

Level 3 Cambridge Technical in Business

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Unit 3: Business decisions

INSERT

Friday 12 January 2018 – Morning

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Gateway Revision Ltd

The business

Gateway Revision Ltd is a book publisher. The business is based in a small town in Lincolnshire.

Sonia Brown started the business, operating as a sole trader, in 2006. Sonia, an experienced teacher of English in a secondary school, discovered that her students did not use any of the existing GCSE revision guides. The students said that the guides were boring. They thought that this was because they were written by adults who did not understand what it was like to struggle with a GCSE subject. Sonia decided to write a revision guide for her students. She wrote the book as if it were written by an older brother or sister rather than a teacher. Many parents suggested to Sonia that the guide was good enough to be published. Sonia had the book printed by a local printing firm and was surprised by how well it sold in local schools and colleges. Sonia chose to follow up her GCSE English with one for GCE students, which also sold well.

In 2008 Sonia left her teaching post to commit to the business full-time. She converted the business to a private limited company and is now the sole owner/manager of *Gateway Revision Ltd*. In 2011 Sonia appointed Jason Duval, a friend from her schooldays, to be the company's Finance and Operations Director, leaving Sonia to focus on ensuring that the range of revision guides *Gateway Revision Ltd* publishes reflects the principles she established when writing her first book.

Today, *Gateway Revision Ltd* publishes revision guides aimed across the secondary school curriculum covering GCSE, GCE and vocational subjects such as Business and Information Technology. The business employs over 50 people at its head office including office staff, telesales staff and a team of in-house writers. The business also employs 35 workers at its main warehouse, from where books are packed and dispatched to schools, colleges and private households all over the United Kingdom (UK). *Gateway Revision Ltd's* books continue to be printed by the same local printing firm who printed Sonia's very first revision guide back in 2006.

The challenge

The UK education market is undergoing rapid change. The UK government is reforming the whole examination system with the aim of reducing the number of qualifications available to learners. For example, the range of available GCSEs has been narrowed and the number of examinations candidates sit for each GCSE has been reduced. In addition, many students now have access to smartphones and tablets at school and at home. As a result, the demand for printed books has been falling and the demand for screen-based products such as apps is increasing. These recent trends have led to a fall in demand for *Gateway Revision Ltd's* books. The business has lost market share to some of its more innovative competitors.

Other businesses in the publishing industry are also struggling. Printing firms are no different. Jason has recently learnt that the local business that prints all of *Gateway Revision Ltd's* books is in danger of closing due to financial difficulties.

Jason is aware that *Gateway Revision Ltd* needs to take action to improve its chances of survival. He has recently proposed three options to Sonia and strongly recommends that the business implements one of them.

The options

Option 1 – Buy out the local printing firm

Gateway Revision Ltd could buy out the current owners of its local printing firm. The printing firm could then become a subsidiary of *Gateway Revision Ltd*. Unprofitable parts of the printing business would be closed down and it could stop providing printing services to other customers altogether.

Jason estimates that this option would cost £50,000 and that this could be funded from *Gateway Revision Ltd's* cash reserves of £60,000. This option would reduce the amount *Gateway Revision Ltd* currently spends on printing costs. Investment appraisal suggests a payback period of four years, with an ARR of 5% over the first five years of trading.

Option 2 – Extend the product range

Currently the business only produces books for learners aged 14-19. Jason estimates that, if the business produced books for children aged 7-13, the potential size of the market could more than double. Jason has conducted secondary research which suggests that the educational book publishing market for 7-13 year olds is less competitive than that for the 14-19 age range. Jason is aware that the existing writers lack experience of writing for younger children and so new writers would need to be hired.

Gateway Revision Ltd would need to extend its head office and warehousing facilities to accommodate the larger scale of operations. The capital budget spend for this option is estimated to be £90,000. £50,000 would be funded from the existing cash reserves; the remaining amount would be funded by a commercial loan at a fixed rate of 4.5% over three years. Additional revenue expenditure would include £60,000 per annum for the expanded writing team and increased marketing spend. Investment appraisal suggests a payback period of three years with an ARR of 15% over the first five years of trading.

Option 3 – Expand into overseas markets

Many other countries are increasing their spending on education and placing a greater priority on examinations. Jason has identified South Africa as a suitable country for *Gateway Revision Ltd's* first overseas operation. South Africa has a rapidly growing number of schools offering examinations through the medium of English. This option would require *Gateway Revision Ltd* to create a subsidiary operation in South Africa. This would include a regional office and warehouses in South Africa.

Jason has estimated that the capital costs for this option would be £300,000. This option could be funded with £50,000 cash reserves and a strategic partnership with a South African venture capitalist. The venture capitalist has offered finance of £250,000 in return for a 20% equity stake in *Gateway Revision Ltd*. Additional revenue expenditure would include £100,000 a year to cover the costs of the new operations including a new writing team, and office and marketing expenses. Capital investment appraisal suggests a payback period of eight years with an ARR of 20% for the South African division over the first five years of trading.

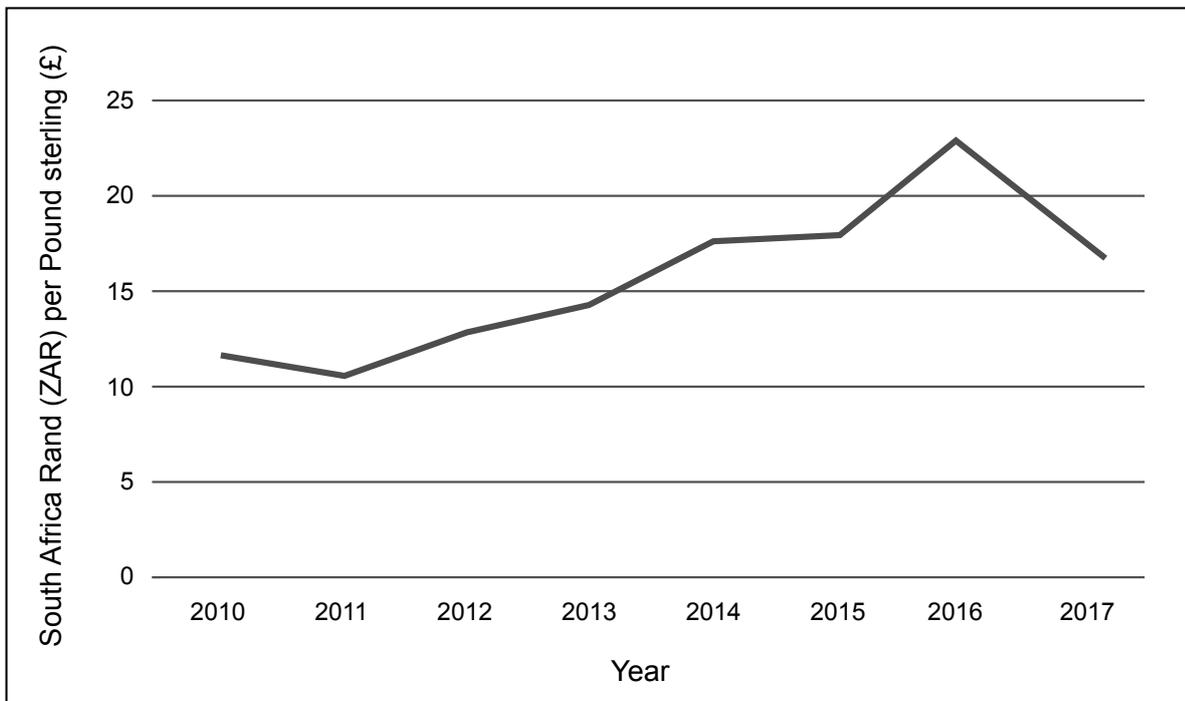
Appendix 1

Examination reform in England

New GCSEs in English Language, English Literature and Maths were introduced in September 2015 with the first examination results published in August 2017. New GCSEs in a number of other subjects were introduced for first examination in Summer 2018. Some new GCEs were also introduced in September 2015 with further subjects introduced over the following two years. These reformed subjects featured less coursework than previous GCSEs and GCEs and also fewer modules (separate blocks of specification content each with its own exam). The overall impact of these changes reduced the number of examination subjects available and reduced the number of examinations sat by candidates. These changes are expected to lead to a reduction in the amount that schools and colleges spend on examination fees.

Appendix 2

The exchange rate between the Pound sterling (£) and the South African Rand (ZAR), 2010-2017



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