Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

BUSINESS **9609/31**

Paper 3 Case Study **May/June 2017**

3 hours

No Additional Materials are required.

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READ THESE INSTRUCTIONS FIRST

An answer booklet is provided inside this question paper. You should follow the instructions on the front cover of the answer booklet. If you need additional answer paper ask the invigilator for a continuation booklet.

Section A
Answer **all** questions.
Section B
Answer **one** question.
You are advised to spend no more than 40 minutes on Section B.
The businesses described in this question paper are entirely fictitious.

The number of marks is given in brackets [ ] at the end of each question or part question.

This document consists of **6** printed pages, **2** blank pages and **1** Insert.

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CAMBRIDGE
International Examinations

[Turn over

Tango Travel Company (TTC)

TTC is the largest travel company in country X. It organises holidays for travellers to many countries. TTC sells mainly 'all-inclusive holiday packages'. These are holidays with air flights and other transport, hotel accommodation, entertainment and most meals and drinks included in the price of the holiday. The company owns six hotels but it buys in all other services from low-cost operators such as airlines, bus companies and hotel owners. TTC operates in the mass market for all-inclusive package holidays, offering good value in the most popular destinations, comfortable (but not luxury) hotels and family-focused menus and entertainments. The global travel business is increasingly competitive. One reason for this is the growing use of the Internet to compare holiday packages and prices. Travellers only make bookings after considering the features of each holiday package being offered by different companies. Increased competition influenced TTC's Board of Directors' decision to focus on a low-cost strategy in all of its operations.

Employment policy

TTC employs a small core of employees at Head Office in country X. They have full-time employment contracts and good conditions of service including pensions and free healthcare. Other TTC employees in country X work in the company's own 'travel agencies'. These are shops, often located in main streets, that sell TTC holidays as well as services such as foreign currency and car hire. A number of these agencies have been closed in the last 10 years due to increasing use of e-commerce. However, the existing agencies still account for 40% of all TTC package holiday sales. Some TTC travel agency employees have full-time contracts with commission payments in addition to their basic salaries, but the most recent recruits have been employed on zero hours contracts.

TTC has many employees based in other countries. These include company representatives who stay at hotels to provide support to TTC's customers. TTC's human resources policy is to recruit as few local workers as possible, therefore these representatives are recruited from country X. The employees based abroad, often in low income countries, have temporary employment contracts which insist on flexible working with only the basic legal minimum employment conditions which apply in each country.

Takeover of Sunny Resort Hotels (SRH)

Two years ago Oli, the Chief Executive of TTC, persuaded the Board to take a rushed decision to take over SRH, which owned six hotels in country Y. This was the first time TTC had owned any hotels. The company had previously relied on other businesses to provide hotel accommodation for its holiday packages. 'By buying and managing our own hotels we will effectively control our accommodation costs in country Y' Oli had told the other directors. 'We will not buy locally produced food and drinks, but instead we will export products from country X. Our objectives for these hotels should be: 80% capacity utilisation, 95% customer satisfaction rating and a low break-even point'.

TTC quickly delayered the management structure within SRH. Employee contracts and payment methods within the six hotels were changed without consultation. All employees were expected to be available for flexible working. SRH, although it had not been very profitable, had a culture that 'put the customers first'. TTC adopted the same low-cost strategy for SRH that was being applied to the rest of the business. However, Oli is now disappointed with the failure to achieve TTC's original objectives for this takeover – see Table 1.

Table 1: Comparing TTC objectives with actual performance in the SRH hotels

Year ending 31 May 2017	Original objective	Actual performance
Annual break-even point	33 800 customers	39 000 customers
Hotel employees leaving voluntarily (an average of 230 people employed)	42	95
Percentage of customers satisfied with food and accommodation	95%	69%
Capacity utilisation (annual capacity = 78 000 customers)	80%	68%

Future expansion plans

Oli and the other directors have plans to expand TTC but disagree over the best strategy to use.

Option 1: This is preferred by Oli and TTC's Marketing Director. It is to take TTC into niche markets by creating a separate division – possibly with a new brand name – which will initially offer cruise holidays on luxury ships aimed at high-income retired people. Demand for cruise holidays is less price elastic than the demand for mass market package holidays.

Option 2: This is preferred by TTC's Operations Director. The idea is to start operating TTC's own airline. Many major global travel companies do this. An airline can add status and prestige to a travel company as aircraft, painted in company colours, help to promote the brand.

Some details of both options are contained in Table 2.

Table 2: Comparison between the two options for future expansion of TTC

	Option 1 – Cruise holidays	Option 2 – Own airline
Major external factor in support of strategy	Rising consumer incomes in most countries and increased demand for income elastic products	Lack of spare capacity of existing airline companies
Key TTC strength this strategy would support	Adds to recognition as a major holiday business	Ability to control costs of air travel component of package holidays
Quote by director in support of strategy	Marketing Director: 'By using some of our existing suppliers we could become a low-cost provider of these new luxury holidays'	Operations Director: 'We would be able to offer more holidays to distant locations and give customers greater choice'
Decision tree expected monetary value over 5 years	$45m	$65m
Major risk to TTC	Failure to differentiate the cruise holiday brand from TTC's existing package holidays	Big investment – possible failure of the airline would result in losses from forced sale of aircraft
Major barrier to entry	Existing operators in this higher priced market segment have well recognised brands	Obtaining airline operating licences and landing times at major airports

Accounting decisions

The Appendix contains a summary of TTC's accounts for the year to 31 May 2017. The Finance Director wants to improve liquidity, reduce gearing and increase recorded profitability over the next financial year. He has already decided to delay payments to all suppliers by an additional month. He has to decide whether to make the changes shown in Table 3 during the next financial year.

Table 3: Finance Director's decisions

Proposed change:	Planned initial impact on accounts:
1. Reduce the dividend payment from \$12m to \$6m.	Increase cash and retained earnings
2. Sell and leaseback the premises of 10 TTC travel agencies (non-current assets) for \$15m to a property company that is keen to buy them. The cash received could pay off some long term loans.	Reduce gearing ratio

Civil unrest in country Z

In the last few months the Government of country Z has taken some unpopular decisions. These have led to thousands of demonstrators on the streets each day. Their marches were peaceful until recently when violence occurred and some people were injured. Foreign tourists feel unsafe and many travel companies have started to fly their customers back home, but TTC has not done this yet. A public relations spokesperson for TTC suggested that it was because the airlines it uses have no spare capacity at present. However, some media reports are claiming that TTC had no contingency plan ready for such emergency situations and wants to save on the costs of organising special flights.

Appendix: Summary of TTC accounting data

Income statement summary (year ending 31 May 2017)		Statement of financial position summary (as at 31 May 2017)	
Revenue	\$346m	Non-current assets	\$138m
Gross profit	\$58m	Current assets including: Inventories	\$17m \$2m
Profit for year	\$23m	Non current liabilities	\$75m
		Capital employed	\$135m
Dividends	\$12m	Total shares issued	12m
Retained earnings	\$11m	Current market share price	\$10

Section A

Answer **all** questions in this section.

1 Analyse the benefits for TTC of using flexible working contracts. [10]

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

(i) difference in labour turnover between the original objective and actual performance [3]

(ii) difference between the margin of safety originally aimed for and that actually achieved. [5]

(b) Assess the most likely reasons why the takeover of SRH has so far failed to achieve TTC's objectives. [12]

3 Discuss a suitable marketing plan for the cruise holidays in Option 1. [16]

4 **(a)** Refer to the Appendix. Calculate:

(i) gearing ratio [3]

(ii) dividend yield. [3]

(b) Discuss the likely impact on TTC's shareholders if the two changes referred to in Table 3 are made during the next financial year. [12]

5 Evaluate the extent to which ethics should influence the activities of TTC. [16]

Section B

Answer **one** question from this section.

6 Refer to Table 2 and other information. Recommend which one of the two strategic options for the future growth of TTC the directors should choose. Justify your recommendation. [20]

7 Discuss the importance of strategic management to the future success of TTC. [20]

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