SUGGESTED SOLUTIONS

KC5 - Corporate Strategy and Contemporary Issues

June 2018

Gleen PLC

Contents

Appendices

*Please note that this is a sample answer. Hence marks should be awarded if the arguments are accurate.

01. Executive Summary

The report entails a discussion of the most pressing issues faced by Glenn PLC and the different actions the company could initiate to improve its performance. The business and ethical issues are evaluated utilizing certain academic models, in order to derive a better understanding of the issues faced. The report includes the analysis of a possible takeover bid, and strategies taken to protect the Shareholder's interests. Glenn is considering reducing its reliance on 'own brand' products and possibly further downsizing it to 'spices'. The company is also focusing on the smooth implementation of its IT systems, so as to minimize disruptions to its ongoing operations. The report covers the appropriateness of the discount factors used in evaluating the X town investment. The report covers strategies to add value to Glenn, given its current situation, so that such strategies could be implemented under a sustainable framework. It also includes recommendations and suitable actions plans. Each recommendation is based on adding value to the business and its practicality, in terms of ease of implementation. The report highlights the critical issues impacting the company, in the 'Conclusions' section of the report, which would require immediate attention.

02. Introduction

Glenn PLC is a conglomerate which operates in the Retail and Restaurants Market Segments in Sri Lanka. Glenn PLC also controls a very successful Supermarket Chain. More than 45% of Sri Lanka's consumers opt for MTs, and to serve them better, Glenn wishes to improve the services it provides.

Glenn has three Retail Brands i.e. MTC, MTS and MTH, which boast unique attributes, enabling it to excel in retailing, in the current business cllimate.

At present, the company is looking to increase its Market Share, and new investment opportunities are being reviewed and evaluated, with a view to serving a larger customer base.

The company also wishes to venture into 'online retailing', and the company is considering installing an IT system for this purpose. However, Glenn is under threat of a takeover bid, and must take immediate action, to protect the interests of its shareholders.

03. Discussion re the issues involved

Appropriateness of DCF

The company has currently evaluated the project, using a 5-year Government Treasury Bond yield and an arbitrary Risk Premium. This calculation is questionable because, although the government Treasury Bond yield may be identified as risk free, the basis for selecting the risk premium, is not known.. It is therefore debatable, as to whether this premium covers the business and financial risks of the X town investment.

Suggestion 1 recommends the use of a discount rate of 12%, which is the WACC. Hence it is vital to know the method of financing of the new investment. Given that it will be a combination of debt and equity, the current capital structure of the company needs to be compared with the former. The WACC represents the rate that the company is expected to pay on average, to finance its long term capital structure. If the financing structure of the new investment (60% debt and 40% equity) remains unchanged, then it is of no consequence. If however, the proposed new investment carries a higher business risk, then this would result in a higher return being demanded, by the investors.

Suggestion 2 is the use of a project specific COC, which is the theoretically correct approach. Under this method, the gearing of Gamehut PLC needs to be compared with that of the existing structure, in order to identify the financial risk, as the equity beta is influenced by the level of financial risk (gearing). It would be necessary to un-gear the beta, so that the business risk is identified, and re-gear it to take account of the financial risk of the project, so that the business risks as well as the financial risks are embedded at optimum level. The above suggestion is valid only if the assumption related to the CAPM model is taken into consideration - eg. no two companies in the same industry are the same/ identical in any aspect of the business. This requires the encapsulation of business risk. The project runs for 5 years, and the degree of risk will change in this time period, although CAPM assumes it to be constant. Further it should be noted that CAPM only considers systematic risk.

Implications of the proposed takeover bid

Looking at the share price of Seth Mayors, it should be noted that the share exchange does not provide an adequate premium for Glenn's existing shareholders.

The terms of the bid are 2 SM shares for 1 G share. Based on current share prices, the market appears to be expecting a substantially increased bid; 2 SM shares are worth Rs.39.4 whereas 1 G share is worth Rs.49.3.

At this ratio, the bid could not possibly succeed. Glenn's shareholders would request that the bid be raised to at least 3 shares for 1 G share, or they would be no better off than if they sold in the market.

To ensure, as far as possible, acceptance by Glenn's shareholders, a revised bid would probably have to be at least Rs.59 or around 3 for 1 (any sensible ratio would be acceptable here, provided it shows a premium on Glenn's pre-bid share price.)

Further the company should take into account the implications of the bid being successful. Seth Mayors and Glenn are different in many aspects. Hence Glenn needs to carefully focus on the business culture and the modus operandi of Seth Mayors so that the two companies could work together. Glenn has been in the Retail Industry since 1956, and would hence question the level of experience of Seth Mayors, in the field of Retailing.

If however, the two companies come together, synergistic benefits can materialize, since Seth Mayors operates "Burger Land" which is a Fast-Food Chain and "Continents" which is a Restaurant Chain. Glenn already has a prominent Restaurant Chain that is highly lucrative, per the financial data provided, and will achieve its objective of increasing market share.

Relevance of 'own brand' products

The benefit to the customer, when offering these types of products, is that it gives them the option of buying products of similar quality, at a lower price. Although the products come with different brand names, the customer expects to get the same product & benefits, when he/she chooses a particular brand. In the current context, Glenn is affected by a reduction in turnover and profits from its 'own brand' products specially jams, water bottles and some "other category" products. The company has the option of focusing more on 'spices', since high growth has been recorded for 'spices', in terms of sales volume and profit margins.

However, MT is now faced with the issue of whether it is feasible to continue selling its 'own brand' products or not, particularly given that it has to forego the opportunity of placing other established brands, whilst doing so. In certain situations, it would be considered somewhat unethical as well as counter-productive, to give shelf space to its 'own brand' products, when high performing, well established brands exist in the supermarket.

Governance and Ethical Issues

One of the financial officers has been misled, and been asked to add wrong figures into a report.

This could be identified as a direct breach of objectivity and professional behavior. A financial officer should not be misled. This is not the professional conduct expected of a senior officer. It is a breach in the level of objectivity required to be demonstrated by a senior officer, if such breach shows bias towards a certain party, knowingly or not.

From the point of view of the business, this could be detrimental to MT in particular, as well as the Chain itself. If the news becomes public, and reaches the Stock Market, the share price of Glenn would be negatively impacted, as a result of shareholders selling off their shares.

In the long run, this may hurt the financials of MT, as there would be un-identified costs, which would be realized eventually.

A supplier contract has been awarded to a close relative of the Finance Director.

Supplier contracts should be awarded to suppliers who are worthy of having such contracts.
Being a Supermarket Chain with a national presence, it is expected that it would have the best performing brands under each category, to attract more customers and provide a better service.

Instead, MT has opted for a middle level player in each particular product category. The selection of a related party, shows bias towards one party in awarding the contract, which means that Glenn's directors have breached 'objectivity'.

Board Balance and Overload of Responsibilities

The pre-seen provides information re all directors. Mr. Dominic Glenn is a relative of the Chairman and the HR Director. Hence, questions arise, as regards the independence of the Non-executive Director. Additionally, the two most important functions, Marketing and R & D are handled by the Director of IT and Marketing. The lack of a Procurement Department within Glenn, is a matter of concern.

Direct implementation of the IT System

Direct implementation is an approach where a system is implemented and tested to ensure it performs properly, and then the old system removed and the new one put in place, without any overlap or limited roll out.

It should be noted that there are alternative methods of installing a new IT system. Multiple methods of implementation could be identified, to introduce a new IT system, in the organization. Eg.

1. Parallel Implementation
2. Pilot Implementation
3. Direct Implementation
4. Phased Implementation

Of the above, Parallel Implementation could be identified as a method which is very safe, as the system is implemented, whilst the old system is still running, in parallel.. If one system fails, the other would still be functioning, to support operations, thus removing the possibility of a complete system shutdown.

The company should also consider maintaining its own mobile fleet or work with an outsourced fleet in order to cater to customer requirements. Along with proper inventory management, efficient logistics is crucial for the success of this business venture. Technological know-how is also vital to successfully support this implementation. For example, as sophisticated order and online tracking is required, GSP technology can be utilized, to facilitate on time delivery.

Strategies to create value for Stakeholders

Backward Integration

In order to deliver fresh produce (especially vegetables, fruits and other essential goods etc.) it is important to maintain a robust relationship with dependable farmers and suppliers. This will add value, since fresh quality produce will be available at MT outlets. If Glenn could form a small circle of dependable suppliers, then this initiative will be sustainable. Whilst Glenn looks forward to offering a unique customer experience, this approach is also in line with Glenn's business model.

Larger format and Regional Expansion

A Hypermarket format with extensive product portfolios could be highly lucrative for Glenn, in the future, since customers wish to purchase all their required products, in a single location. The north central and north western province has strong growth potential, as they are supported by high per capita income growth, and low supermarket penetration. This would add value by providing access to a larger customer base. Well planned investments would grow the long term asset base of the company, with the potential to generate higher revenues in a sustainable manner.

Use of New Technology

In the modern context, 'customer relationship management' is vital for the success of business enterprises. As such, the use of ERP's and SMS alerts, are now popular ways of communication. Glenn therefore needs to re-consider its options. Since the company intends to operate on a larger scale, it would be timely to consider the attributes of the new IT system, and also consider the benefits of implementing an ERP system. This would add value, in that it would enable Glenn to be in touch with its customers, with timely reporting and real- time information, supporting the decision making process.. A well tested and integrated reporting mechanism is much needed in large companies, to enable them to effectively carry out operations, in a sustainable manner. Customer loyalty would thus be assured, resulting in repeat customers.

Novel products

The Company should introduce a separate department for R & D, as customers tend to seek innovative & premium products, particularly in the health & wellness space, focusing on the level of calorie intake in each of the products they purchase. Well established brands such as Coke, Pepsi and even brands such as Elephant House in Sri Lanka, have all developed sugar free beverages. Given that we live in an era where there is much interest in Health & Well Being, the company can add value to its product offerings, whilst also being recognized as a good corporate citizen, by supporting healthy initiatives such as reducing obesity etc., and ensuring that these strategies would be sustainable.

04. Recommendations

Appropriateness of DCF

Recommendation

A project specific COC appears to be more relevant in this regard. However it is recommended that financial as well as non-financial factors are taken into account when making a decision to proceed with the project. Even though the explicit financial benefits are not substantial, it may give the company an advantage, in many ways.

Justification

The Net Present Value method of project appraisal takes several assumptions into account. There are many factors which would have a high degree of sensitivity in contributing to the final value. A small difference over 5 years could make a massive difference to the final value.

Actions

- Non-Financial factors that are affected by the project should be analyzed & evaluated first.
- A sensitivity analysis should be conducted.
- PCA reports should be referred.

Bid to acquire the company

Recommendation

It is recommended that the shareholders should be communicated with, first, to better understand the viewpoint of the shareholders. As the offer is a share exchange, it is important to check whether there will be a benefit to the shareholders, by gaining ownership in shares of the combined entity.

Justification

The Management of Glenn must consider the synergies that may accrue due to the acquisition. The types of synergies must be considered, as the project must generate positive synergies as opposed to negative synergies.

The working environment and the organizational culture must be compared between Glenn and Seth Mayors, to gain a better understanding of whether it is able to consolidate the two working environments.

If there is dissonance after consolidation, problems may arise within the organization, and it would lead to a drop in the company's performance.

Actions

- It would be useful to communicate with the shareholders and have an open dialogue about the situation at hand.
- The offer from Seth Mayors should be analyzed and evaluated, to identify benefits to Glenn's shareholders.
- If a situation should arise, where Glenn would have to defend against the bid, pre-bid and post bid defense mechanisms available should be agreed upon. (Lobbying White knight strategy etc.)
- It would be prudent to analyze the financials of the company Seth Mayors, and to evaluate their performance over the past few years.

Relevance of own brand products

Recommendation

It is recommended that Glenn should limit its reliance on sales volumes of 'own brand' products for a start, and focus on more profitable products, since company profitability had declined. Brands which give better margins should be given prominent shelf space. This should include spice products although they are 'own brand' products, as these have demonstrated high growth in revenue and profit..

Justification

The profitability from sale of Water Bottles has gone down significantly in the space of less than a year. The sales volumes as well as sales margins of jams and other products had also reduced significantly. This could be due to the fixed cost being constant or increasing, despite the declining sales volumes.

Actions

- Allocate more space for other brands, in supermarket shelves, so that MTs can achieve better profit margins from Sales.
- Try to reduce fixed costs associated with 'own brand' products, to improve profitability.
- Improve promotions of 'own brand' products, through new online platforms as well as in supermarket premises, to improve sales volumes.
- Consider allocating more resources to 'spices' product range.

Governance and Ethical Issues

One of the financial officers has been misled and asked to add wrong figures into a report.

It is recommended that the incorrect figures are corrected, first, to ensure the stated accuracy of the profitability figures, for the particular branch, as otherwise, the benefits to the managers may be over stated.

Secondly, it is recommended that the company takes measures to make sure that these types of errors do not happen in the future. Regional Managers should be made accountable, to make sure that the financials are not understated or overstated.

A supplier contract has been awarded to a close relation of the Finance Director.

Proper analysis and justification must be mandated before a supplier contract is approved. Ideally comparisons must be made between available options, and Glenn must select the option with the most benefits to the company.

A range of options should be made available, in each product category, since it will give the customer a chance to pick from several different brands. It is recommended that mid-level suppliers as well as top level suppliers should be given shelf space to display their brands.

Board Balance and Overload of Responsibilities

The Board should establish strict guidelines on the degree of independence of a Non-executive Director. Initially Glenn should decide on what areas Mr. Dominic would have oversight of, so that there won't be a conflict in interest. Further if it is possible, a replacement needs to be made, so that the Non-executive Director's tasks can be performed, considering the best interests of the company. Glenn should maintain separate departments with responsibility for Marketing and for R & D, so that both departments could operate, at maximum efficiency.

Direct Implementation of IT system

Recommendation

It is recommended that Glenn opts for a less risky method of implementation, as it will be a risky maneuver, to implement the new IT system, directly.

Justification

Direct implementation comes with huge risks. If the system fails, it may detrimentally affect both the trading in MTs, and profitability.

Apart from higher risk, higher costs would be incurred if the system is to be taken on-line at once. The support equipment, as well as the expertise and services will cost a significant amount, which may have an adverse impact, on the cash flow position of Glenn PLC.

A sudden change may also not be well received by the organization's staff. Inevitable complications and resulting misunderstandings may lead to an unhappy set of employees. For a service oriented company, having dissatisfied employees, does not bode well.

Actions

- It would be better if Glenn considers the feasibility of adopting a Parallel, Pilot or Phased 'system change-over method' and analyze the costs that may arise under each method, as well as the benefits to be gained.
- Employees should understand why the implementation is critical, and how it may benefit the company and their own work. Take adequate measures to ensure that employees are well informed about the new Information system, and how it operates.
- Performance targets should be reviewed and revised, to better align with the implementation of the new system.

Strategies to create value for Stakeholders

Backward integration

Glenn should immediately make a list of farmers and suppliers and compare their suitability based on attributes such as cost, lead time, quality of products offered (by tracking products that were delivered to Glenn in the past with defects), and responsiveness to new initiatives of Glenn. Glenn should then select to its Top Tier, reliable suppliers from whom quality products can be obtained, with a minimum time lag.

Larger Format and Regional Expansion

Initially Glenn needs to conduct a SAF analysis prior to expanding its business operations. Initially all expansions needs to be in line with the existing business model of Glenn. Selected options should be accepted by the major stakeholders of the company. Since maintaining a robust relationship among stakeholders is the duty of the Chairman, Mr. Roger Glenn will play a vital role in all such communications.. A Feasibility Study should be initiated, to evaluate the pros and cons of the expansion initiative. Glenn should consider the impact of each aspect of the proposed expansion, on both the financial and operational outcomes, to ensure that shareholder wealth is maximized.

Use of New Technology

Glenn should take steps to indicate to the IT company that is currently engaged in the installation of the new IT system, re its proposed expansion plans, and that the company wishes to progress towards installing a fully-fledged ERP System, with integrated reporting and real time information, to support decision making, giving access to a wider range of users. In order to be in line with CRM, Glenn should consider initiating a loyalty card program, website developments etc.

Novel products

Initially it is recommended that Glenn carries out ‘ benchmarking’ of its competitors, to identify the degree to which Glenn currently offers health & wellness products. Glenn should then conduct a competitor analysis, to gauge the price, quality and service levels at which such health & wellness products are supplied, and the level of marketing that supports the positioning of the top selling brands. Glenn should also conduct a ‘customer profitability analysis’, to filter the loyal and high net worth customers of Glenn, and in what market segments they reside, so that premium products could be offered to existing customers across all outlets of Glenn.

05. Conclusions

Glenn PLC will need to find solutions to multiple issues to better align the company with plans to a more profitable and a sustainable future. The bid offer to the shareholders should be evaluated, taking synergies into account, and ensuring that shareholders’ interests are protected. The results of the evaluation, the decisions taken, as well as the rationale for such decisions should be clearly communicated to the shareholders.

Risk should be taken into account when Glenn implements the new IT system, and the implementation procedure should not affect the existing level of operations of Glenn.

Glenn should focus on its more profitable ‘own brand’ products such as spices, as well as on more popular and profitable ‘other brands’, to increase its profitability.

All strategies mentioned needs to be carefully analyzed to ensure value addition, and also sustainability, with reference to the Glenn’s business model.

Appendix 01 SWOT Analysis

Strengths
- A profitable company which is listed in the Stock Market
- A progressive Board of Directors who are qualified
- A balanced BOD with a proper mix of Executive and Non-Executive directors.
- One of the most innovative companies which believes in continuous innovation
- Increase in liquidity over the past year

Weaknesses
- Market share declining slightly over the past year
- No on-line sales platform as yet
- No proper IT department
- Bad customer reviews

Opportunities
- Innovative Marketing & IT Director
- Potential to improve market share using Online Sales
- Use of Social Media Marketing to capture the attention of younger consumers, as well as the ever growing audience in social media sites
- A new information system which would provide a vast amount of data about consumer behavior

Threats
- Market share declining slightly
- Investment in the new IT system not giving a positive NPV
- Profitability reducing in 'own brand' products
- Negative media coverage about sourcing of products

Appendix 02 PEST Analysis

Political & Legal
- Possible government regulation to prevent acquisitions by companies who operate in the same industry
- Possible regulations being introduced regarding a minimum price to be paid to suppliers
- Control of Selling Prices of certain essential products

Economical
- Increased pressure from competitors impacting market share
- The company being an attractive target for acquisition, due to good financial performance
- Shareholders probably expecting higher capital gains

Sociological

- Suppliers not being paid appropriately
- Growing tendency of consumers buying goods online rather than going to supermarkets.
- With more choices available, Customers becoming more loyal to a particular brand

Technological

- Sri Lanka s growing audience in Social Media Platforms
- New IT system which can gather more information, and which is faster
- Venturing into Online Sales

Appendix 03 Takeover Bid calculations

Earnings of Glenn	$ 219,450,000
Ke adj-Glenn	$ 2,194,500,000
Glenn Mkt cap	$ 1,725,500,000
No. of Seth shares for 1 Glenn share	3
3 Seth shares for 1 Glenn share	
Value of 1 Glenn share	59.16
Total value of the bid	$ 2,070,600,000

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