STRATEGIC CASE STUDY MAY 2018 EXAM ANSWERS

Variant 1

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SECTION 1

Requirement 1 – strategic relationships

Couchweb has failed to meet the needs of these key stakeholders, which has led to the loss of programming and uncertainty in the financial markets.

We provided Pinto Studios with a source of revenue from the programming that it created. Movies and TV programmes could be licensed to us for a period, presumably at a premium, before being distributed through conventional channels such as DVD sales and broadcast on conventional terrestrial and satellite television. We have clearly lost sight of the fact that the greatest barriers to entry for competitors are the availability of high-quality content and the means to attract new subscribers. There is very little to prevent any of the major studios, including Pinto Studios, from streaming their own content in competition with Couchweb. The only infrastructure required is a website located on a server that has sufficient bandwidth. Potential subscribers will be aware of Pinto Studios' movies from the publicity from their cinema runs and will recognise new seasons of their favourite TV programmes.

Market analysts earn their living from offering informed advice on the purchase or sale of shares in the companies that they take an interest in. Couchweb appears to have permitted 24 hours to pass already without briefing the analysts who are interested in media companies and seems to be allowing a further 24 to pass while the Board considers its response. In the absence of a reassuring response from Couchweb, the analysts will have to rely on the news that they have received from Pinto Studios, which is undoubtedly damaging to Couchweb because, at the very least, the new streaming service will be a direct competitor to Couchweb that could lure away subscribers. Couchweb should have briefed the analysts immediately after Pinto Studios' announcement, to ensure that the analysts were aware of the implications from Couchweb's perspective. For example, it would have been ideal if Couchweb could have briefed the analysts on the contingency plans that it had in place for dealing with this loss of content and for dealing with the possibility that other major production companies could follow Pinto Studios' lead.

News is published quickly, with online versions of newspapers and 24 hour news channels. The business press needs to be able to publish informed and verified stories as and when they are still current. Pinto Studios' announcement would have been a major news story when it was first announced and editors would have been keen to address as many issues as possible in order to make readers feel well informed. Couchweb should have used the notice that it had to prepare its own press release ready for distribution as soon as Pinto Studios released its announcement. Had it done so, Couchweb's confident response would have been part of the initial story, while it was still current, and so it might have helped to reassure analysts, shareholders and even subscribers. Couchweb's delay will mean that news editors will be far less interested in publishing the company's response and so much of the potential benefit will be lost.

Requirement 2 – implications of reduction in share price

The share price is a very visible indicator of the market's expectations of future successes or failures. A decrease in share price suggests that the market has less confidence in the company's future than it had before. The downturn in confidence could be reinforced by shareholders selling their shares, thereby driving share prices down further and provoking further unrest. This could have adverse implications for the directors' careers because they may be viewed as having failed to prevent this setback from occurring. The directors will also suffer a loss of wealth through their personal ownership of shares in Couchweb.

The decrease in share price may prove temporary and have very little real significance for the Board. There could be astute investors who sold shares immediately after Pinto Studios' announcement because they expected other market participants to overreact. Those investors' intention would be to wait for Couchweb's price to fall before buying their shares back at that reduced price. When those speculators believe that the price has reached its bottom they will start to buy, which will be interpreted as a positive sign and will push up the share price. These movements will have no ongoing significance for the Board, other than serving as a warning to ensure that the market has sufficient information to set Couchweb's share price at a realistic level.

If the decrease in share price persists then Couchweb's cost of equity has effectively increased. This implies that future growth will be restricted by the need to seek a higher return from investment projects, which will inevitably mean that fewer such projects will proceed. The stock market will essentially be telling Couchweb's Board that it regards the company as a riskier investment than it did before and that it requires an increase in the rate of return. Future share issues will be less attractive, partly because more shares will have to be issued to raise any given amount of cash and that will dilute the existing shareholders' investment.

If the share price remains depressed, then the directors' job security may be undermined. One possibility is that the shareholders will seek to replace the directors when they offer themselves for re-election. That threat could put the directors under pressure to offer short-term improvements and savings, even though those are not entirely in Couchweb's long-term interests. The directors may even be concerned that the low share price will create the possibility of a takeover by a rival business that can offer the shareholders a premium over the present market price. In that case, the new owner would undoubtedly replace Couchweb's Board.

SECTION 2

Requirement 1 – SWOT analysis

Strengths

Couchweb has considerable experience of making TV programmes that are successful in terms of viewing figures. It has been able to develop ideas using its extensive database of subscribers' viewing habits.

Weaknesses

Couchweb is unlikely to have the resources to make sufficient programming to meet all of its needs. It relies on third party studios to provide it with big-budget TV programmes and movies that provide variety alongside the more unconventional content that it generates for itself.

Opportunities

Pinto Studios may have to reduce the fees for licensing its TV programmes and movies because they will already have been broadcast on its own streaming service. If Couchweb can retain its existing subscribers and can acquire content more cheaply then its profits may increase.

Threats

The other major studios could follow Pinto Studios' lead and could leave Couchweb struggling to compete in terms of presenting the latest content. It will be more difficult to retain subscribers if Couchweb offers relatively little content that has not been seen elsewhere.

Pulling these observations together, Couchweb has strength in the area of creativity and programme development, but is exposed in terms of maintaining a ready supply of programmes into the medium-term future. Both suggest that growth through acquisition would be the way forward.

Couchweb's skillset already includes the ability to develop new programme ideas and to work with production companies to get them ready for broadcast. These ideas can be developed quickly if Couchweb acquires production companies as going concerns. Couchweb does not necessarily have the skill or longstanding reputation to attract experienced production staff and so it may be more efficient to buy companies with a view to exploiting Couchweb's skills. Any differences in approach that arise because of the acquisition of existing teams of programme makers could also inject some variety into Couchweb's programming and reduce the risk that the formats will become stale.

Couchweb cannot afford to allow its production company to grow organically because it needs to consider the replacement of Pinto Studios' content as a matter of some urgency. Creating a whole season of a TV programme takes months to complete and Couchweb will start to run short of new content in about six months. Acquiring existing production companies will give Couchweb access to production staff and facilities that would take time to gather through recruitment and organic growth. It is also worth noting that subscribers expect to be able to watch the whole season of a new TV programme immediately and so there is little scope to make the first few episodes and broadcast those at weekly intervals while the remainder is being produced.

(Note: Credit will also be given for an appropriate alternative argument provided it is supported by an acceptable SWOT analysis.)

Requirement 2 – Creative Director

The appointment of a Creative Director to the Board would create a very clear focus on the importance of developing innovative and interesting programmes. Couchweb has already had some success that can be attributable to its skill in identifying new types of programmes that appeal to viewers and bringing in a Creative Director could build on that. For example, leading script writers and producers may be encouraged by the fact that this appointment will show that Couchweb encourages creativity. Hopefully, the Creative Director will also have the skill to develop new directions for Couchweb's programming at a strategic level.

Couchweb's mission and vision are focused on content that entertains audiences. The present Board is more focused on commercial skills and distribution. A Creative Director would be able to devote time and energy to creating and buying the best content. At present, the development of programming has been reactive, by focusing on past viewing habits. A Creative Director should be able to draw upon the existing data to inspire innovation, with a view to pushing the entertainment value of the content forward.

Care will have to be taken in this appointment though, because there could be scope for conflict. The existing Board has been successful in delivering phenomenal growth to date. Subscribers must be reasonably happy with existing content or the production companies would not be continuing to create it. It may be that subscribers have enjoyed some of Couchweb's productions because they are different, but they may become bored with these new genres. Couchweb's primary skill is in selling and distributing content and it is probably too early to tell whether it should focus heavily on competing with the major production studios.

There is also the risk that the newly appointed Creative Director will focus on the development of programming that has artistic merit, but that does not necessarily interest subscribers. The new director may be concerned that his or her reputation could be undermined if Couchweb's programmes are not respected by critics. There could also be a danger that production and acquisition decisions will be based on a single person's taste, which may lead to a loss of subscribers if programmes start to become boring and repetitive. It may be more effective simply to offer a wide selection of programmes in the knowledge that every subscriber will find something of interest.

SECTION 3

Requirement 1 – reassuring lender

We should start by identifying the bank’s concerns. Couchweb has very little in the way of tangible assets that could be pledged as security and its intangible assets are unlikely to be transferrable, so have little value as security. Couchweb is already highly geared and so any future borrowings will compete with existing debt in the event of a default. Couchweb has a large cash balance that has actually increased since last year, but the company owes far more in current liabilities for content and so much of that cash may already be committed. The bank loan will be used to invest heavily in the creation of further programme content, which will have little value as collateral.

Couchweb could start by reviewing the position of the media companies that it intends to acquire. They may have tangible assets in the form of studios or equipment that can be pledged as security in support of this loan. Alternatively, Couchweb will have to demonstrate that it has a business plan that will enable it to service this loan without going into default. A realistic cash budget should be prepared with an explicit statement of the assumptions and estimates that underpin it. Couchweb could demonstrate its confidence in those forecasts by offering the bank ongoing reports of its progress, giving the bank the right to foreclose in case of unplanned deterioration in its cash position.

Requirement 2 – negotiation with Mayland Broadcasting Authority

The negotiation will be complicated by the fact that Couchweb's status as a broadcaster is unclear. Couchweb could claim that it is merely a "digital service" and that it is not entirely subject to Mayland Broadcasting Authority. If the Authority manages to impose its authority then Couchweb could argue that it faces competition from other streaming companies, such as Homevideo, as well as conventional terrestrial broadcasters and satellite television providers. It is unlikely that Couchweb will be able to eliminate those competitors altogether because their business models are different. For example, terrestrial broadcasters offer news and other factual content and so audiences will always have some incentive to tune in.

Couchweb’s creation of its own content may displace some of the material that is presently purchased from the major production studios, but that content will then become available for purchase by competing broadcasters. Arguably, Couchweb’s decision to make more of its own programmes will give subscribers a wider choice of programme content if terrestrial broadcasters are able to buy content that Couchweb would previously have taken.

It will be very difficult for Couchweb to abuse its position by increasing subscription prices because doing so will encourage fresh competition. There are relatively few barriers to entry to online streaming provided any new entrant has access to content. If Couchweb increases its subscription prices then it will simply make it more desirable for the other major producers to follow Pinto Studios into creating their own streaming companies.

It could be argued that Couchweb’s decision to increase its own programming output is in direct response to competitive pressures that would otherwise threaten the company’s existence and so potentially reduce consumer choice. Pinto Studios has the potential to become a major presence in this market and it plans to make 100% of its own content, so Couchweb is hardly in a unique position.

Requirement 3 – economic variables

Couchweb is committed to paying a variable rate loan, denominated in a foreign currency. The cost of this finance will be affected by changes in interest rates charged in Lorovia. These rates could change in response to pressures associated with the Lorovian economy, such as a desire to attract investment or to stimulate economic activity.

The cost of borrowing will also be affected by exchange rates. If the L$ strengthens against the M$ then the annual interest payments will become more onerous, even if rates remain constant. The exchange rate will also affect the value of the principal owed, which is another source of gain or loss.

In theory, there could be an interaction between exchange rates and interest rates that will tend to cancel these impacts. Interest rate parity theory implies that the higher interest rates in Lorovia should be viewed as a sign that the L$ is expected to fall in such a way that the total cost of borrowing is the same in both M$ and L$.

While interest rate parity theory has some economic logic, there can be no guarantee that it will cancel out the currency effects of borrowing in L$. There could be factors at play, such as government policy, that might interfere with the economic mechanisms and so Lorovias' interest rates could remain artificially high. There is also no guarantee as to the timing of any movement in exchange rates, so the value of the L$ may remain higher than anticipated at the time of the repayment of the principal

Requirement 4 – currency risks

It would be ideal if Couchweb could deal with this risk through some form of internal hedging. That could be relatively simple if Lorovia is one of the many countries where Couchweb has a large number of subscribers. The subscriptions in that currency could be banked locally and used to pay interest over the term of the loan. Given that Couchweb holds substantial cash reserves anyway, it may even be possible for the company to accumulate L$ over time with a view to repaying at least part of the debt in that local currency.

The alternative might be to arrange a currency swap, whereby the commitments to pay interest and capital are exchanged with a third party that requires to raise an equivalent loan in M$. Couchweb would essentially be looking for an intermediary that would be prepared to arrange such a swap interest, which could be difficult given the size of the loan and the time period. There could be quite significant costs associated with arranging such a swap, in terms of professional fees and bank charges. There could also be a risk of default, leaving the risk uncovered, in the event that the counterparty is unable to meet its commitments.