



Cambridge Pre-U

BUSINESS AND MANAGEMENT

9771/02

Paper 2 Strategic Decisions

May/June 2023

3 hours



You must answer on the enclosed answer booklet.

You will need: Answer booklet (enclosed)

INSTRUCTIONS

- Answer **all** questions.
- Follow the instructions on the front cover of the answer booklet. If you need additional answer paper, ask the invigilator for a continuation booklet.

INFORMATION

- The total mark for this paper is 100.
- The number of marks for each question or part question is shown in brackets [].

This syllabus is regulated for use in England, Wales and Northern Ireland as a Cambridge International Level 3 Pre-U Certificate.

This document has **8** pages. Any blank pages are indicated.

Read all the case study material and then answer all of the questions which follow.

Countryside Properties plc (Countryside)

Countryside is a UK-based housebuilder and urban regeneration company. It primarily operates in London and the South East of England, but it is expanding its operations in other regions, notably the North West of England. Countryside currently operates through two divisions:

- Housebuilding
- Partnerships

The Housebuilding division develops medium to large scale sites, providing private housing on private land. The Partnerships division is engaged in urban regeneration projects that involve using land owned by the public sector to build private homes. Many of the houses built by the Partnerships division are 'affordable homes'. The UK Government defines affordable homes as those for sale or rent to people whose needs would not otherwise be met by the market because of high house prices. The provision of affordable housing is a key element of the government's plan to end the housing crisis, tackle homelessness and provide aspiring homeowners with a step onto the housing ladder. The Partnerships division operates in the London area and in the North West. These urban regeneration projects are developed as partnerships with public sector landowners, such as local authorities and housing associations.

Countryside executives describe this two-division structure to be a 'balanced business model'. The Housebuilding division is expected to perform well when the economy is expanding rapidly and house prices are rising. The Partnerships division is lower risk and is likely to produce steadier returns over time if government policy does not change in providing financial support for 'affordable homes' projects.

Table A shows an extract from the 2020 Annual Report and Accounts which contains data about these two divisions and the company's targets for 2023. These targets are based on the company's market forecasts.

Table A: Housebuilding and Partnerships divisions, 2020 results and 2023 targets

	Partnerships		Housebuilding		Group	
	2020	2023	2020	2023	2020	2023
Completed housing units	3213	8000	840	1500	4053	9500
Operating profit margin (%)	5.2	15	7.0	18	5.5	15
Return on Capital Employed (ROCE) (%)	13	40	4.9	25	7.1	30

Housing market – determinants of supply and demand

The UK housing market is subject to frequent changes in the determinants of supply and demand. These changes can make strategic analysis and long-term planning by housebuilders difficult. In recent years some of the most significant changes in supply and demand determinants in the market for private housing have been:

Rising costs of skilled labour and housebuilding materials

Total construction costs increased from between 3.5% to 5.5% every year from 2012 to 2020. Labour shortages in the construction industry are worsening, especially in skilled trades such as bricklaying and plastering. Increased housing demand combined with the decisions of many EU-based workers to return home following Brexit has resulted in labour shortages in the industry. As a consequence, labour wage rates are increasing. Costs of important construction materials such as timber, copper piping and bricks are rising faster than general inflation.

Government intervention

The UK Government has interventionist policies that impact on both the demand and supply of private sector housing. The Help to Buy scheme was introduced to offer low interest loans to first-time buyers of newly built properties. Some analysts believe that this scheme has had the effect of raising house prices and making them less affordable for those groups who do not qualify for government assistance. The Help to Buy scheme is costly for the government. If it is forced to cut back on spending then reducing the scope of the scheme could be one of the options for saving money. On the supply side, the UK Government is relaxing planning restrictions to make it easier for construction businesses to gain planning permission for large housing developments, even on prime agricultural land and in areas of outstanding natural beauty. Environmental pressure groups try to stop many new developments and construction industry executives may become concerned about negative publicity if their businesses are seen to be destroying environmentally sensitive sites.

Demographic and social changes

There are now more single-person households in the UK than ever before. These people often live in small apartments and houses. It is estimated that there are 8 million people living alone, up by 4% in 10 years. This trend is likely to continue. Single-person households now represent 29% of all households in the UK. This trend has two effects on housing demand. Firstly, more properties are required in total as fewer are being 'shared' and, secondly, relatively fewer family type homes are being demanded. The overall UK population is projected to increase, at least for another 10 years. After this, the ageing population may lead to annual deaths exceeding births. The Office for National Statistics projects that the UK population will surpass 69.6 million by mid-2029 and reach 72 million by mid-2041 – increases of 4.2% and 7.8%, respectively, from mid-2019. There are many uncertainties however, including EU immigration trends and the birth rate following the social and economic upheaval of the Covid 19 pandemic. Clearly, population projections need to be incorporated into the housebuilding industry's strategic analysis and long-term plans.

Improving profitability

Despite recent increases in Countryside's share price (see Fig. A), the directors are under pressure from shareholders to improve the profitability of the company. The expected rapid recovery in the UK economy and the housing market following the Covid 19 pandemic may not be sufficient to improve the company's financial performance to the extent demanded by some shareholders. The directors will be focusing on other strategies that they could adopt to increase profit margins and the return on capital employed in the coming years.

These strategies could focus on marketing, operations or human resource management. Some construction industry analysts believe that there might be opportunities to increase the prices of completed houses, especially if unemployment continues to fall and real incomes increase. Countryside directors could decide to complete some houses on selected sites to even higher standards with top-quality fittings and additional value could be added to these by charging premium prices. In contrast, some housebuilding companies are trying to increase margins by reducing costs. This includes sourcing less costly materials, reducing construction time by more effective project planning and by only building houses which have been sold 'off plan' (before construction begins).

All these and similar strategies have limitations. Social housing or 'affordable homes' might have price caps imposed on them by the government or local authorities. Even if these did not exist, would Countryside want to be seen to be raising prices of its housing to lower income customer groups? Cost cutting measures might damage the reputation the company has carefully developed for using relatively high cost but sustainable building materials and construction methods where possible. Building only houses already sold 'off-plan' means that no finished houses are held in inventory to show to potential purchasers.

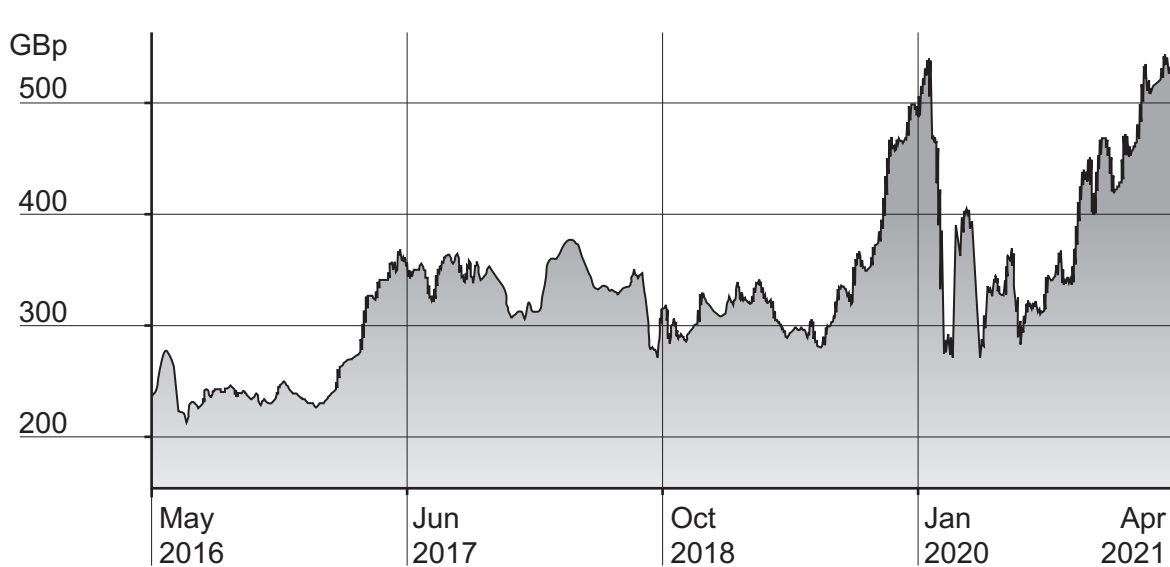
Should the Housebuilding division be disposed of?

In 2020, Countryside reported operating profits falling to £54.2m, a reduction of 77% from 2019. David Howell, the Chairman, stepped down and Rothschild and Co was appointed as adviser to examine splitting the business into two separate entities. Countryside has been under pressure from its third-largest shareholder, US-based Browning West. This institutional investor has called for its own representative to join Countryside's Board of Directors and for the company to focus only on its Partnerships social housing division. If this strategy was adopted, the Housebuilding division would probably be disposed of to another construction company or listed on the Stock Market as a separate company. The capital raised could be returned to shareholders, invested in expanding the Partnerships division or used to reduce the already low gearing ratio of 6%.

'Since July [2020], we have been accelerating the growth plans as we progress towards our goal of delivering 10 000 homes in our Partnerships division,' said Chief Executive Iain McPherson. 'As more capital is allocated to Partnerships, we are reorganising the business to facilitate a future separation of the Housebuilding division to optimise long-term shareholder value.'

The 2020 Annual Report revealed that completed house sales decreased 29% in the year to end-September, with revenue down 31% to £892m and adjusted operating profit margin falling sharply. The average time taken to construct each house increased during the year due to disruptions caused by the Covid 19 pandemic. McPherson said the group had started the new financial year 'in a strong position to recover from the impacts of the pandemic' and 'on track' to reach the upper end of operating profit expectations for the 2021 financial year.

Fig. A shows recent movements in Countryside's share price.



Source: factset.com

Fig. A: Countryside share price, 2016–2021 (pence)

Tables B and C contain data on Countryside's ROCE and extracts from the 2020 financial accounts.

Table B: Countryside ROCE (%)

2016	2017	2018	2019	2020
26.8	30.6	37.4	37.8	7.1

Table C: Extracts from Countryside 2020 Annual Report and Accounts (at 30 September) (£m)

	2020	2019
Revenue	892	1237
Cost of sales	784	984
Inventories	1059	808
Current assets	1359	1122
Current liabilities	361	349
Non-current liabilities	162	144

Section 1

- 1 (a) Calculate, at 30 September 2020, the current ratio. [3]
- (b) Calculate, at 30 September 2020, the acid test ratio. [3]
- (c) Explain the usefulness of liquidity ratio results to Countryside's directors. [6]
- (d) Analyse the potential benefits to Countryside of having a relatively low gearing ratio. [13]

Section 2

- 2 Evaluate the likely impact on Countryside of government intervention which affects the determinants of supply and demand in the housing market. [25]
- 3 Recommend a marketing strategy that Countryside might use to improve profitability. Justify your recommendation. [25]
- 4 Evaluate the possible strategy of Countryside disposing of its Housebuilding division. [25]

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