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Business

for Cambridge International AS & A Level

WORKBOOK

Peter Stimpson



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Brighter Thinking
Better Learning
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> How to use this book

Throughout this workbook, you will notice recurring features that are designed to help your learning. Here is a brief overview of what you will find.

LEARNING INTENTIONS

Learning intentions open each chapter. These help you with navigation through the workbook and indicate the important concepts in each topic. The learning intentions also map to the content in our *Cambridge International AS & A Level Business Coursebook*.

KEY TERMS

These provide a reminder of the key definitions that you need to recall for each chapter topic.

Key skills exercises

These are scaffolded exercises which support your progression through the course and enable you to put into practice what you have learnt so far. The exercises have been clearly linked to the key skills that you need for Business.

- For knowledge and understanding exercises, there will be key content that you need to know and understand.
- For application exercises, you should use the context provided either by the question or the data response material in your answer.
- For analysis exercises, you need to explain why or how something is important, or why or how it is an advantage or disadvantage. Analysis can either be 'simple' or 'developed'. Developed analysis takes a well-explained point and extends this by demonstrating connections between causes, impacts and/or consequences. The book contains many worked examples and sample answers to exam-style questions illustrating 'developed analysis'.
- For evaluation exercises, you are required to make supported decisions, draw conclusions and give judgements. The skill of evaluation can be shown in several different ways. These are illustrated in some of the sample answers to exam-style questions that demand this skill. You can demonstrate effective evaluation, not only by making judgements or weighing up arguments/strategies, but by giving a clear and justified conclusion.

TIPS

Tips are provided throughout this workbook to help with your learning. The tips provide you with additional practical guidance and advice in preparing the answers to exercises and exam-style questions.

WORKED EXAMPLES

Worked examples provide you with sample answers in order to help you understand how to respond to questions using key skills.

EXAM-STYLE QUESTIONS

More demanding exam-style questions provide you with an opportunity to further practise what you have learnt in each topic.

Improve this answer

This offers you an opportunity to evaluate a sample answer to a question, which has been written by the author. Advice and guidance are provided in order to help you assess the answer. The relevant key skills are often annotated as well.

Your challenge

After studying Improve this answer, you are then asked to apply the advice to your own answer.

Annotation of worked examples and exam-style questions

The answers are annotated with an abbreviated version of the relevant key skills:

- **[K]** Knowledge and understanding
- **[Ap]** Application
- **[An/An+]** Analysis (An+ is used to indicate developed or extended analysis)
- **[E/E+]** Evaluation (E+ is used to indicate effective evaluation)

You can find answers to the activities and exam-style questions in the digital workbook.

Note: Throughout the text, dollars (\$) refer to US dollars, unless otherwise stated.

> Introduction

This workbook is designed to help you develop your knowledge as you study for the Cambridge International AS & A Level Business syllabus (9609) from 2023. It aims to give you support as you put into practice the knowledge and skills you learn as you progress through your course. Working through the many exercises in this book will help you to feel more confident about what you need to know to be a successful student of business.

An important feature of the workbook is that it includes a range of exercises in every chapter to help you build up your core skills. It is important that you gain as much practice as possible in developing the following skills:

- knowledge and understanding
- application of knowledge and understanding
- analysis
- evaluation.

You will gain the most benefit from the workbook by using it together with our *Cambridge International AS & A Level Business Coursebook*.

Answers to all of the exercises and exam-style questions are provided online. These were written by the author to allow you to access a response for each question. Many of these are in the form of ‘building block’ answers. These are outline answers that make clear the important stages that should be followed in developing a complete and detailed answer. The ‘building blocks’ give you a framework to work with and make clear the:

- knowledge you should demonstrate
- application references you should include
- analysis points that could be developed
- evaluation guidelines for weighing up your answer and giving a final conclusion.

Other answers to exercises and exam-style questions, also written by the author, are given in a complete form to demonstrate the length and content of good example responses. Some are also annotated with abbreviations to indicate the key skills that the answers demonstrate.

Complete your own answers before referring to the building block answers or the completed/annotated answers. The more practice you gain, the better your answers will become.

Enjoy your study of business and use this book as an invaluable resource, guide and support towards achieving success on your course.

Demonstrating the key skills

When preparing answers to questions in the coursebook or the workbook, it is very important that you:

- Understand how to use key skills that are relevant to the question you are being asked. The next section explains the main Cambridge International command words used in Business.
- Understand how to demonstrate these key skills in your answers.

This section helps you understand how you can prepare answers that demonstrate the four key skills.

Once you have understood this section, you should be able to:

- prepare effective answers to the hundreds of questions the workbook contains
- fully understand why the annotations in the Worked examples and 'Improve this answer' exercises are appropriate.

Knowledge and understanding

This skill can be demonstrated in the following ways:

- accurate definition of key term
- identification of relevant point, factor, cause or effect.

Application

This skill can be demonstrated by putting the knowledge shown into a business context. It might be demonstrated by a reference to the form of business ownership, the number or skill levels of the employees, accounting data, the objectives of the business, the external environment it operates in and so on. It is very important to remember that the application point made must be relevant to the question asked and must not just be a section copied from the data or case. Many examples of application are given in the Worked examples and 'Improve this answer' exercises.

Analysis

This skill is very important and can be demonstrated in a number of ways:

- using appropriate methods and techniques to make sense of qualitative and quantitative business information
- explaining causes, impacts and consequences
- distinguishing between factual evidence and opinion in a data response exercise or case study
- drawing valid inferences and making valid generalisations.

It is very important to understand that analysis can be either 'simple' or 'developed'. Here is an example to explain the difference:

If the business reduces its price then demand from consumers is likely to increase. This is simple analysis and the impact or cause of the change in price is simply explained.

If the business reduces its price then demand from consumers is likely to increase. If demand is relatively elastic then not only will demand increase but it will increase by a greater proportion than the fall in price and revenue will increase. This is an example of developed analysis as the consequence of the price reduction is fully explained and there is a consistent line of argument.



Evaluation

This skill is very significant when answering those questions that ask you to ‘evaluate’ or ‘advise’. The skill can be demonstrated in a number of ways:

- weighing up evidence and assessing the strengths of options or strategies
- making judgements about the relative importance of factors in a business decision or the relative impact of different decisions
- making reasoned and supported conclusions
- giving clear and supported advice to business managers about a future strategic decision, based on preceding analysis and weighing up of the options.

It is very important to understand that evaluation can be either ‘limited’ or ‘developed/effective’.

An example of limited evaluation would be a conclusion that is based on very few arguments or little evidence. An example of developed and effective evaluation would be a judgement or advice to managers that is clearly supported by evaluative comments that weigh up key arguments, clearly focused on the business referred to in the question.

There are many examples of these skills (including simple/developed analysis and limited/effective evaluation) in the Worked examples and the ‘Improve this answer’ exercises.

> Introduction to command words

The command words and definitions in the following table are taken from the Cambridge International syllabus (9609) for examination from 2023. You should always refer to the appropriate syllabus document for the year of your examination to confirm the details and for more information. The syllabus document is available on the Cambridge International website at www.cambridgeinternational.org. The guidance that appears in this table has been written by the authors.

Questions will often start with one of the command words from the table below. It is important that you understand what each one is asking you to do.

These are the command words used in the Cambridge International AS & A Level Business syllabus (9609) and in the exam-style questions and most of the activities in this book. In time, and with experience at answering questions, you will find it easy to understand what skills you have to demonstrate in your answers to each question.

Command word	Definition	Guidance
Advise	write down a suggested course of action in a given situation	You should aim to make a reasoned judgement and include a supported conclusion.
Analyse	examine in detail to show meaning, identify elements and the relationship between them	You need to give a detailed answer with a clear line of argument demonstrating the links/relationships between factors or the consequences of an event or decisions.
Assess	make an informed judgement	You should aim to compare the advantages and disadvantages of a particular issue or decisions and come to a supported conclusion.
Calculate	work out from given facts, figures or information	You are always advised to show your working.
Define	give precise meaning	You should use the key terms in the coursebook.
Evaluate	judge or calculate the quality, importance, amount or value of something	You should aim to make a reasoned judgement and include a supported conclusion.

Command word	Definition	Guidance
Explain	set out purposes or reasons/ make the relationships between things evident/ provide why and/or how and support with relevant evidence	You should aim to give more detail than 'define' by, for example, applying to the case study context.
Identify	name/select/recognise	You should state a relevant point about a business term.
Justify	support a case with evidence/ argument	You are asked to make a decision/come to a conclusion and support this with evidence and argument.

Additional guidance (e.g. phrases such as 'To what extent ...?') may also be seen in the assessment for this syllabus.

The information in this section is based on the Cambridge International AS & A Level 9609 syllabus for examination from 2023. You should always refer to the appropriate syllabus document for the year of your examination to confirm the details and for more information. The syllabus document is available on the Cambridge International website at www.cambridgeinternational.org.

> Unit 1

Business and its environment

> Chapter 1

Enterprise

LEARNING INTENTIONS

In this chapter you will:

- analyse what is meant by business activity, opportunity cost and the economic problem
- analyse how businesses add value
- analyse why businesses succeed or fail
- apply the characteristics of successful entrepreneurs and intrapreneurs
- evaluate the role of entrepreneurs and intrapreneurs in businesses
- analyse the role of enterprise in a country's development
- evaluate the benefits and limitations of business plans.

KEY TERMS

Added value Adding value Business plan Capital goods Consumer Consumer goods Consumer services
Customer Entrepreneur Factors of production Intrapreneur Multinational business Opportunity cost

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- the nature of business activity
- important factors of production
- skills and personal qualities needed by successful entrepreneurs and intrapreneurs
- why businesses succeed or fail
- role of enterprise
- business plans.

- 1 Identify the **four** factors of production.
- 2 Explain how a good reputation for quality can help a business add value.
- 3 Define the term 'opportunity cost'.
- 4 What is meant by 'the business environment is dynamic'?
- 5 Identify **five** characteristics of a successful entrepreneur or intrapreneur.
- 6 Identify **three** reasons why a recently established business might fail.
- 7 Explain **one** difference between business risk and uncertainty.
- 8 Identify **three** ways in which a country benefits from the start-up of new businesses.
- 9 Identify **three** elements of a business plan.

- 10 Identify **three** benefits to an entrepreneur of preparing a business plan.
- 11 Identify **two** possible barriers to entrepreneurship.
- 12 Explain the difference between an entrepreneur and an intrapreneur.
- 13 Explain the difference between a national business and a multinational business.

Application

Sami's new business

Sami lives in a low-income country with few job opportunities. He is bored with his job in a petrol service station where he has worked since leaving school. He feels that he is being watched all the time by his manager. He plans to set up a business with a small sum of money given to him by a relative. He will make and decorate ceramic pots to sell to tourists. Sami started making pots in an art class at school and enjoyed it. He will use a simple pottery wheel and an electric kiln. He cannot work from home as pottery can be very dusty work. Clay and paint to decorate the pots will be bought from suppliers. He wants to use his skill to make pots for most of the working day. However, he knows that he will have to keep records of all of the transactions his business has with suppliers and customers. He thinks that he will have to employ someone to help him with selling the pots and administration of the business.

- 14 Explain **two** reasons why Sami decided to set up his own business.

WORKED EXAMPLE FOR Q14

One reason

One reason is that Sami wants to be independent by owning his own business **[K]**. This is shown by the fact that 'he feels he is being watched all the time by his manager', which does not give him any independence at all **[Ap]**.

TIP

Do not make up your reasons! Read the case study carefully and identify two reasons why Sami took this decision.

- 15 Explain **two** factors of production that Sami will need before he can start operating his business.
- 16 Explain **two** challenges that Sami will face in starting his business.
- 17 Explain how Sami will add value in his business.

Analysis

- 18 Analyse **two** benefits to Sami's country of his decision to start up his own business.

WORKED EXAMPLE FOR Q18

One benefit

Sami will employ at least one other worker **[K]**. He will need someone to help him sell pots and carry out administrative tasks such as looking after the paperwork **[Ap]**. This will help reduce unemployment in Sami's country **[An]**. This will lead to more people in jobs earning income to increase demand for products **[An+]**.

- 19 Analyse **two** reasons why Sami's business could fail.

Evaluation

- 20 Do you think Sami's business will be successful? Justify your answer.
- 21 Evaluate the most important entrepreneurial characteristics that Sami will need to help make the business a success.

TIP

For Q20, think of at least one reason why Sami's new business might be successful (e.g. it might be something to do with his own skills). Then consider what problems might arise that would impact on the success of Sami's business. Analyse how and why these factors would affect the success of Sami's business and come to an overall and justified conclusion.

EXAM-STYLE QUESTIONS

Short answer questions

- 1 Analyse **one** way in which a country might benefit from entrepreneurs opening new businesses. [5]
- 2 Analyse **one** reason why a business might fail. [5]

Essay questions

- 1 a Analyse the role of intrapreneurship to the success of a business. [8]
- b 'Any hard-working person can become a successful entrepreneur.' Evaluate whether you agree with this statement. [12]

Data response questions

Sadiq Boat Repairs (SBR)

Sadiq set up SBR three years ago. He prepared a detailed business plan. He found several investors and banks prepared to offer him finance. The business repairs boats and boat engines. Sadiq located his business in a small workshop next to a large harbour. There are many small boats in the harbour.

Sadiq is a skilled mechanic and a keen boat owner. He used to work for a large car manufacturer but found the work repetitive. He works long hours as he does not employ any workers. He likes dealing with customers directly. He does all of the paperwork for the business.

Sadiq belongs to a sailing club and is friends with many of the members. He buys in boat and engine repair parts for his customers. His final price for each job includes the cost of these parts and the time he has spent on the job. He thinks he might be able to add further value by selling new boat engines to customers whose engines cannot be repaired. He has been offered some low-cost spare parts for engines, which would also help to increase added value.

- a i Identify **one** type of business capital. [1]
- ii Explain the term 'add value'. [3]
- b Explain **two** factors, other than Sadiq's own personal qualities, that have led to the success of SBR. [6]
- c Analyse **two** ways in which Sadiq's business could increase added value. [8]
- d Evaluate Sadiq's role in the success of his business. [12]

CONTINUED**Improve this answer**

This is a sample answer to data response Qb.

Location is important for any business **[K]**. If the site is too expensive, it can mean that costs are too high and no profit is made **[An]**. Sadiq must have chosen a cheap location.
All new businesses need customers and the quicker customers are gained, the more successful the business is likely to become **[K]**. Sadiq's customers will pay money to the business and this can then be used to pay the costs of the business and pay back any loans that were needed to set it up **[An]**.

Your challenge

See whether you can improve this answer. It clearly identifies two factors. Both of these are briefly explained in terms of how they contributed to the success of a business. However, it seems to lack detailed application. Just referring to 'Sadiq' does not make the answer applied. A better answer is available online – but write yours out first!

> Chapter 2

Business structure

LEARNING INTENTIONS

In this chapter you will:

- classify industries into levels of economic activity – primary, secondary, tertiary and quaternary – and analyse changes in their relative importance
- analyse the differences between the private sector and public sector in your country
- identify the different forms of legal structures of business and evaluate the most appropriate one for different businesses
- analyse the advantages and disadvantages of changing from one type of business ownership to another.

KEY TERMS

Articles of Association Command economy Cooperative Franchise Free-market economy Joint venture
Limited liability Memorandum of Association Mixed economy Public corporation Partnership
Primary sector business activity Public sector Public limited company Private limited company Private sector
Quaternary sector business activity Secondary sector business activity Share Shareholder Social enterprise
Sole trader Tertiary sector business activity

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- different levels of economic activity
 - the different sectors of an economy
 - the main forms of business ownership.
- 1 Identify **three** industries in the primary sector.
 - 2 Identify **three** industries in the secondary sector.
 - 3 Explain **one** difference between the tertiary sector and the quaternary sector.
 - 4 Identify **three** types of economic activity that are usually undertaken by the public sector.
 - 5 Are public limited companies in the private sector or the public sector?
 - 6 Explain the term ‘limited liability’.
 - 7 If a small sole-trader business expands by employing one worker, why is it not now a partnership?
 - 8 Identify **two** benefits that a partnership has over a sole-trader business.
 - 9 Identify **two** benefits that a public limited company has over a private limited company.
 - 10 Give **one** advantage and **one** disadvantage to an entrepreneur of setting up a franchise business.

- 11 Identify **two** objectives of most social enterprises.
- 12 Identify **two** examples of cooperatives operating in your country.
- 13 Outline **two** common differences between cooperative organisations and other forms of business ownership.

Application

	Primary	Secondary	Tertiary	Quaternary
Country A	30 (45)	32 (20)	30 (28)	8 (7)
Country B	3 (4)	15 (25)	65 (57)	17 (14)

Table 2.1: Business sectors in Country A and Country B (% of output) in current year (and five years ago)

- 14 Explain **two** possible causes of the changes in the relative importance of the business sectors in Country A, as shown in Table 2.1. Country A is a low-income country experiencing rapid economic growth.
- 15 Explain **two** possible consequences of the changes in the relative importance of the business sectors in Country B, shown in Table 2.1. Country B is a high-income country.

Gill's dresses: 1

Gill is a skilled dressmaker. She makes dresses to her own designs. She used to sell her dresses to clothes shops but she recently decided to sell them only at city centre markets. Selling at these markets takes up a lot of Gill's time. Currently, she works at home but needs additional space for the inventories of materials she has. She also plans to employ a worker who will help her cut material and sell finished dresses at the markets. Gill's old sewing machine keeps breaking down and she needs to replace it. She is worried that her savings might not be enough to pay for a new one.

- 16 What evidence above suggests that Gill is a sole trader?
- 17 Explain **two** benefits to Gill of taking on a business partner.

TIP

Read your answer for Q16 carefully. Does it make clear references to Gill and/or her business?

WORKED EXAMPLE FOR Q17

One benefit

Gill is planning to expand her business by buying/renting additional storage space for materials [Ap]. This will need finance [K] and Gill may not have enough savings, so a partner will bring finance into the business [Ap].

- 18 Is Gill's business in the private sector or public sector? Explain your answer.
- 19 In which level of economic activity would you classify Gill's dressmaking business? Explain your answer.

Analysis

Gill's dresses: 2

Gill decides to form a partnership with her friend Maria, who is keen to make dresses but is not very skilled. She has told Gill that she will put a substantial amount of capital into the business and that she knows a lot about fashion.

A specialist clothing retailer has suggested a joint venture proposal to the partners. The owner plans to open a small fashion shop in the city and has asked Gill and Maria to supply dresses. The retailer would manage the sale of the dresses.

- 20 Analyse **one** disadvantage to Gill of taking on a partner.
- 21 Analyse **one** benefit and **one** drawback to Gill and Maria of converting the business into a private limited company.

WORKED EXAMPLE FOR Q21

One benefit

The benefit would be that both Gill and Maria will have limited liability [**K**]. Maria plans to put a substantial amount of capital into the business [**Ap**]. Gill and Maria would benefit from only risking the capital they invested in the business [**An**]. This would protect their other assets from being liquidated if the business fails [**An**] and could encourage them to invest more into the business, leading to further expansion [**An+**].

TIP

Your answer to Q21 should provide the basis of your answer to Q22. Include at least one paragraph in Q22 explaining your decision as to whether they should form a private limited company.

Evaluation

- 22 Do you think that Gill and Maria should form a private limited company? Justify your answer.
- 23 Advise Gill and Maria whether or not to form a joint venture with the retailer. Justify your answer.

EXAM-STYLE QUESTIONS

Short answer questions

- 1 Explain the difference between primary sector business activity and tertiary sector business activity. [3]
- 2 Analyse **one** benefit to an entrepreneur of starting a franchised business. [5]

Essay questions

- 1 a Analyse **two** benefits to a sole trader of forming a partnership. [8]
 b 'The owners of all private limited companies should consider converting their businesses into public limited companies.' Evaluate this view. [12]

TIP

For short answer Q1, start with a definition of each type of business activity and then explain the differences between them.

CONTINUED

TIP

In the previous questions, notice that there are more marks available for the essay questions than for the short answer questions. Write in clear paragraphs. For Q1b, the final paragraphs should explain and justify why owners of a private limited company might or might not consider converting the business to a public limited company.

Data response questions

Cassy's jewellery

Cassy makes wedding rings, and other items of jewellery, for women and men. Sajiv is her business partner. Their business is in the private sector. They sell jewellery through the business's website. The sold items are posted to customers. Sajiv is responsible for accounts, arranging finance from the bank and buying material supplies. The partners employ two skilled jewellery makers. Sajiv has invested more capital in the business than Cassy. He is thinking of the benefits of limited liability if their partnership is converted into a private limited company.

Both Cassy and Sajiv want new challenges. They could expand their business, called C and S Gems, by employing more workers and renting a large workshop. However, last week they were asked by a large company, MGC, which makes expensive jewellery, if they wanted to buy a franchise from MGC. The franchise licence would give Cassy and Sajiv the legal right to copy MGC's many well-known jewellery designs. These would then be sold through an MGC branded shop. The cost of the franchise licence is high and C and S Gems would have to be sold to finance this. 'This franchise would give us less risk and a well-known brand name,' said Sajiv.

- | | | | |
|---|----|---|------|
| a | i | Identify one feature of the private sector. | [1] |
| | ii | Explain the term 'limited liability'. | [3] |
| b | | Explain two ways in which tertiary sector businesses could help Cassy's business. | [6] |
| c | | Analyse two problems that Cassy and Sajiv might experience from changing the business from a partnership to a private limited company. | [8] |
| d | | Evaluate whether Cassy and Sajiv should sell their business and buy the MGC franchise. | [12] |

Improve this answer

This is a sample answer to data response Qd.

A franchise means buying a licence to trade under the name of another business [K]. If this business is well known with a good brand name, it can reduce operating risks [An].

MGC is a large company and appears to have a good brand name [Ap]. This means Cassy and Sajiv would not have to spend much on advertising as customers will already know about MGC jewellery designs [An]. Lower advertising and promotion costs, because of the well-known brand name, will help to make the franchised business more profitable [An+]. Risks will be reduced as MGC will have much experience in operating retail stores and will be able to pass this on to Cassy and Sajiv [An]. They are both ambitious and want new challenges [Ap]. Setting up a new shop and making well-known jewellery designs will give them these challenges [An]. The franchise is likely to be very profitable and they will get a good return on their capital.

Your challenge

See whether you can improve this answer. It makes some relevant points and the consequences of these are explained in some detail, which is the skill of analysis. Some of these points are also applied to the data response question. However, it seems to lack the important skill of evaluation, although the final sentence could be used in a conclusion. The answer does not give an overall conclusion supported by the analysis shown. A better answer is available online – but write yours out first!

> Chapter 3

Size of business

LEARNING INTENTIONS

In this chapter you will:

- apply several ways of measuring the size of businesses
- analyse the benefits small businesses can have on a country's economy and their own industry
- analyse the advantages and disadvantages of small businesses and of family businesses
- analyse the difference between internal and external growth
- identify and analyse different forms of external growth: merger/takeover, joint ventures and strategic alliances
- evaluate the impact of different forms of external growth on business stakeholders
- analyse why a merger/takeover may not achieve its objectives.

KEY TERMS

Capital employed Conglomerate integration External growth Horizontal integration Market capitalisation
Market share Merger Organic growth Revenue Strategic alliance Synergy Takeover
Vertical integration – forward, backward

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- different ways in which business size can be measured
- the benefits of small businesses
- how to compare the advantages of small and large businesses
- the strengths and weaknesses of family businesses
- types of external growth, and how external growth differs from organic growth
- the different impact types of growth can have on stakeholder groups
- reasons for the use of joint ventures and strategic alliance.

- 1 Define the term 'revenue'.
- 2 Explain the term 'market capitalisation'.
- 3 How is market share measured?
- 4 Why might a business with high capital employ only a few workers?
- 5 Identify **three** benefits of small businesses to an economy.
- 6 Identify **three** advantages large businesses often have compared with small businesses.
- 7 Identify **three** common strengths of family businesses.
- 8 Identify **three** common weaknesses of family businesses.
- 9 Explain the difference between organic growth and external growth.

- 10 Explain **one** difference between a merger and a takeover.
- 11 Explain the difference between horizontal and vertical integration.
- 12 Explain **one** difference between forward vertical integration and backward vertical integration.
- 13 Explain what ‘conglomerate integration’ means.
- 14 Explain what ‘synergy’ means.
- 15 Identify **two** problems that could result from rapid business growth.
- 16 Explain the term ‘joint venture’.
- 17 Explain the term ‘strategic alliance’.

Application

Freya’s Transport (FT)

Freya is the majority shareholder and managing director of FT. It is a large transport company that operates bus routes throughout the country. It owns 445 buses and has a large route network. A recent survey of FT’s bus passengers concluded that the majority thought that FT offered excellent service at reasonable fare levels. See Table 3.1.

Last week FT signed an agreement with Company A to combine the two businesses. Company A is a long-established family-owned business. It employs several members of the same family. The managing director of Company A is retiring and no one in the family feels able to replace him. Most workers consider that they are treated like family members and very few leave the business. Some of Company A’s routes are the same as FT’s and the two businesses used to compete fiercely. Freya has to decide whether to reduce the total number of buses operating on these routes following the integration. She aims to use this integration to make FT much more profitable.

Last year FT bought out a specialist bus manufacturing business, Company B. It supplies FT and other bus operating companies with the large vehicles needed. FT’s managers wanted more control over the design and price of this major resource. They have the objective that newly designed buses will be introduced in 12 months’ time. The new designs should make more provision for elderly passengers as many of FT’s customers are in the 60+ age group. FT’s directors now control a manufacturing business for the first time.

	FT	Bus company A	Bus company B	Other bus companies
Capital employed	\$100m	\$75m	\$66m	\$35m
Employees	1 700	1 800	1 200	400
Revenue	\$123m	\$110m	\$75m	\$36m

Table 3.1: Data comparing FT with competitors

- 18 How much bigger, in percentage terms, is FT than Company A when measured by **a** revenue and **b** capital employed?

WORKED EXAMPLE FOR Q18a

FT earned \$13m more in revenue than Company A. This is 11.8% more than Company A ($13 \div 110 \times 100$).

TIP

For all calculation questions, you should show your workings.

- 19 Explain **one** advantage and **one** disadvantage to Company A of being a family business (before integrating with FT).
- 20 Explain **one** possible advantage to FT of becoming a larger business.
- 21 Explain **one** possible advantage to one of the other businesses of being small.
- 22 Is FT using organic growth or external growth in order to expand?
- 23 Was the integration with Company A an example of a merger or a takeover? Explain your answer.
- 24 Was the integration with Company B an example of a merger or a takeover? Explain your answer.
- 25 Classify the **two** examples of integration explained in the data response material as: horizontal integration; forward vertical integration; backward vertical integration; or conglomerate integration.
- 26 Explain **two** ways in which FT's customers might be affected by the integration with Company A.
- 27 Explain **two** ways in which FT's customers might be affected by the integration with Company B.

Analysis

- 28 Analyse the possible advantages to any **two** of FT's stakeholder groups from the integration with Company A.
- 29 Analyse the possible disadvantages to any **two** of FT's stakeholder groups from the integration with Company B.
- 30 Analyse **two** likely reasons why FT's managers integrated the business with Company A.
- 31 Analyse **two** likely reasons why FT's managers integrated the business with Company B.

WORKED EXAMPLE FOR Q31

One reason

Backward vertical integration will ensure a supply of buses to FT in future **[K]**. It will mean that FT can control the manufacture of buses to its own design, such as providing easy-access buses for the elderly **[Ap]**. FT should be able to obtain these specially designed buses more cheaply than if it were buying them from an independent manufacturer **[An]**, which should reduce fixed costs and increase profit **[An+]**.

Evaluation

- 32 Evaluate whether FT should continue to expand by using horizontal integration.
- 33 Evaluate whether FT should expand by vertical integration in future.
- 34 Evaluate whether FT should expand through organic growth in future.
- 35 Evaluate possible reasons why, after three years, the two examples of integration used by FT were not successful.

EXAM-STYLE QUESTIONS

Short answer questions

- 1 Explain **one** difference between a merger and a takeover. [3]
- 2 Explain **one** way in which the size of businesses in car manufacturing could be measured. [3]

Essay questions

- 1 a Analyse **one** benefit and **one** drawback to a family-owned beauty salon business from expanding by opening more salons. [8]
- b 'External growth is usually unsuccessful so businesses should expand organically.' Evaluate this view. [12]

Data response questions

RT Engineering (RTE)

RTE is a private limited company that manufactures advanced electric motors for use in washing machines. It has expanded by moving to large factories on several occasions but it still has a low market share in the market for washing machine components. It supplies two of the largest washing machine manufacturers in Country Y. It also exports 10% of its output. RTE designed these motors to be quiet, efficient and very reliable. RTE employs 45 workers. The total washing machine industry in Country Y, including all suppliers, employs 2 500 workers. RTE's capital employed is \$75 000. Some businesses in the industry have formed joint ventures.

RTE is a family-owned business. Sadiq is the current managing director. The workers enjoy working at RTE and Sadiq always takes an interest in them. The business was started by Sadiq's great-grandfather. Sadiq only takes ten days' holiday each year. He is reluctant to change manufacturing methods. His nephew, Asif, works in the factory. Asif is keen to take over as managing director in three years' time when Sadiq plans to retire. Asif wants to introduce the most advanced production processes and expand the business by taking over a large but badly managed competitor. Sadiq thinks that recruiting an external manager to help Asif learn about management would be an advantage.

- a i Identify **one** benefit of a joint venture. [1]
- ii Explain the term 'capital employed'. [3]
- b Explain **one** benefit of RTE to: i) the economy and ii) the industry it is in. [6]
- c Analyse **two** possible reasons why Sadiq has not used external growth to expand RTE. [8]
- d Evaluate the advantages and disadvantages to RTE of it being a family business. [12]

CONTINUED

Improve this answer

This is a sample answer to data response Qc.

External growth through integration between two businesses can be by merger or takeover. Some businesses only expand organically and not externally by integration. One reason for this is that organic growth is slower and easier to manage **[K]**. It can often be financed from internal sources. A takeover of another business often needs a large loan to be taken out to avoid running out of cash. This loan will have to be repaid with interest. This could make the business less profitable, at least in the short run **[An]**.

Another reason why businesses do not grow externally is the risk that the integration might not be successful. There are many cases where management teams cannot work together **[K]**. The culture of the managers from the two businesses might be different. This means there will be no synergy and the integration will be unsuccessful **[An]**, if, for example, the two management teams have a very different approach to corporate responsibility. A socially irresponsible action by managers in one of the businesses will damage the image of the integrated business **[An+]**.

Your challenge

See whether you can improve this answer. It demonstrates good understanding of the types of growth and the benefits and limitations of organic growth. The consequences of these points are explained, and this is developed analysis. However, the answer lacks the skill of application to the business in the case study. A better answer is available online – but write yours out first!

> Chapter 4

Business objectives

LEARNING INTENTIONS

In this chapter you will:

- analyse the importance to businesses of setting objectives
- analyse the objectives for private sector businesses and public sector businesses
- analyse the importance of business objectives being SMART
- discuss the importance of corporate social responsibility and the triple bottom line
- analyse the links between mission statements, aims, objectives and strategy
- analyse the role of objectives in business decision-making
- analyse how objectives can be communicated and their likely impact on the workforce
- analyse why objectives might change over time
- evaluate how ethics can influence business objectives and activities.

KEY TERMS

Business objective Business strategy Corporate social responsibility (CSR) Ethical code (code of conduct)
Mission statement SMART objectives Tactic Triple bottom line

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- the importance of setting objectives
- the relationship between corporate objectives and strategy
- the need to communicate objectives
- why objectives might change over time
- the increasing importance of corporate social responsibility and ethical decision-making.

- 1 Identify **two** examples of business objectives.
- 2 What do the letters SMART stand for?
- 3 What are the differences between objectives and strategies?
- 4 Define the term 'mission statement'.
- 5 Explain the term 'triple bottom line'.
- 6 How is the mission statement of a business related to its objectives?
- 7 Identify **one** way in which a business could demonstrate corporate social responsibility.
- 8 Define the term 'corporate social responsibility'.
- 9 Identify **two** ways in which business objectives could be communicated to any one stakeholder group.
- 10 Explain **one** purpose of an ethical code of conduct.

Application

JD Traders (JDT)

Jacques is managing director of JDT. The company buys wooden furniture from foreign suppliers and sells it through its retail store. It was set up two years ago. Initially, trading was very difficult and Jacques was mainly focused on the business's survival and just selling enough to cover costs. Recently, the growing reputation of the business for good-quality products sold at fair prices has helped sales to rise.

Jacques wants to expand JDT's sales by 10% each year. Using a decision-making framework, he has decided to open a store in another city next year and employ more workers. The workers would be offered generous employment contracts as Jacques wants excellent customer service to be a key feature of his business. Workers will have more job security than those working for other local businesses.

Jacques has recently rejected an offer by a foreign supplier of 100 wooden tables at very low prices. He believes that the wood was felled illegally from an ancient forest and that new replacement trees were not planted.

- 11 How has the objective of this business changed over time?
- 12 Suggest **one** SMART objective for this business to achieve next year.
- 13 Explain **two** ways in which JDT seems to be acting socially responsibly.

WORKED EXAMPLE FOR Q13

One way

One way to act socially responsibly is to treat workers fairly [K]. JDT will do this by offering generous employment contracts, giving better job security than other local employers [Ap].

- 14 Suggest a suitable mission statement for JDT.

Analysis

- 15 Analyse **one** advantage to JDT of acting ethically.
- 16 Analyse **two** benefits to JDT of using a decision-making framework with clear objectives.

WORKED EXAMPLE FOR Q16

One benefit

The decision-making framework or model puts objectives at the centre of decision-making. Decision-making needs a focus otherwise the decisions will not achieve the required objectives [K/An]. JDT wants to increase sales by 10% each year [Ap]. Using the model to help, Jacques would have considered alternative ways of reaching this target. He has chosen the plan to open a new shop, and this is appropriate as the new shop should increase sales of furniture and therefore increase the profits of the business [An+].

- 17 Analyse the possible links between the mission statement suggested in your answer to Q14 and the objectives and strategies of JDT.

TIP

You need to read the data response material carefully to be able to answer Q14. For example, the focus Jacques gives to acting responsibly might feature in your suggested mission statement.

Evaluation

- 18** Discuss whether JDT's profits will rise or fall if the business follows a strict ethical code.

TIP

For Q18, think about whether ethical decision-making will add to costs or increase future revenue. You need to give an overall conclusion or a judgement that is supported by the arguments that you use.

- 19** Evaluate the importance of corporate social responsibility to JDT's future success.

TIP

For Q19, explain why corporate social responsibility might be important to the company's success, but also weigh up other factors that might be important to JDT's overall success.

EXAM-STYLE QUESTIONS

Short answer questions

- 1** Explain **one** difference between a mission statement and a business objective. [3]
- 2** Analyse **one** way in which ethics could influence the activities of a business. [5]

Essay questions

- 1 a** Analyse **two** benefits to business decision-making of having clear objectives. [8]
- b** 'Our manufacturing business cannot afford to be socially responsible. Our market is so competitive we must aim to achieve the lowest costs possible.' Evaluate this view. [12]

Data response questions

CC Trucks (CCT)

CCT makes trucks for mining companies. The vehicles are huge and expensive. CCT offers a range of special offers and services such as long guarantee periods to encourage mining companies to buy CCT trucks.

Recently, a CCT salesperson was found guilty of offering bribes to a mining company executive to sign a large order for CCT trucks. 'Did this salesperson not know about our ethical code?' complained CCT's managing director to the other directors. 'This has left me thinking that perhaps our employees are not fully aware either of this code or of CCT's mission statement and our SMART corporate objective.'

CCT used to be the only major manufacturer of large mining trucks but two Chinese manufacturers have recently entered the market. The global economic slowdown has reduced the demand for mined products such as metals, and the prices of these are falling.

Only a very small number of employees leave CCT each year. The workforce has some of the best working conditions in the secondary sector of industry.

CONTINUED

- a i Identify **one** reason for a business having an ethical code. [1]
- ii Explain the term ‘SMART objectives’. [3]
- b Explain **two** disadvantages to CCT of not communicating objectives clearly. [6]
- c Analyse **two** reasons why it might be necessary for CCT to change its objectives over time. [8]
- d Evaluate whether ethical decision-making will conflict with CCT’s future profitability. [12]

Improve this answer

This is a sample answer to data response Qd.

Ethical decisions are those based on a moral code of conduct [K]. This means that the business is trying to do the right thing by not taking bribes, not employing children, not using misleading advertisements and so on [K]. Ethical business decision-making can lead to higher costs. For example, using cheap immigrant or child labour and not offering employment contracts can result in very low labour costs. These low costs can be used either to keep prices low or raise profit margins [An].

Offering bribes can increase the sales revenue of a business. By not offering bribes as company policy, important orders can be lost in countries where this kind of, usually illegal, financial incentive is expected by businesspeople or government officials [An].

By following an ethical code and using ethics as a basis for decision-making, of course CCT will make lower profits in the future [E].

Your challenge

See whether you can improve this answer, which is strong on knowledge and there is some analysis. The impact and consequences of the points made about ethical decision-making are explained, and this is analysis. However, the answer lacks the very important skill of application. The answer could apply to many businesses, and the key to effective data response answers is to make sure that they are applied clearly to the business referred to in the data. The attempted evaluation is not well applied or supported. A better answer is available online – but write yours out first!

> Chapter 5

Stakeholders in a business

LEARNING INTENTIONS

In this chapter you will:

- analyse the meaning of 'stakeholder', both internal and external
- analyse the roles, rights and responsibilities of key business stakeholders
- assess the impact of business decisions on stakeholders and the need for business accountability
- assess the impact of stakeholder aims on business decisions
- identify conflicting stakeholder aims
- evaluate how these conflicts might be responded to by business.

KEY TERMS

External stakeholders Internal stakeholders Stakeholder concept

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- different types of business stakeholders and their likely aims
- impact of stakeholder aims on business decisions
- impact of business decisions on stakeholders
- how businesses are accountable to stakeholders and should try to reduce conflict between stakeholder aims.

- 1 Define the term 'stakeholder'.
- 2 Identify **two** likely objectives of employees of a business.
- 3 Why is government interested in the activities of a business?
- 4 Why is the local community likely to be affected by the activities of a local business?
- 5 What rights do customers have?
- 6 Why is a business's bank interested in the decisions taken by that business?
- 7 Explain why shareholders are also stakeholders in a limited company.
- 8 Identify **one** possible conflict of interest between any two stakeholder groups of a business.
- 9 Identify **one** example of how a change in business objectives could affect stakeholders.
- 10 Explain the difference between internal stakeholders and external stakeholders.

Application

South Central Trains (SCT)

SCT is a private limited company. It has a seven-year licence from the government to operate trains in one region of Country X. It makes a very small profit. It has to repay a bank loan next month and it has many suppliers (creditors) who must also be paid. SCT's managers have just announced a large increase in ticket prices. 'As the main road into the capital city will be dug up and widened for the next few months, this is a good opportunity to earn more revenue from train customers. Higher prices will bring more cash into the business too,' said the managing director.

SCT has delayed buying new trains and it operates old trains that have high pollution emissions. Some train workers have complained about the impact on their health. 'If we can start to make a profit, we can ask shareholders to invest by buying more shares to help pay for new trains,' explained the managing director to other SCT directors.

- 11 Why are SCT's creditors interested in the performance of this business?
- 12 Explain **two** aims of the bank as one of SCT's stakeholders.
- 13 Explain **one** conflict of aims between two of SCT's stakeholders.

WORKED EXAMPLE FOR Q13

The objective of SCT's shareholders is to receive higher returns **[K]**. SCT operates old trains. This might increase returns for shareholders in the short term as the business does not use its profits to buy new trains **[Ap]**. This could benefit shareholders if they receive a higher share of profits. This would then help SCT attract more investment from shareholders **[An]**. However, old trains are polluting **[Ap]** and this is damaging the health of train workers **[Ap]**.

- 14 Explain **one** way in which SCT could act responsibly towards the local community.

Analysis

- 15 Analyse **one** advantage to SCT of satisfying stakeholder aims.
- 16 Analyse **one** benefit and **one** drawback to SCT of paying the bank and creditors as soon as possible.

WORKED EXAMPLE FOR Q16

One drawback

One drawback is that paying the bank and creditors quickly will reduce the cash held in the business **[K]**. There is an opportunity cost **[An]** to this. This cash could have been used by SCT to help buy new trains or stop the existing ones from polluting so much **[Ap]**, which would have benefited its workers and the environment and improve the health of workers and the local population **[An+]**.

- 17 Analyse how the potential conflict identified in the answer to Q13 might be resolved by SCT.

WORKED EXAMPLE FOR Q17

Using retained profits to invest in buying new trains, which are cleaner and use less fuel [K/Ap], the business would improve working conditions for employees, which would meet one of its objectives [An]. This would also increase future profitability, as new trains should cost less to operate, which could increase profit and benefit the shareholders [An+].

TIP

For Q18, think about whether shareholders are likely to gain or lose from a long-term policy of not satisfying other stakeholder objectives.

Evaluation

- 18 Discuss whether SCT should aim only to satisfy shareholders' objectives and not those of other stakeholders.
- 19 Evaluate the importance to SCT's future success of being accountable to stakeholders by being socially responsible.

EXAM-STYLE QUESTIONS

Short answer questions

- 1 Explain **one** role of creditors in a business. [3]
- 2 Explain **one** responsibility customers have to a business. [3]

Essay questions

- 1 a Analyse the aims of any **two** stakeholder groups of a business. [8]
- b 'We cannot possibly meet the aims of all stakeholder groups so we will only attempt to satisfy our shareholders.' Evaluate this view of a senior manager of a large business. [12]

Data response questions

DF Farms (DFF)

DFF owns several farms in Country Y. It employs temporary workers at busy times of the year and pays low wages as unemployment is high. The farms use many chemicals for pest control and to kill weeds. These chemical products protect the crops and increase the amount the farms produce. DFF does not know whether these chemicals affect local wildlife or customers who consume DFF's food products. DFF charges high prices for its food products in local markets if there is no competition.

The chief executive officer of DFF sent a report to all shareholders recently. The report included: 'We know that stakeholder aims can impact on our business decisions but we need to make a profit too. The company aims to be accountable to all stakeholder groups. However, we believe that our main responsibility is to you, our shareholders, who provide the capital for the business.'

- a i Identify **one** example of an external stakeholder group. [1]
- ii Explain the term 'accountable to stakeholders'. [3]
- b Explain how DFF's objective to make profits affects any **two** stakeholder groups other than shareholders. [6]
- c Analyse **two** ways conflict has arisen between the aims of DFF's different stakeholder groups. [8]
- d Evaluate whether DFF should consider the impact of its decisions on stakeholders other than shareholders. [12]



CONTINUED

Improve this answer

This is a sample answer to data response Qb.

A profit objective might impact on workers **[K]**. Cutting costs is one way of making higher profit and this might mean reducing wages **[An]**. A profit objective might impact on customers **[K]**. If chemicals are used to increase food production **[Ap]** they may have a long-term effect on customers' health **[An]**.

Your challenge

See whether you can improve this answer. The answer identifies two relevant stakeholder groups in this case. However, only the second point about customers is developed in the context of this farm. A better answer is available online – but write yours out first.

> Chapter 6

External influences on business activity

LEARNING INTENTIONS

In this chapter you will:

- analyse how and why the state intervenes in business ownership through privatisation and nationalisation
- analyse why governments use legal controls over business activity and how these may impact on business decisions
- evaluate the impact of technology on business decisions
- evaluate the impact of competitors and suppliers on business decisions
- evaluate how changes in society can impact on business strategy
- examine the impact of the growing importance of sustainability on business decisions
- assess the nature, purpose and potential uses of environmental audits.

KEY TERMS

Demographic Environmental audit Free international trade Globalisation Information technology (IT) Monopoly Nationalisation Pressure groups Privatisation Protectionism Quotas Social audit Sustainability Tariffs

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand the external influences that can have an impact on business activities, decisions and strategies: legal, technological, competitors, social and environmental.

- 1 Identify **two** reasons why a government might privatise a business in the public sector.
- 2 Explain **two** reasons why a government might nationalise a business in the private sector.
- 3 Identify **two** legal controls that, in your own country, impact on how businesses manage their workers.
- 4 Identify **two** legal controls that, in your own country, impact on how businesses market their products.
- 5 Identify **two** legal controls that, in your own country, impact on the production operations of business.
- 6 Explain **two** likely effects on a business of an ageing population.
- 7 Identify **two** social changes that could have an impact on business marketing decisions.
- 8 Identify **four** ways in which new technology can influence business activities/operations.
- 9 Explain **one** benefit to a business of being a monopoly.
- 10 Define the term 'globalisation'.

- 11 Explain **two** likely effects on businesses in your country from increased free international trade.
- 12 Identify **two** examples of multinational businesses that operate in your country.
- 13 Identify **two** benefits to your country of these multinational businesses operating there.
- 14 Identify **two** reasons why a business might decide to protect the environment.
- 15 Explain **one** difference between an environmental audit and a social audit.
- 16 Explain what is meant by a sustainable business decision.

Application

Timber Products Limited (TP)

TP manufactures and sells furniture. The timber (cut wood) it uses comes from the large forests that the company owns. Most of the furniture is sold through the company's own retail shops, but lower-quality and damaged items are sold directly from the factory with no guarantees. Often these are promoted to customers who visit the factory as being of the same high quality but at lower prices. The forests that TP owns are so large that the company does not replace the trees it cuts down with young trees. This strategy has been recently criticised by a large environmental pressure group as it is not sustainable in the long term. Also, during heavy storms, earth is washed into rivers from the deforested areas and this is making fishing more difficult for local people.

The government is planning to nationalise all large forests. A government spokesperson said, 'Forests are a national resource which should be managed sustainably. They should be open for everyone to walk in to and enjoy.'

TP finds it difficult to recruit enough workers. It pays low wages to timber cutters and they have dangerous equipment to handle. This recruitment problem is made worse by the country having an ageing population, with net immigration falling to low levels last year. These demographic and social changes are also having an impact on the styles of furniture that TP produces.

The government is introducing new legal controls over business activities. A minimum wage is being introduced as well as strict health and safety regulations at work. Consumer protection is being improved with controls over unfair advertising and poor-quality products.

A new managing director has recently been appointed at TP. She wants to make TP a more responsible organisation yet some shareholders oppose this. She wants to buy high-technology equipment that is both safer and more adaptable than existing labour-operated machines. They will allow different styles and sizes of furniture to be made by the same computer-controlled equipment.

- 17 Explain **one** way in which TP is likely to be affected by the government's new legal controls.
- 18 Explain **two** ways in which new technology might benefit TP.

WORKED EXAMPLE FOR Q18

One way

One benefit of new technology equipment is that it should be safer than the dangerous equipment used now [K]. New cutting machines that automatically stop when the operator lets go will improve safety in the forests [Ap]. This will reduce lost output of wood caused by accidents [Ap].

- 19 Explain how social and demographic changes might affect TP.
- 20 Explain the action the pressure group could take against TP.
- 21 Explain **two** likely reasons why the government plans to nationalise large forests.

Analysis

- 22 Analyse **two** possible impacts on TP's operations of the proposed legal controls.
- 23 Analyse **two** ways in which TP could respond to these new legal controls.
- 24 Analyse **two** possible disadvantages to TP of adopting new technology.
- 25 Analyse **two** possible benefits to TP of accepting its responsibility to the environment.

WORKED EXAMPLE FOR Q25

One benefit

One benefit would be a good supply of timber in future, if TP replaced cut-down trees with newly planted ones [K/Ap]. The forests are so large that TP does not bother to plant new trees to replace those cut down. This can cause soil erosion problems that damage the environment [An]. By planting new trees, TP will benefit the environment as well as increasing its supply of timber for the future [An], helping the business to stay in operation [An+].

TIP

When answering Q26, you should try to explain the costs and possible benefits these controls might have on TP. Do you think the costs outweigh the benefits for TP?

Evaluation

- 26 Evaluate whether government controls will have a positive or negative impact on TP's future.
- 27 Evaluate how TP should react to the changing external influences.

EXAM-STYLE QUESTIONS

Decision-making questions

Bernadette's Meals (BM)

BM produces high-quality prepared foods which are sold in upmarket grocery retailers. BM's food is prepared and packaged ready for consumers to heat up and serve. All meals are cooked in BM's small kitchen by skilled workers who prepare food by hand, cook it in small quantities using BM's own recipes, and package it carefully in attractive microwaveable boxes. This old-fashioned production method suits the workers and the management.

The family-owned business has always put quality before market share, but the directors are becoming increasingly concerned about falls in sales and profits over recent years.

BM produces traditional products using old-fashioned recipes that often appeal to older consumers. The population of the country where BM is based is youthful. It has been boosted in recent years by large numbers of migrants who have introduced their own food tastes and methods of cooking. As a result, consumer food tastes are changing.

BM's costs are likely to increase as the government has announced that health and safety regulations at work, which used to apply only to large businesses, will now have to be adopted by all businesses. New legal controls on limiting how many days fresh foods can be stored will also affect BM as none of its products are designed to be frozen.

One of BM's directors wants to reduce labour costs and widen the range of foods being produced. These aims would be achieved by purchasing new technology food-processing equipment that can mix food ingredients to many different recipes, portion the food into the right quantities and package the meals automatically.

CONTINUED

- 1 Analyse **two** problems that BM is likely to experience from introducing technological change. [8]
- 2 Evaluate ways in which BM could respond to changing external influences. [12]

Improve this answer

This is a sample answer to decision-making Q1.

Technological change is being introduced in many industries. It often involves the use of computer-controlled equipment which aids either the design or the manufacturing process [K]. One problem with introducing new technology is that it can be very expensive [K]. Many businesses can find it difficult to finance. If finance is borrowed, this adds to interest costs for several years, which will reduce the profits of the business [An].

The second problem is the resistance of the workforce and, sometimes, management to technological change [K]. This can lead to job losses as it is often more efficient. Workers who remain will need new skills and training. This can be expensive and workers might worry about whether they are able to learn the skills [An]. Managers might be worried about not understanding the new machines too.

Your challenge

See whether you can improve this answer. It has some strengths. It identifies potential problems that can result from technological change and these are simply analysed. See whether you can improve this answer, which clearly lacks developed analysis or any direct application to the business. In your answer you should try to make sure that the BM business context is a key part of your explanations. No evaluation is required as the command word was ‘analyse’. A better answer is available online – but write yours out first!

> Chapter 7

External economic influences on business activity

LEARNING INTENTIONS

In this chapter you will:

- analyse how governments help business, constrain business, encourage enterprise and deal with market failure
- analyse the macroeconomic objectives of governments
- analyse the nature and causes of economic growth and its impact on business decisions
- analyse the business cycle and its impact on business decisions
- analyse the different causes of unemployment and inflation
- evaluate how economic objectives and economic performance can impact on business activity
- evaluate the impact on business decisions of changes in monetary, fiscal, supply-side and exchange rate policies.

KEY TERMS

Budget deficit Budget surplus Business cycle Cyclical unemployment Deflation Economic growth
Exchange rate Exchange rate appreciation Exchange rate depreciation External costs Fiscal policy
Frictional unemployment Gross domestic product (GDP) Inflation Market failure Monetary policy Recession
Structural unemployment Supply-side policies Unemployment Working population

Key skills exercises

Knowledge and understanding

To answer questions in this chapter you will need to know and understand:

- how governments can intervene to support business and enterprise
- the economic objectives of governments and how economic performance can impact on business activity and decisions
- the economic policies that governments can use
- the impact on business activity and decisions of changes in governments' economic policies.

- 1 Identify **two** reasons why governments might intervene to encourage enterprise.
- 2 Identify **two** reasons why governments might intervene to constrain business activity.
- 3 Explain **two** examples of 'market failure'.
- 4 Explain **two** ways in which governments can deal with market failure.

- 5 Explain what is meant by the business cycle.
- 6 Explain **one** difference between a boom and a recession.
- 7 Identify **two** possible effects of an increase in GDP on business decisions.
- 8 Explain **one** difference between inflation and deflation.
- 9 Identify **two** economic objectives of most governments.
- 10 Explain **two** ways in which a business might be affected by increased unemployment.
- 11 Explain **one** difference between an exchange rate appreciation and an exchange rate depreciation.
- 12 Identify **two** types of taxes used by most governments to raise revenue.
- 13 Explain what is meant by monetary policy.
- 14 Identify **two** examples of supply-side policies.

Application

Exclusive Hotels (EH)

EH is a public limited company. It operates six luxury hotels in Country X. High prices are charged for bedrooms and restaurant meals. Most customers are from Country X and only 8% are from other countries, mainly foreign businesspeople and tourists. EH imports most of the food and drinks sold through its hotel restaurants as well as all of the furniture for the hotels' bedrooms.

Recent economic data for Country X show that inflation is rising and that unemployment is falling quickly. The government is so worried about higher prices that it has been encouraging the central bank to raise interest rates. Yesterday, the central bank increased interest rates to 6% and the exchange rate of Country X's currency appreciated immediately. The government has also used fiscal policy to reduce demand in the economy. Income tax rates have been increased and the sales tax (VAT) has been raised by 5%. The chief executive of EH is worried about the impact on EH of these changes. She told the other directors, 'I remember how badly our business was affected by the last recession seven years ago. If the economy goes into recession again, it will damage our type of business in particular.'

- 15 Explain what stage of the business cycle Country X's economy seems to be in.
- 16 Explain **two** ways in which EH could be affected by the increase in interest rates.
- 17 Explain which economic objective the government is aiming to achieve by its fiscal policy changes.
- 18 Explain **two** ways in which EH could be affected by the change in the exchange rate.

WORKED EXAMPLE FOR Q18

One way

An appreciation of the currency will mean that Country X's currency buys more foreign currency. This will reduce the cost of imported products **[K]** such as imported food and drink used in EH's hotels **[Ap]**.

Analysis

- 19 Analyse **one** reason why the demand for EH's services fell sharply when the economy was in recession.
- 20 Analyse **one** way in which EH could be affected by increasing inflation.
- 21 Analyse how businesses in Country X might be affected by a falling rate of unemployment.
- 22 Analyse **one** advantage to EH of economic growth.

WORKED EXAMPLE FOR Q22

One advantage of economic growth to EH is that it can lead to increases in consumer incomes [K]. As hotels and catering are usually a luxury (income elastic) product [Ap], any increase in consumer incomes is likely to lead to an even greater relative change in demand for these products [An]. Increased demand will result in higher revenue for EH and higher profit [An+].

TIP

Your answer to Q23 should include an analysis of how changes in rates of tax and interest will impact on EH. You should also assess how the business could respond (e.g. perhaps build some hotels with fewer facilities and lower prices).

Evaluation

- 23 Evaluate how EH could respond to the economic policy decisions taken by the government and the central bank.
- 24 Evaluate the measures EH's managers could take to make the company less affected by the business cycle in Country X.

EXAM-STYLE QUESTIONS

Decision-making questions

Bikes For All (BFA)

BFA manufactures bicycles in Country Y. There are four models in its product range. The basic shopping model has a retail price of \$100. The cross-country model is priced at \$150. A racing bicycle model is priced at \$350, as it is made from expensive lightweight materials. It has an excellent reputation with serious and professional cyclists. The latest model is an e-bike, which uses an advanced battery system, developed and produced by a foreign business, to aid the rider. The retail price for this bicycle is \$500. It is the only bicycle model currently exported by BFA and this bicycle accounts for 30% of total output. 25% of the materials and components the company uses are imported.

The economy of Country Y is forecast not to grow in 2023. This is largely because the global economy is slowing down and may even be in recession in two years' time, according to some economists. In addition, Country Y's government is using fiscal policy to reduce its huge budget deficit. It has increased taxes and reduced government spending, and it is forecast to follow this policy for the next two years. Table 7.1 shows measures of economic performance for Country Y.

CONTINUED

	2021	2022 (forecast)	2023 (forecast)
GDP growth rate (%)	3	2	0
Unemployment rate (%)	6	7	9
Inflation (%)	4	3	1
Exchange rate index	100	95	90
Central bank interest rate (%)	7	6	4

Table 7.1: Economic data and forecasts

- 1 Analyse how BFA could be affected by any **two** of the measures of economic performance, including the forecasted data. [8]
- 2 Evaluate how BFA should respond to the economic data for Country Y. [12]

Improve this answer

This is a sample answer to decision-making Q2.

BFA is going to be greatly affected by these changes in the external economic environment if the forecasts turn out to be true. As Country Y's economy is forecast not to expand in 2023, consumer incomes will not be growing **[K]**. As the forecast is still for inflation by then, real incomes could fall **[K/An]**. A depreciating exchange rate will make imported components more expensive and these could reduce BFA profits **[Ap/An]**. Higher taxes will also reduce consumers' disposable income **[K]**. With all of these changes in the external economic environment it will be important for BFA to respond quickly.

Firstly, the company could expand production of its cheaper bicycles as these are likely to have a lower income elasticity of demand than the two more expensive models **[Ap]**. As real incomes are falling, the demand for these lower-priced models could increase, especially as many consumers might not now be able to afford cars **[An]**. If demand for the two cheaper models increases, BFA could move resources from making the e-bike and the racing model to the two cheaper designs **[Ap/An]**. However, the profit per bicycle could be much less with these two models and BFA might have planned to develop its brand image more effectively in the higher priced segments of the market **[Ap/E]**.

BFA could start exporting all of the other three designs that it currently does not sell abroad. Other countries' economies might not have the same risk of recession as in Country Y **[K]**. Demand for bicycles might be high and BFA could replace some lost sales in Country Y with these new markets **[Ap]**. A depreciating currency will also make BFA bicycles cheaper abroad so output might not have to be reduced and jobs could be saved **[An+]**. However, BFA would have to be aware of any differences in consumer protection rules between these countries and Country Y, as well as different laws about bicycle construction and safety **[E]**.

Your challenge

See whether you can improve this answer. It has some very good points. It demonstrates clear understanding of the economic data and the trends shown by these data. The impact and consequences on BFA of some important changes in the data are clearly analysed. The answer is also well applied, as much of the analysis is focused on the products made by BFA. However, there is no overall evaluated judgement. A better conclusion is available online – but write yours out first!

> Chapter 8

Business strategy

LEARNING INTENTIONS

In this chapter you will:

- analyse the meaning and purpose of business strategy
- analyse the meaning and purpose of strategic management
- evaluate approaches to developing business strategies, including: blue ocean strategy; scenario planning; SWOT analysis; PEST analysis; Porter's five forces; core competence framework; Ansoff's matrix; force field analysis; decision trees.

KEY TERMS

Ansoff matrix Blue ocean strategy Core competence Decision tree Diversification Expected (monetary) value
Force field analysis Market development Market penetration PEST analysis Porter's five forces model
Product development Scenario planning Strategic analysis Strategic choice Strategic implementation
Strategic management SWOT analysis

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand the:

- meaning and purpose of strategy and strategic management
- different approaches that can be used to help businesses develop a strategy: blue ocean strategy; scenario planning; SWOT analysis; PEST analysis; Porter's five forces; core competence framework; Ansoff's matrix; force field analysis; decision trees.

- 1 Explain what strategic management means.
- 2 Explain the main purpose of strategic analysis.
- 3 Explain what a blue ocean strategy is.
- 4 Which aspects of SWOT analyse the internal features of a business?
- 5 Identify **one** example for each of **four** factors that would be considered during a SWOT analysis for a social networking business.
- 6 What is meant by Ansoff's matrix?
- 7 Identify the **four** factors that, in Porter's model, contribute to competitive rivalry.
- 8 Explain what is meant by the term 'core competence'.
- 9 Explain **one** difference between constraining and driving forces in force field analysis.
- 10 Explain **one** benefit for a business of using scenario planning.
- 11 Explain **one** difference between market penetration and market development.
- 12 Which of the **four** growth strategies is the riskiest?
- 13 Identify a recent example of product development.
- 14 Explain **one** way employee resistance to change could be reduced as a constraining force.

- 15 Identify **one** limitation of force field analysis.
- 16 Explain why probabilities are an important part of a decision tree.
- 17 Define the term ‘expected monetary value’.
- 18 Identify **one** limitation of decision trees.

Application

Outdoor Clothing (OC)

Rajev is the chief executive officer of OC, which is a public limited company based in Country X. OC makes a wide range of specialist clothing for outdoor leisure activities. All products carry the OC brand logo. Examples of its range include:

- shirts and dresses for use in hot climates which protect the wearer from the sun’s harmful rays
- lightweight leisure clothing for people who enjoy walking and cycling
- waterproof trousers, jackets and boots to protect skiers and keep them warm in cold weather.

Rajev has just left a board meeting with other directors. They were discussing the three growth strategies which Rajev has proposed. After several years of falling profit, OC has managed to reverse this trend by cutting production costs. It has transferred most production to low-cost countries. OC is now one of the lowest-cost producers of specialist outdoor clothing in an increasingly globalised industry. However, OC’s overall sales are not increasing. Country X’s economy has been in recession, but last month economic growth was recorded. The demand for most of OC’s products depends on consumer incomes. Rajev thinks that the economic environment is now right for growth strategies that will expand OC profitably. Rajev’s three strategic options are:

Strategy A: Sell all OC products online, not through retailers. This should give OC a higher operating profit margin. Two large retailers, which sell a high proportion of OC’s output, have just merged.

Strategy B: Start selling the OC clothing ranges in Country Y for the first time. Rajev has provided the directors with the information shown in Table 8.1.

Strategy C: Purchase the patent and manufacturing rights to an innovative clothing material. The fabric is called Weartex. It is better than OC’s famous synthetic fabric Litetec. Weartex is very lightweight yet completely waterproof and windproof. It can be washed easily and dries in minutes. It could open up opportunities for innovative and differentiated OC products.

Rajev told the directors, ‘We must take advantage of our low costs to achieve substantial sales growth and keep shareholders satisfied. We must move quickly. One of our major competitors has announced a technical breakthrough in the manufacture of synthetic materials. This will cut its material costs by 50%. We may not be one of the lowest-cost producers forever.’

The OC project manager has undertaken an analysis of the three strategic growth options. He has estimated much of this data but he has also consulted with other directors. See Table 8.1, Figure 8.1 and Table 8.2.

Country X	Country Y
<ul style="list-style-type: none"> • Total population is rising by 4% per year. • 35% of the population is under 24 years old. • A government-owned company has a monopoly on internet service provision. • Import quotas on imported electronic goods have been abolished. • Business property taxes on city centre shops have recently increased. 	<ul style="list-style-type: none"> • Average incomes are rising by 8% per year, leading to more foreign holidays. • The building and construction industry is booming due to low interest rates. • Unemployment is falling. • Import tariffs have recently been increased by the government. • Currency is appreciating against most other currencies.

Table 8.1: Selected economic and social data for Country X and Country Y

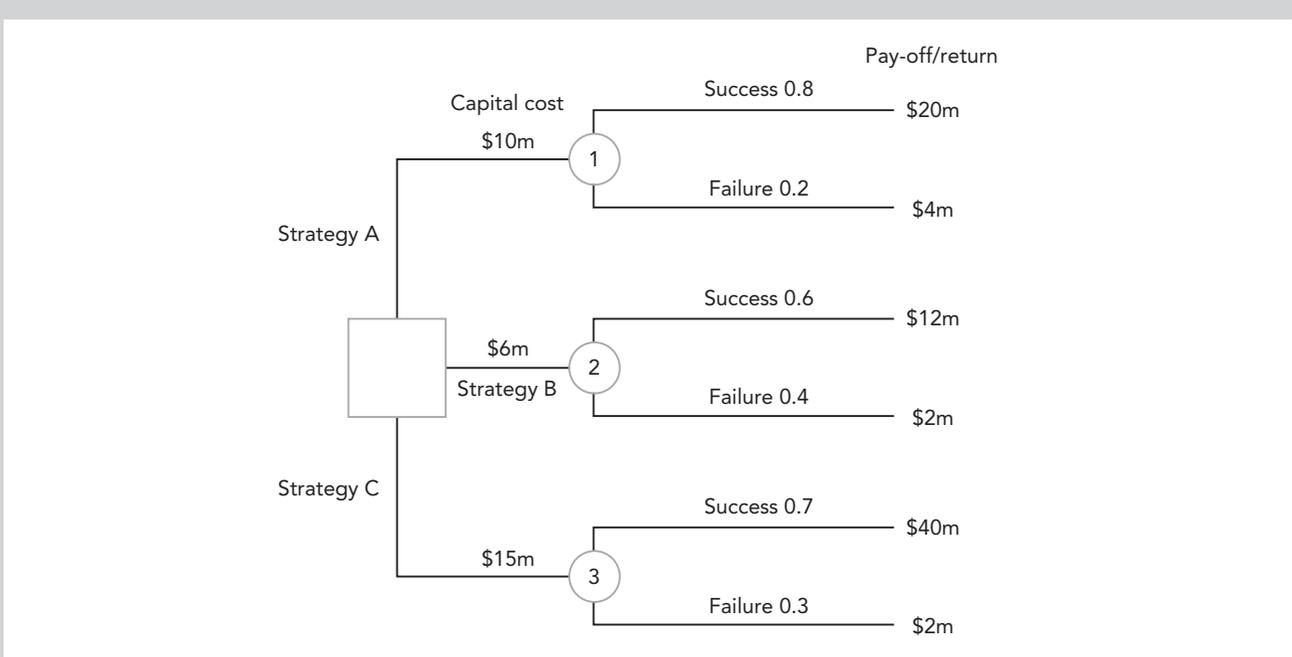


Figure 8.1: Decision tree for three growth strategies (financial returns for first five years)

	Strategy A	Strategy B	Strategy C
Summary	Sell all OC products exclusively online and not through retailers	Start selling the SC clothing ranges in Country Y for the first time	Purchase the patent and all manufacturing rights to Weartex
Ansoff's classification	See answer to Q19	See answer to Q19	See answer to Q21
Major constraining forces and values (out of 10)	Sales representative job losses (6) Website set-up costs (8)	Language barriers (5) Cultural differences (7)	Employee training to produce fabric (6) Cost of the patent (8)
Major driving forces and values (out of 10)	Social trend of online buying (8) Lower advertising costs (5)	Country X market maturing (4) Booming economy (5)	Competitive pressures (5) Customer demand for new materials (9)
Force field overall scores C = constraining forces D = driving forces	C = 32 D = 35	C = 33 D = 29	C = 30 D = 33

Table 8.2: Analysis of the three growth options

- 19 Classify Strategy A and Strategy B according to Ansoff's matrix.
- 20 Explain **one** example of a strategy that would be a form of diversification for OC.
- 21 If Strategy C is adopted and leads to the development of several non-clothing products, how would it be classified in Ansoff's matrix?
- 22 Explain **one** way in which the outcome probabilities could have been assessed.

23 Calculate the expected values at the nodes 1, 2, 3.

WORKED EXAMPLE FOR Q23

Node 1

$$\text{Node 1} = (\$20\text{m} \times 0.8) + (\$4\text{m} \times 0.2) = \$16.8\text{m}$$

24 Explain how any **one** driving force for **each** strategy could be increased.

25 Explain how any **one** of the constraining forces could be reduced.

Analysis

26 Analyse **two** benefits to OC of using Ansoff's matrix.

27 Analyse **two** limitations of the decision tree that OC's project manager is using.

28 Analyse **two** uses of the force field analysis OC's project manager is using.

29 Analyse **two** limitations of the force field analysis.

TIP

Question 26 uses the command word 'Analyse' meaning you should explain in detail why or how something is a benefit of limitation.

WORKED EXAMPLE FOR Q29

One limitation

One limitation is that the allocation of values to each constraining or driving force can be subjective [K]. Why did 'language barriers' obtain the value it was given [Ap]? If these values prove to be inaccurate, the benefits of using force field analysis are much reduced and other techniques become more important [An]. If 'language barriers' is given a value that turns out to be too low then, if Strategy B is chosen, language barriers might become a real problem and the business might have to spend more on language training courses [An+].

30 Explain **one** strength of OC.

31 Explain **one** weakness of OC.

32 Explain how **one** political factor might affect OC.

33 Explain how **one** legal factor could affect OC.

34 Analyse how **two** economic factors might affect OC.

WORKED EXAMPLE FOR Q34

One factor

One economic factor could be exchange rates [K]. As Strategy B involves selling OC products to Country Y for the first time [Ap], an appreciation of Country Y's exchange rate would allow OC to sell its products to this country at lower prices than originally planned [An], leading to higher than forecast sales and profits from exporting [An+].

35 How could Weartex become a core competence for OC?

36 Analyse **two** benefits to OC of undertaking PEST analysis.

37 Analyse **two** limitations of a SWOT analysis undertaken by the chief executive of OC.

38 Analyse **two** social factors which could affect OC in future.

- 39 Analyse how OC's competitive rivalry might be affected by:
- a merger between two large retailers that currently sell OC's products
 - one technological advance that makes the manufacture of synthetic clothing fabrics much cheaper.

WORKED EXAMPLE FOR Q39b

This increases the threat of substitute products being developed and it might also reduce barriers to entry [K]. If buyers of outdoor clothing now prefer the clothing ranges produced using this cheaper fabric, competitive rivalry increases for OC [Ap]. If new businesses are encouraged to come into this market because it is now cheaper to produce and use synthetic fabrics in outdoor clothes, again competitive rivalry increases for OC. As this market becomes more competitive, OC might consider other strategies to improve its competitive position [An].

Evaluation

- 40 Advise OC's directors which of the three growth options the business should adopt. Justify your answer.
- 41 Evaluate the significance to OC of SWOT and PEST analysis as a basis for developing future business strategies.

EXAM-STYLE QUESTIONS

Decision-making questions

Quality Travel Company (QTC)

QTC is the largest travel company in Country X. It organises holidays for travellers to many countries. QTC also sells holiday packages. These are holidays with flights and other transport, hotel accommodation, entertainment, and meals and drinks included in the price the traveller pays. The company owns six hotels but it buys in all other services from low-cost operators such as airlines, bus companies and hotel owners. QTC operates in the mass market for package holidays. It offers good value in the most popular destinations, comfortable hotels and family-focused menus and entertainments.

The global travel business is increasingly competitive. One reason for this is the growing use by consumers of the internet to compare holiday prices and make bookings only after considering the features of each holiday package being offered by different companies.

Increased competition influenced QTC's board of directors' recent decision to focus on a low-cost strategy in all of its operations. The directors have plans to expand QTC but there are disagreements over the best strategy to use:

Option 1: This is preferred by QTC's marketing director. It is to take QTC into niche markets by creating a separate division. This will have a new brand name. It will initially offer exclusive cruises aimed at high-income retired people. Price elasticity of demand for cruises is lower than for mass market package holidays.

Option 2: This is preferred by QTC's operations director. It is to start operating its own airline. Many other major global travel companies operate their own airline. This can add status and prestige to a travel company as aircraft, painted in company colours, help to promote the brand.

QTC's directors have undertaken strategic analysis in the form of PEST and SWOT analysis. A decision tree analysis has been undertaken and the potential risks and barriers to entry for both strategic options have been considered. Key points from this research and analysis are shown in Table 8.3.

CONTINUED

	Option 1	Option 2
Major external factor supporting strategy	Rising world incomes and increased demand for income elastic products	Lack of spare capacity of existing airline companies
Impact on QTC's strengths	Adds to global recognition as a major holiday business	Gives the ability to control costs of the air travel component of package holidays
Directors' opinions on strategy	Marketing director: 'By using some of our existing suppliers we could become a low-cost provider of these new exclusive holidays.'	Operations director: 'We would be able to offer more holidays to distant locations and give customers greater flexibility.'
Decision tree: Expected monetary value over 5 years	\$45m	\$65m
Major risk to QTC	Failure to differentiate the holidays from traditional package holidays	It is a major investment – failure will result in losses from forced sale of the aircraft
Major barrier to entry	Existing operators in these higher-priced market segments have well-recognised brands	Obtaining airline operating licences and landing times at major airports

Table 8.3: Comparison between the two options for further expansion of QTC

- 1 Analyse the benefits of strategic analysis to QTC. [8]
- 2 Advise QTC which strategy it should choose. Justify your answer. Your answer should make reference to Table 8.3 and other information. [12]

Business strategy questions

Hybrid Power Solutions (HPS)

HPS is a public limited company specialising in the manufacture of engines for buses and trucks. It is based in Country X in Europe. Six years ago, HPS invested in developing a new type of hybrid power system. Hybrid power systems use both petrol-driven engines and electric motors to drive a vehicle. They are more environmentally friendly than petrol-only engines. Political, legal and environmental changes in many markets are requiring bus and truck operators to use hybrid engines. Since these engines started to be sold 4 years ago, HPS sales have doubled and profit margins are higher too.

The long-term corporate mission of HPS is now 'to develop unrivalled hybrid engine technology and create power solutions for the next century'. The core competence that HPS has gained in hybrid engines is also used in the company's power systems for boats and trains.

A business consultant has completed a SWOT analysis (see Table 8.4) and a PEST analysis (see Table 8.5).

CONTINUED

Strengths Well-known brand Patented hybrid engine designs Committed workforce	Opportunities New markets for existing power systems (e.g. small ones for cars) Transfer production to low-cost country Increase share in existing markets
Weaknesses Long time to develop new engine systems High debt levels to finance hybrid power developments High production costs	Threats Competitive rivalry from US manufacturers Price wars could drive down profit margins Pure electric vehicles may become a legal requirement

Table 8.4: Summary of SWOT analysis for HPS completed by business consultant

Political	<ul style="list-style-type: none"> • There is pressure on governments to make all vehicles other than pure electric ones illegal in city centres. • Existing subsidies for hybrid vehicles may end and be replaced with subsidies for electric vehicles.
Economic	<ul style="list-style-type: none"> • Interest rates might rise. • Country X's currency is expected to appreciate.
Social	<ul style="list-style-type: none"> • There is pressure group activity against large vehicles on the roads. • Demand for personal car transport is still increasing.
Technological	<ul style="list-style-type: none"> • Some engine makers are working on hydrogen power systems that would make hybrid engines out of date. • There is a danger of HPS patents and designs being copied and produced more cheaply.

Table 8.5: Summary of PEST analysis for HPS completed by business consultant

Strategic options

The directors are considering two strategies for future growth:

Strategy 1: Take over a small manufacturer of buses in a BRICS (rapidly developing) country. This manufacturer does not currently use HPS power systems. It has designed a new large bus that is cheap to build and expected to be popular in lower-income countries.

Strategy 2: Establish a joint venture with R&P, a US-based hybrid engine manufacturer, to design and manufacture a new generation of environmentally friendly engines to compete with hydrogen ones. The operating base would be in an African country and, if successful, could lead to rationalisation of existing production capacity.

Quantitative and qualitative data regarding these two options are shown in Table 8.6. Both strategic options require detailed analysis before a final strategic choice can be made. Global economic forecasts are shown in Table 8.7.

CONTINUED

	Strategy 1: Take over bus manufacturer	Strategy 2: Joint venture with R&P
Estimated cost	\$200m	\$150m
Forecast ARR (over five years)	15%	20%
Greatest risk factor	Lack of synergy	Research fails to develop innovative product
Estimated chance of strategy failure	30%	20%
Expected (net) monetary value if successful (over five years)	\$90m	\$100m
Greatest constraining factor	HPS directors' lack of experience in bus manufacture	Culture clash with US business managers
Greatest driving factor	Increase sales of HPS engines to this BRICS bus manufacturer	Developing low-cost operations in an African country
Ansoff's classification	Diversification (although in a related industry)	Product development

Table 8.6: Data comparing the two strategic growth options

Annual world GDP per capita growth	5%
European Union (EU) labour costs – annual growth	8%
BRICS labour costs – annual growth	2%
Average increase in global interest rates over the period	4%
Growth in global market share of BRICS bus manufacturers	12%
External costs: EU maximum pollution level in 2026 per bus/truck engine (2020 = 100)	65

Table 8.7: Global economic forecasts, 2020–26

- 1 Evaluate the strategic decision HPS took six years ago to develop hybrid power systems. [20]
- 2 Assess the usefulness to HPS of **two** other approaches to developing new strategies, other than SWOT and PEST. [20]

CONTINUED**Annotate this answer**

This is a sample answer to business strategy Q1.

Looking back on HPS's decision to develop hybrid power systems, it seems to have been an excellent strategic choice. HPS seems to have taken this decision at just the right time. Environmental pressure groups are forcing governments to take measures to reduce pollution from vehicles. One way to do this is to ban non-hybrid vehicles or subsidise hybrid vehicles. HPS will have benefited from these political decisions and this will have helped the business double sales in just four years. Business customers might be willing to pay high prices for hybrid vehicles if they use less fuel and if they can be driven into city centres. This helps to explain HPS's higher profit margins on each power system sold. The market for traditional engines for buses and trucks is probably very competitive. To sell these engines HPS might have had to offer lower prices. However, hybrid engine systems using patented designs offer something different to customers. This product differentiation is an important way to gain competitive advantage. This form of competitive advantage often allows relatively higher prices to be charged and helps to explain the higher profit margins HPS is achieving from these engines. Its newly developed core competence is allowing HPS to develop other products with its hybrid engines. It may develop an excellent reputation for this type of engine and have an excellent brand image.

However, the decision to develop hybrid power systems was obviously costly. HPS has high debt levels. It needed finance to cover the cost of developing the new engines. This high level of debt will become a serious problem if interest rates do increase as suggested in the PEST analysis. High interest payments will reduce profit levels and HPS might not be able to pay back loans.

By focusing so much on hybrid engines, HPS might not have the resources to develop pure electric engines. This is an opportunity cost of spending finance on developing hybrid engines. If the environmental pressure for cleaner air becomes stronger then governments may make all engines illegal in city centres other than pure electric ones. This would then mean that HPS would have a much smaller market for its hybrid engines. There is also the great risk of hydrogen-powered vehicles. HPS does not seem to have developed this type of engine so if these become popular its sales will fall.

More information would have been useful to evaluate whether this strategic decision was a good one. The number of potential competitors and the technology they are developing would allow an assessment of how strong HPS's competitive advantage is. Details of actual sales and profit levels could allow an evaluation of whether the hybrid engines have increased returns to shareholders. The level of debts would also allow an evaluation of how important an increase in interest rates might be to HPS finance costs. However, on balance, this strategic choice of developing hybrid engines seems to have been an excellent one given the information provided.

Your challenge

Although this is quite brief for a business strategy answer, there are some good insights here. The answer avoids trying to refer to all of the data provided and is selective. This is an important strength as it allows the analysis to be developed on a few points rather than just describing many issues. The answer is well applied and shows developed analysis. There are clear attempts to answer the question set and evaluate HPS's earlier strategic decision. This is a very sound effort. Your task is to identify the four key skills. You could annotate a copy or, in your notebook, make a brief note of what was written to demonstrate each skill. An annotated version of this answer is available online – but mark this copy first!

> Chapter 9

Corporate planning and implementation

LEARNING INTENTIONS

In this chapter you will:

- analyse the importance of corporate planning
- evaluate different types of corporate culture and its impact on decision-making
- evaluate the importance of transformational leadership
- analyse how to manage and control strategic change
- evaluate the importance of contingency planning and crisis management.

KEY TERMS

Business process re-engineering Change management Contingency plan Corporate culture Corporate plan
Crisis management Entrepreneurial culture Person culture Power culture Project champion Role culture
Task culture Transformational leadership

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- the meaning and importance of corporate planning
 - different types of corporate culture
 - transformational leadership
 - the management and control of strategic change
 - crisis management and contingency planning.
- 1 Identify **two** benefits to a business of corporate planning.
 - 2 Identify **two** possible limitations of corporate planning.
 - 3 What is meant by corporate culture?
 - 4 Explain the difference between task culture and person culture.
 - 5 What is meant by entrepreneurial culture?
 - 6 Explain the difference between managing change and leading change.
 - 7 Explain what is meant by transformational leadership.
 - 8 Identify **two** important changes that have occurred in recent years within an industry of your choice.
 - 9 Identify **four** stages in contingency planning.
 - 10 Explain the meaning of crisis management.

Application

Outdoor Clothing (OC) (see also OC case study in Chapter 8)

OC's operations management department operates three factories in low-cost countries. Factory workers have very little job security and can be dismissed for minor mistakes. They are only expected to do the job they have been shown how to do and they must not argue with the production supervisors, who take their orders directly from production managers. In contrast, the clothing design department employs 15 independently minded clothing designers. They are encouraged to think up creative and innovative designs for outdoor clothing. Each designer is praised if their designs are successful. If their designs fail to sell, they are still encouraged to take risks with other new designs.

Rajev has instructed the HR department to operate a hard HR strategy to cut costs. The finance department is being encouraged to window dress the accounts to impress shareholders. Rajev has spoken to the marketing director about suggesting to customers that sale prices offer even bigger discounts from the original price than they actually do.

FIRE IN OC FACTORY

Last week a serious fire destroyed part of an OC factory. Three workers were killed and thick black smoke from the fuel stores caused breathing problems in the local town. All production and HR records for the factory were lost in the blaze.

Production has still not restarted. Some retailers are short of supplies of OC clothing. Workers are now complaining that they do not know what will happen to them. Suppliers have just been told to stop sending trucks full of materials with no explanation why.

At a press conference Rajev, the CEO, was reported to say that, 'We were taken completely by surprise. We had

not expected this. We will put everything right soon so there is no need to worry.'

When a major investor in OC heard these comments, he immediately informed OC's board of directors that unless Rajev was quickly replaced as CEO, his investment company would sell all of its OC shares.

Today, the board of directors announced that, 'We regret Rajev's sudden departure. The search for a new CEO will start immediately. We are looking for a transformational leader who can take OC in a different direction.'

- 11 Explain **two** benefits to OC of corporate planning when implementing any one of the possible growth strategies, A, B or C (see OC case study in Chapter 8).
- 12 Identify the corporate culture in the operations management and clothing design departments.
- 13 Explain **two** ways in which the CEO could lead the changes necessary if Strategy A, of selling OC products exclusively online, is chosen.
- 14 Explain **two** reasons why the crisis caused by the fire was handled so badly.

WORKED EXAMPLE FOR Q14

One reason

There appears to have been no contingency planning [K]. 'We were taken completely by surprise' suggests that OC's managers never even considered the possibility of a factory fire and therefore did not plan for this contingency [Ap]. Contingency planning would have given managers experience in what to do and they would have reacted much more quickly than they did [An].

Analysis

- 15 Analyse **two** benefits to OC of appointing a transformational leader to replace Rajev.
- 16 Analyse **two** reasons why leading change and not just managing it are important to OC if Strategy B is chosen.
- 17 Analyse **two** problems OC is likely to experience from not planning for contingencies.
- 18 Analyse **two** possible benefits OC might experience from changing its corporate culture.

WORKED EXAMPLE FOR Q18

One benefit

Under Rajev's leadership, OC's culture seems more interested in cutting costs and increasing returns to shareholders than looking after other stakeholders **[K/Ap]**. Factory workers are paid low wages, some marketing employees might lose their jobs with Strategy A and customers might be misled by the sale pricing claims **[Ap]**. A corporate culture that puts people and not profit first might lead to good publicity, a positive brand image and a quicker response to crises **[An]**. These developments could improve the reputation and sales of OC and, in the long term, its level of profits **[An+]**.

TIP

For Q19, you could focus on explaining the business changes needed within OC if Strategy A is chosen. For example, a large increase in IT employees and direct contact with customers will be needed, so OC must have, for example, social media systems in place to deal with these contacts. You could discuss whether the new CEO is likely to have the qualities needed to change the culture.

Evaluation

- 19 Evaluate how the new CEO could implement the necessary changes within the business, assuming that Strategy A is chosen.
- 20 Evaluate whether changing the culture of OC should be the first priority for the new CEO.

EXAM-STYLE QUESTIONS

Hybrid Power Solutions (HPS) (see also HPS case study in Chapter 8)

Last week, news reached HPS head office that one of its latest hybrid engines, fitted to a truck, had exploded in a busy town centre. No one was injured but the driver of the truck was lucky to escape the fire that resulted from the explosion.

HPS directors immediately called a press conference to explain what action they intended to take. Customers who had trucks fitted with the same model of engine – 230 trucks in total – were asked to take them off the road. Compensation was offered for loss of business. Production of this type of engine was halted and factory workers told that they would be paid in full even though they had no work to do. The exploded engine was shipped back to HPS's engineering division and within 24 hours the cause of the problem had been analysed. A faulty hose connection had allowed petrol to pour onto the electric motor. The supplier of the hose was told to produce an improved hose as soon as possible. This took just three days.

The owners of the 230 trucks were informed that the new hose would be fitted free of charge. HPS took out large advertisements in transport newspapers to reassure future customers about the quality of its products. The adverts stated that this was the first serious incident involving an HPS hybrid engine since they were introduced six years ago.

Media reports did not criticise HPS engines. They praised the speed with which the company had responded to this crisis. The CEO was reported as saying, 'The way we respond to crises like this is more important for the future of HPS than any new power supply invention.'

CONTINUED**Decision-making question**

- 1 Evaluate the statement from the CEO that ‘the way we respond to crises like this is more important for the future of HPS than any new power supply innovation’. [12]

Business strategy question

- 1 Advise the directors of HPS how they could implement successfully either of the two strategic options (outlined in HPS case study in Chapter 8). Justify your answer. [20]

Annotate this answer

This is a sample answer to business strategy Q1.

Strategic implementation means putting a strategy into effect in a planned way with the purpose of reaching a desired objective. Both of these options are major strategic decisions involving significant change and substantial resources. Detailed corporate and departmental planning will be needed, including contingency planning. For example, a political crisis in the country where the buses are manufactured could prevent production from continuing. HPS will need to plan for this and other eventualities. The distance between the country and where HPS is based will also make handling disasters more difficult.

Strategic implementation requires adequate resources to be prepared, especially finance and people. Both options will require much finance and HPS must plan for this or it might face liquidity problems later. A share issue, as HPS is a public limited company, could possibly be sufficient to provide the finance needed for either option. Issuing shares will avoid the increase in long-term loans that would be the other likely source of external finance. It would also help to reduce the financial risk of either strategy as no interest would be payable and share capital is permanent finance. Employees with foreign language skills might be required for either option. The language spoken in the BRICS or African country might not be the same as the language spoken within HPS. HR recruitment strategies must take this into account. HR could undertake a workforce audit to see if any existing employees have foreign language skills or have expressed an interest in working overseas. The involvement of the HR department in strategic implementation will help ensure that the appropriate human resources are in place for the changes that the business is about to experience. These two strategic options may take away vital resources from HPS’s existing operations, which could be damaging, especially as the business is dealing with the hybrid engine explosion.

Managing these resources will be important. However, of even greater importance will be the need to lead the change. A clear vision will be needed to reassure workers, shareholders and other stakeholders that HPS has a clear objective and sense of purpose for whichever option is chosen. The directors will have to explain the reasons for the chosen strategy and the objectives of it to employees and other stakeholders. For example, Strategy 2 seems to fit in best with the original mission statement of HPS, so the vision for this strategy would be well understood by most stakeholders.

Successful implementation of either strategy will be vital to the success of HPS. I advise the directors that failure to plan for and implement effectively either of these strategies could put at risk the entire business, given that it faces increasing competitive rivalry from the company developing the hydrogen engine.

Your challenge

This is another good, if rather brief, answer, which demonstrates all four key skills. Read this answer carefully and note how well structured it is. Each key point is identified and then analysed in the context of HPS. The use of separate paragraphs for each point is very effective and there is a clear conclusion. Your task is to identify the four key skills. You could annotate a copy or, in your notebook, make a brief note of what was written to demonstrate each skill. An annotated version of this answer is available online – but mark this copy first!

> Unit 2

Human resource management

> Chapter 10

Human resource management

LEARNING INTENTIONS

In this chapter you will:

- analyse the role and purpose of the human resource managers in an organisation
- analyse the importance of employee recruitment and selection to an organisation
- evaluate the different methods of recruitment and selection
- assess the main features of employment contracts
- assess the importance of employee training and development in increasing efficiency and worker motivation
- evaluate the importance of employee morale and welfare.

KEY TERMS

Collective bargaining Dismissal Diversity policy Employee appraisal Employment contract Equality policy
Human resource management (HRM) Induction training Job description Labour turnover Off-the-job training
On-the-job training Person specification Recruitment Redundancy Selection Training Unfair dismissal
Workforce planning Work–life balance

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- the role of the human resources department, including the recruitment, selection and training of employees
- the formula for the rate of labour turnover
- employee training methods
- employment contracts
- employee welfare and morale
- management and workforce relations.

- 1 Identify **four** responsibilities of a human resources manager.
- 2 Explain the difference between recruitment and selection.
- 3 Define the term 'internal recruitment'.
- 4 Explain **two** benefits of external recruitment.
- 5 Explain the difference between a job description and a person specification.
- 6 What is meant by an employment contract?
- 7 State the formula for labour turnover.
- 8 Explain the difference between on-the-job and off-the-job training.
- 9 What type of training is usually offered to new employees?

- 10 Identify **two** benefits to a business of training existing employees.
- 11 Explain the difference between redundancy and dismissal.
- 12 What is meant by the term ‘work–life balance’?
- 13 Explain the aim of a typical equality policy.
- 14 What is meant by the term ‘collective bargaining’?

Application

City College (CC)

CC is a private school offering IGCSE and A Level qualifications. Asif is the owner of the school and also the principal. The school employs 46 teachers in 8 subject departments. There are 18 support workers – cleaners, caretakers and technicians. All teaching employees have a written contract but Asif prefers to employ the support workers on an informal basis with no written contract. One support worker complained about this lack of an employment contract. She was so angry that she threatened to damage Asif’s car if he did not give her a written contract. She apologised the next day, but Asif asked her to leave the school and she lost her job.

Asif spends a lot of time recruiting and selecting new teachers. Table 10.1 shows why. He likes to appoint young teachers as he offers them a low salary and they usually use the most up-to-date teaching methods. Asif has no time to train new recruits. They have to pick up important information and details of the school’s procedures by listening to and learning from other teachers.

Asif has recently appointed two new heads of department. The head of Business has been teaching at CC for several years. He is not aware of the latest teaching methods but is reliable. He also plays golf regularly with Asif. The head of Science has just left his previous job to join CC as the school is closer to his home. Asif prefers to appoint male heads of department as ‘they do not leave to look after their families’, as Asif once told a school inspector. Many teachers complained to the inspector that they had no time to themselves during term-time, as Asif insisted on attendance at the college even if they had no lessons.

	2020	2021
Teachers employed by CC	44	46
Numbers leaving CC	12	19

Table 10.1: Teaching staff data for CC

- 15 Calculate the labour turnover for teaching staff in 2020.

WORKED EXAMPLE FOR Q15

$$\begin{aligned} \text{Labour turnover \%} &= (\text{teachers leaving} \div \text{number of teachers employed}) \times 100 \\ &= (12 \div 44) \times 100 = 27.3\% \end{aligned}$$

- 16 Calculate the labour turnover for teaching staff in 2021.
- 17 Explain why management would find these labour turnover results useful.

- 18 Was the support worker who lost her job dismissed or made redundant? Explain your answer.
- 19 Explain **two** benefits to teachers of having employment contracts.
- 20 Explain **two** disadvantages of inadequate employee induction training at CC.
- 21 Which methods of recruitment were used for the two heads of department? Explain your answer.

Analysis

- 22 Analyse **two** ways in which employee training could be improved at CC.
- 23 Analyse how CC could attempt to help employees achieve an effective work–life balance.
- 24 Analyse **two** advantages to CC of adopting an employee equality policy.
- 25 Analyse **two** disadvantages to CC of the trend in labour turnover.

WORKED EXAMPLE FOR Q25

One disadvantage

A high labour turnover results in high recruitment and selection costs **[K]**. This means that CC will have to spend more on this important HR function so less finance will be available in other areas of the school such as for textbooks **[Ap]**. This is the opportunity cost resulting from a high labour turnover **[An]**. This might lead to worse examination results for students, which could damage the reputation of CC and lead to a reduction in student numbers **[An+]**.

- 26 Analyse **two** benefits to CC of effective workforce planning.
- 27 Analyse **two** likely benefits to both management and employees of CC if they could cooperate together.

Evaluation

- 28 Advise whether CC should use internal or external recruitment for heads of departments in future. Justify your answer.
- 29 Evaluate whether CC should be worried about the trend in labour turnover.

TIP

For Q28, consider the benefits and drawbacks of both options, such as the experience of the internal candidates, and provide a justified evaluation.

EXAM-STYLE QUESTIONS

Short answer questions

- 1 Define the term ‘induction training’. [2]
- 2 Analyse **one** benefit of internal recruitment for a large retailing business. [5]

Essay questions

- 1 a Analyse **two** ways in which workforce planning can improve business performance. [8]
- b Evaluate the importance of effective recruitment and selection policies for reducing labour turnover in a hotel. [12]

CONTINUED

Data response questions

Transworld Media (TM)

TM is a news-reporting business that provides televised news stories from around the world to TV broadcast companies. TM employs 50 journalists and 25 TV camera operators. Just three employees left the business last year.

Journalists and camera operators can be asked to travel to any country in the world at short notice. TM's reports are used by over 50 national TV broadcasting companies. Some locations are quite dangerous to work in. All TM employees have to be aware of different cultures and traditions in the countries they report from.

Several journalist and camera operator vacancies exist at TM. The HR department posts job descriptions on the TM website. The job vacancy advert makes it clear that TM's diversity policy is a very important part of its human resource management. All employees are given a detailed employment contract. Due to growing demand for experienced journalists and camera operators, TM has occasionally offered jobs to people who have lacked experience. An extensive training programme is then prepared for these new recruits.

- a i Identify **one** element of a job description. [1]
- ii Explain the term 'human resource management'. [3]
- b i Calculate labour turnover last year. [3]
- ii Explain **one** benefit to TM of a low rate of labour turnover. [3]
- c Analyse **two** reasons why TM operates a diversity policy. [8]
- d Evaluate which methods of training are likely to be most effective at TM. [12]

Improve this answer

This is a sample answer to data response Qc.

A diversity policy means that TM has practices and processes in place to make sure that its employees are very mixed in terms of race, gender, religion and age [K].
 One reason for TM wanting to have a diversity policy is to make its news reports more acceptable to its customers, the national TV broadcasting companies [Ap]. If all TM reporters were the same gender, age, colour and race, the news reports would not be accepted as being truly representative or unbiased and would be unacceptable to TV viewers in most countries [An].

Your challenge

See whether you can improve on this answer. There are not enough skills shown to answer the set question. The reason that is identified is appropriate, it is put into the context of the business in the data and the explanation shows some analysis. Only one reason has been identified and analysed. This is an easy mistake to make so make sure that your answers refer to the number of points demanded by the question. A better answer is available online – but write yours out first!

> Chapter 11

Motivation

LEARNING INTENTIONS

In this chapter you will:

- analyse what motivation is and why motivated workers are important to business
- discuss contributions of motivational theorists and their relevance to business
- analyse the different methods used to motivate workers
- evaluate the appropriateness of different payment systems and evaluate their impact on motivation
- analyse the role of non-financial methods of motivation and evaluate their impact.

KEY TERMS

Bonus Commission Employee participation Empowerment Fringe benefits Hygiene factors
Job enlargement Job enrichment Job redesign Job rotation Motivation Motivators (motivating factors)
Performance-related pay (PRP) Piece rate Profit sharing Quality circle (QC) Salary Self-actualisation
Team working Time-based wage rate

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- what motivation means and why motivated employees are important
- ideas of the main motivational theorists (Maslow, Mayo, Taylor, Herzberg, McClelland and Vroom)
- how to explain the difference between financial and non-financial methods of motivation
- the ways workers can participate in the management of a business.

- 1 Define the term 'motivation'.
- 2 Identify **two** disadvantages that a business might experience from having demotivated employees.
- 3 Identify the **five** levels of Maslow's hierarchy of needs.
- 4 Identify the main findings of Taylor's theory.
- 5 What were Mayo's main findings?
- 6 Explain the difference between Herzberg's hygiene and motivating factors.
- 7 Explain what is meant by McClelland's achievement motivation?
- 8 Explain expectancy as part of Vroom's theory.
- 9 Identify **three** methods of financial motivation.
- 10 Identify **three** methods of non-financial motivation.
- 11 Identify **two** ways in which workers can participate in management of a business.

Application

Shivani's Dresses (SD)

SD was set up nine years ago. It is now a private limited company. Shivani is the managing director. The company has 47 workers. Most of these are employed making designer dresses and dresses for special occasions such as weddings. These are all expensive and customers have high expectations of both quality and original designs.

Each dress is unique and designed by a small team. Team members work closely together on every customer's order.

The designers are paid a salary. There are three managers, including Shivani, who are also paid a salary and have a company pension scheme and health insurance. Dress production workers are paid using a performance-related pay (PRP) scheme, which is based on regular target setting and appraisal of each worker's performance.

Shivani has noticed that the dress production workers do not make such an effective team as the dress designers. Some production workers would like more certainty over their pay levels. Despite this, the level of motivation of all SD employees is high.

Very few workers leave each year and customer satisfaction ratings are very high with many repeat orders. Shivani believes that the regular meetings between herself and all employees are a major reason for the high motivation level. At these meetings, all employees can contribute and influence decisions.

- 12 Explain **two** benefits to SD of a motivated workforce.
- 13 Explain **two** forms of non-financial methods of motivation SD is using.
- 14 Explain **two** possible benefits to SD of using PRP.
- 15 Explain **two** drawbacks to SD of using this system.

WORKED EXAMPLE FOR Q15

One drawback

PRP depends on effective target setting and regular appraisal, as pay is related to meeting targets [K]. It might be difficult to use PRP in this case if one dress is made by several different workers each performing a different task [Ap]. If one worker is slower than the rest, all workers might fail to meet targets and receive less pay for making dresses [Ap].

- 16 Identify **two** fringe benefits that SD offers its managers.

Analysis

- 17 Analyse **two** reasons why piece rate might be inappropriate for production workers in this case.
- 18 Analyse **two** benefits that SD might gain from using job enrichment.

WORKED EXAMPLE FOR Q18**One benefit**

Job enrichment will increase the sense of responsibility of employees, give them feedback on their work and provide a complete unit of work [K]. This will lead to more highly motivated workers experiencing job satisfaction as stated by Herzberg as this was one of his suggested motivators [An]. SD workers will want to produce quality dresses, which will help to retain customers who have high expectations of quality [Ap/An+].

- 19 Analyse, using at least **one** motivational theorist, the advantages and disadvantages of PRP in this case.

Evaluation

- 20 Evaluate the usefulness of the views of Vroom and McClelland to Shivani when attempting to motivate SD's workers.
- 21 Evaluate whether SD should replace the existing payment system with a salary-based payment system for all employees.

TIP

For Q20, think about whether one theorist's ideas are more useful in this case. This would be a form of evaluation.

EXAM-STYLE QUESTIONS**Short answer questions**

- 1 Define the term 'self-actualisation'. [2]
- 2 Analyse **one** advantage to a retail business of commission payments to employees. [5]

Essay questions

- 1 a Analyse **two** elements of Taylor's views on employee motivation. [8]
- b Evaluate whether financial or non-financial methods of employee motivation are likely to be more effective for motivating schoolteachers. [12]

Data response questions**Dan's Kitchen (DK)**

Dan set up his own café, Dan's Kitchen, over 20 years ago. The business now has ten branches. Each branch has a manager and six employees. Three workers prepare meals in the kitchen of each café. They have no qualifications in cooking but Dan gave them a one-day course on how to prepare the most popular dishes. The other three workers serve the meals, make coffee for customers and clear the tables. Dan takes most of the profit out of the business as dividends to himself. Managers are paid a monthly salary. All other employees are paid the legal minimum hourly wage rate.

Dan is worried about levels of employee motivation. He has to recruit many new workers each year to replace those who leave. Customer complaints about food and service reached a record high last month. The main complaint seems to be that the café workers do not work well together. They often argue in front of customers, for example about whose job it is to sweep the floor.

Last week Dan held a meeting with all café managers to talk about the problems. One manager proposed a commission payment system for all café workers, which would encourage more effective working. She presented the data in Table 11.1 to show how this could operate instead of the hourly rate used at present.

Another manager said at the meeting, 'At my last employer, we had a profit-sharing scheme. We were also encouraged to allow employee participation.' Dan said that he would consider all of these proposals.

CONTINUED

	Existing weekly wage per worker	Weekly revenue (commission to be 20% of this ÷ six workers)
High season week	\$240	\$10 000
Average week	\$240	\$7 200
Low season week	\$240	\$5 000

Table 11.1: Wage data for DK

- a i Identify **one** benefit of a profit-sharing scheme. [1]
- ii Explain the term ‘employee participation’. [3]
- b i Refer to Table 11.1. Calculate the difference in weekly wage per worker paid by the two systems during a high season week. [3]
- ii Explain **one** advantage to employees of the current weekly wage payment method. [3]
- c Analyse **two** benefits to DK of using non-financial methods of motivation. [8]
- d Evaluate whether the work of any **two** motivational theorists might help Dan when trying to improve employee motivation. [12]

Improve this answer

This is a sample answer to data response Qd.

Two motivational theorists whose ideas Dan might find useful are Taylor and Herzberg. Taylor believed in workers being rational economic decision-makers (economic man) [K]. This means that he believed that workers only work for money and they will work harder if more money can be earned [An]. If Dan was to offer higher wages, café employees would work harder and they would not leave the business so often [Ap]. Piece work would be the best payment system to adopt, according to Taylor. Workers should be paid for each unit they produce and then they will increase output [An]. According to Taylor, workers also need to be told what to do and do not like thinking for themselves [K]. Herzberg’s two-factor theory is quite different. He believed that there were two types of factors that could influence work effort. Firstly, hygiene factors remove dissatisfaction but they do not actively motivate employees. So pay and working conditions have to be good enough to remove dissatisfaction. After that point, the motivator factors need to be introduced [An]. These are things like complete units of work, responsibility, feedback from managers and so on. Once these factors have been put in place, employees will be motivated to work harder as they have been given more responsibility and trust leading to improved customer service and higher sales and profit [An+]. So, these are the theories that Dan should refer to.

Your challenge

See whether you can improve this answer. The first paragraph identifies a relevant theorist, applies the ideas of this theorist to DK and analyses the possible consequences of this application. However, the answer seems to lack application in the second paragraph. In addition, there is no overall evaluation or judgement, and this is required by the question as the command word is ‘Evaluate’. The answer needs a good concluding paragraph, with overall judgement. A better answer is available online – but write yours out first!

> Chapter 12

Management

LEARNING INTENTIONS

In this chapter you will:

- analyse the main functions of managers
- assess the importance of good management to the success of a business
- evaluate the differences between the views of Fayol and Mintzberg on the role of management
- analyse the key differences in management styles
- evaluate the appropriateness of these styles to different business situations
- analyse the differences between McGregor's Theory X and Theory Y.

KEY TERMS

Autocratic management Democratic management Laissez-faire management Management Manager
McGregor's Theory X and Theory Y Paternalistic management

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- the main functions of management
- management roles (Fayol and Mintzberg)
- the main management styles
- Theory X and Theory Y.

- 1 Define the term 'manager'.
- 2 Explain **two** functions of management.
- 3 Explain Fayol's views of a manager's role.
- 4 Identify the **three** management roles identified by Mintzberg.
- 5 Identify the **three** features of a manager's interpersonal roles as suggested by Mintzberg.
- 6 Define the term 'autocratic management'.
- 7 Explain **one** difference between democratic management and laissez-faire management styles.
- 8 Explain **one** difference between the work typically performed by a manager and the work performed by a supervisor.
- 9 Identify **two** beliefs of Theory X managers.
- 10 Identify **two** beliefs of Theory Y managers.

Application

Asian Retailers (AR)

AR is a large business with retail stores in several Asian countries. The stores sell clothing, furniture and electrical goods. Rohit is the chief executive officer. He was appointed last year after the previous CEO was replaced following shareholder opposition. The owners of AR are very worried about falling sales and profits.

Rohit is proud of his reputation as a manager who gets things done and stands for no nonsense. Rohit wants to cut costs at AR. He has told all store managers to stop holding weekly meetings with workers to discuss store-related issues. 'Workers should be on the shop floor selling. Managers are paid to think and take key decisions,' he said at a recent meeting of all store managers.

Rohit has visited nearly all of the AR stores since being appointed. He has reallocated resources from store redecoration to advertising and promotion. He has made sure that pricing and product decisions are coordinated between stores in all countries. He has set all store managers ambitious targets for sales increases. Directors who fail to meet targets for their departments will have their contracts terminated. Rohit will leave this to the HR department as he avoids undertaking this type of communication himself.

A major development within AR has been Rohit's announcement that all of AR's products will also be made available online through e-commerce. This will need careful planning, and a new e-commerce director has been appointed. Rohit will report on this and other developments to shareholders at a special general meeting.

A recent fire in one AR store resulted in very quick decisions by the store manager about an alternative temporary location and how customers' existing orders were to be met. When Rohit heard of this he said, 'I told you that my style of management always works best.'

- 11 Explain the management style Rohit seems to be using.
- 12 Explain **two** management functions undertaken by Rohit.

WORKED EXAMPLE FOR Q12

One management function

Rohit sets objectives and targets, and this is a function of management [**K**]. The case study states that Rohit has set all store managers ambitious targets for sales increases [**Ap**]. These will help Rohit measure the performance of shop managers [**Ap**].

- 13 Explain which of Mintzberg's management roles Rohit seemed to be undertaking when he considered the e-commerce option.
- 14 Explain **two** possible benefits to AR if Rohit had adopted the democratic style of leadership.

Analysis

- 15 Analyse why effective management is important to AR.
- 16 Analyse **two** disadvantages of the management style that Rohit is using.

WORKED EXAMPLE FOR Q16**One disadvantage**

Rohit seems to be using an autocratic style of leadership [K]. He stands for no nonsense, and cancelled weekly meetings with shop staff, which were an opportunity for them to participate [Ap]. This means that he will not get the benefit of the workers' opinions on, for example, what customers seem to most want to buy [An]. This could lead to poor decisions about items to be sold in shops and lower sales as a result [An+].

- 17 Analyse how **two** of Mintzberg's informational roles are important to the effective management of AR.

Evaluation

- 18 Evaluate whether AR's managers should adopt different leadership styles in different situations.
- 19 Evaluate the likely impact on AR's managers and other employees if Rohit used the democratic style of management.

TIP

For Q18, think about at least two different business situations for AR, such as a flood at the warehouse. Analyse which leadership style would be most suitable in each case and justify your answer as fully as you can.

EXAM-STYLE QUESTIONS**Short answer questions**

- 1 Explain **one** of Fayol's roles of management. [3]
- 2 Analyse **one** difference between an autocratic management style and a laissez-faire management style. [5]

Essay questions

- 1 a Analyse **two** ways in which managers can contribute to business performance. [8]
- b Evaluate whether the democratic management style is the most appropriate one to use in a social media business. [12]

Data response questions**Rapid Pizza (RP)**

RP operates a pizza delivery service. It is owned and managed by Mohamed. The business has a lot of competition and sales have not increased for months. Some workers have recently asked for a pay rise that keeps up with inflation. Mohamed rejected this and said they could all have one free pizza a week instead.

Mohamed studied Business at school and believes that he is an effective manager. He describes himself as a Theory X manager, saying, 'I am good at telling my workers what to do. I make sure that the business has sufficient resources of capital and labour. In particular, I think setting targets is really important. Only last week I told my workers that they had to increase sales by 10% next month.' Mohamed has heard of Mintzberg and thinks he undertakes all of the management roles identified by Mintzberg very effectively.

Mohamed likes managing the business but does not like dealing with workers. He gets angry quite quickly, both with customers who complain and with workers who 'try to tell me how to run my business, such as which toppings we should have on our pizzas'. He admitted to a friend that he could not understand why his workers did not have the same motivation that he had. He told his friend, 'I do not let them worry about taking decisions as I do that for them. For example, when delivering to a new address, I always tell them which route they must take.'

CONTINUED

- a i Identify **one** of Fayol’s roles of managers. [1]
- ii Explain the term ‘Theory X manager’. [3]
- b Explain **two** examples of where Mohamed seems to use autocratic management. [6]
- c Analyse **two** benefits to RP if Mohamed adopted a Theory Y approach to his employees. [8]
- d Evaluate the most suitable management style Mohamed should use within RP. [12]

Improve this answer

This is a sample answer to data response Qd.

Mohamed seems to use the autocratic style as he tells workers rather than asking them (democratic style) or letting them get on with work themselves (laissez-faire) [K].

If Mohamed used the democratic style, he could benefit from the workers’ own experience [K]. For example, the delivery drivers are the workers who have direct contact with customers when they take pizzas to their homes. They might be told about which toppings customers would most like to try on the pizzas and the workers could tell Mohamed this [Ap].

If he responded to what customers actually want he might have a greater chance of reaching his 10% sales increase objective [An].

If Mohamed let workers get on with their work, he might find that they become more responsible and motivated because they are being trusted. Some workers might know the town better than Mohamed, so letting them decide on the best route to take could mean that the pizzas are delivered more quickly and are fresher when the customers eat them [Ap/An].

Your challenge

See whether you can improve this answer. It explains the management style currently used in the business and an alternative style. The possible impact of using this alternative style is clearly analysed and is in the context of this business. The answer has these strengths, but it needs a final conclusion/evaluation as the question is asking for a judgement about the most suitable management style. A better answer is available online – but write yours out first!

> Chapter 13

Organisational structure

LEARNING INTENTIONS

In this chapter you will:

- analyse why organisations need a structure
- analyse the relationship between business objectives and organisational structure
- analyse the different types of organisational structure, and their advantages and disadvantages
- assess the main features of a formal organisational chart
- evaluate the conflict between trust and control with delegation
- analyse differences between authority, accountability and responsibility
- examine the appropriateness of centralised and decentralised structures
- outline the differences between line and staff authority.

KEY TERMS

Accountability Authority Centralisation Chain of command Decentralisation Delaying Delegation
Level of hierarchy Line managers Matrix structure Organisational structure Span of control

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- the traditional hierarchical organisational structure and key features (e.g. levels of hierarchy and spans of control)
- alternative organisational structures such as matrix structures
- the contrasts between centralisation and decentralisation
- the meaning and importance of delegation, responsibility, authority and accountability.

- 1 Identify **two** purposes of an organisational structure.
- 2 Identify **two** attributes of an effective organisational structure.
- 3 What is meant by the term ‘hierarchical organisation’?
- 4 Define the term ‘level of hierarchy’.
- 5 Explain how a matrix structure differs from a traditional hierarchical one.
- 6 What does a span of control of five mean?
- 7 Define the term ‘chain of command’.
- 8 Who retains responsibility when authority is delegated?
- 9 Identify **two** advantages of a centralised structure.

- 10 Identify **two** advantages of a decentralised structure.
- 11 Explain **one** difference between staff managers and line managers.
- 12 Explain what delayering means.

Application

National Department Stores (NDS)

NDS is a family-owned business. Chuck, the current managing director, is the fourth generation of the family to control the business. NDS has 14 stores in Country X selling clothing, furniture, electrical appliances and food. Chuck is also planning the creation of an NDS website to allow shoppers to buy online. This will require the employment of more IT specialists. Chuck takes all of the final purchasing decisions made by all of the product departmental heads. Junior managers have little delegated authority.

In a recent survey of customers, some complained about the outdated clothing and fashion designs. All shop managers and workers are only allocated to one department (e.g. electrical appliances). There is little contact between employees in one product department and the others. One employee said, 'I am a member of the electricals department but I do not feel a part of the shop itself or of the business.'

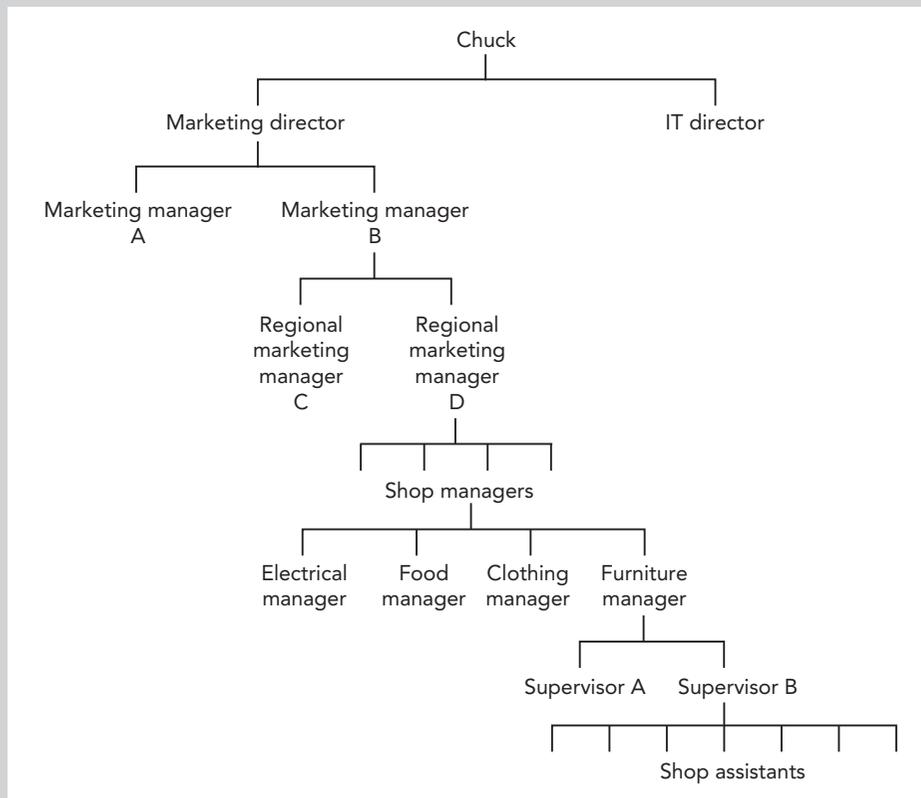


Figure 13.1: Section of the NDS organisation chart

- 13 Look at Figure 13.1. What is the:
- span of control for Manager B?
 - span of control for Manager D?
- 14 How many levels of hierarchy are there in the marketing department?
- 15 To whom is Manager C directly accountable?
- 16 Identify **one** line manager and **one** staff manager.
- 17 Explain why the structure shown could not be described as a matrix structure.

WORKED EXAMPLE FOR Q17

Matrix structures would bring teams together drawn from different departments [Ap]. NDS has a hierarchical structure based on departments [K] and each manager only ever seems to have experience of one department [Ap].

- 18 Explain the likely impact on the NDS marketing department if at least one layer of managers was removed.

Analysis

- 19 Analyse **two** benefits to NDS of changing the organisation to a matrix structure.

WORKED EXAMPLE FOR Q19

One benefit

A matrix structure creates a team-based organisation. Each team will have representatives from each major functional department [K] and this will improve communication and coordination between departments [An]. In the case of NDS, each shop could be treated as a team with representatives from each department within each shop so employees will still feel as if they are part of the shop itself [Ap]. This improved coordination could lead to consistent decisions, for example on pricing, which gives consumers a clear image of the business, which might lead to increased demand, sales and profit [An+].

- 20 Analyse **two** likely impacts on junior managers in the marketing department of increased delegation.
- 21 Analyse **two** possible drawbacks to NDS of rapidly increasing the level of delegation to junior managers.

Evaluation

- 22 Advise how NDS should change the structure of the organisation. Justify your answer.
- 23 Evaluate the impact on the business of becoming a less centralised organisation.

TIP

In your answer to Q22, analyse the possible advantages of product-based departments rather than an organisation based on management functions. You should evaluate the possible use of matrix organisations, delayering and any other changes you could propose. Provide a clear final judgement suitable for NDS.

EXAM-STYLE QUESTIONS

Decision-making questions

World Shoes (WS)

WS is one of Africa’s largest shoe manufacturers. It has three factories in different African countries. It sells most of its output through its own shops. It has 213 shops in 20 different countries, most in Africa but some in southern Europe. A simplified section of WS’s organisational structure is shown in Figure 13.2.

A new chief executive, Zendaya, has just been appointed. She is not impressed by the current organisational structure or the centralised approach to decision-making that WS uses. The board of directors takes all strategic decisions. Important tactical decisions in each department are taken by the functional directors. Very little decision-making is delegated to lower levels of the organisation, the factory managers or shop managers.

Zendaya recognises the possible advantages of this centralised approach. She said to the directors at her first board meeting, ‘It means we have the same company policies in operations, human resources and marketing in all of the countries we operate in. This provides consistency, coordination and avoids conflicts. We are able to buy all of our supplies centrally. However, is this approach really suitable for a multinational business which is aiming to expand even further?’

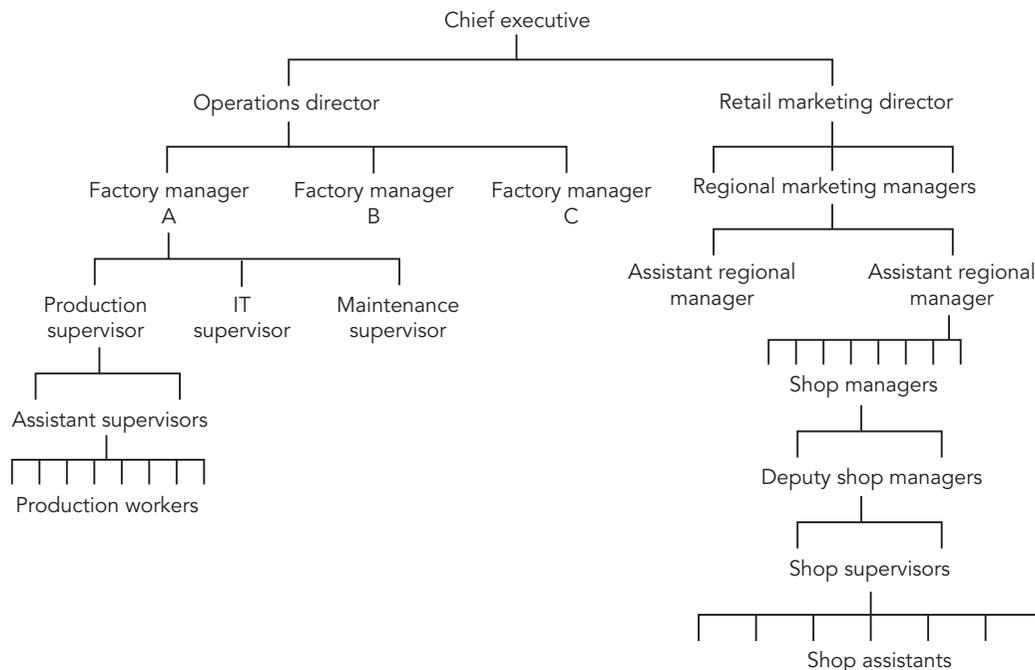


Figure 13.2: WS’s organisation chart

- 1 Analyse the advantages and disadvantages to WS of having a centralised approach to decision-making. [8]
- 2 Advise WS on a revised organisational structure that will allow for greater delegation and flexibility in future. Justify your answer. [12]

CONTINUED**Improve this answer**

This is a sample answer to decision-making Q1. Skills are shown in brackets to help you.

A centralised structure or organisation means that all of the important decisions are taken by senior managers at head office **[K]**. There is very little delegation to lower levels of management or supervisors **[K]**. This has several advantages to WS. By centralising the purchase of leather and other materials used in shoes **[Ap]**, the cost per shoe will be lower. The suppliers will be willing to reduce their prices knowing that they are supplying a large quantity. This is called an economy of scale. This will help to make WS's shoes more competitive **[An]**.

Secondly, taking decisions at the centre means that all factories and all shops owned by WS will be operated in the same way. The shops will all have the same shoes for sale, the same displays and products will be sold at the same prices **[Ap]**. This will help to achieve consistency and a clear brand image for the company. Customers in all countries will know what to expect from a WS shop, which will lead to higher sales and profits **[An+]**.

In the factories, the same HR policies will be used and there will be no feeling from one group of workers that those in another factory are being better paid or better treated. This will help to build a united and cohesive workforce. If a junior manager from one WS factory is promoted to a senior position in another factory, they will know exactly how the new factory operates. No induction training will be needed **[An]**.

Your challenge

See whether you can improve this answer. It is very one-sided and only considers the advantages of centralisation. These advantages are well understood as the answer demonstrates good knowledge, application and analysis skills when referring to these advantages. However, the answer does not consider disadvantages, as the question demanded. When you prepare a better answer, remember to apply the disadvantage of centralisation to WS. A better answer is available online – but write yours out first!

> Chapter 14

Business communication

LEARNING INTENTIONS

In this chapter you will:

- analyse the importance of effective communication to business
- evaluate the advantages and disadvantages of different communication methods
- analyse the causes of barriers to communication and how to overcome them
- evaluate the differences between one- and two-way, vertical and horizontal, formal and informal communication
- evaluate the role of management in facilitating communication.

KEY TERMS

Communication barriers Effective communication Electronic communication Formal communication channels
Horizontal communication Information overload One-way communication Spoken communication
Two-way communication Vertical communication Visual communication Written communication

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- why business communication is important and the key features of effective communication
 - what different communication methods exist and how these can impact differently on the effectiveness of communication
 - what the barriers to communication are and how to overcome them.
- 1 What does feedback mean?
 - 2 Identify **two** examples of situations in which effective communication would improve business efficiency and help to achieve the required goal.
 - 3 Identify **two** methods of spoken communication.
 - 4 Identify **two** methods of written communication.
 - 5 Identify **two** methods of electronic communication between managers in the same organisation.
 - 6 Identify **one** type of message that might be best transmitted using a visual method.
 - 7 Identify **three** possible barriers to communication.
 - 8 For each of the barriers identified above, explain one way in which it might be overcome.
 - 9 Explain the difference between one-way and two-way communication.
 - 10 Explain the difference between horizontal communication and vertical communication.
 - 11 In communication, what is meant by the term ‘receiver’?

Application

National Department Stores (NDS)

NDS directors recently decided to close ten underperforming shops in Country Y and open six new shops in Country X. The decision to close the Country Y shops was not announced for several weeks as the directors did not want the decision to impact on the share price before the annual general meeting. However, an internal email was leaked to the newspapers and shop workers in Country Y started to discuss the news story one lunchtime. One worker said, 'Not only are we the last to know about this decision but we were never asked why we thought sales were falling in our shops. Customers were telling us that the latest fashion and furniture ranges were just not right for our country during the current recession.'

Two weeks later, the directors sent a letter to all regional managers to inform them of the company's plans. It told them to tell the shop managers in the shops that were being closed about the decision. Shop managers were to be instructed to pin a notice on each staffroom door. The notice told the shop workers about the closure, planned for the end of the month.

- 12 Identify which methods of communication NDS uses most often.
- 13 Explain **two** barriers to effective communication within NDS.

WORKED EXAMPLE FOR Q13

One suggestion

There seems to be too much reliance on written communication, such as emails and letters **[K/Ap]**. Letters, in particular, prevent quick and effective feedback, which is a major barrier to effective communication within NDS as the shop managers were not given the opportunity for feedback **[Ap]**.

- 14 Which communication network seems to be used within NDS?
- 15 Identify **one** example of vertical communication used within NDS.
- 16 Is one-way or two-way communication used within NDS? Explain your answer.

Analysis

- 17 Analyse **two** limitations of using noticeboards as a medium of communication at NDS.
- 18 Analyse **one** way in which NDS is made less efficient as a result of ineffective communication.

WORKED EXAMPLE FOR Q18

One way in which NDS is made less efficient by ineffective communication is lack of feedback, which makes the business less well-informed about employees' feelings and level of morale **[K]**. By not being allowed to discuss issues, workers are not shown any trust and have no responsibility given to them. This does not meet with Herzberg's 'motivators' at all, and a demotivated workforce will reduce employee motivation and efficiency **[An]**. Employees could have told managers some reasons why sales were so bad in the underperforming shops as they have contact with customers **[Ap]**, which would have helped to increase sales and profits **[An+]**.

- 19 Analyse **two** ways in which two-way communication might improve motivation levels within NDS.

Evaluation

- 20 Evaluate how NDS should change the communication methods it uses to improve business efficiency.
- 21 Evaluate the impact on NDS's efficiency if the existing barriers to communication are not overcome.

TIP

In your answer to Q20, you should consider whether two-way communication might be better and which communication methods could best improve business efficiency in this case. Remember to link the communication methods with business efficiency and give a supported final judgement.

EXAM-STYLE QUESTIONS

Decision-making questions

World Shoes (WS) (see also Chapter 13)

'We have just received a huge delivery of red leather and no blue leather. The suppliers are claiming that this is what I ordered on the telephone. Although I posted an order confirmation, they claim they never received it. This is not the first time we have had problems with suppliers like this,' complained the purchasing director to the warehouse manager.

'I see that head office has sent us more of those men's summer shoes that we could not sell last year. I told the shop supervisor they were not right for the market in this country but it's a waste of time telling him anything,' said a WS shop assistant to one of her colleagues.

These are just two of the instances of poor communication that Zendaya, the new WS chief executive, is determined to overcome. 'Our communication methods are out of date and we assume that it should only be one-way. Messages seem to pass through so many people that they take too long to reach the person they were intended for. We need to completely revise the methods and media we use for both internal and external communication,' she reported to a recent board meeting.

- 1 Analyse **two** causes of ineffective communication within WS. [8]
- 2 Advise how communication might be improved both within WS and between WS and its suppliers. Justify your answer. [12]

Improve this answer

This is a sample answer to decision-making Q1.

Ineffective communication will result in many problems for WS. Firstly, by not making clear to suppliers what materials are needed, the business ends up with too much leather of one colour and none of the other colour. This will cause problems in the warehouse and in the factories, as production of blue leather shoes might have to be stopped and sales lost. If some of the red leather has to be sent back to the supplier, this could be expensive for WS to arrange.

Also, poor communication within WS can result in bad decisions. If two-way communication had been effective, then the shop assistant's comment that a certain style of shoe would not sell could have been taken back to the regional marketing managers so that the appropriate styles are sent to the right shops. This would help to increase sales in those shops. Another problem of poor communication at WS is low motivation. The shop assistant seems discouraged and demotivated by her message being ignored. If people are not taken seriously and if their views are not considered in decision-making, then low levels of motivation can be the result. In Maslow's terms, employees' esteem needs are not being met.

CONTINUED**Your challenge**

See whether you can improve this answer. This answer is about the consequences of poor communication, not the causes. Despite the answer containing accurate and effective analysis of the consequences of poor communication, no skills have been annotated because an appropriate answer must focus on the question set. A better answer is available online – but write yours out first!

> Chapter 15

Leadership

LEARNING INTENTIONS

In this chapter you will:

- analyse the purpose of leadership and key leadership roles
- analyse the qualities of a good leader
- evaluate key leadership theories
- analyse the four competencies of emotional intelligence.

KEY TERMS

Emotional intelligence (EI) Emotional quotient (EQ) Informal leader Leadership

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- the qualities of a good leader
 - leadership theories
 - emotional intelligence and emotional quotient.
- 1 Identify **four** leadership roles.
 - 2 Explain the purpose of leadership.
 - 3 Explain the difference between a director and a manager.
 - 4 Identify **four** common qualities or characteristics of good leaders.
 - 5 Explain what is meant by the trait leadership theory.
 - 6 Identify **three** theories of leadership other than the trait theory.
 - 7 Define the term 'emotional intelligence'.
 - 8 Identify Goleman's **four** competencies of emotional intelligence.

Application

GR Builders

‘You told me that I had all the qualities needed to be the new leader of this company, so I don’t know what has gone wrong?’ said Louis to his father. They were analysing the latest accounts of the family building business. Sales and profits were down, yet costs – particularly labour costs – were higher compared with the last two years. ‘It’s never easy to take over managing a family business, especially in such a competitive industry,’ explained Louis’s father. ‘If you had followed my suggestion to study the successful decisions of other building businesses and the way their leaders motivate their employees perhaps we would now be celebrating GR’s success?’

There is no doubt that Louis works hard and is an expert builder. He wanted to make GR the best building business in the region for constructing energy-efficient houses. He had even developed a new cork-based building material that has high insulation qualities. But why are more employees leaving GR than before? Why has his new reward-based payment system not been accepted? Why did workers not understand that the flexible employment contracts he introduced were better for them and GR?

Perhaps one worker who has just left GR had the answer to Louis’s problems. He wrote an email to Louis on the day he left: ‘You always use the same approach towards us no matter how long we have worked for GR. Telling site managers to give us the news about the flexible contracts was not right. You make no attempt to understand our feelings or the reasons why we might not want to work for you.’

- 9 Explain **three** leadership traits that Louis appears to have.
- 10 Explain how Louis might have benefited from observing the behaviour of other business leaders.

WORKED EXAMPLE FOR Q10

The behavioural leadership theory suggests that skills of leadership can be taught and learnt, and that people are not necessarily born with these skills [K]. Louis does have some traits of leadership but these might not be enough as he seems to lack experience in leading people towards his vision [Ap]. By learning from the behaviour and decisions of other leaders, he could have developed his own leadership skills and, for example, discussed the flexible contracts with employees before introducing them to see if they were acceptable to workers [Ap].

- 11 Explain **two** ways in which Louis is not able to show emotional intelligence.

Analysis

- 12 Analyse why effective leadership is important to GR.

WORKED EXAMPLE FOR Q12

Leadership is about encouraging people to follow the vision of the leader [K]. Although Louis appears to have a vision, he cannot communicate this effectively and workers are demotivated so they are leaving GR [Ap]. Effective leadership would communicate the vision to workers and explain their role in meeting it. The introduction of flexible contracts at this time suggests that Louis lacks the emotional intelligence to understand workers’ needs in a competitive industry [Ap/An]. Better leadership would mean that productivity within GR would rise, and labour costs would not increase at a time of falling sales and profits [An+].

- 13 Analyse **two** disadvantages of the way Louis seems to lead GR.
- 14 Analyse how GR would benefit from Louis being able to display greater emotional intelligence.

TIP

For Q15, you could consider two different business situations for GR. Discuss whether a different approach to leadership would be needed in each case.

Evaluation

- 15 Evaluate whether Louis should adopt a different approach to leadership in different situations.
- 16 Evaluate the importance of emotional intelligence competencies to the effective leadership of GR.

EXAM-STYLE QUESTIONS

Decision-making questions

Zainab Recruitment Solutions (ZRS)

Zainab started her recruitment agency five years ago. She now has many contracts from businesses that wanted her to recruit applicants for vacant factory and office jobs. She is very persuasive and used her appealing personality to win these contracts against strong competition. ZRS uses social media platforms as well as traditional advertising to attract applicants. Zainab is proud that ZRS is more advanced in the use of IT than other local recruitment agencies.

ZRS employs ten recruitment consultants who have clear targets and are well rewarded for meeting them. They understand Zainab’s vision for the business: to be the most recommended recruitment agency in the country. However, the consultants think the long hours and hard work Zainab puts in to achieve her ambitions prevent her from having time to consider their needs.

ZRS has just taken over FC, a small family-owned recruitment agency. It specialises in recruiting senior managers and directors for other businesses. This is a growing market segment and Zainab wants to eventually develop ZRS as the leader in this sector. The seven workers it employs agreed to transfer to ZRS but have found the culture to be very different. They used to have much more time to meet business clients and discuss the details of the vacant senior positions. Zainab expects this communication to be done electronically. One of the former FC workers commented that ‘if Zainab expects to gain a good reputation for recruiting senior managers, she will have to change the culture of ZRS’.

- 1 Analyse the benefits to ZRS if Zainab is able to display transformational leadership. [8]
- 2 Evaluate whether Zainab has the qualities needed to be an effective leader of ZRS as it expands. [12]

Annotate this answer

This is a sample answer to decision-making Q2.

Zainab seems to have many of the qualities or traits necessary to be a good leader for ZRS even as it expands. She has led ZRS to rapid growth already and the business is only five years old. This must indicate that she is an effective leader. Zainab works hard and this always gives employees a good example to follow. If they can see their leader putting in many hours of hard work, they are more likely to be willing to work hard for the business too. Zainab clearly has charisma, at least with business clients. She has won many contracts due to her persuasive and appealing personality, and this helps leaders attract followers too. People are more likely to take instructions and guidance from someone with an attractive personality than from someone who is always very cross or rude.

Also, Zainab has a clear vision for the business: to be the most recommended agency and a market leader in recruiting senior managers. This helps to direct her decision-making towards achieving the objectives she has set herself. If she can communicate this vision to employees, and they agree with it, she will have displayed a very important quality of leadership.

CONTINUED

However, there are some doubts about whether Zainab can adapt sufficiently to deal with the leadership issues that arise as ZRS expands. Taking over another business is always risky and this is particularly the case if the cultures are different. FC seems to have been quite people focused with an emphasis on social contact. ZRS is much more focused on tasks and meeting targets, with little scope or opportunity for social contact or even meeting business clients. A different culture for ZRS might be necessary if it wants to gain a big market share of the segment that recruits senior managers and directors. Just emailing details of a vacant position of director to potential applicants might be ineffective as senior managers need to be convinced that they might be suited to a vacancy. Business clients need face-to-face contact with an agency to discuss the precise requirements of a job. At present, Zainab does not seem to be able to adopt transformational leadership, which would allow ZRS to move in the right direction for this new market segment. In addition, Zainab might have great charisma but she also needs to consider the needs of employees. It is not clear whether she has the empathy and emotional intelligence required to manage and lead a larger number of employees. Existing ZRS workers think she does not have enough time for them. FC employees might think that she rejects their old ways of working completely. Unless Zainab can learn to adapt her behaviour to show more empathy towards her employees' needs, she will fail to lead ZRS successfully in future. If Zainab took some time to consider how other leaders' behaviour has enabled them to lead large and expanding businesses, then her charisma, hard work and innovative approach might be a good basis for successful leadership of ZRS in future.

Your challenge

This is a very good answer. The response indicates clear understanding of leadership qualities, applies this understanding to the business context and evaluates whether Zainab possesses them. There is no need to improve on this! Instead, identify the four key skills. You could annotate a copy or, in your notebook, make a brief note of how the answer demonstrates each skill. An annotated version of this answer is available online – but mark this copy first.

> Chapter 16

Human resource management strategy

LEARNING INTENTIONS

In this chapter you will:

- evaluate the difference between hard HRM and soft HRM
- evaluate the impact on business of flexible employment contracts and flexible working
- analyse employee performance by using a range of measures
- assess ways in which employee performance might be improved
- analyse management by objectives, its implementation and usefulness
- assess the changing role of IT and AI in HRM.

KEY TERMS

Absenteeism Annualised hours contracts Compressed working hours Flexible employment contract
Flexi-time arrangement Full-time employment contract Gig economy Hard HRM Home working Job sharing
Labour productivity Management by objectives Part-time contract Shift work Soft HRM Zero-hours contract

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- different approaches to human resource management (HRM)
 - flexible employment contracts
 - productivity, absenteeism and causes of poor employee performance
 - how to improve employee performance
 - management by objectives.
- 1 Explain the difference between a hard HRM approach and a soft HRM approach to managing employees.
 - 2 Explain the difference between full-time and part-time employment contracts.
 - 3 What is meant by a flexi-time contract?
 - 4 Explain home working.
 - 5 Define the term 'zero-hours contract'.
 - 6 Explain the difference between core and peripheral workers.

- 7 Define the term 'shift work'.
- 8 Explain what a gig economy means.
- 9 How is labour productivity measured?
- 10 How is absenteeism measured?
- 11 Explain **one** possible cause of high absenteeism.
- 12 Explain what is meant by management by objectives.
- 13 Identify **two** ways in which the role of IT is impacting on HRM.

Application

Farah's Fruits (FF)

FF owns several large fruit farms. The fruit is all harvested by hand and up to 70 people are employed to do this. This number falls substantially once all the fruit has been harvested but there is still work to do looking after the fruit trees and bushes for five full-time workers. All other employees working on the fruit farms have flexi-time contracts with a zero-hours clause. This means that, even during harvest time, farm employees will only be called in to work and be paid if there is sufficient extra work to do. Some recent human resources data are given in Table 16.1.

FF also operates a fruit juicing and packing factory. This operates all year because when FF's fruit is not available, additional supplies are imported. Thirty people work in this factory: 28 production workers and 2 supervisors. It is the job of supervisors to train new workers in operating the many different machines used, but no off-the-job training is offered. Before festival periods, the factory works a two-shift system. Workers' contracts require them to work nights if FF demands this.

FF is planning to purchase new machinery to increase labour productivity in both fruit picking and fruit juicing.

FF employs four administration employees. Two are on temporary contracts. They have been told that only one will be employed in future. They have both asked FF's manager if they could share this job and if it could be made permanent.

	Last year	This year
Average farm workers employed per day	60	64
Total weight of fruit picked (kilos) per year	150 000	145 000
Average number of workers absent each day	6	4

Table 16.1: FF employment, absenteeism and output data for fruit pickers

- 14 Does FF seem to be adopting a soft or a hard approach to HRM? Explain your answer.
- 15 Explain two factors that FF should consider when deciding whether to offer a newly selected worker a part-time or a full-time contract.

16 Calculate the labour productivity for this year and last year.

WORKED EXAMPLE FOR Q16

Last year

Labour productivity = output ÷ number of workers
 = 150 000 ÷ 60
 = 2 500 kilos per year per worker

17 Calculate the rate of absenteeism for this year and last year.

WORKED EXAMPLE FOR Q17

Last year

Absenteeism (%) = (number of workers absent ÷ total number of workers) × 100
 = (6 ÷ 60) × 100
 = 10%

18 Explain **two** possible causes of these changes in employee performance.

Analysis

- 19 Analyse **two** benefits to FF of flexi-time employment contracts.
- 20 Analyse **two** possible disadvantages to FF of zero-hours contracts.

WORKED EXAMPLE FOR Q20

One disadvantage

Zero-hours contracts mean that there is no security of hours or pay for employees [K]. One week they could work 40 hours and the following week no hours at all. Workers will not be loyal to FF if they can get a better employment contract with another business [An]. This will mean that during the harvest season FF is short of workers and fruit rots on the trees as not enough workers can be attracted to work for FF with zero-hours contracts [Ap/An+].

- 21 Analyse **one** benefit to FF of demanding that workers operate a shift system at certain times of year.
- 22 Analyse **one** benefit to FF of purchasing new capital equipment that increases labour productivity.

Evaluation

- 23 Advise whether FF should change its approach to human resource management. Justify your answer.
- 24 Evaluate how FF could try to improve labour productivity without purchasing more capital equipment.

TIP

In your answer to Q23 you should discuss whether a different approach should be used for different types of workers. Consider if it is ethical to use the hard approach. Make sure that there is an overall conclusion based on the context of this business.

EXAM-STYLE QUESTIONS

Asian Domestic Machines (ADM)

ADM manufactures washing machines, refrigerators and freezers in several factories. Some factories are located in countries with high incomes and high demand for kitchen equipment. The most recently built factories are located in low-income countries with high unemployment. Employee performance varies greatly between the factories. Each factory has its own production manager, who has very different views on the best approach to human resource management. Important differences exist between factories, and these can be shown by studying two ADM production locations.

Factory A is located in a low-income country. In Factory A, flexi-time contracts were introduced three years ago for all new production workers. About 45% of all production workers in this factory now have this form of employment contract. Training is only given to each worker for the specific task to be undertaken.

Factory B is located in a high-income country. It still offers full-time contracts to 98% of its production workers. Workers are encouraged to become multi-skilled and join quality circles. Workforce participation is encouraged.

ADM's directors have set the long-term objective of maximising returns to shareholders. They aim to do this by achieving high sales targets in all of the high-income countries ADM markets its products in. There are many competitors producing domestic machines. Some focus on low-priced machines. Others promote a top-quality brand image with advanced technology built into their machines.

ADM sells most of its products in the high-income countries' markets through e-commerce. It delivers the units directly to customers' houses. It offers an installation service and takes back old units, which are then disposed of. Three years ago it made its own delivery drivers redundant. It replaced them with an on-demand delivery provider, which has the contact details for many hundreds of drivers. These drivers are offered each delivery and installation job as it becomes available on a gig economy basis. ADM calculates that the average cost reduction for delivery and installation is about 45% compared to employing its own delivery workers. In recent months, customer complaints have increased by 30%, 8% of orders are cancelled due to delivery delays, and insurance claims for damage caused by poor installations have also risen.

	Factory A	Factory B
Labour turnover	23%	9%
Number of production workers employed	2 000	3 000
Annual production (units)	300 000	600 000
Number of workers absent on an average day	135	150

Table 16.2: HR data for ADM's Factory A and Factory B, 2021

Decision-making questions

- 1 a Refer to Table 16.2. For both factories, calculate:
 - i labour productivity [3]
 - ii absenteeism. [3]
- b Evaluate the possible links between measures of employee performance at ADM's factories and the employment contracts offered to employees. [12]
- 2 Evaluate whether ADM should make the delivery drivers full-time employees or continue to employ them on gig contracts. [12]

CONTINUED

Business strategy question

1 Evaluate whether ADM’s HRM strategy is likely to help the business achieve its long-term objective. [20]

Improve this answer

This is a sample answer to decision-making Q2.

Gig contracts are part of the gig economy, which means that workers have no employment contract but take on jobs for payment with no other benefits [K]. They operate as if they are self-employed and have all of the benefits and risks associated with self-employment [K]. This greatly reduces business costs as there are no payroll taxes (i.e. the taxes paid to government when someone is an employee). ADM does not have to give holiday pay or make pension contributions. This helps to make ADM much more competitive and it might be able to offer consumers lower prices. This should lead to higher sales and profit [An].

There are so many drivers available that it should be possible to always get a gig driver when needed, this is like ordering an Uber taxi. ADM will have no fixed or overhead costs of employing drivers but will always be able to obtain a driver when needed. This seems to be the best of both worlds [An].

Many people prefer flexi-time contracts or gig contracts. It offers them flexibility and they are able to manage their own time without close supervision by managers. It is increasing in most countries as businesses look for ways to reduce costs [K]. The internet makes recruiting gig workers easy as demand can be sent out on an app and several potential delivery drivers might apply for each job [An].

Employing delivery drivers does not make sense as it will raise costs and make ADM less competitive [An].

Your challenge

See whether you can improve this answer. The answer mentions the name of the business but the points made are not fully rooted in the case study context. Just writing the name of the business is not true application. The lack of application will also limit the relevance of any evaluative judgement that the answer makes. It is also a one-sided answer. This means that the evaluation is weak too, as judgements and conclusions must consider both sides of an issue and apply clearly to the case study business. A better answer is available online – but write yours out first!

> Unit 3

Marketing

› Chapter 17

The nature of marketing

LEARNING INTENTIONS

In this chapter you will:

- analyse the role of marketing
- analyse the relationship between marketing objectives and corporate objectives
- understand the distinction between consumer and industrial markets
- analyse the relationship between demand, supply and price
- analyse the difference between market orientation and product orientation
- measure market growth and market share
- evaluate the relative advantages of mass marketing and niche marketing
- assess the significance of market segmentation and how this might be achieved
- understand the importance of customer relationship marketing.

KEY TERMS

Consumer market Consumer profile Customer (market) orientation Customer relationship marketing (CRM)
Demand Equilibrium price Industrial market Market growth Market segment Market share
Market size Marketing Marketing objectives Market segmentation Mass marketing Niche marketing
Product orientation Supply

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- the essential principles and concepts of marketing
- the distinctions between market and product orientation and mass and niche marketing
- the different ways of segmenting markets
- customer relationship marketing.

- 1 Identify **three** tasks of a marketing manager.
- 2 Why is marketing not just about selling?
- 3 Give **two** examples of common marketing objectives.
- 4 Why should marketing objectives be linked to business objectives?
- 5 What is meant by the term ‘customer (market) orientation’?
- 6 What is meant by the term ‘product orientation’?
- 7 What is the main aim of customer relationship marketing?
- 8 How is market size measured?

- 9 How is market share measured?
- 10 Explain the difference between niche marketing and mass marketing.
- 11 Why is product differentiation important?
- 12 Identify **two** ways in which markets may be segmented.
- 13 What is meant by industrial marketing?

Application

Global Drink Company (GDC)

GDC produces soft drinks (sodas) in several factories around the world. The brand name used by GDC is Sodacola. This is a well-known name that has been used by GDC for many years. Sodacola is the market-leading cola drink in many countries. The brand name is supported by global promotion campaigns using famous celebrities. Although the company produces many different flavours of Sodacola, the basic recipe is the same and they are all sold in cans with the same designs. GDC has made no attempt to enter the sports drink market or the markets for diet drinks or organic health drinks. A junior version of its Sodacola drink, with less artificial sweetener and sold in attractive cartons, not cans, is the only variation on the basic Sodacola formula.

In 2021, GDC's total sales revenue was \$30 billion and the total global market for soft drinks was \$120 billion. In 2022, the total market is forecast to be \$135 billion and GDC hopes to increase its own revenue by 15%.

Sodacola is made using a traditional but secret recipe. When GDC tried to change this two years ago, in order to save on costly ingredients, consumers responded by reducing demand by 35%. This was despite an expensive promotion campaign. GDC reluctantly returned to the old recipe 18 months ago.

- 14 Identify whether GDC uses product orientation or market orientation.
- 15 Explain whether GDC sells to a consumer market or an industrial market.
- 16 Calculate the forecast percentage increase in the size of the global soft drinks market.
- 17 Calculate GDC's market share for 2021.

WORKED EXAMPLE FOR Q17

$$\begin{aligned} \text{Market share (\%)} &= (\text{sales of business} \div \text{total market sales}) \times 100 \\ &= \$30\text{bn} \div \$120\text{bn} \times 100 = 25\% \end{aligned}$$

- 18 Calculate GDC's market share for 2022, assuming that the forecasts are correct.
- 19 How does GDC currently segment the markets it operates in?
- 20 Does GDC attempt to explain the difference between its products? Briefly explain your answer.

Analysis

- 21 Analyse **two** drawbacks to GDC from using mass marketing.
- 22 Analyse **two** benefits to GDC from using a market-oriented approach to marketing.
- 23 Analyse **two** benefits to GDC of Sodacola being market leader with the highest market share.

WORKED EXAMPLE FOR Q23

One benefit

Being market leader means having the highest market share of a particular product market [K]. Sodacola is the market leader in many countries it operates in as it has a well-known brand name [Ap]. GDC will benefit from supermarkets and other retailers wanting to make sure they hold inventories of this popular drink [An]. Such stores might place Sodacola in the most visible and prestigious places in their stores so customers can see it easily, and this will lead to increased sales and impulse buys [An+].

TIP

For Q26, consider two ways in which GDC could segment its market and the possible costs and benefits of segmenting in these ways. Give an overall conclusion (e.g. the best way to further segment the market).

- 24 Analyse **two** ways that GDC could further segment the markets it operates in.
- 25 Analyse **two** benefits to GDC of the marketing department coordinating closely with the operations department.

Evaluation

- 26 Evaluate whether further segmentation will increase GDC sales.
- 27 Evaluate whether GDC should adopt a customer-oriented approach to its marketing.

EXAM-STYLE QUESTIONS

Short answer questions

- 1 Define the term 'mass marketing'. [2]
- 2 Analyse **one** difference between consumer markets and industrial markets. [5]

Essay questions

- 1 a Analyse, with examples, **two** differences between market (customer) orientation and product orientation. [8]
- b Evaluate whether niche marketing would allow a car manufacturer of mass-produced family cars to become more profitable. [12]

Data response questions

Cathy's Cakes (CC)

CC used to make cakes for sale in the local weekly market. It has expanded greatly to become one of the country's largest cake manufacturing businesses. CC is well known for producing a limited range of popular cakes in such large quantities that costs and therefore retail prices are very low. All CC cakes are sold to large supermarket companies. CC does not make expensive decorated cakes, wedding cakes, birthday cakes or cakes for special festivals.

Cathy is still the managing director. For several years, her marketing objective has been to have the largest market share of any cake producer in the country. There has been considerable market growth in recent years as consumers' incomes have increased. CC's limited range of cakes for the mass market has led to CC's sales not rising at the same rate as the market. Table 17.1 shows recent sales data and a forecast for 2022.

CC buys in all of the ingredients needed. Sugar is the most important ingredient and CC is worried about the recent increase in the market price of sugar. Sugar is grown in many countries but depends on good weather conditions.

CONTINUED

	2021	2022 (forecast)
CC's sales	\$3.2m	\$3.3m
National cake sales	\$14.0m	\$16.8m
CC's market share	See Qbi	19.6%

Table 17.1: Sales data for CC and the national cake market

- a i Identify **one** example of a marketing objective. [1]
 ii Explain the term 'market growth'. [3]
 b i Calculate CC's market share in 2021. [3]
 ii Using your result and Table 17.1, explain **one** reason for the trend in CC's market share. [3]
 c Analyse **one** supply factor and **one** demand factor that could cause the price of sugar used by CC to increase. [8]
 d Evaluate whether CC should adopt a market segmentation strategy. [12]

Improve this answer

This is a sample answer to data response Qd.

Market segmentation is when a business identifies different groups or segments of consumers and sells different products to these groups **[K]**. The alternative to market segmentation is trying to sell the same type and design of product to all customers. This might not be profitable for a product such as computer printer paper, which is difficult to differentiate. The customers who need to buy printer paper probably all need the same type and quality of paper. It does not matter what is their gender, income, location and so on. The costs of segmenting the market could be greater than any increase in revenue, so attempting to segment this market would lead to a loss being made **[An]**.

The costs of market segmentation can be high **[K]**. Market research must be done to gain data to be able to split up customers into different groups. Each group should share the same common characteristics (e.g. age, gender, income level, social class). Designing and producing different products for these different groups can also be expensive (e.g. producing no-sugar soft drinks for people who are dieting as well as the standard sweetened soft drinks). Different promotion campaigns to appeal to different segments of the market might also be needed, and this will add to costs compared to just having one standard type of advert and promotion **[An]**.

Another disadvantage to market segmentation is that by focusing on small segments of the main market, sales might not be high enough to cover all the costs of operating the business, so an overall loss might be made **[An]**.

However, a car manufacturer could benefit from market segmentation and sales and profits might increase. By selling different products to different types of consumers, sales could increase. Not everyone wants the same standard product and consumers might buy a product from another business if they consider that their particular needs and tastes are not being satisfied **[An]**. As consumer incomes increase with economic growth, consumers want to be seen with branded products that are differentiated and aimed directly at them. So the sale of expensive jewel-encrusted mobile phones is very high in some rich countries, but it would be too expensive to sell these phones to all consumers as a standard mass market product **[An+]**.

So market segmentation can be very profitable. It will be profitable if the costs of segmenting the market into different distinct groups is less than the extra sales revenue that can be gained **[E]**.

Your challenge

See whether you can improve this answer. It has some clear strengths. It identifies the potential benefits and limitations of market segmentation. The consequences of these are well analysed. However, the answer is not fully applied to the business in the case. When applying answers to data response questions, the examples used should be from the business referred to in the data. The product references should have been to cakes, not printer paper, soft drinks or mobile phones. A better answer is available online – but write yours out first!

> Chapter 18

Market research

LEARNING INTENTIONS

In this chapter you will:

- analyse what market research is and the purpose of it
- differentiate between the main sources of data
- evaluate the usefulness of data collected from primary research and secondary research
- analyse the need for sampling
- assess the reliability of market research data
- analyse and interpret qualitative and quantitative data.

KEY TERMS

Arithmetic mean Market research Median Mode Primary research Qualitative data Quantitative data
Range Sampling Secondary research

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- the benefits to be gained from market research
- the key differences between the collection of primary data and secondary data
- the purpose of sampling
- how to interpret and analyse market research data.

- 1 Identify **two** benefits of undertaking market research for an entrepreneur.
- 2 Identify **two** benefits of primary research.
- 3 Identify **two** benefits of secondary research.
- 4 Identify **three** possible sources of secondary data.
- 5 Explain the difference between quantitative research and qualitative data.
- 6 What is meant by test marketing?
- 7 Identify **two** limitations of secondary research.
- 8 Identify **two** ways in which a business could conduct a consumer survey.
- 9 What is the purpose of sampling?
- 10 Explain **one** limitation of sampling.
- 11 Outline **two** ways in which the internet can be used to aid market research.
- 12 Explain the difference between the mean and mode of a set of data.

Application

Global Drink Company (GDC)

GDC's marketing director now wants the company to produce a wider range of products aimed at the youth market to respond to growing competition. She has asked Hassan, a marketing manager, to be responsible for this. Hassan starts by using secondary research he had accessed from the internet. He wanted to find out the age distribution of the country where GDC's head office is based. He purchased a detailed market research report published last year. In addition, he planned detailed primary research. To test out a questionnaire, he selected 50 young GDC employees. One of the questions he asked was: 'How many cans of soft drink do you buy each week?' The results are shown in Table 18.1.

After the trial questionnaire, Hassan decided to use social media and mobile phones as much as possible to undertake his main primary research. He wanted to undertake qualitative research to find out why young consumers preferred one drink brand over others, what prices they were prepared to pay and what promotion methods they thought were most appealing. He was going to use a sample of 100, split into age groups, and then select a certain number from each age range based on the population data he had researched.

Number of drinks bought each week	Number of people
3	3
4	5
5	15
6	18
7	6
8	3

Table 18.1: Responses to the question: 'How many cans of soft drink do you buy each week?'

- 13 Identify **one** benefit to Hassan of using sampling.
- 14 Explain **two** benefits to GDC of using social media for market research.
- 15 Refer to Table 18.1. What is the modal number of drinks consumed?
- 16 Calculate the mean number of drinks consumed.

WORKED EXAMPLE FOR Q16

Number of drinks bought each week (f)	Number of people (x)	Total number of drinks consumed (fx)
3	3	9
4	5	20
5	15	75
6	18	108
7	6	42
8	3	24

Total $fx = 278$; mean = $278 \div 50 = 5.56$ cans per week

- 17 Explain **two** benefits of the secondary data that Hassan used.
- 18 Explain **two** possible sources of bias in the primary research results.
- 19 Explain **two** ways in which the market research results could be presented.

Analysis

- 20 Analyse **two** drawbacks to Hassan of the secondary data he used.

WORKED EXAMPLE FOR Q20

One drawback

One drawback of the secondary data is that one of the sources Hassan used, a market research report **[K]**, was out of date **[Ap]**. It was published last year, and the surveys on which it was based might have been done two years ago. Consumer tastes can change quickly in the soft drinks market, so up-to-date market research data is essential **[An]**. Out-of-date data can be inaccurate and can lead to poor business decisions being made **[An+]**.

- 21 Analyse **two** advantages of using a pre-recorded mobile phone questionnaire rather than street interviews.
- 22 Analyse **one** benefit of any **two** ways of presenting the data to be gathered.
- 23 Analyse **two** ways in which IT could make Hassan’s research more effective.

Evaluation

- 24 Evaluate the likely accuracy of the market research data that will be collected by using the methods proposed by the marketing manager.
- 25 Evaluate the most cost-effective ways for GDC to undertake market research.

TIP

In your answer to Q20, you should consider sample size, whether the sample is likely to be truly representative, potential bias, suitability of the questions, and suitability of the methods. Make your overall conclusion clearly and assess whether other methods could lead to more accurate data.

EXAM-STYLE QUESTIONS

Short answer questions

- 1 Define the term 'secondary research'. [2]
- 2 Explain the difference between the mean and the range of a set of data. [3]

Essay questions

- 1 a Analyse **one** advantage and **one** disadvantage of using the internet and mobile communications to gather market research data. [8]
- b Evaluate whether a sports clothing manufacturer should use primary research or secondary research to gather market information. [12]

Data response questions

Get Fit Gym (GFG)

GFG has been established for 16 years. It was one of the first well-equipped gyms in the area but competitors have opened in recent years. Membership has fallen for each of the last three years. Suzi, the manager, has just finished undertaking some quantitative market research. She aimed to find out why membership is falling, and what equipment and classes members use most. She also wanted to find out what members think of the levels of service being offered. As there are over 2000 members, she selected a sample of 30. She interviewed the 30 gym members individually and then formed them into three focus or discussion groups. The results of one of the interview questions is shown in Figure 18.1. Suzi is very pleased with the research data she has collected. She told a meeting of gym employees that using the market research data will guarantee the success of GFG in the future.

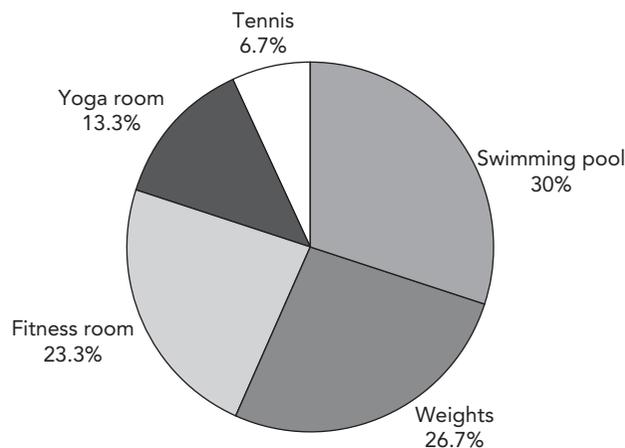


Figure 18.1: Responses to the question: 'Which gym facility do you use the most?'

- a i Identify **one** reason for sampling. [1]
- ii Explain the term 'quantitative market research'. [3]
- b i Using Figure 18.1, calculate the number of people from the sample of 30 who stated that the swimming pool was the gym facility that they used most. [3]
- ii Explain **one** benefit to GFG of using this form of data presentation. [3]
- c Analyse **two** benefits of the primary research methods used by GFG. [8]
- d Evaluate whether using the market research data will guarantee the success of GFG in future. [12]

CONTINUED

Improve this answer

This is a sample answer to data response Qc.

Suzi used a face-to-face interview with each of the sample of 30. The sample was small – only 30 out of over 2 000 members – so she could have done this quite quickly **[Ap]**. She could ask members the questions when they visited the gym and note their answers. They would not have to fill out a questionnaire themselves **[K/Ap]**.

Suzi then formed the sample members into three focus groups to allow them to discuss qualitative issues that would be of interest to her. These could include 'why some friends have left GFG', 'what the other gyms offer', 'how much they charge', and similar issues **[K/Ap]**. This form of research would gather qualitative information for Suzi **[K]**.

Your challenge

See whether you can improve this answer. The answer is quite brief but it does identify important features of primary research and these are well applied to the business. However, it lacks the really important skill of analysis. In this case, the answer should have analysed why the features of primary market research that have been identified are of significant benefit to this business. The points made are not developed or clearly explained. A better answer is available online – but write yours out first!

> Chapter 19

The marketing mix – product and price

LEARNING INTENTIONS

In this chapter you will:

- analyse what the marketing mix means and what its key components are
- evaluate the importance of product decisions to a marketing mix
- use and apply product portfolio analysis
- analyse the stages of the product life cycle and evaluate its usefulness for marketing decisions
- apply the Boston matrix analysis and evaluate the usefulness of it for marketing decisions
- analyse different pricing methods and evaluate their relevance in different business situations
- evaluate the importance of pricing decisions to a marketing mix.

KEY TERMS

Brand Competitive pricing Consumer durable Contribution-cost pricing Cost-plus pricing Dynamic pricing
Extension strategy Intangible attributes Marketing mix Market skimming Mark-up pricing Penetration pricing
Product Product life cycle Product portfolio analysis Product positioning Psychological pricing
Tangible attributes Unique selling point (USP)

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- components of the marketing mix, focusing on product and price
- the product life cycle and the Boston matrix
- different pricing strategies.

- 1 Identify the **four** elements of the marketing mix.
- 2 What is meant by dynamic pricing?
- 3 Identify the stages of a product life cycle.
- 4 What is meant by the tangible attributes of a product?
- 5 Identify **two** possible benefits to a business of having a product with a USP.
- 6 Define the term 'brand'.
- 7 What is meant by product positioning?
- 8 Draw a simple product life cycle.
- 9 What is a product portfolio?

- 10 Draw and label a Boston matrix.
- 11 What does the term ‘cash cow’ mean?
- 12 Identify **three** determinants of the price of a product.
- 13 Explain the difference between cost-plus pricing and contribution-cost pricing.
- 14 Explain the difference between market skimming and penetration pricing (or market penetration pricing).
- 15 What is meant by price discrimination?

Application

Global Drink Company (GDC)

Sales of Sodacola branded drinks did not increase at all in the last three months. One brand introduced two years ago has not reached its market share objective in a market segment that is growing rapidly. The main brand, CoolSoda, has 20% of its market segment, which is not growing. Surplus finance from this product has helped GDC to prepare two new drinks to add to its product portfolio. As a result of market research, one of the new drinks – Top-Pop – will be aimed at teenagers and the other one – SportSoda – at people who enjoy sport. Both drinks will have features that GDC believes will make them stand out from the competitors. Top-Pop will contain water sourced from mountain streams to appeal to young people’s interest in environmental and health issues. SportSoda will contain a performance-enhancing blend of minerals and vitamins, developed by GDC’s own product development team. Test markets have been used for both products.

Costly promotion campaigns are planned for both products. Top-Pop, in particular, is entering a competitive market segment and many teenagers do not have high disposable incomes. A premium high price is being considered for SportSoda, but a lower price designed to gain high market share quickly is planned for Top-Pop.

- 16 Explain how the Boston matrix would classify CoolSoda.
- 17 Has GDC attempted to give both new drinks a USP? Explain your answer.
- 18 At what stage of its product life cycle would you place CoolSoda?
- 19 Explain the **two** pricing methods being considered for the new drinks.
- 20 Explain **two** factors that GDC should consider before finally deciding on a price for Top-Pop.

WORKED EXAMPLE FOR Q20

One factor

Costs will be an important factor [K]. The price will need to cover the transport cost of the mountain water [Ap] added to the cost of the bottle in which the drink is to be sold [Ap].

Analysis

- 21 Analyse how GDC can use the Boston matrix in its product portfolio decisions.
- 22 Analyse why GDC might decide to use price discrimination when SportSoda is sold in different countries.
- 23 Analyse **two** ways in which GDC could vary the price of Top-Pop as it passes through the stages of its product life cycle.

- 24 Analyse **two** ways in which the promotion of SportSoda might change as it passes through the stages of its product life cycle.

WORKED EXAMPLE FOR Q24

One way

One way in which the product life cycle will affect promotion decisions for SportSoda is during the introduction phase [K]. The product is being sold to the market for the first time so potential customers will need informative adverts about this new product [An]. As the soda market has so many brands and is so competitive [Ap], the informative advertising will have to be extensive and wide-ranging, as this will increase consumer awareness leading to increased sales in the introduction stage [An+].

TIP

For Q26, you should think about how important price is in the two market segments being aimed at. Consider if high prices would lead to low demand because of limited consumer incomes or if a high price would help generate a differentiated and high-quality image. Analyse and evaluate other factors which would determine the success of these products.

Evaluation

- 25 Evaluate the usefulness of product portfolio analysis to GDC.
- 26 Evaluate whether the pricing decision for either of these products would be very important to its sales success.

EXAM-STYLE QUESTIONS

Short answer questions

- 1 Define the term ‘product portfolio analysis’. [2]
- 2 Explain **one** difference between market penetration and market skimming pricing strategies. [3]

Essay questions

- 1 a Analyse **two** ways a business can extend the life cycle of one of its existing products. [8]
- b Evaluate whether a mobile (cell) phone service provider should use competitive pricing techniques or cost-based pricing techniques. [12]

Data response questions

Voyage Cars (VC)

VC manufactures cars. Currently the company sells two models. The Genie is a small car with two doors. This model of car was very popular with young consumers as it is suitable as a first vehicle. However, sales of the Genie have recently started to fall in this increasingly competitive market segment. It is sold at a contribution (or marginal cost) price. It has a small engine and is only available in a limited range of colours. It has been on the market for five years. VC’s Marketing Director thinks that the demand for the Genie depends greatly on the price set for it.

The Lynx is a fast sports car. It is much more expensive and is targeted at the young career-minded consumer who wants to impress their friends. It uses a lot of fuel. It has been on the market for two years and was part of VC’s objective to take the company up-market.

In three months’ time, VC is launching a new model called the EcoStar. It has an electric motor run on advanced VC-developed batteries. These batteries mean that the EcoStar can travel much further on one charge than other electric cars on the market. This product differentiation gives the EcoStar a USP. Market analysts believe that it will take competitors at least four years before they can launch similarly advanced car models. VC forecasts that the total cost of production of the EcoStar in its first year will be \$250 million based on a planned output level of 20 000 cars. VC plans to add a profit mark-up of 100% to help pay for the costs of development and the huge promotion campaign planned for its launch.

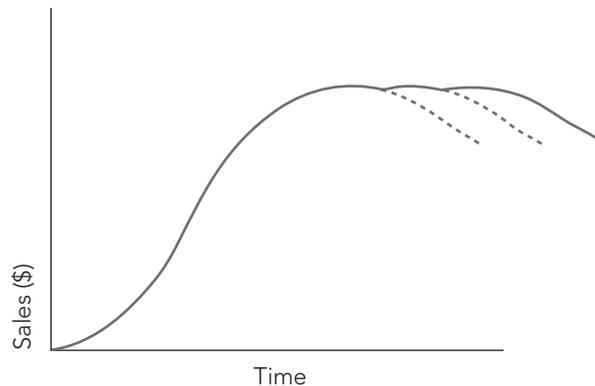
CONTINUED

- a i Identify **one** benefit of competitive pricing. [1]
- ii Explain the term ‘unique selling point (USP)’. [3]
- b i Calculate the price for EcoStar based on the cost-plus method and the company’s profit mark-up. [3]
- ii Explain **one** disadvantage of this pricing method. [3]
- c Analyse **two** marketing decisions for the EcoStar that might change when it enters the maturity stage of its life cycle. [8]
- d Evaluate extension strategies that VC could adopt for the Genie model. [12]

Improve this answer

This is a sample answer to data response Qd.

Extension strategies are decisions taken by a business to try to extend the life cycle of a product [K]. They are introduced towards the end of the maturity stage of the life cycle or very early on in the decline stage. The effect of these extension strategies is shown below [K].



VC could make the Genie available in exciting new colours [K] which would appeal to young consumers, such as students. Just making it available in a limited range of boring colours is certain to be a cause of falling sales, especially as this is a competitive market segment [Ap/An]. VC could use market research among university students to find out what colour cars they really prefer. This information could then be used to decide on the new colours for the Genie [Ap/An]. VC could also fit a larger engine and adapt the product more to its upmarket objective [K/Ap]. This model would then be a better fit for the VC product portfolio, especially with the Lynx sports car. The car would appeal to a wider range of potential consumers who wanted more than just a car that is cheap to run. These two strategies would extend the life of the Genie model and reverse the recent decline in sales [An+].

Your challenge

See whether you can improve this answer. It has key strengths. A good understanding of extension strategies is shown. The examples used are clearly applicable to the business in the data. The consequences of the proposed extension strategies are also analysed in terms of their likely impact on car sales. However, the answer lacks the very important skill of evaluation. A better answer is available online – but write yours out first!

> Chapter 20

The marketing mix – promotion and place

LEARNING INTENTIONS

In this chapter you will:

- identify the differences between sales promotion, advertising and direct promotion
- analyse the different objectives of a promotion campaign
- analyse the factors to consider when making promotion-mix decisions
- evaluate the methods used to measure the effectiveness of promotional spending
- evaluate the impact of developments in digital marketing
- analyse the importance of packaging in the marketing of a product
- assess the importance of place in the marketing mix
- discuss different distribution channels and assess their appropriateness in different circumstances.

KEY TERMS

Advertising Branding Channel of distribution Digital distribution Digital promotion Direct promotion
E-commerce Online marketing (e-commerce) Physical distribution Promotion Promotion mix Sales promotion

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- the role of promotion and place as elements of the marketing mix
- distinctions between advertising, sales promotion and digital marketing
- different sales promotion techniques
- the advantages and disadvantages of distribution channels, including the internet.

- 1 What is meant by the term ‘promotion’?
- 2 Identify **two** possible objectives for a promotion campaign.
- 3 Explain the difference between informative and persuasive advertising.
- 4 Is advertising an above-the-line form of promotion or is it below-the-line?
- 5 Identify **three** factors that could influence the advertising media used by a business.
- 6 Define the term ‘sales promotion’.
- 7 Identify **two** examples of sales promotion.
- 8 What is the main purpose of branding?
- 9 What is meant by the term ‘promotion budget’?

- 10 Explain **two** ways of promoting a product to an industrial market that would not be used for a consumer product.
- 11 What is meant by a one-intermediary channel of distribution?
- 12 Define the term 'e-commerce'.
- 13 What is meant by the term 'viral marketing'?
- 14 Explain two examples of digital promotion.
- 15 What is meant by the term 'integrated marketing mix'?
- 16 How can packaging support a product's brand image?

Application

Voyage Cars (VC)

VC is now planning the promotion of its new car model, the EcoStar. The directors of the company cannot agree on how big the marketing budget should be. One option is to set it at 5% of the expected first year's revenue gained from EcoStar. A forecast of 20 000 cars has been made and the full cost price of \$25 000 agreed. The marketing department plans to spend 60% of this budget on advertising through traditional media.

As the marketing director told his colleagues, 'We have to establish the EcoStar brand quickly with a recognisable and differentiated identity and raise customers' expectations if we are to reach the targets set for this product.'

Social media and viral marketing will also be used to promote this product. VC does not sell cars directly to consumers. It sells through garages that act as distributors. They buy cars from VC – either for inventory or as a direct result of a customer order – and handle all of the customer service of displaying and selling the cars. VC does not plan to use all of its existing garage distributors to sell EcoStar, as the image and brand of the product is very different from that of the Genie.

- 17 Explain **two** possible promotion objectives for VC.

WORKED EXAMPLE FOR Q17

One objective

One objective is to achieve a stated percentage share of the national car market [**K/Ap**] within a certain time period, which is both measurable and time-specific, and could be achievable given sufficient promotion [**Ap**].

- 18 Calculate VC's marketing budget if the revenue formula is used.
- 19 Is VC planning to spend more money on below-the-line promotion or above-the-line promotion? Explain your answer.
- 20 Explain how successful branding of the EcoStar would help VC.

Analysis

- 21 Analyse **two** ways in which VC could make use of digital promotion.
- 22 Analyse **two** ways in which VC could determine whether its promotion of EcoStar is successful.

WORKED EXAMPLE FOR Q22

One way to analyse the success of this promotion is to survey potential customers [K]. They could be asked if they have heard of this new car and whether they thought it had a differentiated identity from other car brands [Ap]. If they do think it has a distinct brand, they might be more likely to buy it [An]. This form of measurement would help to show that the promotion campaign had been successful and help determine promotion decisions in future [An+].

- 23 Analyse **two** advantages to VC of using a one-intermediary channel of distribution.
 24 Analyse **two** disadvantages to VC of using a one-intermediary channel of distribution.

Evaluation

- 25 Advise on the most appropriate methods of promoting EcoStar as it passes through its product life cycle. Justify your answer.
 26 Advise on an integrated marketing mix for EcoStar. Justify your answer.
 27 Evaluate the importance to EcoStar's success of VC making extensive use of the internet for marketing.

TIP

For Q25, explain why the methods and types of promotion will change over the life cycle of this product. Explain and support your conclusions, to improve the quality of your evaluation.

EXAM-STYLE QUESTIONS**Short answer questions**

- 1 What is meant by the term 'channel of distribution'? [2]
 2 Differentiate between a sales promotion and advertising. [3]

Essay questions

- 1 a Analyse how a perfume manufacturer could use branding to differentiate one of its products. [8]
 b Evaluate the importance of promotion to a mobile (cell) phone business as a newly developed advanced mobile phone goes through its product life cycle. [12]

Data response questions**Magic Cameras (MC)**

The market for low-priced cameras has collapsed, as mobile phones are now fitted with easy-to-use cameras. However, the market for cameras that offer great flexibility and the potential for professional images with interchangeable lenses is growing. MC has a wide range of medium-priced cameras. It has just finished developing one of the most advanced cameras available to the market, called the ProPix. It is ultra-light, as weight is a common criticism of quality cameras. It is wi-fi connectable and is available with a range of excellent lenses for top-quality pictures.

ProPix will take MC into a different market segment. Sales promotion and advertising will be used to attract potential customers' attention. The marketing director wants to promote the camera using social media and viral marketing as much as possible. He told other directors, 'We have allocated a marketing budget of \$500 000 for ProPix. Only \$125 000 of this will be spent on advertising through traditional media as I want to connect with a new type of internet-focused consumer.'

The new camera will be distributed globally using specialist wholesalers and carefully selected retailers. These shops will have to demonstrate to MC that they have employees with a high technical understanding of the ProPix camera.

CONTINUED

- a i Identify **one** example of sales promotion. [1]
- ii Explain the term ‘viral marketing’. [3]
- b i What proportion of the ProPix marketing budget does MC plan to spend on advertising? [3]
- ii Explain **one** way in which the impact of this advertising could be measured. [3]
- c Analyse **one** advantage and **one** disadvantage to MC of using a two-intermediary distribution channel. [8]
- d Evaluate how MC could best use the internet in its marketing for ProPix. [12]

Improve this answer

This is a sample answer to data response Qc.

Using a wholesaler has big benefits. It means that the manufacturing business does not have the cost of keeping inventories **[K]**. This frees up capital and space which can be devoted to making the products **[An]**. Secondly, retailers are specialists in marketing to customers face-to-face **[K]**. They will spend money on making the shop look attractive and will display the goods attractively. They can answer any questions that customers have about the cameras and this will give consumers confidence in the product **[An]**. Manufacturers are not always experienced in selling to consumers and they would have to employ specialist sales staff if they did not use retailers. So using retailers keeps costs lower for manufacturers for two reasons **[An]**.

Your challenge

See whether you can improve this answer. This answer indicates a misunderstanding of the question, which is about two-intermediary distribution, not just one-intermediary. The link between wholesalers and retailers needs to be made more clearly. The answer also lacks direct application to cameras. The examples used in an answer should be directly applied to the business in the data. A better answer is available online – but write yours out first!

> Chapter 21

Marketing analysis

LEARNING INTENTIONS

In this chapter you will:

- calculate and interpret elasticity of demand – price, income and promotional
- analyse the impact of elasticity results on business decisions
- evaluate the importance of new product development and of research and development
- analyse sales data using the moving-average method
- evaluate the impact of sales forecasting on business decisions.

KEY TERMS

Cyclical fluctuations Delphi method Income elasticity of demand Jury of experts New product development (NPD)
Price elasticity of demand (PED) Promotional elasticity of demand Random fluctuations
Research and development (R&D) Sales force composite Sales forecasting Seasonal fluctuations
Test marketing Trend

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- measures of elasticity, and the impact of elasticity results on business decisions
 - reasons for and evaluation of new product development
 - methods of sales forecasting.
- 1 State the formula for price elasticity of demand (PED).
 - 2 Explain what a PED result of -2 means.
 - 3 Explain what happens to revenue when a business reduces the price of a product with a PED of -0.5 .
 - 4 State the formula for income elasticity of demand.
 - 5 Explain what a promotional elasticity of demand of $+2$ means.
 - 6 What does a negative income elasticity of demand tell us about the type of product?
 - 7 Define the term ‘research and development (R&D)’.
 - 8 Explain **two** potential advantages to a business of developing a new product.
 - 9 Explain **two** reasons why expenditure on R&D might not lead to a successful new product.
 - 10 What is meant by the jury of experts method of sales forecasting?
 - 11 What does the term ‘moving average’ mean?
 - 12 Explain **two** possible limitations of the moving average method of sales forecasting.

Application

Marta's Ices (MI)

MI is a family-owned ice cream business. It manufactures 45 different flavours of ice cream that are sold through 24 of MI's own shops. The business has expanded in recent years and, on average, now opens two new shops each year. The last four shops the company has opened have not done as well as the sales forecasts predicted. The marketing manager of MI believes that the market for standard ice cream may be becoming saturated. There is also evidence that a fall in consumer incomes has had a negative effect. The only ice cream that has increased sales has been the Tropical Fruit ice cream, which was promoted heavily during the summer. Sales details are given in Table 21.1.

The marketing manager thinks that new product development is the best way to increase sales further. Last year, MI launched an Ice Cream Cookie, which had such disappointing sales that it was withdrawn after three months. 'We failed to plan for this product and just assumed that the MI reputation would help make it a success,' explained the marketing manager. Another new product is now in the development stage. This is called Iced Desserts and is a range of popular desserts that have been mixed with MI ice creams and then frozen. Test market results are encouraging and have led a group of MI senior managers to forecast annual sales at around \$1 million in the first year.

Sales of two types of ice cream have been carefully recorded in recent months. Prices of both products were changed and sales recorded again. The results are shown in Table 21.2.

	2020	2021
MI's total ice cream sales (units)	12.0m	11.4m
Consumer incomes per year (average)	\$10 000	\$9 800
Sales of Tropical Fruit ice cream (units)	0.5m	0.6m
Promotion budget for Tropical Fruit ice cream	\$20 000	\$22 000

Table 21.1: Selected sales and other data for MI

	Ice Cream A	Ice Cream B
Original price	\$1.00	\$1.50
Changed price	90 cents	\$1.35
Original demand	1 500 units per week	800 units per week
Changed demand	1 800 units per week	840 units per week

Table 21.2: Price and demand data for MI

- 13 Calculate the PED for ice cream A based on the data in Table 21.2.

WORKED EXAMPLE FOR Q13

PED = percentage change in demand \div percentage change in price

Percentage change in price = -10% [$(-10 \text{ cents} \div \$1) \times 100$]

Percentage change in demand = 20% [$(300 \div 1\,500) \times 100$]

PED = $20 \div -10 = -2$

- 14 Explain what this result means.
- 15 Calculate the PED for Ice Cream B based on the data in Table 21.2.
- 16 Explain what this result means.
- 17 Calculate the income elasticity of demand for MI's ice cream.

WORKED EXAMPLE FOR Q17

Income elasticity = percentage change in demand \div percentage change in income

Percentage change in demand = $(-0.6\text{m} \div 12\text{m}) \times 100 = -5\%$

Percentage change in income = $(-\$200 \div \$10\,000) \times 100 = -2\%$

Income elasticity of demand for MI ice creams = $-5 \div -2 = 2.5$

- 18 Explain what this result means.
- 19 Calculate the promotional elasticity of demand for Tropical Fruit ice cream, based on the data given.
- 20 Explain what this result means.
- 21 Outline **two** potential benefits to MI of developing Iced Desserts.
- 22 Which methods of sales forecasting is MI using? Explain your answer.

Analysis

- 23 Analyse **two** ways in which business decisions by MI's managers might be affected by elasticity calculations.
- 24 Analyse **two** benefits of sales forecasting for MI.

Evaluation

- 25 Evaluate the usefulness of elasticity calculations to business managers.
- 26 Evaluate the importance of new product development to a business such as MI.
- 27 Evaluate the usefulness of sales forecasting to MI.

TIP

For Q27, you should try to compare the benefits with the costs/limitations of sales forecasting in this case study. Also consider what factors might influence the future sales of MI's product, and whether sales forecasting is guaranteed to be accurate.

EXAM-STYLE QUESTIONS

Decision-making questions

Medical Drugs Incorporated (MDI)

MDI is one of the largest pharmaceutical (medical drug) companies in Europe. It spends around 10% of its annual sales on research and development (R&D) into new drugs. MDI also manufactures a large range of drugs, including many famous branded drugs for colds, allergies and headaches.

MDI's board of directors cannot agree on the company's future R&D strategy. Some directors want to cut the investment in R&D, close a section of this department and focus resources on expanding production of the branded medicines. The other directors want MDI to stay as a major research company aiming to discover new life-saving drugs. If these drugs can be proven to be safe and effective, then substantial profits can be earned as there will be no close competitors for several years. Data on the R&D spend and recent discoveries of MDI and the other three large drug companies are shown in Table 21.3.

Total spending on drugs can vary for several reasons. Government spending cutbacks can reduce the amount that hospitals have available for spending on drugs. The launch of a new drug to relieve allergies can lead to a sharp increase in demand. Seasons can also affect demand. For example, medicines to treat allergies are sold in summer and more drugs that fight the symptoms of colds are sold in winter. MDI wants to forecast sales for its drugs to allow enough resources to be allocated to production and inventory levels. An extract of a time series analysis undertaken by MDI's marketing department is shown in Table 21.4.

Company	Total R&D investment: 2018–2021 (\$m)	Number of new drugs discovered 2018–2021
MDI	\$120m	6
A	\$300m	12
B	\$250m	15
C	\$50m	4

Table 21.3: R&D investment and new drugs discovered

Year	Quarter	Sales revenue	Eight-period moving total	Centred quarterly moving average (trend)	Seasonal variation
2020	3	120	690	90.625	29.375
	4	85	705	X	-8.75
2021	1	80	725	95.625	Y
	2	95	750		
	3	125	765		

Table 21.4: Extract of time series analysis undertaken by MDI (all figures \$m)

CONTINUED

- 1 a Calculate the values for:
- i X [1]
 - ii Y. [1]
- b Calculate the forecasted sales for 2022 quarter 2 if the line of best-fit trend value is 102 and the average seasonal variation for Q2 is -2.3 (all figures in \$m). [1]
- c Evaluate the usefulness of sales forecasts based on time series analysis for MDI. [12]
- 2 Evaluate whether MDI should invest further in R&D. [12]

Improve this answer

This is a sample answer to decision-making Q1c.

Sales forecasts such as the moving average method can be useful. They tell a business what sales will be in the future and this makes planning much easier [K]. By knowing what sales will be, MDI will be able to make sure that the factory is large enough to cope with increased demand for medicines [An]. It can employ more workers if the sales forecasts show that demand is increasing [K]. So, without sales forecasts – such as the moving average method – MDI will not know how many medicines to make and keep in inventory, so customers might be disappointed if not enough products are available [An].

Your challenge

See whether you can improve this answer. It is rather poor. It refers to two possible uses of sales forecasts based on time series analysis but the analysis is limited. There are references to ‘medicines’ but the points made could apply to any product. So, the answer is not directly applied to the business or product in the case study. It is also too brief and contains no evaluative judgement or overall conclusion. A better answer is available online – but write yours out first!

> Chapter 22

Marketing strategy

LEARNING INTENTIONS

In this chapter you will:

- analyse the importance of planning marketing strategy
- analyse the need for a coordinated and consistent marketing strategy
- analyse the need to link marketing strategy to marketing objectives
- evaluate the changing role of IT and AI in marketing
- evaluate and select appropriate strategies for entering international markets.

KEY TERMS

Global localisation International marketing Marketing strategy Marketing plan Pan-global marketing
Quota Tariff

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- the contents and purpose of a marketing plan
 - the meaning and purpose of marketing strategies
 - the role of IT and AI in marketing
 - strategies for international marketing.
- 1 Identify **four** of the main elements of a marketing plan.
 - 2 Explain **two** benefits of preparing a marketing plan.
 - 3 Explain **two** possible limitations of marketing planning.
 - 4 What is meant by the term ‘marketing strategy’?
 - 5 Explain the need for a coordinated marketing strategy.
 - 6 Explain **two** ways in which AI is impacting on marketing for many businesses.
 - 7 What is meant by the term ‘globalisation’?
 - 8 How has free trade increased globalisation?
 - 9 Identify **three** reasons why a business might start to sell its products in other countries.
 - 10 Identify **four** ways in which international marketing is different to national marketing.
 - 11 Identify **four** ways in which a business could enter a foreign market for the first time.
 - 12 Explain the difference between pan-global marketing and global localisation marketing.

Application

Value Clothes (VC)

VC is a well-established manufacturer and retailer of value clothing, which is low-priced and of reasonable quality. VC's range of clothes is traditionally designed and does not follow the latest fashions. VC operates only in Country X, which has low average incomes. Unemployment is rising in Country X and it has an ageing population. VC has several important competitors and the overall clothing market is not growing.

VC's directors want to expand the business by selling clothes in Country Y for the first time. This country has average income levels that are increasing rapidly. It has a youthful population that is increasingly attracted to buying products with well-known brand names. VC's directors think the company should buy its own shop premises in Country Y to distribute its clothes. VC's marketing manager suggested, 'By selling our clothes in Country Y at the same low prices we should be able to establish a high market share quickly.'

- 13 Explain which method of entering Country Y's market VC is planning to use.
- 14 Explain **two** benefits to VC of marketing its products internationally.

WORKED EXAMPLE FOR Q14

One benefit

VC can benefit from the greater sales potential in Country Y [**K**] as it has high average income levels [**Ap**]. The market is not growing in Country X, so to start selling clothes to Country Y will give VC a chance of increased total sales [**Ap**].

- 15 Is VC planning to use pan-global or global localisation marketing?
Explain your answer.

Analysis

- 16 Analyse **two** other ways in which VC could enter the market in Country Y.
- 17 Analyse **two** problems that VC could experience in Country Y if it made no changes to its marketing mix.
- 18 Analyse **two** problems for VC if it decides to adopt a global localisation approach to marketing its products in Country Y.

WORKED EXAMPLE FOR Q18

One problem

One problem would be higher costs [**K**]. A global localisation approach will mean undertaking detailed market research to find out the needs and tastes of local consumers to allow appropriate product decisions to be taken [**An**]. Specially designed products for Country Y will lead to higher costs and, if sales are not much higher, VC could make a loss from this strategy [**An+**]. VC seems to make traditional clothes and these are unlikely to be popular in Country Y with a youthful population [**Ap**].

- 19 Analyse **two** benefits to VC of using detailed market planning.

Evaluation

- 20 Evaluate the factors that will influence the success of VC's first attempt at international marketing.

TIP

For Q20, you should weigh up whether VC's approach to marketing in Country Y for the first time is likely to be successful. Consider how marketing success could be measured: by level of sales; level of profits; market share. Analyse what factors might influence the success of this strategy. Make a judgement about which factor(s) will have most influence on the success of this strategy.

- 21 Advise which marketing strategy VC should use when selling its products in Country Y. Justify your answer.
- 22 Evaluate the importance to a retail business of a coordinated marketing strategy.

EXAM-STYLE QUESTIONS

Aisha's Processed Foods (APF)

APF produces a range of high-quality ready meals and frozen food products. These are sold to supermarkets in Country P. APF has ten of its own retail outlets in towns with high average incomes. The business has grown rapidly in recent years. Table 22.1 gives details of its growth strategy over the last ten years.

Year	Strategy	Major impact on business
2011	Expanded into new factory that doubles capacity	Higher borrowing was needed. Costs per meal were reduced.
2015	Took over FR Foods, a business producing similar products to APF	Profit fell for two years as costs of combining the two businesses were greater than expected.
2017	Opened first retail store and later expanded to a total of ten shops over three years	Direct contact with consumers helps to provide feedback to operations and marketing departments.
2020	Took over XCEL Food Processing company	Market share in Country P rose to 55%. Government competition office warned it will oppose further control over the market. Additional loans were needed to finance the takeover.

Table 22.1: Growth strategies of APF

APF's production costs are low as the business employs many immigrant workers on the minimum wage. The market for ready meals and frozen food is becoming more competitive. Last year the government of Country P decided that the country should join a large free trade area. Imports of all food products have increased, especially those that meet the needs of the many different ethnic groups that live in Country P.

CONTINUED

As part of its detailed marketing planning, APF has analysed potential new marketing strategies. The processed food market in Country P is mature and saturated. The directors of APF have researched opportunities in the food markets in other countries. Marketing products internationally for the first time will incur high costs. Additional finance will be required.

APF has been able to obtain capital from a foreign investor. Banks in Country P were reluctant to lend to the company. APF plans to start by selling products to Country R. Average incomes are lower than in Country P. Country R is a member of the same free trade group.

The directors of APF now have to decide on which marketing strategy to adopt for selling to Country R. Details of the two options are given in Table 22.2.

	Marketing strategy A	Marketing strategy B
Products	No change in products. This will allow quicker entry into a foreign market than developing new products.	Some new products adapted for new market to reflect local tastes/cultures. It will take time and finance to develop these.
Prices	Same as in Country P with full cost price and small profit margin, converted into foreign currency.	Low prices to establish market share. This may not cover the full cost of the products to start with.
Promotion	Same packaging, sales promotions and advertising as now, but a change in language for the foreign market.	Expensive new promotions such as advertisements that clearly use local people and make local culture references.
Place	Try to set up direct links with supermarkets in Country R and distribute directly to these shops.	Sell through local distributor to supermarkets in Country R. This uses the local distribution system but an additional intermediary.

Table 22.2: The two alternative marketing strategies for APF

Decision-making question

- 1 Analyse the impact on APF of globalisation. [8]

Business strategy question

- 1 Advise whether APF should adopt Marketing strategy A or Marketing strategy B. Justify your answer. [20]

Improve this answer

This is a sample answer to decision-making Q1.

Globalisation is when countries agree to trade with no trade barriers and allow the free movement of capital and, increasingly, workers [K].

Globalisation is both helping APF and acting as a constraint. APF is experiencing more competition in Country P's market. However, it will be able to import food ingredients more cheaply without tariffs [Ap].

APF will be able to sell its own products more cheaply to other members of the free trade area. It can raise capital more easily from other countries as it did in this case when the banks in Country P were reluctant to lend to the business [Ap]. APF can employ more migrant workers as a result of globalisation as there is freer movement of workers between many countries [K].



CONTINUED

Your challenge

See whether you can improve this answer. It does display some knowledge of globalisation and its possible impact on the case study business. The examples given are clearly related to APF. However, it is not only quite brief but lacks any detailed analysis. The possible positive or negative consequences of globalisation on APF are not fully developed or explained, and this needs to be done for analysis to be demonstrated in the response. A better answer is available online – but write yours out first!

> Unit 4

Operations management

> Chapter 23

The nature of operations

LEARNING INTENTIONS

In this chapter you will:

- analyse what is meant by operations management
- analyse the nature of the production process and how value can be added
- differentiate between production and productivity, efficiency and effectiveness
- analyse how a business could increase the sustainability of its operations
- evaluate labour intensive and capital intensive operations
- evaluate the advantages and disadvantages of different operations methods.

KEY TERMS

Added value Batch production Capital intensive Effectiveness Efficiency Flow production
Job production Labour intensive Level of production Mass customisation Production Productivity
Sustainability of operations Transformation process

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- the meaning of operations and operations management
- the transformation process
- the important differences between production and productivity, and efficiency and effectiveness
- the important differences between labour intensive production and capital intensive production
- the main operations (production) methods: job, batch, flow and mass customisation.

- 1 What is meant by the term ‘production’?
- 2 Identify **three** inputs needed in the production process.
- 3 Explain the difference between capital (e.g. machinery) and intellectual capital.
- 4 Identify **two** ways in which the production process can help a business add value to bought-in inputs.
- 5 Explain how it is possible for the level of production to increase but for the rate of productivity to fall.
- 6 State the formula for labour productivity.
- 7 Explain **two** ways in which a manufacturing business could increase labour productivity.
- 8 Explain **two** ways in which a manufacturing business could increase sustainability.

- 9 Explain the difference between an efficient production process and an effective production process.
- 10 Identify **two** examples of industries where labour intensive production is still common.
- 11 Identify **two** limitations of labour intensive production.
- 12 Explain **two** factors that will influence the decision by a business whether to adopt labour intensive or capital intensive production processes.
- 13 Identify **two** limitations of capital intensive production processes.
- 14 What is meant by the term 'job production'?
- 15 Explain the difference between batch production and flow production.
- 16 Identify **two** benefits of mass customisation.

Application

Fast Food Kitchen (FFK)

FFK has a problem. The demand for burgers and taco wraps outstrips the output levels being achieved in the kitchen. The business has an excellent reputation for home-cooked food but service levels are poor. Customers complain about the long wait for food to be served, and some leave before the food they have ordered arrives. This leads to food wastage and profits are falling. FFK employs two excellent chefs and some other kitchen workers. It has recruited three more kitchen employees and they began work at the start of month 3.

The food sold by FFK uses a slow-job production process. Each stage is undertaken by teams of workers cutting meat and vegetables, preparing the bread buns or taco wraps, cooking the ingredients, putting the food on a plate and garnishing it with salad. They use simple equipment such as knives, a meat mincer and one gas cooker. Details of production levels and employment levels in the kitchen are shown in Table 23.1.

FFK's managers are planning to purchase an automatic burger-making machine, as well as a large batch production oven and grill that can be digitally controlled by a single worker.

	Month 1	Month 2	Month 3
Number of meals produced	20 000	21 000	26 000
Number of employees in the kitchen	10	11	14
Labour productivity per month	2 000	See Q17	See Q18

Table 23.1: Production levels and numbers employed in the kitchen

- 17 Calculate labour productivity in month 2.

WORKED EXAMPLE FOR Q17

Labour productivity per time period = output in time period ÷ number employed

Month 2 labour productivity = 21 000 ÷ 11 = 1 909 meals per month per employee

- 18 Calculate labour productivity in month 3.
- 19 Explain **one** impact on business efficiency of this trend in labour productivity.
- 20 Calculate the percentage increase in production between month 2 and month 3.
- 21 Does FFK currently use a labour intensive or capital intensive production process? Explain your answer.

Analysis

- 22 Analyse **two** problems for FFK as a result of the trend in labour productivity.
- 23 Analyse **two** possible reasons why there is this trend in labour productivity.
- 24 Analyse **two** problems that might result for FFK as a result of introducing a capital intensive production process.

WORKED EXAMPLE FOR Q24

One problem

One problem is that capital equipment is expensive and requires finance **[K]**. The purchase of an automatic burger-making machine will require finance **[Ap]**. This could be a problem for FFK, as profit is falling so there might be less cash available in the business for capital equipment **[Ap/An]**. FFK might have to take out a loan to make the business capital intensive and the interest on the loan could reduce profit further **[An+]**.

- 25 Apart from buying new machinery, explain **two** ways that FFK could increase labour productivity.
- 26 Analyse how the operations process at FFK helps to add value.

Evaluation

- 27 Evaluate whether FFK should switch to batch production methods.

TIP

For Q27, you should weigh up whether FFK would lose some of its appeal to customers if meals are not fully prepared by hand and produced in large batches. This will mean some cooked food will be ready a while before a customer order comes in for it. The cost of the equipment is important. Consider if kitchen workers will be made redundant. If yes, this is likely to impact on motivation for those who remain. Evaluate whether capital intensive batch production will solve the poor service problem.

EXAM-STYLE QUESTIONS

Short answer questions

- 1 Define the term 'mass customisation'. [2]
- 2 Explain what is meant by the production (or transformation) process. [3]

Essay questions

- 1 a With the use of examples, analyse the difference between production levels and levels of productivity. [8]
- b Evaluate whether a manufacturer of hand-built racing bicycles should switch to flow production to improve labour productivity. [12]

Data response questions

Shahzad Carpets and Rugs (SCR)

SCR is well known for the quality of the carpets and rugs it makes. All of its products are handmade using old handheld tools and techniques developed over many years. Demand is high as the styles and patterns made by SCR are selected after undertaking market research. Consumers often say that SCR carpets are the best-quality products available. There is a waiting list for SCR's largest rugs and carpets despite the recent recruitment of ten new workers.

Labour turnover is high at SCR. Workers complain of long hours and strict management controls. They also do not like untrained workers being allowed to learn by actually doing the work. Any mistakes untrained workers make have to be corrected by the experienced workers. The operations manager reported to his colleagues recently that 'production effectiveness is high but our level of efficiency is low'. Look at the data in Table 23.2.

The operations manager wants to increase labour productivity. He wants to start making carpets in batches of the same design using computer-controlled machinery. 'These could more than double the rate of labour productivity,' he said. Other managers do not want to use machines and think that there are other ways in which labour productivity could be increased.

	Month 1	Month 2	Month 3
Number of carpets and rugs made	180	183	192
Number of production workers	45	47	55
Labour productivity	4.0	3.9	See Qbi

Table 23.2: Operations data for SCR

- a i Identify **one** benefit of increased efficiency. [1]
- ii Explain the term 'production effectiveness'. [3]
- b i Calculate labour productivity for SCR in month 3. [3]
- ii Explain **one** likely reason for this trend in labour productivity. [3]
- c Analyse **two** ways in which labour productivity could be increased, without purchasing new capital equipment. [8]
- d Evaluate whether the decision to switch to capital intensive production is the right one for SCR to take. [12]

CONTINUED

Improve this answer

This is a sample answer to data response Qd.

Capital intensive production means using a lot of machinery to produce a product and not very many workers **[K]**. A car assembly line using automatic robots would be a good example of capital intensive production. This method of production increases output and, more importantly, it increases labour productivity **[An]**. Each worker can now produce many more cars or units of output per week with machines than they could have done using a labour intensive production process **[An]**. High labour productivity will reduce the labour cost per unit and make SCR much more competitive as well as increasing output, leading to higher profitability for the business **[An+]**. Machines can work all day and a new shift of workers can be called in, and this will increase output. This is what the operations manager wants: to increase output to reduce the waiting lists, so of course SCR should switch to capital intensive methods of production **[E]**.

Your challenge

See whether you can improve this answer. Effective knowledge and understanding of capital intensive production is demonstrated. The points made are explained and analysed by considering the impact of capital intensive production on unit labour costs and productivity. However, it lacks an important skill – that of direct application to the business in the data. In addition, the conclusion is weak and not supported. There should be an overall conclusion that is well justified by the arguments that have been used. A better answer is available online – but write yours out first!

> Chapter 24

Inventory management

LEARNING INTENTIONS

In this chapter you will:

- analyse why businesses hold inventories and the costs of inventory holding
- analyse the advantages and disadvantages of traditional inventory management systems
- evaluate the just-in-time (JIT) inventory management system and compare it with just-in case (JIC) inventory management.

KEY TERMS

Buffer inventory Economic order quantity Inventory Just-in-case (JIC) inventory management
Just-in-time (JIT) inventory management Lead time Re-order quantity

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- the importance of inventory holding and inventory management
- the costs and benefits of holding inventories
- the risks and benefits of JIT and JIC.

- 1 What is meant by the term 'inventory'?
- 2 Identify **three** costs of holding inventories.
- 3 What costs are linked to running out of inventories?
- 4 Identify **three** types of inventory.
- 5 What is meant by buffer inventory?
- 6 Why is a long lead time a problem when re-ordering inventory?
- 7 What is meant by just-in-time?
- 8 Identify **three** conditions for JIT inventory management to be effective.
- 9 Outline **two** benefits of JIT inventory management.
- 10 Outline **two** benefits of JIC inventory management.

Application

Folding Bike Co (FBC)

FBC produces uniquely designed folding bicycles. It buys in most of the materials and components it needs. Some of FBC's suppliers are located in the same country within 50 km of FBC's factory. Supplies of the special metal frames and tyres are purchased from manufacturers located in another country. This is 2000 km away from FBC's factory.

FBC uses a JIC inventory management system. It holds a high level of inventories of most components that it buys in, especially imported ones. The inventory control chart for the most commonly used size of bicycle tyre is shown in Figure 24.1. FBC's demand for tyres of different sizes from the inventory warehouse varies with output levels for different models of bicycle.

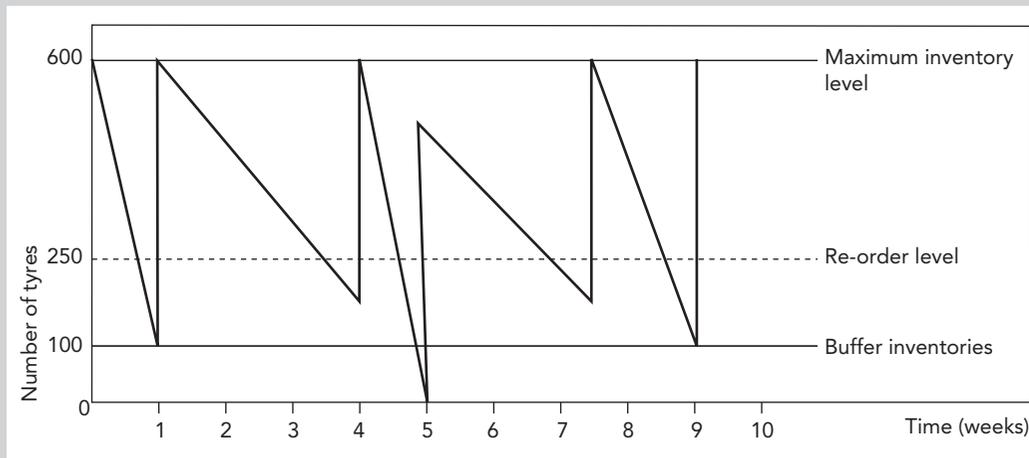


Figure 24.1: Inventory chart for one type of tyre

- 11 Is the lead time between ordering and delivery more or less than 1 week? Refer to the inventory chart (Figure 24.1) in your answer.
- 12 Explain what happened during week 5.
- 13 Calculate the average weekly rate of inventory usage from the start of the time period (0) to the end of week 4, assuming there was an inventory of 180 tyres left at the end of week 4.
- 14 Refer to Figure 24.1. How many tyres of this type were used during week 1?

WORKED EXAMPLE FOR Q14

500 tyres. There were 600 tyres at maximum inventory level at the start of the week, and this was reduced to 100 tyres (buffer inventory level) at the end of the week.

Analysis

- 15 Analyse **two** costs to FBC of holding inventories of this tyre.
- 16 Analyse **one** problem for FBC if it reduced the re-order level for tyres. Refer to Figure 24.1 in your answer.
- 17 Analyse what would have happened if delivery of this tyre from the supplier had not been made at the end of week 5.

- 18 Analyse **one** reason why good communication between the production department and the inventory manager is important in this case.
- 19 Analyse **two** benefits of FBC using JIC inventory management to hold high inventories.

WORKED EXAMPLE FOR Q19

For one benefit

One benefit is that supply problems could occur as FBC imports the tyres and other parts [Ap]. Transport problems will delay delivery [K] especially as FBC is a long distance from the suppliers of frames and tyres. High inventories using JIC inventory management reduce the risk of transport problems [An]. This reduces the risks and costs of production stopping because there are no tyres or other parts available [An+].

- 20 Analyse **two** factors that FBC should consider before switching to JIT inventory management.

Evaluation

- 21 Discuss whether JIT management of inventories should be adopted at FBC.

TIP

For Q21, discuss the potential advantages and disadvantages for FBC. You could refer to Figure 24.1. Evaluate the important factors that are required for JIT to work efficiently. Give an overall judgement.

EXAM-STYLE QUESTIONS

Short answer questions

- 1 Define the term 'inventory re-order level'. [2]
- 2 Analyse **one** condition necessary for JIT inventory management to be effective. [5]

Essay questions

- 1 a Analyse **two** reasons for the importance of effective management of inventories for a manufacturing business. [8]
- b Evaluate whether a food processing business should adopt JIT inventory management. [12]

CONTINUED

Data response questions

Spartacus Sports Shoes (SSS)

SSS produces exclusive, highly priced sports shoes for top athletes. The shoes are also bought by wealthy fashion-conscious consumers. Most of the company's sales are to individual customers who make special requests for the size, colour and decorative features they want. SSS also supplies some shoe retailers that are located in the most expensive shopping districts of major international cities. SSS holds inventories of finished sports shoes to supply these retailers when needed.

SSS purchases most of its supplies from local businesses but all leather used by the company is imported. Local leather is available but it is often of inferior quality. SSS managers think that using leather from local suppliers would damage the excellent reputation the business has for quality, customer service and prompt delivery. SSS uses JIC inventory management for leather supplies and holds high inventories of this material. The maximum inventory level is 40 tonnes and the buffer inventory level is 10% of this amount. The economic order quantity, calculated by the SSS inventory manager, is 36 tonnes. The inventory level at which a new order is sent is 10 tonnes. This is calculated so that, taking into account the lead time of two weeks, the buffer inventory level is reached just as a new delivery arrives.

- a i Identify **one** type of inventory. [1]
- ii Explain the term 'buffer inventory level'. [3]
- b i Calculate the average weekly rate of inventory use. [3]
- ii Explain **one** cost that would increase if the size of each order was reduced. [3]
- c Analyse **two** benefits to SSS of having high levels of inventories. [8]
- d Evaluate whether SSS should adopt JIT inventory management. [12]

Improve this answer

This is a sample answer to data response Qd.

SSS should not use JIT as it would be very risky for the business **[K]**. Running out of inventories would lead to a real crisis and this could put the whole business at risk. There could be many reasons why suppliers fail to deliver on time. There might be a lot of traffic on the motorway or there could be a truck drivers' strike. Any problems like this would mean that the lead time is longer than usual and then inventories could fall to zero **[An]**. Production would have to stop, workers would have nothing to do and customers would be disappointed. These problems could damage the good name of the business and lead to customers buying products from competitors **[An+]**. It is far too risky to use JIT, so SSS should always hold high inventory levels just in case something unforeseen happens to the next delivery **[E]**.

Your challenge

See whether you can improve this answer. There is a clear understanding of the risks involved with JIT management of inventories. The consequences of these are well explained so the skill of analysis is demonstrated too. However, no potential benefits of JIT are analysed and the answer lacks direct application to SSS, so there is little evidence of evaluation. The conclusion is not in the context of this business. The arguments made and the final judgement and conclusion should be rooted in the context of the data response business. A better answer is available online – but write yours out first!

> Chapter 25

Capacity utilisation and outsourcing

LEARNING INTENTIONS

In this chapter you will:

- analyse the meaning and calculation of capacity utilisation
- evaluate the benefits and limitations of high capacity utilisation
- analyse the impact of low capacity utilisation
- evaluate the different approaches to excess capacity or capacity shortage
- assess the reasons for the rapid growth of outsourcing
- evaluate the benefits and limitations of outsourcing.

KEY TERMS

Business process outsourcing (BPO) Capacity shortage Capacity utilisation Excess capacity
Full capacity Outsourcing Rationalisation

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- the meaning and measurement of capacity utilisation
- capacity shortage and excess capacity, and the problems these cause
- how capacity problems might be overcome
- the risks and benefits of outsourcing.

- 1 State the formula for calculating capacity utilisation.
- 2 What is meant by excess capacity?
- 3 Identify **one** reason for a capacity shortage.
- 4 How could rationalisation reduce excess capacity?
- 5 Identify **one** disadvantage of maximum (100%) capacity working.
- 6 Identify **two** benefits of outsourcing.
- 7 Identify **two** limitations of outsourcing.

Application

Electric Appliance Company (EAC)

EAC designs and manufactures its famous brand of EcoHeat electric heaters for homes and factories. It operates in a competitive market. A major rival was forced out of business recently as a result of substantial losses, but many competing firms remain in the industry. EAC's fixed costs per month are \$18 000.

EAC's operations director has collected production and output data, as shown in Table 25.1. The operations director reported to today's board meeting that 'this trend in capacity utilisation happened during the same months last year. If it continues, we will be up to 100% of capacity and some customers will be disappointed. We could either extend our factory to increase capacity or outsource some production to another business.'

The chief executive suggested that finance was available for the factory extension but that training additional workers could be expensive. He added that outsourcing, perhaps to an overseas supplier, might give the business more flexibility.

	Month 1	Month 2	Month 3	This month
Production capacity (units)	1 200	1 200	1 200	1 200
Production level achieved	850	990	1 000	1 150
Capacity utilisation (%)	70.8%	82.5%	See Q8	See Q10

Table 25.1: Production and capacity utilisation levels at EAC factory

- 8 Calculate capacity utilisation in month 3.

WORKED EXAMPLE FOR Q8

$$\begin{aligned} \text{Capacity utilisation (\%)} &= (\text{current output} \div \text{production capacity}) \times 100 \\ &= (1\,000 \div 1\,200) \times 100 = 83.3\% \end{aligned}$$

- 9 Explain **one** likely reason for this trend in capacity utilisation.
 10 Calculate capacity utilisation in month 4.
 11 Identify **two** likely causes of this trend in capacity utilisation.
 12 Identify **two** risks to EAC of taking the outsourcing option.

Analysis

- 13 Analyse **two** possible disadvantages to EAC of high levels of capacity working.
 14 Analyse **two** possible advantages to EAC of high levels of capacity working.

WORKED EXAMPLE FOR Q14

One advantage

One advantage to EAC of a high level of capacity utilisation is that unit costs should be quite low [K]. Fixed costs are \$18 000 per month and when output rises from 850 to 1 150 per month, the unit fixed cost falls from \$21.2 to \$15.65 [Ap]. This will make EAC much more competitive [An] and means that the business could afford to lower prices, leading to increased demand [An+].

Evaluation

- 15 Evaluate whether EAC should use outsourcing or extend its existing factory to solve the potential shortage of capacity problem.

TIP

For Q15, analyse the advantages and disadvantages of both ways of solving the capacity problem and make a reasoned and supported conclusion.

EXAM-STYLE QUESTIONS

Short answer questions

- 1 Define the term 'rationalisation'. [2]
- 2 Analyse **one** problem a medical equipment manufacturing business could experience from operating at full capacity. [5]

Essay questions

- 1 a Analyse **two** benefits to a business of increasing capacity utilisation. [8]
- b Evaluate whether a famous brand of Swiss watch, which cannot meet demand from existing capacity, should outsource some component production to a manufacturer in South America. [12]

Data response questions

Invictus Van Hire (IVH)

IVH operates 15 van hire centres in Country X. Demand for hire vans is mainly from businesses that need additional transport capacity for short periods. Some of the customers are people who are moving house and want to do the removals themselves. The economy of Country X failed to grow last year and this had the effect of cutting demand for van hire. Some van hire businesses have rationalised by closing branches and reducing opening hours.

IVH have fixed costs of \$450 000 per month, including van-leasing costs. The existing excess capacity (see Table 25.2) is making the business much less profitable. IVH managers have been making the business more flexible in recent years. For example, they outsourced nearly all accounting work and are only appointing new employees on flexible employment contracts. However, 75% of IVH employees are still on permanent full-time contracts and trade union leaders are very keen to maintain these.

Month	1	2	3	4	5	6
Total vans available	1 100	1 100	1 100	1 100	1 100	1 100
Vans hired	600	550	600	700	770	810
Capacity utilisation (%)	54.5	50	54.5	63.6	70	See Qbi

Table 25.2: IVH van-hire capacity and actual numbers of vans hired (current year)

CONTINUED

- a i Identify **one** example of rationalisation. [1]
- ii Explain the term ‘outsourcing’. [3]
- b i Calculate the rate of capacity utilisation in month 6. [3]
- ii Explain **one** effect of the trend in capacity utilisation. [3]
- c Analyse **two** drawbacks to IVH of low levels of capacity utilisation. [8]
- d Evaluate whether IVH should rationalise resources to reduce excess capacity. [12]

Improve this answer

This is a sample answer to data response Qd.

Rationalising means reducing resources in the business so that capacity is cut **[K]**. This will reduce the overheads or fixed costs of the business. IVH’s monthly fixed costs of \$450 000 **[Ap]** would be reduced, so the losses of the business will be reduced too – or the profits increased **[An]**. Rationalisation in this case would cut the number of outlets. This could be done by closing one of the two branches that are closest to each other **[K]**. Customers would still be able to hire vans from the other branch. The number of vans would have to be reduced too. So if 100 vans were sold off or returned to the leasing company, the capacity utilisation in month 6 would rise to 81%, helping to reduce the average cost of each van hired out **[Ap/An]**. Cutting fixed costs will reduce average cost and the consequence of this would be an increase in IVH’s profitability **[An+]**.

Workers would probably have to be made redundant when one or more branches close and this will further reduce costs **[K]**. This might upset the trade union and officials might call industrial action. This might be unlikely, though, as the economy is not doing very well and the trade union would worry about IVH having to close even more branches **[An]**. IVH might be able to avoid redundancy if it introduces more flexible labour contracts for existing workers as these would cut back on fixed costs too as the hours of each worker could be reduced **[Ap/An/E]**.

Your challenge

See whether you can improve this answer. This response does have some strengths. It shows good understanding of rationalisation. The points made are well applied to the business and the consequences are analysed too. However, it seems to lack one very important part of a successful evaluative answer. There is no overall, supported conclusion. A better answer is available online – but write yours out first.

> Chapter 26

Location and scale

LEARNING INTENTIONS

In this chapter you will:

- assess the importance of location decisions to the success of a business
- evaluate the factors that influence location and relocation decisions
- evaluate reasons for and impact of offshoring and reshoring
- analyse why businesses may want to increase scale of production
- analyse the importance of economies and diseconomies of scale and impact on unit costs.

KEY TERMS

Diseconomies of scale (internal and external) Economies of scale (internal and external) Offshoring
Optimal location Qualitative factors Quantitative factors Reshoring Scale of operations

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- factors that influence location and relocation decisions
 - reasons for offshoring and reshoring
 - factors that influence the scale of production
 - economies and diseconomies of scale.
- 1 What is meant by the term ‘optimal location’?
 - 2 Explain **one** benefit of a multi-site location to a business.
 - 3 What is meant by the term ‘offshoring’?
 - 4 Explain **one** potential problem of an international location decision.
 - 5 Explain **one** reason why a business might reshore some of its operations.
 - 6 Give **two** examples of quantitative factors that influence business location decisions.
 - 7 Give **two** examples of qualitative factors that influence business location decisions.
 - 8 Identify **two** possible reasons why a business might offshore some of its operations.
 - 9 Define the term ‘economies of scale’.
 - 10 Give **two** examples of economies of scale that a business might benefit from as it increases its scale of production.
 - 11 Explain what is likely to happen to unit costs if a business has diseconomies of scale.

- 12 With the use of examples, analyse the difference between internal economies of scale and external economies of scale.
- 13 Outline **two** ways in which increased globalisation has impacted on location decisions of businesses.

Application

Folding Bike Co (FBC)

Dashin started making bicycles in his garage 25 years ago. He had designed a folding bicycle that fitted into a small suitcase. Once out of the case, it could be quickly unfolded to become a bicycle suitable for small adults or children. Dashin made the first bicycles by hand. He talked to customers about the colour of frame and the type of saddle they wanted. He used mainly bought-in components but he made some parts himself. Dashin called his business the Folding Bike Co (FBC).

Now, 25 years later, FBC has a factory on the edge of the capital city. Production uses a computer-controlled flow line. Some components are still bought in from suppliers. The scale of operation of the business has increased in recent years. This has impacted on the unit cost per bicycle. See Table 26.1.

Some production is also offshored. When FBC is very busy, a low-cost supplier in South America produces bicycle kits that are then quickly assembled by FBC in its factory. This increases total output. Transport hold-ups have caused some supply problems. The quality of some of the kits is poor.

Dashin is now considering obtaining a bank loan to finance relocation to a larger factory. Some data about two possible locations are shown in Table 26.2.

Annual output	10 000	100 000	200 000
Unit bicycle cost of production	\$135	\$105	\$95

Table 26.1: Increased output results in lower unit cost

	Location A	Location B
Annual fixed-site costs	\$6m	\$9m
Maximum annual potential output	300 000	500 000
Distance from a main city	40 km	10 km
Distance from a major seaport	220 km	250 km

Table 26.2: Selected data about two alternative locations for FBC

- 14 Explain what happens to unit cost as the business expands its scale of operation.
- 15 Outline **two** possible reasons to explain this trend.
- 16 Explain **two** likely economies of scale that FBC might benefit from if it continues to expand.
- 17 Explain **one** reason why FBC has offshored some production.

Analysis

- 18 Analyse **two** benefits to FBC from declining unit costs as its scale of operation increases.

WORKED EXAMPLE FOR Q18

One benefit

One benefit is higher profit **[K]**. If the average cost of producing each bicycle is reduced while the price remains the same, then profit per bicycle will increase **[Ap/An]**. Higher profit per unit will then provide additional retained profit for expansion of FBC or for the purchase of advanced equipment, which could help to further reduce the unit cost of bicycle manufacture **[An+]**.

TIP

For Q19, you should analyse the advantages and potential drawbacks to FBC from offshoring more output. You need to make an overall judgement as part of your reasoned conclusion.

Evaluation

- 19 Evaluate whether FBC should offshore a higher proportion of its total output.
20 Advise which location should be chosen for the new factory. Justify your answer.

EXAM-STYLE QUESTIONS

Decision-making questions

Special Sports Clothing (SSC)

SSC produces exclusive and expensive sports shirts and shorts for famous athletes. The products are also bought by wealthy fashion-conscious consumers who want to be seen in what SSC claims are the highest-quality and sportiest clothes on the planet. All SSC clothes are sold online. Consumers can design their own style of logo to be printed on shirts and shorts. SSC promises to make and despatch all orders within seven days. Over 60% of sales are to consumers in Country X, where the SSC factory is located, but this proportion is declining.

SSC clothing is made in a small factory on an industrial estate. Several of the other businesses on this estate supply SSC with important materials and services. The company directors relocated the business to the estate four months ago. The site has high rental costs. It is near the main city and close to a good transport network. SSC has difficulty in recruiting suitably experienced production workers. The managing director recently told her colleagues, 'I am not sure we made the right decision to locate here. Do the external economies of scale make up for the higher rental costs?'

SSC has grown considerably in recent years. Table 26.3 shows the rising output and changing unit cost of producing the most popular sports shirt.

The managing director of SSC aims for continued growth of the business. She thinks that globalisation has created more opportunities for international relocation. She is researching the possible benefits to SSC of relocating its factory to a country with much lower rental costs. Another option for SSC is to use outsourcing to manufacturers in other countries so some production would be made by other businesses.

Annual output	500 shirts	2 000 shirts	10 000 shirts
Unit cost of sports shirt	\$25	\$22.50	\$23.50

Table 26.3: Rising SSC annual output and the unit cost of the most popular sports shirt

CONTINUED

- 1 a Calculate the percentage change in unit cost as output increased from 500 shirts to 2000 shirts per year. [2]
b Calculate the percentage change in unit cost as output increased from 2000 shirts to 10 000 per year. [2]
- 2 Analyse **two** likely reasons for these changes in unit costs of production. [8]
- 3 Advise whether SSC should relocate its factory to another country. Justify your answer. [12]

Annotate this answer

This is a sample answer to decision-making Q3.

SSC has clearly expanded in recent years judging by the increased output of the most popular sports shirt. This seems to have caused some operations problems. Unit costs have increased. This suggests that the existing factory is too small to cope with increased output, leading to some diseconomies and inefficiencies. As SSC seems likely to grow further in future, a relocation to another factory is inevitable. The question is, should it be located in the same country and region, or in another country altogether?

It might be possible for SSC to build a larger factory on the existing industrial estate. This would give the company the continued benefit of its links with local suppliers. These suppliers of important materials will know SSC and its senior managers. They will be aware of the importance of quality and prompt delivery if SSC is to meet its seven-day promise for new orders. Relocating internationally will break these links and new relationships will have to be established with suppliers in another country. These could take time to build up, and the quality of materials and the reliability of suppliers might not be as good as is currently the case.

As SSC sells only online, the proximity of the market is not an issue in its location decision. All orders will have to be delivered to each customer wherever the factory is located. However, the reliability of local postal services and courier businesses will be an important qualitative factor in SSC's location decision.

Most sports clothing is manufactured in low-wage economies, even clothing which is sold under globally known brand names. This gives the sports clothing businesses a major cost saving and helps to make them competitive. If SSC's existing factory is in a higher-cost country, this will make SSC less competitive. This might not be a major problem if the brand image that results from selling to famous sports stars allows the company to charge premium prices for its shirts and shorts. However, the potential cost advantages from an international offshore location would increase SSC's profits unless quality is reduced. The issue of quality is crucial. If SSC cannot be completely sure that the quality of its products will be maintained by an international relocation, it should aim to expand its existing factory or build a large one nearby.

The final location decision cannot be made without more information. SSC's operations director needs to evaluate quantitative data about the existing site and possible international sites. Break-even analysis and profit comparisons need to be made. An assessment of cultural differences should be made. The potential impact on consumer demand of a switch to a low-cost country also needs to be assessed, as some athletes will not want to be associated with a brand that is seen to operate unethically.

After these quantitative and qualitative factors have been assessed, a final location decision can be made. On the basis of the evidence provided, I would advise that SSC tries to expand its existing factory and not relocate internationally. The company could use outsourcing if it reached full capacity. This would allow it to assess the potential quality of supplies of shirts and shorts from suppliers in another country. This evidence could be used in future to help SSC decide whether, eventually, it should relocate its operations internationally.

Your challenge

This is a good answer. It is well balanced between the existing location of SSC and an international relocation. There are frequent references to case study material. The points made are well analysed in terms of why they might influence a location decision. The justification for additional data before a final decision can be taken is well made. There is an overall conclusion with supported advice. There is no need to improve on this! Instead, identify the four key skills. You could annotate a copy or, in your notebook, make a brief note of what was written to demonstrate each skill. An annotated version of this answer is available online – but mark this copy first.

> Chapter 27

Quality management

LEARNING INTENTIONS

In this chapter you will:

- analyse the concept of quality and the importance of quality
- analyse the difference between quality control and quality assurance
- analyse the importance of businesses establishing quality-assurance systems
- evaluate the effectiveness of total quality management (TQM)
- evaluate the importance of benchmarking in quality management.

KEY TERMS

Benchmarking Internal customers Quality assurance Quality control Quality product
Quality standards Total quality management (TQM) Zero defects

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- the meaning and importance of quality
- the contrasting approaches to achieving quality products
- how benchmarking aids quality management.

- 1 What is meant by the term ‘quality product’?
- 2 Explain **two** benefits to a business of producing a product that meets customer expectations.
- 3 Explain how poor quality might reduce the competitiveness of a business.
- 4 Explain the difference between quality control and quality assurance.
- 5 Explain the term ‘total quality management’.
- 6 What does zero defects mean?
- 7 Explain **one** purpose of benchmarking.
- 8 Identify **one** possible limitation of benchmarking.

Application

Excel Aircraft Components (EAC)

EAC manufactures components used in the aircraft industry. Recently, demand for its products reached an all-time high. As output increased and capacity utilisation approached 100%, some significant problems started to occur within the EAC factory. These were:

- increasing numbers of faulty products being rejected by quality inspectors
- delays in production caused by poor-quality materials bought in from some suppliers
- increased complaints from employees, who were being asked to work harder. They were not involved in solving quality problems that could make production more effective.

The CEO told other directors, ‘Unless our employees in all departments work harder to solve these problems, we will have to make clear that the consequence will be the loss of their jobs.’

The operations director replied, ‘I have been suggesting for some time now that we need to adopt total quality management. This change will require some investment in training as well as a different style of leadership.’

- 9 Explain **two** reasons why the consequences of low quality are becoming more serious.

WORKED EXAMPLE FOR Q9

One reason

Low-quality materials from some suppliers lead to quality problems in the finished product **[K/Ap]**. When the factory is operating at full capacity, there will be production delays if output has to be stopped because of low-quality materials **[Ap]**.

TIP

When answering Q11 you should make a clear distinction between these two approaches to managing quality before analysing the benefits and limitations of them.

- 10 Explain **two** possible links between low employee motivation and the problems that EAC’s operations department is experiencing.
- 11 Does EAC seem to be using quality control or quality assurance? Explain your answer.

Analysis

- 12 Analyse **two** disadvantages of EAC not adopting the quality assurance approach.

WORKED EXAMPLE FOR Q12

One disadvantage

In focusing on quality control, EAC employs quality control inspectors **[K]**. There has been an increase in the number of faulty products identified by these inspectors **[Ap]**. As employees are not held responsible for quality and there appear to be no quality assurance standards, the cost of increased numbers of faulty products is rising **[An]**. Reworking faulty products will raise costs for EAC and make it less competitive **[An+]**.

Evaluation

13 Evaluate whether total quality management would be appropriate for EAC.

EXAM-STYLE QUESTIONS

Decision-making questions

Resort Spa Hotels (RSH)

RSH operates 30 luxury hotels. Managing the quality of customer service at RSH used to be based on quality control checks by supervisors. For example, the head of housekeeping used to check a sample of rooms that had been cleaned, the catering manager sampled recipes devised by the chefs, and secret clients monitored the length of time taken to check in and out of the hotels. Employee motivation was low and labour turnover high. Three years ago a new chief executive introduced total quality management (TQM). She insisted that all employees should have responsibility for the quality of customer service. Clear and measurable assurance standards were set for as many hotel activities as possible. Employees were encouraged to check their own performance against these. As this was combined with an effective performance-related pay scheme, customer complaints fell by 75%, employee absenteeism was halved and labour turnover reduced.

Employee training costs increased but total hotel costs have fallen as a result of TQM. The chief executive is now determined to make RSH much more efficient and improve its price competitiveness. In a recent benchmarking exercise, RSH compared well on cleanliness of rooms and customer retention. However, it had a higher level of wastage of food and drink than the best in the industry. RSH plans to undertake regular benchmarking on issues such as waste levels, customer retention rates and customer satisfaction levels.

- 1 Analyse how the introduction of TQM achieved the benefits outlined in the case study. [8]
- 2 Evaluate the importance of benchmarking in quality management for a business such as RSH. [12]

Improve this answer

This is a sample answer to decision-making Q2.

RSH is a tertiary sector business and quality is just as important as in manufacturing [Ap]. The hotel must meet customer expectations of customer service [K]. Failure to meet customer expectations will lead to low occupancy rates, poor customer retention and poor reviews on travel websites. Quality in a hotel means polite employees, clean rooms, good facilities and good food – all to the levels expected by hotel guests [K/Ap]. It is a very competitive industry and, if RSH does not satisfy guests, they will soon find other hotels to stay at [Ap]. So quality is vital to RSH if it is to remain competitive [An].

Your challenge

This is an incomplete answer. The content could be relevant to the question set but the answer has not referred to benchmarking at all. In addition, there is no attempt at evaluation. There are no arguments either for or against benchmarking exercises in this industry. The answer could have started with a definition of benchmarking, and this would have helped to keep the rest of the response well focused. There is no judgement at all, other than the sentence on the importance of quality. A better answer is available online – but write yours out first!

> Chapter 28

Operations strategy

LEARNING INTENTIONS

In this chapter you will:

- analyse the factors influencing operations decisions including information technology (IT) and artificial intelligence (AI)
- analyse the need for flexibility and process innovation
- evaluate the impact of enterprise resource planning (ERP)
- evaluate the techniques of lean production
- analyse the key elements of operations planning
- evaluate the usefulness of critical path analysis (CPA) and network diagrams in project management.

KEY TERMS

Cell production Critical path Critical path analysis (CPA) Dummy activities Earliest start time
Enterprise resource planning (ERP) Free float Kaizen Latest finish time Network diagram
Process innovation Simultaneous engineering Total float

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- flexibility, innovation and the role of IT and AI
- the concept of lean production and links to inventory control and capacity management
- techniques that businesses can use to help achieve lean production
- enterprise resource planning
- the use of critical path analysis and network diagrams in project planning.

- 1 Identify **one** aim of lean production.
- 2 How does simultaneous engineering save resources?
- 3 How can flexibility in production achieve greater efficiency?
- 4 Explain the term 'Kaizen'.
- 5 State **three** claimed benefits of lean production.
- 6 Identify **three** situations in which lean production might not be appropriate.
- 7 Explain **two** uses of artificial intelligence (AI) in operations management.
- 8 Explain the term 'enterprise resource planning' (ERP).
- 9 Explain **one** benefit of ERP.
- 10 Explain **one** potential limitation of ERP.
- 11 What **three** pieces of information do the nodes on a network diagram display?
- 12 State the formula for total float.

- 13 State the formula for free float.
- 14 Give **one** potential benefit of knowing the total float of an activity.
- 15 Define the term 'critical path'.
- 16 What is a dummy activity?
- 17 Explain **two** advantages of critical path analysis (CPA).
- 18 Explain **two** limitations of CPA.

Application

Maximum Electric Vehicles (MEV)

MEV manufactures a range of electric cars. The technology used in electric motors and battery packs is constantly changing. MEV aims to develop and manufacture a new model every three years, but the CEO is keen to reduce this to two years to become more competitive. Simultaneous engineering is increasingly being used within MEV. The company researches innovative processes to make production as efficient as the best in the industry.

Operational flexibility is an important objective. The CEO claims that MEV can vary its production volumes, delivery times and car specifications more quickly than any other similar manufacturers. This gives an important competitive advantage as more rivals join the industry. MEV receives most of its orders for vehicles through its online dealership. It communicates directly with consumers about the different specifications they require. MEV boasts that no two vehicles leaving its factory are completely the same. Supply chain management is excellent and this is aided by enterprise resource planning (ERP). This is used to communicate with the 126 suppliers of parts and components.

Lean production has always been a feature of MEV's operations. Waste is minimised at all stages of production. Employees are involved in reducing waste through Kaizen groups. Team working is encouraged and cell production is used for making the most of the sub-assemblies of each vehicle. These assemblies are then finally put together by robotic machinery to give the highest standards of finished product.

- 19 Explain how lean production is achieved at MEV.
- 20 Explain **two** benefits to MEV of lean production.

WORKED EXAMPLE FOR Q20

One benefit

Lean production reduces waste in production to a minimum. This helps to reduce costs [K]. By reducing the waste of time in production or the waste of materials used, unit costs of making electric cars will fall [Ap]. This could be important to MEV as more rivals are entering the electric car market, helping to keep MEV competitive [Ap].

- 21 Explain **two** possible benefits to MEV of process innovations.

Analysis

- 22 Analyse how ERP helps MEV achieve efficient operations.
- 23 Analyse **two** benefits to MEV of very low rates of wastage.

24 Analyse the role of employees in achieving lean production within MEV.

WORKED EXAMPLE FOR Q24

Lean production requires the cooperation and involvement of employees. Cutting waste needs employees to help identify the causes and suggest improvements, as they are the people who actually produce the goods [K/An]. MEV's employees belong to Kaizen groups and they will be used to analyse operations problems [Ap]. As electric vehicles are quite a new technology the potential for reducing waste is probably quite significant [Ap]. Employees must accept the need for multi-skilling to ensure that cell production operates effectively in the manufacture of the different sub-assemblies [An+].

TIP

When answering Q25, you could evaluate your response by judging that the issues could be linked or related in some way. This will demonstrate that you understand some important links that exist in managing a business.

Evaluation

- 25 Evaluate whether operational flexibility is more important for MEV than achieving the lowest possible costs of production.
- 26 Evaluate whether all businesses should aim to develop and introduce process innovations.

EXAM-STYLE QUESTIONS

High Quality (HQ) – an online marketing strategy

HQ is a well-known chain of food supermarkets, owned and managed by one family. The business has a reputation for quality fresh food. In a recent What Shop? survey, HQ was one of the most expensive stores for an average customer's weekly shop.

HQ currently operates from 120 locations throughout the country. It is experiencing increasing competition from discount retailers and businesses that sell food and other household requirements online. Six months ago, the directors of HQ undertook detailed analysis of the company's current situation. A business consultant was commissioned to help the directors develop future business strategies. The consultant focused on adding further detail to the directors' SWOT analysis and on developing the company's core competencies.

Two months ago, the directors of HQ decided on a strategy of taking the business online as well as retaining most of the existing stores. HQ will launch a new website that will allow online ordering of all of the 8 000 different items found in one of the HQ supermarkets. Delivery within four hours is going to be promised by the company. Many new trucks will be needed and over 100 drivers will need to be recruited. The directors plan for the new website and transport team to be ready for a huge national launch of the project in six months' time. It is by far the largest IT project HQ has ever attempted. To reduce costs, the directors have decided that all development of the website and the online ordering system will be done in-house and not outsourced to specialist businesses. The schedule of the major activities is shown in Table 28.1.

Activity	Duration (weeks)	Preceding activities
A	2	–
B	5	A
C	9	A
D	3	A
E	4	D
F	3	B, C, E
G	1	F
H	3	G
I	7	F
J	3	H, I

Table 28.1: Major activities for the HQ online selling project

CONTINUED**Decision-making questions**

- 1 a i Draw the network diagram for the project. [6]
 ii Insert all ESTs and LFTs. [4]
 b Evaluate the usefulness of critical path analysis (CPA) in managing this project. [12]

Business strategy question

- 1 Evaluate whether the approaches to developing business strategy focused on by the consultant and the HQ directors were the most appropriate ones to use in this case. [20]

Annotate this answer

This is a sample answer to decision-making Q1b.

CPA is a planning technique that uses a network diagram of project activities. The critical path is made up of activities A, C, F, I and J. The length of this critical path is 24 weeks, which is just less than the target time of six months. This suggests that the project should be completed in time for the launch of the online selling of HQ products. If there is a delay in any of the critical activities, such as C for example, this might extend the completion time to over six months. In this case, more resources would need to be devoted to one of the later critical activities, such as I, to reduce the estimated duration. In this way, the completion time could be kept down to six months. It might be possible to switch some employee resources from one of the activities with a float time, such as H, to help complete I in less than the estimated duration. Reallocating resources in this way is a major benefit of CPA.

The CPA and the network diagram will help HQ complete this project on time. It shows the main activities, the logical relationship between them and the critical activities. These must be focused on by the project team within HQ to try to make sure that the durations are not exceeded. Using the diagram allows resources to be switched from non-critical to critical activities, as explained above.

The CPA and the diagram will not guarantee success of this project or its completion within six months, however. This is a one-off project, not undertaken by HQ before, and there might be considerable inaccuracies in the estimated durations. The project is also larger than anything HQ has attempted before, in terms of IT. It could be that the IT employees in the business are just not capable of managing such a complex project, and it might have been wiser to outsource this to IT specialists, even though this would have been more expensive.

On balance, I think there are too many uncertainties about this project and HQ's ability to manage it. Yes, the CP analysis and the network diagram will be useful in the ways analysed but only up to a point. What would be much more useful is a skilled externally appointed IT expert with knowledge of this type of project to help manage and see it through to completion within six months.

Your challenge

This time you have been provided with a really good answer! It demonstrates very good understanding of critical path analysis. The benefits and limitations of this technique have been well analysed in context. The answer has made a good attempt to evaluate the usefulness of this concept based on the arguments that have been analysed. There is no need to improve on this! Instead, identify the four key skills. You could annotate a copy or, in your notebook, make a brief note of what was written to demonstrate each skill. An annotated version of this answer is available online – but mark this copy first!

> Unit 5

Finance and accounting

> Chapter 29

Business finance

LEARNING INTENTIONS

In this chapter you will:

- analyse the importance of working capital to a business and how it is managed
- differentiate between capital expenditure and revenue expenditure
- analyse the different sources of long-term and short-term finance, both internal and external
- analyse the factors managers consider when taking a finance decision
- advise on and justify appropriate sources of finance for different business needs.

KEY TERMS

Business plan Capital expenditure Crowd funding Debentures Factoring Hire purchase Leasing
Liquidation Liquidity Long-term loans Microfinance Overdraft Revenue expenditure Rights issue
Share (or equity) capital Start-up capital Working capital Venture capital

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- reasons why businesses need finance
 - capital expenditure and revenue expenditure
 - internal and external sources of finance
 - factors that influence the finance decision.
- 1 Identify **two** reasons why a new internet café will require finance.
 - 2 Define the term 'working capital'.
 - 3 How can working capital be used as a source of finance?
 - 4 Outline **two** ways in which trade receivables can be managed.
 - 5 Outline **two** ways in which trade payables can be managed.
 - 6 Explain the difference between capital expenditure and revenue expenditure.
 - 7 Why might a business be liquidated if it has no working capital?
 - 8 Explain the difference between a bank loan and an overdraft.
 - 9 Identify **one** advantage of leasing fixed assets.
 - 10 What is meant by the term 'rights issue'?
 - 11 Identify **two** ways in which a public limited company can sell additional shares.
 - 12 Is a sale of shares an example of internal or external finance?
 - 13 Define the term 'venture capital'.

- 14 Define the term 'microfinance'.
- 15 Give **one** advantage of microfinance schemes to business start-ups in low-income countries.
- 16 What is meant by the term 'crowd funding'?
- 17 Identify **one** advantage of crowd funding for a new business start-up.
- 18 Why is the size of existing borrowing important to a manager when considering taking out a further loan?
- 19 Why is factoring considered a short-term source of finance?
- 20 Explain the difference between hire purchase and leasing of equipment.
- 21 Identify **one** advantage to a business of receiving a government grant.
- 22 Identify **one** relationship between the legal structure of a business and its main sources of finance.

Application

Brightest and Best Cleaning (BBC)

Jason set up his home cleaning business, BBC, two years ago. He offers cleaning services to householders in his town and in the local area. Jason used his own savings to start up the business. He bought a cheap van and a large electric household floor cleaner. He uses the best cleaning products available as he wants to establish a reputation for being the 'brightest and best cleaning service for your home'.

Jason is a sole trader despite having expanded his business by employing three workers. One keeps the accounts and answers the telephone at the very small office and store area for cleaning products that Jason now rents near his home. The other two workers help Jason clean homes quickly. Jason makes a profit from his business and he wants to expand it further by buying a second van and renting a larger storeroom. He thinks an overdraft would be the best source of finance to use.

- 23 Outline **two** benefits to Jason of using his own savings to start up the business.
- 24 Why can Jason not sell shares to raise finance?
- 25 Outline, using examples from the case study, the difference between capital expenditure and revenue expenditure.

WORKED EXAMPLE FOR Q25

Capital expenditure is on assets that last for more than one year **[K]**. The vans and electric cleaners last for more than one year **[Ap]**.

Revenue expenditure is on costs or assets that last less than one year **[K]**. In this case, it includes cleaning products and cleaners' wages **[Ap]**.

- 26 Outline **one** disadvantage to Jason of using an overdraft to finance business expansion.
- 27 Suggest **two** sources of finance, other than an overdraft, that Jason could use to pay for the expansion of the business.
- 28 Are the sources you have suggested in Q27 internal or external sources?
- 29 Outline **one** disadvantage to Jason of each of the sources suggested in Q27.

Analysis

Brightest and Best Cleaning (BBC)

Jason expanded the business by using his savings from the first two years of operation and a small bank loan. BBC's cleaning services are very popular and some customers have asked Jason if he cleans offices too.

Jason has decided to expand into office cleaning. To offer a reliable service all year round, Jason has calculated that he will need three more vans, a small crane to access windows in high office buildings, more cleaning machines and additional employees. He has discussed his plans with a bank manager, who explained Jason's finance options. Some options would require Jason to change the legal structure of his business.

- 30 Analyse **two** benefits to Jason of selling shares in his business by converting it into a limited company.

WORKED EXAMPLE FOR Q30

One benefit

One benefit for Jason of selling shares is that capital will be raised [**K**], which is permanent and will not have to be repaid [**An**]. Finance raised from selling shares does not incur interest costs, which would be an additional business expense [**An**], reducing profit for the year and retained profit [**An+**]. BBC will not have to repay the amount raised, which could be a substantial amount for quite a small business [**Ap**].

- 31 Analyse **two** factors that might discourage Jason from taking out further loans to expand the business.
- 32 Analyse **two** reasons why a bank might be unwilling to give Jason a big loan without a detailed business plan for his expansion.

WORKED EXAMPLE FOR Q32

One reason

A big loan is a large risk for the bank [**K**]. The bank will want reassurance from a business plan that Jason has thought carefully about how much capital he needs and what he intends to spend it on, especially as BBC is still quite a small business [**An/Ap**]. If Jason is able to give detailed sales and profit forecasts he increases his chance of gaining a loan [**An+**].

TIP

For Q33, consider what Jason will need the finance for. Analyse the advantages and disadvantages of two sources of finance. You need to make a supported final judgement in your conclusion.

Evaluation

- 33 Advise Jason which sources of finance to use for the business expansion. Justify your answer.

EXAM-STYLE QUESTIONS

Short answer questions

- 1 Explain **one** source of finance available to a sole trader. [3]
- 2 Analyse, with examples, the difference between short- and long-term sources of finance. [5]

CONTINUED

Essay questions

- 1 a Analyse **two** ways in which available sources of finance are influenced by the form of business ownership. [8]
- b Evaluate the factors the directors of a public limited company should consider before taking decisions about additional long-term sources of finance. [12]

Data response questions

Terrafirma Transport (TT)

TT is a public limited company. It used to be owned by the Sarlat family and the family still owns 40% of the shares. TT operates daily bus routes in Country X and offers bus hire to groups and schools. It also operates employee transport for large companies that need their workers to arrive at work on time.

Several years ago, TT was in financial difficulties. Debts increased and it was owed huge sums by business customers who had taken longer to pay than expected. The directors arranged a sale of assets that were considered not to be essential to the company.

Since then, TT has been managed by Sami, the new chief executive officer. TT has just started to become profitable and now there are plans to expand. Sami wants to double the number of buses to be used mainly for employee transport contracts. Some buses will be leased and others bought as Sami has been offered a discounted price by one bus manufacturer. Two new TT depots will be needed, each with their own fuel and spare parts inventories. He has not yet decided whether to use share capital or take out an additional long-term loan to finance the expansion.

- a i Identify **one** benefit of the sale of assets. [1]
- ii Explain the term ‘share capital’. [3]
- b Explain **two** benefits to TT of leasing some of the additional buses. [6]
- c Analyse **two** reasons why TT will need to increase its working capital when it expands. [8]
- d Evaluate whether TT’s directors should take out a further loan or sell additional shares to finance TT’s expansion. [12]

Improve this answer

This is a sample answer to data response Qc.

Working capital is the finance needed for the day-to-day operation of the business [K]. It is used to buy inventories and pay bills. It is also needed for the materials used and wages paid in making products that are sold on credit, i.e. before customers pay for them [K].

An expanding business will usually need to hold more inventories of materials. These will need to be financed, increasing the need for working capital [An].

Secondly, expanding businesses need more customers [An]. Many customers demand credit terms before buying products, especially expensive ones. Additional working capital will be needed to make the products if there is a delay between selling them and being paid for them [An+].

Your challenge

See whether you can improve this answer. This is an accurate response, showing good understanding of working capital and why it is required. There is some analysis of the points made but the explanations are not applied to TT. In data response questions, it is important to refer to the business context and use relevant sections to apply your answer.

A better answer is available online – but write yours out first!

> Chapter 30

Forecasting and managing cash flows

LEARNING INTENTIONS

In this chapter you will:

- analyse the importance of cash to business
- differentiate between cash flow and profit
- analyse the purpose of cash-flow forecasts
- analyse simple cash-flow forecasts
- analyse the different causes of cash-flow problems
- evaluate different methods of improving cash flow.

KEY TERMS

Bad debt Cash flow Cash-flow forecast Cash inflow Cash outflow Closing cash balance Credit control
Insolvent Net cash flow Opening cash balance Overtrading

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- how cash flows differ from profit earned
- net cash flows, cash inflows and cash outflows
- the causes of cash-flow problems
- different ways to improve future cash-flow position.

- 1 What does the term 'net cash flow' mean?
- 2 Identify **two** reasons why the profit earned by a business in one month may not be the same as the net cash flow that month.
- 3 Why is cash more important than profit in the short run?
- 4 Identify **three** factors that can lead to cash flowing into a business.
- 5 Identify **three** factors that can result in cash outflows.
- 6 Explain the difference between opening cash balance and closing cash balance.
- 7 Identify **two** possible causes of cash-flow problems for a business.
- 8 Identify **two** ways a business could try to increase cash inflows.
- 9 Identify **two** ways a business could try to reduce cash outflows.
- 10 Outline **two** reasons why cash-flow forecasts could be unreliable.

Application

Café Fajita (CF)

CF specialises in Mexican food such as fajitas and tacos. It has been open three weeks and already has a number of regular customers. Some pay cash and some pay with credit cards. It takes at least three weeks for CF to receive payment from the credit card operating companies. Local businesses have also started using CF to take clients for lunch. Business customers are offered four weeks' credit.

The owners are two brothers with equal investments in the partnership. Ramos thinks his business is already making a profit. However, his brother, Antonio, who is responsible for accounts and administration, has just warned Ramos that the business is almost up to its overdraft limit. 'How can that be?' asked a surprised Ramos. 'We have doubled the number of customers since the first week.' Antonio sat Ramos down at the end of a busy day's trading and explained the cash-flow forecast shown in Table 30.1.

Ramos was amazed that CF was planning such a large overdraft. 'Have you included the big business lunch for AVA we are catering for in week 8?' asked Ramos. 'Yes, of course,' said Antonio. 'That should make us a good profit but it makes the cash flow worse, at least in that week. We have to pay cash on delivery to all of our suppliers as they do not give credit terms to start-up businesses like ours.'

Week	4	5	6	7	8	9
CASH IN:						
Cash customers	4	4.2	4.4	4.6	5	5.4
Payments from credit card companies	0	1	1.2	1.3	1.5	1.7
Business accounts paid	2	2.1	2.3	2.5	2.7	3
Total cash in	6	7.3	7.9	8.4	9.2	Z
CASH OUT:						
Payments to food suppliers	2	3.1	3.3	3.8	4	4.5
Wage payments	2	2	2	2.2	2.4	2.4
Equipment leasing costs	1	1	1	1	1	1
Rent and other fixed costs	1	1	1	4	1	2
Advertising/promotions	2			1		2
Total cash out	(8)	(7.1)	(7.3)	(12)	(8.4)	(11.9)
Net cash flow	(2)	0.2	0.6	X	0.8	(1.8)
Opening balance	0.5	(1.5)	(1.3)	(0.7)	(4.3)	(3.5)
Closing balance	(1.5)	(1.3)	(0.7)	(4.3)	Y	(5.3)

Table 30.1: Cash-flow forecast for CF, 4th to 9th week of trading (\$000)

- 11 Explain why cash-flow forecasting is important for CF.
- 12 In week 8, why would you expect the profit made to be higher than the net cash flow?
- 13 Calculate values X, Y and Z.

- 14 Explain **two** problems that CF might experience at the end of week 9.
- 15 Explain **two** reasons for the worrying trend in cash flow for CF.
- 16 Explain **two** ways in which monthly cash inflows could be increased.
- 17 Explain **two** ways in which monthly cash outflows could be reduced.

WORKED EXAMPLE FOR Q17

One way

Advertising and promotion costs could be reduced; e.g. in week 9, it is planned to spend \$2 000 [K/Ap]. This seems unnecessary as CF already has a good customer base [Ap].

Analysis

- 18 Analyse the limitations of the ways suggested to improve monthly cash inflows in answer to Q16.
- 19 Analyse the limitations of the ways suggested to reduce monthly cash outflows in answer to Q17.

WORKED EXAMPLE FOR Q19

By reducing advertising and promotion spending, CF could see sales fall in future weeks [K]. We do not know how many of the regular customers are attracted by promotions such as a free drink with a fajita [Ap]. Cutting advertising and promotion spending so early in the life of the business could put its future sales success at risk [An]. A short-term reduction in cash outflows in this way might lead to long-term damage to sales [An+].

Evaluation

- 20 Advise on the best ways for CF to avoid a cash-flow crisis by week 9. Justify your answer.
- 21 Evaluate the extent to which a reliable cash-flow forecast will help to ensure CF's future success.

TIP

For Q21, explain the benefits of cash-flow forecasting to CF, making reference to Table 30.1. Explain the limitations of cash-flow forecasting, e.g. it may be inaccurate. Consider other factors that will influence future success, such as how pleased the business customers are with the party for week 8. Conclude with an overall judgement.

EXAM-STYLE QUESTIONS

Short answer questions

- 1 Define the term 'cash-flow forecast'. [2]
- 2 Analyse **one** reason why a cash-flow forecast for a fashion clothing business might be inaccurate. [5]

CONTINUED

Essay questions

- 1 a Analyse **two** reasons why a profitable business can have cash-flow problems. [8]
 b Evaluate the usefulness of cash-flow forecasts to a new business start-up in social media. [12]

Data response questions

Henri's Computer Repairs (HCR)

Henri set up his business three years ago. He repairs all types of computers and tablets. He is surprised by how many business customers he has. HCR gives these customers three months to pay bills. When he started, Henri expected mainly private customers who would pay in cash for repairs to home computers. He employs five skilled computer engineers who are always very busy. He can trust them to fix any problem quickly and efficiently. He pays them high wages and a monthly bonus for completing repairs before the estimated time. HCR has other costs too. Each engineer needs a van and specialist testing equipment. Several of the vehicles and some of the test equipment need replacing, and Henri plans to buy these in two to three months' time. HCR started operating from Henri's garage but it now rents a new building on an industrial estate. Henri thinks this helps to promote the business. HCR also promotes itself via its website and an advertisement in a local business newspaper.

HCR's accountant has asked Henri to look at the latest cash-flow forecast. The accountant suggested that urgent action, such as use of debt factoring, is needed to prevent an overdraft becoming necessary. Henri suggested raising prices to cash customers by 20% in month 3 and reducing promotion by 50% in that month as two ways of improving the cash-flow position.

An extract of the cash-flow forecast is shown in Table 30.2.

	Month 1	Month 2	Month 3
CASH IN:			
Cash sales	5	5	6
Payments from trade receivables (creditors)	12	13	15
Total cash in	17	18	21
CASH OUT:			
Rent	3	3	3
Wages and bonuses	8	10	9
Computer spare parts	2	3	4
Promotion and other costs	1	1	3
Capital expenditure	0	15	6
Total cash out	(14)	(32)	Z
Net cash flow	3	Y	(4)
Opening balance	X	11	(3)
Closing balance	11	(3)	(7)

Table 30.2: Extract from HCR's cash flow forecast – next three months (\$000)

CONTINUED

- a i Identify **one** reason for debt factoring. [1]
 ii Explain the term 'net cash flow'. [3]
- b i Calculate the values of X, Y and Z. [3]
 ii Explain **one** problem for HCR if it reaches the end of month 3 with the closing balance indicated. [3]
- c Analyse the likely impact on HCR's cash flow position by the end of month 3 if the changes suggested by Henri are made. State any assumptions made. [8]
- d Evaluate which is the best way for HCR to improve its cash flow position. [12]

Improve this answer

This is a sample answer to essay Q1a.

Profit is revenue less costs. Net cash flow is cash in minus cash out **[K]**. In a business where all payments and revenue are in cash, profit and cash flow could be the same. In most businesses there will be some credit. Credit can be offered by suppliers when supplies arrive but do not have to be paid for immediately. Credit can be offered to customers when products are delivered but the customer is given time to pay **[K]**. So, a profit or loss might be made but the cash received will be different **[An]**.

Your challenge

See whether you can improve this answer. It starts well and there is evidence of good understanding of both profit and net cash flow. However, only one example is used and this is not well explained in sufficient analytical detail. The response does not make clear why, over a given time period, net cash flow will be different from profit. Also, the answer does not refer to any specific cash-flow problems. A better answer is available online – but write yours out first!

> Chapter 31

Costs

LEARNING INTENTIONS

In this chapter you will:

- analyse the need for cost information
- analyse types of costs: fixed, variable, direct and indirect
- analyse the differences between full costing and contribution costing
- apply and evaluate the technique of full costing
- apply and evaluate contribution costing to accept/reject special order decisions
- draw and interpret break-even charts and calculate the break-even point
- apply and evaluate break-even analysis in simple business decision-making situations.

KEY TERMS

Break-even point of production Contribution costing Contribution per unit Cost centre Direct costs
Fixed costs Full costing Indirect costs Marginal costs Margin of safety Profit centre Variable costs

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- cost classifications
 - why some costs vary with output and others do not
 - the key features of a break-even chart and calculation
 - what full costing means
 - what contribution costing means
 - the problems of accurately allocating fixed/overhead costs.
- 1 Identify **three** reasons why managers need accurate cost information.
 - 2 Explain the difference between direct and indirect costs.
 - 3 Explain the difference between fixed and variable costs.
 - 4 Explain whether a direct cost can also be a fixed cost.
 - 5 Explain the difference between marginal cost and average cost.
 - 6 What is meant by the break-even level of production?
 - 7 What will happen to the break-even point if fixed costs increase but all other costs and prices remain unchanged?
 - 8 Define the term 'safety margin' (or margin of safety).
 - 9 State the break-even formula.
 - 10 If the contribution per unit increases, what will happen to the break-even level of production?

- 11 Explain the difference between a cost centre and a profit centre.
- 12 Identify **one** reason why it is difficult to allocate overheads to products or cost centres.
- 13 Why would a business making and selling just one type of product have no problems in allocating overheads?
- 14 Identify **one** possible advantage of full costing.
- 15 What is meant by the term 'contribution cost'?
- 16 How can selling a product for less than its full cost add to the profit of a business?
- 17 Why might a business decide not to outsource production of a component even though it is being offered for a price less than the full cost of making it within the business?
- 18 Why might a business decide to continue to make a product that makes a loss when using full costing?

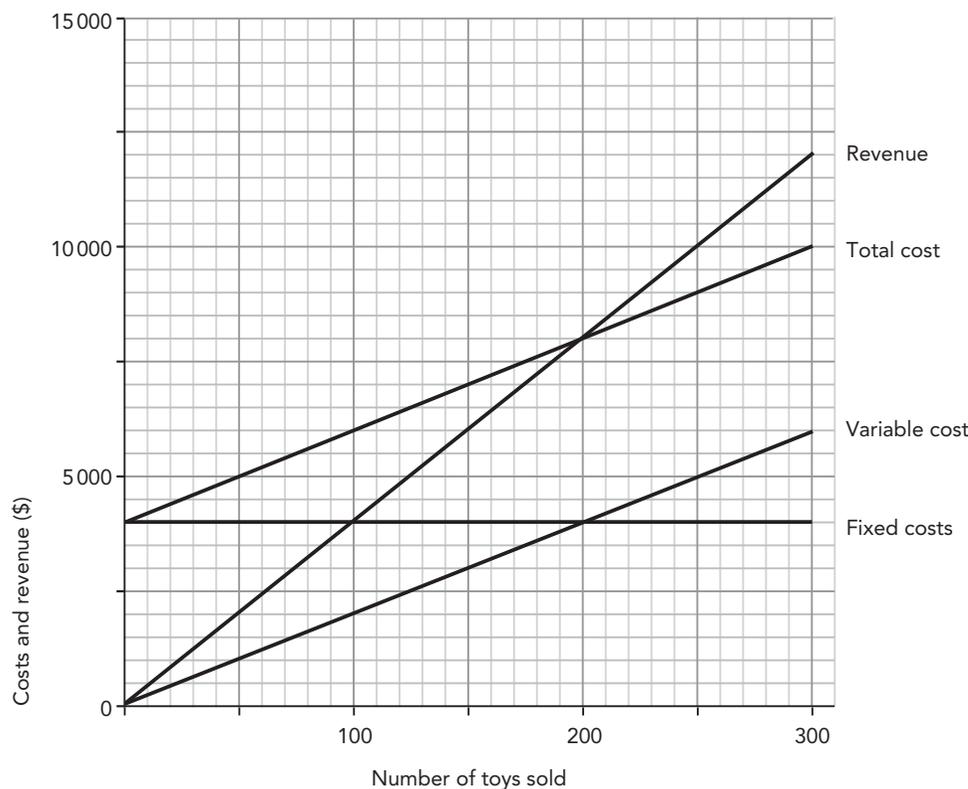


Figure 31.1: Monthly break-even chart for a manufacturer of playground equipment

- 19 Refer to Figure 31.1. Identify the number of units that need to be sold for this manufacturer to break even.
- 20 Refer to Figure 31.1. What would be the margin of safety if the manufacturer sold 280 toys in one month?
- 21 Refer to Figure 31.1. What would happen to the break-even level of sales if the price per item of equipment was increased?

Application

Seaport Hotel (SH)

SH is a luxury hotel with 300 bedrooms. The hotel has a large gymnasium and swimming pool that can be used by non-residents. There are several conference rooms, which are popular with local businesses for seminars, meetings and large conferences. There are separate divisions in the hotel, all headed by a sub-manager: accommodation, restaurants, conferences, gymnasium and swimming pool.

Leo, the general manager of the hotel, is worried about the low profitability of the conference division. He has asked the sub-manager of the conference division for some recent cost, price and demand data (see Table 31.1).

‘We could increase the daily price per delegate by 5% to improve profitability,’ said the conference manager. ‘Yes, or we could save 10% per delegate on cheaper food and drinks,’ replied Leo, ‘or increase our advertising fixed costs and try to increase the number of delegates by 20 each week. We need to take one of these decisions to improve the profitability of this division.’

Variable cost per conference delegate per day (food, drinks, etc.)	\$30
Weekly fixed costs of the conference division	\$21 000
Average number of delegates per week (attending for 1 day each)	320
Price charged to businesses per delegate per day	\$100

Table 31.1: Data for conference division

- 22 Identify **two** examples of direct costs for the conference division.
- 23 Are the direct costs you have identified in Q22 also variable costs? Explain your answer.
- 24 Identify **two** examples of fixed costs for a hotel.
- 25 Calculate the total weekly cost of the conference division if there are 350 delegates attending for one day each.
- 26 Calculate the average cost at this output level.
- 27 Calculate the break-even number of delegates each week (attending for one day).

WORKED EXAMPLE FOR Q27

Break-even = fixed costs ÷ contribution per unit = \$21 000 ÷ (\$100 – \$30) =
300 delegates per week (for one day each)

- 28 Calculate the break-even number of delegates following Leo’s proposed price increase.
- 29 Explain the impact of higher prices on the break-even point and the margin of safety.

Analysis

- 30 Analyse **two** ways in which the conference manager could use the cost information provided.
- 31 Analyse **two** reasons why the production manager would find it useful to understand the difference between fixed and variable costs.
- 32 Analyse **two** limitations to break-even analysis in this case.

WORKED EXAMPLE FOR Q32

One limitation

One limitation in this case is that the variable cost line is a straight line because the cost of \$30 per delegate for food and drink is constant **[K/Ap]**. It might be possible, with a larger number of delegates, to obtain economies of bulk purchasing, in which case the variable cost line would not be of a constant gradient and neither would the total cost line **[An]**. This would reduce the number of delegates needed to break even **[An+]**.

- 33 Analyse why the marginal cost of providing services to an additional delegate would be less than the average cost.

Evaluation

- 34 Advise, using break-even analysis, which decision should be taken for improving the profitability of the conference division. Justify your answer.

TIP

For Q34, analyse the impact of the two different decisions that could be taken by calculating break-even point, weekly profit and safety margin. Using your results, advise which decision to take, identifying the limitations of break-even analysis at the same time.

EXAM-STYLE QUESTIONS

Short answer questions

- 1 Analyse the difference between variable cost and fixed cost for a petrol station, giving an example of each. [3]
- 2 Analyse **one** benefit to a production manager of using break-even charts. [5]

Essay questions

- 1 a Analyse **two** reasons why it is important for a business that makes several products to differentiate between direct and indirect costs. [8]
- b Evaluate the usefulness of break-even analysis to a retail business that operates several shops. [12]

CONTINUED

Data response questions

Special TVs (STV)

STV makes some of the largest televisions on the market. The business has a reputation for excellent quality products and innovative design and engineering. The STV brand and associated logo are well recognised in customer research. The business currently operates at 80% of capacity. STV is profitable, but the newly appointed CEO wants to drive down costs and maintain quality. She aims to use retained earnings to finance additional R&D to keep STV as brand leader.

She has identified the TV speaker department as a potential area of the factory's output that could be outsourced to save on costs. The space created could be used for the CEO's proposed new home cinema screen project. The CEO has obtained an offer from a foreign company with electronics experience to supply STV with TV speakers of the same specification as those made in-house. The cost per speaker would be \$34. She wants to compare this with the cost of STV-produced speakers. See Table 31.2.

STV's marketing director has been asked by HiQRetail plc to supply 200 STV products each month. HiQRetail wants the TV frame to be redesigned slightly and the products rebranded with its own name and logo. It is trying to become better known as an own-brand retailer of quality electronic products. The retail company has offered to pay \$900 per TV. In discussion with HiQRetail, STV's marketing director discovered that the retailer was also in negotiation with another manufacturer of large TVs. The marketing director promised to give HiQRetail a reply within one week after the possible contract had been discussed at the next STV board meeting. Table 31.3 shows the data that the marketing director wanted to discuss at that meeting.

	STV speaker production
Direct labour cost per unit	\$14
Direct material cost per unit	\$18
Indirect cost per unit, based on output level of 800 speakers per month	\$12

Table 31.2: STV speaker production costs

Direct labour cost per unit	\$320
Direct material cost per unit	\$240
Average cost per unit of making design changes	\$25
Indirect (overhead) cost per unit, based on current output level of 800 TVs per month	\$400

Table 31.3: Cost of producing TVs for HiQRetail

- a i Identify **one** example of an indirect cost. [1]
- ii Explain the term 'direct labour cost'. [3]
- b i Calculate the impact on STV's profit if it accepts the outsourcing offer, stating the assumptions made. [3]
- ii Calculate the impact on STV's profit if it accepts the offer from the retailer. [3]
- c Analyse **two** factors STV should consider when deciding whether to accept the outsourcing offer. Use your answer to Qbi and other information in your answer. [8]
- d Advise the directors whether the contract with the retailer should be accepted. Use your answer to Qbii and other information to justify your answer. [12]

CONTINUED**Annotate this answer**

This is a sample answer to data response Qd.

The contribution per TV as shown in my answer to Qbii is \$315 if this order is accepted. This is because the price being offered, \$900, is greater than the total direct cost of making each TV, excluding any special costs for this order. The retailer wants a slight redesign and new brand names put on the TVs. The cost of this is a direct cost but we do not know how much it will be. In addition, we do not know who will pay the delivery costs from STV to the retailer. This is another direct cost and it will reduce the contribution per TV of \$315. Assuming these additional direct costs per TV are less than \$315, the total order should make a positive contribution.

Without these extra direct costs, it would make STV a monthly contribution of $\$315 \times 200 = \63000 . This contribution would add to STV's profit as the indirect or overheads costs will have to be paid anyway. STV should have the capacity to produce these additional TVs as it is only operating at 80% of total capacity. This order will help to secure workers' jobs and will prevent the retailer obtaining the TVs it wants from a competing business. So it appears that this will be a profitable order for STV and it should be accepted.

However, there are other factors to consider. The retailer's TVs might take sales away from STV's existing retailers. STV might make a bigger contribution from existing retailers than it does from HiQRetail. So, if demand for existing STV TVs falls because HiQRetail is now stocking its own branded STV products, STV's overall profit could fall. Another factor is how other retailers might react. If they discover that HiQRetail has a special deal, they might demand one too. If not, they might stock STV's competitors' products. This would lead to an overall fall in STV's sales.

There is not enough information to make a definite decision but on balance the orders should be accepted. If HiQRetail bought TVs from a competitor, this would also reduce STV's sales so it would be better if the retailer bought STV's products. This is why I advise that the special order is accepted, and it might lead to further orders from this new customer.

Your challenge

This is an effective answer, showing good understanding and analysis. There is good use of the data provided and the answer to Qbii. The answer is well applied to the business context. A balance of points is made and there is a supported overall conclusion and judgement. There is no need to improve on this! Instead, identify the four key skills. You could annotate a copy or, in your notebook, make a brief note of what was written to demonstrate each skill. An annotated version of this answer is available online – but mark this copy first!

> Chapter 32

Budgets

LEARNING INTENTIONS

In this chapter you will:

- analyse why financial planning is important
- analyse the benefits of setting budgets
- examine the importance of types of budgeting: incremental, zero and flexible
- analyse the potential limitations of budgeting
- use variance analysis to assess adverse and favourable variances from budgets.

KEY TERMS

Adverse variance Budget Budget holder Delegated budgets Favourable variance Flexible budgeting
Incremental budgeting Variance analysis Zero budgeting

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- what budgets are and how budgeting aids business control and monitoring
 - different ways in which budgets can be set
 - how budgets and actual performance are compared using variance analysis.
- 1 Explain the difference between a budget and a forecast.
 - 2 Give **one** reason why a new start-up business should set budgets.
 - 3 Why might there be a benefit in asking the budget holder to be involved in setting budgets?
 - 4 State **one** problem that might result from all departments being able to set their own budgets independently of each other.
 - 5 How do businesses allocate resources?
 - 6 How can budgets help to control and monitor a business?
 - 7 Explain the difference between zero budgets and flexible budgets.
 - 8 Does an adverse variance mean that profit is higher or lower than budgeted?
 - 9 Identify **one** possible cause of a favourable variable cost variance.
 - 10 Identify **one** possible cause of an adverse fixed cost variance.
 - 11 Identify **one** possible reason for a favourable revenue variance.

Application

Greybridge College (GC)

GC offers a range of courses to students from the age of 16. Many of its students are adults who want the chance to further their education. GC is organised into subject departments. Each department is given an annual budget containing details of the expected revenue, direct costs and allocated overheads for the next 12 months. The principal of GC sets these budgets based mainly on the performance of each department over the previous year. Some adjustment is made for inflation and for changes in the popularity of certain subjects. Heads of department are expected to meet these budget targets and are held to account if they do not.

Some departments have set higher prices for their courses than others. Those departments that have to work with small groups or require a lot of equipment or expensive materials are expected to charge more than those departments that have mainly classroom-based subjects with the potential to teach large classes. The budget for the Science department for the 12 months just ended is shown in Table 32.1. The actual outcomes are also shown.

	Budget	Actual
Revenue	528	505
Direct labour cost	335	346
Direct material cost	73	70
Allocated overheads	45	48

Table 32.1: Science department budget and actual outcomes for the last 12 months (\$000)

- 12 Calculate the variances for the last 12 months.
- 13 Indicate whether the variances are favourable or adverse.

WORKED EXAMPLE FOR Q13

One variance

The revenue variance is (\$23 000), which is adverse as it has the effect of reducing the contribution/profit made by this department **[K/Ap]**.

- 14 Suggest **one** reason for the revenue variance.
- 15 Suggest **one** reason for the direct materials variance.
- 16 Suggest **one** reason for the labour direct cost variance.
- 17 Outline **two** benefits to GC of setting budgets.
- 18 Does GC appear to use incremental budgeting or zero budgeting? Explain your answer.

Analysis

- 19 Analyse the limitations of the budgeting process at GC.
- 20 Analyse **one** benefit to GC of using zero budgeting.

WORKED EXAMPLE FOR Q20

Zero budgeting means starting from zero and explaining or justifying the budgets for the next future time period [K]. This could help GC as last year's budget might not be a good basis for setting budgets for the next year. For example, if a new Technology department has opened within GC, then this could take students away from Science, so it would be misleading to just base budgets on last year's figures [Ap/An]. It would be more accurate to assess, from the new situation, what the demand for and needs of the Science department are now likely to be. Its performance could be monitored more accurately [An+].

- 21 Analyse **one** benefit to GC of using delegated budgeting.

Evaluation

- 22 Advise on what action GC could take to reduce the chances of adverse variances in future. Justify your answer.
- 23 Evaluate the improvements GC could make to improve the budgeting process.

TIP

For Q23, assess the problems with the current GC budgeting system. Analyse how changes might improve it (e.g. consider zero or flexible budgets and head of department involvement in setting budgets). Finally, make a clear judgement in your conclusion.

EXAM-STYLE QUESTIONS

Short answer questions

- 1 Explain **one** purpose of budgeting. [3]
- 2 Analyse **one** benefit to a new school of having a budgeting system. [5]

Essay questions

- 1 a Analyse **two** benefits of giving managers some control over budget setting. [8]
 b Evaluate whether budgets for a retail store should be fixed for a 12-month period. [12]

Data response questions

Best Supermarket (BS)

BS operates a large out-of-town supermarket. It sells fresh and frozen food, drinks, children's clothes and kitchen tools. It is owned and managed by the Best family. Ros, the current managing director, is proud of her employees. Most have been with the business for many years and they like Ros's laissez-faire leadership style, which gives them a lot of freedom and responsibility.

Despite the good employer–employee relationship, last year Ros had major concerns about BS. Revenue and profits had fallen for each of the last three years. 'I can tell from the accounts that we are not doing as well as a few years ago, but the accounts do not tell me why or which departments are producing disappointing results,' she told family members.

'I think we need a clearer set of targets for each department,' said Joe, her son, who had just taken Business A Level. 'But I don't set targets,' said Ros, 'as I assume that the employees know we are trying to sell more each year.'

CONTINUED

Joe suggested setting clear budgets for each of the departments of the shop. ‘You could treat them like mini businesses with their own revenue, cost and profit targets,’ he said.

That was last year. Since then Ros and Joe have worked together to give each department monthly budgets. These are incremental budgets. They are compared with actual results, and variances are calculated and discussed each month with the manager of each department. An example for the frozen food department is shown in Table 32.2.

When these data were discussed, the manager of the department was surprised that Ros and Joe had not taken several factors into account. ‘When you set the budget for last month, didn’t you know that we had planned a maintenance programme for the freezers, which meant shutting some of them down for a week? This reduced the number of items that were available on display. The labour cost was higher because of the maintenance costs. One new range of frozen ready meals sold very well last month but this did not show up in your budget because there is just one figure for the whole department. I think you just take the previous month’s figures and add a bit on, which I don’t think is the right way to budget for this business.’

	Budget	Actual
Revenue	13	10
Direct labour cost	5	6
Direct material cost	3	2
Allocated overheads	2	2

Table 32.2: Budget and actual data for the frozen food department for last month (\$000)

- a i Identify **one** feature of an incremental budget. [1]
 ii Explain the term ‘variances’. [3]
 b i Calculate the profit variance from Table 32.2. [3]
 ii Explain the factor that contributed most to profit being below budget. [3]
 c Analyse **two** benefits to BS of setting monthly departmental budgets. [8]
 d Evaluate how budgeting within BS could be made more effective. [12]

Annotate this answer

This is a sample answer to data response Qd.

BS now has a system of budgeting which is better than not having budgets at all. However, several improvements could be made to ensure the budgets are even more effective at measuring and monitoring performance. Ros and Joe do not seem to involve the departmental managers when setting budgets. They seem to decide on the budgets and just hand them out to each department as targets to be met. Having targets can be beneficial as it gives a clear focus to each department to work towards. However, if it is thought that targets are very difficult or impossible to achieve, they just demotivate. This seems to be the case at BS. According to the frozen food department manager, it was going to be impossible to meet the revenue target for last month because of the planned maintenance programme for the freezers. If the manager had been consulted and had participated in the budget setting, the targets could have been more realistic and more motivating.

CONTINUED

Similarly, if Ros and Joe had bothered to ask, they would have found out that labour costs were going to be higher last month due to maintenance costs for the freezers, which are clearly a direct cost as they do not apply to any other department. It seems unreasonable to criticise the frozen food manager and his department for not meeting a profit target when two factors could have been discussed with Joe and Ros before the budget was set.

Perhaps the most important change that should be made with the BS budgeting system is to encourage participation with managers in setting these monthly targets. The managers and their departments will then be much more motivated in trying to achieve them as well as the involvement leading to much more realistic budgets to start with.

Other changes that would make budgeting at BS more effective would be to break them down into smaller units. For example, having one big budget for frozen food is less helpful than having budgets for each major range of frozen foods – such as meat, pizzas, vegetables and so on. This would allow much more accurate monitoring of the sales performance of each type of frozen food and corrective action could be directed to the range of food that was underperforming. This would save managers time by directing their attention to the range of products that are underperforming.

The other main change that should be made is the use of zero budgeting for some products rather than taking last month's figure and adding some on, as seems to have been happening. This means that the existing budgets will not take into account any increase in sales from the new ranges being introduced in the shop. It also means that the monthly budgets will ignore any seasonal effects, such as more frozen food being bought by consumers in the winter when fewer fresh products are available. Again, participation by each departmental manager in the budget-setting process would allow these seasonal variations to be reflected in the budgets. This suggests that involvement and participation in the setting of budgets is the key improvement that BS should make. This change should be easy to make at BS because the employees seem loyal and are well respected by senior managers, so the introduction of participation should be easy to achieve.

Your challenge

This is a good answer that displays very good understanding of budgets. The points made are well explained and analysed. This means that the ways of making budgeting more effective are explained in detail. The answer is clearly rooted in the case. It contains evaluative comments throughout so effective judgement is shown. There is no need to improve on this! Instead, identify the four key skills. You could annotate a copy or, in your notebook, make a brief note of what was written to demonstrate each skill. An annotated version of this answer is available online – but mark this copy first!

> Chapter 33

Financial statements

LEARNING INTENTIONS

In this chapter you will:

- analyse the need for businesses to keep accounts
- analyse the main components of a statement of profit or loss (income statement)
- analyse the main components of a statement of financial position
- evaluate the importance of inventory valuation
- evaluate the importance of depreciation.

KEY TERMS

Asset Cost of sales Current assets Current liabilities Depreciation Dividends Expenses Gross profit
High-quality profit Intangible assets Intellectual capital or property Liability Low-quality profit Net book value
Net current assets Net realisable value Non-current assets Non-current liabilities Profit for the year (profit after tax)
Profit from operations (operating profit) Reserves Retained earnings Revenue Share capital Shareholders' equity
Statement of financial position Statement of profit or loss Straight line depreciation Trade accounts receivables (debtors)
Trade accounts payable (creditors)

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- the meaning of different types of assets and liabilities
- the structure of the main financial statements
- inventory valuation
- straight line depreciation.

- 1 Identify **three** reasons why managers need to keep accurate accounting records.
- 2 Define the term 'cost of sales'.
- 3 What is the key difference between gross profit and operating profit?
- 4 If expenses are deducted from gross profit, what is the figure obtained called?
- 5 All other things remaining constant, how would an increase in dividends impact on retained earnings? Explain your answer.
- 6 Which of the financial statements records the value of a business and the shareholders' equity at the end of the financial year?
- 7 Using examples, explain the difference between an asset and a liability.
- 8 Using examples, explain the difference between a tangible non-current asset and an intangible asset.
- 9 Using examples, explain the difference between current assets and non-current assets.

- 10 How is the value of net assets calculated?
- 11 Define the term 'retained earnings'.
- 12 Is trade accounts payable an example of an asset or a liability?
- 13 Give **one** example of a non-current liability.
- 14 Give **one** example of a current liability.
- 15 Identify **two** items usually recorded in shareholders' equity.
- 16 Explain the term 'depreciation of non-current assets'.
- 17 Explain **two** reasons why many non-current assets depreciate in value.
- 18 State the formula for annual straight line depreciation.
- 19 Other things remaining unchanged, what happens to annual depreciation if the expected useful life of a non-current asset is reduced?
- 20 What happens to the profit of a business when depreciation is included in the accounts?
- 21 How does depreciation affect the net asset value of non-current assets?
- 22 Why would profit be recorded inaccurately if depreciation was not applied to a non-current asset but the cost of it was recorded a) when it was first bought; b) when it was disposed of?
- 23 How does a lower valuation of inventories, which have been held for over a year, affect the published accounts of a business?
- 24 Explain the term 'net realisable value'.
- 25 Explain the term 'reserves' on a statement of financial position.

Application

Hurtwood Computing (HC)

HC is a limited company that retails computer hardware and software. It operates two large retail shops. Its latest statement of profit or loss is almost ready to be published and is summarised in Table 33.1.

Several days before the statement of profit or loss was published, an accountant in the finance department identified two pieces of information that had not been included. There is still time to make amendments before the accounts are published.

Firstly, a new truck had been purchased at the start of the financial year. The cost of this had not been recorded on the accounts. HC depreciates vehicles over an estimated useful life of four years. The truck is expected to be worth 20% of its purchase price in five years' time. It cost HC \$40 000.

Secondly, one brand of tablet computer has sold less well than expected. 500 units of this tablet remain in inventory even though they were purchased by HC over six months ago. They were bought for \$120 each but have been replaced by more advanced models. HC was planning to retail them for \$160 each. However, the marketing director thinks they might have to be sold at a 75% discount on this price. 'No one wants last year's model of tablet,' he explained to HC's CEO.

	\$000
Revenue	1 500
Cost of sales	800
Gross profit	X
Expenses (including depreciation)	400
Operating profit	Y
Tax (@40%)	120
Profit for the year	180
Dividends	Z
Retained earnings	100

Table 33.1: Summary of HC's latest statement of profit or loss

- 26 Calculate the missing values for X, Y and Z.
 27 Calculate the annual depreciation of the new truck.

WORKED EXAMPLE FOR Q27

New truck: annual straight line depreciation = (purchase price – residual value) ÷ length of useful life
 = (40 000 – 8 000) ÷ 4 = \$8 000

- 28 Amend the statement of profit or loss showing the annual depreciation of this truck.
 29 Explain the different profit figures on this statement of profit or loss and the original one shown in Table 33.1.
 30 Recalculate the cost of sales based on the new net realisable value for the inventory of the tablet computers held for more than six months.
 31 Amend the statement of profit or loss in Table 33.1 showing both the depreciation amendment and the net realisable value amendment.

Analysis

- 32 Analyse **two** benefits to HC of accurate recording of depreciation.
 33 Analyse **one** benefit to HC of accurate recording of net realisable values (NRV) for inventories.

WORKED EXAMPLE FOR Q33

If the original purchase price of these tablet computers had been used on HC's published accounts, this would have been higher than the NRV [K] by \$80 per unit [Ap]. This would have led to the cost of sales being too low, tax paid too high and annual recorded profit for the year too high [An]. This higher profit figure could mislead stakeholders into believing the business is performing better than it actually is and could lead to the share price being overvalued. Once the tablets are sold, a loss would have to be recorded on them, surprising stakeholders and possibly resulting in a lower share price [An+].

- 34 Analyse the relationships between the two main published accounts when non-current assets are depreciated.

Evaluation

- 35 Evaluate the view that the valuation of HC's assets can never be entirely accurate, so the published accounts should not be relied upon by stakeholders.

TIP

Your answer for Q35 should explain how current and non-current assets should be recorded. Analyse the problems of accurate valuation. You should evaluate whether stakeholders can rely on published accounts based on these points.

EXAM-STYLE QUESTIONS

Decision-making questions

Park Bay Printers (PBP)

PBP is a public limited company. It is one of the largest newspaper and book printers in the country. It is a successful business and two attempts have been made to take it over in recent years. These failed because the shareholders trust PBP directors to deliver high dividends each year. The PBP share price has risen in recent years. PBP is based in a large city centre site that it purchased 30 years ago. The company uses a special colour-printing process that it patented several years ago.

PBP has just purchased a large digitally controlled printing press that will save on labour costs. The purchase price of the press was \$5 million. The machine it replaces lasted for 25 years but the CEO of PBP has explained to the directors that 'with the rapid pace of technological change, we cannot expect this new press to still be economically viable after about five years. It could be worth only \$0.5m at the end of its economically useful life.'

The owners of a rival printing business, HZP, are studying PBP's latest accounts. A summary from the statement of financial position is shown in Table 33.2. HZP's main shareholder said, 'I think this business is undervaluing its non-current assets. If we put in a takeover bid for its shares above their current price, I believe we could still be buying up the company cheaply as it has so much goodwill.'

	\$m
Property	12
Equipment and vehicles	23
Intangible assets	1
Total assets	39
Retained earnings	20
Non-current liabilities (loans)	10
Total equity and liabilities	39

Table 33.2: Summary of PBP's latest statement of financial position

CONTINUED

- | | | |
|---|---|------|
| 1 | a Calculate annual depreciation for the new printing press. | [2] |
| | b Analyse two reasons why this annual amount might not, in fact, be accurate. | [8] |
| 2 | Analyse the impact the annual depreciation of non-current assets will have on both the statement of profit or loss and the statement of financial position. | [8] |
| 3 | Evaluate the importance to PBP of measuring the value of its non-current and current assets as accurately as possible. | [12] |

Improve this answer

This is a sample answer to decision-making Q3.

Non-current assets are those that are expected to be owned and used for more than one year. They include property, machinery and vehicles **[K]**. Current assets include trade receivables and inventories. The valuation of most of these assets can never be entirely accurate. How much is a plot of land or a building worth? The only way to find out is to sell these assets, which most businesses do not want to do. Therefore, estimates have to be made each year when the accounts are published. With PBP's site, bought 30 years ago, it would be really misleading if the original purchase price was still being used on the accounts **[Ap]**. The value has probably appreciated greatly, but the problem is by how much. Any estimate used on PBP's accounts might be inaccurate and HZP might have some property experts who believe that the site is worth more than PBP's accounts actually state.

Equipment and machinery depreciate. As the CEO said, with the pace of change, depreciation is now more difficult to predict. If assets such as a printing machine go out of date more quickly than expected, it might have to be replaced early and this means that the annual depreciation and net book value have been calculated inaccurately **[An]**.

Intangible assets are difficult to value. PBP has a patent on a printing process and it is not clear how this has been valued **[Ap]**. If it would cost a rival business more than \$1m to develop a similar process, then PBP has probably undervalued its intangible assets.

Current assets are also difficult to value accurately, especially inventories and debts which might turn out to be bad debts. For example, PBP might have some paper inventory that has been damaged by water, so how should this paper now be recorded on PBP's accounts? It would be misleading, perhaps, to record it as being valued at its original purchase price **[An]**.

The valuation of all of these assets obviously affects the total value of the business.

Your challenge

See whether you can improve this answer. It shows evidence of good understanding of the valuation of assets. In addition, there is some good application to the case study business. The answer demonstrates the skill of analysis in explaining the benefits of correct asset valuations. However, the consequences of inaccurate valuations of assets are not analysed in any detail. The answer also lacks detailed evaluation of the importance of accurate asset valuations. A better answer is available online – but write yours out first!

> Chapter 34

Analysis of published accounts

LEARNING INTENTIONS

In this chapter you will:

- calculate liquidity ratios and evaluate methods of improving liquidity
- calculate profitability ratios and evaluate methods of improving profitability
- calculate financial efficiency ratios and evaluate methods of improving financial efficiency
- calculate gearing ratios and evaluate methods of improving gearing
- calculate investor ratios and evaluate methods of improving returns to investors.

KEY TERMS

Acid test ratio Capital employed Current ratio Dividend Dividend cover ratio Dividend per share
Dividend yield ratio Earnings per share Gearing ratio Gross profit margin ratio Liquidity
Operating profit margin Price/earnings ratio Rate of inventory turnover Return on capital employed (RoCE)
Share price Trade payables turnover (days) Trade receivables turnover (days)

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- current and acid test ratios
- gross profit margin, operating profit margin and return on capital employed ratios
- trade receivables turnover, trade payables turnover, rate of inventory turnover ratios
- gearing ratio
- price/earnings, dividend yield and dividend cover ratios.

- 1 Explain what is meant by profitability.
- 2 Explain how capital employed is calculated.
- 3 State the formula for return on capital employed (RoCE).
- 4 Explain why the gross profit margin is always higher than the profit margin.
- 5 Explain **two** ways in which the operating profit margin can be improved.
- 6 Explain why the current ratio result is always higher than the acid test ratio result.
- 7 Identify **one** way in which a business could improve its acid test ratio result.
- 8 Explain **two** reasons why a business might record a lower return on capital employed (RoCE) this year than last year.
- 9 Why is a high rate of inventory turnover an indication of an efficient business?

- 10 What would a policy of using debt factors do to the trade receivables turnover?
- 11 Identify **two** reasons why the dividend yield ratio could increase.
- 12 What does a high dividend cover ratio indicate about the strategy of the management of that business?
- 13 State the formula for the price/earnings ratio.
- 14 Explain **two** reasons for a price/earnings ratio increase between two years.
- 15 Explain **one** way in which the rate of inventory turnover could be improved.
- 16 Why is a high gearing ratio claimed to be risky for the business?
- 17 Identify **one** way in which the gearing ratio could be reduced.

Application

Seaport Hotel (SH)

Leo wants to evaluate the profitability and liquidity of his hotel business. The economy is in recession and a large hotel group has just gone out of business. Other hotels are offering discounted prices to attract guests. Leo believes that SH is liquid and profitable enough to survive but he has asked the hotel's accountant for key financial data. They will then undertake ratio analysis to assess the hotel's profitability and liquidity. This data is shown in Table 34.1.

Leo has always paid suppliers very promptly. He thinks that this will encourage them to meet any urgent requests for further catering or hotel supplies. Many hotel guests are business clients. Their businesses can take up to two months to pay SH.

	2021	2020
Revenue	5	5.2
Cost of sales	4	3.8
Operating profit	0.2	0.6
Inventories	1	0.8
Cash in bank and hotel	0.1	0.6
Trade receivables	0.6	0.6
Current liabilities	2	1.6

Table 34.1: Key financial data for Seaport Hotel (\$m)

- 18 Calculate the gross profit margin for 2020.

WORKED EXAMPLE FOR Q18

Gross profit = revenue – cost of sales = \$1.4m

Gross profit margin (%) = (gross profit ÷ revenue) × 100 = (\$1.4m ÷ \$5.2m) × 100 = 26.9%

- 19 Calculate the gross profit margin for 2021.
- 20 Calculate the operating profit margin for 2020.

WORKED EXAMPLE FOR Q20

Operating profit margin (%) = (operating profit ÷ revenue) × 100 = (\$0.6m ÷ \$5.2m) × 100 = 11.5%

- 21 Calculate the operating profit margin for 2021.
- 22 Suggest **two** factors that might have caused the trends in these profit margin results.
- 23 Calculate the current ratio for 2020.

WORKED EXAMPLE FOR Q23

Current ratio = current assets (inventories + cash + trade receivables) ÷ current liabilities
= \$2m ÷ \$1.6m = 1.25:1

- 24 Calculate the current ratio for 2021.
- 25 Calculate the acid test ratio for 2020.

WORKED EXAMPLE FOR Q25

Acid test ratio = liquid assets ÷ current liabilities = \$1.2m ÷ \$1.6m = 0.75:1

- 26 Calculate the acid test ratio for 2021.
- 27 Suggest **two** factors that might have caused the trends in the liquidity ratios.

Analysis

- 28 Analyse **two** reasons for the declining profitability at SH.
- 29 Analyse **two** possible problems that might result from this decline in profitability.
- 30 Analyse **two** benefits to Leo of undertaking this ratio analysis.
- 31 Analyse **two** reasons for the changes in SH's liquidity.
- 32 Analyse **two** ways in which SH's liquidity could be improved.

Evaluation

- 33 Advise Leo on ways in which the liquidity of SH could be improved.
Justify your answer.
- 34 Advise Leo on ways in which the profitability of SH could be improved.
Justify your answer.

TIP

For Q32, you should include an analysis of the ways in which the value of current assets or liquid assets could be increased or current liabilities reduced.

EXAM-STYLE QUESTIONS

Decision-making questions

Sports Gear (SG)

SG manufactures fashionable sports shoes. They are bought mainly by consumers who want quality shoes for playing sports such as tennis and golf. Other consumers buy them as fashion accessories to match their designer clothes. SG sells only to exclusive sports or fashion retailers. It does not allow online purchases to be made. All of SG's sales to retailers are on credit, and it purchases all of its supplies, such as leather, on credit. SG's finance director is analysing the company's accounts using key ratios. She thinks that SG's financial performance is being badly affected by several factors:

- Increasing interest rates, which are reducing consumers' discretionary incomes.
- The failure of the latest design of sports shoe to reach sales targets. Output levels have not yet been cut to reflect these disappointing sales.
- Demands from retailers for longer credit periods.

The finance director started to calculate the important ratios. As she did so, she wondered whether it had been a good idea for SG to increase borrowing in 2021 to finance the purchase of land to build an extension to its main factory. This building work has not yet been started. Her thoughts also turned to how to improve the results for next year and whether a reduction in the rates of depreciation on non-current assets would be noticed by stakeholders.

	2021	2020
Revenue (for year) (\$m)	42	40
Operating profit (for year) (\$m)	6	7
Cost of sales (for year) (\$m)	21	19
Average inventories (\$m)	2	1
Non-current liabilities (as at 31/12) (\$m)	19	16
Capital employed (as at 31/12) (\$m)	38	35
Trade receivables (as at 31/12) (\$m)	4	3
Trade payables (as at 31/12) (\$m)	4	2
Dividend per share (\$)	2	2
Share price (31/12) (\$)	12	15
Earnings per share (\$)	3	4

Table 34.2: Selected financial data for SG

CONTINUED

- | | | |
|---|--|------|
| 1 | Analyse the profitability of SG, using appropriate ratios. | [8] |
| 2 | Analyse the gearing and financial efficiency of SG, using appropriate ratios. | [8] |
| 3 | Evaluate methods the management of SG could use to improve financial efficiency. | [12] |
| 4 | Evaluate methods the management of SG could use to improve profitability. | [12] |
| 5 | Evaluate whether shareholders in SG should consider selling their shares. | [12] |

Improve this answer

This is a sample answer to decision-making Q5.

Shareholders invest in companies to make a financial return **[K]**. This can either be through receiving dividends or from increases in the share price, or both **[K]**. The dividend per share has remained the same over the two years shown, at \$2. This is despite the operating profit falling **[Ap]**. This suggests that managers are keen to keep shareholders loyal to the company by paying the same dividends even when profit falls **[An]**. The dividend yield has actually increased from 13.3% to 16.6% but this is because the share price has fallen **[An]**.

The dividend yield is now higher than rates of interest in most countries, so shareholders seem to be getting a good return and should not sell their shares **[Ap/E]**.

The price/earnings ratio has risen from 2.6 to 4, so this is also good news for investors as it shows that earnings per share have fallen by more than the share price **[Ap/An]**. This suggests that investors still have confidence in SG for the future **[An]**. If investors thought that the company had a poor future, they would sell shares in SG and the share price would fall by more than it has. This would reduce the price/earnings ratio **[An]**. So, on balance, the shareholders in SG should not sell their shares **[E]**.

Your challenge

See whether you can improve this answer. It contains some accurate ratio calculations and some accurate analysis. There is an evaluation and final advice to shareholders. However, the arguments are all one-sided and there is no balance to the evaluation. Consider, in detail, some reasons why the shareholders should sell their shares before coming to an overall judgement. A better answer is available online – but write yours out first!

> Chapter 35

Investment appraisal

LEARNING INTENTIONS

In this chapter you will:

- explain what investment means and the need for appraising investment projects
- analyse the meaning, calculation and interpretation of the payback method of investment appraisal
- analyse the meaning, calculation and interpretation of the accounting rate of return (ARR) method of investment appraisal
- analyse the meaning, calculation and interpretation of the net present value (NPV) method of investment appraisal
- evaluate quantitative results and their impact on investment decisions
- evaluate qualitative factors and their impact on investment decisions
- compare investment appraisal methods, including their limitations.

KEY TERMS

Accounting rate of return (ARR) Average investment Criterion rates Forecasted net cash flow Investment appraisal
Net present value (NPV) Payback period

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- payback period
- average rate of return
- discounted cash flow and net present value (NPV).

- 1 What is meant by ‘the payback on this project is three years’?
- 2 Why is a quick payback often preferred by businesses?
- 3 Identify **one** limitation of the payback method of investment appraisal.
- 4 How is average investment for a project calculated?
- 5 What is meant by ‘the accounting rate of return (ARR) for this project is 13%’?
- 6 Why is a high ARR preferable to a low one?
- 7 Identify **one** limitation of the ARR method of investment appraisal.
- 8 What is meant by discounted cash flow?
- 9 What is meant by ‘the net present value (NPV) of this project is \$3.6 million’?
- 10 What would happen to this NPV if the discount rate was raised?
- 11 Identify **one** limitation of the NPV method of investment appraisal.
- 12 Identify **three** qualitative factors that might influence a business investment decision.

Application

Sunshine Boat Builders (SBB)

SBB makes luxury boats for the super-rich. Demand is currently very high for SBB boats. The directors are planning an expansion of the boatyard's manufacturing capacity. Half of the cost would be financed by long-term loans. The new boatyard has to be near the river for the easy launch of new boats. There is no room to expand on the existing site, so an additional location is being considered. The managing director prefers Site A, just three kilometres from the existing boatyard but in an area of great natural beauty. The operations manager prefers Site B. It is much cheaper as it is in a low-income country. The government of this country is keen to attract new industry. He comments, 'There is so much space for future expansion, the views of local residents will be ignored by the government and local workers are willing to learn new skills.'

The finance manager has estimated the net cash flows from these two alternative locations, as shown in Table 35.1. The leases on the two sites will be for four years and will have no residual value. When the managing director saw these figures, he was worried that the finance manager might not have considered transport and training costs. He asked the finance manager whether the forecasts had been adjusted for the extra risks involved in operating in another country.

Year ending	Site A	Site B
0	(20)	(12)
1	10	6
2	12	8
3	10	6
4	8	6

Table 35.1: Forecast net cash flows (\$m)

- 13 Calculate the payback for Site A.

WORKED EXAMPLE FOR Q13

1 year and $(10 \div 12) \times 12$ months = 1 year and 10 months

- 14 Calculate the payback for Site B.
 15 Explain why a quicker payback might be of benefit to SBB.
 16 Calculate the accounting rate of return (ARR) for Sites A and B.
 17 Explain why a business would generally prefer a project with a higher ARR.
 18 Using a rate of discount of 10% (as shown in Table 35.2), calculate the net present value (NPV) of these two sites.

Year	1	2	3	4
Discount factor at 10%	0.91	0.83	0.75	0.68

Table 35.2: Discount factors at 10%

Analysis

- 19 Analyse the payback for each site and the ARR results.
- 20 Analyse why SBB might consider the NPV results to be more important for the final decision than either payback or ARR.

WORKED EXAMPLE FOR Q20

NPV results take the time value of money into consideration [K]. This means that NPV does not only depend on *how much* future cash flows are but *when* they are received [K]. This is unlike ARR, which only depends on the amount of cash inflows compared to the cost of the project. The ARR ignores the fact that cash flows lose money in today's terms the longer into the future they are received [An]. Payback ignores the profit of an investment project and only considers when cash flows are received. In this case, Site B has a slightly quicker payback but a significantly higher ARR [Ap]. NPV combines both the size of cash flows and the timing of them to give the net value of an investment project in today's money value, so is more useful than both of the other techniques [An+].

TIP

For Q22, consider the likely accuracy of the forecasts, the relative importance of qualitative factors and which of the investment appraisal methods gives the most useful result. Justify any additional information you think might be useful.

Evaluation

- 21 Evaluate which site the managers of SBB should choose based on both quantitative results and qualitative information.
- 22 Evaluate whether the information provided and the investment appraisal results calculated provide sufficient data for the managers to be confident about the choice of site.

EXAM-STYLE QUESTIONS

Decision-making questions

So Cool Cosmetics (SCC)

SCC specialises in soaps, hand and body products, and perfumes made only from freshly picked, organic natural ingredients. SCC's main selling method is a TV shopping channel. There have been several times when demand was so high that SCC completely sold out of products. This keeps customers waiting for the production operations to catch up with demand.

The two partners who own SCC are considering an expansion of production capacity. Currently, most of the products are hand-mixed, using small-batch production, in large containers with basic mixing and bottling equipment. Labels are put on manually. The bottles and other containers are then packed by part-time employees ready for postage to customers.

The partners realise that this production method will have to change to meet demand. However, they disagree on the best alternative method. Sue wants to purchase Machine A, which would allow for flow production of the most popular products. It is fully automated and requires just one operator trained in IT. The machine labels and packages each container. This production process will need a continuous supply of raw materials.

Pat wants to buy Machine B, which would still use batch production but on a much larger scale compared with existing operations. It is semi-automated and will require more employees than Machine A to operate. Pat thinks that products could still be advertised as being mixed carefully by skilled workers. The machine will need thorough cleaning between batches of different products.

CONTINUED

The partners have asked Pat’s brother, a business consultant, to forecast the likely net cash flows from these two machines. They are both estimated to have a useful life of five years, after which they could be sold as scrap. His forecasts are shown in Table 35.3. The expected residual values when the machines are sold are \$30 000 for Machine A and \$15 000 for Machine B. Pat’s brother has warned the partners that interest rates might be increased by the central bank soon and asked them how they intend to finance the new machine.

End of year	Machine A	Machine B	8% discount factors
0	(230)	(135)	1
1	70	60	0.926
2	80	50	0.857
3	80	45	0.794
4	80	35	0.735
5	90 (of which residual value = 30)	35 (of which residual value = 15)	0.680

Table 35.3: Forecasted net cash flows from the two machines (\$000)

- 1
 - a Calculate the payback period for both machines. [2]
 - b Calculate the ARR for both machines. [4]
 - c Calculate the NPV for both machines at an 8% rate of discount. [4]
 - d Analyse the investment appraisal results of the two machines. [8]
- 2 Evaluate which machine SCC should purchase. Justify your answer with reference to the investment appraisal results and other information provided. [12]

Improve this answer

This is a sample answer to decision-making Q2.

The NPV results mean they will make a profit **[K]**. SCC could have used a higher discount rate, though, as interest rates might increase soon **[Ap/E]**. We are not told what the interest rate is **[K]**. Payback is quicker for B by nearly five months **[Ap]**. This means that SCC will receive the initial capital cost back more quickly, which is an advantage **[K]**. ARR is higher for A and this means a higher profit return is made each year **[Ap/An]**. If SCC is short of finance, it should choose B as it is much cheaper. It makes a profit and pays back more quickly. I advise buying machine B **[E]**.

Your challenge

See whether you can improve this answer. It is an incomplete answer and it could have been so much better. None of the points made are applied to the different machines, the nature of the business or its products. There is no attempt to consider qualitative factors, such as the impact of automation on brand image and whether demand really is high enough to justify continuous flow production. The inadequacy of the data provided is hinted at, but more detail could have been given. Although an overall judgement is made, it is poorly supported by analysis of the quantitative results and qualitative factors. A better answer is available online – but write yours out first!

> Chapter 36

Finance and accounting strategy

LEARNING INTENTIONS

In this chapter you will:

- apply accounting data to strategic decision-making
- evaluate business performance using accounting data and ratio analysis
- assess the impact of accounting data and ratio analysis on business strategy
- evaluate the impact of strategic decisions on ratio results
- evaluate the usefulness of published accounts and ratio analysis.

KEY TERM

Annual (company) report

Key skills exercises

Knowledge and understanding

To answer the questions in this chapter, you need to know and understand:

- the significance of accounting ratio results
- the contents of published accounts
- the advantages and limitations of published accounts and ratio analysis.

- 1 State the **three** main accounting statements in the annual report.
- 2 State **three** contents of an annual report apart from the accounting statements.
- 3 Explain how an increase in company debt would impact on the gearing ratio.
- 4 Explain how an increased annual dividend per share would impact on the dividend yield if the share price remained unchanged.
- 5 Explain how business growth that led to profit rising at a faster rate than sales and capital employed would impact on profitability ratios.
- 6 Explain **two** limitations of using published accounts and ratios to compare a company's performance over time.
- 7 Explain **two** limitations of using published accounts and ratio analysis to compare the performance of two businesses.

Application

Supreme Supermarkets Company (SSC)

SSC operates a chain of supermarkets in Country P. Five years ago, the CEO of SSC planned to increase the company's market share within five years. She has achieved that aim but the most recent published accounts suggest that there have been important consequences for the business.

Accounting and other data for SSC is shown in Table 36.1.

	This year	5 years ago
Market share	11.3 %	8%
Revenue	\$360 million	\$200 million
Gross profit	\$36 million	\$28 million
Operating profit	\$6 million	\$8 million
Return on capital employed (RoCE)	8%	12%
Gearing ratio	55%	36%
Price/earnings (P/E) ratio	6	10

Table 36.1: Data about SSC for this year and five years ago

- 8 Calculate the change in the gross profit margin (GPM) ratio over the period.

WORKED EXAMPLE FOR Q8

GPM ratio this year = $(36 \div 360) \times 100 = 10\%$; GPM ratio 5 years ago = $(28 \div 200) \times 100 = 14\%$
 Difference is -4% points.

- 9 Calculate the change in the operating profit margin over this period.
 10 Calculate the change in the return on capital employed (RoCE) ratio over this period.

Analysis

- 11 Analyse possible reasons why the GPM has fallen as result of the CEO's growth strategy.
 12 Analyse **one** further possible reason why the operating profit margin has fallen as a result of the CEO's growth strategy.
 13 Analyse **one** possible reason why the RoCE ratio has fallen.
 14 Analyse **one** possible reason why the CEO's growth strategy has led to the gearing ratio increasing.

WORKED EXAMPLE FOR Q14

The gearing ratio compares non-current liabilities with capital employed [**K**]. The ratio of over 55% means that SSC has financed more of its expansion from loans than from shareholders' equity [**Ap/An**]. The growth strategy might have required the purchase of more supermarket sites and these could have been financed by increasing long-term loans. This would have caused the increase in the gearing ratio [**An+**].

- 15 Analyse **one** possible reason why the price/earnings (P/E) ratio has fallen despite the increase in profit.

Evaluation

- 16 Evaluate the CEO's growth strategy over this period.

TIP

To answer Q16, you should use both qualitative and quantitative evidence to support your analysis of the strengths and weaknesses of the strategy used by the business.

EXAM-STYLE QUESTIONS

Landsend Mining (LM)

LM operates several lead and copper mines. The costs of these mines are increasing as the reserves of metals run down. LM's financial performance is greatly affected by the world prices of both of these metals. A global economic boom leads to high metal prices and high profits for LM. A global economic recession results in low metal prices and low profits for LM. The global economic growth rate in the last two years has been very low.

The directors of LM are worried that the business is too specialised. They have been conducting an assessment of its business performance against two major competitors. These other companies operate lead and copper mines but have other business units too.

Company A also own forests, which it exploits for timber to supply major furniture manufacturers.

Company B recently bought out an electrical vehicle battery manufacturer, which uses some of the metals extracted from Company B's mines.

Table 36.2 contains data being used by LM's directors to compare business performance.

	LM	Company A	Company B
Gross profit margin (%)	23	35	40
Operating profit margin (%)	6	18	20
RoCE (%)	10	15	23
Gearing ratio (%)	20	22	54
Dividend cover	2	3	5

Table 36.2: Ratio results for the three companies (latest data available)

Decision-making questions

- 1 Evaluate the most likely reasons for LM's poor performance compared to the other two companies, based on the ratio results in Table 36.2. [12]
- 2 Evaluate the usefulness of LM's ratio analysis. [12]

CONTINUED

Business strategy questions

Ringmo Electronics (RE)

RE made a bold decision to diversify from TV manufacture ten years ago. The market for traditional TVs has changed very quickly. Consumers demanded much larger screens which RE could not manufacture. Fortunately, it had a small R&D department. This had developed a software package that could, with further testing and development, be sold to car manufacturers to allow autonomous driving of vehicles. This was an advanced program that many car manufacturers were soon interested in buying. Once fully tested, the program was available for sale five years ago. TV sales were declining. The TV factory was sold three years ago.

Sales of the autonomous driving program grew rapidly. The impact on RE's accounting ratios of this diversification, the R&D expenses it incurred and the growth in sales are shown in Table 36.3.

	10 years ago	5 years ago	This year
Revenue	\$120m	\$140m	\$650m
Gross profit margin (%)	11%	9%	25%
Operating profit margin (%)	3%	2%	15%
RoCE (%)	1.9%	1%	11%
Earnings per share	\$0.42	\$0.05	\$6.50
Dividend per share	\$0.30	\$0.20	\$4.90
Share price at end of year	\$3.00	\$0.50	\$86
Gearing ratio (%)	56%	75%	25%
Trade payables turnover period	34 days	52 days	22 days

Table 36.3: Trend analysis of RE's accounting ratios

- 1 Evaluate the impact of RE's finance and dividend strategies for shareholders and potential investors. [20]
- 2 Advise RE on whether it should continue to pursue a diversification strategy. [20]

Improve this answer

This is a sample answer to business strategy Q1.

The diversification seems to have been very successful. Switching from making TVs to developing and producing autonomous driving software means that RE is now selling a different product in a different market, which means diversification **[K/Ap]**. Shareholders who bought shares ten years ago and remained invested in the company have had their loyalty rewarded. They could have sold five years ago when profitability was very low, as shown by an operating profit margin of 2% **[Ap]**. RE directors took the decision to keep making dividend payments to shareholders **[Ap]**. In fact, they paid a dividend above the earnings per share level. This means that the money must have been taken from reserves. **[Ap/An]** Staying loyal to RE has paid off because the returns to shareholders have increased greatly since five years ago. The P/E ratio has risen from 10 to 13.2, showing growing investor confidence in the business **[An]**. The share price has risen by over 160 times, so some shareholders have made a very large gain on buying the shares when RE was in some trouble **[Ap/An]**. This suggests that potential investors should also consider buying shares in RE **[E]**.

CONTINUED**Your challenge**

See whether you can improve this answer. It has some real strengths. The answer shows a clear understanding of what the ratio results indicate and calculates some other ratio results which are appropriate to the question. This is showing some skills of application and analysis. However, the answer makes no reference to finance strategy and the evaluation could be more effective too. A better answer is available online – but write yours out first!

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