Cambridge International AS & A Level

Cambridge International Examinations
Cambridge International Advanced Subsidiary and Advanced Level

BUSINESS **9609/32**

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

3 hours

No Additional Materials are required.

6014037991

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 **5** printed pages, **3** blank pages and **1** Insert.

© UCLES 2017

CAMBRIDGE International Examinations

Hari Hotels (HH)

'We must take advantage of the huge growth in international tourism if we want our company to continue to grow profitably' argued Hari, HH's Chief Executive Officer. 'Globalisation is having a huge impact on tertiary sector businesses such as ours.'

He was speaking at HH's Board of Directors meeting which had been called to discuss the future strategic direction the business should take. The directors were being asked to analyse two strategic options for growth that Hari had proposed. International expansion into other countries, such as country P, is one option. The other option is the closure of three existing HH hotels and using these locations to create 'activity holiday resorts'. These would aim to attract foreign tourists that visit country Z, where HH is based. Increased competition from international hotel chains is affecting all hotels in country Z. However, easier international movement of both labour and capital is also creating new opportunities for businesses such as HH.

HH was started by Hari 23 years ago when he opened his first hotel. Currently the public limited company manages 35 hotels in country Z. It owns 30 of these and rents a further five. The business is well known for offering hotel accommodation of '4 star' quality at competitive prices. 4 stars is the rating given to hotels that offer very clean, comfortable accommodation with many facilities and services. However, they do not offer large conference facilities, swimming pools or gyms which are found in 5 star hotels.

Organisational structure

HH's organisational structure is still based around the functional departments that Hari originally created. Once an overall strategy has been decided at Board level, departmental directors and senior managers then put into effect the necessary changes within their function.

The recent construction of a new hotel in the capital city illustrated the need for coordinating decisions between marketing, operations, finance and human resources. Due to construction problems the opening of this hotel was delayed. Unfortunately, senior managers in the functional departments did not liaise closely with each other. The lack of coordination and communication in promotion activities, employee recruitment and inventory purchase led to major difficulties. These issues had to be resolved at Board level.

Hari and some of his fellow directors are worried that the current organisational structure might not be suitable for future business growth and the changes and challenges resulting from it.

The new hotel location dilemma

HH has decided to open a hotel in the northern region of country Z for the first time. The directors intend to lease a property rather than purchase it. This would allow HH to exit the market in this region quickly if the venture is unprofitable.

The Operations Director has identified two locations to choose between. Location X is an existing 2 star hotel that is not close to a large town or city and has a low fixed leasing cost. This could be converted into a 4 star hotel quite quickly. Location Y is a city centre office building. Conversion into a hotel would take longer and the fixed leasing cost is high. The Operations Director has gathered other information about the two sites in the Appendix.

Marketing strategy

HH adopts a consistent marketing strategy for all of its hotels. Promotion is focused on national newspaper advertisements and Internet sites that also allow online bookings. Prices are competitive with other 4 star hotels, but HH never uses price discounts to fill hotels. Hari would rather leave rooms empty than maximise occupancy at low prices and risk angering customers who had paid full prices. Instead HH offers 'eat and sleep' special offers which encourage customers to stay at one of its hotels and eat all of their meals there too. Last month over 50% of HH's customers

booked using this offer. In the company's hotels last year the average capacity utilisation rate was 80%. Hari asked the Marketing Director to consider whether the marketing strategy would need to be adapted if HH opened hotels in country P for the first time.

Finance needed

Sasha, HH's Finance Director, has been considering alternative sources of finance to pay for future strategic expansion plans. Sasha has estimated that HH will need to raise around $60m over the next two years to finance both the refurbishment of some existing hotels and to pay for the growth option the Board chooses. Sasha's preferred source of finance is a new issue of shares. This option would lead to dividends per share falling for at least two years. Sasha plans to keep total dividends paid the same as in 2017, until expansion becomes profitable. She knows that Hari would prefer HH to increase its non-current liabilities. Sasha has gathered the information needed for this financing decision. See Table 1.

Table 1: Financial information to be used in the financing decision

HH share price – 31 May 2017 (31 May 2016)	$3.00 ($2.80)
HH total issued shares – 31 May 2017	40m
Number of shares owned by Hari and his family	25m
HH capital employed – 31 May 2017	$200m
HH non-current liabilities – 31 May 2017	$85m
Total annual dividends paid – 31 May 2017	$8m
Country Z interest rate – 31 May 2017 (31 May 2016)	5% (6%)

Strategic options for growth: choice and implementation

Details of the two options for growth are shown in Table 2. Each of these options would involve substantial changes in the operations of HH. Many employees would need to acquire new skills. There would be opportunities for some existing employees for promotion to junior management positions in the expanded operations. However, other employees would have to take on a bigger workload before replacements are found for those promoted. Hari intends to recruit senior managers externally.

Hari has asked the other directors to agree to keep secret from employees the Board's discussion about which growth strategy to choose. He is determined not to make the same mistakes that were made when HH bought out a small hotel company called Ajax. An early announcement of this decision led many HH employees to worry about their own pay and conditions which, at the time, were much better than those of Ajax employees. The fear had been that Ajax pay and conditions would be imposed on all employees. 'We will announce our strategic decision at the next Annual General Meeting' Hari told the Board.

Table 2: Information used by HH directors when making the strategic choice between option 1 and option 2

	Option 1 – market development by opening 10 HH hotels in country P. This is a high income country located 500 kilometres from country Z.	Option 2 – close the 3 hotels with lowest profit margins and use these locations to diversify into 'activity holiday resorts' in country Z. These resorts would offer holidays aimed at foreign tourists keen on outdoor activities.
Estimated capital cost	$45 million	$40 million
Estimated Net Present Value (NPV) after 10 years	$13 million	$18 million
Estimated chance of strategy failing	20%	22%
Percentage of HH employees with experience of:	Working in foreign hotels: 35%	Working in 'activity holiday resorts': 18%
Main barrier to entry	Competitive hotel market in country P	Purchase of additional land around the current hotel locations

Appendix: Data about location X and location Y

	Location X	Location Y
Estimated time until opening of hotel	6 months	12 months
Most likely target market	Tourists	Business customers
Capital cost of adapting building to HH standards	$300 000	$500 000
Monthly fixed costs (including leasing cost)	$30 000	$69 000
Variable cost per customer per night	$30	$40
Estimated average price per customer per night	$50	$70
Monthly capacity (customers)	4000	5000
Expected monthly demand	3200	4500
Break-even number of customers per month	1500	See Question 2(a)
Monthly profit at maximum capacity	$50 000	See Question 2(a)

© UCLES 2017

Section A

Answer **all** questions in this section.

1 Analyse the likely impact of globalisation on HH. [10]

2 **(a)** Refer to the Appendix. Calculate for location Y:

(i) break-even number of customers per month [3]

(ii) monthly profit at maximum capacity [3]

(iii) margin of safety. [2]

(b) Refer to your results from **2(a)**, the Appendix and other information. Recommend to HH's directors whether to choose location X or Y for the new hotel. [12]

3 Discuss the changes HH should make to its organisational structure to allow for future business growth. [16]

4 **(a)** Refer to lines 49–57 and Table 1. Calculate:

(i) gearing ratio assuming all $60m is obtained from long term loans [3]

(ii) dividend per share in 2018 assuming all $60m is obtained by the sale of an additional 20m shares. [3]

(b) Refer to your results from **4(a)**, Table 1 and other information. Recommend to the Board of Directors which source of finance should be used by HH to obtain $60m. Justify your answer. [12]

5 Discuss a suitable marketing strategy for HH if it decides to open hotels in country P. [16]

Section B

Answer **one** question from this section.

6 Refer to Table 2 and other information. Evaluate the most important **factors** HH's directors should consider when making the strategic choice between option 1 and option 2. [20]

7 Evaluate the importance of developing a culture of change within HH when introducing new growth strategies. [20]

© UCLES 2017

BLANK PAGE

© UCLES 2017

BLANK PAGE

© UCLES 2017

BLANK PAGE

Permission to reproduce items where third-party owned material protected by copyright is included has been sought and cleared where possible. Every reasonable effort has been made by the publisher (UCLES) to trace copyright holders, but if any items requiring clearance have unwittingly been included, the publisher will be pleased to make amends at the earliest possible opportunity.

To avoid the issue of disclosure of answer-related information to candidates, all copyright acknowledgements are reproduced online in the Cambridge International Examinations Copyright Acknowledgements Booklet. This is produced for each series of examinations and is freely available to download at www.cie.org.uk after the live examination series.

Cambridge International Examinations is part of the Cambridge Assessment Group. Cambridge Assessment is the brand name of University of Cambridge Local Examinations Syndicate (UCLES), which is itself a department of the University of Cambridge.

© UCLES 2017