



# **MARKSCHEME**

**November 2011**

**BUSINESS AND MANAGEMENT**

**Higher Level**

**Paper 2**

29 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
Q1 (d)	Q2 (c)	Q3 (c)	Q4 (c)	Q5 (c)	
Marks 0–6					
<b>0</b>					<ul style="list-style-type: none"> <li>• No knowledge or understanding of relevant issues, concepts and theories.</li> <li>• No use of appropriate terminology.</li> </ul>
<b>1–2</b>					<ul style="list-style-type: none"> <li>• Little knowledge and understanding of relevant issues, concepts and theories.</li> <li>• Little use of appropriate terminology.</li> <li>• No reference is made to the information in the stimulus material. The response is mainly theoretical.</li> </ul>
<b>3–4</b>					<ul style="list-style-type: none"> <li>• A description or partial analysis/examination with relevant knowledge and/or understanding of relevant issues, concepts and theories.</li> <li>• Some use of appropriate terminology.</li> <li>• Some reference is made to the information in the stimulus material, not just to the name of the organization.</li> </ul>
<b>5–6</b>					<ul style="list-style-type: none"> <li>• A balanced analysis/examination with accurate, specific, well-detailed knowledge and understanding of relevant issues, concepts and theories.</li> <li>• An analysis/examination that uses appropriate terminology throughout the response.</li> <li>• Explicit references are made to the information in the stimulus material.</li> </ul>

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

**SECTION A**

**1. (a) Define the following terms:**

**(i) *partnership* [2 marks]**

A partnership is a type of unincorporated organization made up of no more than 20 owners (depending on the country of origin). A partnership will normally have unlimited liability for its owners and key functions will be shared out according to the partnership agreement.

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) *working capital*. [2 marks]**

Working capital, sometimes called circulating capital, is the amount of money needed to pay for the day-to-day running of a business. Without working capital, businesses cannot trade. Working capital provides funds to purchase raw materials or pay invoices to creditors. It is shown in a balance sheet as the difference between current assets and current liabilities.

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) Explain *two* disadvantages for *RL* of having too much working capital in unsold second-hand books. *[4 marks]*

Possible disadvantages could include:

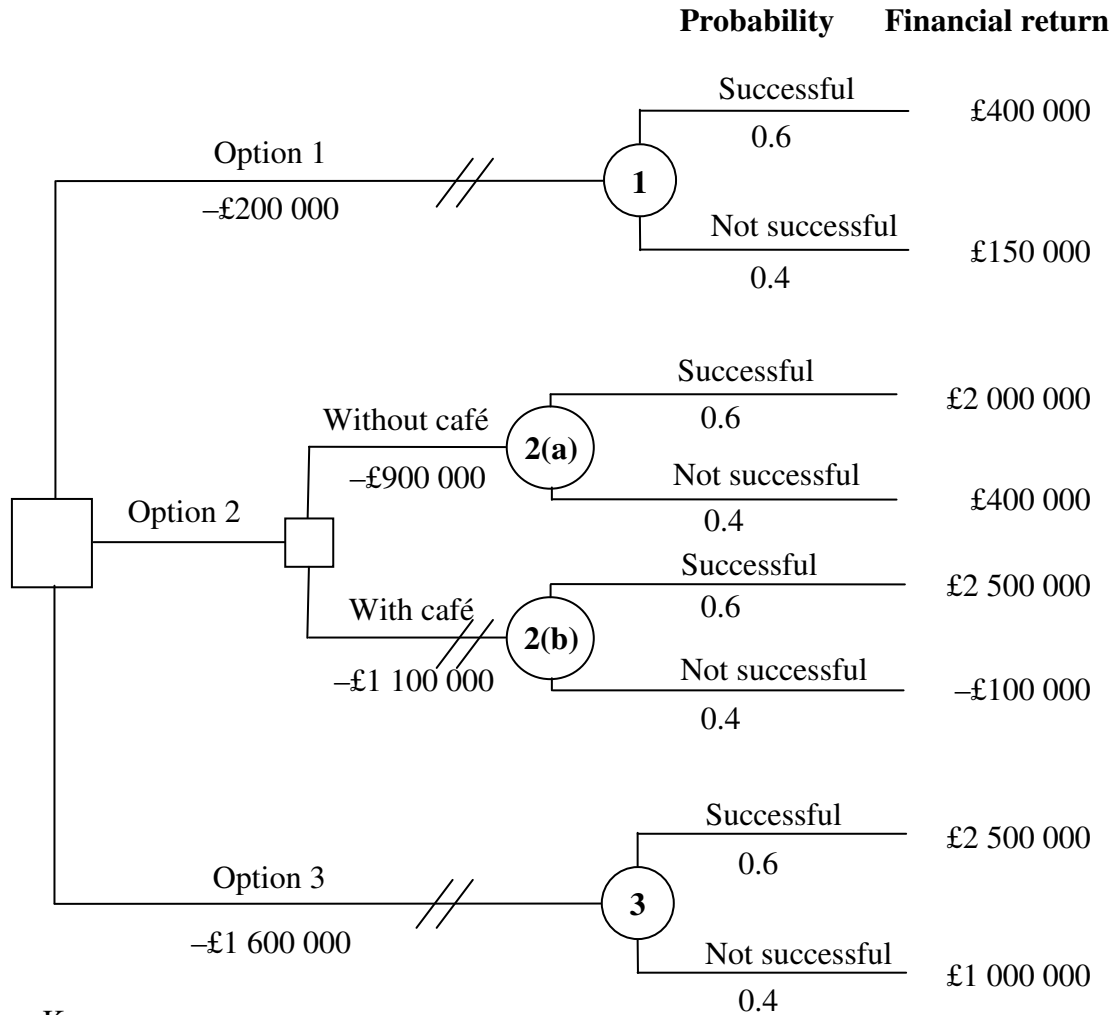
- Opportunity costs of too much money tied up in stock, which is leading to a significant liquidity issue.
- Space in the central London bookshop is being used up in such a manner that customers are beginning to provide negative feedback which could lead to some concerns around word-of-mouth promotion and customer service.
- It would seem that with the growing influence of competition, the value of *RL's* stock of unsold second-hand books may decrease. If the closing stock value of unsold books decrease then cost of sales will increase, negatively impacting on *RL's* gross profit.
- *Accept any other relevant disadvantage.*

**Mark as 2+2.**

Award *[1 mark]* for each appropriate disadvantage identified for *RL* of having too much working capital and *[1 mark]* for an appropriate explanation that directly refers to *RL* up to a maximum of *[2 marks]*.

Award *[1 mark]* for a relevant explanation which is theoretical and has not been applied to *RL*.

(c) (i) Construct a fully labelled decision tree for James' "three options of physical expansion for RL". Calculate the predicted outcome for each option and identify the most profitable option (*show all your working*). [7 marks]



Key

- Decision point
- Possible outcomes
- // Rejected options

Option 1 =  $(400\ 000 \times 0.6) + (150\ 000 \times 0.4) - 200\ 000 = \text{£}100\ 000$

Option 2(a) =  $(2\ 000\ 000 \times 0.6) + (400\ 000 \times 0.4) - 900\ 000 = \text{£}460\ 000$

Option 2(b) =  $(2\ 500\ 000 \times 0.6) + (-100\ 000 \times 0.4) - 1\ 100\ 000 = \text{£}360\ 000$

Option 3 =  $(2\ 500\ 000 \times 0.6) + (1\ 000\ 000 \times 0.4) - 1\ 600\ 000 = \text{£}300\ 000$

On financial grounds the best option is to purchase the building next door without a café (2(a)).

**[1 to 2 marks]**

The decision tree is not accurately constructed, the calculations of each option are not all presented or accurate, but there is some evidence of a general knowledge of the model.

**[3 to 5 marks]**

The principal elements of the decision tree are constructed but may not be entirely accurate. The calculations of each option are largely correct and clearly presented at the top end of the markband. Deduct **[1 mark]** per error. Working may not be shown.

**[6 to 7 marks]**

The decision tree is accurately constructed. The calculations of each option are correct and well presented. For **[7 marks]** a key is provided. Workings are shown.

*N.B.* if the candidate does not draw two decision points, the top markband cannot be reached.

- (ii) **Explain *one* advantage and *one* disadvantage for *RL* of using a decision tree as a decision-making tool.** **[4 marks]**

Possible advantages for *RL* include:

- The brothers can clearly see all the options and sub-options in the visual representation which gives a clear indication of costs and outcomes for *RL*.
- The model provides a quantification of the outcomes of each option as well as the risk attached with the probabilities of success and failure for *RL*.

Possible disadvantages for *RL* include:

- The expected financial return (and thus the final decision) will depend on the probabilities. We have no information as to how James arrived at these figures as they are estimated.
- External and non-financial figures are not included in the diagram, for example moving the bookshop to a large shopping centre outside of central London could alienate some loyal customers. The reactions of competitors are unknown and the risk attitude of the brothers is not reflected in the decision tree.

*Accept any other relevant explanation.*

**Mark as 2+2.**

Award **[1 mark]** for identifying **one** appropriate advantage/disadvantage for *RL* of using a decision tree as a decision-making tool and **[1 mark]** for an appropriate explanation that directly refers to *RL* up to a maximum of **[2 marks]**.



- (d) **Contrast James’ strategy of physical expansion with Nick’s e-commerce strategy.** [6 marks]

James’ expansion option 2(a) without a café produces an expected monetary value of UK£460 000. This money will go some way to easing some of the liquidity problems and with more space perhaps it will allow *RL* to sell some of the older stock which may become worth less as time passes.

However, the cost of the expansion will be UK£900 000 and we have no information on how the brothers intend to pay for this. The liquidity problem could indicate difficulty in obtaining financial support from external sources of funds. Also we need to consider the non-financial factors and the current external environment, which could influence the decision to take a calculated risk on moving the bookshop outside of central London.

Nick’s idea of an e-commerce facility is perceived as a cheaper option and may allow *RL* to compete head on with the new and existing online booksellers such as *Amazon* and allow them to find new customers to sell to. There could be some considerable savings to be made as well as easing growing customer frustration.

However, *RL*’s brand value may diminish if it is now perceived as just another online bookseller. It may also find it hard to compete with *Amazon* which has a greater presence online and brand loyalty of its own. Will *RL* have to find a new promotional catchphrase or can “Hard to find but worth the time” be successfully applied in an e-commerce environment? There could be considerable hidden costs of training and the setting up of a supply chain if an e-commerce facility is to be successfully established.

*Accept any other relevant answer.*

Apply Own Figure Rule (OFR).

For one relevant issue that is one-sided, with no analysis award **up to** a maximum of [3 marks]. For more than one relevant issue that is one-sided, with no analysis award **up to** a maximum of [4 marks].

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

2. (a) Define the following terms:

(i) *total quality management (TQM)* [2 marks]

TQM is the establishment of a culture of quality affecting the attitudes and actions of all employees at all levels in an organization. Every work group or department must think of those they work for as customers. Emphasis is put on customer service, the creation and production of high-quality products, the use of zero defect policies hence getting things right the first time. Overall, quality is higher while costs are reduced.

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) *redundancy.* [2 marks]

Redundancy is the laying off of an employee due to a lack of available work, as the employer is unable to afford to employ him/her anymore, or the business no longer has the need for an employee to carry out work of a particular kind.

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) (i) **Explain why “the global economic recession in 2009–2010 resulted in a severe fall in demand for *Fabia* dresses” and what the likely consequences of the economic recovery are for *Fabia*.** [5 marks]

The global economic recession during 2009–2010 resulted in a significant fall in demand because the main targeted segment is women with income elastic demand. The dresses are perceived and positioned as luxury products. During a recession the income of many customers falls or there may be a fear of possible loss of income. These customers tend to reduce consumption of luxurious products first. They are, therefore, very responsive to a fall or possible fall in their income. Hence for every 1 % fall in the income of the women in the targeted segment, the demand for the luxury dresses will fall by a larger percentage, which can result in a rather significant fall in demand. Conversely, during economic recovery, when income increases or is expected to increase, for every 1 % increase in their income, these women will increase their demand for the dresses by a larger percentage, given the luxurious nature of the product, hence *Fabia* is likely to benefit significantly.

*Accept any other relevant explanation.*

**[1 to 3 marks]**

Limited knowledge of the concept is evident. A list may be provided towards the bottom of this markband. No reference is made to the stimulus material. The explanation may be general, lacks depth or the answer is descriptive for [3 marks]. The explanation is clear and relevant but does not address the consequences of economic recovery for [3 marks]. Some reference is made to the stimulus for [3 marks].

**[4 to 5 marks]**

The explanation is clear and relevant. The concept of income elasticity of demand is used and well applied to *Fabia*. Reference is made to the information in the stimulus material. The explanation is clear and relevant and addresses the consequences of economic recovery.

- (ii) Using Table 1 and any other relevant information, calculate whether outsourcing the production of dresses to *Patella* would be profitable for *Fabia* at 200 000 dresses per annum (*show all your working*). [6 marks]

Candidates are expected to produce calculations of *Fabia's* profit **before and after** a possible outsourcing decision to *Patella*.

Any relevant methods used by the candidate should be rewarded provided the method used is accurate and full workings are shown. Candidates may calculate profit before and after simply by calculating TR – TC, or they may decide to work on the margin – loss of contribution versus a fall in fixed cost, in order to reach the answer.

Candidates are also expected to clearly present their calculations / findings. Some examples of calculations that could be included are shown below (all figures are in US\$):

**Current level of profit before outsourcing:**

TR – TC

$$200\ 000 \times 150 - (7\text{m} + 80 \times 200\ 000)$$

$$30\text{m} - 23\text{m} = 7\text{m}$$

Or

$$\frac{7\text{m}}{70(\text{contribution})} = 100\ 000 \text{ units are required to break-even.}$$

$$\text{MOS} = 200\ 000 - 100\ 000 = 100\ 000 \text{ units.}$$

$$100\ 000 \text{ units} \times 70(\text{contribution}) = 7\text{m total profit.}$$

**After outsourcing:**

Loss of contribution = 5 per garment  $\times$  200 000 units = 1m.

But *Fabia* saves 5m on fixed costs.

**Hence net gain of 4m of extra profit.**

Or

TR – TC

$$30\text{m} - (2\text{m} + 85 \times 200\ 000 \text{ units})$$

$$30\text{m} - 19\text{m} = 11\text{m}$$

$$11\text{m} - 7\text{m} = \mathbf{4\text{m extra profit.}}$$

*Accept any relevant method used.*

Use Own Figure Rule (OFR) if the original calculations are not accurate. Do not double penalize.

**[1 to 2 marks]**

There is some evidence of minimal understanding of the concept of outsourcing but the calculations are inaccurate and/or not well presented. If the final figures are presented without any working award a maximum of **[2 marks]**.

**[3 to 4 marks]**

The calculations of the levels of profit for *Fabia* before and after the possible outsourcing are largely accurate but may be incomplete and/or not well presented. Workings are not clearly shown.

**[5 to 6 marks]**

The calculations of the levels of profit for *Fabia* before and after the possible outsourcing are accurate and well presented. Workings are clearly shown. Allow for one minor mistake for **[5 marks]**.

- (iii) **Using Table 2, prepare a cash-flow forecast for December 2010 for *Fabia* (show all your working).** **[4 marks]**

Cash-flow forecast for *Fabia*, December 2010

	US\$
<b>Opening balance</b>	1 500 000
<b>Inflows</b>	
Cash sales revenue	2 000 000
<b>Total cash inflows</b>	2 000 000
<b>Outflows</b>	
Payment for raw materials	1 600 000
Electricity payments	20 000
Salaries and marketing	175 000
Interest payment	11 000
<b>Total cash outflows</b>	1 806 000
Net cash flow	194 000
<b>Closing balance</b>	1 694 000

Use Own Figure Rule (OFR) if the original calculations are not accurate. Do not double penalize.

**[1 to 2 marks]**

There is very limited evidence of understanding how to construct the cash-flow forecast. The format and the calculations are largely inaccurate with incorrect entries.

**[3 to 4 marks]**

For full marks, the cash-flow forecast is well constructed and presented. There is a heading which specifies the month. Only the appropriate components are used from Table 2 and there is clear knowledge which headings/components should appear in different accounts. For **[3 marks]** there may be one mistake either with the calculations **or** the use of one inappropriate component/heading.

(c) **Analyse the proposal to outsource the production of dresses to *Patella*.** [6 marks]

On the one hand, if *Fabia* outsources the production to *Patella* it will gain an extra \$4m of profit. *Fabia* will be able to concentrate on the design and marketing. Given the fact that the design is one of its main USPs, it might be appropriate just to concentrate on its core competencies and try to establish a greater market share. *Fabia's* USP will be maintained or even improved. Although *Fabia* still has a considerable underutilized capacity and should be able to respond to an increase in demand, *Patella* can produce considerably more dresses for *Fabia*.

However, the redundancy of 65 % of its workforce due to the closure of the manufacturing facility will add extra costs – redundancy payment. This is likely to reduce the amount of the above financial gain. It might also affect the motivation of the remaining employees. A constant fear of further redundancy might affect trust, morale and productivity.

*Fabia's* image of being ethical might be severely impaired due to *Patella* being a company which takes advantage of the lack of regulations in Vietnam. *Patella* might act unethically in terms of its treatment of employees, damage to the environment and pressure on suppliers – unfair trade.

Moreover, domestically, it might lose its ethical reputation given the massive redundancy. The two issues above may result in a fall in demand despite the predicted economic recovery.

In terms of production – using *Patella* might erode the quality of their product and the advantages of using TQM. Again, quality is *Fabia's* USP and therefore should be guarded. *Fabia* is likely to lose control of the production process and the resultant quality. Moreover, once the factory is shut, *Fabia* will find it difficult to re-open it again should it wish to terminate the contract with *Patella*.

Given the fact that *Patella* is located in Asia, *Fabia* may also reduce transportation costs – further financial benefits. However, *Patella* might increase the future price of its dresses – the financial benefits might be reduced.

*Accept any other relevant analysis.*

**N.B.** it is not expected that the candidates incorporate all of the above points/issues.

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

For one relevant issue that is one-sided, with no analysis award **up to** a maximum of [3 marks]. For more than one relevant issue that is one-sided, with no analysis award **up to** 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 segment***

**[2 marks]**

A market segment is a sub-group – people with similar characteristics and similar needs – within a larger market. Market segments are often identified by age, gender, level of education or occupation, social class, income, ethnic group, geographical region, religion, or political affiliation.

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) *flow production.***

**[2 marks]**

Flow production is a continuous and automated production process where each stage is linked with the next so production time is minimized. Flow production is an increasingly highly automated process using capital-intensive production methods.

Flow production is normally associated with large production runs of largely standardized homogeneous products.

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) **Explain what Shira could do in order to overcome the workers' resistance to change.** **[6 marks]**

Shira should openly communicate with workers about the need (driving forces) for change. She should listen to their fears resulting from the implementation of TQM and try to address them. Some of the workers may fear working in groups and may find the possible job enlargement and enrichment challenging. She should explain how TQM will benefit the whole company in terms of the benefits of empowerment and group decision-making. She could provide opportunities for training and development for those employees who feel they may not be able to cope with the new production method. Shira could also use financial incentives to reward group performance as well as non-financial rewards to further motivate the workers.

TQM will lead to significant management/cultural changes for *Nesbit* with the redeployment of some workers into new roles. Job descriptions will need to be rewritten. Shira should be able to demonstrate that moving to TQM should improve job satisfaction and lead to positive outcomes for *Nesbit* at a time when a number of competitors are threatening their market position. Job security could be enhanced.

Shira might consider some modification of her proposed changes in line with employee suggestions.

*Accept any other relevant explanation.*

**[1 to 2 marks]**

Limited knowledge of change management is evident. A list may be provided for **[1 mark]**. No reference is made to the stimulus material.

**[3 to 4 marks]**

The explanation may be general, lacks depth or the answer is descriptive. Award **[4 marks]** if the explanation is clear but does not address the changes due to the implementation of TQM.

**[5 to 6 marks]**

The explanation is clear and relevant with reference to TQM. The concept of change management is used and well applied to *Nesbit*. Reference is made to the information in the stimulus material.



- (c) Analyse the usefulness of Shira hiring an agency “to prepare a market audit and to conduct market research”. [6 marks]

Some of the arguments for hiring an agency include:

- The task is given to a specialized organization who will have the expertise in terms of staff and resources to carry out thorough research.
- The agency identified a gap in the market.
- The agency will be more objective in their approach without any bias in obtaining the figures. This will be important for the accuracy of the market audit and the market research.

Some of the arguments against hiring an agency include:

- It is likely to be more expensive to hire an agency than for Shira to conduct the research herself.
- An agency will concentrate on external factors and perhaps not too much on *Nesbit's* internal strengths and weaknesses. Consequently the recommendation may not take into account *Nesbit's* financial position and the workers' resistance to producing the new healthy chocolate bar.

*Accept any other relevant analysis.*

**N.B.** it is not expected that the candidates incorporate all of the above arguments.

The response should refer to the use of an agency not to the usefulness of market research in general.

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

For one relevant issue that is one-sided, with no analysis award **up to** a maximum of **[3 marks]**. For more than one relevant issue that is one-sided, with no analysis award **up to** a maximum of **[4 marks]**.

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

- (d) **Discuss whether the launch of Veneziano could change customer perceptions of Nesbit.** [9 marks]

*Nesbit* has been the market leader and enjoys brand loyalty amongst its youth segment of the chocolate market. The introduction of the new healthy chocolate bar will delight some stakeholders who may feel that *Nesbit* is being dynamic, innovative and socially responsible. TQM may result in lower levels of waste and hopefully cost and perhaps there may be some scope for the development of other new bars via research. The new bar Veneziano will be priced higher than its current products and this will also highlight a change (both positively and negatively) in customer perception.

However, it is going to be difficult to change the perception of a company on the release of one new product. Some new customers will want to see further evidence that the company is willing to position itself away from the youth market into more healthy type of chocolate. New promotional campaigns to change perceptions will cost additional funds and it will take time to convince customers that this company has changed irrevocably. Some may be sceptical about *Nesbit's* motive and will not change their overall perception. Of course some younger consumers may be dismayed at these changes and continue to see *Nesbit* as only a “youth” targeting company.

Possible judgment:

Veneziano represents a potentially lucrative move for *Nesbit* and early sales have been impressive. Shira should seek new additional customer feedback once this healthy chocolate bar has been established or other new bars are released onto the market to be confident of *Nesbit's* new positioning as an adult chocolate company.

*Accept any other relevant discussion.*

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) Describe two characteristics of a public limited company. [4 marks]**

Characteristics of a public limited company like *GSK* may include:

- Finance is raised through selling shares to the public.
- A public limited company has to go through the initial stage of flotation/ “going public”.
- After “going public”, shares are traded on a stock exchange. Therefore the shares can be bought and sold by the public.
- The owners have limited liability and can only lose as much as the sum of their investment.
- There may be a divorce of ownership and control.

*Accept any other relevant characteristic.*

**Mark as 2+2.**

Award [*1 mark*] for each relevant and correct characteristic of a public limited company identified and [*1 mark*] for each clear description of the characteristic up to a maximum of [*2 marks*].

**(b) Using the concept of price elasticity of demand, explain *GSK*'s pricing strategy for its flu vaccine. [6 marks]**

*GSK* plans to use price discrimination strategy by cutting prices in sub-Saharan Africa to a quarter of the British and American prices. It appears that *GSK* assumes that the people who will be or are affected in the British and American markets are more price inelastic than those who are affected in sub-Saharan Africa. The possible reason is that the flu vaccine may be regarded as more of a luxury product among the poorer sufferers and more of necessity among the relatively richer ones in British and American markets. By charging higher price for those who can afford the products and have a low price elasticity of demand (less than 1), *GSK* will increase its total revenue. Similarly, by lowering the price to those with a high price elasticity of demand (more than 1) *GSK* will increase its total revenue as well. Given the fact that costs are likely to remain constant, profit will increase while *GSK* can still be perceived as ethical.

*Accept any other relevant explanation.*

**[1 to 2 marks]**

Limited knowledge of the concept of PED and total revenue. A list may be provided for [1 mark]. No reference is made to the stimulus material.

**[3 to 4 marks]**

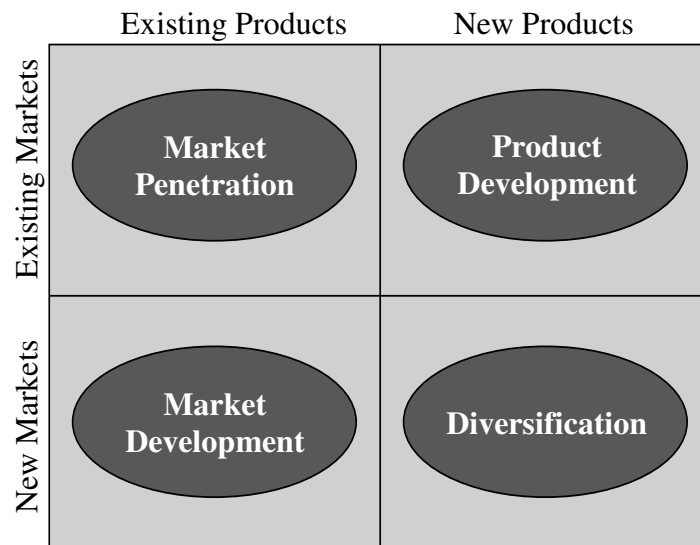
The explanation may be general, lacks depth or the answer is descriptive. Award [4 marks] if the explanation is clear but does not address the concept of PED and its effects on GSK’s pricing strategy.

**[5 to 6 marks]**

The explanation is clear and relevant with reference to PED and total revenue resulting from the two types of consumers. The concept of PED and its effects on GSK’s pricing strategy are well applied to GSK. Reference is made to the information in the stimulus material.

- (c) **Using the Ansoff matrix, examine one of the strategic options planned by Andrew.** **[6 marks]**

The Ansoff matrix



[Source: [http://tutor2u.net/business/strategy/ansoff\\_matrix.htm](http://tutor2u.net/business/strategy/ansoff_matrix.htm), accessed 4 March 2011]

**To extend GSK’s product range, particularly in cosmetic products through acquisitions of companies such as Stiefel Laboratories, Inc., an American manufacturer of skincare products.**

This strategy can be seen as a *related diversification* on the Ansoff matrix. GSK can still use its core competencies/experience/knowledge in the consumer product market but enter into a different but somewhat related market/of consumer skincare. It will enable GSK to fulfil its objectives of reducing its dependency on a few cash cows in the pharmaceutical industry. A synergy can be created with the newly acquired companies that can possibly enhance/create GSK’s world dominance and create economies of scale.

While risk will be reduced, *GSK* might face some problems with its acquisition of a company like *Stiefel Laboratories, Inc.*. Legal issues, cultural issues, over diversification, increased costs/diseconomies of scale and so on might erode *GSK's* competitive advantage and focus in the market.

**To enter emerging, fast-growing economies by acquiring *Dr. Reddy's*, an Indian generic drugs company.**

This strategy can be classified as product development – generic products. Some candidates may classify it as market development – taking its current products as well as new generic ones into fast-growing economies. Although it is stated in the stimulus material that *GSK* is operating in many countries, some are likely to be fast-growing economies.

*Nevertheless, give credit to these candidates. Some might see this move as diversification.*

By buying a company that specializes in generic products, *GSK* makes its product more affordable and can be further seen as a more ethical organization. *GSK* can use price differentiation in this way. Furthermore, its profit is likely to increase as the demand for generic products in the fast-growing economies is likely to be high. Lower prices will result in increased TR (relatively elastic PED).

However:

One can argue that selling both generic and non-generic drugs may confuse some customers and they will be seeking the generic rather than the branded ones. Brand erosion may occur and *GSK* might find it difficult to justify high prices for the non-generic products. On a more technical note, purchasing another company may involve costs. Legal and cultural barriers may reduce the effectiveness of this strategy.

*Accept any relevant arguments for or against each option.*

Credit candidates who applied the other strategy and examined the effects. For example: “to collaborate with other pharmaceutical companies”. This decision may be seen as part of a new product development growth strategy.

For one relevant issue that is one-sided, with no analysis award **up to** a maximum of **[3 marks]**. For more than one relevant issue that is one-sided, with no analysis award **up to** a maximum of **[4 marks]**.

If the Ansoff matrix is not used or referred to but the examination is relevant award up to a maximum of **[4 marks]**.

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

- (d) Discuss *GSK*'s aim to “balance the need to make a profit with the ethical side of health care”.

[9 marks]

**Some of the possible issues/arguments which are relevant to the commercial side and the need to be profitable:**

*GSK* must anticipate the needs in the market and come up with a new, effective and innovative product ahead of its major competitors to keep its competitive edge. The costs and duration of the research and development (R&D) stage are significantly large and long. Despite the fact that in 2009, the group received 195 million orders for flu vaccines and it is expected that sales into 2010 will reach US\$1.3 billion, the level of profit might be considerably lower given the enormous costs in R&D and the length of time it takes to develop such a product. *GSK* spent 18 years and US\$3 billion preparing by researching and developing new flu vaccines for the flu pandemic. The relationship between the product life cycle, investment profit and cash flow should also be discussed. *GSK* will only reap the profit when the product starts growing. During the development and the introduction stages coupled with the possible heavy costs spent on branding, this product draws cash but does not generate profit/TR. Therefore, one may argue that while there is a need/demand for this product, *GSK* should indeed charge as high a price as possible to recoup the costs of R&D and to generate sufficient profit to enable it to develop further solutions/cures for other diseases for the benefit of mankind. There is also the issue of generic products versus *GSK*'s branded product. After the patent expires or even before, due to imitation, other pharmaceutical companies might produce similar products charging considerably lower prices which can erode *GSK*'s profit. The shareholders also expect good returns for such a long and risky investment otherwise they might sell their shares with a possible significant effect on the value of *GSK*.

*Accept any relevant argument.*

The arguments above can be judged as significant in determining *GSK*'s decision to be highly commercial, profit-orientated and charge a high price for the flu vaccine.

**However, some of the possible arguments for being ethical:**

Andrew is aware that it is expected by many stakeholders like the wider community, *World Health Organization*, governments of countries where the incidence of the flu is high but the standards of living of most members of the population is low, that *GSK* perhaps should be more ethical/socially responsible and should not consider profit at all times as their main objective. Consequently, *GSK* plans to cut prices in sub-Saharan Africa to a quarter of the British and American prices and to share research with rivals on tropical diseases. It is clear that the pricing strategy chosen is of price discrimination. Given the fact that it is going to be done on a geographical basis, the strategy is likely to work to a large extent. There is always a danger of the re-selling of a product in developing countries, but it is a risk that *GSK* is probably willing to take to be seen as an ethical organization. On the other hand, collaborating with rival companies may result in the transfer of knowledge/industry secrets to competitors. *GSK*'s competitive advantage/USP may be eroded.

However, being ethical can also benefit *GSK* in the long term especially given its strategic growth option in terms of approval by the local government of their acquisition and/or joint venture, resulting in possible tax concessions and so on. TR/profit may also increase due to price discrimination.

*Accept any other relevant argument.*

It looks as if *GSK* has other strategies that enable growth, reduced risk and increased profit in the long as well as the short term. Therefore, being ethical and reducing the price in sub-Saharan Africa will not likely create too much resentment among the shareholders – especially if those affected or government in the British and American markets are willing to pay higher prices. The other risks mentioned above may also be seen as manageable and not very significant. *GSK's* aim seems very viable/achievable without much, if any resentment.

*Accept any other conclusion/judgment as long it is substantiated and based on 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 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) Define the following terms:

(i) *current liabilities*

[2 marks]

Current liabilities – a debt that has to be paid within 12 months – short-term. Liabilities are also considered as sources of funds *e.g.* overdraft, creditors, short-term loan.

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) *wholesaler.*

[2 marks]

A person or an organization which buys large quantities of products from manufacturers/suppliers and sells on in smaller quantities/volume to other business users or retailers. A wholesaler can be seen as a middle person who “breaks bulk”.

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) Explain the effects on *Eat Well's* profit and loss account resulting from using LIFO and FIFO stock valuation (*figures are not required*). [6 marks]

If *Eat Well* uses a FIFO method of stock valuation, the value/price of the stock that is bought first is used. Given the fact that the last batch of stock is measured/counted as closing stock and **assuming** that the older stock is cheaper, the method of FIFO results in higher value of closing stock, consequently lower value of cost of goods sold and higher level of gross profit as opposed to LIFO. The use of LIFO stock valuation will result in a lower value of closing stock as the older/**assuming** cheaper stock is left. Higher cost of goods sold will therefore result in lower gross profit (GP).

Given the higher recorded GP under FIFO, the use of the FIFO method results in higher tax liability that will further increase the current liability of *Eat Well* with a direct negative effect on its retained profit. The use of LIFO will produce an opposite effect. Under LIFO, *Eat Well* may benefit from a lower tax rate/lower current liability and therefore the use of this method can mitigate the increase in the level of tax by the government.

*Accept any other relevant explanation.*

**N.B.** it is expected that the candidates explain the differences between the methods and its effects on *Eat Well's* profit and not just assert that it is different/opposite.

It is not expected that the candidates use figures to demonstrate/reinforce the above issues.

**[1 to 2 marks]**

The response demonstrates limited knowledge of the methods and their effects. A list may be provided. No reference is made to *Eat Well*.

**[3 to 4 marks]**

Some knowledge and understanding of the methods and their effects is shown. The explanation might not incorporate both methods and/or the response is descriptive. Some reference is made to *Eat Well* but it may be generic.

**[5 to 6 marks]**

A good knowledge and understanding of the methods and their effects is shown. The explanation incorporates both methods with specific application to cost of goods sold in a clear and appropriate manner. Appropriate reference is made to *Eat Well*.

- (c) Analyse Kaa’s decision to change *Eat Well’s* stock control method to just-in-case (JIC). [6 marks]

Just-in-time (JIT) stock control method is designed to minimize the costs of holding stock by the use of a planned schedule and use of resources through the production/operation process. The system relies on a very efficient ordering and delivery system as stock is ordered and arrives upon the start of the operation. If a just-in-case (JIC) stock control method is used, Kaa will have to decide on the level of the buffer stock he wants to keep. It should not be too high as the stock is a very perishable product/food. At the same time and for the same reason Kaa will have to decide on the maximum level of stock to be kept to accommodate unexpected demand. The higher the level of stock, the more expensive it will be for *Eat Well* with a greater chance of the stock/food deteriorating. If it is a risk that Kaa wants to take he has to correctly estimate the lower and upper level of stock and has to calculate or agree upon how quickly the delivery will arrive (lead time) and establish an order level. The estimation of these figures might be difficult. Once established the system should not be technically difficult to operate with the use of a computer and software. Kaa will reduce the occurrences of being left out of stock due to frequent delays in deliveries of ingredients as he can use the buffer stock. *Eat Well* is less likely to suffer from a loss of reputation. Using a wholesaler will also enable Kaa to respond to customers’ demand for a more varied menu and less offerings of local dishes. Kaa will also reduce his dependency on unreliable local farmers and be able to gain purchasing economies of scale due to bulk buying of the ingredients. This may resolve the current cash-flow problems. However, by not using JIT stock control, Kaa may experience further cash-flow problems as his money will be tied up in stock. More waste will occur especially given the nature of the business and the fact that currently *Eat Well* prides itself on the fresh ingredients it uses.

*Accept any other relevant argument for and against provided it is relevant and applicable.*

It is expected that the candidates will use **two** arguments for and **two** arguments against JIC for the response to be judged as a balanced one.

For one relevant issue that is one-sided, with no analysis award **up to** a maximum of [3 marks]. For more than one relevant issue that is one-sided, with no analysis award **up to** a maximum of [4 marks].

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

- (d) **Discuss the usefulness of market research for Kaa in order to “determine how to attract more customers and how to compete more effectively”.** [9 marks]

Given the current changes/threats in the external environment mentioned in the stimulus as well as some internal weaknesses, one can argue that *Eat Well* should carry out both primary and secondary research.

*Eat Well* will need to find out more about:

- the consumers tastes, preferences, opinion regarding the use of organic food, the need for more varied and less traditional dishes
- the 7Ps used by the new/successful competitor nearby
- the possible changes required to *Eat Well's* current marketing mix in order to become more competitive
- the competitors' customers' opinions/preferences
- the changes in the government regulations and the possible effects in terms of practices and costs on *Eat Well*
- internal financial issues like costs, expenses and prices in order to address the current cash-flow problems
- *accept any other relevant/applicable information that might be needed.*

Given the above, some of the methods and sources that can be used are:

#### **Primary research**

Possible **sources** to be consulted: current customers, potential customers/members of the local community, competitors' customers. Kaa should assess their opinions and get some recommendations regarding the above. Primary research is effective but expensive. The possible **methods** that can be used are: questionnaires, personal interviews, telephone interviews, postal surveys, any other relevant IT-based research, focus groups, consumers panels, interviews. The above can give Kaa up-to-date, unique, and personal first-hand information in order to adjust its own marketing mix, especially the menu. However, the above methods are time-consuming, very costly and are subject to human bias. It is doubtful if Kaa himself has the time, the experience or the desire to carry out the research by himself. He will need to design and carry out the primary research in an appropriate way that will give relevant accurate results. He is, after all, the chef. Moreover, the sampling methods to be chosen as well as the unpredictable nature of human response might reduce the validity of the results. *Eat Well* is quite likely not to have the expertise to conduct the market research appropriately. Subcontracting it to a specialized organization is a valid but expensive option.

*Accept any other relevant primary source or method provided it is well applied to the needs of Eat Well.*

**N.B.** it is not expected that each sampling method will be assessed. It is also not expected that the candidates make an explicit distinction between sources and methods.

**Secondary research**

*Eat Well* can look for data and research that have been done before by more specialized bodies. The information can be accessed very quickly and cheaply, especially with the use of technology. While any other organization, including its competitors have access to the information, it can still prove very relevant, useful and affordable for *Eat Well* which is a small family-run organization experiencing some cash-flow problems. Some of the relevant sources that *Eat Well* can use are: government publications on the new health and safety regulations as well as eating habits of the population. Printed information from the competitors can also be used. Information like the menus, costs of production, ingredients, any relevant information on the use of the 7Ps, market share, the profit and the market share. Commercial publications can be used as well as industry specific publications where information about health, eating habits, or any relevant changes in the external environment can be found. Internal documents can also be used like the profit and loss account to assess the fluctuation in demand, the costs of production, the suitability of the pricing strategy or any other relevant issues regarding the 7Ps.

*Accept any other relevant secondary source provided it is applied to the needs of Eat Well.*

However, the information gathered may be outdated, unreliable or does not directly meet *Eat Well's* needs. Overall, both types of market research should be used. Given the fact that *Eat Well* is only a small local restaurant, perhaps the use of primary research is possible and more relevant as the market is very geographically concentrated supplemented by a cheaper and more general secondary research. However, a different discussion which concludes that secondary research is more preferable should be fully accepted provided it is substantiated.

*Accept any other relevant discussion.*

**N.B.** it is not expected that the candidates incorporate all of the above points/issues.

A balanced response will highlight the strengths **and** weaknesses of the chosen source of market research.

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.

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