



UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education Advanced Level

BUSINESS STUDIES

Paper 3

CASE STUDY

9707/03

May/June 2007

3 hours

Candidates answer on the enclosed Answer Booklet.

Additional Materials: Answer Booklet/Paper

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, candidate 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, graphs or rough working.

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

DO NOT WRITE ON ANY BARCODES.

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.

This document consists of **5** printed pages and **3** blank pages.



CRAFT DESIGNS

Recent rapid growth

The growth of Ade's business had surprised everyone, especially Ade. Since starting the private limited company twelve years ago it has become the market leader in the tourist gift market in his country. The company produces stone sculptures, wooden carvings and printed textiles. 90% of sales are to tourists, either through Ade's own shops or other retail outlets. There is no doubt that the rapid expansion of the business has been helped greatly by the 300% increase in foreign tourists visiting the country over the last 10 years. 5

Ade has always been an independent person. His first job in the local soft drinks business had frustrated him despite offering a regular income and secure working conditions. He disliked working for a large organisation in which he had no real responsibility or chance of promotion. When the drinks firm was taken over he, with several other workers, was made redundant. Several of his colleagues immediately started looking for new jobs but Ade used the first two weeks after his redundancy to think seriously about his future. 10

He believed he was a natural salesman since winning the Young Enterprise Award at school for his own "mini company" selling home made sweets. Ade's winning smile and quick sense of humour helped him to break all sales records! He wanted to use his skills to his own advantage. He had a small amount of savings and he decided to use these to set up his own market stall, selling printed textiles that his sister and her friends were already making for a large retail store in town. 15

Now, twelve years later, he has several small workshops producing quality sculptures, wooden carvings and printed textiles. Ade still purchases about half of the finished goods needed from independent producers. This outsourcing of supplies gives the business great flexibility without having to build further workshops. One of the main problems with outsourcing from other producers is the need for additional quality control checks. About half of all products are sold through the company's retail shops, located in all of the major tourist areas. The rest are sold, on credit, to other gift shops. 20
25

The growth of the business has brought both its rewards and problems. At the most recent Board of Directors meeting the following issues had been discussed.

Product portfolio

Although growing in overall size, the tourist market is changing. Fewer family groups visited the country last year. These visitors had tended to buy large gifts for their homes. However, recently there has been a huge increase in the number of young travellers. These younger tourists seemed to fall into two distinct groups. The first group are dominated by high income earners who visit the country to stay at luxury lodges and hotels. The other main group is made up of tourists who take part in "environmentally aware" or "eco-tourism" holidays, visiting the country's beautiful nature reserves. This group is often worried about the exploitation of scarce resources. Market research evidence also seems to suggest a move away from large-scale traditional craft gifts towards jewellery made from precious metals and gem stones. Ade realised the company had to adapt to keep up with these changing tastes. 30
35

He was keen to move into the jewellery market, but realised the specialist nature of the product and the segmentation of the market. Workshop space was not currently available to expand into jewellery production but the Operations Director put forward a rather surprising proposal at the meeting. 40

“Look at this financial data (Table 1). The workshop production of stone sculptures is unprofitable. This situation results from higher raw material costs – stone supplies are now running out in our country – and lower than expected price rises for the finished goods. If we stopped producing these stone products, this would free up workshop space for jewellery production. We could then totally outsource production of stone products to manufacturers in other countries with greater reserves of the natural stone. Our staff will need retraining to make jewellery or, if they cannot learn the new skills required, they will have to be replaced by new workers.” 45

The directors studied the following table produced by the Operations Director but they were not all convinced by his arguments. 50

Table 1: Financial data for the three products manufactured by Craft Designs

| For year ending 31/5/07 | Stone sculptures (\$000) | Wooden gifts (\$000) | Printed textiles (\$000) |
|---|--------------------------|----------------------|--------------------------|
| Sales revenue (from products made in own workshops) | 4,000 | 3,000 | 6,000 |
| Direct material costs | 2,000 | 500 | 1,500 |
| Labour costs | 1,000 | 1,000 | 2,000 |
| Allocated factory overheads | 500 | 300 | 300 |
| Allocated administration overheads | 750 | 600 | 600 |
| Profit / (Loss) | (250) | 600 | 1,600 |

Economic conditions

The growth of the company had occurred during a period when the macro-economic conditions in the country had been favourable. Recently, some economists have been suggesting that significant changes might be needed in Government economic policy to keep the economy growing steadily. Ade showed the Government economic forecasts in Appendix A to the other directors. He said: “Our company will undoubtedly be affected if these forecasts turn out to be true”. 65

Control of working capital

The Finance Director produced the financial data contained in Appendix B. She commented that: “We have not managed to control our finances as well as planned. Rapid sales growth has not improved our working capital position. If I were to calculate the debtors days and stock turnover ratios, the results would reinforce the need to take action to improve our financial efficiency. Unfortunately, all possible actions involve some drawbacks to the business”. 70

Appendix A – Government Economic Forecasts

| | End of 2007 | End of 2008 | End of 2009 | 75 |
|---|-------------|-------------|-------------|----|
| Inflation (annual %) | 10 | 20 | 18 | |
| Unemployment as % of working population | 7 | 8 | 9 | |
| Exchange rate index (2006=100) * | 100 | 95 | 90 | |
| Interest rates (%) | 8 | 14 | 12 | |

* The exchange rate index measures the average value of a country's currency. A higher value would indicate a currency appreciation. 80

Appendix B – Extract from Craft Designs published accounts for year ending 31/5/07

| | | |
|-----------------------------------|-------|----|
| Sales Revenue | \$28m | |
| Gross profit | \$12m | |
| Debtors | \$7m | 85 |
| Stocks including work in progress | \$4m | |
| Short term creditors | \$12m | |
| Cash | \$1m | |

Section A

Answer **all** questions in this section.

- 1 Discuss the risks and rewards to Ade resulting from his original decision to set up his own business. [14]
- 2 (a) Calculate the effect on the company's profit of stopping production of the stone sculptures. Show your calculations and state any assumptions you make. [6]
 - (b) Using your result from (a) and any other useful information from the case, recommend whether Ade should stop production of the stone sculptures. [10]
- 3 Evaluate the likely impact on the business of the forecast economic conditions in Appendix A. [14]
- 4 (a) Using the two ratios suggested by the Finance Director, analyse and comment on the financial efficiency of Craft Designs. [10]
 - (b) Outline **two** drawbacks to the ratio analysis that you have conducted. [4]
 - (c) Discuss **two** ways in which the Finance Director could improve the financial efficiency of the company. [8]
- 5 Evaluate the importance to Craft Designs of effective market segmentation in the tourist gift market. [14]

Section B

Answer **one** question from this section.

- 6 Discuss the relative importance of the factors, **apart from** external economic conditions, that are most likely to affect the future success of Craft Designs. [20]
- 7 The Operations Director has proposed outsourcing all supplies of stone sculptures so that the company could start jewellery production. Discuss how Ade might try to solve what you consider to be the most important **human resource** and **operational management** problems that might result from this decision. [20]

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