UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS

GCE Advanced Level

MARK SCHEME for the October/November 2011 question paper

for the guidance of teachers

9707 BUSINESS STUDIES

9707/31 Paper 3 (Case Study), maximum raw mark 100

This mark scheme is published as an aid to teachers and candidates, to indicate the requirements of the examination. It shows the basis on which Examiners were instructed to award marks. It does not indicate the details of the discussions that took place at an Examiners' meeting before marking began, which would have considered the acceptability of alternative answers.

Mark schemes must be read in conjunction with the question papers and the report on the examination.

- Cambridge will not enter into discussions or correspondence in connection with these mark schemes.

Cambridge is publishing the mark schemes for the October/November 2011 question papers for most IGCSE, GCE Advanced Level and Advanced Subsidiary Level syllabuses and some Ordinary Level syllabuses.

1 Analyse the advantages and disadvantages for LPC of being heavily dependent on the sales of books written by Abbas Khan. [**10**]

	Knowledge 3 marks	Application 2 marks	Analysis 5 marks
Level 2	2–3 marks Two or more relevant points made, showing good knowledge.	2 marks Points made are well applied to case.	3–5 marks Good use of theory to explain advantages and disadvantages.
Level 1	1 mark One relevant point made, showing some knowledge.	1 mark Some application to case.	1–2 marks Good use of theory to explain one side or limited use of theory to explain one or both sides.

Answers could include:

Reference to the case: 30% of sales from Khan's books.

Advantages:
- Easier to promote books from just one author – marketing economies of scale.
- LPC name and reputation closely tied to successful author – may lead other authors to want to get LPC to publish their books.
- Easier to get LPC's books into good positions in book shops.

Disadvantages:
- Being dependent on a successful author has increased sales and profits – but will this continue?
- Suppose author died or decided to use another publisher?
- Changes in consumer tastes/reading trends could have a huge negative impact on sales and profit.
- Success has put a strain on capacity.
- Market segment may not grow in the future.

2 (a) Assume the book printing department was closed and the offer from AAP had been accepted. Calculate LPC's profits for the 12 months to 31 October 2011. Clearly state any assumptions you make. [10]

Award maximum of 6 marks for relevant calculations and 1 mark per appropriate assumption stated + 1 mark per explained assumption, up to a maximum of 4 marks.

Calculation		**Mark**
Profit	Profit reduced by $50 000	6
	New profit is $1.15m	6
	Profit increased by $700 000	6
	New profit is $1.9m	6
New Total Costs	$6.5m (4.3 + 1.45 + 0.75)	3
	$5.75m (4.3 + 1.45)	3
	$5.05m (4.3 + 0.75)	2
Existing direct costs	$4.25m	2
	$5.0m	2
Existing total costs	$6.45m	2
Some relevant use of data		1

BUT: What happens to overhead costs? Will they still have to be paid? How 'fixed' are they? Are transport costs included in AAP's price?

(b) Using your answer to (a) and other relevant information, recommend whether the company should outsource all book printing to AAP. Justify your answer. [16]

	Knowledge 3 marks	Application 3 marks	Analysis 6 marks	Evaluation 4 marks
Level 2	2–3 marks Two or more relevant points made.	2–3 marks Points made are well applied to case.	4–6 marks Good use of theory to explain advantages and disadvantages.	3–4 marks Judgement shown in considering both advantages and disadvantages.
Level 1	1 mark One relevant point made.	1 mark Some application to case.	1–3 marks Good use of theory to explain one side or limited use of theory to explain one or both sides.	1–2 marks Judgement shown but on one side only.

Answers could include:
- Impact on profits is marginal (unless the indirect costs can be quickly reduced after printing division is closed).
- Is it worthwhile changing?

Points for:
- LPC at full capacity – this reduces the need for capital expenditure to increase capacity.
- Able to focus on other parts of the publishing process.
- Smaller size, fewer staff – easier communication?
- Fixed assets could be used for other divisions of the business.
- Sale of fixed assets will improve liquidity.

Points against:
- More information on AAP needed.
- Quality?
- Speed?
- Transport costs?
- Will prices from AAP rise once the printing division is closed?
- Redundancy costs for the 300 workers.
- Issue of corporate social responsibility.
- Impact of exchange rate fluctuations.

Evaluation:
- Other information needed before a final decision can be made, e.g. cost of expanding capacity.
- Impact of economic data on book sales – perhaps capacity will not be a problem.
- How important is it to the business to be vertically integrated and control the whole publishing process?
- Final recommendation needs to be well supported and justified.

3 Discuss the likely benefits and drawbacks to LPC of the accounting and finance changes suggested by the company accountant (lines 61–66). [12]

	Knowledge 2 marks	Application 2 marks	Analysis 4 marks	Evaluation 4 marks
Level 2	2 marks Good knowledge shown.	2 marks Good application to case.	3–4 marks Good use of theory to explain answer.	3–4 marks Good judgement shown.
Level 1	1 mark Some knowledge shown.	1 mark Some application to case.	1–2 marks Some use of theory to explain answer.	1–2 marks Some judgment shown.

Answers could include:

- These seem to be examples of window-dressing to make the published accounts more attractive to external users.
- Expected life of assets: this will reduce annual depreciation charge, increasing net profits. Net realisable value of fixed assets will be higher than they would otherwise have been. BUT when assets are sold/disposed of, if insufficient depreciation has been charged then a book loss will have to be recorded.
- Sale and lease back: ownership is transferred to leasing company (reducing fixed assets) but cash increases (increases current assets). Business is more profitable – accounts look more liquid to external creditors including banks. BUT leasing charges will add to annual overhead costs of the business, cutting net profits.
- Intangible assets: increases net asset value and shareholders' funds BUT how reliable are the valuations? Will external users be convinced by these valuations? They may have to be 'written off' if author changes publisher or if his popularity declines.

Evaluation:

- In the short-term these policies may appear to be attractive – but will accounts users be convinced by them?
- In the long-term they could have serious consequences: over-valued assets, reduced value of fixed assets (leasing) and higher overheads (leasing).
- May depend on why the accountant wants to do this. Is he planning on obtaining new sources of external finance, which might be more likely to be gained using 'window-dressed accounts'.

4 Recommend and justify a suitable marketing strategy for increasing LPC textbook sales over the next 12 months. Your answer should include relevant analysis of the data in Table 2. [16]

	Knowledge 3 marks	Application 3 marks	Analysis 4 marks	Evaluation 6 marks
Level 2	2–3 marks Good knowledge shown.	2–3 marks Good application to case.	3–4 marks Good use of theory to explain answer.	4–6 marks Good judgement shown.
Level 1	1 mark Some knowledge shown.	1 mark Some application to case.	1–2 marks Some use of theory to explain answer.	1–3 marks Some judgment shown.

Table 2: Marketing data for textbooks

	LPC textbooks	Competitors' textbooks
Average time span since new edition	5 years	2 years
Average cost of producing each new edition	$18 000	$20 000
Likely increase in first year's sales after new edition	5 000 copies	7 000 copies
Change in 2010 sales after a 10% price reduction	Sales rose by 30 000 copies to 630 000	Sales rose by 200 000 copies to 1000 000
Average textbook price after 10% price reduction	$4.50	$5.40
Average credit period offered to bookshop	1.5 months	2 months
Promotion elasticity of demand	0.2	0.4
Promotion spending in 2010	$20 000	$30 000

Answers could include:

- PED is –0.5 for LPC and –2.5 for competitors.
- Launch new editions: each new edition would cost $18 000 but would earn (on average) 5 000 × $4.50 = $22 500 in additional revenue in first year (BUT would it make a gross profit?).
- Can new editions be commissioned and published within twelve months?
- Reduce prices again by 10%: new average price = $4.05 and sales would rise by 5% (assuming same PED) to 661 500 (new revenue = $2 679 075 which is less than existing revenue of $2 835 000) BUT PED might be higher if competitors do not lower their prices.
- Increase promotion spending to $30 000 – increase of 50% which could increase sales by 10% (6 300) which earns $283 500 extra revenue (new revenue $3 118 500).
- Compare with competitors: they seem to have been more successful in launching new editions – is this the most important factor in the success of textbooks?

- PED is greater – reasons for and consequences of this?
- Promotion ED is higher – perhaps promotions are more effective so it is not just a case of 'spending more' but 'spending more wisely'?
- Evaluation: which is likely to be the most important component of the marketing strategy/mix in the case of textbooks?
- Need to ensure an integrated strategy, e.g. if new editions launched then more promotion might be needed BUT would it be a mistake to lower prices too as it might present them as 'cheap' texts?

5 Consider the economic data in Appendix A and the fact that 300 redundancies are possible. LPC plans to increase salaries to directors and dividends to shareholders this year. Is it right to increase directors' salaries and shareholder dividends at this time? Justify your answer. [16]

	Knowledge 3 marks	Application 3 marks	Analysis 4 marks	Evaluation 6 marks
Level 2	2–3 marks Good knowledge shown.	2–3 marks Good application to case.	3–4 marks Good use of theory to explain answer.	4–6 marks Good judgement shown.
Level 1	1 mark Some knowledge shown.	1 mark Some application to case.	1–2 marks Some use of theory to explain answer.	1–3 marks Some judgment shown.

Appendix A: Economic forecasts for the country where LPC operates

	2012	2013
Annual increase in real GDP	1.5%	–2%
Annual inflation	4%	6%
Average exchange rate index of country's currency against other currencies	100	90
% of population aged 5–15 years	16%	17%
% of population aged 16–18 years	4%	3%
Unemployment as % of working population	5%	7%

Answers could include:

Yes:
- Directors could leave to find better-paid positions.
- They have been successful in increasing sales and profits.
- Making workers redundant is a major strategic decision that needs to be taken by well-paid and well-motivated directors.
- Closing the printing division and making workers redundant might increase profits in future.
- It is a plc – shareholders need high dividends to keep them invested in the business.
- This might help to maintain/increase share price, which could make it easier to raise additional share capital in future.

No:
- This could be seen as being unethical behaviour.
- Workers will not have their safety needs being met – and now they see resources being used to pay directors' salaries/dividends.
- Impact on motivation of staff is likely to be negative.
- Would the finance used be better spent on issuing new editions of books and helping to secure workers' jobs?

Evaluation:
- How high are the increases?
- How will the redundancies be announced and will they receive big pay-offs?
- What are other similar firms doing? How do directors' salaries and dividends compare with other similar companies to LPC?
- Any conclusion is possible but it needs to be based on preceding analysis of points.

Questions 6 and 7: use this mark grid.

	Knowledge 3 marks	Application 3 marks	Analysis 4 marks	Evaluation 10 marks
Level 3				7–10 marks Good judgement shown in text and conclusions.
Level 2	2–3 marks Good understanding shown.	2–3 marks Good application to case.	3–4 marks Good use of theory to explain points made.	4–6 marks Some judgement shown in text and/or conclusions.
Level 1	1 mark Some knowledge shown.	1 mark Some application to case.	1–2 marks Limited use made of theory.	1–3 marks Limited judgement shown.

6 Evaluate the most important factors likely to affect LPC's future success by undertaking a SWOT analysis of the business. [20]

Answers could include:

- SWOT – situational analysis of internal strengths and weaknesses and external opportunities and threats.

Strengths:

- Vertically-integrated – benefits of this.
- Profitable.
- Loyal workforce.
- Abbas Khan's books.

Weaknesses:

- Over-dependence on one author.
- Too big – poor communication?
- Vertically-integrated – problems of this?
- Old editions of textbooks.

Opportunities:

- Develop new editions.
- Export books – depreciating exchange rate.

Threats:

- Increased competition in textbooks.
- Economic data.
- Technological changes.
- Analysis of any TWO points from different sections of SWOT needed for maximum analysis marks.

Evaluation:

- Which are the most important factors and why?
- Can the business overcome its weaknesses?
- Is the decision to use finance to increase salaries and dividends rather than develop new editions a crucial factor?
- How accurate are the economic forecasts likely to be?
- Is the future bright or not for this business? Overall judgement needed for top level evaluation.

7 Evaluate the strategic choices which LPC could make to improve its competitive advantage in an increasingly competitive world. [20]

Answers could include:

Changes in a competitive world include:
- Competition – in textbook market.
- Technology – e-books.
- Economy – inflation forecast to rise, can LPC keep costs down?
- Possible social/demographic changes, e.g. business is heavily dependent on children's books and textbooks.

Strategic choices include:
- Market penetration – increasing sales of existing books.
- Product development – new ranges of books or e-books.
- Market development – books sold to new markets, foreign language books for example.
- Diversification – into unrelated product markets.
- Rationalisation – focus on one aspect of the publishing industry.
- Give examples of these in context and analyse how they can help 'improve competitive advantage in an increasingly competitive world'.

Evaluation:
- Cost of strategic options.
- Risk element – use of Ansoff.
- Consideration of strategic choice models and/or Porter's cost leadership or differentiation model.
- Actions of competitors – indications are that they may be more effective/competitive than LPC.
- Management ability to cope with significant strategic change, e.g. diversification?
- Final conclusion could be in the form of a justified recommendation of what the business should do.