



UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS  
General Certificate of Education Advanced Level

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**BUSINESS STUDIES**

**9707/03**

Paper 3 Case Study

**For Examination from 2011**

SPECIMEN PAPER

**3 hours**

Additional Materials: Answer Booklet/Paper

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**READ THESE INSTRUCTIONS FIRST**

If you have been given an Answer Booklet, follow the instructions on the front cover of the Booklet.

Write your Centre number, index number and name on all the work you hand in.

Write in dark blue or black pen.

You may use a soft pencil for any diagrams, graph or rough working.

Do not use staples, paper clips, highlighters, glue or correction fluid.

**Section A**

Answer **all** questions.

**Section B**

Answer **one** question.

The businesses described in this question paper are entirely fictitious.

You are advised to spend 40 minutes on Section B.

At the end of the examination, fasten all your work securely together.

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

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This document consists of **5** printed pages and **1** blank page.



## MERCARDO

### The current situation

Mercardo is a public limited company. It manufactures a range of consumer electrical goods. It is best known for its washing machines and refrigerators. The company's current mission statement is: 'Making the world a cleaner and fresher place for everyone'. In the most recent SWOT analysis undertaken by the company its main strength was identified as: 'Customers see our products as reliable and good value'. The key opportunity identified was: 'Extending our brand name to other products and markets'.

Mercardo manufactures its products in four factories in the same country and exports them to over 30 countries worldwide. Flow production methods are used. The company is profitable and sales are expanding, helped by rising consumer incomes in most countries. This success has resulted in problems for the business that require important decisions to be made by the Board of Directors.

### Organisational problem

Mercardo was founded many years ago by a brilliant engineer called Jin Alves. He had controlled the business using an autocratic leadership style. When Jin retired his son, Bernie, took over and used the same leadership style. All of the company's factories, functional departments (marketing, finance and research and development) and regional divisions operate under centralised control. All managers report to Head Office regularly and all major decisions have to receive central approval. This structure had real advantages when finances were very limited and when junior managers lacked experience. Now that the company is very large and has sales offices abroad, this centralised structure no longer seems appropriate. Bernie and his directors are thinking about introducing a decentralised management structure.

### Capacity problem

The existing factories have almost reached their production capacities. The Operations Director is concerned about operating labour and machines at nearly 100% of capacity. The directors have recently discussed the advantages and disadvantages of building an additional factory but located in another country.

### Quality problem

Although the company has been able to increase output, quality levels have fallen in recent months. There seem to be several possible reasons for this. Production staff are increasingly unhappy about the differences in pay between production line workers and all other staff. One trade union leader told a meeting of managers that 'My production line workers earn 50% of the pay of the quality control inspectors who are employed to check their work – yet these inspectors do not even make anything! Workers could be organised into teams and made responsible for the quality of their own output.'

All production staff are paid a low weekly wage plus a bonus for meeting output targets. All other staff in Mercardo, including the quality inspectors, are paid annual salaries. These salaries can be negotiated each year following interviews (based on staff performance) with managers. The use of two very different pay systems is causing anger amongst the production workers.

### Financial efficiency problem

Rising profits have not led to improved cash flow for the business. The Finance Director has been worried about this for some time. She has gathered some recent accounting data to analyse the company's financial efficiency (Appendix B). She might have to improve the ways in which the company manages its working capital. This could allow the business to reduce its high borrowing level.

**Pollution problem**

One of Mercardo's factories uses very old equipment that leads to a great deal of smoke and much waste. Many residents have complained to Mercardo and to an environmental pressure group. The pressure group has suggested that the pollution levels are greater than the Government allows. Mercardo's Operations Director does not want to close the factory as it would lead to lost production. 'Closing the factory would reduce our profits but also lead to job losses in this area of high unemployment' she said. She intends to replace the equipment when the company can afford it – perhaps in several years time.

**Future growth – new markets or new products?**

The company's main products are sold in markets that have almost reached maturity. Competition from other producers of washing machines and refrigerators in these markets is very high. Some of Mercardo's directors, led by the Operations Director, are keen to see the company research and develop new products that will lead to future sales and profits growth. One of the products being considered is a new type of mobile phone (cell phone). The design of this phone allows it to be produced with a choice of a wide range of features. These include a video camera, advanced games console, Internet access and safety alarm. Different features will appeal to different groups of consumers. The Operations Director believes that these different features will allow effective segmentation of the mobile phone market in many different countries.

The Marketing Director is worried about the cost of this strategic option. She would prefer the firm to continue with the strategy of further market development. She has researched the consumer electrical products market in country Z and she wrote a report to the Board suggesting that there is considerable potential in country Z for Mercardo's existing products. 'We should not take the risk of researching and developing advanced products that we have little experience of. Selling our existing products in new markets is the safer option' she concluded in her report.

The Finance Director has produced some forecasted cash flows for these two options – Option A is the new market and Option B is developing the new phone product. These forecasts are shown in Appendix A.

**Appendix A: Forecasted Net Cash Flows \$m**

End of year	Option A – new market	Option B – new product
0	(5.0)	(6.0)
1	2.5	4.0
2	2.5	3.0
3	2.5	3.0

10% discount factors:

Year 1 0.91

Year 2 0.83

Year 3 0.75

**Appendix B: Accounting data for Mercardo \$m**

	30/9/2008	30/9/2009
Trade receivables (debtors)	32	46
Inventories (stocks)	120	180
Annual revenue (sales turnover) for year ending	400	500
Cost of sales for year ending	200	250

**Appendix C: Forecast economic data for country Z and average of other countries Mercardo sells products in**

2012	Country Z	Average of other countries
% Growth in GDP	5	3
% Inflation	12	4
% Unemployment	6	8

**Section A**

Answer **all** questions in this section.

- 1 Analyse the advantages and disadvantages for Mercardo of introducing a decentralised management structure. [10]
- 2 (a) Using data in Appendix A, calculate for both strategic options A and B:
  - (i) Average Rate of Return (ARR) [4]
  - (ii) Net Present Value (NPV) using 10% discount factors in Table 1 [4]
- (b) Briefly assess the value of these results to Mercardo's directors. [4]
- (c) Discuss whether Mercardo should keep open the factory that pollutes the local environment. [12]
- 3 (a) Using data in Appendix B and appropriate ratios, analyse the financial efficiency of the business. [6]
- (b) Evaluate any **two** ways in which the business might improve its financial efficiency. [8]
- 4 Evaluate the most important features of a marketing strategy that would be appropriate for the new phone, assuming this was developed. [16]
- 5 Evaluate the most appropriate ways, both financial and non-financial, of motivating staff in a Mercardo factory. [16]

**Section B**

Answer **one** question in this section.

- 6 Evaluate the factors that Mercardo directors should consider before making the strategic choice between the two alternative growth strategies. [20]
- 7 Discuss the significance of strategic analysis to the future success of Mercardo. [20]

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