MARK SCHEME for the May/June 2014 series

9771 BUSINESS AND MANAGEMENT

9771/02   Paper 2 (Strategic Decisions), 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 should be read in conjunction with the question paper and the Principal Examiner Report for Teachers.

Cambridge will not enter into discussions about these mark schemes.

Cambridge is publishing the mark schemes for the May/June 2014 series for most IGCSE, Pre-U, GCE Advanced Level and Advanced Subsidiary Level components and some Ordinary Level components.

CAMBRIDGE
International Examinations

Section 1

1   **Using the financial statements as at 26 February 2011:**

(a) (i) Calculate the asset turnover ratio for HRG [3]
Formula: Turnover/Net assets (1)
Turnover £5,851.9m/Net assets £2,741.2m (1)
= 2.13 (3)
Correct answer only = 3 marks

(ii) Calculate the acid test ratio for HRG [3]
Formula: Current assets – inventories/current liabilities (1)
Current assets £1,898.7m – inventories £1,016.8m = £881.9m (1)
/Current liabilities £1,118.5
= 0.79 (3)
Negative answer = –1 mark
Correct answer only = 3 marks

(b) With reference to part (a) comment on the usefulness of <u>one</u> of these ratio values to HRG [6]

Knowledge AO1 2 marks	Application AO2 4 marks
2 marks Candidate shows precise knowledge of the ratio. Two distinct points.	**4–3 marks** Candidate uses two contextual points
1 mark Candidate shows limited knowledge of the ratio. One point explained.	**2–1 marks** Candidate uses one contextual point

Asset turnover
Measures the productivity of assets
How much turnover is generated by the assets employed?
2011 v 2010 comparison 2.13 v 2.10 (marginal improvement)
For every £1 invested in net assets £2.13 of turnover was generated
Industry specific/benchmark required
Increasing turnover using the same or fewer assets will improve this ratio
If HRG close the less profitable stores this could improve the ratio
ARA

Acid test
Also known as the quick ratio
A more severe test of liquidity than the current ratio because of the exclusion of stocks as a liquid asset
Stock for HRG may be considered relatively liquid (stock turnover ratio)
0.79 means that currents assets minus stock do not cover current liabilities
Industry specific
A ratio less than 1 is typical of retailers
2011 v 2010 comparison 0.79 v 1.0
ARA

(c) Using any <u>two</u> elements of Porter's Five Forces model, analyse the competitive position of HRG [13]

	Knowledge AO1 2 marks	Application AO2 5 marks	Analysis AO3 6 marks
Level 3		**5 marks** Candidate fully engages with the case context.	**6–5 marks** Candidate fully develops analytical points.
Level 2	**2 marks** Candidate shows clear and precise knowledge of Porter's model. Two aspects of Porter's 5 forces used.	**4–3 marks** Candidate links case material to his answer.	**4–3 marks** Developed analysis of arguments.
Level 1	**1 mark** Candidate shows a vague understanding of Porter's model. One aspect of Porter's 5 forces used.	**2–1 marks** Candidate makes a limited attempt to apply knowledge to the case study.	**2–1 marks** Weak analysis of ideas, failure to develop points.

1 Bargaining power of suppliers
   Likely to be low because of excess capacity in the economic downturn
   HRG have numerous suppliers available
   Globalisation has increased possible suppliers and reduced supplier power
   Vast competition between suppliers

2 Bargaining powers of buyers
   Online purchasing has increased the power of buyers
   Price comparison sites have increased buyer power
   Number of potential retailers to choose from has increased buyer power

3 Threat of new entrants/barriers to entry
   Tesco entry into the online market
   Entry barriers through economies of scale advantage exist

4 The threat of substitutes
   This could affect Argos TV sales if consumers use mobiles or iPads

5 Competitive rivalry among existing firms
   Amazon
   Tesco
   Ebay
   ARA

Section 2

	Knowledge AO1 3 marks	Application AO2 6 marks	Analysis AO3 8 marks
Level 3		**6–5 marks** Arguments are consistently based upon clear and relevant case context.	**8–6 marks** Candidate fully develops analytical points.
Level 2	**3–2 marks** Candidate shows detailed knowledge.	**4–3 marks** Candidate makes a good attempt to apply knowledge to the specific case scenario.	**5–3 marks** Developed analysis of arguments.
Level 1	**1 mark** Candidate shows some knowledge.	**2–1 marks** Candidate makes very limited attempt to apply knowledge to the specific case study.	**2–1 marks** Weak analysis of the ideas, failure to develop points.

	Evaluation Descriptor AO4	Marks
High	Extensive reasoned judgement in answer and conclusion	8–6
Mid	Good judgement shown in the answer and conclusion or extensive judgement in answer or conclusion	5–3
Low	Weak judgement shown in answer or conclusion.	2–1

2 **Evaluate how HRG could respond to the continued prospect of volatile exchange rates**

[25]

- Definition of exchange rate
- Interpretation of volatile
- Likely duration of the volatility
- Refer to fig. 3
- Only 33% of products are imported. This means 66% are domestically sourced. Could this figure be increased?
- Use fixed exchange rate contracts with suppliers
- Increase flexibility of suppliers. Perhaps import from different countries. Realistic?
- Volatility can work in HRG's favour if the £ appreciated v the US$
- Currency cost is only one factor to be considered. Lead times, quality and other issues are significant
- Use currency hedging
- HRG also exposed to Euro and other currencies
- ARA

3 **Evaluate whether current director remuneration packages are appropriate given the performance of HRG** **[25]**

- See Table 3
- How is 'appropriate' defined?
- Current performance of HRG is very average
- See chart for underperformance of HRG v FT350 index
- Performance related pay
- What does pay include (fringe benefits)?
- Pay differential between directors and shop floor workers
- Are the companies that HRG benchmarks pay against comparable?
- Do employees get fringe benefits and perks such as share options?
- The link between pay and motivation (theorists)
- Should the pay reflect higher unemployment and a reduction in real incomes?
- The 'shareholder spring' highlights a growing resentment of director salaries
- If directors are not well paid, they may leave
- It could be difficult to attract excellent directors if pay is not comparable with industry norms
- Ethical considerations
- ARA

4 **Recommend and justify a strategy which could enable Argos to improve profitability** **[25]**

- Cost reduction strategy: This could involve the non-renewal of leases. Possibly store closures especially underperforming stores. Store closures could be costly.
- Try and renegotiate leases
- Consider shutting one store in a location that has two stores (decision depends on performance)
- Improve the product offering and/or alter the product offering to reflect consumer tastes, margins and group position (see Table 1)
- Increasing the prices is unlikely to be successful given the level of competition and the weak consumer demand
- Continued focus on its key competitive advantages of price and convenience
- Is improving profitability realistic in the current economic climate? Perhaps maintaining profits or survival is more realistic
- 2011 ROCE 8.31% v 2010 9.08% (falling ROCE)
- 2011 Gross profit margin 32.15% v 2010 32.67%
- 2011 Net profit margin 4.29% v 2010 4.81% (suggests large overheads and cost of sales
- ARA