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# Answers

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**1 (a) (i) Introduction**

2Tel is one of the largest network operators in the world. It is aware that licences for providing mobile networks in The Federated States (TFS), a densely populated country with 70 million people, are due for renewal in three years' time. It is currently evaluating whether it wishes to bid for one of these licences, either in its own right, or through the prior acquisition of one of the current licensees.

It has commissioned this briefing paper into the business environment which the current licensees operate in. This briefing paper begins with an analysis of the wider macro-environment of the industry, using a PESTEL analysis. The paper then considers the competitive forces within the industry using aspects of Porter's five forces framework.

The briefing paper concludes with, as requested, a summary of the opportunities and threats which 2Tel should consider before it decides to enter this market.

**Political perspective**

Licences are granted by the government for eight years and so it may, at first sight, appear that licence allocation is an important political factor in the mobile network industry. However, the previous government effectively de-politicised the awarding of licences by defining selection rules based on certain minimum criteria (for example, financial and environmental criteria) and the size of the bid. The licences are awarded to the four highest bidders who fulfil the minimum criteria. So, the current performance of licensees is not currently taken into account in the bidding process. This has implications for 2Tel. From a political perspective, there is no particular benefit to be gained by bidding as a current licensee. The praise of Ofnet and the gratitude of the government for the network operators' phone and message information used to convict offenders in the recent riots count for nothing in the selection process. At present, under the current rules, 2Tel has as much chance of winning a licence in its own right. Indeed, this is reflected in Professor Tan's research and his suggested bid success probabilities.

However, it has to be recognised that the selection criteria are politically decided and so there is a possibility that the current government will change the selection rules before the licences come up for renewal. Issues with the current scheme have already been recognised and it has been agreed that companies who fail to retain their licence will be paid an exit fee of \$100m. This will mean, for example, if 2Tel wins one of the licences in its own right then it will have to compensate the company which has lost the licence. Thus there will be a \$100m fee for new entrants, which is additional to the bid for the licence. Furthermore, a possible change in selection rules raises at least two issues. Firstly, the government could change the rules so that incumbent licensees were favoured (as long as they have performed effectively) and so there would be a benefit to be gained from acquiring a current licensee. Again, this has been recognised in Professor Tan's research and his allocation of bid success probabilities. There appears to be some support for this change of rules within the government. One government minister has suggested that 'the help provided to us (by the network operators) during the recent riots, should be acknowledged in some way'. Secondly, in an attempt to raise more money to address the national debt, the government could decide that more than four companies should be licensed in the future, increasing competition in the sector and raising more income for the government. This might affect the profitability of the existing licensees.

A very significant political issue is the presence of a regulator (Ofnet) in the sector, who particularly focuses on pricing, service availability and service transfer. The prices of all the four licensees are negotiated with the Ofnet regulator and, consequently, the prices of all four networks are very similar. Ofnet also requires the four licensees to have arrangements in place which allow customers to easily transfer from one network to another. Ofnet has generally praised the performance of all four licensees, except in this last area. It has suggested that it is still too difficult for customers to move network provider, and it intends to bring in regulations which make it easier. Fines will be imposed on networks which do not follow these regulations. The powerful role of the regulator is of particular significance to 2Tel. 2Tel has traditionally operated in countries where there is little or no government regulation of network operators. In these markets prices can be largely determined by the company itself, free from external influence.

**Technology of mobile networks**

Two aspects of technology are important to licensees operating in TFS. Firstly, innovations in mobile telephone technology are very important to the network licensee because, as well as encouraging the use of the network, new products also tend to make greater demands on those networks, in terms of speed and bandwidth. Thus there is need for continual investment in the network. Secondly, this investment includes a need to continually review the technology and configurations available for constructing and supporting the network itself. There is a need to invest in new technologies and technical configurations which offer greater speed, reliability and, if possible, lower costs. However, it has to be recognised that both of these technology factors are not unique to TFS, and are likely to be even more significant in markets which 2Tel is already competing in.

**Sociocultural and economic considerations**

The possession of a state-of-the-art mobile device remains an important status symbol in TFS. Having the latest features and applications is important to people and so devices are regularly upgraded, hence having features which place significant demands on the network, as discussed in the previous section of this report.

The role of the mobile phone network in assisting organised crime and civil disobedience has posed dilemmas for the network operators. On the one hand, they have been praised for their good citizenship in passing relevant information to the police. However, on the other hand, they have been criticised by civil liberties bodies for making this information available. An influential newspaper, whilst recognising the contribution of the networks to apprehending offenders, also criticised them for not withdrawing the networks at the height of the riots. 'Instead of helping catch offenders, the networks, by making their services unavailable, might have prevented the offences in the first place.' 2Tel has to be aware that TFS is an increasingly socially fragmented country with vocal minority groups representing a wide range of pressure groups and communities.

One of the licensees is currently subject to legal action where people are suing the company for releasing information to the government. The company, and the information it holds, is subject to the Data Protection Act, which exempts information held to prevent or aid the detection of crime, but lawyers for both the company and the offenders are confident of success when the case comes to court.

The election of the current government was prompted by a belief that its policies would address the five years of economic decline presided over by the previous government. In general, the population is suffering from high unemployment, static incomes and, more recently, increased taxes and removal of benefits (this measure provoked the riots already discussed) imposed by the austerity government. However, these economic problems do not appear to have any discernible effect on the use of mobile devices. During this five-year period of decline, the use of the mobile networks has increased significantly. This may, of course, be partly as a result of the regulator, who can reasonably be assumed to exerting a pressure to keep prices low. However, it must also be some reflection of the importance which the population as a whole places on mobile phones and being able to make mobile calls. It is seen as a necessity, rather than a luxury.

### **Legal and environmental issues**

Reference has already been made to the Data Protection Act (sociocultural) and regulation from Ofnet (political). TFS has many laws which are enacted within a complex and expensive legal system. Employees are expensive to employ and are difficult to dismiss. Furthermore, legal outcomes are difficult to forecast due to the unpredictable conduct of judges.

Like all companies operating in TFS, the network operators are expected to comply with environmental regulations. However, environmental issues are more an issue for the mobile phone manufacturers and the environmentally-friendly disposal of these mobile phones is an ongoing problem for the manufacturers, but this is not a problem for the network operators.

- (ii) Importantly, from a Porter's five forces perspective, there is no threat of new entrants into the industry during the licence period. However, at the end of the licence period, anyone who meets the bidding criteria can potentially be allocated a licence and enter the market place. So, the licences are an effective barrier to entry during the licence period. At bidding time, it is access to capital which forms the largest barrier to entry, as the success of the bid (at present) is largely determined by the size of the bid. This access to capital is particularly significant to potential new entrants as they will potentially be required to pay a \$100m entry premium.

Again, from a five forces perspective, the policy of Ofnet to make network transfer relatively easy theoretically increases the bargaining power of customers, and this should exert a downward pressure on prices. Customers are tied into annual contracts, but it should become increasingly easy for them to transfer supplier with no switching costs. At present, evidence suggests that few customers do actually change operators. This may be because of the difficulty of switching (which is the view of the regulator) or it may be because no great price advantage can be gained by switching provider. Evidence suggests that most move due to poor service or poor reception in their geographical area. The fact that mobile charges are so similar between the four rival companies (mainly due to the regulator) means that there is little incentive to move on price grounds.

Porter's five forces framework has competitive rivalry at its centre. When considering competitive rivalry within the industry, there are certain factors which should contribute to vigorous competition; for example, low switching costs and undifferentiated products. However, competition is limited to four similar size companies competing in a growing market place which is subject to price regulation. Competition on price grounds is very difficult because of the activities of the regulator, who is keen to satisfy the government's wish for no supplier to dominate the market. Thus competitive rivalry is restrained and, to some extent, controlled and competition is based largely on coverage, service, and brand image. It is likely that if one supplier did begin to dominate the market, then the regulator would impose rules to re-balance competition.

At present, it is difficult to envisage any threat of substitute products to the mobile networks. Even the threat of 'doing without' seems unlikely, given people's increased dependence on the mobile phone.

- (iii) The conclusion of this briefing paper is, as requested, a summary of the opportunities and threats associated with this market.

### **Opportunities**

The relatively imminent re-licensing of mobile networks provides a significant business opportunity. This business is then largely protected (within constraints imposed by the regulator) for eight years. The licences provide an effective barrier to entry.

Despite the economic decline of the country, sociocultural trends suggest a buoyant demand for network services. As mobile products become more sophisticated, it seems reasonable that this demand will continue to increase for the foreseeable future. There appears to be very little threat of substitutes to the mobile network and people are reluctant to 'do without'.

The current licensees acknowledge that technology has to be continually updated. 2Tel is an acknowledged technology leader with expertise in markets which are, at least, as demanding.

### Threats

There is a concern that the government will change the licensing bidding criteria, to favour incumbent licensees, before the next granting of licences. This would be a threat to 2Tel's chance of entering the market in its own right.

The market is highly regulated and pricing has to be agreed with a regulator. 2Tel is inexperienced in working in such an environment and it may be seen as a threat to 2Tel's independence and also to its long-term profitability.

The legal framework in TFS is burdensome and legal outcomes are, to some extent, unpredictable. Threats of legal action and the effects of social disruption may lead to 2Tel to conclude that TFS is not a particularly attractive market to enter. There are threats associated with political interference, public criticism, legal action and legal compensation.

## (b) Scenarios

Developing scenarios is particularly appropriate where there is a high level of uncertainty and so it is impossible to build a single view of how environmental influences might affect an organisation's strategy. The case study scenario is dominated by two very significant environmental factors. The first is the bidding rules for the mobile technology licences. These rules are decided by government and current rules do not favour the current licensees. However, there is evidence that the government is moving its position on this and it has already introduced one measure which will help current licensees, the payment of a \$100m exit fee to licensees who fail to get their licence renewed, to be funded by an extra entry fee by the successful licensees. The other factor is the price which competing companies are willing to pay for the licences.

2Tel wishes to evaluate the two options of bidding for a licence. The first option is to acquire T-Me, one of the current licensees. The second option is to bid directly for a licence. It wishes to consider four scenarios.

- (1) Acquire T-Me and then failing to gain a licence.
- (2) Acquire T-Me and then gaining a licence.
- (3) Bidding directly for a licence as 2Tel and failing to gain a licence.
- (4) Bidding directly for a licence as 2Tel and gaining a licence.

### Buying T-Me

Buying T-Me offers a number of advantages:

- (1) If bidding rules are changed to favour current licensees, then 2Tel (through T-Me) has a better chance of being granted a licence. Research by Professor Tan shows that in countries where current licensees are favoured, then a current licensee has a 0.6 probability of being granted a licence, compared with probability of 0.2 for new bidders.
- (2) T-Me has experience of the bidding process in TFS. It has been suggested that the cost of putting the bid together (bid cost), will be half that of a new inexperienced bidder.
- (3) T-Me is experienced in working in the TFS culture and with the people of TFS. It is a country which is heavily regulated and T-Me has worked effectively with the industry's regulator (Ofnet) over the period of this licence. 2Tel does not have experience of operating in a heavily regulated environment. Its main networks are in countries where regulation is weak or non-existent.
- (4) There are short-term opportunities for improving the financial performance of T-Me. 2Tel has suggested that it can raise net profit to \$100m per year in the final two years of the contract. This appears to be a very reasonable target. The figures in Table One suggest that T-Me's net profit margin is currently 11.42%, the lowest of the four competing companies. A net profit of \$100m (on current revenue) would bring the net profit margin up to 14.29%, still below the average industry performance of 14.7%.

2Tel has been informed that they may be able to acquire T-Me for \$400m. Their research (conducted by Professor Tan) suggests that the next eight-year contract can be won for \$550m and that a net profit of \$120m can be driven out of the company for the next eight years. Here is an analysis for the two scenarios which require the purchase of T-Me. All figures are in \$million.

Buy T-Me and fail	Outflows	Inflows
Purchase of T-Me	400	
Bid cost	10	
Net profit (2 years)		200
Exit income		100
Total	410	300
Net gain (loss)		(110)

Buy T-Me and gain	Outflows	Inflows
Purchase of T-Me	400	
Bid cost	10	
Contract fee	550	
Profit (2 years)		200
Profit (new contract)		960
Exit income (Note 1)		100
Total	960	1,260
Net gain (loss)		300

(Note 1) Assumes exit at the end of the licence period and that this exit income is still at current levels.

### Bidding directly for a licence

Bidding directly for a licence has a number of advantages:

- (1) If bidding rules are not changed, then 2Tel has the same probability of successfully gaining a licence as T-Me.
- (2) One of T-Me's competitors is currently in a legal dispute concerning the disclosure of information to the government. If they lose this court case (and many anti-government judgements are being made at present), then successful claims may be made against the other network operators. Bidding directly for a licence avoids any potential legal costs associated with contesting claims and compensating potential claimants.
- (3) It avoids the cost of purchasing T-Me. There are likely to be significant costs associated with performing due diligence on T-Me and negotiating and finalising the acquisition.
- (4) It avoids having to impose organisational change at T-Me in an attempt to drive out short-term improvements in net profit. 2Tel has estimated that it can increase net profit to \$100m per annum. It does appear to have a successful acquisition record, but it also has to be recognised that there is significant evidence to suggest that planned performance improvements in acquired companies are often not realised, particularly in the short term.

Here is an analysis of the direct bidding scenarios.

Bid and win	Outflows	Inflows
Bid cost	20	
Contract fee	550	
Exit fee (payable to losers)	100	
Profit (new contract)		960
Exit costs (Note 1)		100
Total	670	1,060
Net gain (loss)		390

<b>Bid and lose</b>	20	
Net gain (loss)		(20)

(Note 1) Assumes exit at the end of the licence period and that this exit income is still at current levels.

### Analysis

From the perspective of risk aversion, the bidding directly for licences appears the best option. Potential losses are minimised (\$20m, compared to \$110m) and potential returns maximised (\$390m compared to \$300m). If expected values are used which represent the current bidding rules, then this conclusion remains valid.

Scenario	Net gain (loss)	Probability	Expected value
Buy and lose	(110)	0.6	(66)
Buy and win	300	0.4	120
Bid and win	390	0.4	156
Bid and lose	(20)	0.6	(12)

The buying option has a net expected gain of \$54, compared to a net expected gain for the bid option of \$144m.

However, if the bidding rules are changed to favour the incumbent, then the buy option has a greater expected return (\$136m compared to \$62m).

Scenario	Net gain (loss)	Probability	Expected value
Buy and lose	(110)	0.4	(44)
Buy and win	300	0.6	180
Bid and win	390	0.2	78
Bid and lose	(20)	0.8	(16)

However, a number of issues have to be raised.

- (1) The statistical probability values for the changed bidding rules are based on research conducted in other countries where bidding is biased towards the current licence holders. These may not be appropriate for TFS. They could be too high or too low.
- (2) Expected values are really more appropriate for a series of decisions, where, over time, the return will tend towards the expected value. The actual values will occur (subject to forecast errors) – not the expected ones.
- (3) The bid price of \$550m is itself an estimate and the probabilities of bid success only relate to this bid price. The analysis might suggest that a higher bid is made, which should have a higher probability of success. For example, a direct bid of \$750m from 2Tel would still lead to a net profit of \$190m for the contract – a return of over 20%.
- (4) No probabilities have been attached to the chance of the government changing the selection rules before the next licences are allocated.

2Tel might also like to take a second look at the buy and lose option. The unattractiveness of this scenario is largely due to the proposed purchase price of T-Me. It may be possible to reduce or restructure this price, or both. For example, the company could offer \$290m now, and \$110m on successful gaining of the next contract. However, the possible compensation claims are problematic. They are difficult to predict and at this stage, it would seem unlikely that they can be insured against (risk transfer).

### Conclusion

Under the current licence allocation arrangements, the agreed price for T-Me is too high, given the risks involved. So, the recommendation is to bid directly for the licence. However, if the purchase price for T-Me could be re-negotiated or re-structured, then there are advantages of acquiring T-Me and using this as a vehicle for the bid.

However, if the bidding rules change to favour the incumbent licensees, then purchasing T-Me becomes the preferred approach from a financial perspective. However, the spectre of possible compensation payments remains and these might be powerful enough to still persuade the board of 2Tel that a direct bid, unencumbered by the past, might still be preferable, even though the chance of winning the licence might be reduced.

- 2 (a) Here is a monthly analysis of the data given in the scenario.

Product	A	B	C	D	Total
Production (units)	2,000	5,500	4,000	3,000	
Unit marginal costs					
Direct materials	3	5	2	4	
Direct labour	9	6	9	6	
Variable production overheads	2	3	1	2	
Variable cost per unit	14	14	12	12	
Total monthly variable cost	28,000	77,000	48,000	36,000	
Fixed monthly overheads	4,000	4,000	4,000	4,000	
Total in-house monthly cost	32,000	81,000	52,000	40,000	205,000
Buying costs per unit	11.5	16.5	12.5	13.5	
Total monthly buy in cost	23,000	90,750	50,000	40,500	204,250

The data suggest that only products A and C can be sourced more cheaply through outsourcing. Products B and D can be produced more cheaply in-house.

If products A and C are sub-contracted, the company would then have spare capacity. There is no evidence from the scenario that there is any demand for further production for B and D. More research has to be conducted to see if, in fact, production capacity is a limiting factor at the company and can be effectively utilised to produce more of B and D. If this is the case, then there would be a powerful argument for outsourcing A and C.

The reaction of the company's workforce also has to be taken into consideration. If production of B and D cannot be expanded to take up the spare capacity, then redundancies may be required and so strike action may take place as a result of an industrial dispute. Evidence also suggests that products A and C require more labour intensive processes. So even if spare capacity is used up, demand for labour would reduce. There are also likely to be costs associated with redundancies which do not appear to have been taken into consideration.

The company has no experience in managing an outsourced supplier and ensuring that supplied products are of the required quality. Contractual terms will have to be established for specifying the terms of supply and for specifying service level agreements and penalties for failing to supply. Quality acceptance criteria will have to be established and a process set up for formally accepting the products produced by the outsourcer. This management of the outsource supplier will require one-off and continuing costs which do not appear to have been factored into the proposal.

The company has always advertised itself as producing locally in the region. It is part of their marketing campaign and an attraction to local customers. Sourcing the products through geographically remote outsourcers invalidates the marketing message and may also lead to adverse customer reaction. The company needs to understand the reasons why customers buy its products in the first place before it makes such a decision.

The justification for outsourcing product C is purely made on the saving of fixed costs attributable to its manufacture. The variable production cost of C is actually less than the buy-in cost (\$48,000 compared with \$50,000), but the addition of the fixed overhead makes the outsourcing option cheaper. There are two issues here: the reliability of this estimate of fixed costs and the likelihood that these savings can be delivered by management when the production of the product is outsourced. It seems unlikely that all four products will have exactly the same direct effect on fixed costs; it looks more like an arbitrary figure. Furthermore, on many occasions, fixed costs savings do not actually materialise. Management fails to deliver.

Finally, the outsourcing prices offered may depend upon outsourcing the whole of production to Tinglia. If this is the case, then the outsourcing option is very slightly cheaper (\$204,250 compared with \$205,000) but this again depends upon the reliability of the fixed overhead data and the ability of management to save these fixed costs once production is outsourced. The cost of shutting the production capacity in Yvern and employee redundancy costs also have to be taken into consideration.

### Summary

The decision to make or buy certain products should not be taken on cost savings alone. The company has considerable experience of making the products and the location they are produced in appears to be important to both the company (from its marketing message) and its customers. In contrast, the company has no experience in outsourcing and managing outsourced providers. In addition, the new managing director's assertion that 'all four products can be produced more cheaply by the supplier in Tinglia' is ambiguous. If he means that the products can be made more cheaply in Tinglia *if all four products are outsourced*, then he is just about correct, although data on overhead costs would have to be reconsidered and other costs associated with outsourcing investigated. However, if he means that all products can *individually* be produced more cheaply in Tinglia, then he is clearly incorrect. Products B and D can be produced more cheaply in-house. However, partial outsourcing may lead to spare labour and machine capacity issues in the factory in Yvern.

- (b) The managing director states that he wishes to follow a generic strategy of *cost leadership*. However, it seems likely that he has misunderstood the term or that he is knowingly using it as a euphemism for cost reduction. His slide missed out important information.

Target	Strategic advantage	
	Low cost	Unique
All customers	Cost Leadership	Differentiation
Market segment	Cost Focus	Differentiation Focus

A generic strategy of cost leadership means being the lowest cost producer *in the industry as a whole*.

It seems unlikely that the company can pursue such a strategy. It has larger rivals (who will be able to obtain better economies of scale) both within the region and within the country as a whole. There is no evidence of technical advantage, and indeed the managing director has commented on outdated information technology. There is no suggestion, either, of other factors which would allow the company to achieve cost leadership, such as having favourable access to sources of supply, or raw materials or labour.

A differentiation strategy assumes that competitive advantage can be gained, in the industry as a whole, through particular characteristics of a company's product. Companies which pursue such a strategy worry less about costs and seek, instead, to be perceived in the industry as unique. For example, the product may be innovative or superior in some way. Again, this does not appear to apply to YTR, in the context of the industry.

Both cost leadership and differentiation require superior performance, which does not appear to be a characteristic of YTR.

A focused or niche strategy takes place when a firm concentrates its attention on one or more market segments or niches. In doing so it could aim to be a cost leader for a particular segment. This is the cost focus strategy identified in the managing director's slide. This is often associated with an environment where 'broader scope' companies exhibit an element of over-performance, offering a particular segment much more than it wants, at a price which reflects this. This may be a possible strategy for YTR if their products are largely indistinguishable from other producers in Yvern. However, outsourcing production does not appear to be the right way of pursuing this strategy.

Alternatively, a company might pursue differentiation for a particular segment; a differentiation focus strategy. This strategy seeks to provide a perceived high quality product to a selected market segment or niche. Such products may be heavily branded and sold at a substantial price premium. There is evidence to suggest that YTR has a strong brand and meets a demand for regional, locally produced products.

A better strategy for YTR is focus, where it can serve a particular niche where it can largely insulate itself from the competition. Porter suggests that a company must pursue one of these strategies. Both cost leadership and differentiation require superior performance and some form of focus strategy is easier, as it is simpler to dominate a niche market.

### 3 (a) Objectives and scope

From the perspective of the 'traffic lite' project, the change in mayor has led to an immediate change in the objectives driving the project. This illustrates how public sector projects are susceptible to sudden external environmental changes outside their control. The project initially proposed to reduce traffic congestion by making traffic lights sensitive to traffic flow. It was suggested that this would improve journey times for all vehicles using the roads of Brighttown. However, the incoming mayor now wishes to reduce traffic congestion by attracting car users onto public transport. Consequently she wants to develop a

traffic light system which will give priority to buses. This should ensure that buses run on time. The project is no longer concerned with reducing journey times for all users. Indeed, congestion for private cars may get worse and this could further encourage car users to switch to public transport.

An important first step would be to confirm that the new mayor wishes to be the **project sponsor** for the project, because the project has lost its sponsor, the former mayor. The **project scope** also needs to be reviewed. The initial project was essentially a self-contained technical project aimed at producing a system which reduced queuing traffic. The revised proposal has much wider political scope and is concerned with discouraging car use and improving public bus services. Thus there are also proposals to increase car parking charges, to reduce the number of car park spaces (by selling off certain car parks for housing development) and to increase the frequency, quality and punctuality of buses. The project scope appears to have been widened considerably, although this will have to be confirmed with the new project sponsor.

Only once the scope of the revised project been agreed can revised **project objectives** be agreed and a new **project plan** developed, allocating the resources available to the project to the tasks required to complete the project. It is at this stage that the project manager will be able to work out if the proposed delivery date (a **project constraint**) is still manageable. If it is not, then some kind of agreement will have to be forged with the project sponsor. This may be to reduce the scope of the project, add more resources, or some combination of the two.

## (b) Cost benefit

The re-defined project will have much more tangible effects than its predecessor and these could be classified using the standard approach suggested in the scenario. Benefits would include:

- One-off financial benefit from selling certain car parks – this appears to be a predictable *financial benefit* of \$325,000 which can be confidently included in a cost/benefit analysis.
- Increased income from public bus use – this appears to be a *measurable benefit*, in that it is an aspect of performance which can be measured (for example, bus fares collected per day), but it is not possible to estimate how much income will actually increase until the project is completed.
- Increased income from car parks – this appears to be a *quantifiable benefit* if the assumption is made that usage of the car parks will stay at 95%. There may indeed be sufficient confidence to define it as a *financial benefit*. Car park places will be reduced from 1,000 to 800, but the increase in fees will compensate for this reduction in capacity. Current expected daily income is  $1,000 \times \$3 \times 0.95 = \$2,850$ . Future expected income will be  $800 \times \$4 \times 0.95 = \$3,040$ .
- Improved punctuality of buses – this will again be a *measurable benefit*. It will be defined in terms of a Service Level promised to the residents of Brighttown. Improved punctuality might also help tempt a number of vehicle users to use public transport instead.
- Reduced emissions – buses are more energy efficient and emit less carbon dioxide than the conventional vehicles used by most of the inhabitants of Brighttown. This benefit should again be *measurable* (but non-financial) and should benefit the whole of the town, not just areas around traffic lights.
- Improved perception of the town – the incoming mayor believes that her policy will help attract green consumers and green companies to the town. Difficulties in classifying what is meant by these terms makes this likely to be an *observable benefit*, where a group, such as the Go Green team, established by the council itself can decide (based on their judgement) whether the benefit has been realised or not.

The costs of implementing the project will also have to be re-assessed. These costs will now include:

- The cost of purchasing more buses to meet the increased demand and frequency of service.
- The operational costs of running more buses, including salary costs of more bus drivers.
- Costs associated with the disposal of car parks.
- Costs associated with slowing down drivers (both economic and emotional).

The technical implementation requirements of the project will also change and this is almost certain to have cost implications because a solution will have to be developed which allows buses to be prioritised. A feasibility study will have to be commissioned to examine whether such a solution is technically feasible and, if it is, the costs of the solution will have to be estimated and entered into the cost-benefit analysis.

- ## (c) A stakeholder grid (Mendelow) provides a framework for understanding how project team members should communicate with each stakeholder or stakeholder group. The grid itself has two axes. One axis is concerned with the power or influence of the stakeholder in this particular project. The other axis is concerned with the stakeholder's interest in the project.

**The incoming mayor:** High power and high interest. The mayor is a key player in the project and should be carefully and actively managed throughout. The mayor is currently enthusiastic about the project and this enthusiasm has to be sustained. As the likely project sponsor, it will be the mayor's responsibility to promote the project internally and to make resources available to it. It will also be up to her to ensure that the promised business benefits are actually delivered. However, she is also the person who can cancel the project at any time.

**OfRoad – a government agency:** OfRoad were critical of the previous mayor's justification for the project. They felt that the business case was solely based on intangible benefits and lacked credibility. It is likely that they will be more supportive of the revised proposals for two reasons. Firstly, the proposal uses the classification of benefits which it has suggested. Secondly, the proposal includes tangible benefits which can confidently be included in a cost-benefit analysis. OfRoad is likely to have high power (because it can intervene in local transport decisions) but relatively low interest in this particular project as the town appears to be following its guidelines. An appropriate management strategy would be to keep watch and monitor the situation, making sure that nothing happens on the project which would cause the agency to take a sudden interest in it.

**The private motorist of Brighttown:** Most of these motorists will have a high interest in the project, because it impacts them directly; but, individually, they have very little power. Their chance to influence policy has just passed, and mayoral elections are not due for another five years. The suggested stakeholder management approach here is to keep them informed. However, their response will have to be monitored. If they organise themselves and band together as a group, they might be able to stage disruptive actions which might raise their power and have an impact on the project. This makes the point that stakeholder management is a continual process, as stakeholders may take up different positions in the grid as they organise themselves or as the project progresses.

- 4 (a) There is considerable evidence to suggest that *strategic drift* particularly affects organisations which have experienced a long period of relative continuity during which strategy has either remained unchanged or changed incrementally to react to relatively minor changes in the external environment or industry. This appears to be the case at TMZ. It had enjoyed 35 years of success and growth based on contracting musical artists to its record label and recording and distributing their songs and music through an appropriate physical media. Table one shows that revenues increased continuously in the period 1965–2000. Profit margins fell during the period, reflecting problems in cost control as established musical acts took longer to produce albums and senior staff of TMZ adopted a more relaxed and indulgent approach to their artists. However, even at the end of the period, TMZ remained a profitable company.

**Table one: gross and net profit margin – 1965–2000**

	1965	1970	1980	1990	2000
Revenue (\$million)	10	70	120	150	170
Gross profit margin	40.00%	42.86%	37.50%	33.33%	29.41%
Net profit margin	30.00%	31.43%	25.00%	20.00%	14.71%

During this period, the company had reacted positively to significant changes in its environment. Sociocultural changes, represented by musical fashion and technology changes (from vinyl, through tape cassette to compact disc (CD)) had been successfully surmounted. However, such success can often lead to complacency, with the organisation continuing to pursue a strategy which progressively fails to address the changing strategic position of the organisation and this failure leads to deterioration in organisational performance. This is known as *strategic drift*.

Evidence for this strategic drift starts to emerge in 2003, four years after the launch of the first file sharing company. People within TMZ warned about the possible implications of digital downloading of music. However, senior management at TMZ had rejected this warning and believed that the drop in revenue was due to 'the wrong music, promoted to the wrong people at the wrong price'. They adopted a policy of signing new artists, increasing advertising spend and cutting CD prices. In the policy, 2003–2007, revenues dropped significantly and the company made significant losses (see table two).

\$million	2003	2004	2005	2006	2007
Revenue	165	150	130	100	80
Gross profit	45	30	10	0	(10)
Net profit	20	5	(15)	(20)	(30)
Gross profit margin	27.27%	20.00%	7.69%	0.00%	(12.50%)
Net profit margin	12.12%	3.33%	(11.54%)	(20.00%)	(37.50%)

**Table two: gross and net profit margin – 2003–2007**

Johnson, Scholes and Whittington suggest that it is important to realise why strategic drift occurs. They suggest that managers, faced with the complexities of steering an organisation, tend to look for solutions based on the *current ways of doing and seeing things*, grounded in the *existing organisational culture*. So, for example, when revenues from compact discs (CDs) started to decline, the senior managers at TMZ instigated relatively conventional responses to falling sales (increased advertising, reduced prices) and also adopted approaches which had worked before (signing new artists). These may have worked if the environmental change had not been so significant. However, what they failed to realise was that the way people were consuming music was fundamentally changing.

The realisation of performance problems is often followed by a period of flux where no clear direction is pursued. When conventional strategies failed, TMZ resorted to litigation, suing the companies who downloaded music to consumers. In effect, TMZ was attempting to preserve the status quo, trying to ensure that the market remained the same as the one they had operated in so successfully for 40 years. However, not only did this not arrest the decline of the company, it also led to problems with both performers and music fans. In 2010, with the very existence of the company threatened, management was able to define a strategy which worked with the digital download and music-sharing community, to establish a completely different business model based on licensing and ring tones.

This illustrates that a period of flux may itself be followed by *transformational change*, in which there is a fundamental change in strategic direction. TMZ re-defined its business model in 2010. It was fortunate that it had enough stakeholder investment to see it through a difficult period. In many organisations transformational change takes place too late and the organisation fails.

Johnson, Scholes and Whittington suggest that the challenge for managers is to stand apart from their own experience and organisational culture so that they are able to recognise the emerging strategic issues which they face. They also suggest that a second challenge relates to the management of strategic change. New strategies might require actions outside the scope of the existing culture. Thus people within the organisation are required to substantially change their core assumptions and their ways of doing things. The senior management at TMZ were warned about the possible effect of digital downloading, but they were unable to change their basic assumptions about how the music industry worked.

#### **(b) The learning organisation**

The point has already been made that strategic drift will take place when changes in an organisation's environment take place at a greater rate than the rate of strategic change within the organisation itself. In such circumstances, the organisation begins to be increasingly misaligned with the environment it is operating in. The challenge is to try to ensure that misalignment does not occur in the first place, but if it does, to tackle it quickly.

The likelihood of strategic drift suggests that the strategy development process in an organisation needs to encourage people to have the capacity and willingness to challenge and change their core assumptions and 'ways of doing things'. This is one of the commonly claimed principles of a 'learning organisation'.

Traditionally, organisations have been organised and structured around order and control. They were built for stability and continuity, rather than change. However, influential writers have increasingly claimed that this is unsuitable for the dynamic conditions of trading in the 21st century. They have suggested that modern society and all of its institutions are in a continuous process of transformation and to react to this we all must become adept at learning. 'We must become able not only to transform our institutions, in response to changing situations and requirements; we must invent and develop institutions which are 'learning systems', that is to say, systems capable of bringing about their own continuing transformation.' (Donald Schon)

The learning organisation is an 'ideal' towards which organisations should evolve in order to respond to contemporary pressures. It is characterised by a view that both collective and individual learning is key to organisational success. A learning organisation is one which is capable of continual regeneration based on the knowledge, experience and skills of individuals working in an organisational culture which encourages mutual questioning and challenge. It emphasises the potential capability of an organisation to regenerate from within.

Advocates of the learning organisation suggest that the collective knowledge of all the individuals within an organisation greatly exceeds what the organisation 'knows' in its formal documentation, filing and information systems. They suggest that it is the responsibility of management to encourage processes which reveal the knowledge of individuals and encourage the sharing of this knowledge. Hence the learning organisation is closely connected with the principles of knowledge management, the other strand in the CEO's policy statement. As a result of free-flowing knowledge, individuals within an organisation become more sensitive to the changes happening around them and this helps them contribute to identifying opportunities and threats in the external environment and also to them developing strategies to tackle these threats or to exploit the opportunities.

In such an approach managers play a less directive and a more facilitative role. It is easy to see the attraction of this to TMZ where the impact of digital downloading was already being discussed in 2003, but was dismissed by complacent senior management. In contrast, in a learning organisation, ideas which do not fit in with current norms are not dismissed or ignored, but acted upon. Questioning and challenging the 'taken-for-granted' is essential if an organisation is to avoid strategic drift. It helps build a resilient organisation which does not take success for granted and reinvents itself using internal capabilities to build a new business model. A new business model was eventually adopted by TMZ, but only when it was close to extinction and radical change was needed to ensure survival.

#### **(c) Knowledge management**

Johnson, Scholes and Whittington define organisational knowledge as the 'collective and shared experience accumulated through systems, routines and activities of sharing across an organisation'. Managing organisational knowledge is important because as organisations get larger, it becomes more difficult to share what people know. The organisation increasingly does not 'know what it knows' and so it makes unnecessary mistakes, duplicates activity and misses opportunities as a result of this. Furthermore, it is also increasingly likely that organisations, particularly in countries such as Artazia, will have to achieve competitive advantage through accumulated experience (their knowledge), rather than through conventional assets such as physical resources. Fearghal McHugh writing in the *Student Accountant* (issue 07/2010) suggested that 'having knowledge can be regarded as more important than possessing the other means of production – land, building, labour and capital – because all the other sources are readily available in an advanced global society'.

Knowledge management itself has been facilitated by the increasing functionality of computerised information systems. In this context an important distinction is made between data, information and knowledge. Knowledge is primarily associated with the discovery of trends or patterns of behaviour. Discovering such patterns would have helped TMZ realise that consumers were moving away from purchasing physical music media to downloading its digital equivalent. In the market which TMZ currently finds itself in, discovering patterns and trends remains extremely important as consumer behaviour is still unpredictable and is affected by new technologies, emerging legislation and changes in values.

Conventional knowledge management systems are often based around an intranet application where all explicit knowledge about processes, procedures, standards, products, customers and policies are stored. Such repositories are convenient places to locate explicit organisational knowledge and they have practical benefits, such as eliminating the costs of storage, printing and distribution. Data warehouses can store vast amounts of information and provide the basis of reports, comparisons and responses to queries posed at different levels of summation. Data mining software may be used to discover previously unknown relationships between data and these can be used to guide decision-making and predict future behaviour.

However, although technology has provided many opportunities to analyse the formal data captured by an organisation, the social aspects of knowledge sharing remain important. Employees need opportunities to develop, discuss and share information which they feel would be mutually beneficial. Not only might this require physical facilities (coffee areas, restrooms, social and sports clubs), it also requires a culture of trust in the organisation supported by a leadership approach which values learning and an organisational structure which supports communication and information sharing. Thus there is a clear link between knowledge management and the principles of the learning organisation. Social networks can also be used to support this facet of knowledge sharing and indeed might be the natural preference of the younger employees of the organisation. It is in the social aspects of knowledge sharing that many employees reveal their tacit knowledge (knowledge which they do not know they know, as opposed to explicit knowledge) which can be vital for the effective performance of a particular task.

- 1 (a) (i)** 1 mark for each appropriate point up to a maximum of 14 marks
- (ii)** 1 mark for each appropriate point up to a maximum of 8 marks
- (iii)** 1 mark for each appropriate point up to a maximum of 4 marks
- Professional marks will be given for structure, coherence, style and clarity of the report up to a maximum of 4 marks
- (b)** 1 mark for each appropriate point up to a maximum of 20 marks; this could include:
- Quantitative analysis of acquire T-Me and fail – up to 4 marks
  - Quantitative analysis of acquire T-Me and win – up to 2 marks
  - Quantitative analysis of bid directly and win – up to 2 marks
  - Quantitative analysis of bid directly and lose – up to 2 mark
  - Expected value analysis – buy – up to 2 marks
  - Expected value analysis – bid – up to 2 marks
- 2 (a)** 1 mark for each appropriate point up to a maximum of 15 marks; this could include:
- Up to 1 mark for analysis of data associated with each product, up to a maximum of 6 marks
  - Up to 1 mark for quantitative analysis of sending complete production to Tinglia
- (b)** 1 mark for each appropriate point up to a maximum of 10 marks
- 3 (a)** 1 mark for each appropriate point up to a maximum of 5 marks
- (b)** 1 mark for each appropriate point up to a maximum of 14 marks; this could include:
- Up to 1 mark for values for each quantitative or financial benefit
  - Up to 0.5 mark for classifying each benefit correctly up to a maximum of 3 marks
- (c)** 1 mark for each appropriate point up to a maximum of 2 marks for each stakeholder. Three stakeholders leading to a maximum of 6 marks for this part question
- 4 (a)** 1 mark for each appropriate point up to a maximum of 15 marks; this could include:
- Up to 1 mark for correct GP margin and appropriate comment 1965–2000
  - Up to 1 mark for correct NP margin and appropriate comment 1965–2000
  - Up to 1 mark for GP margin and appropriate comment 2003–2007
  - Up to 1 mark for NP margin and appropriate comment 2003–2007
- (b)** 1 mark for each appropriate point up to a maximum of 5 marks
- (c)** 1 mark for each appropriate point up to a maximum of 5 marks