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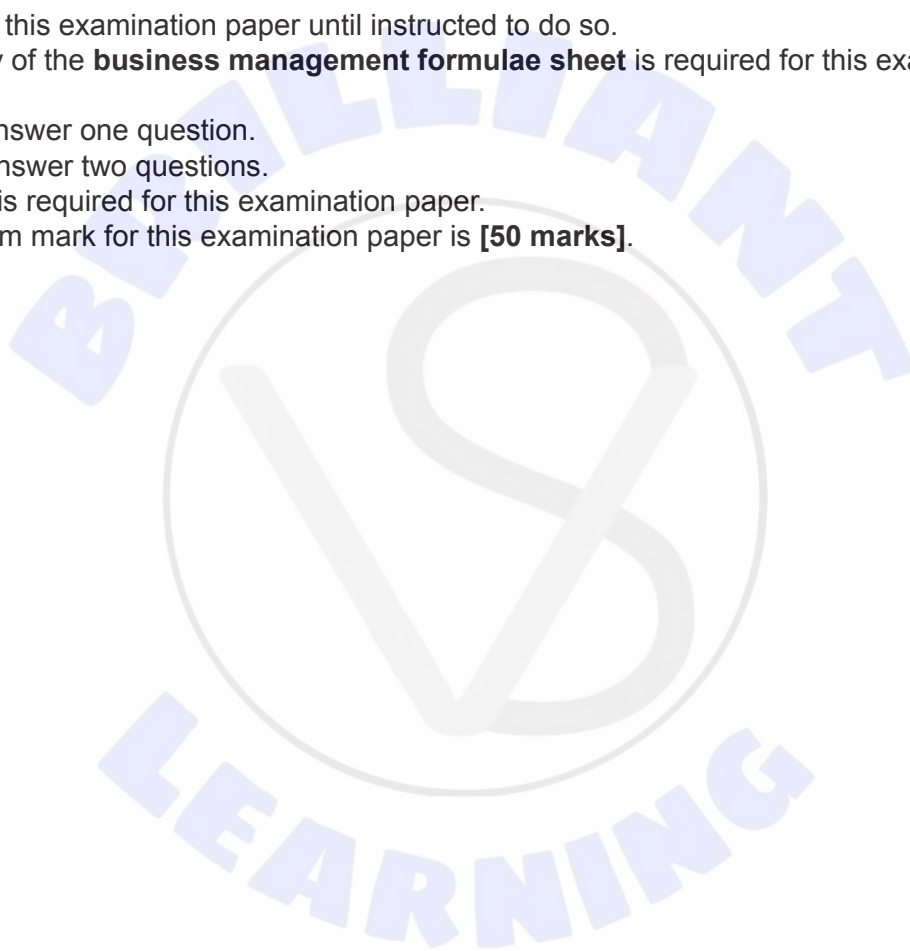
Business management
Higher level
Paper 2

Monday 3 May 2021 (morning)

1 hour 45 minutes

Instructions to candidates

- Do not open this examination paper until instructed to do so.
- A clean copy of the **business management formulae sheet** is required for this examination paper.
- Section A: answer one question.
- Section B: answer two questions.
- A calculator is required for this examination paper.
- The maximum mark for this examination paper is **[50 marks]**.



Section A

Answer **one** question from this section.

1. The Pie Store (TPS)

The Pie Store (TPS) bakes pies and sells them in its three retail stores. When developing its brand, *TPS* used the mathematical symbol pi (π). In 2020, each store made a profit.

Table 1: Financial information for *TPS*' three retail stores for 2020 (all figures in \$)

| | Store 1 | Store 2 | Store 3 |
|------------------------------------|----------|----------|----------|
| Sales | 180 000 | 223 000 | 170 000 |
| Cost of goods sold | 90 000 | 120 000 | 85 000 |
| Gross profit | 90 000 | 103 000 | 85 000 |
| Expenses | 66 000 | 76 000 | 67 000 |
| Net profit before interest and tax | X | Y | Z |

At the end of 2020, the balance sheet for *TPS* (the three stores combined) showed \$200 000 in assets and \$120 000 in liabilities. \$50 000 of the liabilities was long-term debt.

- (a) Describe **one** step in the development of a brand. [2]
- (b) Calculate:
- (i) which store made the highest net profit before interest and tax (*no working required*); [1]
- (ii) which store had the highest profitability (*show all your working*). [2]
- (c) Calculate:
- (i) *TPS*' equity; [1]
- (ii) *TPS*' return on capital employed (ROCE) (*show all your working*). [2]
- (d) Explain **one** effect that the \$50 000 long-term debt may have on *TPS*' profit and loss account. [2]

2. Sharon’s Super Lunches (SSL)

Sharon’s Super Lunches (SSL) is a cooperative that provides healthy school lunches. The lunches are delivered daily to students, who order them online. SSL aims for a minimum order size of 50 lunches to deliver to a school.

Table 2: Sales and other financial information for SSL for one week

| | |
|-----------------------------|---------|
| Forecasted sales of lunches | 3200 |
| Maximum sales of lunches | 4000 |
| Price of lunches | \$10.20 |
| Variable costs per lunch | \$6.40 |
| Fixed costs for SSL | \$7980 |

SSL is considering a new promotional strategy for healthy school lunches: they will donate a free school lunch to a student in a lower-income area for each lunch purchased in a higher-income area.

- (a) Describe **one** feature of a cooperative. [2]
- (b) Using total contribution, calculate the forecasted total profit for SSL **before** the introduction of the new promotional strategy (*show all your working*). [2]
- (c) Construct a fully labelled break-even chart for SSL for **before** the new promotional strategy is introduced (*show all your working*). [4]
- (d) Explain **one** advantage to SSL from implementing the new promotional strategy. [2]

Turn over

Section B

Answer **two** questions from this section.

3. Soft Skin Cosmetics (SSC)

Soft Skin Cosmetics (SSC) is a private limited company that produces a small range of face creams and soaps. Its products are designed and produced in the United States, and are made from safe, natural ingredients.

SSC has a product-orientated marketing approach. Tiffany Presley, one of the company's co-founders, believes that SSC's consumers value health above fashion. "The skincare market is full of toxic products, but ours are healthy even if they don't smell or look as nice," she says. Chelsea Presley, SSC's other co-founder, wants to develop the first sunscreen free of synthetic chemicals. However, product innovation is costly and risky. If the new sunscreen is a failure, several years of research and development costs will be wasted, which SSC cannot afford. SSC currently lacks the scale to innovate.

SSC does not pay for advertising. It relies on social media and word-of-mouth promotion. Its brand awareness is very high among young women, and customer reviews are very positive about SSC's quality and effectiveness. The company only sells online, not in retail outlets. To reach unsatisfied demand domestically and internationally, SSC would have to broaden its current distribution channels.

SSC practises corporate social responsibility (CSR). It does not test its products on animals, and supports several charities protecting endangered species. Pressure groups publicly recognize SSC's commitment to animal welfare.

Currently, multinational companies dominate the global skincare market. Small emerging companies rarely survive. Chelsea wants to convert SSC to a public limited company, but Tiffany disagrees: she argues that shareholder pressure toward profit maximization could jeopardize consumer and animal safety.

- (a) State **two** features of product innovation. [2]
- (b) Explain **one** advantage **and one** disadvantage for SSC of having a product-orientated marketing approach. [4]
- (c) Explain **one** advantage **and one** disadvantage to SSC of practising corporate social responsibility (CSR). [4]
- (d) Discuss Chelsea's idea to convert SSC into a public limited company. [10]

4. ReVolve Ltd (RV)

ReVolve Ltd (RV) manufactures and sells high-quality, high-priced bicycles to high-income earners. Operating in a niche market, its advertising slogan and unique selling point/proposition (USP) is “hand made to order, in the USA, delivered within seven days”. Brand loyalty is strong, but brand recognition outside of its customer base is weak. 98% of its sales are to customers living within 50 miles of the business.



Prior to 2017, RV received an increasing number of customer complaints that phone lines were often engaged and calls not returned. As such, it adopted e-commerce. Its website now allows customers to:

- customize their choice of bicycle
- place orders
- pay for purchases
- have their questions answered.

RV employs 20 highly paid, skilled employees using job production. To retain these workers, RV has raised their wages significantly since 2016.

Increasing competition from imports of hand-made high-quality bikes has forced down prices in this niche market. RV has been making increasingly larger losses since 2017. In 2020, its sales fell by 15%. Inflation is forecasted at between 2% and 3% for the next three years. As such, RV’s directors are considering two options to enable it to lower the prices of its bicycles.

Option 1: Offshore production to China, where production costs are significantly lower. The bicycles would be manufactured using batch production. RV would focus only on the design and marketing of its bicycles.

Option 2: Invest in new job production techniques that enable parts to be glued rather than welded, which only requires unskilled labour. Investment would cost \$3 500 000 and the forecasted annual net cash flow is \$600 000.

- (a) Define the term *niche market*. [2]
- (b) Explain **two** benefits to RV of the decision to adopt e-commerce. [4]
- (c) (i) Calculate the payback period if RV chooses **Option 2** (*show all your working*). [2]
- (ii) Explain **one** disadvantage to RV of using the payback period method of investment appraisal. [2]
- (d) Recommend whether RV’s directors should choose **Option 1** or **Option 2**. [10]

Turn over

5. KapTan

KapTan (KT), which manufactures rechargeable batteries for cordless consumer products like vacuum cleaners, began five years ago as a business with a product orientation. It sells business to business (B2B). Multinational companies dominate the rechargeable battery industry, and *KT* suffered from cash-flow problems in its first year of trading. Its profits are small and, in the last two years, have fallen.

KT has now developed an innovative battery that is small and lightweight. This battery is an emergency power source allowing electric cars to reach a charging station. However, the battery can only be used ten times before it runs out. *KT* has insufficient finance to create a battery that can be recharged an unlimited number of times.

Through market research, *KT* has discovered that:

- no other emergency batteries for electric cars exist
- owners of electric cars fear running out of power
- *KT*'s new battery could be obsolete in five years.

KT has the capacity to produce 90 000 of these new batteries each year. The average cost is \$200 per unit. *KT* has insufficient funds to invest in additional capacity.

KT is considering two options:

Option 1: Market and sell directly to existing car owners through business to consumer (B2C) at a retail price of \$400. *KT* will need to borrow significant capital to finance this option.

Option 2: Accept an offer of a five-year strategic alliance with a manufacturer of electric cars. *KT* would provide its product exclusively at \$250 per unit. Sales are guaranteed.

Table 3: *KT*'s forecasted and guaranteed worldwide unit sales (in 000s) for the two options

| Year | Option 1 forecasted sales | Option 2 guaranteed sales |
|-------------|---------------------------|---------------------------|
| 1 | 50 | 40 |
| 2 | 60 | 50 |
| 3 | 100 | 85 |
| 4 | 110 | 80 |
| 5 | 90 | 60 |
| Total sales | 410 | 315 |

- (a) Define the term *product orientation*. [2]
- (b) With reference to **Option 1**, for *KT*, explain the relationship between the product life cycle, investment, profit and cash flow. [4]
- (c) With reference to *KT*, explain **two** problems that a new business may face. [4]
- (d) Recommend whether *KT* should choose **Option 1** or **Option 2**. [10]



References:

4. [Bicycle] Hall, E., (2006). My new bicycle [online]. Available at <https://www.flickr.com/photos/mulegirl/99132433> (CC BY-SA 2.0) <https://creativecommons.org/licenses/by-sa/2.0/> [accessed 29 August 2019].

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