



MARKSCHEME

November 2010

BUSINESS AND MANAGEMENT

Higher Level

Paper 2

28 pages

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The markbands on pages 3–4 should be used where indicated in the markscheme.

Section A		Section B			Level descriptors
(c) questions					
Q1 (c)	Q2 (c)	Q3 (c)	Q4 (c)	Q5 (c)	
Marks 0–6					
0					<ul style="list-style-type: none"> • No knowledge or understanding of relevant issues, concepts and theories. • No use of appropriate terminology.
1–2					<ul style="list-style-type: none"> • Little knowledge and understanding of relevant issues, concepts and theories. • Little use of appropriate terminology. • No reference is made to the information in the stimulus material. The response is mainly theoretical.
3–4					<ul style="list-style-type: none"> • A description or partial analysis/examination with relevant knowledge and/or understanding of relevant issues, concepts and theories. • Some use of appropriate terminology. • Some reference is made to the information in the stimulus material, not just to the name of the organization.
5–6					<ul style="list-style-type: none"> • A balanced analysis/examination with accurate, specific, well-detailed knowledge and understanding of relevant issues, concepts and theories. • An analysis/examination that uses appropriate terminology throughout the response. • Explicit references are made to the information in the stimulus material.

Section B			Level descriptors
(d) questions			
Q3 (d)	Q4 (d)	Q5 (d)	
Marks 0–9			
0			<ul style="list-style-type: none"> • No knowledge or understanding of relevant issues, concepts and theories. • No use of appropriate terminology.
1–2			<ul style="list-style-type: none"> • Little knowledge and understanding of relevant issues, concepts and theories. • Little use of appropriate terminology. • No evidence of judgments and/or conclusions. • No reference is made to the information in the stimulus material.
3–4			<ul style="list-style-type: none"> • A description with some knowledge and/or understanding of relevant issues, concepts and theories. • Some use of appropriate terminology. • No evidence of judgments and/or conclusions. • Some reference is made to the information in the stimulus material, not just to the name of the organization. • The response is mainly theoretical.
5–7			<ul style="list-style-type: none"> • A response with relevant knowledge and understanding of relevant issues, concepts and theories. • A response that uses relevant and appropriate terminology. • Evidence of judgments and/or conclusions that are little more than unsubstantiated statements that has balanced analysis and demonstrates understanding. • Explicit references to the information in the stimulus material are made at places in the response.
8–9			<ul style="list-style-type: none"> • A response with accurate, specific, well-detailed knowledge and understanding of relevant issues, concepts and theories. • A response that uses appropriate terminology competently throughout the response. • A response that includes judgments and/or conclusions that is well supported and underpinned by a balanced analysis. • Explicit references to the information in the stimulus material are made throughout the response.

SECTION A

1. (a) (i) **Define the term *variable costs*.** **[2 marks]**

Variable costs are costs that vary in “direct proportion” to change in output/level of production.

Candidates are **not** expected to word their definition **exactly** as above.

Award **[1 mark]** for a basic definition that conveys partial knowledge and understanding.

Award **[2 marks]** for a full, clear definition that conveys knowledge and understanding similar to the answer above.

For **only** a relevant: example **or** application to the stimulus award **[1 mark]**.

- (ii) **Identify *two* advantages for Dan of operating as a sole trader.** **[2 marks]**

Possible advantages could include:

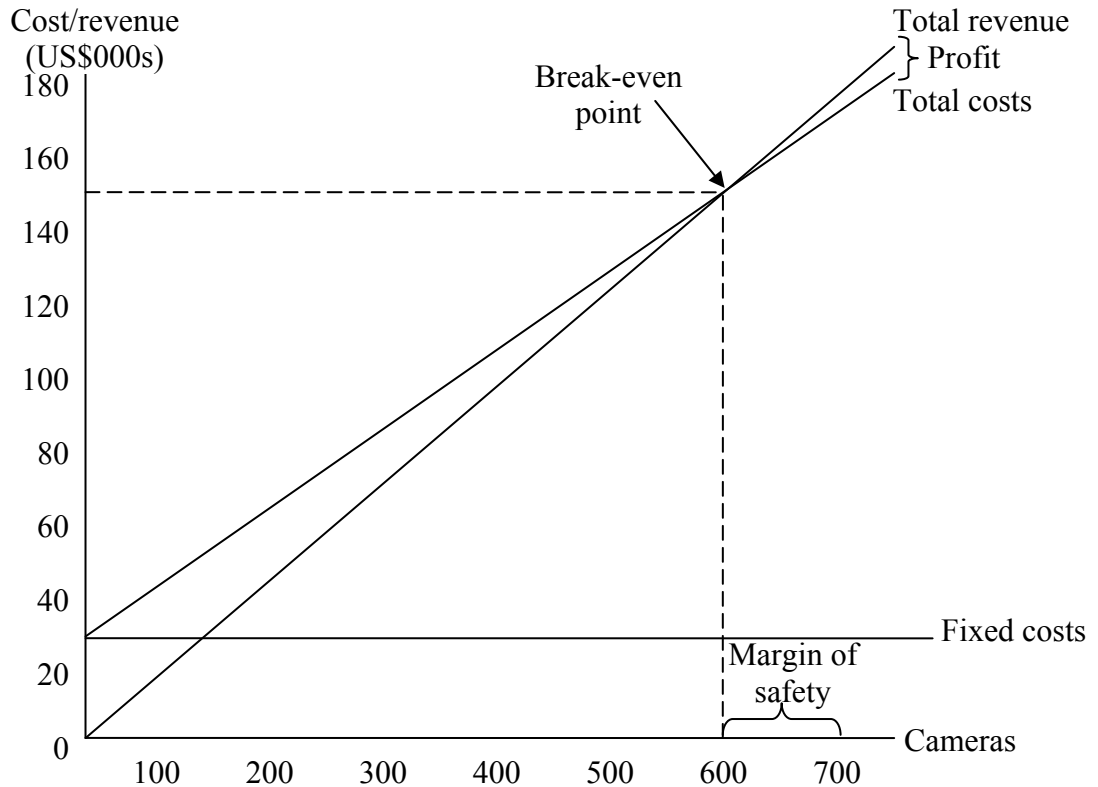
- Dan as a sole trader has complete creative and management freedom
- Dan can be more customer focused due to constant interaction and communication with the customers
- Dan does not have to share the profit with anyone else
- *accept any other relevant advantage.*

Award **[1 mark]** for each relevant and appropriate advantage identified up to a maximum of **[2 marks]**.

- (b) (i) Construct a fully labelled break-even chart for *Dan Electro* for 2010. Calculate and indicate the break-even point, the margin of safety and the projected profit at 700 cameras (*show all your working*). [7 marks]

The break-even point is:

$$\frac{\text{Fixed cost}}{\text{Contribution}} = \frac{\text{US\$30 000}}{\text{US\$250} - \text{US\$200}} = 600 \text{ cameras}$$



The margin of safety is:
 $700 - 600 = 100$ units

The projected profit at 700 units is:

$$\text{Margin of safety} \times \text{contribution per unit} = 100 \text{ units} \times \text{US\$50} = \text{US\$5000}$$

Or:

$$\text{Total revenue} - \text{total cost} = \text{US\$175 000} - \text{US\$30 000} + (200 \times 700) = \text{US\$5000}$$

Do not double penalize candidates.

Award marks as follows:

[1 mark] for appropriately labelled axes.

[1 mark] for an accurately drawn and labelled total revenue curve.

[1 mark] for an accurately drawn and labelled total costs curve.

[1 mark] for identification of the break-even point and **[1 mark]** for showing calculation at the correct value of 600.

[1 mark] for identification of the margin of safety.

[1 mark] for correct calculation of the projected profit.

If the candidate produces a table rather than a chart, award **[0 marks]**.

- (ii) Calculate the number of cameras *Dan Electro* must sell in order to double the projected profit (show all your working). [2 marks]**

The doubled level of profit is:

Target: US\$5000 × 2 = US\$10 000

$$\frac{\text{Fixed cost} + \text{target profit}}{\text{Contribution}} = \frac{\text{US\$30 000} + \text{US\$10 000}}{\text{US\$50}} = 800 \text{ cameras}$$

Do not double penalize for a mistake carried forward.

Award **[1 mark]** for the correct workings and **[1 mark]** for the correct calculation/figure.

- (iii) Calculate the price per camera that needs to be charged (at expected sales of 700 cameras) in order to double the projected profit (*show all your working*). **[2 marks]**

$$\begin{aligned} \text{Price} &= \frac{\text{target profit} + \text{total costs}}{\text{output}} = \frac{\text{US\$10 000} + (\text{US\$30 000} + \text{US\$140 000})}{700} \\ &= \text{US\$257.14 (2 d.p.)} \end{aligned}$$

Do not double penalize for a mistake carried forward.

Award **[1 mark]** for the correct workings and **[1 mark]** for the correct calculation/figure.

- (iv) Explain *two* possible limitations of the break-even model as a decision tool for *Dan Electro*. **[4 marks]**

The possible limitations/drawbacks of the break-even model are:
The model assumes that all cameras are sold.

Dan Electro might not be able to sell all of its cameras and, therefore, the total revenue curve might not be as high/accurate as the model assumes:

- The model is also used under the assumption of unchanging conditions. Inflation and interest rates might indeed increase (forecasted) which could affect the demand for the camera.
- Also, the effectiveness of the model depends on the accuracy of the data. Dan might not have computed all the costs/revenue accurately.
- The model assumes a linear relationship, which is quite unlikely in real life. Dan might decide to reduce the price of the cameras to stimulate sales.

Given the above, the use of the model can become less effective as a decision tool for Dan.

Accept any other relevant explanation.

Mark as 2+2.

Award **[1 mark]** for identifying each relevant and correct limitation of the break-even model and **[1 mark]** for each explanation of the limitation with application to the stimulus material.

Award a maximum of **[2 marks]** overall if there is no application to the stimulus material.

- (c) **Examine two possible strategies for *Dan Electro* to prevent cash flow difficulties.** [6 marks]

Some of the possible strategies that are available for *Dan Electro* in order to overcome the forecasted cash flow difficulties are:

Increase inflow of money:

Dan can look for a partner. Forming a partnership can inject cash quickly with the added benefits of knowledge and expertise. The responsibilities of running the business can also be shared. However, Dan will lose the benefits of being a sole trader – benefits such as complete freedom in decision-making and the retaining of all profit.

Dan could increase the price of the cameras. Dan has very loyal and, therefore, price inelastic customers. Some customers indicated that they would be willing to pay a higher price. This enables him to increase the price and at the same time to increase *Dan Electro's* total revenue. However, given the increase of online competition and the current customers' perception of the camera being good value for money, this option is somewhat risky. *Dan Electro* might end up with fewer customers and less total revenue.

Dan Electro's marketing expenses are relatively small. Dan might want to consider a marketing drive to promote the product so as to increase sales and then sell more than 700 cameras – which is rather a small amount. However, care has to be taken that the extra marketing expenditure does not outweigh the extra revenue. Perhaps it is a risk worth taking given the increased competition.

Taking another loan from the bank might inject immediate cash, but may not be seen as a wise move as Dan is still paying back US\$1000 in interest on the previous loan and the interest rate is predicted to rise.

Decrease outflow of money:

The main problem that can be seen from the data is the transportation cost per camera, which is a significant 22.5% of the variable costs. Dan could negotiate a reduction in such costs with the current supplier. Perhaps a bulk buying deal can be agreed upon. However, Dan will have to take the risk of being left with unsold stock, which is risky given the fast changing technology in this market.

Rent is currently extremely expensive. The costs for an “expensive and desirable” location are unnecessary given the fact that Dan operates an online business. A move to a cheaper and non-central location could provide a good solution. The service quality should not be harmed by this change.

Also, Dan should ask for some credit facilities with the current supplier rather than continue with the current agreement of paying in advance. This will alleviate the cash flow difficulties. However, the supplier may not agree and may decide to supply to other retailers given the increase in online competition.

Another possibility is to look for a cheaper local supplier. However, the quality of the cameras may be compromised and *Dan Electro* may lose its competitive advantage.

Accept any other relevant examination.

To achieve the top markband candidates must give a balanced examination of **two** possible strategies.

For one relevant issue that is one-sided, award up to **[3 marks]**. If the response is a one-sided relevant approach with no balanced examination, award a maximum of **[4 marks]**.

Marks should be allocated according to the markbands on page 3.

2. (a) (i) **Define the term *copyright*.** [2 marks]

Copyright is a form of intellectual property right where ownership permission is sought to use it. It provides legal protection for a company against other rivals using its published works.

Candidates are **not** expected to word their definition **exactly** as above.

Award [1 mark] for a basic definition that conveys partial knowledge and understanding.

Award [2 marks] for a full, clear definition that conveys knowledge and understanding similar to the answer above.

For **only** a relevant: example **or** application to the stimulus award [1 mark].

(ii) **Identify *two* disadvantages for *BBT* of operating as a private limited company.** [2 marks]

Some of the disadvantages for *BBT* may be:

- Private limited companies are not able to raise as much finance as public limited companies. *BBT* is unable to raise share capital from the general public to finance the R&D since shares can only be sold to private family members and friends with the approval of the board (although currently Mark is the only shareholder in the company).
- Despite Mark being the sole shareholder of the company, he does not have complete privacy enjoyed by sole traders and partnerships due to the fact that some of the financial data and other information have to be published.
- Mark needs to have his company accounts audited by an external accountant, which adds to the administrative costs of the business.
- It is usually far more expensive to establish a private limited company compared to setting up a sole proprietorship or a partnership.
- *Accept any other relevant disadvantage identified.*

Award [1 mark] for each appropriate and relevant disadvantage identified, up to a maximum of [2 marks].

- (b) (i) Calculate the missing figures X, Y, Z and with those figures and from the financial information provided, construct a complete balance sheet for *BBT* for 2010. [7 marks]

X = 10 500, Y = 48 000, Z = 10 500

Balance sheet for *BBT* Limited as at 31st October 2010

	US\$	US\$
Fixed assets		30 000
<i>Less</i> depreciation	1 500	
Total (net fixed assets)		28 500
Current assets		
Stock	0	
Debtors	28 000	
Cash	2 000	
Total		30 000
Current liabilities		
Creditors	48 000	
Short-term borrowing	0	
Total		48 000
Net assets		10 500
Share capital		2 000
Loan capital		0
Retained profit		8 500
Capital employed		10 500

Award [1 mark] each for the calculation of (X) capital employed, (Y) creditors and (Z) net assets. Maximum award for calculations is [3 marks].

In terms of layout, award [4 marks] for a fully accurate and fully labelled balance sheet that conforms to the layout in the guide. If the balance sheet balances but the order of the assets or liabilities is slightly inaccurate (according to the generally accepted method the candidate has chosen), award [3 marks]. If the balance sheet balances but the order of the assets or liabilities is significantly inaccurate, such as placing share capital and retained profit as a liability, award [2 marks]. Award [1 mark] if the candidate conveys some understanding of a balance sheet and some sense that assets equal liabilities + owners' equity.

Do not penalize a response more than once for errors that are carried forward.

- (ii) **BBT's net profit before interest and tax as at 31 October 2010 was US\$27 695. Calculate the value of BBT's current ratio and return on capital employed (ROCE).** [2 marks]

$$\text{Current ratio} = \frac{\text{US\$30 000}}{\text{US\$48 000}} = 0.625$$

$$\text{ROCE} = \frac{27\,695}{10\,500} \times 100 = 263.76 \% \text{ (2 d.p.)}$$

Award [1 mark] for each correct calculation up to a maximum of [2 marks]. Apply Own Figure Rule (OFR).

If only the correct final figures are given without calculations, award [2 marks].

- (iii) **Using financial and non-financial factors, explain why the bank manager refused to finance the R&D of the new educational software.** [6 marks]

The current ratio is just 0.625, *i.e.* for every US\$100 of current liabilities, BBT has only US\$62.5 of current assets. Hence, BBT clearly lacks sufficient liquidity to pay for its short-term liabilities and this represents high risk to the bank manager. BBT may have to stop trading due to liquidity problems despite making profit and having a very healthy ROCE ratio. It is evident that the bank manager is more concerned about liquidity than profitability and perceives the situation as undesirable – “your balance sheet has deteriorated”.

Other financial considerations might include:

- Debtors account for over 93% of its current assets (US\$28 000 out of US\$30 000). This represents high risk to the bank as it raises the likelihood of bad debt.
- BBT does not have any stock to sell to generate extra cash to pay its short-term liabilities.
- BBT owes US\$48 000 to its creditors. This sum is significantly more than the value of its current assets.

Non-financial factors that might have influenced the bank manager's decision include:

- BBT's patent (its unique selling point) is about to expire and this makes the company significantly less competitive, especially as other rival companies have recently entered the online education market. The bank manager might be worried that a significant amount of time and money is needed to develop new patented software.
- Educational software has a short shelf-life (life cycle) during which time the investment costs may not be recouped.

Accept any other financial and non-financial factor to support a valid explanation.

Award **[1 to 2 marks]** for a general or limited response and/or no reference to the stimulus material.

Award **[3 to 4 marks]** for a partial explanation of why the bank manager refused to finance the R&D. The response may cover two issues/reasons only. For a meaningful reference to and explanation of only financial **or** non-financial factors for **[3 marks]**.

Award **[5 to 6 marks]** for a thorough, relevant explanation of why the bank manager refused to finance the R&D that includes meaningful reference to both financial (which includes actual figures) **and** non-financial factors. The response should cover more than two issues/reasons.

- (c) **Examine *two* possible alternative sources of finance that Mark might use to fund the R&D of the new educational software.** **[6 marks]**

Possible sources of finance might include:

- Using retained profits – whilst this would not incur any interest payment, it is unlikely that the US\$8500 the company holds would be sufficient to fund the R&D. *BBT* could sell dormant or underutilized assets to raise cash; again this might not be sufficient to fund the R&D.
- Business development loans to meet the specific development needs of *BBT*. The USA government might offer financial aid for educational purposes to support *BBT's* R&D of the new software. However, *BBT* is a profit-making private limited company that has to compete with state owned or charitable education providers.
- Venture capital – venture capitalists might be attracted to *BBT* due to its potential of earning high profits on the commercialization of the software. However, this option might result in Mark having to give up some ownership rights to the company.
- *Accept any other relevant source of finance in the context of BBT.*

Accept any other relevant examination.

To achieve the top markband candidates must give a balanced examination of **two** possible alternative sources of finance.

For one relevant issue that is one-sided, award up to **[3 marks]**. If the response is a one-sided relevant approach with no balanced examination, award a maximum of **[4 marks]**.

Marks should be allocated according to the markbands on page 3.

SECTION B

3. (a) Define the following terms:

(i) *market share* [2 marks]

Market share is the percentage of all sales within a market that are held by a company (or a product/brand). Market share can be measured in terms of total revenue or by units sold.

Candidates are **not** expected to word their definition **exactly** as above.

Award **[1 mark]** for a basic definition that conveys partial knowledge and understanding.

Award **[2 marks]** for a full, clear definition that conveys knowledge and understanding similar to the answer above.

For **only** a relevant: example **or** application to the stimulus award **[1 mark]**.

(ii) *external growth.* [2 marks]

External growth is growth from outside the company such as by acquiring or merging with another company. It is the quickest form of growth.

Candidates are **not** expected to word their definition **exactly** as above.

Award **[1 mark]** for a basic definition that conveys partial knowledge and understanding.

Award **[2 marks]** for a full, clear definition that conveys knowledge and understanding similar to the answer above.

For **only** a relevant: example **or** application to the stimulus award **[1 mark]**.

- (b) Draw the Boston Consulting Group (BCG) matrix for 2010 and distinguish between the position of *Microsoft's* online search engine and *Google's* online search engine. [6 marks]

		Market share	
		High	Low
Market growth	High	Stars	Question marks
	Low	Cash cows	Dogs

Microsoft's online search engine could be classified as a question mark (problem child) if one refers to the sentence “after pursuing unsuccessful internal growth strategies...” One might conclude that *Microsoft's* online search engine had low market share in a fast-growing industry that grows from US\$40 billion to US\$80 billion. Hence, *Microsoft* presents a large bid for *Yahoo!* Still, the combined **expected** market share is 35% which clearly indicates that at the point of its takeover bid, *Microsoft* had a lower market share. It is the second largest company in the market.

One might argue that it can be classified in 2010 as a star. The industry has grown/is growing, but given the dominant position of *Google*, an assumption is made that the online search engine of *Microsoft* is not a cash cow.

Credit either of the two possibilities.

Google's online search engine services can be classified as a star – its online search engine has the largest market share in a fast-growing industry from 2008 to 2010. Accept the classification of *Google* as a cash cow if supported by relevant explanation/assumption, as the stimulus material does not provide information of the exact growth rate from 2010 onwards.

[1 to 2 marks]

The response is in the form of a list. No clear distinction is made between the positions of the search engines *Microsoft* and *Google*. The BCG matrix is not drawn. If only the matrix is drawn and fully labelled award up to **[2 marks]**.

[3 to 4 marks]

The response provides a reasonable distinction between the positions of the search engines of *Microsoft* and *Google*. The response may be brief. The BCG matrix is drawn but may not be entirely accurate and/or fully labelled. The application/distinction between the positions of the products of the two organizations may lack detail or accuracy in places. The position of the search engine of one organization is well explained. Some reference is made to the stimulus material. At the bottom of the markband there is a tendency towards fragmentary common sense points.

[5 to 6 marks]

The response provides a clear, relevant, detailed and accurate distinction between the positions of the search engines *Microsoft* and *Google*. The BCG matrix is drawn; it is entirely accurate and is fully labelled. Allow for one inaccuracy in drawing for **[5 marks]**. Reference is made throughout to the stimulus material.

- (c) **Examine the possible effects that a successful takeover bid by *Microsoft* of *Yahoo!* would have on employees and one other stakeholder.** **[6 marks]**

The hostile takeover will result in extensive job losses, probably more among *Yahoo!*'s employees. The job losses or even a threat/fear of job losses will negatively affect some of the remaining employees. Moreover, some of the employees in a middle/junior management position in *Yahoo!* may lose their positions and power. Consequently, the motivation of many employees might be negatively affected. A fall in motivation can result in a loss of efficiency and potential synergy between the two organizations. However, one might argue that *Yahoo!*'s employees will not be able to afford the demonstration of any kind of dissatisfaction given their fear of further job losses. Efficiency might increase. A takeover might create some eagerness among employees to collaborate on R&D. On the other hand, *Microsoft*'s management might enjoy more power/interest/financial rewards. Hence, their motivation is likely to increase as well as efficiency and productivity.

Some of the other possible stakeholders are:

The respective shareholders, the managers, competitors, potential investors, the wider community, the government and consumers.

If *Microsoft* is successful in its hostile takeover bid of *Yahoo!* the following possible effects can be examined:

Microsoft shareholders: stronger market position may enhance shareholders' value in the long run, especially given the predicted cost saving of at least US\$1 billion that can enhance profit. However, in the short run some of their dividends may have to be forgone to finance the takeover bid.

Managers: *Yahoo!*'s managers may lose their positions. *Microsoft*'s management might enjoy more power/interest/financial rewards.

Other shareholders: given a more prominent position for *Microsoft*, in terms of market power, profitability and so on, *Google* shareholders might experience a fall in dividend.

Job losses might have further negative consequences on the wider community.

Consumers: may benefit from more choice, more innovative products and possibly lower prices in the market as the dominance of *Google* will be somewhat reduced.

The above stakeholders are used just as examples. Reward any other relevant stakeholder(s) introduced as long as the examination uses relevant information from the stimulus material.

For one relevant issue that is one-sided, award up to **[3 marks]**. If the response is a one-sided relevant approach with no balanced examination, award a maximum of **[4 marks]**.

For **[5 marks]** a response may be judged as somewhat balanced as long as some contrasting/opposite and detailed effects on two different groups of stakeholders is apparent.

Marks should be allocated according to the markbands on page 3.

(d) Discuss *Microsoft's* decision to launch a hostile takeover bid for *Yahoo!*. [9 marks]

The response should focus on the possible interest and benefits as well as the possible disadvantages to *Microsoft* resulting from a proposed hostile takeover bid. The response should not be a repetition of the previous answer where the focus is on the interest of specific stakeholders. (There may be a minor overlap between the questions.)

The possible benefits to *Microsoft*:

Microsoft pursued unsuccessful internal growth strategies and, therefore, looked at this external growth option as an opportunity. This type of external growth will enable *Microsoft* to achieve its immediate goal to acquire a big share of the online search engine market quickly after playing a largely unsuccessful catch up game with *Google*, who has the largest share of the online search engine market. *Yahoo!* has other services like e-mail. Therefore, the proposed takeover could be judged as a good strategic move on behalf of *Microsoft* to enhance its product portfolio by acquiring other online services in a growing market.

The strength of the financial argument lies in the cost saving of at least US\$1 billion, possibly due to various economies of scale such as financial, managerial, technical, and/or marketing.

A synergy is expected to be created between the two organizations. Analysts predict that “the combination of the two companies’ engineering resources and expertise would expand the research and development (R&D) capability” to produce better and more innovative services. A competitive advantage might be created or at least this takeover can be judged as a market follower strategy (Porter), or possibly a defensive move against the market leader. Perhaps, due to a fall in *Yahoo!*’s share price, the takeover deal might not be as expensive as it might have been had *Yahoo!* not experienced a 40% fall in their shares.

However, *Yahoo!* indeed suffered a decline in profit and saw its shares fall by 40%. Moreover, it was forced to cut 1000 jobs. *Yahoo!*’s added value and the possibly synergy might be questioned by some. Moreover, due to the fact that the takeover is actually hostile, operational and cultural clashes may be created, which can reduce the operational efficiency of the company. *Yahoo!*’s somewhat lower brand image/market position might negatively affect *Microsoft*’s reputation.

A takeover is likely to lead to extensive job losses. The proposed change might be extremely difficult to implement and be more expensive than originally estimated. *Microsoft* might find it difficult to recruit in the future.

It is also expected that the proposed takeover is likely to attract the attention and possible action of the government. However, as *Google* was the market leader in 2010 and the proposed takeover bid will result in *Microsoft* and *Yahoo!*’s combined market share of 35%, it is unlikely that any drastic action will be taken against *Microsoft*.

Accept any relevant argument for or against the proposed takeover.

On the whole, it appears that given the present needs/objectives of *Microsoft*, the potential benefits are the more significant ones and the proposed takeover is likely to be the appropriate strategic move against an extremely strong competitor. The possible drawbacks are more on the speculative side – apart from job losses which occurred anyway in *Yahoo!*.

Accept any other relevant discussion.

A balanced response is one that covers at least **two** arguments in favour and at least **two** arguments against.

For one relevant issue that is one-sided, award up to **[3 marks]**. If the response is a one-sided relevant approach with no discussion, award a maximum of **[4 marks]**.

Award a maximum of **[5 marks]** if the answer is of a standard that shows balanced analysis and understanding throughout the response with reference to the stimulus material **but** there is no judgment/conclusion.

Candidates cannot reach the **[5–7]** markband if they give judgment/conclusions that are not based on analysis/explanation already given in their answer.

Marks should be allocated according to the markbands on page 4.

4. (a) Define the following terms:

(i) *unique selling proposition (USP)* [2 marks]

Unique selling proposition (USP) refers to the unique features/attributes/benefits of a product/service that a company focuses on and promotes to its target market in order to differentiate it from its competitors.

Candidates are **not** expected to word their definition **exactly** as above.

Award **[1 mark]** for a basic definition that conveys partial knowledge and understanding.

Award **[2 marks]** for a full, clear definition that conveys knowledge and understanding similar to the answer above.

For **only** a relevant: example **or** application to the stimulus award **[1 mark]**.

(ii) *income elasticity of demand.* [2 marks]

Income elasticity of demand measures the responsiveness of consumers' demand to a change in real income. It is calculated by dividing the percentage change in demand by the percentage change in real income.

Candidates are **not** expected to word their definition **exactly** as above.

Award [1 mark] for a basic definition that conveys partial knowledge and understanding.

Award [2 marks] for a full, clear definition that conveys knowledge and understanding similar to the answer above.

For **only** a relevant: example **or** application to the stimulus award [1 mark].

(b) **With reference to Porter's generic strategies model, distinguish between the competitive advantages of the two business models in the airline industry.** [6 marks]

Porter suggests that a business can achieve a competitive advantage over its rival by using one of the following generic strategies:

- cost leadership
- differentiation
- focus (cost or differentiation).

Budget airlines like *Ryanair* use a cost leadership strategy. The organization is geared to reducing costs in every aspect of operation and offering a standard but adequate product/service to many segments in the market. The general approach is low costs that are lower than the major competitor; a no frill service and a low price suitable for price elastic consumers. Perhaps it could be argued by some candidates that the strategy used is a cost focus approach where businesses concentrate on particular segments (price conscious consumers).

Full service airlines like *British Airways* use a broad differentiation strategy. These airlines seek to provide service benefits that are different from those of their competitors and are widely valued by the consumer. The aim is to achieve a competitive advantage by offering a better service at a higher price than the budget airlines/competitors. These airlines target business as well as economy class passengers who want a differentiated/full service.

Perhaps it can also be said that full service airlines use a focused differentiation strategy for business/first class passengers. This strategy seeks to provide high and unique perceived product/service benefits, justifying a substantial price premium to a selected market segment of business people who expect a very high level of comfort and are willing to pay a premium price for such differentiated services.

Candidates need to refer to “costs” as Porter uses the term “cost leadership” strategy as one of the three strategic options. The cost leadership will result in a lower price. Candidates must use the correct order and terminology. Porter does not use the terminology “price leadership”. In case of confusion, less marks will be awarded based on the use of the business terminology and so on – as stated in the markbands below.

Accept any of the generic strategies of each airline, provided that there is a distinction between the competitive advantages of the two business models.

[1 to 2 marks]

No reference is made to both types of airline and/or the information in the stimulus material. The answer may be no more than a list of some possible actions/tactics or strategies.

[3 to 4 marks]

The response exhibits a partial distinction between two different and contrasting strategies used by both types of airlines – the budget and the full service ones. Award ***[3 marks]*** if the distinction demonstrates some application of Porter’s generic strategies even though they are not implicitly identified. Award ***[4 marks]*** if the distinction demonstrates a fuller application of Porter’s generic strategies model.

[5 to 6 marks]

A detailed, relevant, applicable distinction is provided of two different and contrasting strategies used by both types of airline – the budget and the full service ones. The explanation/distinction demonstrates a sound understanding and application of Porter’s generic strategies model. The distinction uses the relevant terminology appropriately. (If there is no use of the relevant terminology, the candidate cannot access this markband.)

Explicit and consistent references are made to the budget airlines and also full service airlines – and to the information in the stimulus material to support the distinction.

- (c) **Examine the likely effects on the airline industry of cross price elasticity of demand *and* income elasticity of demand.** **[6 marks]**

Other modes of travel are substitute goods. The low figure of 0.5 for cross price elasticity of demand indicates that there is not a significant movement from air travel to other modes of travel. This is probably due to the significant increase in fuel costs, as mentioned in the stimulus material, that affects nearly all other modes of travel. It appears that the global airline industry does not have to worry about alternatives/substitute products/services, as the rail and car industries are also hit by an increase in fuel prices. Other factors – the other types of elasticities mentioned – are likely to be more significant in determining customers’ reactions. The competition lies within the airline industry.

On the other hand, income elasticity of demand of 3 seems to have contributed/or likely to contribute significantly to a fall in demand. Income elasticity of demand for services is very elastic. Consumers are very responsive to a change in their income. National and disposable income is falling. With a global economic downturn many customers are likely to significantly reduce their demand for such a relatively luxury service (normal good).

Accept any other relevant examination.

To achieve the top markband candidates must give a balanced examination of both cross price elasticity of demand **and** income elasticity of demand.

For one relevant issue that is one-sided, award up to **[3 marks]**. If the response is a one-sided relevant approach with no balanced examination, award a maximum of **[4 marks]**.

Marks should be allocated according to the markbands on page 3.

- (d) **Discuss the claim made by the *British Airways* CEO “that full service airlines are more likely to sustain their competitive advantage”.** **[9 marks]**

On the one hand, it can be argued that the CEO of the full service airline might be correct. The average price elasticity of demand of all classes of passengers is less than one (0.95), which means that on the whole consumers are relatively price inelastic. The full service airlines are clearly successful in branding and differentiating their services among business and first class passengers who might still be willing to pay a higher price/extra for additional services.

Higher prices will result in a lower quantity demanded for air travel. Both types of airlines are likely to experience a fall in quantity demanded. The effect on total revenue will be determined by the relative percentage increase in price to the relative percentage fall in quantity demanded. Therefore, an increase in price will not result in a fall in total revenue for full service airlines, given the price elasticity of demand being determined by loyalty and the targeting of business people.

At the same time, given the relatively high price elasticity of demand of passengers travelling on budget airlines (1.9), this type of airline is likely to experience a fall in total revenue (and, therefore, profit).

However, the increase in the costs/price of fuel (variable cost) puts pressure on all airlines' profits. The full service airline might still not survive the slowdown unless operational efficiency is increased. Also, a point may come when passengers will not be willing or able to afford the services if the economic downturn persists. It is likely that business people will travel less due to the economic downturn. Moreover, many consumers have already moved away from the full service airlines and use budget airlines. 25% of passengers on the low budget airlines like *Ryanair* are business travellers. The graph also supports the notion that while the growth rate of first/business class passengers is stagnating, the growth of the economy class passenger has slowed down – whilst still growing. Heavy reliance on first/business class passengers might not be an appropriate strategy to be used by the full service airlines during a downturn/recession, especially given the high income elasticity of demand (3).

It appears that both types of airline are under enormous pressure regarding pricing policy and efficiency but, perhaps, as also indicated by some market analysts, the budget airlines are in a better position to weather the storm given their size and flexibility. Therefore, the full service airlines are not more likely to sustain their competitive advantage.

Accept any other relevant discussion.

A balanced response is one that covers at least **two** arguments in favour and at least **two** arguments against.

For one relevant issue that is one-sided, award up to **[3 marks]**. If the response is a one-sided relevant approach with no balanced discussion, award a maximum of **[4 marks]**.

Award a maximum of **[5 marks]** if the answer is of a standard that shows balanced analysis and understanding throughout the response with reference to the stimulus material **but** there is no judgment/conclusion.

Candidates cannot reach the **[5–7]** markband if they give judgment/conclusions that are not based on analysis/explanation already given in their answer.

Marks should be allocated according to the markbands on page 4.

5. (a) Describe *one* advantage and *one* disadvantage of primary market research for *Bricko Group*. **[4 marks]**

Advantages of primary market research for *Bricko Group* include:

- it allows *Bricko Group* to gather new data and information from customers in order to identify their purchasing patterns and to anticipate changes in their spending behaviour
- it provides up-to-date and, therefore, perhaps more reliable market research findings in order for *Bricko Group* to compete with its rivals such as *Peppa Toys*
- it is conducted for the specific needs of *Bricko Group* and, therefore, directly addresses the problems it currently faces
- *accept any other relevant advantage that is described in the context of Bricko Group.*

Disadvantages of primary market research for *Bricko Group* include:

- the relatively higher cost of conducting primary research adds to the expenses of *Bricko Group*
- the potentially monotonous and time-consuming task of collecting and interpreting primary data could delay decision-making at *Bricko Group*
- imperfections in market research techniques (such as a statistically invalid sample size) will lead to unrepresentative and misleading findings
- *accept any other relevant disadvantage that is described in the context of Bricko Group.*

Mark as 2 + 2.

Award **[1 mark]** for each relevant and correct advantage/disadvantage identified and **[1 mark]** for a clear description up to a maximum of **[2 marks]**.
If there is no application to *Bricko Group*, even just by mentioning the name, award a maximum **[3 marks]**.

- (b) Explain *two* benefits and *one* limitation of a Kaizen approach to manufacturing for *Bricko Group*. [6 marks]

Kaizen is the Japanese philosophy of changing for the better, *i.e.* continuous or continual improvement. Kaizen is, therefore, a process of improvement in productivity and efficiency from making **small** and **continuous** progress. The production manager wants to implement Kaizen in order to deal with some of the problems being faced by *Bricko Group*, especially the increased number of defective products.

Possible benefits of a Kaizen approach for *Bricko Group* could include:

- Kaizen can help *Bricko Group* to eliminate waste generated, including the waste generated by its defective products, through investigating ways to improve the productivity and efficiency of the company's processes and operations as well as the implementation and use of zero defect policies. Kaizen is, therefore, fundamental for lean production and quality assurance. It is evident that *Bricko Group* needs to cut costs in order to compete with *Peppa Toys*. The implementation of Kaizen can enable *Bricko Group* to reduce costs as well as increase quality and become more competitive.
- Since suggestions for improvements can come from all ranks within the organization, not only are more ideas generated, but *Bricko Group* also benefits from having more motivated staff (since they are able to express their own points of view). The involvement of staff and the process of generating ideas can enable *Bricko Group* to overcome the apparent lack of innovation and the current failure to launch new products.
- Since people tend to be resistant to change, the workforce might be more receptive to making small changes that lead to productivity gains. This is because small but continuous changes are far less disruptive to the organization than large one-off changes.

Possible limitations of a Kaizen approach for *Bricko Group* could include:

- The initial implementation tends to be costly and time consuming. *Bricko Group* might not be able to afford it due to the need to become more competitive in the very short term. The stimulus indicates that the financial manager is looking for ways to reduce costs, hence *Bricko Group* might not be able to afford the implementation of Kaizen.
- Kaizen is not necessarily easy to implement. The implementation of Kaizen requires the effort and devotion of each and every member of the workforce to make productivity gains. This is a problem for organizations that have individuals who are simply not motivated by taking on extra responsibility or working in cohesive teams.
- Whilst Kaizen might be appropriate to the highly skilled and creative staff in the R&D department, such an approach may not be so applicable to the production plant workers where a more traditional "command and control" or "scientific management" system might be the norm.

Accept any other relevant benefit/limitation explained.

Mark as 2+2+2.

Award a total of **[4 marks]** for **two** benefits and **[2 marks]** for **one** limitation.

Award **[1 mark]** for each relevant and correct benefit/limitation identified and **[1 mark]** for each clear explanation of the benefit/limitation up to a maximum of **[2 marks]** in the context of *Bricko Group*.

(c) Analyse the importance and role of branding for *Bricko Group*. [6 marks]

The role of branding to *Bricko Group* includes:

- Creating a legal identity for its products that are protected by law in the various countries that *Bricko Group* operates in.
- Acting as a vital source of product differentiation (mainly from its rivals but also from its other toys).
- Encouraging customer loyalty or brand loyalty in the *Bricko Group* brand.
- Creating an image of high-quality branded toys.
- Raising international recognition and awareness of the *Bricko Group* brand.

Consequently, branding is important to *Bricko Group* because:

- It acts as a form of intellectual property, thereby giving *Bricko Group* the ability to differentiate itself from *Peppa Toys* and other rivals.
- Intellectual property rights can increase the book value of *Bricko Group* on its balance sheet – thereby making it easier for *Bricko Group* to secure external sources of finance to fund its R&D plans.
- Brand recognition and brand loyalty can help *Bricko Group* to regain lost market share and maintain its market position and market standing. However, it appears that *Bricko Group* was not able to maintain its superior market position. Its brand loyalty is somewhat weaker.
- Research has shown that customer purchasing habits are affected by branding and not just prices. In some cases, the brand is considered more important than the price. However, in the case of *Bricko Group*, consumers prefer their rival's lower price.

However, it appears that the competitors also recognized the role and possibly the importance of branding and used it to their advantage. Moreover, branding is only one part of the consumer's buying decision. The market positioning of the brand is also important. *Bricko Group* charges higher prices, perhaps because of its market presence, but this has led to its market share falling. Customers were clearly attracted to brand image and market positioning of *Peppa Toys* and other competitors.

Accept any other relevant analysis.

Candidates need to consider the importance **and** role of branding for the response to be considered balanced and to achieve the top markband.

For one relevant issue that is one-sided, award up to **[3 marks]**. If the response is a one-sided relevant approach with no balanced analysis, award a maximum of **[4 marks]**.

Marks should be allocated according to the markbands on page 3.

(d) Discuss the financial manager’s proposal “to outsource the production facilities to Bangladesh”. **[9 marks]**

Outsourcing refers to the strategy of transferring internal business activities to an external organization. The main purposes of this are to improve efficiency and reduce costs of production. In the case of *Bricko Group*, the financial manager is proposing to shift production facilities to Bangladesh where subcontractors should be able to carry out the outsourced work at a lower cost.

The arguments for this proposal include:

- A reduction in production costs. Outsourcing overseas (offshoring) can help *Bricko Group* to remain internationally competitive with the emergence of increased competition in the toy market and other sectors such as online gaming.
- *Bricko Group* can perhaps develop other important activities like marketing and R&D in order to compete more successfully.
- Cost reduction advantages can also mean that *Bricko Group* becomes able to reduce prices to compete with *Peppa Toys*’ lower prices and so recover or gain greater market share.
- Outsourcing production facilities overseas can also eliminate the growing concerns from environmentalists in the European Union (EU)/Sweden who are worried about the pollution generated in *Bricko Group*’s production plants. Outsourcing to Bangladesh can help *Bricko Group* by eliminating the need to comply with the stricter health and safety regulations in the EU. Whilst quality standards must still be adhered to, offshoring ultimately helps to reduce the company’s costs.

However, the arguments against this proposal include:

- Concerns at *Bricko Group* since its core function (manufacturing toys) is being outsourced – most businesses outsource their auxiliary rather than core functions.
- Outsourcing to Bangladesh will most likely cause job losses in Sweden. This will upset staff who had previously enjoyed job security at a company that had pride in promoting “a sense of family for its employees”.
- Subcontractors in the Bangladesh plant need to be monitored to ensure that production deadlines and quality standards are met. This will add to *Bricko Group’s* operational and administrative costs. In addition, maintaining quality standards of the toys might prove more difficult when dealing with an overseas subcontractor and hence the reputation of *Bricko Group* might be at risk.
- Certain stakeholder and pressure groups may have ethical concerns with *Bricko Group’s* use of outsourcing to Bangladesh for the fear that the company might exploit foreign workers in less economically developed countries.

Accept any other relevant discussion.

Candidates are expected to reach a conclusion in their answers.

Given the fact that figures/data are not given on possible cost saving, it might be difficult to come to a definite and final conclusion. Nevertheless, the arguments against seem stronger given the past performance/history/reputation of *Bricko Group*. The quality issue of children’s toys is of significant importance and perhaps it can be said that *Bricko Group* should not risk it. The possible negative effects on the loyal staff and the consequent effect on employees’ motivation, organizational culture and so on are also very significant. *Bricko Group* should perhaps find other ways to cut costs and overcome some of the current difficulties it is facing. The proposed implementation of Kaizen might just be the solution for cost cutting.

A balanced response is one that covers at least **two** arguments for and at least **two** arguments against.

For one relevant issue that is one-sided, award up to **[3 marks]**. If the response is a one-sided relevant approach with no balanced discussion, award a maximum of **[4 marks]**.

Award a maximum of **[5 marks]** if the answer is of a standard that shows balanced analysis and understanding throughout the response with reference to the stimulus material **but** there is no judgment/conclusion.

Candidates cannot reach the **[5–7]** markband if they give judgment/conclusions that are not based on analysis/explanation already given in their answer.

Marks should be allocated according to the markbands on page 4.