accommodation are stable.	$15 m	0.8	Success: $30 m Failure: $10 m
2: Develop for housing	**Housing**: Mix of expensive apartments and housing for low income groups. Quite risky as prices of expensive apartments could fall if the property market boom ends.	$20 m	0.7	Success: $40 m Failure: $18 m
3: Sell site after 3 years	**Do not develop site**: Keep site for 3 years and then sell it. This is a risky option as land prices could rise or fall.	Nil	0.5	Success: $10 m Failure: $5 m

Appendix 2: Summary of GC's accounting information as at 31 May 2014

Gearing ratio	35%
Capital employed	$200 m
Total shares issued	100 m
Current market share price	$2 (was $3 at 31 May 2013)
Current ratio	1.1
Acid test ratio	0.3

Section A

Answer **all** questions in this section.

1 Analyse how the Government's policies to cut the rate of inflation are likely to affect GC. [10]

2 (a) Using data in Table 1, calculate:

(i) payback period [2]

(ii) net present value (NPV) at a discount rate of 12%. [4]

(b) Using your results from **2(a)** and other information, discuss whether further research and development expenditure is advisable for GC. [14]

3 Evaluate the sources of finance GC could consider for the development of the Phoenix site. [14]

4 (a) Using Appendix 1, calculate the expected monetary values for the 3 options for the Phoenix site. [6]

(b) Using your results from **4(a)** and other information, recommend to GC which of the 3 options for the Phoenix site should be chosen. Justify your answer. [14]

5 Discuss whether GC should be more accountable to its stakeholders by reporting on its CSR activities in its Annual Report. [16]

Section B

Answer **one** question in this section.

6 Discuss how the strategic decision to close the brick factory should be implemented. [20]

7 Evaluate the extent to which more effective long term planning might influence GC's future success. [20]

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