STRATEGIC CASE STUDY AUGUST 2018 EXAM ANSWERS

Variant 2

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SECTION 1

Part 1

Identifying a price for the proposed MBO newspaper titles

Valuing these eight newspaper titles to identify an appropriate price is likely to prove challenging. None of the methods are likely to be perfect, and a significant amount of negotiation will be required to attain a fair and reasonable value and acceptable price suitable to both parties. As an unquoted business, we have no stock market value, which is likely to make valuation difficult as we may have to make estimations of value based on similar organisations. However, three other newspaper publishing businesses are quoted on the Borland stock exchange so this may assist us in the valuation process.

A starting point would be to use an asset-based valuation method. This would provide both parties with a minimum value of the proposed buy-out to set a starting point for price negotiations, based on the sum of the value of the physical assets of the proposed eight newspaper titles. However, we must take into consideration that this valuation will not include intangible assets.

A more difficult consideration is valuing the intellectual capital of the MBO, which is likely to be high in this case due to the collective skills, knowledge and experience of the MD's and the employees in the Eastern region, together with the value of the brands associated with each news title, which must be included in the valuation. We could use the Calculate Intangible Value (CIV) method to estimate the value of the eight newspaper titles' intangible assets. This is based on a comparison of the total return that those businesses are producing against the returns that would be expected based on the average returns of its tangible assets. However, the main drawback is that it is based on historical figures, which is not likely to reflect the real value of those newspaper titles.

We could use a discounted cash flow method, whereby we would estimate the future annual after-tax cash flows of the eight newspaper titles, discounting these at an appropriate cost of capital. The cost of capital chosen should reflect the risk of the MBO's future cash flows, which may be difficult to assess as an unquoted company.

However, we could use the cost of capital used by other quoted newspaper publishing businesses in Borland as a reference point.

Other Financial considerations

We must also consider any potential loss of revenue, and subsequent impact on profitability of FNG from the removal of these newspaper titles from FNG's portfolio. Obviously, proceeds from the sale of these eight newspaper titles will be a positive factor for FNG in the short term, but we should consider the longer-term impact going forward on the viability of the rest of the portfolio without these eight newspapers. Certain advertisers may withdraw advertising contracts should our remaining portfolio not be of sufficient size. Therefore, we need to carefully consider the potential knock-on financial impact of reducing our portfolio of titles. A further consideration is how the MBO team intend to pay us. Will it be a cash deal (but they will likely need to borrow money to make that happen)? Will they offer a deferred payment proposal i.e. they would pay an amount upon completion with the remaining payments being made by instalments? Or they may offer us shares in the new business for a fixed period of time with them having the option to buy back the stake as they start to generate cash. All of these options need the Board's full consideration.

Part 2

Risks for FNG

The main risk for FNG is not obtaining a fair price from the sale of the MBO business and undervaluing the sale. This could lead to a longer-term impact on the overall value of the remaining FNG business portfolio and put it under threat from takeover from larger news publishing businesses in Borland. After the sale, FNG will have reduced in size from 40 to 32 newspaper titles (20% reduction), with significantly fewer assets. This could be a significant risk to the continuation of the rest of the business.

Our external investors may see this as a sell-out and a weakening of the business and they may withdraw their support and/or sell their shares. They are likely to challenge this strategic direction, as too may some of the Finch family shareholders, which could bring disharmony and put pressure on the senior managers.

This could be damaging to our reputation in the industry. FNG has not undertaken such a sale of its business assets before and this move may be seen by some as the beginning of a trend. It may be damaging to our reputation amongst our customers and we may lose a number of loyal readers in other regions if they believe we are going against our principles.

We may lose loyal, experienced staff in other regions as a result of this MBO. They may see this MBO as the beginning of the end for FNG and seek alternative employment in other news publishing organisations.

We have no experience of MBO's and, therefore, to protect our interests it would be prudent to employ the advice of experts/consultants in MBO's to assist us in our negotiations. This is likely to be expensive in the short-term but will hopefully assist in assuring that our long-term interests are protected and that we get the best deal possible.

Risks for MBO team

The MD's who are proposing the MBO in the Eastern region are likely to risk a high personal cost, both financially and emotionally. They will have to invest some of their own money into the business, resulting in a high risk to their own personal finances and security. They also risk their own reputations in the industry, should the MBO fail. Many of the MD's in this region are long standing members of the organisation, used to security and relative stability which will no longer be guaranteed following an MBO. There is a huge personal risk to their own careers and reputations if the MBO fails.

There is also a risk that, although the MD's are highly experienced in running their own newspapers, they have a lack of knowledge of the whole business process. Centralised service provision, such as advertising contract negotiations, information systems management and human resource management will now have to be managed and operated by the new management team. This will be a significant challenge and increase the risk of failure of the business.

Historically, there is a high risk of failure of MBO's generally and any external investors will place a lot of pressure on the MBO team to make it a success. Initially, the MBO team may indeed find it difficult to secure sufficient levels of investment in this proposed buy-out, bearing in mind the current climate of the newspaper industry. These investors will be taking on significant levels of risk and thus will place significant levels of pressure on the MBO team to make the MBO a success.

SECTION 2

Part 1

Stakeholder reaction to MBO and how to manage

Customers/ Newsreaders

Most of our newsreaders are not likely to notice any difference, as long as the MBO newspaper titles continue to operate uninterrupted following the sale. We can presume that most will have little interest in the proposed MBO and customers do not have any power over the decision. Customers will only be interested if it will affect them directly, but this impact is unlikely to be significant. Therefore, from our perspective, minimal effort is required for this stakeholder group. However, we must make sure that any information presented in our publications regarding the MBO is presented in a positive and reassuring way. It would also be wise to keep an eye on our social media sites to see what our customers' reaction is generally and respond appropriately.

Investors/ Family owners

The Finch family is still a major owner of the business and also there are a number of family members working in the business. This is most likely to be the most powerful stakeholder group with a high level of interest in the MBO decision. This decision will impact on their own wealth as shareholders and the impact it may have on the reputation of the Finch name will be a significant factor. Therefore, the Finch family are classified as key stakeholders. They may indeed try to put a stop to this proposal if they see it as against their interests, both financially and reputationally, or if they consider it to be the demise of the business. It is important that we manage these stakeholders carefully through constant communication throughout the process. Obviously, our Chief Operating Officer and Chairman, both Finch family members, are involved in the proposal and therefore, they will be useful in communicating this decision positively to the rest of the family investors.

Staff

The staff, particularly in the eight Eastern region newspaper titles, will have a high interest in this decision, as it may affect their long-term employment prospects.

However, staff are likely to have lower power to affect the decision. However, we will need to be mindful of the influence of the Borland Union of Journalists who could, indeed, increase the power of staff, through demands for strike action or demands for reassurance of employment security. If the unions were to act aggressively, then this could significantly increase the power of the staff. Therefore, we need to keep this stakeholder group satisfied. We must be open and staff must be kept informed throughout. Those in the Eastern region will require reassurance that any prevailing legislation in Borland regarding transfer of undertakings will be adhered to. FNG will need to reassure the employees remaining in FNG of the continuation of the remaining part of the business.

Advertisers

Advertisers may perceive this proposal as a negative step for FNG, reducing its potential customer reach through the loss of 20% of FNG's total portfolio of titles. Therefore, they are likely to take a keen interest in this decision. They are likely to have limited direct power to influence our final decision, but their interest and concerns should be listened to. We must make sure we keep our key advertisers up to date during any negotiations and ensure that we reassure them of the positive aspects of remaining with our business. However, it's worth noting that, whilst most of the advertisers will be local to the eastern region, there may be some nationwide organisations who advertise in some or all of our other publications as well.

Part 2

Acceptability of conditions of sale

It is understandable why our Chairman wishes to protect the long-term interests of FNG. However, we must be careful that any conditions placed on the MBO are not seen to be unethical or deliberately restricting the potential long-term success of the newly formed business. Clearly, our first priority is to ensure we adhere to employment legislation in regard to transfer of undertakings but we must also consider a wider range of ethical issues and consequences in regard to this MBO.

As part of our Corporate Social Responsibility statement, it states that we "…hold regular employee forums and are committed to communication and consultation with employees during times of change". Alan's suggestion that we offer all staff working for the Eastern region newspaper titles be offered jobs elsewhere within the FNG group would appear to be in keeping with this. However, is this giving false promises? Where are the roles going to come from that we are going to offer to these employees?

Firstly, it would seem inappropriate to offer employees the opportunity to leave the newly formed business before it begins, but not allow other FNG employees the opportunity to work for the newly formed business once it is operational. Staff may have a genuine reason for wanting to work for one of the eight Eastern regional newspapers but would not be permitted to do so if these terms stood. This could also be seen to be unprofessional if we were to poach staff from the newly formed business before it commenced operating, leaving it understaffed and unable to obtain suitably qualified or experienced staff as replacement. There is a risk that our own objectivity could also be called into question from such an action.

The point relating to the MBO team being required to sign a confidentiality agreement would be very difficult to adhere to or, indeed, to monitor whether this has been breached. These eight MD's have gained a huge amount of experience and possess a high level of tacit knowledge about the industry and the FNG business, which they will inevitably use to run the newly formed business. To expect them to not use any of their previous knowledge, experience and business contacts is unrealistic and highly unlikely. However, it will be important to stress within any terms of sale that information and knowledge used should not be done in such a way that could be detrimental to FNG.

The proposed condition to prevent redundancies and closures for three years following the sale could be considered to be unacceptable. Redundancies and closure of a business may indeed be required to ensure the continuation of the business and such a clause could be seen as lacking in objectivity. It could be construed as being more about protecting the reputation of FNG, rather than protecting the interest of the employees in the newly formed business. The Chairman could be seen to be trying to prevent risk to FNG's own reputation rather than the new business itself.

If we are to consider applying conditions of sale on the MBO, we may want to restrict the newly formed business from competing directly against FNG in its other regions for a specified period of time i.e. to restrict its activities to the Eastern region. It is common in MBO sale negotiations that the newly formed company is not permitted to compete directly against the original business.

SECTION 3

Part 1

Use of proceeds of MBO

We must first take into account that external shareholders only account for a 40% holding of our shares. Although Mr Lal is our largest external shareholder, we may wish to ignore his request, as he has little influence on our decision making. However, we may consider that it would indeed be a viable option to keep shareholders happy by using the MBO proceeds of sale to pay a dividend. In particular, payment of a dividend to the non-family shareholders, who may currently be nervous that the business is at risk due to the MBO, may go some way towards reassuring them and assisting in retaining them. They have shown loyalty to FNG through a period of declining performance and a dividend would be a gesture of goodwill. Dividends have declined sharply in recent years and payment in the next financial year of an increased level of dividends may increase shareholder confidence. However, we would need to gauge the reaction of this potential use of the MBO proceeds by the family shareholders, some of whom may perceive this as an inappropriate use of the proceeds in the current climate and could be used to build the business.

If we are considering continued growth of the business as outlined in our Annual Report, we may consider using some of the proceeds of sale to invest in alternative acquisitions to replace the Eastern region news titles. We may look for opportunities to purchase other regional newspapers, as we have experience of this, albeit some considerable time ago.

We should also consider further investment in alternative approaches to news delivery, such as the acquisition of or investment in the development of digital news formats, such as our existing news websites, apps and social media.

We could always keep the proceeds of sale in the bank for future opportunities or we could pay bonuses to our senior staff to reward them for their loyalty to the business. However, this is not advised at this point in time, as it is likely to be seen as inappropriate at a time when the business has undergone significant rationalisation.

I would suggest that it would be appropriate to use some of the proceeds of sale for a dividend payment and the rest should be used to invest in future growth opportunities, as and when they become available.

Part 2

Removal of comments made on social media

It is not advised to remove the comments made on social media unless they are perceived to be inflammatory or offensive. None of these comments highlighted on the Eastvale Times social media site so far are considered as such. Removing them could be seen as some form of admission of guilt or an intolerance to criticism. As a news organisation our ethos is built on freedom of expression and the right to an opinion. To remove these comments would be going directly against these principles presented in our mission statement.

Our integrity and professional behaviour is likely to be challenged directly by any actions to remove critical comments. It is simply dishonest of us to remove comments without offering any form of response to them and is an unprofessional way of going about dealing with comments we simply do not like. If it was found out that comments had been deliberately removed then this would lead to a complete lack of trust from our customers and the wider public and could have a severe impact on our reputation.

It would be far better to have a company-wide policy of responding to social media comments with a positive answer, to demonstrate that our business refutes the points made. But this must be done positively. We must encourage expression of opinion and social media does exactly that. However, it would be wise to have a policy on monitoring and responding appropriately in a formalised manner.

Part 3

Benefits of implementing a social media strategy

The key feature of social media is that it is interactive and user-generated (such as user comments, photos or videos) and allows us as a business to connect with our customers directly. Importantly, social media is an excellent opportunity for us to generate valuable information about our customers through monitoring and analysing their online activity and opinions.

A formalised social media strategy would form part of, and support, our overall information strategy in the business. In the future, social media will be an integral part of our business model and in our news delivery and therefore social media must be an integral part of our information strategy. A formalised integrated approach to a social media strategy would help to ensure that our information systems (including social media) are aligned with our overall business objectives to support our future business direction and growth.

Information generated through social media is a hugely useful strategic resource and asset to our business and could be a major part of building and maintaining competitive advantage. Therefore, it should not be left to chance and we need to develop a social media strategy to manage and develop social media activity effectively, to support future strategy.

The systems required to maintain and manage social media content are likely to be costly and require expertise to run and manage effectively. It is important to have a defined strategy to ensure this is done effectively, particularly at a time when cost management is critical. Information created by social media is also likely to be hugely important to our advertisers. It will be a strategic advantage to us to manage social media well in order to grow our digital advertising which is a key strategic objective.

Part 4

Strategic benefits of enhanced customer interaction through social media

The first benefit is better customer relationships, encouraging the trust of customers and building long-term relationships. As a business, news delivery is based on trust. Even more so since the spate of ‘fake news’ stories that have plagued the news industry. By giving our customers the opportunity to comment and interact with the news we are building relationships with them that we simply cannot achieve if communication is only one way. Opening a dialogue with and between customers should encourage debate and interest in our news.

An important benefit of social media activity is the information about customers that it can generate for us. Systems can, and should be, put in place to collect data relating to our customers’ social media profiles and activity. This data, if analysed and used correctly, could be strategically valuable to us. Use of this data can assist us in understanding the information usage and needs of customers which we can then use to deliver the news stories and advertising they require.

In addition to this factor, a better understanding of customers is also more valuable to our advertisers and is likely to attract more advertisers if we can assure them of a real understanding of our customers’ needs. Targeted advertising can be used which is likely to be far more attractive to advertisers.

Social media content can in fact be the news itself, as social media comment sometimes generates news stories. It could be seen as a cost-effective way of creating news stories by using our readers to provide stories, photos and comments. However, we need to be careful in managing this. News needs to be checked for reliability and credibility of sources. Our reputation could be at stake if not carefully managed.