Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

BUSINESS **9609/33**

Paper 3 Case Study **May/June 2017**

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.

DC (NH/SG) 132265/2

Pedro Vela Shoes (PV)

Pedro Vela started PV which is now a successful business making shoes. By the time Pedro was 35 PV was a private limited company with a factory making a range of shoes. 80% of sales are now exported via agents or direct to multinational shoe retailers. PV is one of many shoe manufacturers in one region of the country. PV benefits from reliable suppliers of machinery and raw materials.

PV's market position

PV has operated successfully for 14 years but for the last three years profits have been falling. Competition is increasing in all the markets PV operates in. Costs of production are also increasing and larger shoe manufacturers are taking over smaller businesses. Pedro has prepared a detailed report that analyses the market position of PV and the reasons for falling profits. The report concludes with an outline of possible actions that might be taken. Pedro does not want to sell PV.

Marketing

Major multinational shoe retailers have buyers located in the same region as PV's factory. In addition there are independent agents who arrange to supply both domestic and international shoe retailers. Pedro makes sure that he keeps good contacts with as many agents and buyers as possible, regularly inviting them to the factory and sending them samples.

The market is changing and retailers are increasingly interested in smaller orders, shorter delivery times, higher quality and more differentiated products.

The buyer for a major retailer warned Pedro: 'I like your products and the designs and quality are good, but we cannot keep on ordering from a business that does not meet agreed delivery dates. Also, price is becoming a crucial factor in our decision to buy.'

20% of PV's output is sold within the domestic market to a small number of retail outlets. There is increasing competition from cheaper imported shoes.

Pedro has attempted to forecast future sales for export. He has used past sales data (see Appendix 1). He predicts that PV is likely to increase export sales and will continue to be successful despite the buyer's warning.

Production

PV's shoes are made using batch production with each employee specialising in one task. The leather and fabric parts of the shoes are cut out and shaped before being stitched and glued together. Other components, including shoelaces, are added. Checks for quality are only done after this stage, just before the shoes are packaged in boxes. The boxes are supplied and printed by outside printing firms.

Pedro's report showed that production problems contributed to falling profits. He identified two objectives (that should help to cut costs):

- Reduce the percentage of finished shoes failing to meet quality standards to 5%
- Reduce inventory levels.

Last year the factory's average capacity utilisation was 95%. Material waste was high and 20% of finished shoes failed to meet quality standards. PV holds a high level of inventory (of raw materials and components) in order to enable manufacture of many designs and meet increases in orders quickly.

Pedro thinks there may be more efficient and effective ways of working.

Outsourcing

The readily accessible network of suppliers is a major strength for PV. It enables PV to obtain materials and outsource production of many components. This leads to an efficient supply chain. However, it has made PV dependent on some key suppliers. Pedro is worried that costs are outside his control. He knows he needs to communicate with his suppliers more frequently.

Investment

Pedro's report identified a significant problem: the age and condition of the machinery used in production. PV is still using the machines that were put into the factory when it was first set up. This is leading to higher maintenance costs and possibly contributing to delays and lower quality. Investment in replacement machinery would solve these problems. Pedro has researched the cost of this and estimated the financial benefits that replacement might achieve (see Appendix 2). Shoe making machinery is likely to have a working life of at least ten years. This makes it difficult to forecast future cash flows and set a lifetime for this investment project. Pedro has decided that five years is a cautious estimate of useful life. He has also chosen not to give any residual value for the machines. He now has to decide whether to make this investment and obtain the finance needed for this investment.

Human Resources

Pedro assumes that all of PV's 117 employees are good at their work. There are two senior managers responsible for shoe production. Pedro consults them but he makes all the major decisions. The managers then communicate with workers and make sure Pedro's decisions are implemented. This means decisions are implemented quickly and workers know exactly what they are required to do.

One of the senior managers has recently been to see Pedro about employee attitudes and said: 'The workers know that they are paid at the average basic wage rate for the industry. However, other local firms are increasingly offering more opportunities for bonuses or payments for faster working and better promotion possibilities. Despite labour turnover currently being low we cannot assume that our employees are very satisfied. Increasing numbers of workers have told me that they are thinking of leaving the business. What can we do to prevent labour problems becoming significant?'

Future options

PV faces a difficult time and Pedro is aware that he must act to ensure future success. Pedro believes that he needs to rethink his marketing strategy. He has investigated two options. Each option will cost money and his accountant tells him that finance is only available for investing in one of these options. He intends to use the SWOT and PEST analysis from his report to help him decide (see Appendix 4).

Option A

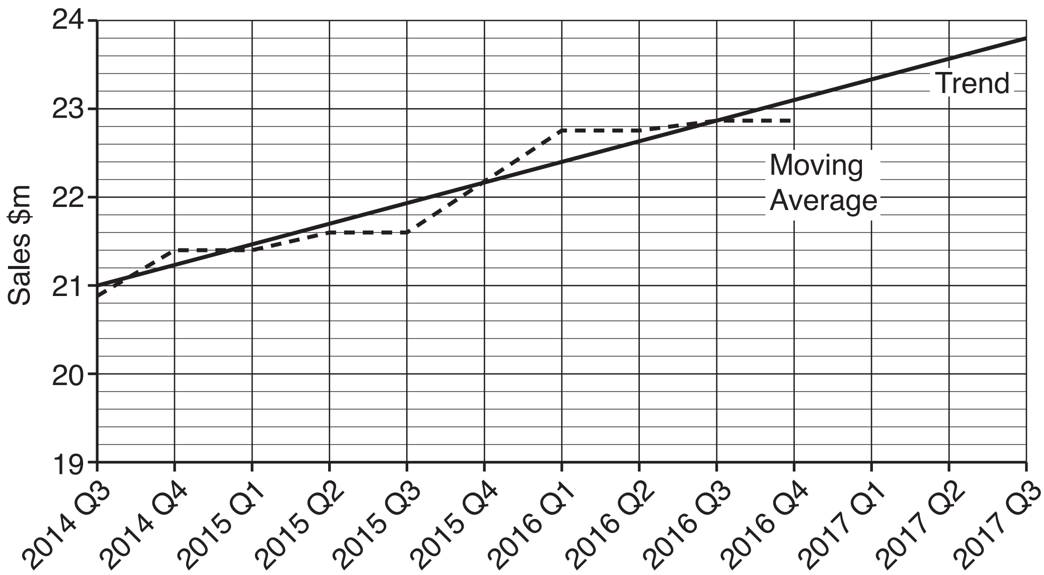
Enter the niche market of exclusive designer shoes. These shoes would sell at a premium price with a high mark-up. They would be distributed through carefully chosen retail outlets. Pedro is aware that research must be undertaken before entering this market.

Option B

Change the marketing strategy to increase sales in the domestic market by opening PV's own shoe shops. This would reduce PV's reliance on the export market.

Appendix 1: Past PV export sales

Year	Quarter	Sales $m	Sales trend (moving average) $m	Seasonal variation $m	Average seasonal variation $m
2014	1	25			
	2	21			
	3	15	20.875	–5.875	–6.125
	4	20	21.375	–1.375	See 2(a)(ii)
2015	1	30	21.375	See 2(a)(i)	7.438
	2	20	21.625	–1.625	0.313
	3	16	21.625	–5.625	–6.125
	4	21	22.125	–1.125	See 2(a)(ii)
2016	1	29	22.750	6.250	7.438
	2	25	22.750	2.250	0.313
	3	16	22.875	–6.875	–6.125
	4	21	22.875	–1.875	See 2(a)(ii)
2017	1	30			
	2	24			



Appendix 2: Forecast cash flows for new machinery

Year	Net cash flow $m	Discounted net cash flow $m (discounted at 10%)
0	–2.0	–2.0
1	0.5	0.455
2	0.5	0.415
3	0.5	0.375
4	0.4	0.272
5	0.4	0.248

Appendix 3: 10% discount factors – value of $1 in future time periods

Year	6	7	8	9	10
Discount factor	0.56	0.51	0.47	0.42	0.39

Appendix 4: SWOT and PEST analysis for PV

Strengths	**Weaknesses**
• Organised and motivated senior management • Existing supply chain • Existing sales and distribution networks • Low labour turnover	• Inflexible workforce • Old machinery • High material wastage rate • Not meeting order delivery dates
Opportunities	**Threats**
• New products • New markets • Market penetration	• Loss of workforce to local competitors • Increasing competition • Rising price of materials

Political factors	**Economic factors**
• Government grants for new business investment not available from next year • Stable government in export markets	• Rapidly increasing consumer incomes in domestic market • Consumer income stable in export market • Exchange rate of PV's home country currency is depreciating
Social factors	**Technological factors**
• Increasing use of small exclusive shops in export markets • Increasing interest in designer shoes in domestic market	• More advanced shoe making machinery available • New innovative materials for shoes increasingly available

Section A

Answer **all** questions in this section.

1 Analyse the benefits to PV of outsourcing the manufacture of components for its shoes. [10]

2 **(a)** Refer to the table in Appendix 1. Calculate:

(i) seasonal variation in 2015 Quarter 1 [1]

(ii) average seasonal variation in Quarter 4. [1]

(b) Refer to the table **and** graph in Appendix 1. Calculate PV's forecast sales for Quarter 3 in 2017. [3]

(c) Discuss the usefulness of sales forecasts to PV when making marketing decisions. Refer to your result from **2(b)**. [12]

3 Discuss how PV might change the way it organises production to achieve its objectives. [16]

4 **(a)** Refer to Appendix 2. Calculate:

(i) payback period [2]

(ii) accounting rate of return over the 5 year life of the investment [3]

(iii) net present value over the 5 year life of the investment. [2]

(b) Refer to Appendices 2 and 3. Calculate the discounted payback period if the net cash flows of $0.4m continue after year 5. [2]

(c) Refer to your answers to **4(a)**, **4(b)** and other relevant information. Recommend whether PV should invest in new machinery. Justify your answer. [12]

5 Evaluate how PV should respond to the threat of employees leaving the business (lines 65–71). [16]

Section B

Answer **one** question from this section.

6 Evaluate the importance of strategic analysis for PV when considering options A and B. [20]

7 Discuss the importance of strategic management to the future success of PV. [20]

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