# STRATEGIC CASE STUDY AUGUST 2018 EXAM ANSWERS

## Variant 1

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## SECTION 1

*Part 1*

**Strategic risks of selling the proposed five daily titles**

Strategic risks are those risks that arise due to following a particular strategy chosen by an organisation. The strategy being followed here is to divest our five worst performing titles based on lowest circulation figures.

There are several risks associated with FNG selling the five proposed daily titles which could impede its ability to meet its strategic goals and objectives.

**Profitability**

Although FNG has stated that its aim is to restore the prosperity of FNG by selling the titles with the lowest circulation, it has included two titles that make an operating profit. By selecting titles for disposal based on circulation rather than profit FNG may be making a sub-optimal selection of titles for disposal. A better choice of titles might arise if it uses operating profit/loss performance rather than circulation as the basis for selection.

There may be other titles with higher circulation that make a loss or lower profit than the current choices which would be a more appropriate selection for disposal to improve the overall profitability of the group. A broad range of factors beyond simply circulation should be considered to ensure the right titles are selected for disposal.

Also, regarding profitability, how certain are we that all the costs associated with these five titles would disappear if the titles were sold? It is possible that some of the overheads currently being absorbed by these titles would remain and need to be allocated to other titles, thus reducing group profitability even more.

Finally, it is worth noting that the operating profit/loss figures associated with each title have been provided by the respective local finance directors and may therefore need to be validated if they are considered in the decision-making process.

**'Critical mass'**

We must also consider whether removal of these titles will affect the ability of the group to attract advertising revenue, particularly from advertising clients who value being able to advertise in up to 40 titles through one publishing point. Five titles represent over 10% of the overall group. Organisations that advertise in all the newspapers offered by FNG may no longer feel they can reach a wide enough audience. They could even remove advertising from the whole group as a result. Certainly, the amount FNG will be able to charge to those advertising in all newspapers will have to fall to compensate the reduction in audience reached. This may reduce profitability in the long run, rather than increase it.

**Growing the overall audience**

In the CEO's statement, specific reference is made to the corporate goal of 'growing the overall audience'. Selling five titles clearly contradicts that goal and if the money saved is not invested in growing audience numbers elsewhere there is a risk this strategic goal will be harmed by the disposals. Additionally, disposals may be badly perceived in the marketplace. FNG has long prided itself as a wholesome group with a family ethos and has never disposed of titles before. It is possible that this strategic decision could cause a backlash from employees, advertisers and readers who might boycott the remaining titles in the group in response. Ultimately this move could damage the FNG brand.

**Preserving access to local communities**

Within the FNG website extracts there is reference to 'maintaining a focus on the importance that our print newspapers still play at the heart of our local communities'. The act of disposing of five titles contradicts this notion and may again be badly perceived by organisational stakeholders, therefore damaging profitability in the long term.

Overall the potential profit effect of disposal of these five titles needs to be fully assessed. Obviously, their sale will generate proceeds that can be invested back into the business but FNG needs to make sure they are invested into areas that generate greater long term returns that the disposed of titles had the potential to do.

*Part 2*

**Appraisal of the external business environment in which FNG operates**

The following briefing statement is an appraisal of the external business environment in which FNG operates, explaining what factors have contributed to ongoing reductions in profit and examining why the newspaper industry is not as buoyant as it used to be.

From a traditional 'PESTLE' framework the most influential factors are 'T', 'S' and 'E', technological, social and environmental changes. These are explored below:

**Technological changes - the internet**

The single biggest influence on the decline of newspapers has been the rise of the internet.

The advent of the internet suddenly allowed vast quantities of information to be accessed, free of charge. It provided a forum for people to share news, make contact, sell goods, and interact in a way they have never been able to do before.

Both the editorial element of traditional print newspapers and the advertising element were affected by the internet. Suddenly, if you needed the latest local team news, you could find it quickly, easily and for free on the internet. If you wanted to sell a household item, it would be far more effective through eBay than your local newspaper. If a large advertiser wanted exposure to a vast market it would be more effectively achieved online or through email campaigns.

Therefore, the demand both for readership of printed newspapers and advertising in printed newspapers has declined irreversibly because of the internet.

**Social changes - changing habits**

The internet has led to global changes in social habits. Forty years ago, picking up a newspaper at your local store or having one delivered directly to your door was an inherent part of many people's daily life.

Now, as each generation becomes increasingly comfortable with internet usage for all elements of their news and information, the habit of reading newspapers has fallen. The profile of readership is often older, with young people preferring more dynamic means of news provision.

Printed newspaper information is quickly out of date. There is a thirst for real time information, 'on the go'. Global news can reach our computers and phones within seconds of occurring and updates can be obtained by the minute. By the time most stories are reported in print newspapers, they are old news.

Mobile phones, particularly smart phones have exacerbated the trend and people have become used to instant gratification in terms of news consumption. When information takes even a few minutes to obtain these days, it is considered too long. Similarly, with purchases, many take only a few minutes to complete on your computer or phone. Society is increasingly geared up for speed.

**Environmental changes - a paperless society**

A final external factor worthy of mention is the trend towards a 'paperless society'. Although a smaller influence than the internet or social changes mentioned above, increasing concerns about the environment have caused people to seek paperless and environmentally friendly options where they can. Provision of information online appears, at least on the surface, more environmentally friendly than printed newspapers and this will have contributed to some people's changing habits over time.

## SECTION 2

*Part 1*

**The merits of each of the suggested valuation techniques**

An asset-based valuation looks at the balance sheet value of an organisation’s assets and subtracts the value of its liabilities to obtain a valuation. It can be performed on a going concern basis or a break-up basis, the latter of which will produce the lowest valuation. This is often the technique which produces the lowest valuation for a business as it does not include the value of intangible assets which can be substantial, particularly in an old business such as FNG which has good brand awareness, reputation and valuable business partnerships with customers, suppliers and employees in place. It does not consider the future earnings potential of the five titles to any degree. From that perspective the valuation appears unreasonably low.

However, if all the selected titles for disposal are loss making, as is the case in this scenario, the buyer may argue that the group being offered for sale is of little value beyond the value of its assets, and hence this valuation technique is completely appropriate.

FNG, by contrast, have proposed a valuation based on a multiple of revenue.

This is likely to lead to a significantly higher valuation than the asset-based approach and so would naturally be preferred by the selling organisation.

However, the use of revenue to value a section of the business which appears to be persistently loss making would almost certainly be considered completely unreasonable by the buyer and the sale would be extremely likely to fail.

**Which of the two valuations is more appropriate**

As they stand, neither of the two proposed valuations appears appropriate. At the lowest asset-based valuation FNG are unlikely to agree to sell and, at the highest revenue-based valuation, the interested buyer is unlikely to buy.

**Progression to a final sale**

At this point it may come down to the motivation on each side of the transaction. If FNG are desperate to sell these five titles, to stop the losses and gain the proceeds of a sale for investment elsewhere in the business, it will have to compromise on the asking price and reduce price significantly from the revenue multiple it has talked about. It is highly unlikely any buyer would accept a revenue-based valuation on loss making operations.

If the buyer is keen to buy the five titles, perhaps with plans for synergies, better management and economies of scale then it will also need to increase from its position of the net asset valuation offered so far, otherwise FNG is extremely unlikely to agree to sell the titles to it.

Hence compromise is required on both sides from the current extreme positions to progress this to a sale. Ultimately, valuations are completely irrelevant, no matter what their basis, if the seller won't sell or the buyer won't buy.

*Part 2*

**How we should motivate the workforce in such uncertain and unstable times**

It is not surprising that the workforce is currently feeling unsteady in the face of the changes taking place at FNG.

We can see in the social media chat that employees are unhappy with being 'kept in the dark', and conflicting information appears to be circulating regarding the changes being made. There is also evidence of scare mongering in the comment, 'I think the whole organisation is going to be sold - go find yourselves a new job everyone!'

FNG needs to manage this situation much better, by providing clear, accurate information to staff about the changes that are being made. Good communication is key to a smooth change process. At present, it appears this is not happening and, as a result, misunderstandings are arising and employees are becoming fearful.

Staff need to understand the motivation for the change. FNG could explain to them the issues it is facing as a group and the risk that presents to ongoing prosperity and the security of everyone's jobs, so that staff understand the pressing need to act to remain commercially viable.

FNG could also get employees involved in the changes taking place so that they feel part of the process and less 'out of control'. Focus groups could be set up to look at ideas for positive changes at FNG moving forward, and ideas to improve morale as the five titles are sold should be listened to.

FNG should ensure it keeps staff at the titles being disposed of well informed of the timings and nature of changes, as far as they know them. The uncertainty will be very stressful for employees at the outgoing titles and for their sake, and the sake of the employees that remain, care should be taken to treat people with due respect and care. FNG cannot make any assurances regarding the plans of the new buyer, but it can keep staff informed of what is known and inform staff of their rights under TUPE - Transfer of Undertakings (Protection of Employment) arrangements.

Strong leadership is another key element of managing change well. The tone from the top should be positive and confident and dialogue with staff welcomed and encouraged so that reassurance can be given to remaining staff that their titles are remaining within the group.

Finally, a bonus scheme could be an effective short-term tool in motivating staff again. New targets could be devised, and a feeling of a fresh start generated, with rewards for staff who positively influence results. FNG would have to ensure that the benefits of such a scheme outweighed the cost due to difficult trading times, but this action could go some way to quietening the voices of discontent.

## SECTION 3

*Part 1*

**The potential risks of implementing the proposed bonus scheme**

There are several risks arising from the proposed bonus scheme.

Firstly, it may de-motivate, rather than motivate, the workforce. The scheme requires a year on year increase in profit before any bonus is triggered. The teams at each title may feel this is an impossible, unattainable target with trading conditions as difficult as they are and, therefore, make no attempt to achieve it.

If the teams do feel they can influence profitability to generate a year on year increase in profit, they may do so at the expense of long term prosperity. For example, they may reduce investment in capital equipment or staff, or cut corners in other areas of the business in order to generate a good year of profit and earn their bonuses. Indeed, this is such a potentially generous scheme if year on year profit was achieved that they might even be incentivised to manipulate results to achieve their bonus.

As the bonus is based on improved profits compared with the previous year, if the new scheme is to come into operation next year then, to get as big a bonus as possible next year, the managers may deliberately seek to keep the profit for this year as low as possible, for example by holding back sales for this year until next or by trying to bring forward costs into this year that should really belong in next year's accounts.

Furthermore, this scheme is currently only being offered to the senior management teams at each site. This could upset the rest of the workforce, who are not eligible for a bonus and cause senior management teams issues in motivating their staff. If staff know about the scheme being offered to senior members and feel left out or discouraged the net effect could reduce profit rather than increase it.

Finally, the notion of leaving the teams to 'decide how to split it between themselves', also appears to present a risk. Arguments may arise over the way the final bonus is split, and this could be significant enough to render the scheme pointless to some people or even motivate people to leave, if they are truly unhappy with the mechanics of the split.

*Part 2*

**How the risks could be managed**

To ensure the scheme is motivational, the managing directors and their teams at each title need to be involved in working out a fair target. This may not be related to an increase in year on year profit if that is unobtainable. It may be related to revenue, cost control or improvements in digital profit. Whatever metric suits the strategic direction of FNG.

Robust systems of internal control and audit should detect any attempts to manipulate figures to generate the bonus, and the scheme should be subject to checks to ensure it is implemented correctly. In order to reduce the motivation to prioritise short-term results over long-term prosperity there may need to be additional measures added to the scheme to encourage long-term thinking. Again, if these are devised in conjunction with the people at the titles they are likely to be relevant and motivational.

Regarding the split of the bonuses, it may be preferable to offer guidance, or even be prescriptive with the titles about how to split the bonus pot between different job positions at each title. This will reduce the potential for arguments at the titles and make the scheme simpler to implement.

*Part 3*

**Impact of bonus scheme on shareholder dividends**

The proposed bonus scheme should have a positive impact on any future shareholder dividends. As the scheme will only be activated if a year-on-year increase in profit after tax is achieved, it is effectively self-financing. If profit after tax does not increase, no bonus will be paid.

As FNG has not achieved a year-on-year increase in profit for very many years, this would be an excellent performance result and could lead to higher dividend distributions overall.

Shareholders would benefit by receiving up to 95% of any increase in profit performance (depending on distribution policies) and would be unlikely to be worried about the 5% given to the senior management teams that led to this improvement being achieved in the first place.

*Part 4*

**Communication of the scheme**

As mentioned previously, involvement in the new scheme from the outset seems preferable in terms of generating buy-in and ensuring the measures set achieve the desired objective of improving organisational performance.

This may be better done face to face, perhaps with all titles sending one or two representatives to head office for a day or two where they can work out the best possible scheme together.

After this point, further communications could be made electronically. The internet facilitates conference calling across geographically dispersed locations which would allow as many participants to be present as required. This is logistically easier to arrange and cheaper than to gather all those people for a meeting in person.

Head office could present the scheme via conference call to all members of staff at the various titles, taking questions and interacting as appropriate. Follow up questions and thoughts could also be communicated via the internet.