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BUSINESS AND ORGANISATION
STANDARD LEVEL
PAPER 1

Friday 16 November 2001 (afternoon)

1 hour 45 minutes

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- Read the case study carefully and then answer all the questions.

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CASE STUDY

The Grandeco Oil Company

The Grandeco Oil Company was founded in Venezuela in 1930 by Victor Grande. Successful oil exploration, combined with rising oil prices ensured rapid expansion for many years and it was decided in 1965 to set up a network of gas (petrol) stations in Venezuela to add another profitable dimension to the organisation. Although there were initial problems with distribution, the gas (petrol) stations, called the 'Grande Stations', eventually became popular with Venezuelans since they had a reputation for quality service and value for money. Venezuelans also preferred to purchase gas from a Venezuelan company. The 'Grande' brand name had an established market position.

In 1990 management of the company was handed over to Victor Grande's grandson Eduardo. It soon became apparent that Eduardo intended to assert his authority over the organisation. Eduardo planned to ensure the continued growth of the company through the acquisition of companies in neighbouring countries. Any directors that opposed his ideas were either demoted or replaced. Emphasis was placed on achieving targets and following company policies and procedures.

Eduardo financed the expansion of Grandeco Oil Company by using reserves, but it became evident that he would also need to raise funds from other sources. His Financial Director advised that the options were to issue more shares or to borrow. Eduardo was reluctant to reduce the family's control of the business - they owned over 60 % of the shares - so he decided to fund the expansion with loan capital. In the following 5 years Grandeco Oil Company acquired a controlling interest in oil companies in Peru, Argentina, United States, Chile and Brazil. Details of the companies acquired are shown in Table 4.

However, by 1995 the performance and profitability of Grandeco began to cause concerns among the directors. At the Board of Directors meeting in May, the Operations Director suggested that the decline in profitability reflected rising interest and distribution costs. The financial performance of the company is shown in Table 1 and Table 2.

The Personnel Director explained that there had been resistance from managers in the companies acquired. In particular the managers appeared to run their operations as if nothing had changed after the takeovers. There was no apparent commitment to implement Grandeco's mission of providing quality service and value for money. In addition, the Personnel Director suggested that there was growing resentment towards head office. Local managers complained that they were not consulted and several had resigned. It was clear that each country and acquired company had its own distinct culture and management style - ranging from democratic to autocratic. Executives from USoil, the subsidiary in the United States, were astonished at the apparent lack of sensitivity to their local problems and the Personnel Director was concerned that union representatives would no longer tolerate being told what to do.

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The Personnel Director suggested that communication problems, language and cultural differences had not been addressed as the organisation grew. The Personnel Director also felt that Grandeco should review the structure of the organisation, since the current emphasis
40 on centralisation and following company policy and procedures had, she felt, resulted in slow decision-making and low morale, particularly in the acquired companies. The organisation chart for Grandeco is shown in Table 3. The Operations Director agreed and argued that a more flexible management system needed to be introduced, whereby the head office could focus on appointing key staff, administration and Grandeco strategy, while the
45 regional offices could focus on ensuring that marketing was appropriate to local needs.

Table 1

Selected Financial Data
Grandeco for year ending 31 April (US$ million)

		1990		*1995*
Sales Revenue		1000		*1400*
Less Cost of Goods sold				
Direct materials	300		*450*	
Direct labour	200		*300*	
Production overheads	100	600	*150*	*900*
Gross Profit		400		*500*
Less selling expenses	100		*180*	
administrative expenses	100	200	*160*	*340*
Net Profit before interest and tax		200		*160*
Less interest		25		*115*
Net profit before tax		175		*45*
Less tax		75		*15*
Profit after tax		100		*30*
Less dividend		10		*10*
Retained profit		90		*20*

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Table 2

<u>Selected Financial Data</u>
<u>Grandeco as at 31 April (US$ million)</u>

Fixed Assets		1990			*1995*	
Premises		500			*700*	
Plant/equipment	200			*250*		
Less accumulated depreciation	100			*130*		
		100			*120*	
Total Fixed Assets			600			*820*
Current Assets						
Stock	70			*90*		
Debtors	50			*60*		
Cash in Bank	50			*10*		
		170			*160*	
Less current liabilities						
Creditors	50			*120*		
Overdraft	30			*10*		
		80			*130*	
Working Capital			90			*30*
Net Assets			690			*850*
Less long term liabilities			290			*505*
			400			*1360*
Shareholders Funds						
Shares issued	300			*1340*		
Reserves	100			*20*		
			400			*1360*

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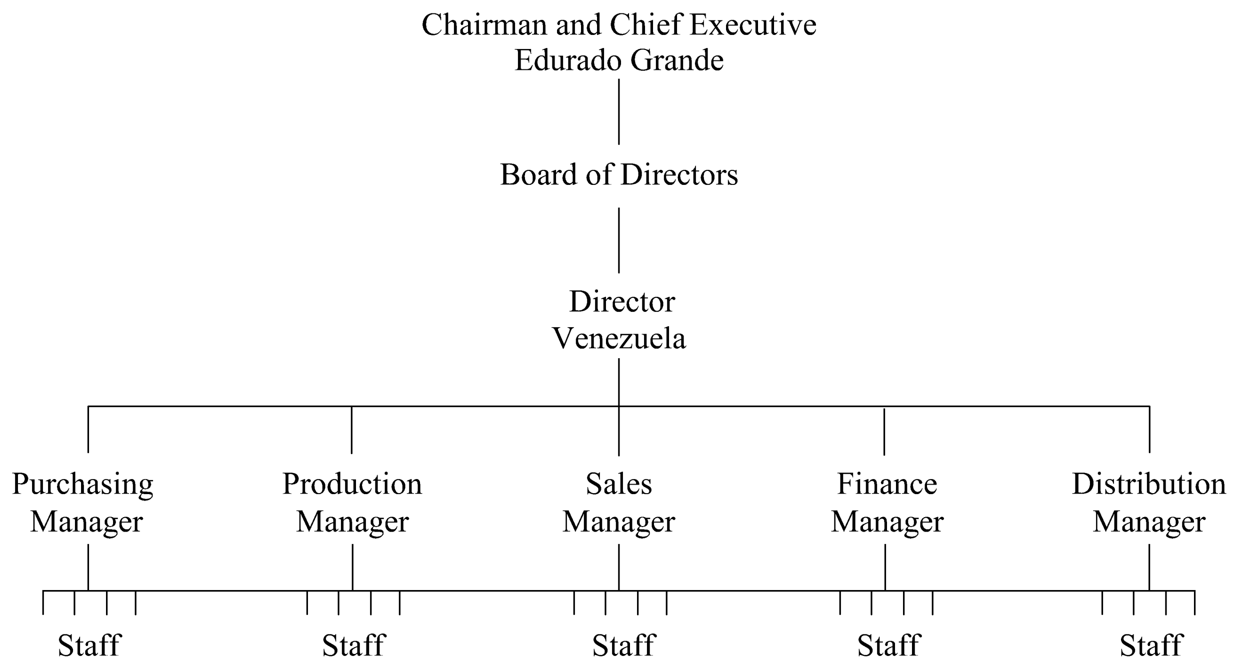
Table 3

Organisation chart for Grandeco 1995



A similar structure exists in Argentina, Peru, Chile and United States.

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Table 4

Grandeco Acquisitions

Country	Company/Brand	Market Share	Date Purchased
Peru	Perutrol	30%	January 1991
Argentina	Arpetrol	25%	June 1992
Chile	Chilpetrol	28%	February 1993
Brazil	Brazoil	10%	February 1993
United States	USoil	2%	March 1993

1. Why might Grandeco have decided to expand through acquisitions (purchases) of other companies, Table 4, rather than by setting up their own Grandeco gas (petrol) stations in other countries? *[6 marks]*

2. The Marketing Director is considering **two** options:

(i) keep the existing brand in each country

or

(ii) replace each brand with the Grandeco brand.

Evaluate the marketing advantages and disadvantages of each strategy. *[7 marks]*

3. Refer to Table 1 and Table 2, Selected Financial Data.

Calculate the following for 1990 and 1995, and comment on changes between them:

(a) the current ratio *[3 marks]*

(b) net profit margin *[3 marks]*

(c) return on net assets. *[3 marks]*

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4. Assess the consequences of raising funds through a significant increase in borrowing. *[6 marks]*

5. Assume you are the Personnel Director. Write a report to the Operations Director, explaining how communication, language and cultural problems might be addressed. *(Line 37)* *[10 marks]*

6. Use the organisation chart in Table 3 to explain the following terms:

(a) authority

(b) delegation

(c) span of control

(d) horizontal communication. *[8 marks]*

7. Explain how a decentralised organisational structure might help to overcome the problems of slow decision-making and low morale identified by the Personnel Director. *(Lines 40-41)* *[4 marks]*