STRATEGIC CASE STUDY FEBRUARY 2018 EXAM ANSWERS

Variant 1

The February 2018 exam can be viewed at

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SECTION 1

The likely strategic advantages and challenges of acquiring Glimmer compared with our usual organic approach to growth

One of Royals' strategic aims for the next three years is to open more gyms in Hylandia and further afield. Glimmer will help satisfy this aim and is an opportunity for Royals to achieve growth in gym numbers. Buying 30 gyms will be quicker than opening 30 gyms organically and therefore can achieve a large part of Royals growth target for 2018 at speed.

Synergies are possible whereby Royals and Glimmer reduce their aggregated costs by operating together as one bigger organisation. For example, they may utilise bulk buying discounts or obtain more favourable financing deals as part of a bigger operating unit. Also by sharing ideas both elements of the business may find more effective ways of working.

It also appears that this particular acquisition may be a cost-effective way to open 30 new gyms as Frederik indicates that Glimmer can be obtained “at a very good price”.

By acquiring a company overseas, overall risk might reduce. For example, economic or political changes in Hylandia may not occur in Rodia and may therefore lead to one geographical part of our business balancing out a poor turn in the fortunes of another.

An overseas acquisition allows Royals to grow if the home market is saturated. As a company with a very competitive home market and high levels of target new gym openings, this can lead to opportunities for growth that could not be achieved at home.

However, the acquisition of Glimmer is a new type of venture for us. To date we have achieved growth purely organically. We do not have experience of acquisitions and may need to obtain professional advice.

Gaining 30 gyms at once may be a challenge for our management team who have previously managed gym openings at a steady pace. If we acquire Glimmer we instantaneously gain the responsibility of managing 30 new gyms. We could however, leave the existing management structure in place until we have agreed our approach.

Any acquisition process can be concerning for our staff. Unlike organic growth an acquisition leads to uncertainty and fear, particularly at the target company, and if staff leave as a result the target can become less valuable.

Differences in culture may not be easy to manage. Through organic growth Royals can roll out their desired company culture as they proceed. This will be more challenging when acquiring Glimmer and we will have to decide whether we want to change the culture at Glimmer to bring it in line with our Royals culture.

Acquiring companies overseas can be expensive. Legal and other professional advice will be required to ensure the requirements of operating in a new country are understood and the lack of familiarity in terms of legal and regulatory requirements remains a risk. We lack experience overseas.

Ways to ensure Glimmer staff remain motivated, reassured and loyal throughout the change

It is understandable that Glimmer staff would be concerned about job security. They operate a heavily staffed luxury gym model which is a complete contrast to Royals as their potential new owners.

As we do not want to impose our budget approach on Glimmer there is no need for staff to be concerned and good communication will be a key part of ensuring Glimmer staff know their intentions in this regard.

Glimmer staff will need to be reassured, perhaps face-to-face, that Royals value and intend to keep the luxury, highly staffed approach in Rodia. Communication needs to educate staff about the impacts of the change and dispel rumours.

There are a number of ways communication could be achieved – one example might be for Frederik or Marco to visit each of the Rodia gyms and communicate a motivational message explaining their intention to retain staff. They could also talk about the success to date of Glimmer and opportunities for further success under the strong management and financial structure of Royals.

If it is logistically impossible for Frederik and Marco to cover this work, it could be undertaken by region, with members of the Royals management team passing this message back to broader numbers of gym staff.

Royals may want to back up face-to-face meetings with good quality, regular and transparent electronic communications by email or an intranet to keep staff informed of the process and their part in it. The other benefit of electronic communication is that it quickly and easily facilitates a two-way flow of information.

Another way of ensuring staff remain loyal and motivated is to involve them in the process. Letting them have their say and giving them roles within the acquisition project will help them to feel part of the new organisation and reassure them they have a future post-acquisition.

Removing uncertainty through timely and appropriate information exchange is key to preventing staff from searching for alternative employment through fear of their own position within the organisation. Reassuring staff of their long term role by sharing ideas and plans will reduce concerns and may lead to the generation of new and useful ideas that smooth the course of the change.

If it is financially viable, we could offer Glimmer staff a small bonus for staying in our employment for an agreed amount of time post acquisition, and could arrange social events with key Royals staff members to lift spirits and build relationships.

SECTION 2

The best choice of supplier

Advantages and disadvantages of TopKit

The advantages of continuing to use TopKit is their good quality equipment and reliability. We would not have to worry about whether the equipment or installation service provided would be satisfactory and this reduces risk. TopKit have supplied Royals for many years and are a trusted key supplier.

Furthermore, although TopKit does not appear as cheap as Fit-u-Like, we do obtain a good bulk buying discount from our current supplier which may be further improved with additional purchases in Rodia. Further bulk discounts could reduce the difference in cost between the two suppliers.

However, there are disadvantages to using TopKit in Rodia.

As Rodia is overseas we will have to arrange for the international transportation of the equipment which will be costly. International transportation could also lead to damage, or other logistical issues such as delays and items lost in transit.

We should find out whether TopKit are experienced in international sales to indicate how well equipped they might be for such a process, and enquire as to the additional charges involved in them providing the equipment overseas.

Advantages and disadvantages of Fit-u-Like

The main advantage of using Fit-u-Like is primarily related to cost. Fit-u-Like is apparently cheaper than TopKit and there will not be the costs and inconvenience of international transportation. Additionally, people local to Rodia may feel pleased if they see Royals utilising a local supplier which could improve reputation.

However, we cannot be assured of the quality of the equipment or installation which is of particular concern in a luxury gym operation. There are already indications of potential issues with quality evident in notes 1 and 2 to the Fit-u-Like quote whereby they make a point that not all machines will be new and that they take no responsibility for accidents or injuries occurring on their machines.

Note 3 to the quote requires payment in advance which also presents a significant risk. We have no experience of this supplier and therefore do not know that they will supply and fit the equipment to our standards.

If we have paid in advance, we will have no power to ensure they do a good job or fix any arising problems and we may have issues obtaining a refund if one is required.

How we can ensure our requirements for equipment and installation are met if we proceed with Fit-u-Like

If we do proceed with Fit-u-Like there are a number of steps we can take to reduce the risks described above.

Firstly, we can ensure that the fitting out of the gym is treated as a project and have a suitable project plan drawn up. This should include important factors such as the timescales, ensuring that key activities and milestones are included, such as testing of the equipment once it is in place and sign off between all key parties.

A detailed service level agreement (SLA) should be implemented, clearly laying out our requirements when purchasing equipment from Fit-u-Like. Elements that may be detailed could include a requirement that all machinery was new, not refurbished, or the amount of testing required before installation. It may require that all problems arising within a month of installation require an on call 24-hour response from Fit-u-Like to rectify the problem at their own cost.

It would also be sensible to obtain references and investigate Fit-u-Like's reputation beforehand. If previous customers offer glowing references and assurances that Fit-u-Like have done a good job we can feel more assured to trust them as a new supplier to Royals.

We may want to monitor the installation process, ensuring we do not sign off any installations that do not meet our requirement, and run thorough testing of the equipment supplied to ensure it is fit for purpose before we authorise invoices for payment.

We should certainly not pay the full amount in advance as suggested on the quotation, but pay under our normal credit terms once we are satisfied that the installed machinery is fit for purpose. If this is not acceptable to Fit-u-Like another payment alternative might be to negotiate stage payments, say 1/3 up front, 1/3 on installation and 1/3 after a suitable settling in time period.

If Fit-U-Like are serious about wanting to do business with us going forward, then they should be prepared to negotiate. We should also have a discussion with Fit-U-Like about warranty arrangements as there is no mention of this in their quotation. It is important to know where we stand if a machine breaks down.

Finally, I would recommend that we do not sign up to their disclaimers of responsibility. If there are injuries caused by their negligent construction or installation we should not allow ourselves to accept responsibility or liability for that.

SECTION 3

How developing luxury gyms in Hylandia might affect our generic strategy

We are currently operating at close to what Michael Porter would describe as a cost leader. We run an efficient gym model and achieve low costs through bulk discounts and a 'no frills' approach. We do not buy the cheapest possible equipment but the cost of our premium equipment is significantly lowered by generous volume discounts from TopKit.

Opening luxury gyms moves us to the other end of the spectrum towards what Porter would describe as a differentiator. Luxury gyms require high capex to develop a service which is better than what most other gym providers offer in the market, with lavish spas, cafes and continual staff interaction. If we pursue both approaches at once, in the same country, we are likely to become confused. Porter would describe it as "stuck in the middle".

The basic premise of operating as a budget gym versus a differentiator are contrasting, and the confusion and the working difficulties this may cause could adversely affect our profit.

We don't have the skills and experience to launch luxury gyms in Hylandia. It is likely that new staff would be required, which would be expensive. If the existing management team is used, this takes time away from the area they know best – budget gyms.

We would have to consider how it would affect our approach to equipping a gym. Our current no frills approach would not work. We may need new staff to perform this work or our current staff would need to learn how to furnish luxury gyms. It is likely that the planning processes would be different and new suppliers would be required.

Customers may be confused about what Royals now stands for. This confusion is avoided with Glimmer overseas but if a luxury gym is launched in Hylandia, Royals customers may start to question the notion of accessibility and affordability. Royals may need to launch the luxury gyms under a different brand name to avoid confusion which again is expensive.

How opening luxury gyms might risk achievement of our strategic objective

In terms of meeting Royals strategic objective, the luxury gym concept may go some way to helping Royals to be the 'leading gym business in Hylandia. If we break this down into the focus areas that lead to achievement of that objective we can see that:

1. This focus area would be challenging to manage. The brand must strengthen Royals strategic position as the leading provider of accessible and affordable gym facilities. Opening luxury gyms in Royals name would completely confuse this proposition and even under a different trading name could damage the essence of the Royals brand.

2. Royals will enhance their provision of high quality gym facilities but it is questionable whether luxury gyms improve Royals flexibility. Accessibility will increase to people with more money but this offering does not improve accessibility to all potential customers. Indeed, if building luxury gyms led to less budget gyms being built then accessibility would decrease overall.

3. In terms of efficiency, this is not what a luxury gym is about and any efforts to maximise the utilisation of floor space would work against the spacious luxury offered by high end gyms.

Royals could invest high amounts of capital in luxury gyms in Hylandia and not improve their ability to meet their strategic objective.

Why we might need different KPIs for Glimmer

There are many KPIs that are useful in a gym business, and the choice of which ones to use comes down to the preferences, requirements and objectives of key stakeholders. Certainly, there will be several KPIs that are important to both Royals and Glimmer such as revenue / square metre (showing how well individual gyms are using their space and allowing comparisons across venues) and membership numbers per gym (tracked against similar gyms and over time to ascertain movements).

However, Royals and Glimmer, although both gym providers, operate in a different manner and towards a different target market; the former being a budget gym and the latter a luxury gym. Therefore, there are KPIs that are more important to Glimmer than Royals that may need to be added to the existing management KPIs to evaluate the performance of Glimmer.

Two KPIs we should use to specifically measure the success of Glimmer

1. Average revenue per member per month – perhaps of limited use in a budget gym where spend will be little more than the monthly membership fee, but of great use in a luxury gym where peripheral spending is a more important contributor to profit.

2. Customer service ratings – in a luxury model every single lost customer makes a big difference to profit, therefore it is even more important to measure customer satisfaction at these gyms and predict and prevent any loss of members.

Options for raising finance going forward

There are three key ways of raising finance to expand further by launching a brand of luxury gyms in Hylandia (bearing in mind that GEM wish to exit):

1. Raise more debt. Royals is highly profitable and Glimmer has traded successfully over the first six months since acquisition. We should explore whether our existing bank (or another one) might increase the available facility based on this increased profitability. Debt is the cheapest form of finance available, and therefore we should explore this possibility before any other. Whilst this would not necessarily provide GEM with their desired exit, the bank might be prepared to use some of the additional debt to buy back some or all of GEM's shares at a valuation to be agreed.

2. Seek a new private equity partner who is prepared to provide additional finance for the business (termed a secondary buyout). This will mean that existing shareholders would be diluted, but the valuation of the business could be very high, especially considering the higher profitability of Royals following the Glimmer acquisition. This would also be a way of exiting GEM, with the new private equity partner perhaps prepared to invest for new shares as well as buying GEM's shares in the process.

3. List Royals on the Hylandia stock exchange and trade our shares publicly. One of the advantages of doing this is that new shares can be issued on listing, thereby raising cash for expansion. Another advantage is that GEM could then sell its shares to anyone prepared to buy them. The downside of doing so is the increased regulation and reporting required for a public company, a higher level of corporate governance, and the costs of listing are also very high.