

## 5: Financial information and decisions

### Paper 2 – Topic questions

The questions in this document have been compiled from a number of past papers, as indicated in the table below.

Use these questions to formatively assess your learners' understanding of this topic.

Question	Year	Series	Paper number
1b	2017	March	22
3b	2017	March	22
4a	2017	June	21
4b	2018	March	22

## Bags and Belts (BB)

BB is a small private limited company. It manufactures leather handbags and belts. It only uses the best quality leather. BB sells the bags and belts using its own brand name to large retailers. BB currently does not use the Internet in its business operations.

The leather used by BB has always been purchased from the same local business since BB was set up. This supplier guarantees high quality leather and has always delivered on time.

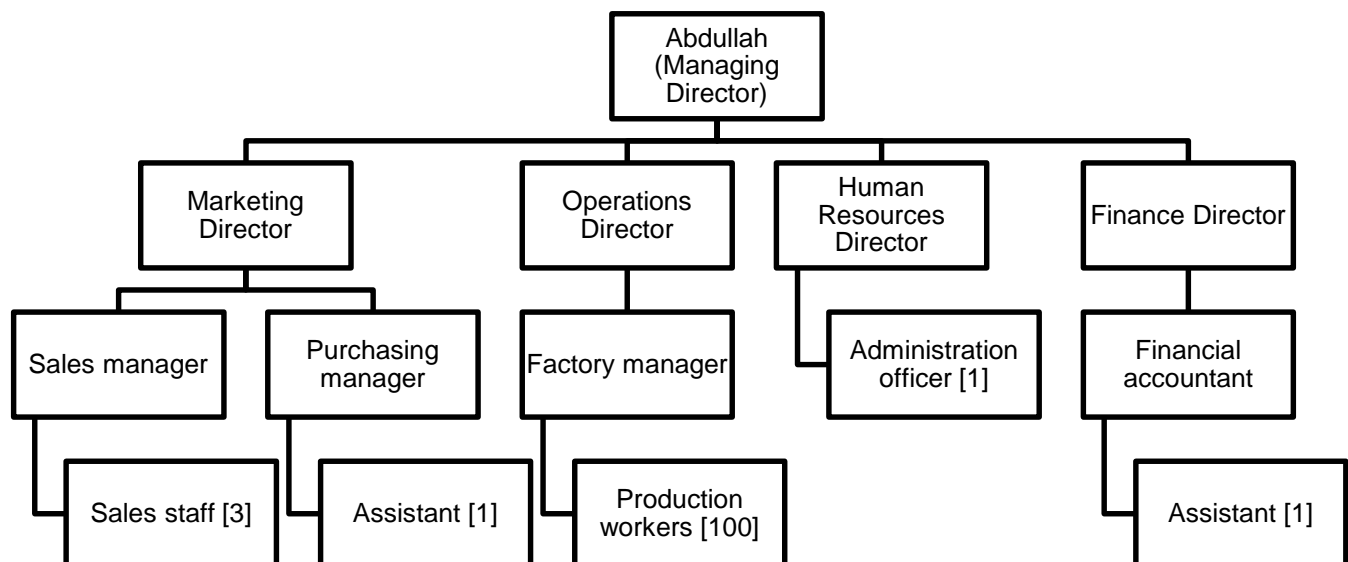
BB was started 35 years ago and is now managed by Abdullah, the grandson of the original owner. The other directors are all members of the family. BB employs workers from the local community to manufacture the handbags and belts.

BB uses batch production. The workers who make the handbags and belts are skilled, but wage costs are kept low by employing young workers to pack the products. The production process has waste materials and these are put into the nearby river. However, local people complain that it affects their drinking water.

The directors want to increase profit. They are thinking of either increasing prices or making some of the handbags out of a material that looks like leather but is much cheaper to buy. The Marketing Director thinks the demand for their handbags is price inelastic as many consumers are loyal to the BB brand.

### Appendix 1

#### Organisation chart for BB



## Appendix 2

From: Abdullah  
To: BB directors

I want BB to expand and I am considering the following two options.

### Option A:

Sell BB branded handbags to wholesalers. This will allow BB to sell its handbags all over the country. We will need to spend a lot of money on advertising in magazines aimed at people on high incomes. The economy has been growing rapidly and many people now have high incomes.

### Option B:

To accept a contract to manufacture luxury handbags for a major global business. This global business will then sell these handbags using its own channels of distribution across the world. The global business has a recognised luxury brand and its handbags sell at very high prices in exclusive shops all over the world. All the workers will need to be skilled and fully trained as the highest quality will be expected. New equipment costing \$20000 will need to be purchased. BB will still make some BB branded handbags.

We must meet to discuss which option you think we should choose.

## Appendix 3

### Summary of BB balance sheet (\$000)

	2015	2016
Non-current assets	100	120
Current assets:		
Inventories	10	40
Cash	10	10
Trade receivables	10	40
Current liabilities:		
Trade payables	40	50
Non-current liabilities:		
Long-term bank loan	80	80

- 1(b)** Consider the advantages and disadvantages of the following **two** ways of increasing BB's profit. Recommend the best way for BB to choose. Justify your answer.

Increasing prices: .....

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Changing to lower cost materials: .....

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Recommendation: .....

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## T T-shirts (TT)

TT is a private limited company set up 15 years ago in country P. It buys ready-made plain white T-shirts and then prints designs on them. The T-shirts are imported from country Q, a developing country. TT has 50 different designs that are produced in batches of various sizes, from child size to extra large adult size.

The T-shirts are sold to small retailers in country P. These retailers expect high quality products. The Marketing manager is considering changing the 'place' part of its marketing mix as she wants to increase sales of T-shirts.

The share capital invested to start up the company was \$2m. Shareholders' funds had increased to \$8m by 2015, but stayed at this level in 2016.

TT directors want to expand the company by exporting their T-shirts and are considering the following two options.


### Option A:

Take over DesOwn, a competing company, which manufactures personalised T-shirts to the customers' own designs. This company only sells online and its brand is recognised worldwide. It has a large share of this global e-commerce market. TT will have to raise \$10m to buy out the existing shareholders. Some workers could be made redundant if departments in the new company are merged with those in TT.

### Option B:

Invest in expanding its own production facilities by buying new computer-controlled equipment for \$500 000. This will allow an increase in the production of the existing range of T-shirts. TT could then sell directly to large retailers in other countries. However, they may have to use an agent or go into a joint venture to be successful.

## Appendix 1: Advertisement



**T T-shirts**

- High quality material used
- Many designs available – lots of choice
- All sizes available – from child to extra large adult
- Buy T-shirts from small clothing retailers across the country

## Appendix 2

### **SMS (text) message from TT production employee to a friend**

Really unhappy at TT factory! – expected to do a lot of work on tasks I am not paid for – expected to advise customers on designs when I have no training on this – shouted at if I do anything wrong or do not make a lot of T-shirts each week – the Operations manager just tells me what to do and she never asks what I think. If I say anything then I am told to keep quiet. Really fed up and want to leave. ☹

I never know what is happening at the factory as information is only put on one noticeboard but that is in the other building!

### **Appendix 3**

#### **TT financial information (\$m)**

	2015	2016
Revenue	10	15
Cost of sales	2	4
Expenses	7	9
Capital employed	10	14

- 4(a)** Identify and explain **one** reason why TT will need short-term finance and **one** reason why TT will need long-term finance.

Short-term finance reason: .....

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Long-term finance reason: .....

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## City Café (CC)

When George Brown left school he worked as a chef in several restaurants but he had always wanted to be his own boss. He set up City Café (CC) as a sole trader 15 years ago. He purchased a building with \$10 000 he received from his grandfather and made it into a café. It is located in the centre of Main City, in country X. George works very hard and is willing to take risks. He creates his own recipes for the café and his customers like the food.

CC has been successful every year and George has always paid himself a high salary. However, he now wants to increase the profit from CC by expanding the café. It is already open every day from 08:00 to 20:00 and in order to serve more customers he needs a larger café. The café is located in a very busy shopping mall. George has undertaken some market research and found out that 50% of his customers visit the café every day. The other 50% of customers visit less frequently and are often attracted by the special menu items on the board outside the café.



George is considering two options for expansion.

### *Option 1:*

Buy the building next door and make it into one larger café that can serve 50% more customers. The building became empty after a clothes shop closed. The cost of the shop is \$20 000 and it will cost \$10 000 for redecorating and building work.

### *Option 2:*

Move to a new building 10 kilometres away in another part of the city. This building is twice as large as the existing café and will cost \$2 000 a year to rent as it is not for sale. George will be allowed to redecorate and he will need to buy equipment for the kitchen. The total cost for this will be \$5 000. It is in a busy part of the city with many shoppers visiting the area.

## Appendix 1

Daily News

2 February 2018

The Government has forecast that interest rates will be increased later this year. This is very worrying for many local businesses that require finance. Country X has a fast growing economy and the Government does not want this to lead to higher inflation.

A multinational coffee shop chain wants to open cafés in malls all over country X, attracted by the high rate of economic growth. Local businesses are worried about the competition from this business as it benefits from economies of scale. Some market researchers think that customers will prefer to stay with their local café and not use an international style of café.

## Appendix 2

### Three applicants for the vacancy of chef (cook)

	Jim	Sally	Vera
Experience	6 years as a chef in a small café with some responsibility for managing the café	10 years as a chef in a large city centre restaurant	18 years as a chef in a high quality café in an expensive shopping mall
Age	25	35	40
Interests	Holidays abroad	Taking part in cooking competitions	Baking cakes and cooking
Qualifications	Health and safety qualification 3 IGCSEs	Qualified chef 6 IGCSEs	12 IGCSEs 2 Cambridge A Levels
Wage per hour in previous job	\$5	\$7	\$10

## Appendix 3

### Cash flow forecast for CC for the second half of 2018 (\$000)

	July	August	September	October	November	December
Cash from sales	10	15	10	5	5	4
Total cash inflows	10	15	10	5	5	4
Payment to suppliers	3	5	2	2	2	2
Fixed costs	4	4	4	4	4	4
Bank loan repayments	2	2	2	2	2	2
Total cash outflows	9	X	8	8	8	8
Net cash flow	1	4	2	(3)	(3)	(4)
Opening bank balance	1	2	6	8	5	2
Closing bank balance	2	6	Y	5	2	Z

- 4(b)** Consider the following **three** sources of finance that CC could use for expansion. Recommend which source of finance CC should choose. Justify your answer.

Take out a bank loan: .....

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..... Form a  
partnership with a family friend:.....

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Sell some business assets from the old café :.....

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Recommendation:.....

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Question	Answer	Mark																	
1 (b)	<p><b>Consider the advantages and disadvantages of the following two ways of increasing BB's profit. Recommend the best way for BB to choose.</b></p> <p><b>Justify your answer.</b></p> <p>Relevant points might include:</p> <table><tr><td></td><td>Advantages</td><td>Disadvantages</td></tr><tr><td>Increasing prices</td><td>Increases revenue – especially if demand is price inelastic</td><td>May reduced demand – especially if close competitors do not change their prices</td></tr><tr><td>Changing to lower cost materials</td><td>Lowers input costs – improved cash flow</td><td>Quality may be lower – lead to poor reputation – lose brand image of high quality</td></tr></table> <p>Knowledge/Analysis/Evaluation – award up to 10 marks using the levels-based mark scheme below.</p> <table><tr><td></td><td>Knowledge/Analysis/Evaluation</td></tr><tr><td>Level 3</td><td>At least 2 × Level 2 + 9–10 marks for well justified recommendation of which way to choose to increase profit and why not the alternative way. 7–8 marks for limited recommendation of which way to choose to increase profit.</td></tr><tr><td>Level 2</td><td>4–6 marks Detailed discussion of advantages and/or disadvantages of each way to increase profit.</td></tr><tr><td>Level 1</td><td>1–3 marks Outline of each advantages and/or disadvantages of each way to increase profit.</td></tr></table> <p>Level 1 – 1 mark for each L1 statement (max of 3 marks) e.g. Increasing prices will lead to increased revenue which will mean increased profit.</p> <p>Level 2 – 1 × L2 explanation can gain 4 marks and a further mark can be awarded for each additional L2 explanation (max 6 marks) e.g. Increasing prices will lead to increased revenue which will mean increased profit. This is due to the brand loyalty of customers resulting in the elasticity being inelastic, therefore revenue should increase and lead to higher profit. (L2 for developing the discussion about elasticity and 1 app mark for identifying that the product has brand loyal customers which is likely to result in inelastic demand).</p> <p>Level 3 – For L3 to be awarded there needs to be at least two L2 marks awarded and then a recommendation of which is the best way to increase profit.</p> <p><b>Award up to 2 additional marks for relevant application</b></p>		Advantages	Disadvantages	Increasing prices	Increases revenue – especially if demand is price inelastic	May reduced demand – especially if close competitors do not change their prices	Changing to lower cost materials	Lowers input costs – improved cash flow	Quality may be lower – lead to poor reputation – lose brand image of high quality		Knowledge/Analysis/Evaluation	Level 3	At least 2 × Level 2 + 9–10 marks for well justified recommendation of which way to choose to increase profit and why not the alternative way. 7–8 marks for limited recommendation of which way to choose to increase profit.	Level 2	4–6 marks Detailed discussion of advantages and/or disadvantages of each way to increase profit.	Level 1	1–3 marks Outline of each advantages and/or disadvantages of each way to increase profit.	12
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3 (b)	<p><b>Refer to Appendix 3. Calculate two liquidity ratios for both years. Do you think BB is in a good financial position to be able to expand the business? Justify your answer.</b></p> <p>Relevant calculations:</p> <table><tr><td></td><td>2015</td><td>2016</td></tr><tr><td>Current ratio</td><td>0.75 (L2)</td><td>1.8 (L2)</td></tr><tr><td>Acid test ratio</td><td>0.5 (L2)</td><td>1 (L2)</td></tr></table> <p>Knowledge/Analysis/Evaluation – award up to 10 marks using the levels-based mark scheme below.</p> <table><tr><td></td><td>Knowledge/Analysis/Evaluation</td></tr><tr><td>Level 3</td><td>At least 2 × Level 2 + 9–10 marks for well justified recommendation as to whether or not BB is in a good financial position. 7–8 marks for some limited judgement shown in recommendation as to whether or not BB is in a good financial position.</td></tr><tr><td>Level 2</td><td>4–6 marks Liquidity ratios correctly calculated</td></tr><tr><td>Level 1</td><td>1–3 marks Outline of the changes in the figures.</td></tr></table> <p>Level 1 – 1 mark for each L1 statement (max of 3 marks) e.g. The amount of inventories has increased by \$30 000.</p> <p>Level 2 – 1 × L2 calculation can gain 4 marks and a further mark can be awarded for each additional L2 calculation (max 6 marks) e.g. The current ratio for 2015 is 0.75. (L2 for correct calculation)</p> <p>Level 3 – For L3 to be awarded there needs to be at least two L2 calculations awarded and then a recommendation which justifies whether or not BB is in a good financial position to expand.</p> <p><b>Award up to 2 additional marks for relevant application.</b></p>		2015	2016	Current ratio	0.75 (L2)	1.8 (L2)	Acid test ratio	0.5 (L2)	1 (L2)		Knowledge/Analysis/Evaluation	Level 3	At least 2 × Level 2 + 9–10 marks for well justified recommendation as to whether or not BB is in a good financial position. 7–8 marks for some limited judgement shown in recommendation as to whether or not BB is in a good financial position.	Level 2	4–6 marks Liquidity ratios correctly calculated	Level 1	1–3 marks Outline of the changes in the figures.	12
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Question	Answer	Mark
4 (a)	<p><b>Identify and explain one reason why TT will need short-term finance and one reason why TT will need long-term finance.</b></p> <p>Knowledge [2 × 1] – award one mark for each reason  Analysis [2 × 1] – award one mark for a relevant explanation for each reason  Application [2 × 2] – award two application marks for each reason</p> <p>Award one mark for each reason (maximum of two), such as:</p> <p>Short-term finance – needed on a day-to-day basis to keep the business running:</p> <ul style="list-style-type: none"> <li>• Working capital /cover expenses/pay wages</li> <li>• Pay for materials/Inventories of T-shirts</li> <li>• Cash flow problems</li> </ul> <p>Long-term finance – needed over a long period of time to support expensive business development. Will need to be repaid in many instalments:</p> <ul style="list-style-type: none"> <li>• Investment in equipment/machinery/fixed assets</li> <li>• Take over another company/expand</li> </ul> <p>Award a maximum of three additional marks for each explanation – 2 of which must be applied to this context – of each reason.</p> <p><b>Indicative response:</b></p> <p>Short-term finance will be needed to pay for inventory (k) in this case it will be the T-shirts that are to have prints on them (app). The T-shirts will need to be purchased from abroad and paid for long before they have designs printed on them (app) and sold so working capital will be needed to allow this to take place. (an)</p> <p>Possible application marks:</p> <p>Private limited company; set up 15 years ago; in country P; buys ready-made plain white T-shirts; T-shirts imported from country Q, a developing country; 50 different designs; batches production of various sizes; sold to small retailers in country P; share capital \$2 m; increased to \$8 m by 2015; expand the company; exporting T-shirts; take over DesOwn, a competing company; sells online; raise \$10 m to buy out the existing shareholders; buying new computer controlled equipment for \$500 000; sell directly to large retailers; use an agent or a joint venture.</p> <p>There may be other examples in context that have not been included here.</p>	8

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4 (b)	<p><b>Consider the following three sources of finance that CC could use for expansion. Recommend which source of finance CC should choose. Justify your answer.</b></p> <p>Relevant points might include:</p> <table border="1"> <thead> <tr> <th>Source of finance</th><th>Advantages</th><th>Disadvantages</th></tr> </thead> <tbody> <tr> <td>Take out a bank loan</td><td> <ul style="list-style-type: none"> <li>Large amounts borrowed</li> <li>Lower interest than many alternative sources of finance</li> </ul> </td><td> <ul style="list-style-type: none"> <li>May lose house if fail to make repayments</li> <li>Interest paid so increased expenses</li> <li>May be more difficult to gain another bank loan as already has one</li> </ul> </td></tr> <tr> <td>Form a partnership with a family friend</td><td> <ul style="list-style-type: none"> <li>Already knows the person</li> <li>Will be able to help run the business</li> </ul> </td><td> <ul style="list-style-type: none"> <li>Will have to share profit</li> <li>May have disagreements on how to run the café</li> </ul> </td></tr> <tr> <td>Sell some business assets from the old café</td><td> <ul style="list-style-type: none"> <li>Less need to borrow money</li> <li>No interest payable</li> </ul> </td><td> <ul style="list-style-type: none"> <li>May not have enough assets to raise sufficient capital</li> <li>As CC wish to expand they are more likely to want to keep business assets rather than sell them</li> </ul> </td></tr> </tbody> </table> <p>Knowledge/Analysis/Evaluation – award up to 10 marks using the levels-based mark scheme below.</p> <p><b>Level 1 [1–3 marks]</b></p> <p>Outline of the advantages and disadvantages of each source of finance. 1 mark for each L1 statement (max of 3 marks) e.g. Large amounts of capital can be borrowed with a bank loan.</p> <p><b>Level 2 [4–6 marks]</b></p> <p>Discussion of the advantages and disadvantages of each source of finance.</p> <p>1 × L2 explanation can gain 4 marks and a further mark can be awarded for each additional L2 explanation (max 6 marks) e.g. Large amounts of capital can be borrowed with a bank loan and the money can be paid back in monthly instalments making it easier to pay it back as the café increases its sales of food and drinks. However, there are the increased costs from interest payments payable on the loan. (Level 2 plus one application mark for answering in the context of the food and drinks sold)</p>	Source of finance	Advantages	Disadvantages	Take out a bank loan	<ul style="list-style-type: none"> <li>Large amounts borrowed</li> <li>Lower interest than many alternative sources of finance</li> </ul>	<ul style="list-style-type: none"> <li>May lose house if fail to make repayments</li> <li>Interest paid so increased expenses</li> <li>May be more difficult to gain another bank loan as already has one</li> </ul>	Form a partnership with a family friend	<ul style="list-style-type: none"> <li>Already knows the person</li> <li>Will be able to help run the business</li> </ul>	<ul style="list-style-type: none"> <li>Will have to share profit</li> <li>May have disagreements on how to run the café</li> </ul>	Sell some business assets from the old café	<ul style="list-style-type: none"> <li>Less need to borrow money</li> <li>No interest payable</li> </ul>	<ul style="list-style-type: none"> <li>May not have enough assets to raise sufficient capital</li> <li>As CC wish to expand they are more likely to want to keep business assets rather than sell them</li> </ul>	12
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	<p><b>Level 3 [7–10 marks]</b></p> <p>For L3 to be awarded there needs to be at least two L2 marks awarded and then a recommendation of the best source of finance to choose.</p> <p>9–10 marks for well justified recommendation as to the best source of finance to choose rather than the alternatives.</p> <p>7–8 marks for some limited judgement shown in recommendation as to the best source of finance to choose.</p> <p><b>Award up to 2 additional marks for relevant application.</b></p> <p>Possible application marks:</p> <p>Set up as his own boss – sole trader; set up 15 years ago; bought a building for \$10 000; cafe is open 6 days a week; pay himself a high salary; already has an existing bank loan; advertises using menu board outside the café; information from Appendix 1 such as interest rates are increasing and multinational coffee shop chain; information from Appendix 3 from the cash flow forecast.</p> <p>There may be other examples in context that have not been included here.</p>	