



**AQA**

A-level

**2**

Fourth edition

# Business

For A-level Year 2

## ANSWER GUIDE

John Wolinski  
Gwen Coates

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# Introduction

This teacher guide is written to accompany the AQA A-level Business 2 (fourth edition) textbook written by John Wolinski and Gwen Coates and published by Hodder Education. Pages from this guide can be photocopied for use with students.

The chapters of this book contain two main sets of questions: practice exercises and case studies. Both of these sets of questions are intended to achieve two main aims:

- 1 to allow students to test their understanding of the content, on completion of a chapter or during the examination revision period
- 2 to enable students to practise answering exam-style questions within the time constraints they will face during the final examinations.

The primary aim of the **practice exercises** is to test your understanding, so most questions are focused on straightforward tests of knowledge and understanding, alongside general questions testing application and analysis. Paper 1 of the A-level includes multiple-choice questions, short-answer questions and essays. Therefore, the practice exercises provide practice for some of the

types of questions students may face in this particular paper. In some cases practice exercises might also be based on data/information provided; these types of questions form the basis of Paper 2 of the A-level which consists of three sets of data response questions. One of these three data response questions will be based entirely on numerate/graphical data; the other two will be based on articles, which may include some numerate data. Therefore some practice exercises may provide exam practice for Paper 2 of the AQA A-level Business qualification.

In the A-level, Paper 3 is a series of questions based on a single case study. The **case studies** in the textbook are a blend of data response articles and case studies, so that questions on these case studies provide good practice for both the Paper 2 and Paper 3 examination papers; particularly the latter.

Most AQA questions require two (or possibly three) lines of argument. The exercises in the book may ask for more arguments or factors because, for revision purposes, it is felt that students need to be able to understand a wider range of ideas for a full understanding of a particular topic.

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## Marking the practice exercises, case studies and essays

**Multiple-choice questions:** 1 mark is awarded for a correct answer – no explanation is required.

**Calculations:** A correct answer earns full marks. Elements of the calculation are awarded a mark, so that a student can earn part marks for their working, even if the final answer is incorrect.

**Short-answer questions:** In most cases these questions are marked by levels of response, using the three levels of response grid included in this introduction. For questions of 6 marks, 2 marks are awarded for each level. For 5-mark questions level 1 would have only 1 mark; for 4-mark questions level 2 would be the only level with 2 marks (i.e. 2–3 marks for level 2).

The questions linked to each case study in the A-level textbook are based on the format of the AQA A-level Business examinations. Please note, however, that the case studies as individual entities do not match the format of the AQA examinations. The content of each chapter has a limited focus and so, with a few exceptions, it has not been appropriate to exactly match the overall AQA format.

The marking scheme for each case study question consists of two sections:

- a summary of the potential relevant ideas that candidates might include in their answer
- a marking template showing how the marks are allocated to each skill.

A suggested set of points or arguments that students might use are presented in each chapter of this guide. In order to show the skills requirements of each question, a set of templates are provided on pp.5–8 for use with the summaries.

The templates show the AQA 'levels of response' approach to marking, indicating what is expected from a candidate in order to reach a given level. It should be noted that these templates are only a guide. Depending on the structure of individual examination papers, it is possible that there are minor differences in the marks allocated for each level, especially for low mark questions.

## Levels of response for a 6-mark question

(This can be adapted for 3–5 mark questions)

Level	The student will typically demonstrate:	Marks
3	<b>A good response overall that focuses on many of the demands of the question.</b> Provides a good explanation of relevant factors using knowledge and understanding applied to the context.	<b>5–6 marks</b>
2	<b>A reasonable response overall that focuses on some of the demands of the question.</b> Provides a reasonable explanation of relevant factors using knowledge and understanding with some application to context.	<b>3–4 marks</b>
1	<b>A limited response overall with little focus on the demands of the question.</b> Demonstrate some knowledge and understanding and identifies relevant factors with little application to context.	<b>1–2 marks</b>

## Levels of response for a 9-mark question

Level	The student will typically demonstrate:	Marks
3	<b>A good response overall that focuses on many of the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"><li>• demonstrates a depth and range of knowledge and understanding of issues in the question</li><li>• demonstrates analysis that is well developed and is applied effectively to the context.</li></ul>	<b>7–9 marks</b>
2	<b>A reasonable response overall that focuses on some of the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"><li>• demonstrates a limited knowledge and understanding of a range of issues in the question or a good knowledge and understanding of relatively few issues in the question</li><li>• demonstrates analysis that is developed and is applied to the context.</li></ul>	<b>4–6 marks</b>
1	<b>A limited response overall with little focus on the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"><li>• demonstrates a limited range and depth of knowledge and understanding of issues in the question</li><li>• demonstrates analysis with little development and with mainly descriptive application to the context.</li></ul>	<b>1–3 marks</b>

## Levels of response for a 12-mark question

Level	The student will typically demonstrate:	Marks
3	<b>A good response overall that focuses on many of the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"><li>• demonstrates a depth and range of knowledge and understanding of issues in the question</li><li>• demonstrates analysis that is well developed and is applied effectively to the context.</li></ul>	<b>9–12 marks</b>
2	<b>A reasonable response overall that focuses on some of the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"><li>• demonstrates a limited knowledge and understanding of issues in the question or a good knowledge and understanding of relatively few issues in the question</li><li>• demonstrates analysis that is developed and is applied to the context.</li></ul>	<b>5–8 marks</b>
1	<b>A limited response overall with little focus on the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"><li>• demonstrates a limited range and depth of knowledge and understanding of issues in the question</li><li>• demonstrates analysis with little development and with mainly descriptive application to the context.</li></ul>	<b>1–4 marks</b>

Higher mark questions (16–25 marks) also include a requirement to show evaluation.

## Levels of response for a 16-mark question

Level	The student will typically demonstrate:	Marks
4	<b>An excellent response overall that is fully focused on the key demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates a depth and range of knowledge and understanding that is precise and well selected in relation to issues in the question</li> <li>• demonstrates analysis throughout that is well developed, is applied effectively to the context and considers a balanced range of the issues in the question</li> <li>• makes judgements or provides solutions that are built effectively on analysis, show balance and have a clear focus on the question as a whole throughout.</li> </ul>	13–16 marks
3	<b>A good response overall that focuses on many of the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates a depth and range of knowledge and understanding of issues in the question</li> <li>• demonstrates analysis that is well developed, is applied effectively to the context and considers a range of issues in the question</li> <li>• makes judgements or provides solutions that are built on analysis, show balance and address the question as a whole.</li> </ul>	9–12 marks
2	<b>A reasonable response overall that focuses on some of the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates a limited knowledge and understanding of a range of issues in the question or a good knowledge and understanding of relatively few issues in the question</li> <li>• demonstrates analysis that is developed, applied to the context and considers some of the issues in the question</li> <li>• makes judgements or provides solutions that are built on analysis, but lack balance and are not fully focused on the question as a whole.</li> </ul>	5–8 marks
1	<b>A limited response overall with little focus on the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates a limited range and depth of knowledge and understanding of issues in the question</li> <li>• demonstrates analysis with little development, mainly descriptive application to the context, and considers a limited number of issues in the question</li> <li>• makes judgements or proposes solutions that have limited links to analysis or limited focus on the question as a whole.</li> </ul>	1–4 marks

## Levels of response for a 20-mark question

(Please note that the descriptors for these 5 levels also apply to the 5 levels described in 24 and 25-mark questions.)

Level	The student will typically demonstrate:	Marks
5	<b>An excellent response overall that is fully focused on the key demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates a depth and range of knowledge and understanding that is precise and well selected in relation to issues in the question</li> <li>• demonstrates analysis throughout that is well developed, is applied effectively to the context and considers a balanced range of the issues in the question</li> <li>• makes judgements or provides solutions that are built effectively on analysis, show balance and have a clear focus on the question as a whole throughout.</li> </ul>	17–20 marks
4	<b>A good response overall that focuses on many of the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates a depth and range of knowledge and understanding of issues in the question</li> <li>• demonstrates analysis that is well developed, applied effectively to the context and considers a range of issues in the question</li> <li>• makes judgements or provides solutions that are built on analysis, show balance and address the question as a whole.</li> </ul>	13–16 marks

<b>3</b>	<b>A reasonable response overall that focuses on some of the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates a limited knowledge and understanding of a range of issues in the question or a good knowledge and understanding of relatively few issues in the question</li> <li>• demonstrates analysis that is developed, applied to the context and considers some of the issues in the question</li> <li>• makes judgements or provides solutions that are built on analysis, but lack balance and are not fully focused on the question as a whole.</li> </ul>	<b>9–12 marks</b>
<b>2</b>	<b>A limited response overall with little focus on the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates a limited range and depth of knowledge and understanding of issues in the question</li> <li>• demonstrates analysis with little development, has mainly descriptive application to the context and considers a limited number of issues in the question</li> <li>• makes judgements or proposes solutions that have limited links to analysis or limited focus on the question as a whole.</li> </ul>	<b>5–8 marks</b>
<b>1</b>	<b>A weak response overall lacking focus on the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates isolated or imprecise knowledge and understanding</li> <li>• demonstrates undeveloped analysis with descriptive application to the context and lacking focus on the question</li> <li>• makes judgements or proposes solutions based on assertions.</li> </ul>	<b>1–4 marks</b>

## Levels of response for a 24 mark question

Level	The student will typically demonstrate:	Marks
<b>5</b>	<b>An excellent response overall that is fully focused on the key demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates a depth and range of knowledge and understanding that is precise and well selected in relation to issues in the question</li> <li>• demonstrates analysis throughout that is well developed, is applied effectively to the context and considers a balanced range of the issues in the question</li> <li>• makes judgements or provides solutions that are built effectively on analysis, show balance and have a clear focus on the question as whole throughout.</li> </ul>	<b>21–24 marks</b>
<b>4</b>	<b>A good response overall that focuses on many of the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates a depth and range of knowledge and understanding of issues in the question</li> <li>• demonstrates analysis that is well developed and is applied effectively to the context</li> <li>• makes judgements or provides solutions that are built on analysis, show balance and address the question as whole.</li> </ul>	<b>16–20 marks</b>
<b>3</b>	<b>A reasonable response overall that focuses on some of the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates a limited knowledge and understanding of a range of issues in the question or a good knowledge and understanding of relatively few issues in the question</li> <li>• demonstrates analysis that is developed, applied to the context and considers some of the issues in the question</li> <li>• makes judgements or provides solutions that are built on analysis, but lack balance and are not fully focused on the question as whole.</li> </ul>	<b>10–15 marks</b>
<b>2</b>	<b>A limited response overall with little focus on the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates a limited range and depth of knowledge and understanding of issues in the question</li> <li>• demonstrates analysis with little development, mainly descriptive application to the context and considers a limited number of issues in the question</li> <li>• makes judgements or provides solutions that have limited links to analysis or limited focus on the question as whole.</li> </ul>	<b>5–9 marks</b>
<b>1</b>	<b>A weak response overall lacking focus on the demands of the question</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates isolated or imprecise knowledge and understanding</li> <li>• demonstrates undeveloped analysis with descriptive application to the context and lacking focus on the question</li> <li>• makes judgements or proposes solutions based on assertions.</li> </ul>	<b>1–4 marks</b>

## Levels of response for a 25-mark question

Level	The student will typically demonstrate:	Marks
<b>5</b>	<b>An excellent response overall that is fully focused on the key demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates a depth and range of knowledge and understanding that is precise and well selected in relation to issues in the question</li> <li>• demonstrates analysis throughout that is well developed, is applied effectively to the context and considers a balanced range of the issues in the question</li> <li>• makes judgements or provides solutions that are built effectively on analysis, show balance and have a clear focus on the question as a whole throughout.</li> </ul>	<b>21–25 marks</b>
<b>4</b>	<b>A good response overall that focuses on many of the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates a depth and range of knowledge and understanding of issues in the question</li> <li>• demonstrates analysis that is well developed, applied effectively to the context and considers a range of issues in the question</li> <li>• makes judgements or provides solutions that are built on analysis, show balance and address the question as a whole.</li> </ul>	<b>16–20 marks</b>
<b>3</b>	<b>A reasonable response overall that focuses on some of the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates a limited knowledge and understanding of a range of issues in the question or a good knowledge and understanding of relatively few issues in the question</li> <li>• demonstrates analysis that is developed, applied to the context and considers some of the issues in the question</li> <li>• makes judgements or provides solutions that are built on analysis, but lack balance and are not fully focused on the question as a whole.</li> </ul>	<b>11–15 marks</b>
<b>2</b>	<b>A limited response overall with little focus on the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates a limited range and depth of knowledge and understanding of issues in the question</li> <li>• demonstrates analysis with little development, has mainly descriptive application to the context and considers a limited number of issues in the question</li> <li>• makes judgements or proposes solutions that have limited links to analysis or limited focus on the question as a whole.</li> </ul>	<b>6–10 marks</b>
<b>1</b>	<b>A weak response overall lacking focus on the demands of the question.</b> Provides an answer to the question set that: <ul style="list-style-type: none"> <li>• demonstrates isolated or imprecise knowledge and understanding</li> <li>• demonstrates undeveloped analysis with descriptive application to the context and lacking focus on the question</li> <li>• makes judgements or proposes solutions based on assertions.</li> </ul>	<b>1–5 marks</b>

Note: Mark schemes reproduced from AQA A-level Business 7132 mark schemes, June 2018.

# 1 Mission, corporate objectives and strategy

## Practice exercise 1 (55 marks), page 10

- 1** Explain the term 'mission' and give an example of a business mission from an organisation you are familiar with. (5)
- A 'mission' is an organisation's aims or long-term intentions, its ultimate purpose; a business mission is sometimes the same as its corporate aims.
- 2** Identify and explain two influences on the mission of a business. (6)
- Its size; the range of its activities; the nature of its owners, leaders and important stakeholders – their values and beliefs; changes over time in the nature of the business; the performance of the business – its strengths and opportunities; the external environment it faces; the extent to which it demonstrates social responsibility.
- 3a** Explain how the pressures for short-termism are likely to influence the corporate objectives of a business. (5)
- Such pressures often come from institutional investors seeking to maximise their funds and profits. They mean that a business is more likely to focus on short-term profit objectives rather than long-term performance objectives.
- 3b** Explain how business ownership is likely to influence the corporate objectives of a business. (3)
- A business's objectives are determined by its status, whether a sole trader, partnership, private or public limited company. Sole traders set objectives just for themselves, and these will often be about survival. A public limited company will set objectives that satisfy shareholders and powerful stakeholders, and are more likely to be about market share, efficiency and profitability.
- 4** Identify and explain one other internal influence and one other external influence on the corporate objectives of a business. (6)
- Other internal influences: the relative power of stakeholders; ethics; business culture; resource constraints.
  - Other external influences: the external environment such as economic policy, environmental factors, demographic factors and actions of competitors.
- 5** Explain the term 'strategy' in a business context. (3)
- 'Strategy' means the medium- to long-term plans that will allow a business to achieve its objectives. Such plans include details about what is to be done and the financial, production and personnel resources required to implement the plans.
- 6** Distinguish between 'strategy' and 'tactics' in a business context. (5)
- 'Tactics' are the means by which a 'strategy' is carried out. A range of different tactics may be used as part of a single strategy. Tactics enable an organisation to reach the milestones or interim targets that have been set in order to achieve its overall objectives. 'Strategy' tends to be decided at board of director or senior leader level. 'Tactics' tend to be decided by functional heads of departments.
- 7** What is the relationship between the strategy of a business and its mission and corporate objectives? (6)
- Strategy is the general approach a business will use and the policies and plans it will develop in order to achieve its corporate objectives.
  - Corporate objectives are the goals or targets that are set to enable a business to achieve its long-term aims or mission.
- 8** What is a corporate or strategic plan? (4)
- This explains how a firm's aims and objectives will be achieved. It comprises both medium- and long-term actions. It clarifies the role of each department in contributing to meeting corporate objectives, allowing better coordination of activities.
- 9** Identify the various stages involved in the corporate or strategic planning process. (6)
- The creation of a business mission or long-term aims and intentions; the drawing up of corporate

and functional objectives; consideration of the internal/external environment; undertaking a SWOT analysis; making strategic choices; implementing strategy; control and evaluation to monitor the success of the strategy.

**10** Distinguish between strategic and functional decision making. (6)

- Strategic decision making concerns the general direction and overall policy of an organisation. Strategic decisions have significant long-term effects on an

organisation and therefore require detailed consideration and approval at senior management level. They can be high risk because the outcomes are unknown and will remain so for some time.

- Functional decision making tends to be short to medium term and is concerned with a specific functional area rather than overall policy. Functional decisions are usually taken to support the implementation of strategic decisions, and are usually made at middle management level.

## Practice exercise 2 (35 marks), page 13

**1** In relation to SWOT analysis, which of the following is a true statement? (1)

- Strengths are part of the internal audit and look at the future.
- Weaknesses are part of the external audit and look at the present.
- Opportunities are part of the external audit and look at the future.
- Threats are part of the internal audit and look at the present.

The answer is c.

**2** Explain one example of a possible strength a business might have in relation to the work of its marketing function, and one example of a possible strength of its operations management function. (8)

- Strengths in marketing might include: brand loyalty; quality of its sales staff; creativity of its advertisements.
- Strengths in operations management might include: good location; efficient stock control; quality of its products.

**3** Explain one example of a possible weakness a business might have in relation to the work of its finance and accounting function, and one example of a possible weakness of its human resource function. (8)

- Weaknesses in finance and accounting might include: difficulties in raising money; weak financial control and budgeting; low levels of liquidity.
- Weaknesses in human resources might include: inappropriate recruitment methods; poor workforce planning; inadequate reward and motivation systems.

**4** Explain one example of an opportunity in the external environment that might be available to a manufacturing business. (4)

An improving rate of economic growth so that incomes and demand rise; a change in consumer tastes in favour of one of its products; an important competitor experiencing financial difficulties.

**5** Explain one example of a threat in the external environment that might confront a business in the tourism sector. (4)

High interest rates meaning less income to spend on luxuries like tourism; political upheaval in a country where it provides holidays; a failure to develop its online business in comparison with its competitors.

**6** Why might issues about uncertainty and time be important considerations in relation to a SWOT analysis? (5)

- Opportunities and threats relate to the external environment and to the future, which is uncertain and often unpredictable. In addition, the further into the future, i.e. the longer the time period, the more uncertainty there is.
- Strengths and weaknesses relate to the firm itself and to the present, in which there is a greater level of certainty.
- The fact that some aspects of a SWOT analysis involve uncertainty does not mean that it should not be done — by reviewing, assessing and anticipating changes in the external environment, a firm is more likely to be able to deal with any changes that may occur.

**7** Explain the value to any business of undertaking a SWOT analysis. (5)

A SWOT analysis encourages businesses to analyse their existing position and their future prospects. As such, it provides a useful discipline to ensure that strategies are based on a realistic assessment of the business rather than gut feeling.

## Case study: Halfords (40 marks), pages 13–14

- 1 Explain how Halfords' strategy might be translated into tactics for any one of its functional areas, that is for its marketing, operations, finance or human resource functions. (4)

Halfords' strategy is to achieve long-term sustainable growth by specialising in its market for motorists and for cyclists. Tactics for functional areas might include:

- **Marketing:** the pricing of cycles, within appropriate ranges, are consistently as low as or lower than those of competitors.
- **HR:** fully trained staff are available in each store to facilitate repair and servicing of cars, including electric cars, and bicycles.
- **Operations:** seamless procedures from order to delivery and between online and off-line purchasing.

- 2 Using Halfords as an example, or any other business you are familiar with, explain why broad corporate objectives and strategies need to be broken down into functional and tactical decisions if an organisation is to be successful in meeting its aims. (4)

- Broad corporate objectives cannot be achieved and broad corporate strategies cannot be implemented unless they are broken down into smaller units. Thus functional objectives and decisions determine short-term targets that, when successfully co-ordinated and implemented, allow for the overall achievement of corporate objectives.
- Halfords' objective to achieve long-term sustainable growth cannot be achieved unless this objective is broken down into plans and targets for each functional area.

- 3 To what extent does the Case study illustrate the importance to a business, such as Halfords, of ensuring a clear relationship between mission, objectives and strategy? (16)

Answers might include the following:

- Explanation of the term vision and the value of mission to a business.
- Explanation of what objectives are, what influences them and their value to a business.
- Explanation of what strategy is.
- Analysis of the link between these three terms and the importance to a business of ensuring a clear relationship between them.

**Evaluation:** Objectives dictate a firm's future direction. Objectives start off broad at the corporate level and become more detailed at the level of each functional area, thus encouraging a co-ordinated approach. The

same approach is used in determining the corporate plan or strategy that will be put in place to achieve these objectives. The Case study illustrates the importance to Halfords of the relationship between mission, objectives and strategy. Halfords' vision or mission is to 'inspire and support a lifetime of motoring and cycling'. In doing this it aims to achieve long-term sustainable growth. Its strategy to achieve this is to increase its markets in relation to car drivers and cyclists.

- 4 To what extent is a SWOT analysis a valuable approach to strategic planning for a business such as Halfords? (16)

Answers might include the following:

- Explanation of the term 'SWOT analysis' and what its component parts are.
- Explanation of what strategic or corporate planning is and how a SWOT analysis fits in.
- Assessment of the broad advantages of a SWOT analysis.
- Analysis of the usefulness of each element of a SWOT analysis, i.e. the internal analysis of strengths and weaknesses in relation to the present, and the external analysis of opportunities and threats in relation to the future.
- Use of examples provided in the Case study to illustrate each element.
- Analysis of the possible uncertainty likely to be present when analysing the external influences.

**Evaluation:** While the internal analysis of strengths and weaknesses relates to the present, in which there is a greater level of certainty, the external analysis of opportunities and threats relates to the future, which is uncertain and sometimes unpredictable. However, the fact that some aspects of a SWOT analysis involve uncertainty does not mean that it should not be done — by reviewing, assessing and anticipating changes in the external environment, a firm is more likely to be able to deal with any changes that may occur. Halfords' SWOT analysis suggests that it may need to give more attention to its sales and servicing facilities, to the integration of its online and off-line sales and to its digital procedures. However, while these are current weaknesses, they may also be future opportunities. Its main threats come from economic and social factors. For example, a downturn in the economy could have a serious impact on demand for cycles and related products.

## 2 Analysing the existing internal position of a business to assess strengths and weaknesses: financial ratio analysis

### Practice exercise 1 (30 marks), page 21

- 1 Which one of the following is a current asset? (1)
- inventory
  - land
  - machinery
  - share.
- The answer is a.
- 2 Which one of the following is a current liability? (1)
- cash
  - long-term loan
  - payable
  - receivable.
- The answer is c.
- 3 Which one of the following is a non-current asset? (1)
- bank overdraft
  - cash
  - inventory
  - machinery.
- The answer is d.
- 4 What is meant by the term 'balance sheet'? (3)
- A balance sheet looks at the accumulated wealth of a business and can be used to assess its overall worth. It lists the resources that a business owns (its assets) and the items it owes (its liabilities). In addition, it shows the capital provided by the owners, such as shareholders.
- 5 What are the differences between assets, liabilities and equity? (9)
- Assets are those items that are owned by an organisation; they can be current or non-current. Liabilities are the debts owed by an organisation to suppliers, shareholders, investors or customers. Equity represents the funds provided by the owners, in order to set up the business and fund expansion and the purchase of non-current assets.
- 6 Why is it important to distinguish between non-current assets and current assets? (6)
- Non-current assets are those resources that can be used repeatedly in the production process. These are necessary to allow the business to create profit.
  - Current assets are the short-term items that circulate in the business on a daily basis and allow the business to meet its short-term liabilities, ensuring that it has no working capital problems.
- 7 Explain **three** uses of balance sheets. (9)
- **Assessing the value of the business.** Adding non-current assets to the working capital allows analysts to assess the overall worth of the business and thus decide whether it is over- or undervalued, according to its share price.
  - **Gaining an understanding of the nature of the business.** The structure of assets, especially the types of non-current asset and inventories, gives an indication of the type of business. For example, a business whose non-current assets consist largely of land and property is likely to be a primary producer: manufacturers using just-in-time methods may carry low levels of inventory; and firms providing personal services would tend to have high cash levels in comparison with receivables.
  - **Identifying the company's liquidity position.** This shows whether the business is likely to get

into short-term financial difficulties and face problems in paying its payables.

- **Showing sources of capital.** By showing the level of borrowed money, the financial strength

of the business can be seen, along with its vulnerability to high rates of interest. This also allows potential investors to assess whether to lend additional money.

## Practice exercise 2 (20 marks), page 21

Using the data in Table 2.3, calculate the following values:

- |   |   |
|---|---|
| <p>1 Non-current assets (fixed assets)<br/>£191 million (88 + 24 + 11 + 68)</p> <p>2 Current assets<br/>£57 million (19 + 34 + 4)</p> <p>3 Current liabilities<br/>£26 million (23 + 3)</p> | <p>4 Net current assets (working capital)<br/>£31 million (57 – 26)</p> <p>5 Non-current liabilities<br/>£16 million</p> <p>6 Net assets (total net assets)<br/>£206 million (191 + 57 – 26 – 16)</p> <p>7 Total equity (capital)<br/>£206 million (74 + 132)</p> |
|---|---|

## Practice exercise 3 (30 marks), pages 27–28

- |  |  |
|--|--|
| <p>1 Revenue <i>minus</i> 'X' = Gross Profit. 'X' is:<br/>a cost of sales<br/>b expenses<br/>c finance costs<br/>d tax.</p> <p>The answer is a.</p> <p>2 For a public limited company, which tax is deducted from 'profit before tax' to get the 'profit for year' figure?<br/>a Business rates<br/>b Corporation tax<br/>c Income tax<br/>d VAT.</p> <p>The answer is b.</p> <p>3 What is meant by the term 'income statement'?<br/>An income statement is a document that describes the income and expenditure of a business over a given period of time, usually a year. It shows the profit (or loss) made by the business.</p> <p>4 Identify two purposes of an income statement.<br/>• To satisfy legal requirements, as laid down in laws such as the Companies Acts.<br/>• To assist managers in reviewing progress towards targets during the course of the year.<br/>• To allow comparisons to be made between different firms and within firms, such as comparing different divisions or departments.</p> <p>5 What is the difference between operating profit and profit for the year?</p> | <p>(1) <b>Operating profit</b> is the revenue earned from everyday trading activities minus the cost of carrying out those activities. <b>Profit for year</b> is the profit available to shareholders if they choose.</p> <p>The difference between the two is that the operating profit does not allow for finance income and finance costs, and is calculated before tax is deducted.</p> <p>6 Identify the two ways in which profit is utilised.<br/>Dividends to shareholders and retained profit for investment within the business.</p> <p>7 Using the figures below, calculate:<br/>a the gross profit<br/>Gross profit is sales turnover minus the cost of sales.<br/><math>£980,000 - (£400,000 + £110,000) = £980,000 - £510,000 = £470,000</math><br/>b the operating profit<br/>Operating profit is revenue earned from everyday trading activities minus the cost of carrying out these activities. In this case, it is gross profit minus overheads.<br/><math>£470,000 - (£125,000 + £200,000) = £470,000 - £325,000 = £145,000</math></p> <p>8 A company must pay tax of 30 per cent on its profit of £200,000. If it plans to use 60 per cent of its profits (after tax) to build an extension to its factory, how much of its profit will be paid to shareholders?<br/>Profit = £200,000</p> |
|--|--|

minus tax (30% of £200,000) = £60,000  
 Profit after tax = £140,000  
 minus retained profit (60% of £140,000) = £84,000  
 Profit paid to shareholders = £56,000

- 9 Why might shareholders allow a business to keep all of the profit for its own use? (4)

Shareholders will allow a business to keep all of the profit for its own use (known as 'retained profit') in order to increase the assets of the business and increase the value of the company in the long run. This should increase the scope

of the business to make further profit, and shareholders will benefit from higher dividends in future years. Shareholders might also benefit from an increase in the price of the share as the company becomes more valuable.

- 10 Calculate the earnings per share based on the following data: (3)

- Profit for year: £300,000
- Shares issued: 500,000 at 50p each.

Earnings per share = profit for the period / number of shares  
 = £300,000 / 500,000 = £0.60 (60p)

## Practice exercise 4 (10 marks), page 28

- 1 Rewrite the income statement to take into consideration the following changes: (8)
- Revenue: increases by 20 per cent
  - Cost of sales: increases by £100,000
  - Expenses: increase by £150,000
  - Finance income and finance costs: no changes
  - Corporation tax: equal to 20 per cent of profit before tax.

Year ending: 30.6.20 (£000)		
Revenue	3,000	{2,500 + 500}
Cost of sales	(1,250)	{1,150 + 100}
Gross profit	<b>1,750</b>	
Expenses	(1,120)	{970 + 150}

plus (minus) Exceptional items	0	
Operating profit	<b>630</b>	
Finance income	50	
Finance costs	(100)	
Profit before tax	580	
Taxation	(116)	
Profit for year	<b>464</b>	

- 2 Based on these changes, calculate the amended earnings per share on the assumption that the number of shares remains the same as for 30.6.20. (2)

Earnings per share £464,000 / 300,000 shares = £1.55

## Practice exercise 5 (25 marks), page 33

- 1 What is meant by the term 'ratio analysis'? (3)

Ratio analysis is a method of assessing a firm's financial situation by comparing two sets of linked data.

- 2 Identify five different users of ratio analysis. (5)

Managers, employees, government, competitors, suppliers, customers, shareholders.

- 3 Select two of the five users identified in question 2 and explain the reasons why they might use ratio analysis. (8)

- Managers might use ratio analysis to identify the efficiency of the firm and to focus on the relative efficiency of specific areas of the firm. This information allows for planning and control of operations, in order to improve efficiency.
- Employees might use ratio analysis to ascertain whether their jobs are secure and

whether they are receiving a fair reward for their services.

- Government might want to assess the financial health of UK firms and to identify trends in sales, profitability etc.
- Competitors may wish to compare their financial performance with that of rivals in order to see if improvements are possible.
- Suppliers may wish to arrange payment terms and investigate the ability of a firm to pay its debts. They can also investigate types of payment terms offered to other suppliers.
- Customers might use ratio analysis to examine a firm's financial position in order to decide whether the firm is likely to continue to be able to supply its products or services in future years.
- Shareholders could use ratios to provide vital information on the level of reward they might expect to receive.

- 4 Distinguish between comparisons over time and comparisons between businesses. (4)

Comparisons over time tend to focus on one business, in order to measure its current performance against its performance in previous years. Comparison between businesses examine different organisations, usually over a period of one year: for example, comparing one firm's finances with those of a rival organisation.

- 5 A business observes that one of its departments is better at cutting costs than the other departments. This is an example of comparison: (1)
- a over time
  - b to a standard
  - c between businesses
  - d within a business.

The answer is d.

- 6 Identify the four main types of ratio. (4)

Profitability and performance ratios; liquidity ratios; gearing ratio; financial efficiency ratios.

## Practice exercise 6 (20 marks), page 37

- 1 Explain why return on capital employed is considered to be a good measure of a firm's performance. (6)

The return on capital employed is generally considered to be a good measure of a firm's performance because it compares the operating profit (the best measure of a firm's performance) with capital employed (the best measure of a firm's size). Therefore, the ratio is useful in providing objective comparisons between firms of all sizes.

- 2 Explain one reason why return on capital employed might *not* be a good indicator of a firm's success. (6)

- The profit can be distorted by exceptional items that give a profit level that is not sustainable, or is not an accurate reflection of the business's trading activities.
- Capital employed can be a misleading indicator of a business's size. A business that leases

many assets and is labour-intensive may have a much lower capital employed figure than a business that owns its assets and is capital intensive (and so requires much more equipment).

- 3 Based on the information above, calculate the return on capital employed for the year ending 13 September 2014 and the year ending 15 September 2018. (6)

Return on capital employed:

Year ended 13.9.2014:  $(1,080/7,788) \times 100 = 13.9\%$

Year ended 15.9.2018:  $(1,344/10,444) \times 100 = 12.9\%$

- 4 In which year did ABF plc enjoy the best performance? Use the ratios calculated in question 3 to support your views. (2)

2014; the ROCE was higher in 2014 than in 2018, with a small difference of 1.0 per cent between the two years. Profitability has worsened slightly.

## Practice exercise 7 (20 marks), page 39

- 1 In theory, the current ratio should be ideally between  $x:1$  and  $y:1$ , where  $x$  and  $y$  are numbers.

- a What is the ideal value for  $x$ ? (1)

Ideally,  $x$  should be 1.5, giving a ratio of 1.5:1.

- b What is the ideal value for  $y$ ? (1)

Ideally,  $y$  should be 2, giving a ratio of 2:1.

- 2 Why should a firm try to avoid a low current ratio? (4)

A low current ratio means that the business might be unable to meet its current liabilities, as it will have insufficient inventory, receivables

and cash. The business might therefore go into liquidation if it is unable to pay its debts when required to do so by its payables.

- 3 What is the disadvantage of a high current ratio? (4)

The disadvantage of a high current ratio is the repercussion it may have on the business's profits. By holding excessive levels of liquid assets, the business is sacrificing non-current assets. These are the resources that allow the business to create wealth and profits. Ultimately, a high current ratio may lead to lower profits in future years.



# Business

For A-level Year 2

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e: [education@bookpoint.co.uk](mailto:education@bookpoint.co.uk)

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