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Business management
Standard level
Paper 2

Monday 6 May 2019 (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 one question.
- Section C: answer one question.
- 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. Las Migas

Carolina plans to set up a bakery, *Las Migas*, in a small town. Competition from established bakeries is strong. Carolina has asked for a bank loan because her personal savings are insufficient. The bank manager requested the following information:

- a business plan
- a cash flow forecast for the first four months of operations.

Carolina has no experience with financial forecasts but she estimated the figures for *Las Migas* for the first four months of operations. These figures are shown in **Table 1**.

Table 1: Estimated figures for *Las Migas* for the first four months of operations

| | |
|---------------------------|--|
| Estimated sales per month | For the first two months of operations: \$1500 From the third month of operations onwards: \$3500 |
| Monthly rent | \$1000 |
| Interest | \$45 to be paid every two months starting the first month of operation |
| Opening balance | \$100 |
| Ingredients and supplies | 30 % of sales |
| Electricity per month | 1 % of sales |
| Carolina's monthly salary | \$390 |

[Source: © International Baccalaureate Organization 2019]

- (a) State **two** elements, **other than** a cash flow forecast, of a business plan. [2]
- (b) Prepare a cash flow forecast for *Las Migas* for the first four months of operations. [6]
- (c) Explain **one** problem that *Las Migas* may experience as a new business. [2]

2. DuffJD

DuffJD provides a laundry service for towels and sheets to three hotel chains in a major city, Hoyluk. It provides each hotel chain with trade credit.

Competition in this market is increasing, as two rivals are planning to offer laundry services to hotel chains in Hoyluk.

Table 1: Selected financial data for *DuffJD* for 2018

| | |
|----------------------------------|----------|
| Annual fixed costs | \$75 000 |
| Variable costs per item | \$0.50 |
| Price charged per item laundered | \$2.00 |
| Number of Items laundered | 200 000 |

[Source: © International Baccalaureate Organization 2019]

- (a) Define the term *trade credit*. [2]
- (b) Using the financial data for *DuffJD* for 2018, calculate:
- (i) the contribution per unit per item laundered (*no working required*); [1]
 - (ii) the margin of safety (*no working required*). [1]
- (c) Draw a fully labelled break-even chart for *DuffJD* for 2018 using the data provided. [4]
- (d) Explain how an increase in competition may affect *DuffJD*'s margin of safety. [2]

Section B

Answer **one** question from this section.

3. Ace Industries (AI)

Ace Industries (AI) manufactures plastic containers, mostly for the soft and fruit juice industries. The operations management department uses flow production for its standard-sized products and batch production for its customized products.

AI's sales are growing rapidly. It currently has a 6% share of the plastic container market. However, it has recently struggled to meet customized orders on time. Some customers have complained about product quality. Currently, *AI* is organized by region, which allows the company to have strong relationships with customers, who feel that *AI* knows them and cares about their interests. The human resource department is proposing restructuring the organization by function. Not everyone at *AI* agrees with this change. Many think that the problems of late delivery and poor quality could be solved through greater delegation.

Lloyd Rinnegrat, Chief Financial Officer, has suggested that *AI's* management think more deeply about their rapid growth. Except Lloyd, most people at *AI* believe that rapidly growing sales are good – that by increasing its market share *AI* will, in the long run, benefit by being a large organization. However, Lloyd argues that being a small organization has many merits, as shown by the changes in *AI's* recent gross profit margins and net profit margins.

Table 1: Selected financial data for AI

| | 2017 | 2018 | 2019 |
|----------------------------|---------------|---------------|---------------|
| Sales growth | 14 % | 15 % | 12 % |
| Sales | \$327 000 000 | \$376 000 000 | \$421 000 000 |
| Gross profit margin | 57 % | 55.3 % | 53.2 % |
| Net profit margin | 9 % | 8 % | 7 % |

The marketing department has predicted that the soft and fruit juice industries are moving away from major mass-produced drinks and toward niche products, such as exotic fruit drinks and speciality beverages for very particular markets.

[Source: © International Baccalaureate Organization 2019]

- (a) Outline **two** features of batch production. [2]
- (b) Draw a possible organizational chart for a manufacturing firm like *AI* if it is organized by function. [2]
- (c) Calculate:
- (i) the total size of the plastic container market in 2019 (*show all your working*); [2]
- (ii) the difference in *AI's* net profit before interest and tax between 2018 and 2019 (*show all your working*). [2]
- (d) Explain how delegation might help *AI* improve its delivery times. [2]
- (e) With reference to *AI*, discuss Lloyd's view that being a small organization has merits. [10]

4. Willow Enterprises (WE)

Willow Enterprises (WE) was founded in 1989 originally as a small manufacturer of carpeting for high-end commercial and institutional office space. In 1997 the management made several strategic decisions:

- change from the use of cheap man-made materials to more expensive natural fibres in its carpets
- change legal status from a private to a public limited company
- use profits to increase production capacity and expand the sales force
- diversify by taking over other regional businesses, including a retail chain, and transform them into environmentally friendly businesses.

Because of its appeal to environmentally conscious customers, *WE* became the regional market leader and, by 2008, was an important carpet manufacturer at a national level.

At this time, Chief Executive Officer Simon Dee decided that *WE* would adopt a far-reaching programme of corporate social responsibility (CSR). Every year, *WE* committed more resources to various forms of corporate social responsibility (CSR), such as charitable contributions and fair payments to employees and suppliers. By 2018, *WE* had diverse revenue streams and a brand identity strongly associated with corporate social responsibility (CSR).

For the last few years, *WE*'s gross and net profit margins have been falling slightly but steadily. Simon has attributed the declining profitability to diseconomies of scale and one-off (one-time) expenses associated with each takeover. The Chief Financial Officer, Ruth Croft, disagreed. She gave Simon a copy of a 1970 article by the economist Milton Friedman entitled "The Social Responsibility of Business is to increase its Profits".

[Source: © International Baccalaureate Organization 2019]

- | | | |
|-----|--|------|
| (a) | Define the term <i>revenue streams</i> . | [2] |
| (b) | Explain one advantage and one disadvantage of <i>WE</i> changing its legal status to a public limited company. | [4] |
| (c) | With reference to <i>WE</i> , distinguish between internal and external growth. | [4] |
| (d) | Discuss whether <i>WE</i> should retain its programme of corporate social responsibility (CSR). | [10] |

5. Copper Health (CH)

Copper Health (CH) was the market leader in the production of anti-venom* vaccines to treat poisonous snake bites. *CH*'s mission – influenced heavily by corporate social responsibility (CSR) – is to put customers first and profits second in the treatment of snake bites.

Despite 100 000 deaths worldwide each year from snake bites and 400 000 serious injuries, *CH* recently announced that it will no longer produce anti-venom vaccines. Several large Mexican, Brazilian and Indian pharmaceutical companies have entered the market selling anti-venom vaccines at a much lower price than *CH*.

A spokesperson for *CH* said: “We will remain a private limited company where corporate social responsibility (CSR) remains an important driving force for our mission. Our medical research is only financed from retained profit. When the lower-priced competition arrived, our sales and profits of anti-venom vaccines decreased significantly. Treating snakebites no longer makes financial sense. Instead, the technology used to produce anti-venom vaccines will be used to research and develop (R&D) other life-saving vaccines”.

A non-governmental organization (NGO) has demanded action. “*CH* is the largest manufacturer of anti-venom vaccines in the world. Although *CH*'s competitors are increasing their production of anti-venom vaccines they will not be able to produce enough to satisfy demand for the next two years. There will be a major shortage. This will result in many life-threatening injuries and deaths.”

The non-governmental organization (NGO) has urged *CH* to seek new sources of finance to continue the production of the anti-venom vaccine.

[Source: © International Baccalaureate Organization 2019]

* anti-venom: a medication made from antibodies that is used to treat venomous bites and stings

- (a) Define the term *retained profit*. [2]
- (b) Explain **one** advantage **and one** disadvantage for *CH* of having a mission statement. [4]
- (c) Explain **two** possible external sources of finance *CH* could use to continue production of anti-venom vaccines. [4]
- (d) Discuss *CH*'s decision to stop producing anti-venom vaccines. [10]

Section C

Answer **one** question from this section. The organizations featured in sections A and B and in the paper 1 case study may not be used as a basis to your answer.

6. With reference to an organization of your choice, discuss the ways in which **ethics** can influence **innovation** in an organisation. [20]

 7. With reference to an organization of your choice, examine the impact of **culture** on organizational **strategy**. [20]

 8. With reference to an organization of your choice, discuss the ways in which **globalization** can influence organizational **change**. [20]
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