General Certificate of Education
June 2006
Advanced Level Examination

BUSINESS STUDIES **BUS6**
Unit 6

Thursday 22 June 2006 1.30 pm to 3.00 pm

For this paper you must have: • a 12-page answer book You may use a calculator.

Time allowed: 1 hour 30 minutes

Instructions
- Use blue or black ink or ball-point pen.
- Write the information required on the front of your answer book. The *Examining Body* for this paper is AQA. The *Paper Reference* is BUS6.
- Answer **all** questions.
- Do all rough work in the answer book. Cross through any work you do not want marked.

Information
- The maximum mark for this paper is 84.
  4 of these marks are for the Quality of Written Communication.
- The marks for questions are shown in brackets.
- This unit assesses your understanding of the relationship between the different aspects of Business Studies.
- You are reminded of the need for good English and clear presentation in your answers. All questions should be answered in continuous prose. Quality of Written Communication will be assessed in all answers.

Read the Case Study and answer **all** the questions that follow.

SHELL

In February 2005, Shell announced the largest ever profits of a UK company when it revealed its 2004 figure of £9.3 billion. A few days later, Shell's UK rival, BP, declared 2004 profits of £8.7 billion. These figures have attracted both admiration and condemnation.

Despite the success, many people, including shareholders, business analysts and sections of the media, criticised Shell. Some suggested that the company's recent performance had been undermined by poor decision making and bad communications, and that its future prospects were not as good as those of BP. See **Appendix A** for a summary of Shell's performance compared with BP's.

Others, including a number of pressure groups, criticised the 'excessive' profits and argued for a windfall tax on Shell and the other oil companies. A windfall tax is a one-off tax that the UK Government could impose on companies that make very large profits. At the same time as Shell and BP were announcing their record figures, petrol retail prices in the UK reached an all-time high of 85.6 pence per litre. The oil companies' arguments, that 75% of the price of petrol already goes to the UK Government in tax, did not stop many people claiming that the oil companies were exploiting customers and making too much profit.

Shell has grown through a combination of horizontal, vertical and conglomerate growth. Merger and acquisition activity have also been key elements of the company's strategy. The most significant took place in 1907, when Shell merged with the Royal Dutch oil company which was based in Holland. The Royal Dutch/Shell Group is owned jointly by the two companies, and this complex and unusual arrangement has been blamed for poor decision making and bad communications. For much of the past 100 years, there were two separate parent companies, with separate Boards of Directors, which slowed decision making down and confused investors, analysts and customers. In July 2005, it was decided to simplify things and to create just one parent company, Royal Dutch Shell plc, which would be registered in the UK, but pay tax in Holland. See **Appendix B** for a summary of the structure before the change.

Although it is in a massive and complex industry, operating in primary, secondary and tertiary sectors, Shell, in many ways, is just like any other business. It has raw materials of crude oil and gas that it has to discover and extract often from very difficult and inhospitable places such as the North Sea. It also has 'stocks' of work-in-progress as the oil and gas is refined and turned into petrol, engine oil, heating products and also into materials which go to make the range of plastics and chemical products used in the home and in industry. Its stocks of finished goods include those in the petrol pumps and on the shelves of its petrol stations.

Shell has to compete in what economists call an 'oligopolistic petrol retail market' in which a few large companies dominate. There is fierce, short-term price competition, but long-term demand in the petrol industry as a whole is price inelastic, with estimates for price elasticity of demand currently at about -0.8. As a consequence, methods of non-price competition are crucial to capture market share. Shell also has to compete with supermarkets, which battle for market share in petrol retailing.

In order to maintain an advantage, Shell is involved in constant research and development to improve product quality and to generate innovations, such as cleaner fuels, and alternative fuels such as wind and solar power. Another aspect of Shell's retail strategy is its diversification into convenience store retailing through its Shell Select outlets.

The oil industry is one with an extremely long-term view. In order for an oil company to continue to thrive, it needs to be sure that it has sufficient reserves of oil and gas to extract. Oil companies search for oil to replace what they use up. The '*reserves replacement ratio*' shows how much new oil and gas a firm is discovering, compared with the amount it is extracting. In other words, if Shell discovered as much new oil as it extracted and refined in a year, its ratio would be 100%. However, in 2003, Shell's ratio was 98%, and it fell further in 2004 to 75%. In contrast, BP's ratio for 2003 was 175%, and for 2004 it was 106%. Shell has also been criticised for not knowing how much oil it has in reserve. During 2003 and 2004, Shell had to reduce its estimates of its oil reserves three times, resulting in much embarrassment and the resignation of three senior executives. Without doubt, oil reserves are harder and more expensive to find than ever before. An oil company with declining reserves of its own will be even more dependent on buying in oil on the volatile world market. As a consequence, Shell may find it harder to maintain its profit margins.

In addition to all the usual pressures that a large business experiences, oil companies, such as Shell, are very sensitive to claims that their activities damage the environment. It is because of this that Shell goes to great lengths to be seen to act ethically and in ways that are environmentally sound. It publishes statements on how it conducts business with its customers and suppliers, and carries out an annual social audit to assess how successful it has been in achieving its environmental and social aims. **Appendix C** contains extracts from Shell's policy statement.

Can Shell win? Can it satisfy all the demands of its stakeholders, and make the right decisions in order to secure its long-term future? A 2004 survey of staff revealed that less than 40% of employees were happy with the way the company was run. But surely, a profit of £9.3 billion is a sign that it is getting some things right.

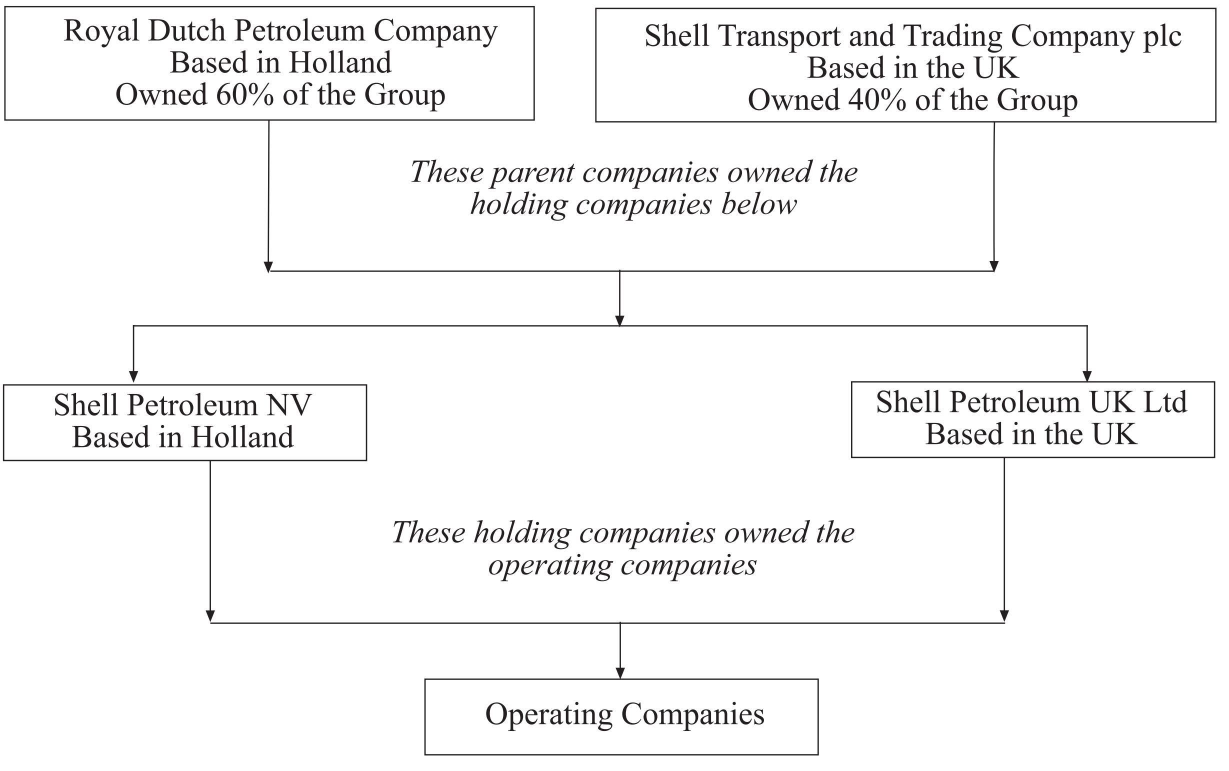
Turn over for appendices and questions

Appendix A: Selected performance data for Shell and BP

	Shell		BP	
	2004	**2003**	**2004**	**2003**
Turnover (£bn)	183.8	143.8	155.3	126.7
Net profit after tax (£bn)	9.3	5.6	8.7	5.5
Capital investment (£bn)	8.2	7.8	9.4	10.9
Dividend paid per ordinary share (pence)	16.9	15.7	16.1	15.5

	April 2005	**April 2004**	**April 2005**	**April 2004**
Share price (pence)	480	390	540	490
Annual % change in share price (April 2004 – April 2005)	23%		10.2%	

Appendix B: Structure of Royal Dutch/Shell before restructuring



Appendix C: Extract from Shell's statement on its environmental and business principles

Shell is committed to sustainable development, which is about integrating the economic, social and environmental aspects of everything we do and balancing short-term wants with long-term needs. Shell is committed to:

- providing clean, affordable energy
- reducing environmental impacts
- consuming less energy and materials
- making social contributions to national and local communities.

In addition, Shell has principles which apply to its business affairs and describe the behaviour expected of employees in all Group companies, joint venture partners and suppliers. These principles are concerned with:

- objectives
- responsibilities to stakeholders
- economic principles
- business integrity
- political activities
- health and safety and the environment
- the community
- competition.

1 Assess the value to Shell of carrying out a social audit. *(14 marks)*

2 To what extent might there be conflicts of interests amongst Shell's stakeholders? *(16 marks)*

3 Many people have argued that companies should have a windfall tax imposed on large profits. Evaluate the actions that Shell might take if the introduction of such a tax became increasingly likely. *(16 marks)*

4 Oil companies, such as Shell and BP, are very large companies that have pursued a strategy of 'horizontal, vertical and conglomerate growth'. Do you think the rewards of such methods of growth are greater than the risks? Justify your answer. *(16 marks)*

5 Using **Appendix A** and the text, together with any other relevant information, discuss the view that shareholders should be concerned about Shell's future prospects. *(18 marks)*

END OF QUESTIONS

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