



May 2018 Strategic case study examination

Pre-seen material



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Couchweb

You are a senior manager in the finance function at Couchweb. You report directly to the Board and advise on special projects and strategic matters.

Couchweb is based in Mayland where the currency is the M\$. Companies prepare their financial statements in accordance with IFRS.

Company Background

Couchweb is a media streaming company which offers access to media content over the internet at any time and from anywhere. Subscribers pay a small monthly fee, in return for which they can log into Couchweb's website and view content online. Subscribers can connect to the service using almost any device that can access the internet, including smart televisions, laptops, tablets and smartphones.

Couchweb's content is exclusively entertainment, primarily TV programmes and movies. Subscribers log in using their own devices and can search Couchweb's catalogue until they find something they wish to watch. The chosen content is then streamed to their device. They can watch their choice of programmes while they are connected to the site, but they cannot download the material to watch offline.

The site tracks the content watched by each subscriber and builds up a profile of the popularity of each TV programme and movie. Couchweb has developed algorithms that can classify subscribers' viewing histories and offer them recommendations based on what they have previously watched.

Couchweb was founded 20 years ago by Chet Nolan, Jen Kramer and Jo Ying. The three founders have been friends since university. Before founding Couchweb, Chet was an IT director for a company which designed websites, Jen was a lawyer specialising in contract law and copyrights within a large law firm and Jo was the marketing director for a large media company.

When first founded, Couchweb rented out DVDs by post to customers, who posted them back after watching them. This service proved popular, although operating costs were high due to postage costs and the need to process the despatch and return of the DVDs. Couchweb's directors were keen to exploit the internet as a means of streaming content directly into customers' homes, using their existing internet connections. The biggest obstacle was the lack of fast and reliable internet connections. These have only been capable of supporting Couchweb's services for about 10 years.

Growing both organically and by acquiring other media companies, Couchweb is now one of the world's largest media companies. Initially, it operated exclusively in Mayland, but it has gradually moved into neighbouring countries and now it streams content to more than 100 countries in over 20 languages.

Couchweb's business model differs from that of most competing television broadcasters. Originally, television was broadcast using terrestrial transmitters that sent signals to aerials connected to viewers' television sets. Until the development of video recorders and other recording devices, content could only be viewed at the time of transmission. Most terrestrial broadcasters rely on advertising revenues (generated by broadcasting advertisements during programmes) to cover their costs.



The other main broadcasting technology is satellite television. Subscribers have satellite dishes attached to their homes. They have a receiver attached to their televisions that can decode the satellite signals and enable them to view content. Most content is broadcast at designated times, as for terrestrial broadcasts, although the receiver boxes can be programmed to record broadcasts allowing subscribers to watch them later. Satellite subscriptions are generally quite expensive because of

operating costs and the need to supply subscribers with the hardware required to receive signals.

Couchweb relies on subscribers accessing content over the internet, using any equipment that offers internet access. All content is placed on a website enabling subscribers to stream TV programmes and movies at any time that is convenient to them. Subscriptions are kept at a low price to attract high volumes of subscribers. Only subscribers can access the content because the website requires a valid user name and password to log in.

Couchweb introduced a number of key innovations in terms of its business model and its use of technology, but the founders have always agreed that it is content that sells subscriptions. Subscribers will cancel their subscriptions if they are disappointed by the choice of content that is offered to them.

Mission statement

Couchweb's mission is "Always entertaining".

Vision

Couchweb's vision is to:

- become the best global entertainment service in the world.
- license the best entertainment content available for streaming to Couchweb's customers.
- provide movie and television production studios with access to audiences.
- encourage innovation and creativity in the production of TV programmes and movies.

Industry background

The media streaming industry is a global business, with a relatively small number of major companies involved. Content is delivered over the internet, which means that there is very little need to establish a physical infrastructure before expanding into other countries. The studios which produce movies and television programmes cater for international audiences, with content often being dubbed or subtitled with a number of languages.

The nature of the media streaming industry creates opportunities for companies such as Couchweb, but there is a constant threat of competitors offering their own innovations, so it is necessary to spend heavily on patents and on research and development.

Couchweb's most immediate competitors are HomeVideo and MovieMaster. Both are smaller companies than Couchweb and neither has products that are as technically advanced. Couchweb has a larger subscriber base and so can afford to spend more on acquiring, and also creating, content.

Couchweb strategy

Most of Couchweb's income comes from customers' monthly subscriptions. The subscription level is kept relatively low and affordable, currently M\$12 per month, so subscribers feel that it offers value for money.

Subscriptions are paid by monthly direct debits and can be cancelled at any time without penalty. The lack of a minimum subscription period or a binding contract reassures subscribers that Couchweb will always have an incentive to provide interesting content.



There is no advertising on the site or during TV programmes and movies. Subscribers are free to enjoy the content without interruption.

The monthly subscriptions give access to all content on the site. Couchweb does not charge differential prices for more popular TV programmes or for new movies. Content does, however, vary between countries. Subscribers' locations can be determined by the Internet Protocol (IP) address of their computers. Subscribers from an

English-speaking country, such as Mayland, will see the Couchweb site in English and will receive English language content. In French-speaking countries the site will be presented in French and the content dubbed into French if necessary. The dubbed versions are prepared by the original production company and Couchweb simply has to buy a licence to show these. There can also be different copyright and licensing restrictions in different countries. For example, a production company may be willing for a movie to be released by Couchweb in Mayland, but to delay its release in other countries until it has finished its cinema run there.

Each subscription is password protected, with each subscriber being permitted to log in up to three devices at any one time. This allows families to watch different programmes in different rooms or for a subscriber to stream content to a smartphone whilst commuting without disturbing access at home.



Subscribers enjoy the fact that they can access all content at any time. This has led to the creation of the concept of 'binge-watching' where subscribers will watch every episode of a TV programme over the course of a few evenings. This differs from traditional TV broadcasts by satellite and terrestrial companies which force viewers to wait until the next episode is broadcast, usually at weekly intervals. Viewers then have to watch at the time dictated by the broadcast or record the programme to watch at their convenience.

Couchweb concentrates most of its production effort on TV programmes rather than movies. These tend to be more popular with subscribers. Couchweb has a reputation for being willing

to take risks in buying programmes that are different and interesting. These often attract a great deal of publicity and attract new subscribers who wish to see these new shows. Some of these programmes have been commissioned and produced by Couchweb itself. For example, Couchweb's "The Politics Game" is presently in its third season and is its most popular show.

Couchweb's only other significant source of revenue is generated from DVD sales of the programmes that it commissions itself. These are not particularly profitable because subscribers can watch the shows online and so the market is largely restricted to those who do not wish to take out a subscription, but do wish to watch a particular programme.

Programming

Subscribers have access to Couchweb's catalogue of approximately 1,100 TV programmes and 4,600 movies. These numbers increase slowly as new content is added, although Couchweb also removes content that is no longer popular or that has reached the end of its licensed period.



TV programmes can be broken down between series and serials, the difference being that a series generally has a separate story in each episode, whereas a serial has a continuing storyline that progresses from one episode to the next. Subscribers enjoy both types of programme, but serials often attract considerable attention from the press and in social media, with ongoing discussion of developing storylines.

Each programme is generally released as a 'season' of around 13 episodes, with a popular programme having the potential to run for many seasons. The rate at which seasons are released depends on a number of factors, including the complexity of the production and the popularity of the programme. A popular programme may have one or two seasons released every year.

Couchweb has a policy of bidding for the exclusive rights to broadcast TV programmes. Contracts usually give Couchweb the right to broadcast a programme for 5 to 10 years and guarantee that no other broadcaster will be granted a licence to broadcast the programme for 6 months from the commencement of Couchweb's rights. The programme will not be released to rent or buy on DVD during that 6 month period. Contracts also give Couchweb the option to acquire further seasons without them being offered to any other broadcaster, unless Couchweb chooses not to exercise its option.

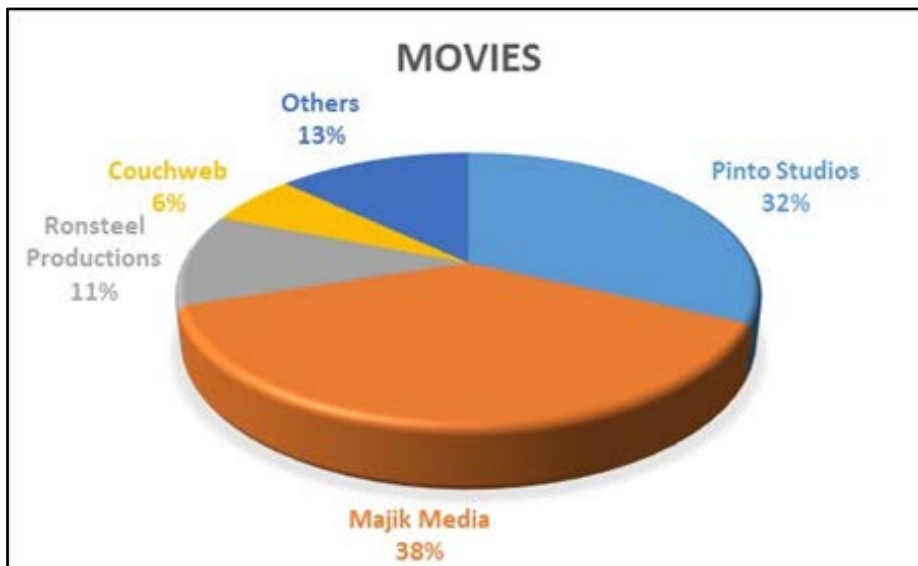
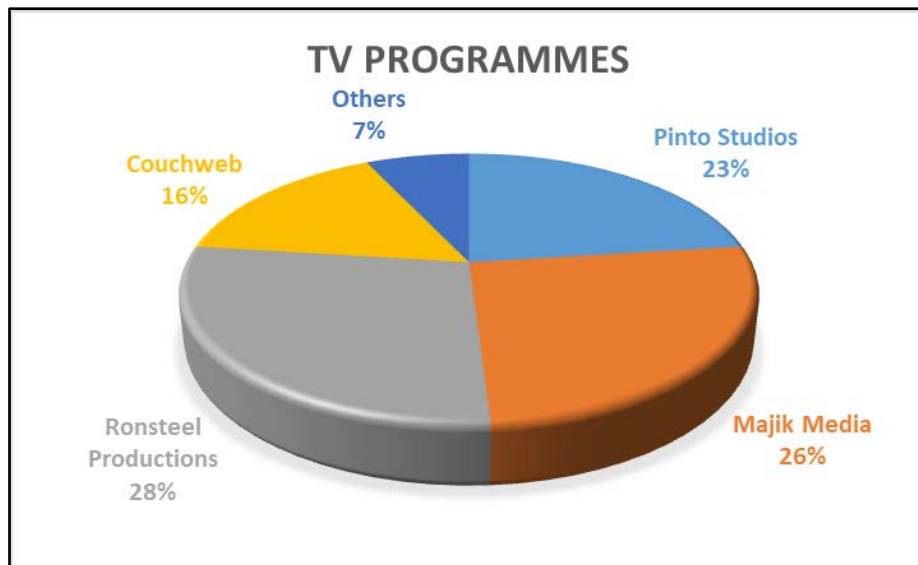
When Couchweb buys a new season it can either release all episodes immediately, so that viewers can watch as many episodes as they wish, or it can release one new episode every week, to build excitement while waiting for the next episode to become available. The latter approach tends to be more effective with serials as each episode tends to end at a crucial point in the story, leaving viewers to wonder how it will be resolved. Once an episode has been released it is available for viewing at any time thereafter.

Couchweb also buys the rights to broadcast movies. Film studios usually show new films in cinemas before releasing them for sale on DVD and then finally making them available to

broadcasters. Couchweb often buys the right to broadcast movies after their cinema run, but before their release on DVD. Again, these contracts usually give a specified period of 5 to 10 years to show the movie and a guaranteed period before it becomes available on DVD or to any other broadcaster.

Couchweb also produces its own TV programmes and movies. Having produced several highly popular TV series, Couchweb attracts top writers, producers and actors to work on its projects. Its movies have attracted relatively little discussion from film critics, partly because they are rarely released in cinemas and so they attract less publicity. Couchweb tends not to license other broadcasters to show its TV programmes and movies, although it does release them on DVD a year after they are first shown.

There are several major production companies which produce both TV programmes and movies. These have contributed to Couchweb's catalogue in the following proportions:



There are three major studios and a large number of small independent production companies, classified as 'others'. These small companies often produce very high-quality content that is popular with Couchweb's subscribers.

Own productions

In 2012, Couchweb conducted a survey of subscribers' viewing habits and discovered that it was becoming increasingly common for them to watch the whole of a new season of a programme over a weekend or over two or three consecutive evenings. The survey, backed up with data gathered from the website, also indicated the factors that attracted viewers. Couchweb realised that it could use this information to commission TV programmes that would attract large viewing figures.

Couchweb started to commission its first TV programme, a crime serial called 'Tumbling Down', aiming for a target audience of 40 million viewers. For the first season of 13 episodes, Couchweb hired a freelance creative director and production team and gave them a budget of M\$6.8 million per episode.

Production took eight months and the resulting programme was so popular with viewers that a second season was commissioned, with a budget of M\$8.2 million per episode. Even with this increased budget, the programme is relatively cheap to produce in comparison to other popular shows. It relies on good writing and excellent acting to develop story lines rather than special effects and other expensive elements.

Tumbling Down is now in its eighth season, with viewing figures averaging 60 million per season. All eight seasons still attract healthy viewing figures both from new subscribers and from those who enjoyed it enough to watch it again.

Tumbling Down remains one of Couchweb's most popular programmes, although it has proven to be the first of many successful programmes and even movies. 'The Politics Game' is presently Couchweb's most popular TV programme, attracting higher viewing figures than many of the more expensive programmes purchased from the major studios.

Couchweb's Board of Directors

Chet Nolan, Co-founder and Chief Executive

Chet co-founded Couchweb. Today he serves as Chief Executive.

Chet has a Bachelor of Science degree in Computer Science.

Jen Kramer, Co-founder and Director of Legal Services

Jen co-founded Couchweb. Today she serves as Director of Legal Services.

Jen has a Bachelor of Law degree.

Jo Ying, Co-founder and Director of Sales and Marketing

Jo co-founded Couchweb. Today he serves as Director of Sales and Marketing.

Jo has a Bachelor of Arts degree and a MBA.

Martine Andels, Director of Finance

Martine has been Couchweb's Director of Finance since 2014. She has a degree in accountancy, an MBA and is a professionally qualified accountant. Martine worked for a large multinational company before joining Couchweb.

Javier Mercot, Director of Business Development

Javier was appointed to the Board in 2013. He was previously a senior sales and marketing manager in a major media company.

Marie Richards, Chairman

Marie has had a long and distinguished career in the media industry. She was head of innovation with a major media company for 12 years. She has served as Couchweb's Chairman for two years.

Jade McLaren, non-executive director

Jade has been a non-executive director for 2 years. She was previously an executive director for a public relations company.

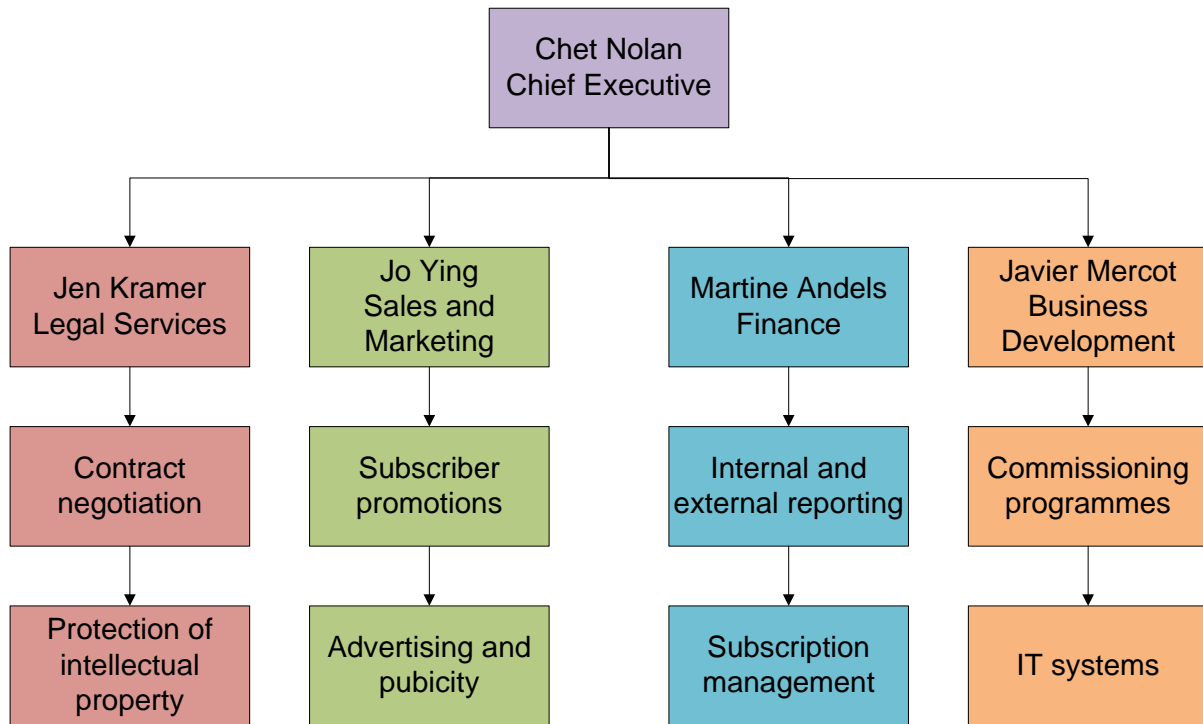
Leroy Dikko, non-executive director

Leroy has been a non-executive director for a year. He was previously managing editor of one of Upland's leading national newspapers.

Zang Chou, non-executive director

Zang has been a non-executive director for 2 years. He was previously an executive director for a manufacturing company. He was a founder of the company which grew to become a very large manufacturing company in Maryland.

Organisation Chart





The following information has been extracted from Couchweb's financial statements for the year ended 30 April 2018

Couchweb
Consolidated statement of profit or loss
For the year ended 30 April 2018

	2018	2017
	M\$m	M\$m
Revenue	13,226.0	10,823.8
Cost of sales	(9,192.1)	(7,446.4)
Gross profit	4,033.9	3,377.4
Research and development expense	(1,069.5)	(854.2)
Other operating expenses	(1,880.2)	(1,630.0)
Operating profit	1,084.2	893.2
Finance costs	(184.0)	(170.0)
Profit before tax	900.2	723.2
Income tax expense	(215.8)	(195.9)
Profit for year	684.4	527.3

Couchweb
Consolidated statement of financial position
As at 30 April 2018

	2018	2017
	M\$m	M\$m
Non-current assets		
Content	9,463.5	7,972.4
Other intangible assets	520.1	342.6
Property, plant and equipment	378.2	296.3
	<u>10,361.8</u>	<u>8,611.3</u>
Current assets		
Content	4,652.7	3,812.8
Cash and cash equivalents	1,942.6	1,533.5
	<u>6,595.3</u>	<u>5,346.3</u>
Total assets	<u><u>16,957.1</u></u>	<u><u>13,957.6</u></u>
Equity		
Share capital and share premium	1,830.0	1,580.0
Retained earnings	1,813.3	1,426.7
	<u>3,643.3</u>	<u>3,006.7</u>
Non-current liabilities		
Loans	5,321.0	4,470.0
Non-current content	3,245.4	2,348.3
Deferred tax	245.6	232.1
	<u>8,812.0</u>	<u>7,050.4</u>
Current liabilities		
Content	4,283.1	3,711.0
Current tax	218.7	189.5
	<u>4,501.8</u>	<u>3,900.5</u>
	<u><u>16,957.1</u></u>	<u><u>13,957.6</u></u>

In line with industry practice, Couchweb shows the cost of creating or licensing content as an asset, amortised over the useful life of those rights. Content that is expected to be amortised within 12 months is shown under current assets and content that is expected to be amortised beyond 12 months is shown as non-current.

The unpaid costs associated with acquiring content are recorded as liabilities, either current or non-current depending on whether payment is due within 12 months or beyond.

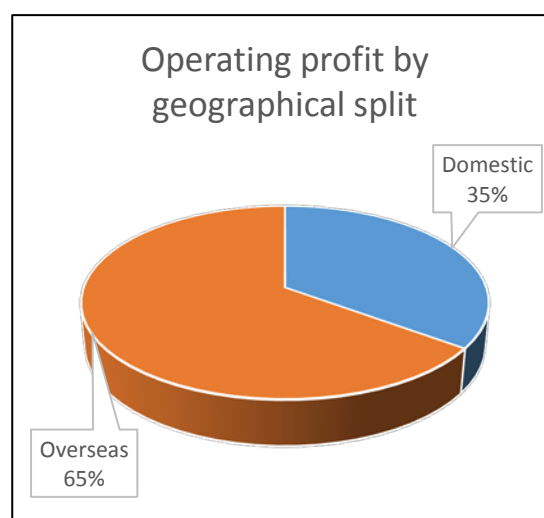
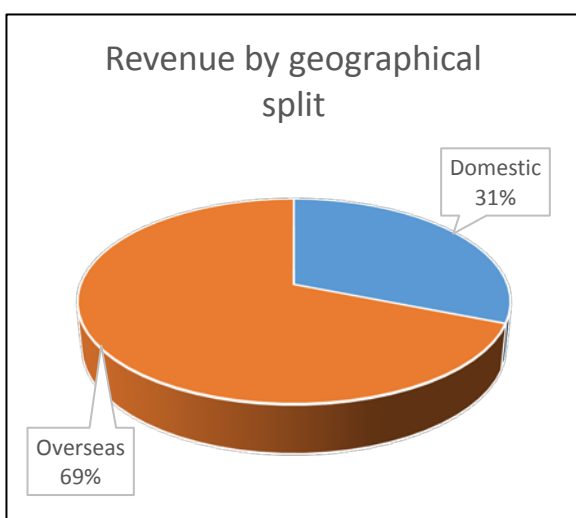
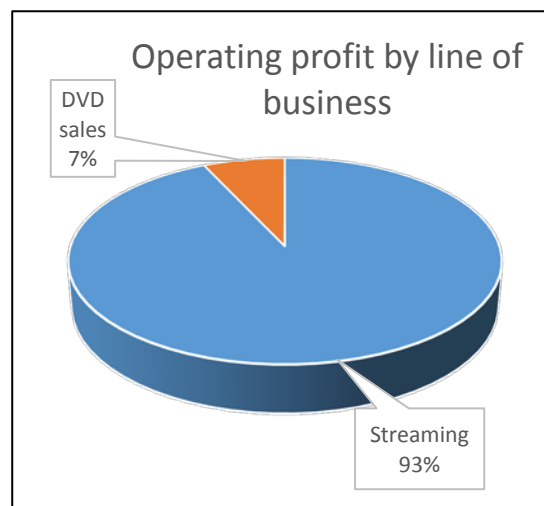
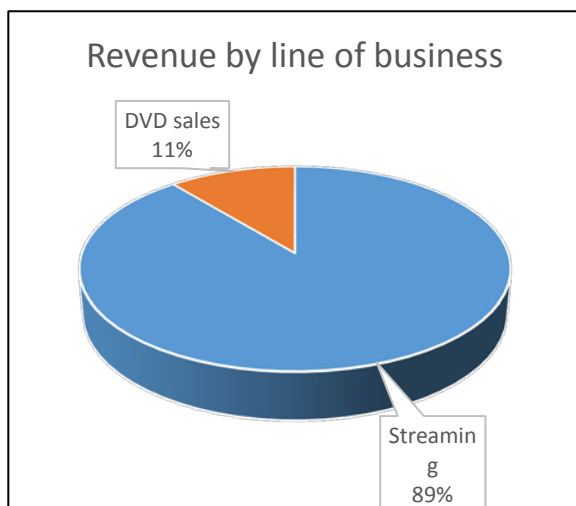
Segmental analysis

By line of business

	Streaming M\$m	Sale of DVDs M\$m	Total M\$m
Revenue	11,771.1	1,454.9	13,226.0
Operating profit	1,008.3	75.9	1,084.2

Geographical

	Domestic M\$m	Overseas M\$m	Total M\$m
Revenue	4,100.1	9,125.9	13,226.0
Operating profit	379.5	704.7	1,084.2



Extracts from a competitor's financial statements

HomeVideo

Consolidated statement of profit or loss

For the year ended 30 April 2018

	2018	2017
	M\$m	M\$m
Revenue	9,447.1	8,588.3
Cost of sales	<u>(6,809.0)</u>	<u>(6,190.0)</u>
Gross profit	2,638.1	2,398.3
Research and development expense	(594.2)	(530.5)
Other operating expenses	<u>(1,343.0)</u>	<u>(1,033.1)</u>
Operating profit	700.9	834.7
Finance costs	<u>(177.4)</u>	<u>(100.0)</u>
Profit before tax	523.5	734.7
Income tax expense	<u>(125.5)</u>	<u>(199.0)</u>
Profit for year	<u>398.0</u>	<u>535.7</u>

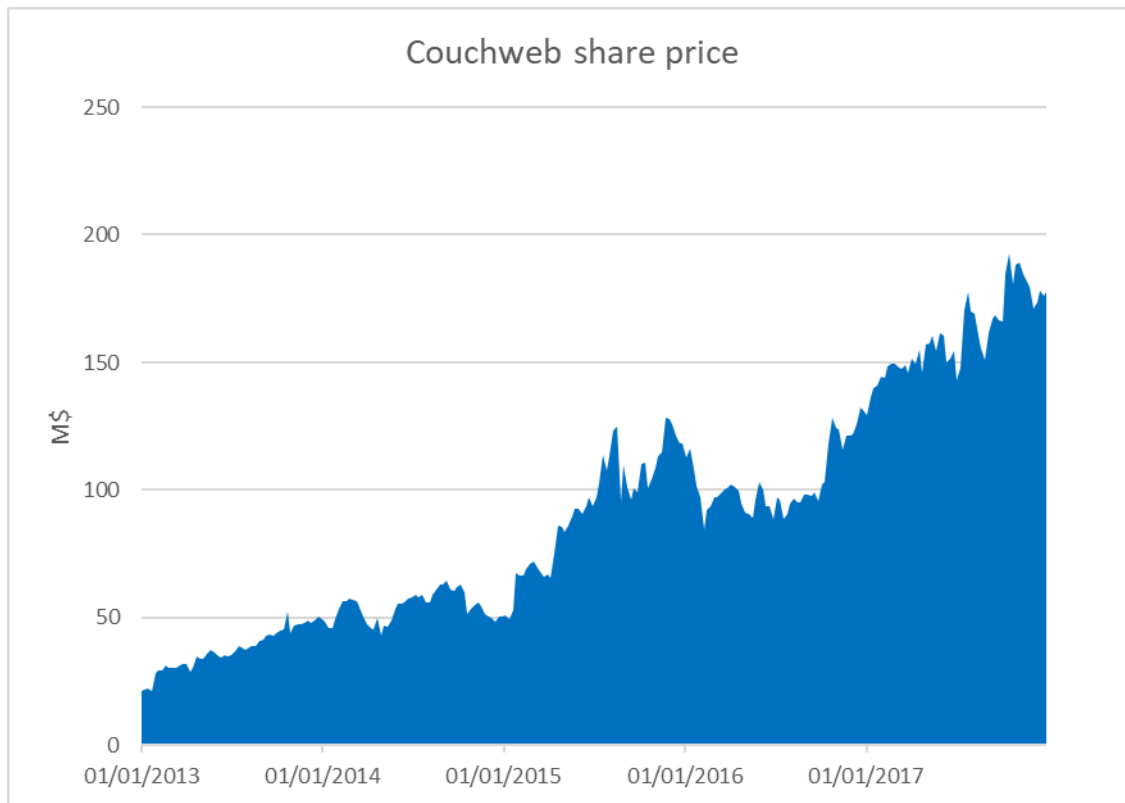
HomeVideo
Consolidated statement of financial position
As at 30 April 2018

	2018	2017
	M\$m	M\$m
Non-current assets		
Content	6,759.6	3,636.7
Other intangible assets	371.5	367.4
Property, plant and equipment	270.1	260.8
	<u>7,401.2</u>	<u>4,264.9</u>
Current assets		
Content	3,877.3	3,419.7
Cash and cash equivalents	1,618.8	1,541.7
	<u>5,496.1</u>	<u>4,961.4</u>
Total assets	<u><u>12,897.3</u></u>	<u><u>9,226.3</u></u>
Equity		
Share capital and share premium	1,321.2	1,321.2
Retained earnings	1,450.6	1,141.4
	<u>2,771.8</u>	<u>2,462.6</u>
Non-current liabilities		
Loans	5,130.0	2,629.4
Non-current content	2,028.4	1,467.7
Deferred tax	153.5	145.1
	<u>7,311.9</u>	<u>4,242.2</u>
Current liabilities		
Content	2,676.9	2,319.4
Current tax	136.7	202.1
	<u>2,813.6</u>	<u>2,521.5</u>
	<u><u>12,897.3</u></u>	<u><u>9,226.3</u></u>

Extract from risk report in Couchweb's Annual Report

Risk factors	
Competition	We face strong competition in the market for our existing products. There are always new companies opening up in Couchweb's key markets. There is always the threat that competitors could come up with a new product that would make them more appealing to customers.
Investment in new innovations	Couchweb must continue to invest in the development of product improvements and replacements. There can never be any guarantee that such investments will be profitable.
New technologies	Couchweb's core business activities centre on seeking out opportunities in the advanced technology industry. The employment of skilled staff to lead the development of these new technologies creates constant pressure for the company, particularly because we are always competing to retain such experts.
Copyright Piracy	Couchweb faces the continual threat of piracy. More advanced attempts at piracy have led to Couchweb making large investments in counter piracy initiatives.
Litigation	There are a number of ongoing lawsuits. None of which has an outcome that is known with any certainty. As Couchweb has grown the number of litigations has also grown. At the moment none of this ongoing litigation is regarded as serious.

Couchweb's share price



Mayland Independent News

TV awards surprise

Last night the Mayland TV awards were held at the fabulous Glitz hotel.

Many people were surprised when the overwhelming winners of the Best TV Series was Couchweb's budget series The Politics Game.

This series is watched by millions of people worldwide and has overtaken all other TV series for viewer numbers. It is made for a fraction of the budget of many mainstream TV series.

This is a fantastic achievement for Couchweb.

Megan Carter, one of the show's stars, made an emotional speech about the excellence of the show's scripts and praised the 'geniuses' at Couchweb who had created such an innovative programme concept and then had the courage to put it into production.

Mayland Independent News

Regulators targeting internet broadcasters

Gina Longe, the Chief Executive of the Mayland Broadcasting Authority, called for clarity over the law relating to streaming media content. At present, the law grants her organisation the right to monitor and license the activities of broadcasters who transmit content over the airwaves, but not content streamed over the internet.

Technically, the law states that companies such as Couchweb and its many competitors are providing a 'digital service'. Technically, they are not broadcasters.

Ms Longe pointed out that this situation creates a number of anomalies. For example, many traditional television broadcasters have websites that enable viewers to watch content that has already been broadcast. In theory, a programme could be banned from broadcast under Mayland law, but could be made available for streaming through the broadcaster's website.

The global nature of the internet also raises concerns. Mayland's law regulates broadcasts over the airwaves that can be received within the country's borders. It is far more difficult to monitor and control content that is accessed through the internet.

Mayland Local

TV stops train wifi

Many commuters were disappointed yesterday when the onboard wifi connections on their trains could not cope with the greater than normal demand. Mayland Rail's IT manager blamed the recent release of season three of Couchweb's hit TV programme The Politics Game. So many passengers attempted to stream the show during the morning and evening rush hours that internet connections became erratic.

Mayland Rail apologised to passengers, but pointed out that it would be impossible to provide sufficient bandwidth to cope with large numbers of passengers streaming media on every train.

Mayland Local

Mayland Mum's Fury.

Maisie Dexter had a shock when her mobile phone bill had unexpected charges of M\$2,000 for data connections when she returned from a family holiday in Otherland.

Maisie's four year old son had been using her phone, without her knowledge, to stream the popular children's series Pink Frog. He had taught himself to operate the Couchweb app on her phone.

A spokesman from Maisie's phone company was unsympathetic. He pointed out that she could have disabled international data roaming before she left.