Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

BUSINESS **9609/32**

Paper 3 Case Study **February/March 2016**

3 hours

No Additional Materials are required.

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READ THESE INSTRUCTIONS FIRST

An answer booklet is provided inside this question paper. You should follow the instructions on the front cover of the answer booklet. If you need additional answer paper ask the invigilator for a continuation booklet.

Section A
Answer **all** questions.
Section B
Answer **one** question.
You are advised to spend no more than 40 minutes on Section B.
The businesses described in this question paper are entirely fictitious.

The number of marks is given in brackets [ ] at the end of each question or part question.

This document consists of **6** printed pages, **2** blank pages and **1** Insert.

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Barbarossa Sports (BS)

BS manufactures sports clothing and footwear and has been operating for 30 years. Ten years ago the family owned company became a public limited company. Sarah is the Managing Director. Sarah and other family members together own 25% of BS shares.

BS has two small factories in country F. It sells its branded sportswear called 'Elwood' to retail outlets throughout country F. It has also recently started exporting 20% of its products to country P. BS currently only sells direct to specialist sports retailers. BS has a good relationship with its existing customers and a reputation for reliability and good quality products.

One of the BS factories manufactures casual sports shoes and running shoes. The other factory manufactures sports clothing. In 2015 28% of BS's revenue was from shoes and 72% was from clothing.

Leadership styles
Each factory has a manager. Sarah delegates authority to the two managers and lets them choose their own leadership style. The two factories operate as separate cost centres and each factory manager negotiates prices with their own suppliers.

- Jake manages the clothing factory. He insists on making all of the decisions himself. He believes his workers should stay focused on the task and ask few questions. Workers are very demotivated and labour turnover and absenteeism are high. Workers have complained that very little training is provided in the use of the machines. Health and safety standards are low. A recent change in working practices was introduced with no worker consultation but it has led to higher productivity.

- Neeraj manages the shoe factory and is passionate about sport, having been a keen athlete in his youth. He encourages teamwork and consultation. He values his workers' feedback and opinions. Workers regularly meet to discuss business developments and quality issues. Labour costs per unit in the factory are high. Neeraj has not been successful in encouraging workers to change working practices to increase productivity.

Factory closure
The two factories are located 100 km from each other and many job roles are duplicated. Machinery in both factories is over 10 years old and needs to be replaced.

At a recent Board meeting, the Finance Director stated: 'Closing the shoe factory and moving production to the clothing factory would make more financial sense in the long term, rather than operating two separate factories. I estimate that this will initially cost $1m to expand and equip the expanded factory to accommodate more workers and the required machinery.' Sarah replied: 'This seems to make sense but we would need to decide whether Jake or Neeraj would be the best person to manage the newly expanded factory. This strategic change will need to be managed carefully.'

The Finance Director has presented the following options for the required machinery.
- *Lease option* – Take out a 5-year lease on new machinery with maintenance costs paid for by the leasing company. This option has a payback period of 1 year 8 months and a net present value of $394 500.
- *Purchase option* – Buy machinery that is already 2 years old and could be resold for a residual value of 30% of the purchase price after 5 years. BS would pay for the maintenance of the machinery.

Appendix 1 shows the expected net cash flows from these two options.

BS's marketing strategy

Sarah's aim is to make BS one of the most profitable sportswear companies in country P. Falling sales figures in country P are a worry to Sarah so she knows a new marketing strategy will be needed. The current sportswear market in country P is worth $5.8bn and is forecast to grow by 3.2% in 2016. Her aim is to increase BS's market share in country P from 5% to 10%. She realises this will be difficult given the forecast economic data shown in Appendix 4.

Cost-based pricing is used by BS when agreeing contracts with retailers in both country P and country F. BS will only supply retailers who agree to display point of sale promotion in the most prominent position within their shops. Although BS has a website it does not yet allow retailers to order online, preferring to communicate with them by telephone and post. The main methods of promotion are phoning specialist sports retailers in countries F and P and placing expensive adverts in specialist magazines aimed at these retailers.

Competitors

The global sportswear industry is expanding rapidly. Sarah thinks there could be two reasons for this. There has been a lot of recent press coverage about the importance of healthy lifestyles and increased television coverage of global sporting events. These factors have boosted sales of BS sportswear by 5% over the last year in country F. However, competitive rivalry is also increasing, particularly in the developing market in country P. Fashion retailers are now developing their own affordable brands of sportswear which are proving popular amongst 25–35 year olds.

Shareholder conflict

At the recent Annual General Meeting shareholders demanded a better return on their investment in the future. However, Sarah wants to exploit the upcoming Olympics and increased consumer spending in the industry and reinvest future profits to expand the business. Appendix 2 shows an extract from BS company accounts.

Future strategic options

Sarah believes that BS must take strategic decisions to develop and become more profitable in the long term. She is considering the following alternative strategies.

- *Strategy A* – Sarah has been approached by the owner of a chain of fitness centres in country F. He is interested in working with BS to develop a range of Elwood branded health food supplements to be sold exclusively in their fitness centres.
- *Strategy B* – Take over an existing sportswear factory in country P to supply this market. This would overcome import tariffs imposed by the Government of country P.

Choosing between the two strategies will not be easy. Sarah knows that BS does not have sufficient retained earnings to finance both strategies. Sarah has prepared the data in Appendix 3 to help make this choice. Sarah does not have much experience of managing change but she believes that drawing up a new business plan might be a good starting point.

Appendix 1: Required machinery – forecast net cash flows for the two financing options

Year	Lease option ($000s)	Purchase option ($000s)
0	(200)	(1000)
1	100	500
2	150	500
3	200	400
4	200	350
5	150	250

10% discount factors: Year 1: 0.91, Year 2: 0.83, Year 3: 0.75, Year 4: 0.68, Year 5: 0.62

Appendix 2: Extract from BS company accounts

	Year ending 31 December 2014	Year ending 31 December 2015
Profit for the year	$240m	$200m
Total dividend paid	$60m	$52m
Total shares issued	400m	400m
Earnings per share	$0.60	$0.50
Dividend per share	$0.15	$0.13
Market share price	$2.25	$2.10
Dividend yield	6.67%	See question 2(a)(i)
Price earnings ratio	3.75	See question 2(a)(ii)

Appendix 3: Data to be used when choosing between strategies A and B

	Strategy A (food supplements)	Strategy B (factory in country P)
Ansoff Matrix	Diversification	Market development
Force field analysis: Forces for change: Forces against change Most important force against change:	12:7 Exclusivity deal	10:8 Communication with workers abroad
Decision tree: Expected net values (after 5 years of operation)	$4m	$3m

Appendix 4: Forecast economic data for country F and country P, 2017

	Country F (%)	Country P (%)
Interest rate	3	8
Annual GDP growth	3	2
Annual rate of inflation	4	6
Unemployment rate	5	8
Increase in population age 25–35	1	4

Section A

Answer **all** questions in this section.

1 Analyse the likely benefits to BS of moving all of its production to one factory (lines 29–31). [10]

2 **(a)** Refer to Appendix 2. Calculate for 2015:

(i) dividend yield [4]

(ii) price earnings ratio. [4]

(b) Discuss whether the Board should increase dividends to shareholders. Use your results from **(a)** and other information to justify your answer. [12]

3 Evaluate a marketing strategy that BS could use to achieve a market share of 10% in country P. [16]

4 **(a)** Refer to Appendix 1. Calculate for the **purchase** option:

(i) payback period [2]

(ii) net present value at a discount rate of 10%. [4]

(b) Recommend to BS whether to lease or purchase the machinery. Use your results from **(a)** and other information to justify your choice. [12]

5 Recommend to Sarah which one of the two existing factory managers she should appoint to manage the newly expanded factory in country F. Justify your answer. [16]

Section B

Answer **one** question in this section.

6 Evaluate the usefulness to BS of the methods of strategic choice in Appendix 3. [20]

7 Assume strategy B is chosen. Discuss how BS might implement the strategic changes required. [20]

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