M19/3/BUSMT/HP1/ENG/TZ0/XX

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BUSINESS MANAGEMENT

HIGHER LEVEL

PAPER 1

Practice examination 2019 – **Radeki de Dovnic Manufacturing**

2 hours 15 minutes

INSTRUCTIONS TO CANDIDATES

- Do not open this examination paper until instructed to do so.
- A clean copy of the **IB Business Management case study – Radeki de Dovnic Manufacturing** is required for this examination paper.
- Read the case study carefully.
- A clean copy of the **IB Business Management formulae sheet** is required for this examination paper.
- Section A: answer two questions.
- Section B: answer question 4.
- Section C: answer question 5.
- A calculator is required for this examination paper.
- The maximum mark for this examination paper is **[60 marks]**.

SECTION A

Answer **two** questions from this section.

QUESTION ONE

a. Outline the importance of wholesalers (line 52) to Radeki de Dovnic Manufacturing. **[4 marks]**

b. With reference to Radeki de Dovnic Manufacturing, distinguish between capital expenditures (line 54) **and** revenue expenditures. **[6 marks]**

QUESTION TWO

a. Outline **two** key features of a democratic leadership style **and two** key features of a paternalistic leadership style (line 89). **[4 marks]**

b. With reference to Radeki de Dovnic Manufacturing, explain the importance of branding (line 123). **[6 marks]**

QUESTION THREE

a. With reference to Radeki de Dovnic Manufacturing, distinguish between product innovation **and** process innovation (line 94). **[4 marks]**

b. Explain **two** reasons why organisations such as Radeki de Dovnic Manufacturing implement corporate social responsibility strategies. **[6 marks]**

SECTION B

Answer the **compulsory** question from this section.

QUESTION FOUR

Executives at RDM have suggested that it might be profitable to make the manufacture of customised aluminium water bottles a distinct division of the company. Jan and his chief financial officer (CFO) are unsure if this is a good idea and whether it would be in line with the strategic objectives of RDM. However, buoyed by the success of the manufacturing trial and the positive feedback received from the medical company receiving their aluminium water bottles, Jan believes that this is a project worth investigating.

He tasks his CFO to coordinate with the marketing and operations departments to conduct market research to assess the potential demand for such a product and estimate production capacity, the costs, price points and revenues associated with the manufacture of aluminium water bottles. The marketing team conducted a series of surveys and **focus groups**.

Jan is especially interested in how a marketing mix could create a **unique selling point** for such a product and the quantities that will need to be sold to breakeven.

When the team reports back to Jan, they forecast the following:

- Maximum production capacity: 20,000 units per month
- Fixed costs: €80,000 per month.
- Unit variable costs (including direct labour and raw materials): €2.50 per unit.
- Delivery costs: €1.50 per unit
- Retail price: €9.99 per unit.

They also report that there is considerable interest among potential customers in having a fully customisable water bottle to meet the specifications of each customer. However, there is considerable competition in this niche market, particularly from low-cost Chinese manufacturers.

a. Define focus group **and** state whether the use of focus groups is an example of primary or secondary market research. **[2 marks]**

b. Calculate the break-even point **and** profit at full capacity. Comment on your answer. **[4 marks]**

c. Explain the importance of RDB having a unique selling point for its aluminium water bottles. **[4 marks]**

d. Using information from the case study, additional information above **and** your results from part (b), discuss whether RDM should proceed with setting up a new division to produce customised aluminium water bottles. **[10 marks]**

SECTION C

Answer the **compulsory** question from this section.

QUESTION FIVE

5. To help with the operations management strategy at RDM, Jan has tasked his chief financial officer (CFO) to provide him with detailed financial forecasts and cost estimates regarding alternative locations for the possible new production facility.

When reporting back to Jan, the CFO summarised the information in the following table. The quantitative information relates to the initial cost and profitability of three alternative locations for the production facility:

- Option A: Poland
- Option B: Germany
- Option C: Slovenia

Each of these locations has good rail, road and seaport infrastructure for exporting into European markets and even further abroad if opportunities arise.

Taking into consideration the external economic environment, the CFO was able to produce profitability forecasts based on the different economic conditions that can prevail at any time in the European market for healthcare products – during periods of fast and normal economic growth, as well as economic recession. Based on market research the CFO believes that there is a 20% chance of fast economic growth, 50% chance of normal economic growth and a 30% chance of a recession

Table 1: Cost and profit estimates for production facilities in three European countries

			Projected profits based on economic conditions ($m)		
		Initial cost ($m)	**Fast growth**	**Normal growth**	**Recession**
Option A	**Open factory in Poland**	120	400	200	-100
Option B	**Open factory in Germany**	150	500	300	-50
Option C	**Open factory in Slovenia**	80	150	120	100

RDM has the option of financing the alternative production facilities through an initial public offering (IPO); i.e. to “go public” [line 117]. It also has the option of securing funding with a long-term bank loan, and the CFO notes that while interest rates are at historic lows bank lending restrictions are relatively tight in the current economic and regulatory environment.

RDM does not have the option of issuing additional shares privately to raise the large amount of capital that is required to finance this project, even for the low-cost country. The balance sheet of RDM is shown (Table 2, below) and this provides important financial information to bankers and prospective shareholders interested in a possible IPO.

Table 2: RDM balance sheet

Radeki de Dovnic Manufacturing **Balance Sheet as of 30 April 2019**		
	$m	**$m**
Fixed assets		
Fixed assets	50	
Accumulated depreciation	2	
Net fixed assets		48
Current assets		
Cash	1	
Debtors	1.2	
Stock	3.5	
Total current assets	5.7	
Current liabilities		
Overdraft	0.5	
Creditors	1.5	
Short-term loans	2.2	
Total current liabilities	4.2	
Net current assets (Working capital)		1.5
Total assets less current liabilities		49.5
Long-term liabilities (debt)	30	
Net assets		19.5
Financed by:		
▪ Share capital	11	
▪ Retained profit	8.5	
Equity		19.5

Using the case study and the additional information on pages 3 - 5, recommend what you believe to be the best option for RDB to achieve its strategic objectives **and** the company's best method of finance.

You will find it useful to prepare a decision tree based on the data for the options **and** calculate the expected values of each option.

[20 marks]