Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

BUSINESS STUDIES	**9707/33**
Paper 3	**October/November 2015**
CASE STUDY	
	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, candidate number and name on all the work you hand in.
Write in dark blue or black pen.
You may use an HB pencil for any diagrams or graphs.
Do not use staples, paper clips, glue or correction fluid.
DO **NOT** WRITE IN ANY BARCODES.

Section A
Answer **all** questions.
Section B
Answer **one** question.
You are advised to spend 40 minutes on Section B.
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 **5** printed pages and **3** blank pages.

Farah's Fruit Farms (FFF)

Farah became the Chief Executive Officer of FFF, a public limited company, 15 years ago. She has developed the business into one of the largest suppliers of fresh fruit and vegetables in country A. FFF now owns 15 farms. 50% of FFF's output is sold directly to large supermarket chains in country A. 25% is exported to a food distribution company in country B. The rest is used to produce tinned vegetables or fruit juice in FFF's own processing factory located in country A. If there is a poor harvest FFF buys in supplies of fruit and vegetables from farms in country C.

Should dividends be increased?

At the Annual General Meeting (AGM) last month, many shareholders spoke encouragingly about the success of Farah and her management team. However there were complaints about the low dividend proposed by the Board. Farah explained at the AGM: 'The directors believe that the need for internal finance during a period of rapid company growth justifies the level of dividends that we are proposing. With further successful growth, dividends can be slowly increased over the years to come – but not yet.' Some angry shareholders tried to organise a vote against the re-election of some directors but this attempt to change Board members failed to gain enough support. A summary of the evidence shareholders used when arguing for a dividend increase is contained in Table 1.

Table 1: Selected data used by shareholders of FFF

	2015	**2014**
Profit (before tax) for the year	\$16m	\$12m
Total dividends	\$4.5m proposed	\$4m paid
Share price as at 30th September	\$10	\$7
Total number of issued shares	20m	20m
Dividend yield	See **2(a)(i)**	2.85%
Price earnings ratio	See **2(a)(ii)**	11.67
Gearing ratio	22%	24%
Average dividend yield for public limited companies in country A	5%	6%
Average price earnings ratio for public limited companies in country A	9	12
Central bank base lending rate	6%	8%

Problems in fruit juice production

Unit costs of fruit juice production have increased by 15% in 2015. This is not as a result of increases in fruit costs but has been caused by declining production efficiency. Labour productivity and capital productivity have both declined, while waste levels and inventory levels have increased.

Customer complaints about the quality of some of the fruit juices have increased. One batch of old orange juice had mistakenly been sold to a supermarket. Its 'sell by date' had not been printed on the containers due to broken packaging equipment. Several customers complained about the effect this juice had on their health.

A television report had even suggested that FFF juice had led to several cases of poisoning. FFF's Marketing Director rejected this suggestion and quickly responded by using over half of the annual promotion budget on television advertising in one week. The imported machine used for packaging has been idle for several weeks due to delays over obtaining a spare part. No contingency plan had been prepared.

The Operations Director plans to adopt lean production practices within the fruit juice production section of the factory. He reported to a recent Board meeting: 'All of FFF's production and quality problems can be solved by the adoption of lean production techniques'.

Special order

A buyer from the biggest supermarket chain in country B has met with Farah to discuss a possible first order from FFF for canned vegetables. This order would initially be for two years only. It would raise the capacity utilisation of this production line from 75% to 95%. The buyer is a tough negotiator and has offered no more than $0.30 per can for 400 000 cans per year. This is $0.10 less than FFF's usual selling price. Farah has heard rumours that the buyer has also been talking to other food growers and processing companies within country A. Before deciding whether to accept the order Farah studied the data in Table 2, prepared for her by the Operations Director.

Table 2: Operations data for FFF vegetable canning division

Factory capacity	2 million cans per year
Allocated factory fixed costs per can at maximum capacity	$0.10
Packaging and labelling cost per can	$0.08
Average unit cost of vegetables per can	$0.15
Transport costs per 2000 cans	$100

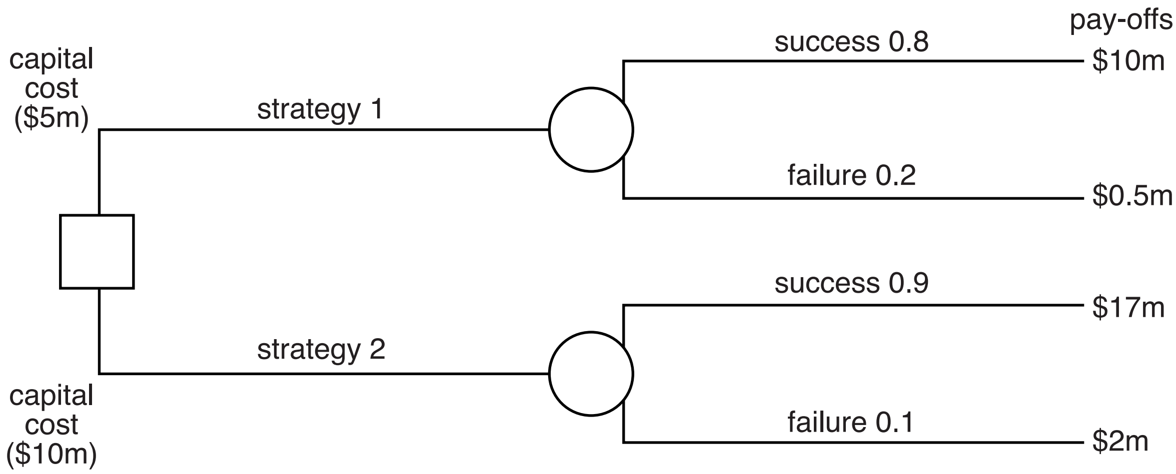
Workforce issues

Only 15% of employees on FFF's farms are given full time permanent contracts. 18% of factory workers have full time permanent contracts. The harvesting of fruit and vegetables is seasonal so the farms employ most workers on a temporary basis. Demand for canned vegetables and fruit juice is also subject to seasonal and cyclical variation. However, FFF has experienced a general upward trend in sales in recent years, although no attempts have been made to forecast future sales using moving averages.

The extensive use of temporary and flexible contracts for most of the factory workers helps to control costs. FFF has a very small budget for employee training. This low cost human resource strategy helped to make FFF one of the most competitive food supply businesses in 2014. However, this strategy does have its drawbacks. Labour shortages at key times can occur if FFF's workforce planning proves to be incorrect. These shortages are especially important if they are for workers with special skills such as machine maintenance staff or machine operators. In addition, as unemployment continues to fall in country A, potential employees become more reluctant to accept employment contracts that offer little job security.

Future growth strategies
Farah is keen to continue with the expansion of FFF. She takes great pride in controlling such a well-known business. Other directors support her objective of putting long term growth ahead of short term profit. Farah has asked the Board of Directors to decide between two growth strategies that have been identified by a team of management consultants in a report she commissioned. Information about the two strategies is contained in Appendix 1 and Appendix 2.

Appendix 1: Decision tree for the two potential growth strategies



Appendix 2: Data for the two potential growth strategies for FFF

Growth	Strategy 1	Strategy 2
Outline	Introduce a range of ready prepared meals. These meals would use ingredients from FFF farms and meat suppliers in country A.	Establish a new factory in country B where labour costs are currently 50% less than in country A.
Major risk	Supply of meat, to be used in these ready prepared meals, is controlled by three companies in country A. Supplies could be withdrawn if FFF tries to insist on lower meat costs.	Disruption to production caused by industrial action. Trade unions have recently been legalised in country B and many strikes have been organised in an attempt to raise wages.
Estimated internal rate of return over 5 years	12%	15%
Annual average rate of growth in GDP in last 5 years	Country A: 4%	Country B: 6%
Competitive rivalry	Not high at present time as ready prepared meals are not widely available in country A. If demand increased it would be easy for existing food producers to develop their own range of ready prepared meals.	Likely to increase as the new Government is encouraging competition between private sector businesses. Many industries have recently been privatised.

Section A

Answer **all** questions in this section.

1 Analyse the likely effects on FFF of a depreciation in the exchange rate of country A's currency. [10]

2 **(a)** Refer to data in Table 1. Calculate for 2015:

(i) dividend yield [3]

(ii) price earnings ratio. [3]

(b) Using your results from **(a)** and other information, advise FFF's shareholders whether to sell or keep their shares in FFF. [10]

3 Evaluate the extent to which you agree with the Operations Director that: 'All of FFF's production and quality problems can be solved by the adoption of lean production techniques'. (Lines 35–36.) [16]

4 **(a)** Calculate the effect on FFF's annual profit if the decision was made to accept the special order from the supermarket chain in country B. [6]

(b) Using your result from **(a)** and other information, recommend to FFF's directors whether they should accept the special order. Justify your answer. [16]

5 Assess the extent to which the use of sales forecasting might improve the effectiveness of FFF's human resource management, such as workforce planning. [16]

Section B

Answer **one** question from this section.

6 Using Appendix 1, Appendix 2 and other information, recommend to the Board of FFF whether they should choose growth strategy 1 or growth strategy 2. [20]

7 Evaluate the extent to which contingency planning might help FFF achieve its long term growth objective. [20]

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