



Rewarding Learning

ADVANCED

General Certificate of Education

2018

Business Studies

Assessment Unit A2 1
assessing
Strategic Decision Making



ABU11

[ABU11]
THURSDAY 7 JUNE, AFTERNOON

TIME

2 hours.

INSTRUCTIONS TO CANDIDATES

Write your Centre Number and Candidate Number on the Answer Booklet provided.
You may use a calculator.
Answer **all** questions.

INFORMATION FOR CANDIDATES

The total mark for this paper is 90.
Quality of written communication will be assessed in Questions **2, 3, 4 and 5**.
Quantitative skills will be assessed in Question **5**.
Any working should be clearly shown since marks may be awarded for partially correct solutions.

Figures in brackets printed down the right-hand side of the pages indicate the marks awarded to each question or part question.

ADVICE TO CANDIDATES

You are advised to take account of the marks for each part question in allocating the available examination time.

Study the information in the case study below and answer all the questions that follow.

Bedzzz Ltd

Bedzzz Ltd is a family-owned company, based near Strabane, which manufactures a limited range of high quality beds that are sold mainly on the UK market. It was formed 10 years ago and now employs 35 workers. The business has experienced steady growth in sales and profits. Consequently, shareholders have always been rewarded with substantial dividends. These are necessary to ensure that shareholders continue to invest in the company and also to attract new investment.

Bedzzz Ltd is extremely proud of its corporate culture. Its mission statement, "We always do our best to help our customers rest", is displayed prominently throughout the factory and in all its sales brochures. The company is committed to using environmentally friendly materials of the highest quality and to reducing its carbon footprint. All its beds are 100% recyclable and it operates a disposal service for old beds and mattresses. Bedzzz Ltd has won a number of awards which recognise its environmental efforts.

Financial information relating to Bedzzz Ltd is shown in **Table 1** below:

Table 1: Extracts of financial information relating to Bedzzz Ltd

| Accounting information for year ending 31 March | 2018 £ | 2017 £ |
|---|-----------|-----------|
| Income Statement | | |
| Sales Revenue | 4,064,000 | 3,670,000 |
| Gross Profit | 2,147,000 | 1,835,000 |
| Expenses | 1,745,000 | 1,445,000 |
| Net Profit | 402,000 | 390,000 |
| Ordinary Dividends | 400,000 | 390,000 |
| Statement of Financial Position | | |
| Non-current Assets | 1,350,000 | 1,096,000 |
| Current Assets | 642,000 | 594,000 |
| Total Assets | 1,992,000 | 1,690,000 |
| Equity | | |
| Share Capital | 200,000 | 200,000 |
| Retained Earnings | 92,000 | 90,000 |
| Total Equity | 292,000 | 290,000 |
| Non-current Liabilities | 1,180,000 | 1,070,000 |
| Current Liabilities | 520,000 | 330,000 |
| Total Liabilities | 1,700,000 | 1,400,000 |
| Total Equity & Liabilities | 1,992,000 | 1,690,000 |

In April 2018, the Board of Directors of Bedzzz Ltd, concerned about low workforce morale, growing levels of employee absenteeism and demands for higher wages, decided to recruit a new Managing Director. Recognising that there was a shortage of specialist management experience in the business, the Board appointed Dan Hill, the first non-family member to hold the position.

Highly qualified and with an autocratic reputation, Dan managed, during his interview, to convince the Board members that Bedzzz Ltd was not performing as well as they thought. He referred to Elkington's Triple Bottom Line and also suggested that the business had a limited product range. He was also concerned about the rising level of current liabilities which was mainly due to the bank overdraft rising by £190,000 to purchase inventories and fund the purchase of some non-current assets. The Board were impressed by Dan's vision for the company.

Shortly after his appointment, Dan put forward an ambitious plan to begin producing a range of collapsible camp beds. Although this would require upgrading part of the factory and the purchase of new machinery, Dan felt that the business could gain significantly from internal economies of scale. He identified two possible machines that would be suitable for his plans and produced forecast sales figures for each. These are shown in **Table 2** below:

Table 2: Cost and Sales Revenue forecasts relating to new machinery in Bedzzz Ltd

| Machine A | (£000) | Machine B | (£000) |
|------------------|--------|------------------|--------|
| Cost | (200) | Cost | (600) |
| Net Cash Inflows | | Net Cash Inflows | |
| Year 1 | 80 | Year 1 | 200 |
| Year 2 | 80 | Year 2 | 200 |
| Year 3 | 60 | Year 3 | 200 |
| Year 4 | 60 | Year 4 | 200 |

Dan calculated the Payback period for Machine A to be two years and eight months, and for Machine B to be three years, respectively, which fell within the four-year project lifespan. However, he acknowledged that the higher quality camp beds produced by Machine B was a riskier market segment to target than the more basic beds produced by Machine A.

At their monthly meeting, the Board of Directors were easily convinced that Bedzzz Ltd had to expand its product range but debated which machine might be the better option and what might be the best source of finance. Some board members favoured applying for a bank loan, which currently charges 5% interest per annum. Others suggested financing the machine by reinvesting profits for a few years and not paying any dividends to shareholders.

Dan was indifferent to which source of finance was used. He was more concerned about how he was going to persuade employees to undertake the additional training required to operate the new machinery. He was also concerned about the current financial position, particularly the current ratio, and how it might impact on the strategic plan for Bedzzz Ltd.

- 1 (a) Using the case study information, explain one way in which Bedzzz Ltd might use its mission statement. [4]

- (b) Explain any **two** elements of Elkington's Triple Bottom Line model using the case study information. [6]

- 2 Evaluate the impact on Bedzzz Ltd of the conflict between shareholders seeking to maximise dividends and employees seeking to secure higher wages. [15]

- 3 Evaluate an advantage and a limitation of the Payback method of investment appraisal to Bedzzz Ltd when deciding which machine to invest in. [20]

- 4 Evaluate the sources of finance proposed by the directors of Bedzzz Ltd to finance the purchase of their new machine. [20]

- 5 Evaluate the financial performance of Bedzzz Ltd for the period 2017 to 2018, using the appropriate accounting ratios, taking the information from Table 1. [25]

THIS IS THE END OF THE QUESTION PAPER

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