UNIVERSITY OF CAMBRIDGE INTERNATIONAL EXAMINATIONS
General Certificate of Education
Advanced Subsidiary Level and Advanced Level

BUSINESS STUDIES **9707/02**

Paper 2 Data Response

May/June 2006

1 hour 30 minutes

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

Answer **all** questions.
The businesses described in this question paper are entirely fictitious.
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 **4** printed pages.

(NH) T04330/1

UNIVERSITY *of* CAMBRIDGE
International Examinations

[Turn over

1 **Star Pharmaceuticals**

Star Pharmaceuticals (SP) is a multinational, based in Country A. SP manufactures a wide range of medicines. SP makes very high profits but large investments are needed to develop new medicines. The international market for medicines is highly competitive, but growing rapidly. Recently there have been complaints about SP's prices in some developing countries. SP have developed a new medicine to help with an illness common in these countries.

The Board of Directors are considering a proposal to relocate production facilities for this new medicine to a developing country (Country B). This will enable them to introduce more modern flow production systems. The Board has been given the following information:

	Country A (current location)	**Country B** (proposed location)
Economy	Developed	Developing
Wages	High	Low
Geographical location	Central	Remote
Market for current products	Very large	Small
Market for new product	Small	Potentially large
Government incentives	High	None
Land costs	Very high	Low
Production:		
Fixed costs/year	\$1.5m	\$4m
Variable cost/item	\$6.00	\$2.00
Typical price delivered	\$7.00	\$6.00

Although there is a good supply of labour in Country B, much of it is unskilled. The move will help to reduce bad publicity about multinationals exploiting developing countries. SP will not have to meet the strict employment laws of Country A.

One option the Board is considering if the relocation takes place is to change the organisation structure from one based on function to one based on country.

(a) Explain the following terms:

(i) flow production (line 9) [3]

(ii) variable cost (line 22). [3]

(b) Explain the factors that SP might consider in deciding on an organisational structure if they relocate some of their production to Country B. [6]

(c) Discuss the extent to which ethical issues should concern SP. [8]

(d) **(i)** The break even level of production for the factory in Country A is 1.5 million units. Using the data from the case, calculate the break even level of production for the factory in Country B. [2]

(ii) Using your answer to **(d)(i)**, and other information in the case, evaluate the decision to relocate some production to Country B. [8]

2 Home Farm

Tom and Mary own Home Farm. They produce a range of vegetables. All of their produce is exported through a wholesale outlet in the city. In years when prices are low, the farm makes a loss. Some large countries in their export market are threatening import quotas on vegetables. Exchange rates have a big impact on the profits that the farm makes.

Option A

Mary has been approached by Quicksell, the largest supermarket chain in their country, to supply them with vegetables. Quicksell will offer Home Farm a 5-year contract:

- Mary and Tom will have to spend $20,000 on special equipment for preparing, cleaning and packaging the vegetables;
- All vegetables will have to meet exceptionally high quality and size standards;
- The supermarket will guarantee to buy all suitable products at set prices. These prices have been agreed for the first year at a low level.

If Mary and Tom accept the contract they will have to reduce costs mainly through increased efficiency and making some workers redundant.

Option B

Tom wants to buy a van so that he can transport directly to the wholesale outlets rather than using transport businesses.

Tom and Mary have produced the following cash flows for the two possible options:

Table 1 Cash Flows Forecasts ($000)

Year	0	1	2	3	4	5
New Van	–10	+2	+4	+6	+8	+10
Quicksell contract	–20	+10	+10	+10	+10	+10

To finance either project, Tom and Mary will have to borrow from the bank.

Tom and Mary employ 10 full time staff. The employees are very worried that the Quicksell contract might affect them. As a result they are considering joining The Farmworkers Union (TFU).

(a) Explain the following terms:

(i) wholesale outlet (line 2) [3]

(ii) export market (line 3) [3]

(b) Explain how an increase in the country's exchange rates could affect the farm's profits. [4]

(c) **(i)** Calculate the values of X and Y in the following table:

	Average rate of return (ARR)	Payback
Van	40%	X
Supermarket contract	Y	2 years

[4]

(ii) Using relevant information from the case and these ARR and Payback figures, advise Tom and Mary whether to choose the van or the supermarket contract. Justify your answer. [10]

(d) Analyse reasons why the employees might join The Farmworkers Union (TFU). [6]