



## ADVANCED GCE

# BUSINESS STUDIES

Further Accounting and Finance

# 2875

Candidates answer on the Answer Booklet

### OCR Supplied Materials:

- 8 page Answer Booklet

### Other Materials Required:

- Calculators may be used

**Tuesday 16 June 2009**

**Afternoon**

**Duration: 1 hour 30 minutes**



## INSTRUCTIONS TO CANDIDATES

- Write your name clearly in capital letters, your Centre Number and Candidate Number in the spaces provided on the Answer Booklet.
- Use black ink. Pencil may be used for graphs and diagrams only.
- Read each question carefully and make sure that you know what you have to do before starting your answer.
- Answer **all** the questions.
- Do **not** write in the bar codes.
- If you use additional sheets of paper, fasten the sheets to the Answer Booklet.

## INFORMATION FOR CANDIDATES

- The number of marks is given in brackets [ ] at the end of each question or part question.
- The total number of marks for this paper is **60**.
- You will be awarded marks for the quality of written communication where an answer requires a piece of extended writing.
- This document consists of **4** pages. Any blank pages are indicated.



**A calculator may  
be used for this  
paper**

### Utsaw Wholesalers Ltd (UWL)

Sanjit Naeem is the Managing Director of Utsaw Wholesalers Ltd (UWL), an import wholesale business based in Sparkbrook, Birmingham. The business was established in 2001 and aimed to meet the needs of the large Indian population living in the city. Sanjit travels to India frequently to visit manufacturers which specialise in silk and embroidered fabrics. He chooses the patterns which he thinks will sell and has the fabrics made into a whole range of traditional and contemporary garments in India. He also buys rolls of fabric to bring back to England. When the stock arrives in Birmingham, it is stored in a warehouse owned by UWL and sold to retailers. UWL also sells fabric direct to local market traders.

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Initially, UWL had been very successful but more recently it had found difficulty in selling its stock. Sanjit believes that this is due to much greater competition. He also knows that his competitors operate on a much larger scale than UWL and, hence, can undercut his prices. Sanjit thinks that UWL's small warehouse (only 5000 sq. ft.) is a major constraint because it simply cannot hold more stock.

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Despite this, UWL is still profitable, but it is experiencing increasing liquidity problems. Table 1 gives an indication of the situation.

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**Table 1 – Liquidity data – UWL**

	2007	2008	Industry Average
Stock turnover (days)	40	45	38
Debtors (days)	34	50	28
Creditors (days)	28	24	28
Sales (£)	1.50m	1.30m	
Net profit (£)	0.18m	0.10m	

Footnote to Table 1

All UWL's sales are on credit to customers (debtors). Purchases are 50% of the value of sales at UWL.

The problem was highlighted by a recent request from UWL's bank for the business to reduce its overdraft by £60,000. Sanjit was dismayed by this request but was told that it was part of the tighter credit policy being followed by the bank.

Sanjit has been in discussion with UWL's accountant. Sanjit was told that, in the last month, two of UWL's customers had gone into liquidation and there was no chance of any recovery of the debts owed to UWL. "These will have to be recorded as bad debts I'm afraid, valued at £40,000," the accountant said.

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The accountant suggested that UWL should operate a much tighter budgetary policy. "You need to monitor what product lines are selling and adjust your stock buying policies accordingly. I do not recommend the strategy of selling stock at discounted prices just to sell it. I have been looking at a few figures and am not happy with what I have seen." Table 2 is an extract from the figures gathered by the accountant.

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**Table 2 – Financial extract for Garment A**

	Budget	Actual
Sales of garment A (units)	600	450
Value of sales of garment	£54,000	£36,000
Gross margin per garment	£30	£16
Gross profit	£18,000	£7200

A month later, Sanjit had another meeting with the accountant to discuss how to deal with UWL's problems. Sanjit started by saying that he felt that the main problem was a lack of capacity at the warehouse. "If we had more storage space, we could hold a wider stock range and buy in bulk. I know I could get a 10% discount on most of my stock purchases if our order size was larger. We could also widen the stock range to make us more appealing to retailers. I have been researching into the possibility of acquiring a new warehouse and think that 15,000 sq. ft. is the minimum size we need. This would allow us to treble our turnover next year. With the same gross margins, our profits would certainly increase." 30

"I have looked at a number of possible locations. There's plenty of warehouse space available." He then showed the accountant the results of his search (see Table 3). 35

**Table 3 – Warehouse costs (15,000 sq. ft.)**

Solihull (residential area, outer Birmingham)	£20 per sq. ft. annual rent
Sparkbrook (inner Birmingham)	£8 per sq. ft. annual rent
Purchase cost of warehouse (inner Birmingham)	£85 per sq. ft.

"A specialist commercial finance company would lend a 95% mortgage at 1% above base rate. This works out at 6.5% at present, but it is variable," said Sanjit. "I've not considered things like business rates and other associated overheads though." 40

The accountant looked carefully at the figures and said "What about the possibility of continuing with your present warehouse but specialising in a narrower range of stock such as fabrics? You wouldn't need as much space then would you?" Sanjit did not like this suggestion. The accountant went on to say, "I think you have got three options:

- rent a warehouse;
  - buy a warehouse;
  - specialise in a narrower range of stock."
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"My aim is for UWL to become larger and more powerful. I think that UWL must have a progressive business plan if it is to survive," said Sanjit.

Answer **all** the questions.

- 1 (a) Calculate the average amount of cash owed to UWL by its customers in 2008. [4]
- (b) Evaluate options available to UWL to reduce its overdraft to meet the target set by the bank. [16]
- (c) Analyse the causes of the profit variance shown by the data in Table 2. [6]
- (d) Discuss the usefulness of budgeting as an aid to decision making at UWL. [10]
- 2 (a) Analyse how the liquidation of a customer will affect the accounts of UWL. [6]
- (b) Evaluate the financial implications of the options being considered by Sanjit. [16]

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