GB2.5 Economic climate and business

AQA 8132 · Calculator allowed · about 55 minutes

Total Marks

Name: ________________________________ Date: ____ / ____ / ______

Study the case study below, then answer ALL questions. Show your working for any calculation. In your longer answers, use evidence from the case study and relevant business terminology.

Case Study: Hearthstone Furniture

Case study written for Revision Library. Hearthstone Furniture is a fictional business.

Hearthstone Furniture is a fictional business that designs and makes wooden dining tables in a small workshop. It sells tables directly to customers online and buys timber from a local sawmill.

Two years ago, the sawmill charged Hearthstone Furniture 40 pounds for the timber needed to make one table. Because of rising costs in the timber industry, the sawmill now charges 52 pounds for the same amount of timber.

At the same time, the interest rate on Hearthstone Furniture's business loan has risen from 4 per cent to 7 per cent per year. The loan is for 20,000 pounds, which the business borrowed to buy new workshop equipment.

Consumer confidence has also fallen. Fewer people are buying non-essential items like new dining tables, and Hearthstone Furniture's monthly sales have dropped from 45 tables to 30 tables.

The owner, Fatima, is deciding how to respond. She is considering three options: raising her prices to cover the higher timber costs, finding a cheaper timber supplier, or reducing the range of tables she offers to cut costs.

1 What is most likely to happen to consumer spending on non-essential items, such as new furniture, during a period of rising inflation?

- ☐ A) It usually increases
- ☐ B) It usually decreases
- ☐ C) It always stays exactly the same
- ☐ D) Inflation has no effect on spending

(Total for Question 1 is 1 mark)

2 State two ways a rise in interest rates can affect a business.

(Total for Question 2 is 2 marks)

3 Other than a change in interest rates or inflation, state two other examples of a change in the economic climate that could affect a business.

(Total for Question 3 is 2 marks)

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4 Which one of the following is most likely to explain why the interest rate on Hearthstone Furniture's loan has risen?

- ☐ A) The Bank of England has raised the base rate, for example to help control inflation
- ☐ B) Fatima asked the bank to charge her a higher interest rate
- ☐ C) The value of the pound has risen sharply against other currencies
- ☐ D) The local sawmill has raised its own interest rates

(Total for Question 4 is 1 mark)

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5 Calculate the percentage increase in the cost of timber for one table, from 40 pounds to 52 pounds. Show your working.

(Total for Question 5 is 3 marks)

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6 Hearthstone Furniture's business loan is for 20,000 pounds. Calculate the extra amount of interest Hearthstone Furniture now pays per year, now that the interest rate has risen from 4 per cent to 7 per cent. Show your working.

(Total for Question 6 is 2 marks)

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7 Calculate the percentage fall in Hearthstone Furniture's monthly sales, from 45 tables to 30 tables. Give your answer to 1 decimal place. Show your working.

(Total for Question 7 is 2 marks)

8 Other than the cost of timber, state two reasons why Hearthstone Furniture's other costs might also rise during a period of rising inflation.

(Total for Question 8 is 2 marks)

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9 State two reasons why falling consumer confidence might make trading difficult for a small business like Hearthstone Furniture.

(Total for Question 9 is 2 marks)

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10 Analyse one way in which the rising costs described in the case study might affect Hearthstone Furniture's profit, if Fatima does not change her prices.

(Total for Question 10 is 6 marks)

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11 One option Fatima is considering is finding a cheaper timber supplier instead of raising her prices.

(a) State one advantage to Hearthstone Furniture of finding a cheaper timber supplier. **(1)**

(b) State one disadvantage to Hearthstone Furniture of finding a cheaper timber supplier. **(1)**

(Total for Question 11 is 2 marks)

12 A second option Fatima is considering is reducing the range of tables she offers.

(a) State one advantage to Hearthstone Furniture of reducing its range of tables. **(1)**

(b) State one disadvantage to Hearthstone Furniture of reducing its range of tables. **(1)**

(Total for Question 12 is 2 marks)

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13 Fatima is deciding between three options: raising prices, finding a cheaper timber supplier, or reducing her range of tables.

Recommend which option Fatima should choose. Justify your answer using the information in the case study.

(Total for Question 13 is 9 marks)

Mark scheme · GB2.5 Economic climate and business

Question 1

- **B1** B cao
- **Answer: B**

Question 2

- **B1** one acceptable effect, e.g. it increases the cost of any loans or borrowing the business has
- **B1** a second acceptable effect, e.g. it may reduce consumer spending, since customers also pay more on their own loans/mortgages, leaving less to spend
- **Answer: Any two, e.g. increases the cost of the business's own borrowing; may reduce customer spending as their own borrowing costs rise too.**

Question 3

- **B1** one acceptable example, e.g. a rise in unemployment reducing overall consumer spending
- **B1** a second acceptable example, e.g. a change in exchange rates affecting the cost of imported materials or the price of exports
- **Answer: Any two, e.g. a rise in unemployment; a change in exchange rates.**

Question 4

- **B1** A cao
- **Answer: A**

Question 5

- **M1** 52 - 40 (= 12) seen
- **M1** 12 / 40 x 100 seen
- **A1** 30% cao
- **Answer: 30% increase.**

Question 6

- **M1** 20,000 x (0.07 - 0.04), or 20,000 x 0.04 (= 800) and 20,000 x 0.07 (= 1,400) both found
- **A1** 600 pounds cao
- **Answer: 600 pounds extra per year.**

Question 7

- **M1** 45 - 30 (= 15) seen and 15 / 45 seen
- **A1** 33.3% cao (awrt 33.3%, accept 33%)
- **Answer: 33.3% fall (accept 33%).**

Question 8

- **B1** one acceptable reason, e.g. wages/staff costs may need to rise to keep up with the rising cost of living
- **B1** a second acceptable reason, e.g. running costs such as workshop energy bills may also increase during inflation
- **Answer: Any two, e.g. wages may need to rise with the cost of living; energy/running costs may also increase.**

Question 9

- **B1** one acceptable reason, e.g. customers delay or cancel purchases of non-essential items like dining tables, reducing sales
- **B1** a second acceptable reason, e.g. a small business has less financial reserve than a larger competitor to survive a period of lower sales
- **Answer: Any two, e.g. customers delay/cancel purchases of non-essentials; a small business has fewer reserves to survive weaker sales.**

Question 10

- **Level 1** (1-3): Identifies one or two rising costs with little or no development or use of the case study's figures.
- **Level 2** (4-6): Develops a clear chain of reasoning, using evidence and figures from the case study, to show how rising costs would affect Hearthstone Furniture's profit if prices stay the same.
- **Indicative content:**
  - If Fatima keeps her selling price the same, the 30% rise in the cost of timber per table directly reduces the profit made on every table sold, since revenue per table is unchanged but cost per table has risen.
  - The extra 600 pounds of loan interest per year is a further cost that must be paid out of the same (or, given the 33.3% fall in monthly sales, a smaller) amount of revenue, further reducing overall profit.
  - With monthly sales having fallen from 45 to 30 tables, total revenue is lower even before accounting for higher costs, compounding the squeeze on profit.
  - If the combined effect of higher costs and lower sales pushes total revenue below total costs, Hearthstone Furniture could move from a profit into a loss.
  - A sustained loss would eventually create cash-flow problems, since the business would be paying out more than it receives, threatening its ability to keep trading.

Question 11

- (a) **B1** one acceptable advantage, e.g. it could restore Hearthstone Furniture's profit margin per table without having to raise prices and risk losing customers
- **(a) Answer: It could restore the profit margin per table without raising prices (and risking losing customers).**
- (b) **B1** one acceptable disadvantage, e.g. a cheaper supplier's timber may be lower quality, which could damage the quality/reputation of Hearthstone Furniture's tables
- **(b) Answer: The cheaper timber may be lower quality, which could damage the quality/reputation of the tables.**

Question 12

- (a) **B1** one acceptable advantage, e.g. Hearthstone Furniture could focus its timber budget and workshop time on its best-selling designs, potentially cutting costs
- **(a) Answer: Focusing resources on best-selling designs could cut costs (e.g. less varied timber to buy, less workshop set-up time between different designs).**
- (b) **B1** one acceptable disadvantage, e.g. some existing customers who want a design that has been removed may go elsewhere, reducing sales further
- **(b) Answer: Customers who wanted a discontinued design may go elsewhere, reducing sales further.**

Question 13

- **Level 1** (1-3): Makes simple, undeveloped comments about one or more options, with little or no use of the case study and no clear recommendation.
- **Level 2** (4-6): Gives a developed argument for or against at least one option, using some case study evidence, but does not fully weigh the options or reach a clearly justified recommendation.
- **Level 3** (7-9): Weighs at least two options against each other using detailed case study evidence, and reaches a justified recommendation supported by the analysis given.
- **Indicative content:**
  - Raising prices: would directly cover the 30% rise in timber cost and the extra 600 pounds of loan interest, but risks losing more customers at a time when sales are already down 33.3 per cent and consumer confidence is falling, which could make the situation worse rather than better.
  - Finding a cheaper timber supplier: could restore profit margins without risking further customer loss from a price rise, but may reduce the quality of the tables, which could damage Hearthstone Furniture's reputation for a hand-made product.
  - Reducing the range of tables: could cut costs by focusing on best-selling designs, but with sales already falling, removing choice could push some remaining customers towards competitors instead.
  - A well-justified answer should weigh the risk of each option against Hearthstone Furniture's current weak position (falling sales, rising costs, rising interest) rather than judging each option in isolation.
  - Possible justified conclusions: recommend a cheaper supplier first, since it addresses the timber cost rise directly without the customer-loss risk of a price rise; or recommend a small, partial price rise combined with a cheaper supplier as a lower-risk combined approach, provided the reasoning explicitly weighs the trade-offs given in the case study.