M14/3/BUSMT/HP2/ENG/TZ0/XX

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BUSINESS AND MANAGEMENT
HIGHER LEVEL
PAPER 2

Thursday 22 May 2014 (morning)

2 hours 15 minutes

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- Section A: answer one question.
- Section B: answer two questions.
- A calculator is required for this examination paper.
- Clean copies of the ***Business and Management*** *formulae sheet and discount tables* are required for this examination paper.
- The maximum mark for this examination paper is *[75 marks]*.

SECTION A

*Answer **one** question from this section.*

1. AH Ltd

Jose owns *AH Ltd*, a private limited company, that provides climbing and adventure tourism opportunities for children in Ecuador. *AH Ltd* is partly financed by a non-governmental organization (NGO), which promotes outdoor and other healthy activities in Ecuador. An increase in tourism has meant that *AH Ltd* has been working at full capacity. However, some issues have begun to emerge.

In a meeting with Jose, an NGO representative expressed concern over the quality of the climbing equipment being used. Several minor accidents involving children had occurred. In addition, the NGO representative had not been kept up-to-date on the financial position of *AH Ltd*. After the meeting, Jose showed the following financial figures to his accountant, Marco.

Selected financial information from *AH Ltd*'s accounts as at 31 March 2014 (all figures in US$m).

Cash	0.1
Creditors	0.8
Debtors	0.2
Fixed assets – equipment	1.5
Fixed assets – land and building	9
Loan capital	4
Retained profit	2
Share capital	4

Marco is concerned that the information from *AH Ltd*'s accounts does not show a true reflection of *AH Ltd*'s financial position. For example, Jose has not made any provisions for depreciating the value of the equipment since purchasing it three years ago. Marco has informed Jose that the equipment should be depreciated using the reducing balance method at a rate of 40 % per year.

Jose wishes to expand the business to offer more climbing opportunities. Marco, however, warns that the current equipment needs to be replaced to meet international quality standards. Additional funding from the NGO is not possible, and banks in Ecuador give few loans to small businesses such as *AH Ltd*.

(This question continues on the following page)

(Question 1 continued)

(a) Define the following terms:

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

(ii) *fixed assets.* *[2 marks]*

(b) Explain **one** advantage **and one** disadvantage for *AH Ltd* of working at full capacity. *[4 marks]*

(c) (i) Using the information provided from *AH Ltd*'s accounts, prepare a balance sheet for *AH Ltd* as at 31 March 2014. *[3 marks]*

(ii) Using the reducing balance method of depreciation, calculate the total depreciation charge on the equipment purchased three years ago *(show all your working)*. *[3 marks]*

(iii) Prepare *AH Ltd*'s new balance sheet as at 31 March 2014 taking into account the depreciation charge calculated in part (ii). *[3 marks]*

(d) Explain **one** advantage for *AH Ltd* of using a straight line method of depreciation instead of a reducing balance method of depreciation. *[2 marks]*

(e) Examine **two** appropriate sources of finance for *AH Ltd* to fund the replacement of the old equipment. *[6 marks]*

2. Himalayan Trekking

Himalayan Trekking (*HT*) is a trekking (mountain walking) agency based in Nepal. It has been operating guided treks for tourists in Nepal, Tibet and Bhutan for over 20 years. With a duration of between one and three weeks, *HT* offerings include treks to the Everest Base Camp, tours to Buddhist sites in Tibet, and treks even to the inaccessible Kingdom of Bhutan. Brand loyalty is very strong, with repeat bookings from many clients (trekkers).

The market for trekking has been growing very rapidly with many new businesses setting up to meet the increased demand for "adventure" holidays. In this competitive market, *HT*'s unique selling proposition (USP) is to provide an unforgettable wilderness experience in a socially and ethically responsible manner. It only uses locally produced food and local guides and trekkers camp without wasting too many resources. All clients have to sign a contract to agree that they will act in a socially responsible manner throughout the trek. Though it always had a strong sense of social responsibility, *HT* had not promoted this aspect of the business until the management realized that changes in attitudes towards social responsibility could be used to gain competitive advantage.

HT's brochure states that:

- It is a market leader in adventure tourism for Nepal, Tibet and Bhutan. It caters to a wide range of clients from experienced to inexperienced trekkers.
- In recognition of protecting the fragile environment, economic systems and cultures it treks in, *HT* has been awarded a global quality standard.
- By employing local guides and using locally produced food, *HT* adds much value to the local region.
- It only employs staff that have previous social and environmental experience.
- It financially supports a non-governmental organization (NGO) for Nepali orphans by giving 5% of its turnover to *Child Environment Nepal* (*CEN*).

Selected financial information for *HT* for 2013:

Annual fixed costs (trekking permits set by governments in Nepal, Tibet and Bhutan)	\$800 000
Average variable cost per trekker (food, local guides, transport costs)	\$5000
Average price charged per trekker	\$10 000
Number of clients (trekkers)	300

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(Question 2 continued)

(a) (i) Define the term *unique selling proposition* (*USP*). *[2 marks]*

(ii) Identify **two** external stakeholders of *HT*. *[2 marks]*

(b) (i) Calculate how many clients (trekkers) *HT* would need to meet its target profit figure of $400 000 per year *(show all your working)*. *[3 marks]*

(ii) Using the financial information provided, prepare a fully labelled break-even chart for *HT* for 2013. *[6 marks]*

(c) In 2014, the following changes occurred:
- annual fixed costs increased by 20 %
- rising fuel costs of flights increased average variable costs by 40 % per trekker.

The average price charged per trekker remained the same ($10 000) as did the number of clients (300).

(i) Taking these changes into account, calculate the new break-even quantity **and** margin of safety for *HT* in 2014 *(show all your working)*. *[4 marks]*

(ii) Explain **one** possible response from *HT* to the change in the break-even quantity **and** margin of safety calculated in part (i). *[2 marks]*

(d) Examine why changing attitudes to social responsibility might be important for *HT*. *[6 marks]*

SECTION B

*Answer **two** questions from this section.*

3. Turners

Turners is a famous hotel located in a large city. It is positioned as having the highest quality of customer service and most of the employees have worked for *Turners* for over ten years. Regular customers like knowing the employees at reception and other areas of the hotel. Many customers have commented on the unique style of customer service at *Turners*. They like the fact that the people in the photographs used in promotional materials are actually the people they interact with when staying at *Turners*.

Turners has an expensive, award-winning restaurant. *Turners* had used a price skimming strategy with room rates at over $1000 per night. However, new competition from three other recently opened hotels and other changes in the external environment have resulted in revenue becoming more cyclical. Profits are falling.

Surprisingly, the General Manager, Shane Peterson, also received some negative customer feedback from a random sample of customers. Firstly, they claim that *Turners*' online booking system is slow and unreliable. Customers complain of an overbooked restaurant and untidy leisure facilities. Business customers argue that the newer competing hotels offer better customer service, high-speed internet and other business services for no extra charge. As a result, Shane is reviewing *Turners*' marketing mix.

Shane has to focus on improving customer service as well as reducing costs. He is considering two options:

- Reducing labour costs by implementing Handy's shamrock organization.
- Outsourcing *Turners*' staff training programme. Currently, it uses an internal, on-the-job staff training programme where experienced staff train new employees.

The cost savings from using Handy's shamrock organization would reduce salaries and wages by 7 %. Outsourcing *Turners'* staff training programme would reduce training costs by 9 %. These combined savings could allow *Turners* to offer high-speed internet and other business services for no extra charge to customers.

(a) Define the term *price skimming*. *[2 marks]*

(b) Identify **two** key features of random sampling. *[2 marks]*

(c) Explain the importance of people, process and physical evidence for *Turners*. *[6 marks]*

(d) Examine the usefulness for *Turners* of using Handy's shamrock organization. *[6 marks]*

(e) Evaluate whether *Turners* should outsource its staff training programme. *[9 marks]*

4. Walgreens–Alliance Boots

Walgreens, a public limited company, is the biggest chain of drug stores in the United States (US). It has made an offer for a 45% stake in *Alliance Boots*, the biggest chain of drug stores in the United Kingdom (UK). *Walgreens* has 8000 stores in the US, *Alliance Boots* has more than 3000 stores in Europe and beyond. The combined sales of both companies is US$112 billion. A proposed merger between the two companies would create the world's largest chain of drug stores.

Walgreens' market share has fallen due to increased competition from online drug retailers and supermarkets that can provide similar products at a lower price. There have also been some concerns over customer service in *Walgreens*' stores.

In contrast, *Alliance Boots* has a strong brand image, based on its quality own-brand products and excellent customer service with trained staff, who can provide medical advice for some illnesses.

The merger would have the following positive outcomes:
- increased internal economies of scale
- a world-leading chain of drug stores would be created
- there would be enough finance for an *Alliance Boots* expansion into China and South America
- *Alliance Boots* would be provided with immediate access to the US market
- *Walgreens* would be given access to *Alliance Boots*' research and manufacturing expertise
- a strategic move would be provided for both companies to survive economic problems.

The new combined *Walgreens–Alliance Boots* may also raise issues over control, strategic direction and decision making.

Walgreens' shareholders were not happy about the proposed merger. *Walgreens* shares fell by 6%. Analysts believed that this strategy was not right for *Walgreens*, whose sales fell by 10% in the last year. *Walgreens* would be merging with a business that is exposed to the economic downturn in Europe. *Alliance Boots*' shareholders were also worried. They feared that its reputable brand image could be eroded, especially if stores were created all over the world.

(a) Define the term *public limited company*. *[2 marks]*

(b) Describe the method of growth used by the proposed merger. *[2 marks]*

(c) Explain the changes to **two** of Porter's five forces resulting from the proposed merger. *[6 marks]*

(d) Examine the claim that the merger would result in "increased internal economies of scale". *[6 marks]*

(e) Discuss whether the proposed merger of *Walgreens* with *Alliance Boots* will result in the positive outcomes stated (apart from economies of scale). *[9 marks]*

5. Matchpoint Tennis Club (MTC)

Matchpoint Tennis Club (*MTC*) is a famous members-only club. *MTC* owns tennis courts, changing rooms and a restaurant. The majority of members are between 30 and 50 years old. Most members have high incomes and successful careers. However, *MTC* faces increasing competition from *Best Sports*, a multinational provider of sports centres. An economic downturn has also reduced *MTC*'s profits. Until recently, the restaurant made a valuable contribution to fixed costs but this has fallen significantly in the last 12 months.

Last year, Seb, a former successful tennis player, became the new Managing Director of *MTC*. With the objective to increase revenue, he wrote a five-year plan with the following strategies:

- double membership of *MTC*
- open the restaurant to the general public
- open a sports equipment and clothes shop under the family brand "Matchpoint"
- employ professional tennis coaches (teachers).

Tina, the Marketing Director, agreed with Seb about the strategies. In order to achieve the first strategic objective (double membership), she prepared a marketing budget and proposed the following tactics:

- overall reduction in membership fees of 10%
- discounts for people aged below 18 and over 60 years old
- advertisements in local newspapers and on social networking sites
- a new range of club branded merchandise such as T-shirts and coffee mugs.

Alex, the Human Resources (HR) Manager is concerned about the impact the five-year plan will have on employees. Employees already argue that they work too hard for low pay. An increase in the number of members would increase their workload and responsibilities further. Alex tried to convince Seb that membership of *MTC* was already at saturation point on the product life cycle and that existing members would not like some of the proposed changes to the club.

Alex also stated that since Seb joined the business last year, the friendly atmosphere at the tennis club has disappeared. That atmosphere has been replaced with a focus solely on profit making. Alex would prefer a focus on providing a good quality service for existing members.

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(Question 5 continued)

(a) Define the following terms:

(i) *family branding* *[2 marks]*

(ii) *contribution to fixed costs.* *[2 marks]*

(b) With reference to *MTC*, explain the difference between objectives, strategies and tactics. *[6 marks]*

(c) With reference to *MTC*, examine the dynamic nature of organizations and the relative importance of driving and restraining forces. *[6 marks]*

(d) Discuss the likely success of Seb's five-year plan to achieve an increase in revenue for *MTC*. *[9 marks]*