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Practice (Mock) Exam Paper

for

Edexcel Advanced GCE (A Level) Business

Paper 3

Investigating Business in a Competitive Environment
June 2017 Context: Health and Fitness Industry

Practice (Mock) Exam Paper

Detailed Mark Scheme

Example Model Answers

Minimising Workloads, Maximising Performance

FOREWORD

This resource was **one of six** resources (from APT's Complete Context Companion) written to support teachers and their students preparing for the June 2017 Edexcel A Level Business Paper 3 Exam, which was based on the **Health and Fitness Industry**, and the **private businesses** operating in this market **in the UK** and / or **internationally**. More recent papers can be purchased from APT's website: www.apt-initiatives.com, or from the TES website: www.tes.com/teaching-resources.

The resource consists of a **practice paper and detailed mark scheme / answers**, which tests various aspects relating to the context that students were advised to research in Edexcel's 'Pre-release Material' for the June 2017 Paper 3 exam.

The **practice paper** and **mark scheme (level descriptors)** are written in the same structure, style and format as the sample assessment material (SAM) published by Edexcel at the time of writing for the A Level Business Paper 3 exam. **(Note Q1d and 2d now require students to evaluate specific options and make a recommendation. This change is reflected in APT's Practice Papers published since 2018).**

The **question paper** includes space for students to write down their answers (in line with the SAM published at the time of writing).

Answers are provided in paragraph form, rather than a list of relevant points anticipated to be raised in the answer. They typically contain a range of examples of comments which can earn high marks in relation to the question set. As a result, some of the answers presented may seem a little long, given the time available. However, the total answer may demonstrate the highest level descriptor on more than one occasion. Hence, there is scope to cut such answers down and still secure the maximum marks.

With the exception of answers to calculation questions, **answers** should not be seen as exhaustive - any valid response should be given due credit. **Mark schemes and answers** should, ultimately, be seen as a set of guidelines, not rigid performance criteria.

To conclude, whilst every effort has been made to provide an appropriate question paper, as well as mark scheme and answers for the questions posed, the question paper, mark scheme and answers are intended as **an aid to the teacher** who must retain full responsibility for checking up-to-date specification requirements and exam board assessment material, and the final delivery of subject matter to students. In this context, APT is always available to discuss any aspect of the question papers, mark schemes and answers, should the teacher wish to discuss APT's interpretation.

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Write your name here

Surname	Other names
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APT Initiatives Ltd: **Practice Paper** for
Pearson Edexcel
Level 3 GCE
Business
Advanced
Paper 3: Investigating business in a competitive environment

Time: 2 hours

You do not need any other materials.

Total Marks

Instructions

- Use **black** ink or ball-point pen.
- **Fill in the boxes** at the top of this page with your name.
(Note: Your centre number and candidate number will also be required in the actual exam).
- There are two sections in this question paper.
- Answer **all** questions in both sections.
- Answer the questions in the spaces provided - *there may be more space than you need.*

Information

- The total mark for this paper is 100.
- The marks for **each** question are shown in brackets - *use this as a guide as to how much time to spend on each question. (Note: You have approximately 1 minute per mark - allowing some time to read through each question, the extracts in both sections, and your answers).*
- Calculators may be used.

Advice

- Read each question carefully before you start to answer it.
- Try to answer every question.
- Check your answers if you have time at the end.

Answer ALL questions.

SECTION A

Read the following extracts (A to D) before answering Question 1.

Write your answers in the spaces provided.

Extract A

Importance of innovation in the UK health and fitness market

The market for health and fitness clubs and gyms is very competitive. Consumers are also generally more demanding, sophisticated and experimental. They expect health and fitness clubs and gyms to be innovative, and there is a constant need to invest in new technologies in order to attract and retain customers.

Extract B

The rise of the budget gym

What are now termed 'mid-market' health and fitness clubs have been around since the 1990's. Many offer swimming pool and spa facilities, in addition to a fully-equipped gymnasium and workout studio, with a range of group fitness classes. The prices of monthly memberships have been between £21 and £49, and these have traditionally been offered on a fixed contract, for 12 months or more. 5

Since 2007, the UK market has seen the rise of the 'budget' gym, which began to grow around the latter part of 2008, when the UK was in recession. They are significantly cheaper than many other existing health and fitness clubs, with monthly memberships from £10 to £20, offered on a non-contractual basis. Many are accessible 24 hours a day, 7 days a week, with limited staffing. Facilities are also usually limited to a fully equipped gym, changing rooms and shower rooms, but many also provide access to a range of fitness classes. 10

Pure Gym is one such budget operator. Each Pure Gym requires investment of £1.2m, but the company believes that the UK budget gym market can double in size to 950 sites in the coming years, with between 3.5 million and 4.5 million members - up from 1.9 million as of March 2016. 15

Since 2012, the market as a whole has benefited from economic growth, which has been helped by lower interest rates. Interest rates are, however, expected to rise, which could also have an impact on exchange rates.

(Source of information on Pure Gym:

<http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/11337645/Pure-Gym-founder-on-how-he-built-Britains-biggest-gym-chain.html>; <http://www.bbc.co.uk/news/business-37347229>)

Extract C

The number of sites operated in the UK by private health & fitness clubs and gyms 2011 & 2015

Company / Brand	Founded	Type	No. of UK sites 2011	No. of UK sites 2015
Fitness First	1993	Mid-market	150	74
Anytime Fitness	*2002	Mid-market	4	**55
The Gym Group	2007	Budget	20	74
Pure Gym	2009	Budget	25	160

* Founded in the US ** Includes sites in Ireland

(Source: The Health Club Management Handbooks: www.healthclubhandbook.com)

Extract D

UK Interest Rate Forecast 2017

Q1/17	Q2/17	Q3/17	Q4/17
0.25	0.25	0.25	0.5

(Source: <http://www.tradingeconomics.com/united-kingdom/forecast>)

Value of Pound Sterling Forecast 2017

Q1/17	Q2/17	Q3/17	Q4/17
1.2	1.18	1.17	1.28

(Source: <http://www.tradingeconomics.com/united-kingdom/forecast>)

1 (a) Assess **two** implications for private UK health and fitness clubs and gyms of 'a constant need to invest in new technologies' (Extract A).

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(b) Assess the consequences for existing private UK health and fitness clubs, of the rise of the budget gym (Extract B).

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QUESTION 2 BEGINS ON THE NEXT PAGE.

SECTION B

Read the following extracts (E to H) before answering Question 2.

Write your answers in the spaces provided.

Extract E

The Gym Group's Focus on Organic Expansion

The Gym Group was founded in 2007. It is one of the longest national operators of 24-hour, low-cost budget gyms. Gyms are located in prime city centres and membership costs just £10.99 a month. The Group had just 2 clubs in 2008. This rose to 32 in 2012, 40 in 2013, 55 in 2014 and 74 in 2015.

In June 2013, Phoenix Equity Partners acquired a controlling stake in the business and Bridges Ventures, who had funded The Group since inception, retained a 25% stake. In 2015, the company became a plc, successfully raising £90 million, which it planned to use to pay down debt and fund further expansion, by offering its shares for sale to members of the general public, for the first time, via the stock exchange. 5

Despite an attempted merger with budget rival Pure Gym in 2014, The Gym Group has focused on organic growth. It intends to continue expanding organically within the UK and planned to roll out 15 to 20 gyms throughout 2016 and beyond, despite the market as a whole being regarded as 'mature'. At the same time, it is not ruling out overseas expansion. 10

(Sources: www.healthclubhandbook.com;
<http://www.healthclubmanagement.co.uk/detail.cfm?pagetype=detail&subject=news&codeID=318803>;
<http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/leisure/11983283/The-Gym-Group-celebrates-250m-valuation.html>;
<http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/leisure/11563032/Interview-Gym-Group-boss-limbers-up-for-growth.html>)

Extract F

The Gym Group's Commitment to De-centralised Management

The Gym Group is the only group operator to achieve Silver by Investors in People and was voted as one of 'The Sunday Times 100 Best Companies to Work for 2016'. It makes use of flexible working practices, which includes opportunities for homeworking / e-working in order to reduce the travelling time of employees and ensure a healthy home / work balance. It is also totally committed to the concept of de-centralised management. 5

Managers of each individual gym are encouraged to run the gym as if it were their own business, without the interference of bureaucratic, higher level managers. They have full insight into their profit and loss accounts associated to their individual site, and they are totally involved in setting budgets and targets, as well as being given the freedom to decide how the budget should be spent. 10

(Sources: <http://www.b.co.uk/Company/Profile/336552>; <http://www.leisureopportunities.co.uk/jobs/gymgroup/>)

Extract G**Selected information from The Gym Group plc's Statement of Comprehensive Income for the years ending 31 December 2014 and 2015**

	2015 (£)	2014 (£)
Revenue	59 979 000	45 480 000
Cost of sales	(1 073 000)	(1 040 000)
Gross profit	58 906 000	44 440 000
Administration expenses	(62 712 000)	(42 105 000)
Operating (loss) / profit	(2 701 000)	2 335 000
Finance costs	(9 946 000)	(11 797 000)
Loss for the year attributable to equity shareholders	(11 473 000)	(8 783 000)

(Source: <http://www.tggplc.com/media/66640/24869-Gym-Group-AR15.pdf> - p.65)

Extract H**Selected information from The Gym Group plc's Statement of Financial Position as at 31 December 2014 and 2015**

	2015 (£)	2014 (£)
Non-current assets	134 551 000	118 380 000
Current assets	8 636 000	9 933 000
Total assets	143 187 000	128 313 000
Current liabilities	25 546 000	24 656 000
Non-current liabilities	9 198 000	72 072 000
Total liabilities	34 744 000	96 728 000
Net assets / (liabilities)	108 443 000	31 585 000
Retained deficit	(27 901 000)	(17 398 000)
Total equity shareholders' funds / (deficit)	108 443 000	31 585 000

(Source: <http://www.tggplc.com/media/66640/24869-Gym-Group-AR15.pdf> - p.66)

1 (a) Assess **two** possible reasons why The Gym Group might pursue expansion overseas.

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(b) Assess why The Gym Group might pursue organic business growth over takeovers.

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(Total for Question 2 = 50 marks)

TOTAL FOR SECTION B = 50 MARKS
TOTAL FOR PAPER = 100 MARKS

Mark Schemes & Example Model Answers

SECTION A

1 (a) Assess two implications for private UK health and fitness clubs and gyms of ‘a constant need to invest in new technologies’ (Extract A).

Question Number	Indicative content	Mark
1(a)	<p style="text-align: center;">Knowledge 2, Application 2, Analysis 2, Evaluation 2</p> <p>[Implication: <i>conclusions that can be drawn from this.</i>]</p> <p><i>Possible response:</i></p> <p>Implication: It is likely to incur costs, for example:</p> <ul style="list-style-type: none"> • the cost to purchase and install new technologies. • the cost to train staff how to use the new technologies. • the cost of any borrowing required to fund the investment in terms of interest payments. <p>The higher a business’s costs, the lower the profit, unless revenue increases at a greater rate than the costs. With regard to this, prices could be increased to take into account planned expenditure in new technologies, which would increase revenues and help maximise profit.</p> <p>However, it would only increase revenues if people were willing to pay the higher price, and this may not be possible in the market for health and fitness clubs and gyms, given that it is increasingly competitive. In such a market, any rise in membership prices, risks falling sales.</p> <p>Implication: Constant investment on new technologies is, however, likely to be essential to maintain and attract customers.</p> <p>This is because, customers now have in-depth knowledge themselves about new technologies affecting the industry - as a result of instant access to up to date information over the web and through social media. They may very well choose between different clubs / gyms based on how innovative a club / gym is, for example, in terms of whether they have the most up-to-date gym equipment, such as vibration plates and virtual reality workout stations, as well as whether or not they can book online, or access the club / gym via social media.</p> <p>Investment in the most up-to-date gym equipment may not be so important if there is only one private health and fitness club in a particular area, but in many towns and cities there is more than one private health and fitness facility to choose between, and so keeping up to date with new technologies could be crucial in maintaining a competitive edge.</p> <p><i>Other relevant implications that could be referred to in answers:</i></p>	(8)

It is likely to take up management time, for example:

- management time spent researching new technologies relevant to the industry and deciding whether or not to introduce them.
- management time spent organising and coordinating the purchase and installation of new technologies and training in how to use them.

Therefore, there is an opportunity cost - Management time might be better spent investigating and implementing other revenue generating / cost saving activities.

New technologies may, however, provide an opportunity to maximise revenues and / or reduce costs and, thus, increase profits and profitability in the longer-term. For example:

- There are now wearable mobile apps that allow people to log their activity, manage their diet, view class timetables, and share information on social media. Embracing such technology could help health and fitness clubs and gyms increase membership numbers and / or even provide additional revenue sources, especially amongst 16-34 year olds (who demonstrate the most interest in using these devices). For instance, clubs / gyms could lease or sell fitness bands, or smart watches, as part of a membership package. They could also gather data from such devices to offer a more personalised service to members for an additional fee - through exercise and nutrition plans designed to meet individual member's needs.
- Social media internet technology provides the facility for health and fitness clubs and gyms to very quickly and cheaply interact with members outside of the club / gym environment using Instagram, Facebook, Twitter and Snapchat, for example, and could be used to showcase new exercises and routines, and to remind members of any special offers or events. Such regular interaction can be a very cheap and highly cost effective way to build brand loyalty / aid customer retention. It can also be a very cheap, cost effective way to reach potential new customers - enabling existing members to instantly share information, including word of mouth reviews about the club / gym with friends, family and / or work colleagues, thereby minimising marketing costs.
- Electronic iPads / tablets in the lobby / reception areas can also be used to show timetables and offer the facility for users to sign up for a class, as well as advertise other facilities, such as personal training and beauty treatments, where applicable. This could reduce administration (labour) and marketing costs.
- Electronic devices to sign in and out of a facility can also collate data to determine busy periods, and marketing campaigns subsequently created to encourage use of facilities at off-peak times, thereby helping to maximise revenues and capacity utilisation.

Level	Mark	Descriptor
	0	<ul style="list-style-type: none"> • A completely inaccurate response.
Level 1	1-2	<ul style="list-style-type: none"> • Isolated elements of knowledge and understanding - recall based. • Weak or irrelevant application to business examples. • Generic assertions may be presented.
Level 2	3-5	<ul style="list-style-type: none"> • Accurate knowledge and understanding. • Accurate application to the business and its context. • Chains of reasoning are evident, showing cause(s) and / or effect (s), but may be assertions or incomplete. • An assessment is presented but it is unbalanced, and unlikely to show the significance of competing arguments.
Level 3	6-8	<ul style="list-style-type: none"> • Accurate and thorough knowledge and understanding, supported throughout by relevant and effective use of the business behaviour / context. • Logical chains of reasoning, showing cause(s) and / or effect(s). • Assessment is balanced, well contextualised, using quantitative and / or qualitative information, and shows awareness of competing arguments / factors leading to a supported judgement.

Source: The above Level Descriptors are based upon those published by Edexcel at the time of writing. Wording may differ in places. For the most current versions used by Edexcel refer to Edexcel's website.

(b) Assess the consequences for existing private UK health and fitness clubs, of the rise of the budget gym (Extract B).

Question Number	Indicative content	Mark
1(b)	<p align="center">Knowledge 2, Application 2, Analysis 3, Evaluation 3</p> <p><i>[Consequence: a result or effect, typically one that is unwelcome or unpleasant. Can also be a reaction.]</i></p> <p><i>An answer that focuses on the 'effects' might include reference to the following:</i></p> <p>The rise of the low-cost budget gym could result in reduced demand and, thus, revenues and overall profit for established mid-market operators, thereby restricting targets relating to ROCE and shareholder returns (in the case of limited companies). In extreme cases, this could result in business closure.</p> <p>On the other hand, the rise of the budget gym might not affect memberships and revenues of mid-market operators, given that they offer a wider range of facilities and services, for which people expect and may be willing to pay a higher price. Instead, these budget gyms might attract people who have never been to a gym before, as they were unable to afford it.</p> <p>It should be appreciated, however, that the budget operator arrived during the recession, when unemployment rose and people would have had less income to spend on luxuries, such as going to a gym. As a result, people may have cancelled their membership of their existing club, or decided to trade down and go to one of these cheaper alternatives. This could have forced mid-market operators to look more closely at how they could meet or exceed customer requirements, and give members something they valued over and above the product / service offering of these low-cost rivals, in order to fully justify a higher price point. If they have been unable to do this, this could ultimately have resulted in business closure.</p>	

	<p><i>An answer that focuses on the 'reaction' might include reference to the following:</i></p> <p>Many clubs may initially have looked at lowering monthly membership fees in order to compete on price. This is a simple strategy - it requires no change in operations, but it reduces profit margins, unless costs can be reduced. It would also be difficult for mid-market operators to match the prices of the low-cost budget operators - due to the wider range of facilities they offer, which would be more costly to run.</p> <p>Instead, mid-market operators may have focused on improving the product / service provided through the refurbishment of facilities, including the upgrading of gym equipment - to incorporate the most up-to-date technologies, as well as investment in staff training - to improve level of service. This would obviously incur significant cost. However, faced with low-cost competition, for an established mid-market operator, investment in upgrading and refurbishment could be crucial in fully justifying a higher price in the eyes of existing and potential members, and thus in helping to maintain revenues and margins. Both Fitness First and Bannatyne's have, in fact, taken this further - investing in significant refurbishment, not to compete as a mid-market operator, but in order to reposition themselves as premium fitness brands and justify a higher price point.</p> <p>Mid-market operators might also focus on other elements of the marketing mix, ie other ways to differentiate themselves from low-cost rivals, in ways that customers value, besides 'product' and 'price'. Anytime Fitness has, in fact, managed not just to survive but to thrive and grow, with a strategy centred on convenience and making its gyms as accessible as possible. It does not just open them 24 hours a day, 7 days a week, like many budget operators have done, but locates them in residential areas. It also provides members with access to any of its clubs worldwide free of charge, unlike some lower cost rivals. Such a strategy obviously comes at a cost - of additional staffing and security measures, and potentially higher premises costs - with clubs being situated in residential areas. However, providing greater convenience / accessibility than competitors may be highly valued by customers and something for which they are willing to pay a higher price. It may have enabled Anytime Fitness not only to maintain but increase demand and, thus, revenues, profit and profitability, despite the arrival of low-cost budget alternatives.</p> <p><i>Overall conclusion suitable to either approach / response:</i></p> <p>To conclude, the arrival of low-cost, budget operators may negatively affect demand for, and thus revenues and overall profit of, the mid-market operators. In extreme cases, this could result in business closure. But this is more likely to be the case where the incumbent business has been unable to find ways, other than price, to successfully differentiate their product / service offering, in ways that customers value and fully justify the higher price point.</p> <p><i>Additional 'concluding remarks' to an answer focusing on 'reaction' of existing clubs:</i></p> <p>What they have done is encouraged many of the existing clubs to re-think, re-organise and try to improve, via various means, the facilities and services on offer, in order to maintain or improve their position in the market.</p>	<p>(10)</p>
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Level	Mark	Descriptor
	0	<ul style="list-style-type: none"> • A completely inaccurate response.
Level 1	1-2	<ul style="list-style-type: none"> • Isolated elements of knowledge and understanding - recall based. • Weak or irrelevant application to business examples. • Generic assertions may be presented.
Level 2	3-4	<ul style="list-style-type: none"> • Elements of knowledge and understanding, which are applied to the business example. • Chains of reasoning are evident, showing cause(s) and / or effect (s), but may be assertions or incomplete. • A generic or superficial assessment is presented.
Level 3	5-6	<ul style="list-style-type: none"> • Accurate and thorough knowledge and understanding, supported throughout by relevant and effective use of the business behaviour / context. • Analytical perspectives are presented, with developed chains of reasoning, showing cause(s) and / or effect(s). • An assessment, using quantitative and / or qualitative information, though unlikely to show the significance of competing arguments.
Level 4	7-10	<ul style="list-style-type: none"> • Accurate and thorough knowledge and understanding, supported throughout by relevant and effective use of the business behaviour / context. • A coherent and logical chain of reasoning, showing cause(s) and / or effect(s). • Assessment is balanced, wide ranging and well contextualised, using quantitative and / or qualitative information, and shows an awareness of competing arguments / factors leading to a supported judgement.

Source: The above Level Descriptors are based upon those published by Edexcel at the time of writing. Wording may differ in places. For the most current versions used by Edexcel refer to Edexcel's website.

(c) Assess the likely impact on health and fitness clubs, such as Fitness First, of a reduction in the number of sites it operates in the UK (Extract C).

Question Number	Indicative content	Mark
1(c)	<p style="text-align: center;">Knowledge 2, Application 2, Analysis 4, Evaluation 4</p> <p>[Impact - <i>the action of one object coming forcibly into contact with another; a marked effect or influence.</i>]</p> <p>A reduction in the number of sites will mean loss of future revenues and profit generated from these sites, assuming they were profitable.</p> <p>The smaller scale health and fitness club chain may also lose out on the economies of scale enjoyed as a larger chain, and thus suffer higher unit costs and falling profitability. This especially may be the case when it results in a business being less than half of its original size, as in the case of Fitness First, whose UK sites fell by 76 sites (150 - 74) from 2011 to 2015, which is a reduction of just over 50% (76 / 150 x 100 = 50.67%). Any increase in costs will make it difficult to compete on price, with larger health club chains (and lower cost rivals).</p> <p>Employees may also have fewer promotion prospects, for example, fewer club manager opportunities - 76 fewer in the case of Fitness First UK, as well as fewer area / regional manager opportunities - if club manager / area manager positions were previously available through internal recruitment / promotion.</p>	

	<p>On the other hand:</p> <p>A reduction in the number of sites may increase the profitability of the fitness chain overall, if the sites sold were less profitable than those remaining.</p> <p>The company may also receive a significant amount of income from the sale of these sites, which could be used to re-invest in the business in a more profitable way.</p> <p>It is also easier to coordinate and control a smaller number of sites - there is less chance of diseconomies of scale. Although larger chains can enjoy economies of scale, there is the danger of experiencing diseconomies of scale as a business increases in size. So, instead of unit costs falling as scale increases, beyond a certain scale unit cost will start to rise. A reduction in the number of sites could, therefore, actually result in better performance as a result of the business being easier to coordinate and control.</p> <p>[Note to teachers: Exam papers often include at least one question that was not anticipated from the pre-released material, and / or which requires students to think and work hard in the exam to produce an answer worthy of a high mark. This is one of those questions. It may not be easy to come up with a range of points, but the answer shows competing arguments, and how good use can be made of the evidence (stimulus material) presented on the day of the exam to support points made and demonstrate analytical and evaluative skills.]</p>	<p>(12)</p>
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Level	Mark	Descriptor
	0	<ul style="list-style-type: none"> • A completely inaccurate response.
Level 1	1-2	<ul style="list-style-type: none"> • Isolated elements of knowledge and understanding - recall based. • Weak or irrelevant application to business examples. • Generic assertions may be presented.
Level 2	3-4	<ul style="list-style-type: none"> • Elements of knowledge and understanding, which are applied to the business example. • Chains of reasoning are evident, but may be assertions or incomplete. • A generic or superficial assessment is presented.
Level 3	5-8	<ul style="list-style-type: none"> • Accurate and thorough knowledge and understanding, supported throughout by relevant and effective use of the business behaviour / context. • Analytical perspectives are presented, with developed chains of reasoning, showing cause(s) and / or effect(s). • An assessment is presented, using quantitative and / or qualitative information, though unlikely to show the significance of competing arguments.
Level 4	9-12	<ul style="list-style-type: none"> • Accurate and thorough knowledge and understanding, supported throughout by relevant and effective use of the business behaviour / context. • A coherent and logical chain of reasoning, showing cause(s) and / or effect(s). • Assessment is balanced, wide ranging and well contextualised, using quantitative and / or qualitative information, and shows an awareness of competing arguments / factors leading to a supported judgement.

Source: The above Level Descriptors are based upon those published by Edexcel at the time of writing. Wording may differ in places. For the most current versions used by Edexcel refer to Edexcel's website.

(d) Using the data from the tables in Extract D, evaluate the likely impact of a rise in UK Interest rates on UK-based private health and fitness clubs or gyms.

(Note Q1d and 2d now require students to evaluate specific options and make a recommendation. This change is reflected in APT's Practice Papers published since 2018).

Question Number	Indicative content	Mark
1(d)	<p style="text-align: center;">Knowledge 4, Application 4, Analysis 6, Evaluation 6 Marks for application and analysis - include up to 4 marks for quantitative skills</p> <p>Quantitative skills assessed:</p> <p>QS2: calculate, use and understand percentages and percentage changes QS8: use and interpret quantitative and non-quantitative information in order to make decisions QS9: interpret, apply and analyse information in written, graphical and numerical form</p> <p>The interest rate is the cost of borrowing and the reward for saving. It is a percentage of the amount borrowed or invested. Rates can be fixed or variable.</p> <p>Higher interest rates could result in a fall in the demand for the facilities and services that health and fitness clubs and gyms provide and, thus, falling revenues and / or difficulty achieving objectives relating to growth and expansion, which companies, such as Pure Gym seem keen on pursuing. This is because mortgage holders have more interest to pay and, thus, less money to spend on other goods / services, and consumers are also more likely to save rather than spend, as there is more reward for saving.</p> <p>As the facilities and services provided by health and fitness clubs / gyms would be classed as luxuries not necessities, the demand for such facilities / services is more likely to be sensitive to changes in income, than the demand for necessities (such as food and medicines). Hence, health and fitness clubs, are more likely to suffer a fall in the demand for the facilities and services they provide than, say supermarkets and chemists, when the interest rate rises.</p> <p>Higher interest rates would also increase a business's costs / overheads associated with using an overdraft facility and / or taking out a bank loan. Any increase in costs, lowers profit and, in terms of funding investment, results in a higher break-even point and longer payback period.</p> <p>Whether or not a rise in interest rate will immediately impact on demand and a business's costs will, however, depend upon whether the rate is fixed or variable. If the rate is fixed, then the amount of interest a consumer has to pay on their mortgage and the amount of interest a health and fitness club / gym has to pay on any loan taken out to fund investment, will not directly be affected - at least not until the fixed term comes to an end. If the rate is variable, then the cost of any borrowing will increase and the demand for facilities and services provided by the health and fitness club or gym may fall.</p>	

	<p>The extent to which the health and fitness club will be affected will depend on the extent and length of the increase. In this particular case, the rate is forecast to rise by the end of the year (ie 2017) by just a quarter of a percent. Such a small percentage increase might initially be thought not to have a significant impact. However, when the impact is calculated in monetary terms, the increase in interest payment could, for many budget or mid-market members, exceed the cost of an annual gym membership. For instance, a quarter of a percent rise will increase annual interest on a £100,000 mortgage by £250, and a £200,000 mortgage by £500. This could result in members scaling down to budget operators, or members of budget operators cancelling membership. Any reduction in demand could cause a health club chain to postpone expansion, especially as it would also increase the cost of borrowing - for instance - it would increase the cost to borrow to build a Pure Gym at a cost of £1.2 million by £3,000 a year.</p> <p>If the rate is variable, then besides the extent and duration of the increase, the extent of the effect on the business from a cost perspective, will depend upon the extent to which total capital employed in the business is borrowed; the higher the gearing, the bigger the impact. In this case, a rise in the interest rate could result in a health and fitness club / gym postponing investment as a result - due to the higher cost and longer payback and risk involved. Alternatively, it could result in the business turning to other sources of finance eg retained profit or private equity and share capital to finance investment.</p> <p><i>Students could also refer to the impact a higher interest rate could have on the exchange rate and the subsequent impact a higher exchange rate could then have on clubs or gyms...</i></p> <p>As Extract D states, UK interest rates also affect the exchange rate. A higher interest rate makes UK bank accounts more attractive and increases the demand for the pound, as more investors seek to place money in UK banks. This causes the exchange rate to rise. According to Extract D, the value of the pound is, in fact, forecast to increase by 0.11 from Q3 and Q4 in 2017. This may be a direct result of the forecast rise in the interest rate.</p> <p>If the pound rises (appreciates) in value against other currencies, this could reduce the cost of gym equipment manufactured overseas and imported into the UK - but obviously only if the value rises against the currency of the country in which such equipment is manufactured. With regard to this, the table does not state values of the pound against a specific currency - it would appear to be an aggregate, presumably, taking into account forecast changes in value between a variety of world currencies, such as the US dollar, the Chinese yuan and the euro. Lots of fitness equipment imported in the UK is made in the US and so if the pound rose against the dollar, as a result of a rise in the UK interest rate, then it would cost health and fitness clubs and gyms less to upgrade existing equipment and / or purchase new equipment that has been manufactured in the US.</p>	<p>(20)</p>
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	<p>An appreciation of the pound would also affect the cost to invest in facilities overseas / the cost of overseas expansion. For example:</p> <ul style="list-style-type: none"> • If the pound rose in value against the US dollar, it would make it more expensive for a US-based health and fitness chain, such as Anytime Fitness to expand in the UK. This could temper any expansion plans within the UK and, for UK-based health and fitness clubs and gym, reduce the threat of new entrants from US-based health and fitness chains. • If the pound rose in value against the euro, it would make it less expensive for a UK-based health and fitness chain to expand into Europe, thereby aiding any overseas expansion plans. 	
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Level	Mark	Descriptor
	0	<ul style="list-style-type: none"> • A completely inaccurate response.
Level 1	1-4	<ul style="list-style-type: none"> • Isolated elements of knowledge and understanding - recall based. • Weak or irrelevant application to business examples. • An argument may be attempted, but will be generic and fail to connect cause(s) and / or consequence(s) / effect(s).
Level 2	5-8	<ul style="list-style-type: none"> • Elements of knowledge and understanding, which are applied to the business example. • Arguments and chains of reasoning are evident, but connections between cause(s) and / or consequence(s) / effect(s) are incomplete. Attempts to address the question. • A comparison of judgement may be attempted, but it will not successfully show an awareness of the key features of business behaviour or business situation.
Level 3	9-14	<ul style="list-style-type: none"> • Accurate and thorough knowledge and understanding, supported throughout by relevant and effective use of the business behaviour / context. • Uses developed chains of reasoning, so that cause(s) and / or consequence(s) / effect(s) are complete, showing an understanding of the question. Arguments are well developed. • Quantitative and / or qualitative information is introduced in an attempt to support judgements, a partial awareness of the validity and / or significance of competing arguments and may lead to a conclusion.
Level 4	15-20	<ul style="list-style-type: none"> • Accurate and thorough knowledge and understanding, supported throughout by relevant and effective use of the business behaviour / context. • Uses well-developed and logical, coherent chains of reasoning, showing a range of cause(s) and / or effect(s). Arguments are fully developed. • Quantitative and / or qualitative information are used well to support judgements. A full awareness of the validity and significance of competing arguments / factors, leading to balanced comparisons, judgements and an effective conclusion that proposes a solution and / or recommendations.

Source: The above Level Descriptors are based upon those published by Edexcel at the time of writing. Wording may differ in places. For the most current versions used by Edexcel refer to Edexcel's website.

NB to access levels 3 and 4, students will need to demonstrate quantitative skills to support their judgements.

SECTION B

2 (a) Assess two possible reasons why The Gym Group might pursue expansion overseas.

Question Number	Indicative content	Mark
2(a)	<p style="text-align: center;">Knowledge 2, Application 2, Analysis 2, Evaluation 2</p> <p>Reason - To achieve growth more quickly:</p> <p>The UK market for health and fitness clubs and gyms is described as 'mature', and competition is intensifying. Therefore, The Gym Group's growth objectives might be easier to achieve by penetrating new markets overseas. This is more likely to be the case in overseas markets where the market is growing and / or competition is less intense. This essentially requires researching different geographical markets to find out where there is sufficient demand for its gyms at the prices it needs to charge, in order to secure an acceptable level of profit.</p> <p>Reason - To improve profitability / achieve a higher or faster return on investment:</p> <p>Expansion overseas may enable The Gym Group to charge higher membership fees and / or operate from a lower cost base, thereby increasing profits and profitability and, ultimately, achieving a higher return for its shareholders.</p> <p>If, for example, The Gym Group expands in overseas markets where competition is less intense, then there will be less pressure to keep prices down. Higher monthly membership fees may therefore be charged than those currently charged in the UK, ie higher than the equivalent of £10.99. Profitability will, however, only increase if The Gym's cost base does not increase, and the exchange rate is favourable when remitting profits back to the UK.</p> <p>Premises and / or labour may be cheaper in another country than they are in the UK, thereby enabling the business to operate from a lower cost base. Profitability will, however, only increase if the business is able to charge a similar or higher membership fee to that charged in the UK.</p> <p>If overseas locations are closer to suppliers of fitness equipment, start-up costs might also be reduced as the cost of these supplies might be lower due to lower distribution costs. This would reduce the current £1.2m capital cost required to start up each gym and, ultimately, the length of time to recoup these costs (the payback period), which might very well be a key objective of The Gym Group's private equity investors.</p> <p><i>Another key reason that could be discussed with students:</i></p> <p>To spread risk: Diversification into other markets overseas will reduce The Gym Group's dependency on the UK market for its revenue and will, therefore, make it less vulnerable to changes in the economic climate of the UK.</p>	(8)

Level	Mark	Descriptor
	0	<ul style="list-style-type: none"> • A completely inaccurate response.
Level 1	1-2	<ul style="list-style-type: none"> • Isolated elements of knowledge and understanding - recall based. • Weak or irrelevant application to business examples. • Generic assertions may be presented.
Level 2	3-5	<ul style="list-style-type: none"> • Accurate knowledge and understanding. • Accurate application to the business and its context. • Chains of reasoning are evident, showing cause(s) and / or effect (s), but may be assertions or incomplete. • An assessment is presented but it is unbalanced, and unlikely to show the significance of competing arguments.
Level 3	6-8	<ul style="list-style-type: none"> • Accurate and thorough knowledge and understanding, supported throughout by relevant and effective use of the business behaviour / context. • Logical chains of reasoning, showing cause(s) and / or effect(s). • Assessment is balanced, well contextualised, using quantitative and / or qualitative information, and shows awareness of competing arguments / factors leading to a supported judgement.

Source: The above Level Descriptors are based upon those published by Edexcel at the time of writing. Wording may differ in places. For the most current versions used by Edexcel refer to Edexcel's website.

(b) Assess why The Gym Group might pursue organic business growth over takeovers.

Question Number	Indicative content	Mark
2(b)	<p style="text-align: center;">Knowledge 2, Application 2, Analysis 3, Evaluation 3</p> <p>Organic growth (also known as internal growth) does not involve buying (taking over) or joining together (merging with) another existing business.</p> <p>The Gym Group might pursue organic business growth over takeovers for a number of reasons.</p> <p>Firstly, organic business growth might not require as much capital - as it does not involve the purchase of an existing business, brand name and customer goodwill, which often involves paying shareholders a price for their shares which is above the market price. Neither does it incur costs associated with integrating the new business(es), which, in the case of health and fitness clubs and gyms, might include the cost to re-brand and / or refurbish clubs taken over. With less capital required to start up new gyms, there is less financial risk.</p> <p>Secondly, it does not result in management and / or staff redundancies, which can often occur when a business takes over another business, and which can be costly and challenging to implement. For example, if performance has been poor within the business taken over, senior management may very well be ousted. One or two senior managers may also lose their jobs in order to ensure there is no duplication of resources. Staff redundancies may also occur lower down the hierarchy for the same reasons, ie to avoid duplication of resources and / or reduce costs in order to improve poor performance. Besides adding to costs through redundancy payments, redundancies create uncertainty and anxiety. Hence, they need to be carefully managed in order to minimise absence and / or labour turnover and the associated costs that can stem from feelings of insecurity. Organic business growth avoids these issues.</p>	

	<p>Thirdly, organic business growth maintains the existing management and culture and avoids the potential conflict that can occur with growth through takeovers (besides the potential for conflict associated with redundancies). For example, when taking over another business there can be differences in organisational culture, resulting in conflict with management. For instance, senior managers and individual health and fitness club managers of a business being taken over may have a different philosophy on leadership style, ethics and strategy. In the case of The Gym Group, for example, managers of another club / gym might not be 'comfortable' with a decentralised approach to management, (if they have been used to a more 'centralised' approach), for fear of loss of control, or lack of confidence in handling the additional responsibility this brings. Any differences in attitudes may lead to conflict which could take considerable time to resolve, including investment in management training to change attitudes, which could prove costly. Organic growth avoids such issues.</p> <p>To conclude, The Gym Group might pursue organic business growth over takeovers because it is much easier to coordinate and control, and is far less risky and challenging, for the reasons cited above.</p>	(10)
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Level	Mark	Descriptor
	0	<ul style="list-style-type: none"> • A completely inaccurate response.
Level 1	1-2	<ul style="list-style-type: none"> • Isolated elements of knowledge and understanding - recall based. • Weak or irrelevant application to business examples. • Generic assertions may be presented.
Level 2	3-4	<ul style="list-style-type: none"> • Elements of knowledge and understanding, which are applied to the business example. • Chains of reasoning are evident, showing cause(s) and / or effect (s), but may be assertions or incomplete. • A generic or superficial assessment is presented.
Level 3	5-6	<ul style="list-style-type: none"> • Accurate and thorough knowledge and understanding, supported throughout by relevant and effective use of the business behaviour / context. • Analytical perspectives are presented, with developed chains of reasoning, showing cause(s) and / or effect(s). • An assessment, using quantitative and / or qualitative information, though unlikely to show the significance of competing arguments.
Level 4	7-10	<ul style="list-style-type: none"> • Accurate and thorough knowledge and understanding, supported throughout by relevant and effective use of the business behaviour / context. • A coherent and logical chain of reasoning, showing cause(s) and / or effect(s). • Assessment is balanced, wide ranging and well contextualised, using quantitative and / or qualitative information, and shows an awareness of competing arguments / factors leading to a supported judgement.

Source: The above Level Descriptors are based upon those published by Edexcel at the time of writing. Wording may differ in places. For the most current versions used by Edexcel refer to Edexcel's website.

(c) Assess the likely impact on The Gym Group of its policy of decentralisation.

Question Number	Indicative content	Mark
2(c)	<p style="text-align: center;">Knowledge 2, Application 2, Analysis 4, Evaluation 4</p> <p><i>[Impact - the action of one object coming forcibly into contact with another; a marked effect or influence.]</i></p> <p>In a decentralised organisation lower levels of management have the responsibility for many important decisions. Delegation is a key feature, ie the passing of responsibility and authority to make business decisions to people at lower levels in the organisation. It is especially important as an organisation grows in size and complexity, when it becomes increasingly difficult for the original owner(s) / manager(s) to be part of every decision that takes place. Hence, it may very well be appropriate for The Gym Group, which has grown at a rapid rate, and has further plans for expansion.</p> <p><i>[Note to teachers - The answer below contains a wide range of points that could be brought into an answer to this question. During the exam, students obviously need to be selective and only bring in those points they feel they can discuss well, with reference to the context, within the time available, which for a question worth 20 marks is approximately 24mins, including time to plan and read through their answer.]</i></p> <p>Potential positive impacts on The Gym Group of decentralisation:</p> <ul style="list-style-type: none"> • More productive senior managers. If the business used to be centralised, introducing a decentralised approach would have reduced the time senior / head office managers spent handling queries from, making decisions for, and overseeing the work of, individual gym club managers. Hence, it would have freed up senior management time to concentrate on major / strategic issues, such as investigating opportunities that could maximise the business's potential and, ultimately, the return to shareholders. In the case of The Gym Group, for example, it would have freed up senior management time to identify and investigate the best strategy to achieve the business's ambitious growth objectives. • More appropriate decisions being made that help maximise each individual gym's performance. In 2015, The Gym Group had 74 sites throughout the UK and although each gym is likely to operate in a similar way, because they are in different geographical locations they may face varying degrees and different types of competition, as well as customer bases with different needs, tastes and preferences. These differences could be catered for under a decentralised approach. For example, customers in London may have different preferences with regard to what classes they would like to have offered at the gym to those in Wales, or in Scotland, or indeed in other parts of England, and at what times they would like to have these classes. There may also be a competitor nearby offering specific classes at specific times of the day. 	

Hence, offering something more unique to these classes that customers want to see included, or offering such classes at times that better suit customer needs, may be crucial in maintaining a competitive edge. With decentralisation, decisions that take into account local conditions, for example, over what classes to offer, at what times of the day, can be made by individual gym club managers who, having direct contact with the customers, and direct knowledge of competitor activities, are better placed to make such decisions.

- **Faster response to change.** Because requests do not have to be channelled upwards and decisions awaited from senior managers, each individual gym can also respond more quickly to changes in local market conditions. For example, the arrival of a competitor could threaten memberships and revenues and, ultimately, the survival of an individual gym, unless fast action is taken to review membership packages, and the facilities and services provided, and make any changes necessary to maintain competitiveness and customer retention.
- **Improved morale and motivation of individual gym club managers.** Allowing individual gym club managers to run the gym as if it were their own business could make them feel valued and trusted, thus helping to satisfy esteem needs (in terms of Maslow's hierarchy of needs). They may also feel more fulfilled, as a result of the increased responsibility for decision making, thus helping to satisfy self-actualisation needs (in terms of Maslow's hierarchy). Increased responsibility was also identified as a 'motivator' by Herzberg. Individual gym club managers might also feel less stressed, due to less supervision and constant checking from senior management. Increased job satisfaction and reduced stress could result in less illness, absenteeism and labour turnover and the associated costs, and keeping such costs down would be especially important for a budget operator, such as The Gym Group, which is likely to be operate on low margins in order to maintain low prices.
- **More accurate / realistic budgets and targets.** Because individual gym club managers are '*totally involved in setting budgets and targets*', budgets and targets are more likely to be accurate / realistic. This is because individual club managers, not senior managers, are in the best position to decide what their individual gym club needs in order to maximise performance, and what is or is not achievable, taking into account local market conditions.
- **Reduced scope for conflict.** Budgets and targets can be a key source of conflict between managers and senior managers, if they have had no input into the figures. Hence, the fact that individual gym club managers are '*totally involved in setting budgets and targets*' reduces scope for conflict. Gym staff are also likely to develop more respect for gym club managers if they feel decisions are being made locally, without referral to a higher authority, which could also reduce scope for conflict between staff and managers within individual gyms.

Potential negative impacts:

- **Potential loss of economies of scale.** It should be noted that a standardised approach ie centralisation or decentralisation may not be appropriate for all management functions. It depends upon the potential gains in terms of cost and efficiency. For example, if the majority of supplies were local, then it might be more efficient to decentralise the purchasing function. The decentralisation of personnel functions, such as recruitment, might also be more appropriate for similar reasons. On the other hand, a centralised approach might be more appropriate for Marketing in order to benefit from potential economies of scale, as well as for Finance, given the considerable risk often involved with financial decisions. In this particular case, although individual gym club managers are able to decide where and how budgets should be spent, centralised buying may help secure economies of scale and, thus, be important to keep costs down. Keeping costs down is something which budget operators, such as The Gym Group, will be keen on doing in order to keep prices down, especially in light of increasing competition from other budget operators, such as Pure Gym.
- **Inter-unit conflict and potential loss of control.** With less need to consult senior managers, individual gym club managers may begin to view their activities apart from the activities of the business as a whole, and lose sight of the The Gym Group's overall aim / objectives. The chance of this occurring can, however, be minimised by establishing and communicating a clear mission, aims and objectives throughout all levels of the organisation - to ensure everyone works towards a common goal. Regular feedback to the centre would also still be necessary in order to maintain effective control, allowing checks to be made as to whether the delegated authority is being used effectively.
- **Investment in training.** Decentralisation requires gym club managers to be able to run their gym without constant checking from head office / senior management, and to feel confident in their own abilities to make important decisions. This may have required The Gym Club to invest in management training in order to ensure managers were capable of the additional authority, responsibility and accountability, and overcome any fears and insecurities existing managers may have had.
- **Change to employment packages - benefits / rewards.** It should be appreciated that one of the main barriers to implementing a more decentralised approach lies in managers' willingness to accept responsibility and that an unwillingness to accept responsibility may not only stem from lack of confidence, or concern about greater accountability for decision making, but also because managers feel they have been given extra responsibilities without the associated remuneration. Hence, The Gym Group might also have had to introduce financial rewards to reward management for taking on board the additional responsibility.

	<ul style="list-style-type: none"> • Changes to recruitment and selection procedures. The Gym Group's more decentralised approach, which requires managers to run the gym as if it were their own business, may require managers to be capable of doing more than they have done in the past and a different type of manager, ie one with entrepreneurial skills as opposed to one that just follows instructions / established procedures. Recruitment and selection policies might, therefore, have needed to be adapted to ensure individual gym club managers are selected that fit in with a more 'empowered' organisational culture. <p>Overall, The Gym Group's decentralised approach is likely to have a highly positive impact on the business - enabling individual parts of the business to be highly responsive to changing customer needs and competitor activities, which is likely to be crucial to The Gym Group's success, in an increasingly competitive environment.</p> <p>It will, however, only have a positive impact if individual gym club managers are capable of taking on the additional responsibility for decision making, and possess the entrepreneurial skills required to run the gym as if it were their own business, with the outcome desired by senior management, ie one that ultimately helps to maximise the return to shareholders. As the above discussion has highlighted, this has implications for recruitment, selection, training and rewards. It also requires effective communication from the centre, and feedback to the centre, in order to maintain effective control and ensure each individual unit (ie gym club) works towards a common goal, ie The Gym Group's overall mission, aims and objectives.</p> <p>The centralisation of some management functions, such as the purchasing function, may also still be required in order to avoid potential losses in economies of scale. This would be crucial for a budget operator, such as The Gym Group plc, which not only needs to keep down costs in order to keep down prices, but to maximise the return to its shareholders.</p>	(12)
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Level	Mark	Descriptor
	0	<ul style="list-style-type: none"> • A completely inaccurate response.
Level 1	1-2	<ul style="list-style-type: none"> • Isolated elements of knowledge and understanding - recall based. • Weak or irrelevant application to business examples. • Generic assertions may be presented.
Level 2	3-4	<ul style="list-style-type: none"> • Elements of knowledge and understanding, which are applied to the business example. • Chains of reasoning are evident, but may be assertions or incomplete. • A generic or superficial assessment is presented.
Level 3	5-8	<ul style="list-style-type: none"> • Accurate and thorough knowledge and understanding, supported throughout by relevant and effective use of the business behaviour / context. • Analytical perspectives are presented, with developed chains of reasoning, showing cause(s) and / or effect(s). • An assessment is presented, using quantitative and / or qualitative information, though unlikely to show the significance of competing arguments.

Level 4	9-12	<ul style="list-style-type: none"> • Accurate and thorough knowledge and understanding, supported throughout by relevant and effective use of the business behaviour / context. • A coherent and logical chain of reasoning, showing cause(s) and / or effect(s). • Assessment is balanced, wide ranging and well contextualised, using quantitative and / or qualitative information, and shows an awareness of competing arguments / factors leading to a supported judgement.
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Source: The above Level Descriptors are based upon those published by Edexcel at the time of writing. Wording may differ in places. For the most current versions used by Edexcel refer to Edexcel's website.

(d) Using the data in Extracts G and H and ratio analysis, and any other relevant information, evaluate whether The Gym Group should continue with its planned expansion throughout the UK.

(Note Q1d and 2d now require students to evaluate specific options and make a recommendation. This change is reflected in APT's Practice Papers published since 2018).

Question Number	Indicative content	Mark
2(d)	<p align="center">Knowledge 4, Application 4, Analysis 6, Evaluation 6 Marks for application and analysis - include up to 8 marks for quantitative skills</p> <p>Quantitative skills assessed:</p> <p>QS1: calculate, use and understand ratios, averages and fractions QS2: calculate, use and understand percentages and percentage changes QS8: use and interpret quantitative and non-quantitative information in order to make decisions QS9: interpret, apply and analyse information in written, graphical and numerical form</p> <p><i>Points that could be brought into an argument against further expansion:</i></p> <p>Based on the data provided in Extracts G and H, The Gym Group would initially seem to be in a weak financial situation, despite raising a significant amount of finance through selling shares in 2015, and there is a danger that if it continues to expand this situation will only get worse.</p> <p>The business has made a consecutive overall loss for the two years shown, which seems to have increased as the business has expanded: The loss for the year attributable to equity shareholders in 2014 was £8,783,000. This increased to £11,473,000 in 2015. This is an increase of £2,690,000 which, in percentage terms, is a substantial increase of 30.63% ($\frac{£2,690,000}{£8,783,000} \times 100$).</p> <p>Although, in 2014, The Gym Group achieved an operating profit margin of 5.13% ($\frac{£2,335,000}{£45,480,000} \times 100$) and Return on Capital Employed (ROCE) of 2.25% ($\frac{£2,335,000}{£103,657,000} \times 100$), it made an operating loss of £2,701,000 in 2015.</p> <p>Asset turnover has also fallen from 1.44 times in 2014 ($\frac{£45,480,000}{£31,585,000}$) to just 0.55 times in 2015 ($\frac{£59,979,000}{£108,443,000}$). This fall in efficiency could be a sign of loss of control as the business has increased in size. If so, further expansion would not be advisable until this issue is resolved.</p>	

There is, evidence, in fact that The Gym Group might be suffering from diseconomies of scale, which is always a danger with rapid expansion, as is overtrading.

Diseconomies arise from a number of reasons, most of which concern the problems of managing large businesses. For example, as a business increases in size, effective communication, coordination and control over all aspects of the business, becomes increasingly difficult, especially when the business is spread out geographically, as in the case of The Gym Group. Regular meetings and increased checking procedures may be required to fulfil this function, and this can increase overheads quite significantly. With regard to this, The Gym Group's administration expenses have increased significantly - from £42,105,000 in 2014 to £62,712,000 in 2015. This is an increase of 48.94% ($\frac{£20,607,000}{£42,105,000} \times 100$). What is significant, in terms of economies of scale, is that this percentage increase in administration expenses is higher than the percentage increase in the number of sites during this period, which amounted to just 34.55% ($74 - 55 / 55 \times 100$). If the business is suffering from diseconomies of scale then further expansion should be postponed until appropriate systems have been put in place to support growth.

More worrying, is the apparent weak and weakening liquidity position. The current ratio, in both years, is well below the accounting ideal of 1.5 to 2 to 1, and it has fallen from 0.4 to 1 in 2014 ($\frac{£9,933,000}{£24,656,000}$) to 0.34 to 1 in 2015 ($\frac{£8,636,000}{25,546,000}$). This suggests the business may not have enough cash to meet debts as they fall due. In which case, it could be forced to close as creditors push to declare the business insolvent. This could be a sign of overtrading, ie expansion without sufficient finance. If so, further expansion for The Gym Group would not be advisable as this would threaten the business's very survival.

Points that could be brought into an argument in favour of further expansion:

However, when we take into account other information provided in the various extracts and analyse the figures in more detail, the situation may not be as dire as initially thought, and a strategy of further expansion might not be inadvisable at this point in time.

For instance, one of the reasons why the current ratio is so low, despite the sale of shares in the business, is that the cash received from the sale of shares would appear (as planned) to have been used to pay off a significant amount of long-term borrowing: non-current liabilities have reduced from £72,072,000 in 2014 down to £9,198,000 in 2015. This is a reduction of £62,874,000, and this has reduced the gearing ratio from 69.53% in 2014 ($\frac{£72,072,000}{103,657,000} \times 100$) down to just 7.82% in 2015 ($\frac{£9,198,000}{£117,641,000}$). The business's non-current assets are also valued at £134,551,000 (in 2015). Hence, if The Gym Group were to struggle to meet debts as they fell due, or to finance further expansion, it could seek to increase borrowing again, given that it has plenty of fixed (non-current) assets to offer as security for a loan, (assuming the business has not increased borrowing and the value of non-current assets remains the same, or higher, since the publication of these accounts).

	<p>There is, however, no point in a business expanding further if the current business model is failing to make a profit. But, again, if we examine the information and data provided in more detail, there is evidence to suggest that a decent profit may, in fact, be realised with the current business model. In which case, further expansion, as long as it can be financed appropriately ie there is no risk of overtrading, should not be dismissed.</p> <p>Firstly, Extract E tells us that The Gym Group sold its shares to members of the public via the stock exchange for the first time in 2015. Selling shares to members of the public, especially for the first time (which is called an initial public offering), can be a very expensive process. It can incur significant one-off costs / expenses (besides some ongoing additional expenses associated with becoming a public limited company), which could very well be the reason why administrative expenses rose so substantially in 2015. For instance, there are fees payable to an underwriter, which can be between 5-7% of gross proceeds of the sale of the shares. Underwriting fees for The Gym Group could, therefore, have been between £4,500,000 (£90,000,000 x 0.05) and £6,300,000 (£90,000,000 x 0.07). In addition to these fees there are also legal, accounting and printing fees and promotional expenditure involved in advertising the shares for sale, which could cost several million pounds, as well as other costs relating to tax and legal entity restructuring, making financial statements compliant, valuation reports, and drafting new articles of incorporation. These costs could also be significant. It would, therefore, not be unreasonable to estimate the one-off costs involved in 'going public' for The Gym Group to be in the region of, say, £9 to £10 million. If so, and these one-off costs were taken out of the administration expenses shown for 2015 (£62,712,000 - £9,000,000), then the operating loss in 2015 would actually be an operating profit of £5,194,000 (£58,906,000 - £53,712,000). This would have resulted in an operating profit margin of 8.66% (£5,194,000 / £59,979,000 x 100) which is much higher than that achieved in 2014.</p> <p>Furthermore, with a substantial part of long-term borrowing now paid off, the finance costs (interest payments) and, thus, cash outflows associated with this, will be much lower in subsequent years, and could easily result in a profit for the year being attributable to equity shareholders in 2017, which is only likely to increase as the number of sites increases (unless the business decided to increase borrowing again, in order to fund expansion).</p> <p>To conclude, assuming the current business model is a profitable one and there is, as The Gym Group believes, still significant growth in the demand for budget gyms, then as long as the business has sufficient finance to fund expansion, and appropriate systems are in place to support growth, the business should continue to expand. If it does not, it risks losing market share and future profits to other rival budget chains, such as Pure Gym, who are also seeking to capitalise on the forecast growth in the market for budget gyms.</p> <p><i>Note to teachers...</i></p>	<p style="text-align: right;">PTO...</p> <p style="text-align: right;">(20)</p>
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	<p><i>This answer includes more points than students are likely to be able to think of, or write down in the same level of detail in the exam, due to the limited time available. However, students could easily secure full marks by arguing for or against further expansion - as long as they make use of the quantitative evidence presented to support their judgement and incorporate some competing arguments.</i></p> <p><i>This would be a useful question to use as a basis for a class discussion - with the class divided into two groups - one presenting points in favour, one presenting points against, and students being asked to write up their final decision, with full justification based on the competing arguments they have heard in class.</i></p> <p><i>Additional notes relating to this question you may like to discuss further with students:</i></p> <p>An underwriter is usually an investment bank that generally undertakes the following:</p> <ul style="list-style-type: none"> • works with the company to ensure all regulatory requirements of the IPO are met. • contacts a large network of investment organisations to gauge investment interest and help set the IPO price of the company's shares. • then guarantees a specific number of shares will be sold at the initial price and that they will purchase any surplus. <p>For further information about the costs of going public for the first time (ie IPO's) see: https://www.pwc.com/us/en/deals/publications/assets/pwc-cost-of-ipo.pdf</p>	
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Level	Mark	Descriptor
	0	<ul style="list-style-type: none"> • A completely inaccurate response.
Level 1	1-4	<ul style="list-style-type: none"> • Isolated elements of knowledge and understanding - recall based. • Weak or irrelevant application to business examples. • An argument may be attempted, but will be generic and fail to connect cause(s) and / or consequence(s) / effect(s).
Level 2	5-8	<ul style="list-style-type: none"> • Elements of knowledge and understanding, which are applied to the business example. • Arguments and chains of reasoning are evident, but connections between cause(s) and / or consequence(s) / effect(s) are incomplete. Attempts to address the question. • A comparison of judgement may be attempted, but it will not successfully show an awareness of the key features of business behaviour or business situation.
Level 3	9-14	<ul style="list-style-type: none"> • Accurate and thorough knowledge and understanding, supported throughout by relevant and effective use of the business behaviour / context. • Uses developed chains of reasoning, so that cause(s) and / or consequence(s) / effect(s) are complete, showing an understanding of the question. Arguments are well developed. • Quantitative and / or qualitative information is introduced in an attempt to support judgements, a partial awareness of the validity and / or significance of competing arguments and may lead to a conclusion.
Level 4	15-20	<ul style="list-style-type: none"> • Accurate and thorough knowledge and understanding, supported throughout by relevant and effective use of the business behaviour / context. • Uses well-developed and logical, coherent chains of reasoning, showing a range of cause(s) and / or effect(s). Arguments are fully developed. • Quantitative and / or qualitative information are used well to support judgements. A full awareness of the validity and significance of competing arguments / factors, leading to balanced comparisons, judgements and an effective conclusion that proposes a solution and / or recommendations.

Source: The above Level Descriptors are based upon those published by Edexcel at the time of writing. Wording may differ in places. For the most current versions used by Edexcel refer to Edexcel's website.

NB to access levels 3 and 4, students will need to demonstrate quantitative skills to support their judgements.